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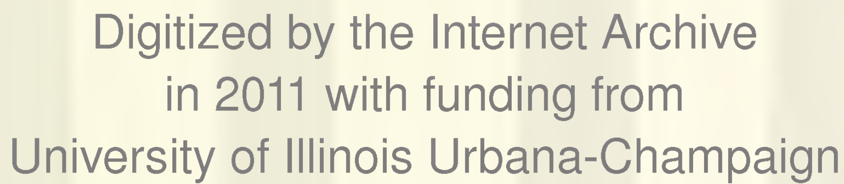
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Abstract

New Zealand has used a sales tax at the wholesale level for over fifty years. The tax, highly selective and with a number of rates, has been subjected to increasing criticism in recent years. In November 1984 the government announced that the tax would be replaced by a value added tax as of April 1, 1986. The value added tax proposed is the broadest that any country has used, with no commodity exemptions, and farmers, government departments, nonprofit organizations, and the like all being responsible for registration and collection and remittance of tax. Some details remain to be worked out.

THE NEW ZEALAND BROAD BASED VALUE ADDED TAX*

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On November 8, 1984, the government of New Zealand announced, in the Budget Speech, the plan to replace the wholesale sales tax by a value added tax, to go into operation April 1, 1986.

The Background

The wholesale sales tax, like that of Australia and the manufacturers sales tax in Canada, has been subject to increasing criticism in recent years.[1] The tax was introduced in 1933, at a flat 5% rate, as a depression emergency revenue measure following the precedent set by Australia in 1930. The tax applies to the last wholesale transaction, the sale to the retailer, and to importation by retailers or final consumers. Over the years, the tax underwent substantial change in rates and coverage, but not in basic structure. Exemptions are very broad. Only about 27% of household expenditures are covered by the tax, which is concentrated on consumer durables, and about one-third of the tax is collected on business inputs.[2] Industrial machinery and equipment, for example, are taxed. As of 1985 there are 12 specific rates and seven ad valorem rates, ranging from 10 to 60 percent. The tax has been yielding about 13 percent of total tax revenue.

*The author is indebted to officials of the New Zealand Treasury and the New Zealand Retailers Federation for their assistance.

1. John F. Due, "The Wholesale Sales Tax in Australia and New Zealand," Canadian Tax Journal, Vol. 31 (March-April 1983), pp. 207-27; and "Accepted V. Controversial Sales Tax Structures--Switzerland, Australia, New Zealand, Canada," Australian Tax Forum Vol. 1 (Dec. 1984), pp. 363-77.

2. New Zealand Treasury. Goods and Services Tax (Wellington: 1984), p. 8.

In earlier years the tax was subject to very little criticism.[1] But as time has passed, and the rates have risen, there has been growing complaint. There are several types of criticisms:

First, the tax is highly selective, and many rates are high. The system had become little more than a set of excises applying to domestic production and importation. Thus it is not capable of raising substantial sums of revenue without intolerable rates.

Secondly, because of the number of exemptions and rates, the tasks of the taxpayers in distinguishing among goods in various rate classes has become increasingly troublesome. The Customs Department, which administers the tax, has equal difficulty in ensuring proper application of the tax.

Thirdly, the tax is highly discriminatory against consumption of various goods and causes distortion in resource allocation.

Fourthly, the application of the tax at the wholesale level has created the fundamental problem of discriminating in favor of firms integrated backward into manufacturing, since the tax applies to prices of these firms that do not include typical wholesale margins. The tax favors large retailers able to buy directly from manufacturers at prices lower than those charged by wholesale distributors. The problem has increased over the years as wholesalers had disappeared from more and more fields. In 1982, to meet the problem the government applied a 15% uplift to the taxable price on direct sales by manufacturers to retailers--but this led to strong protests, particularly from firms in fields in which there were no wholesalers. Likewise, there are complaints that imports by retailers and final consumers are favored over domestic products since the taxable price does not include

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1. John F. Due, "The Wholesale Sales Tax in New Zealand," Canadian Tax Journal, Vol. 4 (Sept.-Oct. 1956), pp. 351-55.

the costs of many wholesale distribution functions. Ultimately, a 25% uplift was applied to the prices of taxable imports by business firms (not final consumers). But these uplift figures are highly arbitrary and inequitable among various firms and products.

As made clear in the 1984 Budget Speech, the prime motive for the proposed change is to allow a reduction in marginal income tax rates and general reliance on direct taxes[1]; this could not be done within the framework of the existing wholesale sales tax because of the limited coverage, and the inherent problems of taxing at the wholesale level and including services within the tax. The primary objectives of tax reform were outlined in the Budget Speech as follows:

> to increase equity;
>
> to lessen tax-induced distortion of resource allocation by reducing anomalies and concessions, broadening the base, and lowering marginal rates; and
>
> to make the tax system more certain and simple.

Previous Consideration of Possible Change

Serious consideration of change from the wholesale tax began with the presentation of the McCaw report in 1982,[2] which urged substantial shift from direct to indirect taxes. The Report also evaluated the various forms of alternative sales taxes, without recommending any particular type. There was substantial support in industry for the value added form, partly because of the strong desire to eliminate the problems of the present tax. Initially, after careful study the Retailers Federation endorsed the value added tax

1. New Zealand has the highest percentage of tax revenues from income taxes (68.9) of any OECD country (1981). D.B. Perry, "A Review of Tax Levels of OECD Member Countries in 1981 and 1982," Canadian Tax Journal, Vol. 32 (March-April 1984), pp. 392-98.

2. New Zealand, Report of the Task Force on Taxation (Wellington: April 1982).

rather than the retail tax, which they feared would concentrate the burden on the retailers and lead to evasion. However, in 1982, the Federation reversed its position, because many small retailers thought the VAT would be too complicated to administer. Ultimately, the Federation again came to favor the value added tax so long as there was one rate and no exemptions.

Announcement of the Tax

As noted above, the Goods and Services tax (GST) was announced in the 1984 Budget Speech (November of 1984) in conjunction with planned reduction in rates of the income tax. The new tax was outlined in the publication, Goods and Service Tax, issued November 9, 1984, a White Paper on Goods and Services Tax, and issued in March, 1985, and a document entitled GST: The Key to Lower Income Tax. The White Paper contains a proposed draft of the legislation. The final draft of the legislation will go to the House of Representatives in July 1985, with passage hoped by August. Registration of firms is planned to start in October, and the tax to go into operation April 1, 1986. The tax will be administered by Inland Revenue rather than the Customs Department, which administers the wholesale sales tax. Customs will collect the tax at importation. The wholesale tax will be abolished, except for levies on tobacco, alcoholic beverages and motor fuel. The revenue from the new tax will be used to allow lower income tax rates, and in part to reduce the deficit.

Features of the Tax

The proposed tax is a value added tax, modelled after the European value added taxes, with very much broader coverage and a single rate, applying to all commodities and all services (other than those rendered by employees to employers).

General Structure: The tax will operate on the tax credit method, tax applying at importation and to all domestic sales, tax paid on purchases being a credit against tax due on sales. The objective is to make the tax completely universal, applying to all goods and services, including all governmental activity, both commercial and governmental in nature.

Not only will the tax apply to all business firms in the usual sense, but to nonprofit organizations, all farmers, and all governmental units. Govermental units are assumed to be providing their services to the Crown and will, it appears, be subject to tax on their expenditures, receiving credit for tax on their purchases. Local authorities will be taxed as well as government of New Zealand Departments. Commercial services of governments will be taxed in the same fashion as sales by businesses. The general aim is to make the tax as productive of revenue as possible at a given rate, and to avoid the complications arising if certain groups, such as farmers, are excluded from operations of the tax or certain commodities or services exempted. The objective is to provide a completely neutral tax.

There is only a very limited number of exceptions to the universal coverage rule:

1. All export sales will be zero rated, thus providing for refund of tax paid on previous transactions and freeing exports completely from tax.

2. Rental of residential facilities is exempted because of the impossibility of taxing owner-occupied homes. All elements involved in constructing and maintaining housing will be taxed.

Short term rentals of hotel and motel rooms will be taxed.

All building construction costs will be taxable, as well as rental of nonhousing real estate.

3. Sales of existing buildings will be subject to tax in the usual way (excluding the value of land) when sold by a registered vendor; sales between nonregistered persons will be free of tax. A sale by a registered vendor of a building purchased from a nonregistered person would be treated as any second hand transaction.

4. On sales by second hand dealers of goods purchased from nonregistered sellers, tax will apply only to the dealer markup, since tax has not applied to the dealer's purchase and no tax credit is possible.

5. Financial services provide the most troublesome aspects in the design of any value added tax; the White Paper simply indicates that this issue is under further review.

6. Churches will not be taxable on the contributions received, but will be taxable on their purchases of taxable goods and services and any regular selling activity.

7. Tax will not apply to visitors' baggage and certain merchandise imported temporarily. Domestic purchases by persons entitled to diplomatic relief from taxes will be taxed but refund provided.

The Treasury rejects food exemption, on the grounds that most of the revenue gain would go to persons in the middle and upper income levels, and that the interests of the poor can be taken care of more satisfactorily by adjustments in benefits from various government programs.

Credit for Tax on Purchases: Credit will be allowed registered firms for t paid on all purchases for business use, including capital equipment, unlike the p tice in some countries under which tax on purchases of motor vehicles, entertainm and other items is disallowed. Credit can be taken for tax paid on purchases, however, only if payment of this tax can be demonstrated on invoices.

Tax Rate: There will be a single rate. The actual figure has not been announced, but 10 percent has been widely mentioned.

Other Features

There are a number of other relevant features of the proposal:

Quotation of Tax: On sales to registered vendors, the tax must be shown separately on the invoice, so that the purchaser may know the amount of tax for which he is entitled credit. The vendor must issue an invoice if the purchaser so requests. On sales to nonregistered persons, the tax may be shown separately or included in the price. The general presumption is that the retailers will typically include the tax in the price, although it is believed that supermarkets may add the tax at the cash register. In Zimbabwe and South Africa, which allow the option, both methods are used, though inclusion appears to be more common. In the United States, separate quotation of tax has been almost universal, even in the states that have not required it.

Taxable Price: The tax normally applies to the sale price, including any charges for incidental services, such as transport, which themselves are taxable. The tax may be adjusted to open market value on nonarms length transactions. On imports, tax applies to the import value plus customs duty and any other taxes due. The taxable price does not include the tax element.

Timing of Tax Liability. On imports, tax is due at the time of clearance from customs. On domestic transactions, normally tax liability will be incurred when the invoice is issued, although in some instances when the service is rendered or the goods become available to the purchaser. On hire-purchase (installment) purchases, tax will apply when the hire purchase agreement is entered into.

Bad Debts: Deduction of bad debts from taxable sales will be permitted, plus credit for the tax paid on the purchase of the goods.

Taxable Activity: Liability for registration as a vendor and collection and remittance of tax is based upon what may be called a "business test." Does the firm or person carry on regular and continuous selling activity, with some form of organizational structure and record keeping? This has the effect of eliminating purely casual transactions from the tax.

Operation of the Tax

The proposed operational patterns are similar to those of value added taxes elsewhere.

Registration: All persons who "make supplies of goods and services in the course of conducting a taxable activity," that is, all persons, including farmers, engaged in selling goods or rendering services as a regular activity must register for purposes of the tax. The government has under consideration the exemption of very small firms from the requirement--perhaps those with annual sales under $2500 dollars (about US $1200). This would exclude only the very small establishments; it is not considered necessary to exclude the typical smaller firms, given the simplicity of the proposed tax. No decision has as yet been made on this issue.

It is expected that there will be about 180,000 registered firms of which 60,000 would be farmers. The number under the wholesale tax is about 9,000.

Returns: Return forms are being developed and will be mailed out in each tax period. The tentative form is very simple--but has one unusual feature: the figure of gross sales is required on a tax inclusive basis, requiring the calculation of the tax due by dividing by one-eleventh (assuming a 10 percent tax rate).

Returns would be required on a two-month basis, due the first day of the second month following the return period (e.g., June 1 for the period March 1-April 30). Firms would be placed on a staggered basis; for half, for example, the return would cover January-February, the other, February-March.

Penalties: A penalty of 10 percent plus 2 percent a month for each subsequent month will apply when payment is not made by the due date. This is the same rule as under the wholesale sales tax. Provisions for enforcement of payment, through ultimate sale of assets, are similar to those for other New Zealand taxes.

When a refund is due, as will be common for exporters and firms making large capital investments in the period, immediate payment will be made by the government, so long as there are no outstanding balances due on this or other taxes.

There are also provisions for so called penal taxes involving a tripling of the amount of tax due in the event of evasion. In addition, criminal penalties are provided, up to $2000 for an individual and $10,000 for a corporation, for a variety of offenses, such as failure to register, to keep adequate records, to issue invoices when requested, falsifying records, issuing false invoices, failure to file returns, etc.

As under the income tax, and as in Australia, there is provision for publication in the Gazette of persons convicted of various offenses under the tax.

Audit: A two stage audit program is planned. Brief inspections, called routine control audits, will be made at fairly frequent intervals, examining books of account and records on a somewhat limited basis, to ensure that the firm is complying with the tax and paying the correct amount of tax, keeping adequate records, and using proper bookkeeping standards.

The second stage is an in-depth investigation, to be undertaken if the control audit reveals noncompliance or fraud.

Transitional Provisions

When the tax goes into effect, firms will have on hand merchandise on which wholesale sales tax has been paid. Provision is made for the credit against GST liability of the amount of wholesale tax that was paid on the purchase or importation of the goods, or the amount of GST that would have been paid had that tax been in effect, whichever is lower.

The tax will apply to all transactions on which delivery is made after April 1, 1986, whether invoiced before or not.

Summary Evaluation

The proposed levy is substantially broader in coverage than any value added tax in operation, particularly by including all services, governmental units, and farmers. The broad coverage avoids some of the troublesome problems created by exemptions and zero rates, particularly the need for exemption or zero rating of major farm inputs, such as feed, seed, and fertilizer, if farmers are not registered, and the tax treatment of sales to government and charitable organizations. The broad coverage also has the advantages of maximum revenue at a given tax rate and the avoidance of distortions. The plan for a uniform rate has tremendous advantage from an operational standpoint; many of the problems in Europe have arisen from multiple rates.

Several issues remain to be solved however. The most serious relates to financial institutions, to be covered in a supplementary Treasury report. This area encounters major problems arising from the fact that interest paid to individuals is not taxed and cannot easily be taxed. There are some

aspects of building construction, sale, and rental of real property not fully solved in the reports. The exact treatment of governmental services is not specified entirely. The most serious operational problem, one not considered in the publications to date, is that of distinguishing between purchases for personal purposes and those for business purposes on the part of farmers and other small business operators and professional persons. While the registration of farmers has merit, it does increase the number of registered firms by 50 percent, and will involve a substantial volume of refunds on exported farm products.

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