

InternetNZ

**GST: Cross-border services,
intangibles and goods**

25 September 2015

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1. Introduction

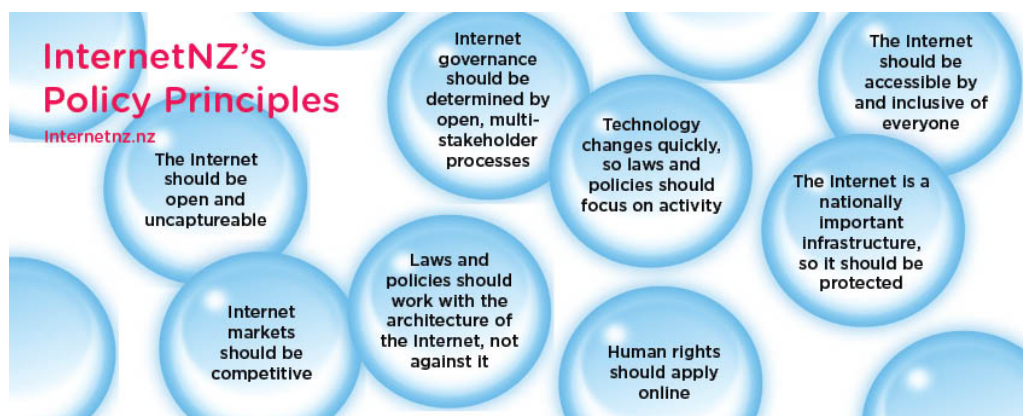
- 1.1 InternetNZ appreciates this opportunity to offer our views on the “Cross-border GST” discussion document.
- 1.2 This introduction summarises our response to the discussion paper. We present more detailed discussion below, and address specific consultation questions in an appendix.

InternetNZ promotes the benefits and uses of the Internet

- 1.3 InternetNZ works to promote and protect the benefits of the Internet in New Zealand. We are a voice for the open Internet, and the opportunities it offers to New Zealanders.

Our policy principles

- 1.4 Our submission reflects our policy principles (see below), in particular:
 - a) Technology changes quickly, so laws and policies should focus on activity
 - b) Laws and policies should work with the architecture of the Internet, not against it
 - c) Internet markets should be competitive.



Summary of InternetNZ Submission

- 1.5 We respect the aim of fair tax treatment for all purchases, whether local or overseas, and whether made online or offline. However, we have practical concerns about how this aim can be implemented without imposing undue costs.
- 1.6 New Zealand is a small market, and benefits from access to overseas products. There is a risk that real or perceived compliance costs will stop overseas suppliers from selling into NZ. Any change in this area must be carefully crafted to avoid barriers to trade.
- 1.7 We recognise that local retailers may see the present situation as unfair. However, it is far from clear that extending GST to low-value overseas purchases will affect the choices of consumers. People buy from overseas for a range of reasons, including variety of products and price differences much greater than the GST margin of 15%.
- 1.8 The pattern of buying from overseas reflects the fact that New Zealand is a small market with limited economies of scale. It also reflects broader trends in how people buy and sell. Within New Zealand, online shops which charge GST have taken market share from traditional retail suppliers. This shift is due to the convenience of buying and selling online, not due to any difference in tax treatment.
- 1.9 Based on our expertise, member concerns, and policy principles, we submit that:
- a) GST collection must not act as a barrier to trade, which would harm New Zealand consumers and businesses by limiting access to imported goods and services
 - b) Compliance costs must be minimised. Any compliance threshold should be no lower than the \$60,000 domestic GST-registration threshold
 - c) IP addresses should not be used as a proxy for tax status because:
 - (i) IP addresses cannot be relied on as an indicator of geographic location
 - (ii) The ordinary operation of Internet technologies could cause New Zealand users to present overseas IP addresses without knowing this, resulting in uncertainty over tax obligations
 - (iii) Deliberate modification of IP addresses is fundamental to secure use of the Internet by businesses and others, and should not have tax implications.
 - d) The “knowledge” offences in the Tax Administration Act 1994 are a poor fit for online GST because:
 - (i) A \$25,000 fine for first offences is disproportionately harsh
 - (ii) Mistakes are easily made online and do not involve severe wrongdoing
 - (iii) Uncertainty and severe penalties risk chilling legitimate buying, selling, and use of Internet technologies.
- 1.10 We welcome the opportunity to discuss our submission with you further. To discuss our submission please contact our Issues Advisor, James Ting-Edwards via james@internetcnz.nz or on 021 156 5596.



Jordan Carter
Chief Executive

2. Online GST should not be a barrier to trade into NZ

- 2.1 InternetNZ protects the benefits and uses of the Internet in New Zealand. One of these is the ability to buy from and sell to people overseas. While we endorse the goal of fair tax treatment, we do have practical concerns about how this may be implemented in a way which preserves the relevant benefits and opportunities.
- 2.2 We are concerned that GST compliance will act as a barrier to trade, harming New Zealand consumers and businesses. In global terms, New Zealand is a small market. Larger overseas markets can produce a wider variety of products, and can produce many things more efficiently. Compared with other countries:
 - a) New Zealand benefits more from access to overseas products
 - b) Suppliers may readily cut off sales to New Zealand based on compliance costs.
- 2.3 For these reasons, we are glad to see an emphasis on minimising compliance costs for overseas suppliers.
- 2.4 We would add that perception of compliance costs is equally important. If it looks difficult to sell into New Zealand, we may lose access to many suppliers.
- 2.5 If we do impose a GST obligation on overseas suppliers, it must be extremely easy to use. This may require a range of educational materials with translations available. Ideally New Zealand's IRD and Customs service would provide apps, programming interfaces (APIs) and training to help overseas suppliers comply. Should we fall short, we risk our reputation as being easy to deal with, and might miss out on imports.
- 2.6 We agree that compliance obligations, if any, may be best dealt with at the level of customer-facing aggregators or marketplaces, as that may lower overall compliance costs.

3. We support a wide definition of “services”

- 3.1 We favour technology-neutral drafting, and support the proposed broad definition of “services”. We agree that in principle all purchases should be taxed on the same basis, without reference to a definition of “digital” or other special classes of product.

4. Low-volume suppliers should have no compliance obligations

- 4.1 We want to ensure that New Zealanders continue to have access to niche suppliers overseas. Even a requirement to collect or report New Zealand sales would be unduly harsh for many low volume sellers.
- 4.2 In general, New Zealand compliance obligations should be proportionate to a specific seller's volume of GST-eligible sales. This might be achieved through a graduated compliance regime, with compliance obligations such that:
 - a) Below a threshold volume of GST-eligible sales, there are no compliance obligations on overseas suppliers
 - b) Between the first threshold and a second higher threshold, there is an obligation only to collect readily accessible proxy data indicating GST-eligible sales
 - c) Above the second threshold as indicated by accessible proxy data, there is an obligation to “take reasonable steps” to identify GST-eligible sales
- 4.3 We recognise that in future these compliance costs may change. For example, if the OECD developed a general framework for reporting international purchase tax, this would make it easier for sellers to handle New Zealand transactions.

5. A compliance threshold should be no lower than the domestic registration threshold

- 5.1 For fairness, the threshold for overseas supplier compliance obligations should be no lower than the domestic GST registration threshold (currently \$60,000).
- 5.2 Overseas suppliers face higher compliance costs than New Zealand businesses. New Zealand businesses have access to local accountants and other advisors, and are likely to be familiar with IRD information and rules.

6. We oppose the use of domestic registration for overseas suppliers

- 6.1 Applying a domestic registration system to overseas suppliers risks permanently damaging New Zealand's reputation as "easy to deal with". Any system for collecting GST from overseas businesses must be tailored to that use. Such a system must be extremely easy to use, well explained, and fit for purpose from day one.
- 6.2 We would welcome an opportunity for overseas suppliers to comment on any proposed compliance and collection systems, including the technical resources and support which would minimise their compliance costs. This might, for example include development of a programming interface (API) for use by overseas suppliers.

7. IP addresses should not be used to assess tax status

- 7.1 InternetNZ is particularly concerned that new tax policies should not interfere with the ordinary operation of the Internet. We support the goal of minimising compliance costs on overseas suppliers. However, we do not support the use of IP addresses to indicate tax resident status.
- 7.2 The discussion paper suggests at 7.5 that IP addresses are one option for identifying tax residency of New Zealanders. We oppose this for two main reasons:
 - a) Though easily collected, IP addresses are unreliable indicators of location
 - b) We oppose linking tax implications to IP addresses, as this would fundamentally impair ordinary uses of the Internet.

IP addresses do not tell us where someone lives

- 7.3 An IP address is like a PO Box- it's one point on the journey between sender and receiver. Just as a physical parcel could contain instructions to send it on somewhere else, sending data over the Internet may involve dozens of "hops" through different systems, each with its own IP address. This passing on of data is fundamental to the Internet. As a result, an IP address does not tell us where a communication starts or finishes.
- 7.4 For tax purposes, it is important to know where someone usually resides. Tracking residence by IP address is like using a PO Box number to identify the owner's street address. We may know that the PO Box is in a particular suburb. But the PO Box, or the suburb, may not be where the owner lives - it may be an intermediate point between sender and receiver.

Users and businesses need to modify and hide IP addresses

- 7.5 There are legitimate reasons for businesses and others to hide or modify the IP addresses they present on the Internet. These legitimate technical choices should not be hampered by tax implications.
- 7.6 For example, it is common network security practice for a business network to present a single external IP address. This external IP may relate to hundreds of internal devices and users, including users who connect to the network from overseas. It is also common for businesses to use a Virtual Private Network (VPN),

creating their own secure network over the Internet. When using a VPN, New Zealand resident employees may appear to be connecting from an Australian office or vice versa.

- 7.7 The Internet is robust and functional because it allows information to flow by any number of paths. When using or designing network systems, users and IT departments should not have to worry about tax rules.
- 7.8 It must remain the case that any user of the Internet can modify their visible IP address without actual or perceived tax implications. Uncertainty in this area would chill legitimate uses of the Internet, ultimately harming New Zealanders. No tax-related liability should flow from hiding, modifying, or misinterpreting IP addresses.

8. Online tax mistakes: educate rather than prosecute

- 8.1 While we acknowledge the need for any tax law to be enforceable, we are concerned that the enforcement measures suggested are disproportionate, and fail to account for the realities of online purchases.

Do not apply current knowledge offences to online purchases

- 8.2 The discussion document at 7.15-7.16 suggests that people avoiding GST on online purchases could face prosecution under s 143A of the Tax Administration Act 1994. Thus a first-time offence by a consumer could attract a fine of \$NZ 25,000 and later offences fines of up to \$NZ 50,000. This would apply where:

“a person knowingly provides altered, false, incomplete, or misleading information to any person in respect of a tax law or a matter or thing related to a tax law”

- 8.3 Our members have expressed concern that this broad definition might cover:
- a) Business or other legitimate use of technologies which alter a user’s IP address or apparent location; or
 - b) Inadvertently accessing a system through an overseas IP address, and thereby avoiding GST on a GST-eligible purchase.
- 8.4 Compared with current situations where existing knowledge offences would apply, we suggest that:
- a) Online purchases will involve lower amounts of money; and
 - b) Online purchases are more likely to involve inadvertence or omission
- 8.5 On this basis, we suggest that the prospect of a \$25,000 fine is disproportionate to the level of likely wrongdoing.

Clarify that tax offences do not interfere with the Internet and VPNs

- 8.6 Instead, where there is a failure to meet tax obligations for online transactions, we would favour:
- a) An educational approach, particularly for overseas suppliers who have less familiarity with New Zealand rules
 - b) An alternative regime of lower-penalty offences where failure to meet tax obligations is inadvertent or relates to low-value transactions
 - c) Clarification that s 143A(1)(c) of the Tax Administration Act 1994 and similar offences do not cover the ordinary use of Internet technologies, including technologies which hide or modify a user’s IP address or location.
- 8.7 To impose penalties of the magnitude suggested would have a chilling effect on business activity online. We again state the need for any compliance rules to be easy for overseas suppliers, and any penalties proportionate to wrongdoing.

Appendix - Discussion paper questions

Below we address the specific questions asked. As a cause-based organisation, we focus on those question with implications for the benefits and uses of the Internet in New Zealand.

We are concerned that any extension of GST on imports:

- a) Should not act as a barrier to trade
- b) Should involve minimal compliance costs for overseas suppliers
- c) Should not add tax implications to the use of Internet technologies, including deliberate hiding or modification of a user's IP address.

3. Low-value imported goods

How does the non-collection of GST on imported goods affect you?

InternetNZ stands for the benefits of the Internet. With the current de minimis threshold for GST, New Zealanders benefit from easy access to the niche goods and economies of scale available overseas. Most goods need not be held at the border, which avoids a potential barrier to trade.

How do you think the collection of GST on low-value goods could be made more cost effective while still protecting New Zealanders from imported threats?

There is no overseas precedent for offshore-supplier registration in relation to low-value goods. New Zealand is a small market, and might best handle this through coordination with partner countries or organisations such as the OECD.

What do you consider is the best structure and level of the de minimis threshold?

Collecting GST on more imports would impose costs on Customs, on the IRD, on suppliers, and on consumers. This includes opportunity costs - new compliance steps might mean New Zealanders miss out on some opportunities to buy online. The de minimis threshold should be set high enough that these costs are minimised, or at least kept lower than the marginal increase in GST collected.

4. A new place of supply rule

Do you agree with the proposed approach for taxing cross-border services and intangibles?

We accept the principle that New Zealand residents should pay GST for goods and services consumed in New Zealand. Our concerns relate to whether this can be implemented efficiently and fairly.

Do you think an approach that distinguishes between "remote" and "on-the-spot" services will produce the right outcomes and do you consider there will be problems in practice in making this distinction?

There may be difficulties in practice. For example, a New Zealand resident may get legal advice from an Australian lawyer. This should be taxed exactly once - depending on subject matter, Australian GST or New Zealand GST might apply. If this is a "remote" service, tax treatment should be the same whether the advice is given in person or via Skype. But some elements may be on-the-spot: signing documents might need to be done in person. Correct tax treatment would require service providers to sort through these issues, which may be unrealistic.

Do you prefer an approach that excludes on-the-spot services so they are outside New Zealand's tax net, or an approach that treats all supplies as being subject to GST, but then excludes on-the-spot services by making them zero-rated?

We would prefer an exclusion to avoid compliance costs on suppliers.

5. Services included and excluded

Do you consider that a rule that covers a wide range of services is appropriate for New Zealand, and do you foresee any problems with such a broad approach in practice?

We favour technology-neutral drafting, which supports a broad definition of “services”.

Do you prefer an approach that only taxes business-to-consumer supplies or an approach that taxes both business-to-consumer and business-to-business supplies?

Aside from supporting low compliance costs, we are not in a position to offer input on this question.

Do you consider that the other proposed exclusions for services and intangibles supplied by a non-resident should ensure that non-residents and resident suppliers received comparable treatment?

We are not in a position to offer input on this question.

6. Requirement for suppliers to register

What do you consider is an appropriate registration threshold for offshore suppliers?

The threshold for registration, or any compliance step, must be at a sales volume which justifies the compliance cost to overseas suppliers. Fairness suggests that this be set at the domestic registration threshold of \$NZ 60,000.

Should business-to-business supplies count towards the registration threshold?

No. Some overseas suppliers may specialise in business-to-business transactions, and should not be subject to GST compliance costs.

Should electronic marketplaces be required to register in certain situations instead of the principal supplier?

Yes. Marketplaces or aggregators are likely to face lower compliance costs than principal suppliers.

What factors do you think are important when determining whether an electronic marketplace should be required to register?

We suggest factors indicating a marketplace has control, handles the information needed for compliance, or has a connection with New Zealand:

- a) Whether the marketplace authorises payment
- b) Whether the marketplace authorises delivery
- c) Whether the marketplace sets terms and conditions
- d) Whether the marketplace has a New Zealand presence or .nz domain name, implying targeting of and familiarity with New Zealand.

7. Information, compliance and enforcement under the proposed rules

What proxies do you consider would be appropriate to use in order for offshore suppliers to determine the residency of their customers?

We consider that IP addresses should not be used to assess tax status:

- a) Like PO Boxes, IP addresses do not reliably show where a user is

- b) Attaching tax implications to IP addresses will impair the legitimate use of basic Internet and network technologies by business and others
- c) Hiding or modification of an IP address alone must never be a tax offence.

Instead, we would suggest the use of billing and delivery details such as:

- a) Currency of originating payment
- b) Billing address
- c) Delivery address

While no proxy is perfect, we believe these will be less volatile than IP addresses.

We reiterate that technical decisions should not have tax implications. Anonymity and experimenting with technology are fundamental to the operation and value of the Internet. The freedom to develop and apply these technologies must remain.

What proxies are likely to be most accessible in practice?

We are not in a position to offer input on this question.

To what extent should offshore suppliers be required to accurately determine the residency of its customers and how much evidence should suppliers be required to obtain?

Compliance costs should be minimised. This implies no obligations below a threshold volume of GST-eligible sales, with the threshold set at high enough to justify the costs imposed on suppliers.

Separate compliance steps could be subject to different thresholds. For example:

- a) Below a first threshold volume of GST-eligible sales, no compliance obligations
- b) Above the first threshold, an obligation to collect only readily accessible proxy data indicating GST-eligible sales
- c) Above a second and higher threshold, an obligation to “take reasonable steps” to identify GST-eligible sales

We suggest that a graduated scheme of the sort indicated would sensibly match compliance costs to volume of sales, reducing the risk that suppliers would refuse to deal with New Zealanders.

If business-to-business supplies are excluded, will offshore suppliers be able to easily distinguish between individuals and GST-registered business in practice and what compliance costs would this impose on them?

We are not in a position to offer input on this question.

Do you agree with the sanctions proposed for incorrect representations by consumers?

No. The sanctions are far too severe, and risk chilling effects on online purchases. They fail to reflect:

- a) The ease of making mistakes online
- b) The low value of most online transactions, and the corresponding low level at which GST might be evaded
- c) The low level of moral culpability which is likely to be involved in even deliberate wrongdoing when shopping online.

When combined with the proposed use of IP addresses to indicate tax status, the proposed sanctions would place many ordinary users and systems administrators at risk of \$25,000 and \$50,000 fines. This is unacceptable.

The “knowledge” offences in the Tax Administration Act 1994 assume that “knowing” provision or omission of tax related information involves deliberate and severe wrongdoing. This is a poor fit for the Internet.

In online shopping, computers interact and exchange information. Good security practice can involve hiding or modifying how a system looks from the outside, including its IP address. Whether users know it or not, their ordinary online shopping may involve the supply of misleading or incomplete technical information. These technical phenomena should not put users or system administrators at risk of committing tax offences.

We propose instead an educational approach, coupled with rules designed for operation on the Internet. Any penalties must be proportionate to the lower amounts involved in online shopping, and must clearly apply only when deliberate attempts are made to avoid tax obligations.

We do not want tax rules to break ordinary uses of the Internet. For example, use of a VPN for security reasons or to access overseas video content should not alone count as a tax offence.

If business-to-business supplies are excluded, do you agree with the application of the reverse charge as suggested?

We are not in a position to offer input on this question.

If business-to-business supplies are excluded, New Zealand business will be required to recover any inadvertently charged GST from the offshore supplier. Do you agree with this approach?

This is one of the difficulties with requiring and trusting overseas suppliers to identify GST eligible purchases, and to collect GST on behalf of the IRD. We favour minimising overall compliance costs, but have no specific comment on where these burdens should fall.

8. Registration and return filing

Of the three options discussed, which registration do you prefer?

We oppose the use of domestic registration for overseas suppliers, as it is not tailored for this purpose

We favour low compliance costs for overseas suppliers. A regional one-stop-shop would help to justify the compliance costs, as these would be spread across a larger target market

As with a New Zealand only regime, a regional one-stop-shop must make compliance easy for overseas suppliers. Depending on how it is set up, an easier, higher quality New Zealand only system might still be preferable.

What compliance costs would be imposed on offshore suppliers if they were required to register under the domestic registration system?

We see initial awareness and understanding as an important part of compliance. The domestic system is not designed for overseas suppliers, and so is likely to have teething issues in this application. We prefer a tailored model which would get this right from day one.

Do you consider there would be significant benefits in pursuing a regional “one-stop-shop” registration system?

Yes, as this would spread compliance costs over a larger target market.

Do you prefer a fixed filing time for offshore suppliers or variable filing times that depend upon the offshore supplier’s turnover?

We are not in a position to offer input on this question

Appendix: International adoption

New Zealand is a small, geographically isolated market. Overseas experience may have limited relevance to us.

It is proposed to apply overseas-supplier registration to imported goods, which no other country has done.

We advise instead a cautious approach, as real and perceived compliance costs may damage our access to overseas goods and services. This would harm New Zealand consumers, and businesses which use imported products as inputs.

About InternetNZ

A better world through a better Internet

InternetNZ is a voice, a helping hand and a guide to the Internet for all New Zealanders. It provides a voice for the Internet, to the government and the public; it gives a helping hand to the Internet community; and it provides a guide to those who seek knowledge, support or any other method of benefiting the Internet and its users.

InternetNZ's vision is for a better world through a better Internet. To achieve that, we promote the Internet's benefits and uses and protect its potential. We are founded on the principle of advancing an open and uncaptureable Internet.

The growing importance of the Internet in people's everyday lives means that over the last twelve months we have significantly reoriented our strategic direction. The Internet is everywhere. We are a voice for the Internet's users and its potential to make life better.

InternetNZ helps foster an Internet where New Zealanders can freely express themselves online - where they can feel secure in their use of the Internet. We foster an Internet where a start-up can use the web to develop a presence and customer base for a new product, and we foster an Internet where gamers can get online and battle it out.

We work to ensure this Internet is safe, accessible and open.

The work we do is as varied as what you can find on the Internet.

We enable partner organisations to work in line with our objects - for example, supporting Internet access for groups who may miss out. We provide community funding to promote research and the discovery of ways to improve the Internet. We inform people about the Internet and explain it, to ensure it is well understood by those making decisions that help shape it.

We provide technical knowledge that you may not find in many places, and every year we bring the Internet community together at NetHui to share wisdom, talk about ideas and have discussions on the state of the Internet.

InternetNZ is the designated manager for the .nz country code top-level domain and represents New Zealand at a global level through that role.

InternetNZ is a non-profit open membership incorporated society, overseen by a council elected by members. We have two wholly owned subsidiaries that ensure that .nz is run effectively and fairly - the Domain Name Commission (DNC) develops and enforces policies for the .nz domain name space, and .nz Registry Services (NZRS) maintains and publishes the register of .nz names and operates the Domain Name System for .nz