

15% GST ?

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With 1 October looming, you should be starting to think about the upcoming increase in the GST rate, and how it is going to impact your business. There is a lot of commentary about the change circulating around in the marketplace; some of it useful, some of it not.

We have pulled together what we see as the most relevant issues for you to consider in the lead-up to 1 October 2010. We have also compiled a practical Checklist for you to work your way through to ensure that your business is well prepared for the change.

- > The Basics
- > Accounting Systems / Reporting Issues
- > Continuous Supplies / Perpetual Invoices
- > Layby & Hire Purchase Sales
- > Supplies Between Associated Persons
- > Change of Use Adjustments
- > Contracts that Span 1 October 2010
- > Getting Things Wrong
- > Specific Issues
- > IRD Audit Activity
- > Marketing Strategies
- > Download Checklist

Although we have tried to identify the issues that will impact the majority of businesses, there may be issues that are unique to your business. We therefore recommend that you give your WHK advisor a call to discuss any specific concerns you may have.

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> The Basics

WHEN DOES THE NEW RATE START?

The 15% GST rate will apply to supplies made on or after 1 October 2010.

There are generally no transitional provisions. All businesses must apply the new rate to supplies made on or after **1 October 2010**.

HOW IS THE NEW RATE OF GST CALCULATED?

The new tax fraction will change from 1/9 to 3/23 – which will make calculating the GST component of prices a lot more complicated than the current method.

For the 12.5% rate, the GST component of a **GST-inclusive** price can be calculated by dividing by 9 and the GST component of a **GST-exclusive** price can be calculated by dividing by 8.

For example:

GST-inclusive price of \$112.50
divided by 9 = \$12.50 GST
(already included in price)

GST-exclusive price of \$100
divided by 8 = \$12.50 GST
(to be added to \$100 price)

For the 15% rate, the GST component of a **GST-inclusive** price will need to be calculated by multiplying the GST-inclusive price by the fraction **3/23** or dividing it by **7.66 recurring**.

Example:

GST-inclusive price of \$115 x 3/23 = \$15 GST
(already included in price)

GST-inclusive price of \$115 divided by
7.6666666666 = \$15 GST (already included
in price)

The GST component of a **GST-exclusive** price will need to be calculated multiplying the GST-exclusive price by 15% to calculate the GST component.

Example:

GST-exclusive price of \$100 x 0.15 = \$15 GST
(to be added to \$100 price)

WHICH RATE WILL APPLY?

The GST rate that is used will depend on the “time of supply”. Generally, this is the earlier of the time an invoice is issued, or a payment is made in respect of a supply of goods or services.

If the time of supply occurs **before** 1 October 2010, the applicable rate is 12.5% (even if delivery of the goods or performance of the services occurs after 1 October 2010).

If the time of supply occurs **after** 1 October 2010, the applicable rate is 15%.

Special “time of supply” rules apply for certain continuous supplies and supplies between associated persons.

FILING RETURNS

If a GST return straddles 1 October 2010, two GST returns will have to be filed:

- One covering the period ending 30 September 2010; and
- One covering the period commencing 1 October 2010.

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> Accounting Systems / Reporting Issues

Now is the time to review your computer systems to ensure that it can cope with the increase in GST. Billing systems, purchasing systems, expense systems and accounting systems will all be affected by the GST increase.

Below are some of the main accounting system issues that your business should consider before 1 October 2010:

- Check if your accounting systems currently have the ability cope with two different GST rates at the same time. A new 15% GST rate will need to be created within your accounting system in addition to retaining the 12.5% rate.
- Does your accounting software need to be upgraded or replaced to incorporate the new rate of GST? The older and more customised your systems are, the more likely it is that substantial changes will be required.
- Can your Accounts Receivable systems raise tax invoices at both GST rates?
- Can your Accounts Payable systems process invoices received at both GST rates?
- Can your Accounts Receivable systems generate credit / debit notes at both rates of GST i.e. at 12.5% and 15%? Credit / debit notes need to use the same GST rate as used on the original tax invoice. For example, if you give a refund after 1 October 2010 for a sale you made before 1 October 2010, then the credit note should be for 12.5%.
- Ensure that your accounting software can correctly process any bad debt write off at the rate used for the original sale i.e. 12.5% for bad debts on sales before 1 October 2010 and 15% for sales after 1 October 2010.
- Ensure that your reconciliation spreadsheets and workpapers are updated to reflect the 15% rate.
- Is the 12.5% rate hardcoded anywhere in your system, including any custom developed reports? If so, the rate will have to be replaced with the 15% rate or the hardcoding needs to be overridden to allow the use of dual rates.
- Ensure all staff are given appropriate training on the GST rate increase so they understand how the rise in GST will impact their responsibilities. For example, the accounts receivable and payable personnel must be able to understand and recognise what implications the change in GST will have on their reports.
- Test any changes to the reporting systems before they are implemented. For example, test your invoices to ensure they disclose the correct GST rate and amount when printed. Test your GST return templates and reconciliation workpapers to ensure your first GST return (post 1 October 2010) is correct.
- Retailers should ensure that their cash registers are adjusted so that receipts disclose the correct rate of GST after 1 October 2010.
- Remember that if a GST return period straddles 1 October 2010, two GST returns will have to be filed:
 - a) One covering the period ending 30 September 2010; and
 - b) One covering the period commencing 1 October 2010.

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> Continuous Supplies / Perpetual Invoices

CONTINUOUS SUPPLIES OF GOODS OR SERVICES

If you supply goods or services on a continuous basis, and receive payments on a regular or periodic basis the time of supply will be triggered throughout the period, rather than all at the start.

This means a contract signed in January 2010, which provides for 12 monthly payments, will be subject to 15% GST after 1 October 2010 - even though the parties expect GST at 12.5% for the entire period of the contract.

You therefore need to carefully consider:

- a) The ability to legally change the price charged to customers for the periods after 1 October 2010 i.e. can you legally pass on the extra GST cost to your customers?
- b) The practical and commercial issues of trying to collect the higher amount from your customers i.e. is it cheaper for your business to simply wear the extra GST cost rather than attempt to recover it from your customers (and potentially risk good customer relations in the process)?
- c) The ability of your accounting system to handle dual GST rates for a single contract (see Accounting Systems for further information).

PERPETUAL INVOICES

It is common practice for perpetual invoices to be issued in the case of continuous supplies, such as leasing commercial buildings. Suppliers typically issue a tax invoice that covers the entire year or longer, showing the due dates for payments.

You must issue replacement invoices for payments due on or after 1 October 2010 to reflect the higher 15% GST rate.

Late Breaking News! To limit any potential confusion, on 23 July 2010 the Government proposed legislative changes to ensure the GST time of supply rules will work well on transition. Certain businesses, such as general insurers and financial leasing companies, who supply goods or services under contractual terms and receive periodic payments, will be able to lock in GST at 12.5% for contracts entered before 1 October, even though payments are not received or due until after 1 October. It is expected that these changes will be approved by Cabinet shortly.

> Layby And Hire Purchase Sales

LAYBY SALES

Goods purchased on layby accounts will attract the higher 15% rate if the final payment is received on or after 1 October 2010. This is because for GST purposes, the time of supply for layby sales occurs at the time ownership of the goods transfers to the buyer. This ordinarily occurs after the final payment is made for the goods.

HIRE PURCHASE SALES

Goods purchased on hire purchase accounts will attract the higher 15% rate if the contract is entered into after 1 October 2010 or the lower 12.5% rate if the contract is entered into before 1 October 2010.

> Supplies Between Associated Persons

The time of supply for transactions involving associated persons is the earlier of an invoice being issued, payment being received or when the goods or services themselves are made available to the recipient or performed.

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For example:
Company X and Company Y are associated. X provides management services to Y throughout the year and issues an invoice for those services in December 2010. For GST purposes, the time of supply is triggered when the management services are provided by X. Therefore, X must account for GST at the rate of 15% on management services provided on or after 1 October 2010, and at 12.5% on management services provided on or before 30 September 2010.

Care must therefore be taken to ensure that GST is accounted for correctly on transactions involving associated persons.

> Change Of Use Adjustments

Goods and services intended originally for business purposes may be used for making non-taxable supplies (e.g. exempt or private purposes). Conversely goods and services intended originally for exempt or private purposes may be used for making taxable supplies.

For GST purposes a supply is deemed to occur when there is a change of use and an output tax or input tax adjustment must be made accordingly.

The GST legislation has been amended to allow a registered person to identify items that changed to a business use before 1 October 2010 and to apply a rate of 12.5% to **one-off** input tax adjustments even if the adjustment is made after 1 October 2010.

Similarly, when output tax is required to be paid as a result of the change of use, the legislation gives registered persons the option of identifying items that changed to a private use before 1 October 2010 and applying the rate of 12.5% to **one-off** output tax adjustments, even if the adjustment is made after 1 October 2010.

However, for **period by period** adjustments, the rate for post 1 October 2010 adjustments will always be 15%.

> Contracts That Span 1 October 2010

WHAT HAPPENS IF I HAVE CONTRACTS THAT SPAN 1 OCTOBER 2010?

The GST Act contains provisions which deal with the impact of a GST rate increase on contracts that have already been entered into. These provisions effectively modify existing contracts to increase the price in line with the increased GST, unless the contract expressly contemplates a change in the GST rate.

Where contract prices are **GST-exclusive**, the GST Act provides that the price will automatically increase to the new rate, unless the contract explicitly provides otherwise. We therefore recommend that prices are quoted "plus GST" wherever possible.

Where contract prices are **GST-inclusive**, suppliers are able to gross up the GST inclusive price, unless the contract specifically precludes a gross up. However, this only applies if the contract is entered into before the expiry of 3 months from 1 October 2010 i.e. before 1 January 2011 (section 78(2) of the GST Act).

For clarity, **purchasers** therefore need to ensure that high value contracts, where the time of supply is expected to be triggered after 1 October 2010, either:

- Include a clause that specifically excludes the application of section 78(2) of the GST Act; or
- State that they are GST-exclusive; or
- State that GST is levied at the specified rate i.e. 15%

Suppliers that make a mistake with the GST-inclusive price of contracts entered into between 1 October and 31 December 2010 (where the time

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of supply is triggered after 1 October 2010) are able to gross up the value of the contracts for the increased GST. This is on the proviso, however, that the contract does not specifically disallow it.

> Getting Things Wrong

WHAT HAPPENS IF I CHARGE MY CUSTOMERS THE WRONG AMOUNT OF GST ON AN INVOICE?

You will have to disclose the GST shortfall to the IRD, make payment accordingly and update your internal records.

Although the IRD has introduced provisions to grant relief from late payment penalties, late filing penalties and use of money interest on GST returns from 1 October 2010 to 31 December 2010, they have not granted relief from shortfall penalties if the wrong amount of GST is paid.

WHAT HAPPENS IF I GET A TAX INVOICE WITH THE WRONG GST RATE OR AMOUNT?

If the details on a tax invoice are not correct, it is deemed to be "invalid". If a taxpayer does not hold a valid tax invoice, technically no GST can be claimed. You should therefore ask your supplier to provide you with a correct tax invoice.

> Specific Issues

PAYMENTS BASIS ADJUSTMENTS

Amounts that payments basis or hybrid taxpayers pay or receive after 1 October 2010 will be accounted for at the new 15% rate. To accommodate the rate increase, an adjustment will have to be made in the GST return covering the September 2010 period. The adjustment takes the difference between a registered person's

debtors and creditors immediately before the rate change, and multiplies it by the difference between the 12.5% and 15% rates. If the result is a positive amount (i.e. creditors exceed debtors on hand) it is treated as an output tax adjustment in the return period. If the result is a negative amount (i.e. debtors exceed creditors) it is treated as an input tax adjustment in the return period.

SECONDHAND GOODS

The timing of input tax credits on secondhand goods acquired needs to be carefully considered. An adjustment similar to the one for payments basis or hybrid taxpayers can be made where full payment has not been made for the secondhand goods prior to the GST rate change.

BAD DEBTS RECOVERED

Where a previously written off bad debt is recovered after the change in GST rate, this is deemed to be a supply in the period within which the recovery occurs. Therefore, GST will have to be returned at the higher 15% rate, reducing the net recovery accordingly.

ENTERTAINMENT EXPENDITURE

Each year businesses are required to make a GST adjustment for entertainment expenditure that is deemed to be non-deductible for income tax purposes. For GST purposes, the non-deductible entertainment is deemed to be supplied on the date your income tax return is filed, or the date your return is due (whichever is the earlier). This is irrespective of when during the year the entertainment actually took place.

For the 2010 - 2011 income tax year, GST registered taxpayers have the option of using the 12.5% rate for non-deductible entertainment expenditure incurred before 1 October, and 15% for later expenditure. Or, they can simply use the 15% rate for the entire entertainment adjustment.

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FRINGE BENEFIT TAX

For GST purposes, fringe benefits are deemed to be supplied at the time the fringe benefit is provided or granted. Accordingly, fringe benefits provided or granted before 1 October 2010 will attract 12.5% GST. Fringe benefits provided or granted on or after 1 October 2010 will attract 15% GST.

EXPORTS

As exports are zero rated for GST purposes, these transactions will not be affected by the rise in GST.

FINANCIAL SERVICES

Given that financial service providers cannot fully recover GST, they should expect a 20% increase in their GST costs if their suppliers pass on the increased GST amount to them.

> IRD Audit Activity

The Government has announced that there will be an additional \$119.3 million allocated to the Inland Revenue over four years to allow it to increase its audit activity.

It is therefore strongly recommended that businesses thoroughly review their processes and systems to make sure the change in the GST rate does not cost them unnecessary interest and penalties.

> Marketing Strategies

MARKETING AND PRICING

With the upcoming increase in the GST rate, now is an excellent time to review your marketing and pricing strategies.

- Consider whether you can afford to absorb the increase of GST within your business, or whether you will pass the cost onto your customers.

Are your customers GST-registered businesses or end consumers? Where businesses primarily contract with other GST-registered businesses, it is expected that the increased GST rate will be passed on to the business customers.

However, for businesses selling directly to end consumers on a GST-inclusive basis, it is likely that many businesses will absorb the extra GST cost in the short term rather than increase their prices overnight.

- Do your contracts allow you to legally increase your prices charged to your customers?
- Tendered contracts need to be reviewed carefully. If you are tendering for a contract over the next few months you will need to take into account the increase in GST in your pricing. Advise any potential client that you will be accounting for the increase in GST in any tender documents you may be submitting.
- Where possible, ensure all pricing is expressed as "plus GST". If a contract is silent on GST, or the price is expressed as "inclusive of GST", the GST legislation only gives a limited right to gross up the price. Suppliers can increase a "GST inclusive" price within 3 months of the rate increase, unless the contract expressly precludes a gross up.
- Ensure that all your pricing on packaging, advertising materials, websites and brochures, as well as pricing on the shelves, is updated to reflect the increase in GST.
- On high value contracts, consider encouraging customers to enter into the contracts before 1 October 2010 so they are only charged 12.5% GST instead of 15%.
- Be prepared for a surge in consumer demand in the lead-up to 1 October 2010, especially if your business sells big ticket items such as whiteware and motor vehicles.

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> Help Preparing for 15% GST

If you would like to discuss some of the points covered in this document, work through the checklist with one of our advisors or talk about how the increase to 15% GST will impact your particular business - please do not hesitate to contact us.

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gst checklist

As announced by the Government in the May Budget, the rate of GST is set to increase from 12.5% to 15% from 1 October 2010. The Government estimates that the increase in the rate will bring in additional revenue of \$2.2 billion in the 2011-2012 year. The last GST rate increase was in 1989 (when it went from 10% to 12.5%) and for the most part it went very smoothly.

As the countdown starts it is important that businesses start planning what needs to be done and consider any associated risks and issues that may arise. In order to cope with the GST transition we suggest you work your way through this practical GST checklist.

IMPACTS	ISSUES	CHECKED
Take Action	• Do you have someone who is responsible for the GST rate change in your business?	<input type="checkbox"/>
	• Identify which sectors of your business will be affected by the change in GST	<input type="checkbox"/>
	• Educate your staff well in advance of the impacts the GST rate change will have on your business	<input type="checkbox"/>
	• Identify areas of risk (accounting software system)	<input type="checkbox"/>
	• Understand your compliance obligations	<input type="checkbox"/>
	• Seek help from your WHK tax advisor on areas you are uncertain about	<input type="checkbox"/>
Accounting Systems	• Can your current accounting software account for the correct rate of GST at 15% on all transactions from 1 October 2010?	<input type="checkbox"/>
	• Has your accounting package been updated with a separate GST code of 15%?	<input type="checkbox"/>
	• Have you checked your accounting software to ensure it can: <ul style="list-style-type: none"> a) Account for bad debts correctly using both of the GST rates? b) Account for debtors and creditors at both of the GST rates? 	<input type="checkbox"/>
	• Educate your staff on the GST changes and identify what their responsibility is when accounting for the increased rate of GST throughout the transitional period.	<input type="checkbox"/>
Periodic Transactions	• Is your computer software correctly able to apply the right rate of GST to:	<input type="checkbox"/>
	• Hire purchase agreements	<input type="checkbox"/>
	• Finance leases	<input type="checkbox"/>
	• Layby sales	<input type="checkbox"/>
	• Long term contracts	<input type="checkbox"/>
	• Contracts overlapping the period of 1 October 2010	<input type="checkbox"/>

IMPACTS

ISSUES

CHECKED

Specific Transactions

- | IMPACTS | ISSUES | CHECKED |
|-----------------------|---|--------------------------|
| Specific Transactions | • Are you aware of the correct treatment for the following types of transactions: | <input type="checkbox"/> |
| | • Second hand goods | <input type="checkbox"/> |
| | • FBT | <input type="checkbox"/> |
| | • Bad debt recoveries | <input type="checkbox"/> |
| | • GST on entertainment expenditure | <input type="checkbox"/> |
| | • Service agreements | <input type="checkbox"/> |
| | • When negotiating contracts have you considered the increase in GST? | <input type="checkbox"/> |

Marketing Strategies

- | | | |
|----------------------|---|--------------------------|
| Marketing Strategies | • Have you considered if the increased rate of GST will affect your customers' behaviour? | <input type="checkbox"/> |
| | • Will the increase in GST affect your cost price of your business? | <input type="checkbox"/> |
| | • Use this time before 1 October to review your pricing strategy. | <input type="checkbox"/> |
| | • Can you on pass on the increase in GST to your customers? If not, have you found a way to absorb the increase in GST within your business operations? | <input type="checkbox"/> |

Compliance

- | | | |
|------------|---|--------------------------|
| Compliance | • Will you have to make a payments basis adjustment in your GST return? | <input type="checkbox"/> |
| | • Will you be required to file a separate GST return for the transitional period? | <input type="checkbox"/> |
| | • Are you aware of how the transitional GST rules will affect your business? If not contact your WHK tax advisor. | <input type="checkbox"/> |

GST TROUBLE SHOOTING

If you would like to discuss the how the GST increase will impact your business please contact your WHK Tax Advisor. We are able to identify areas of risk and establish opportunities to enable your business to implement a process plan and transition your business smoothly over the 1 October period.

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