

Tacks **FAX**



DON'T LET THE IRD NAIL YOU

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Amendments to GST Act

The GST Act has been significantly amended. The following articles (below) are designed to help you get to grips with changes, which are effective from 1 April 2011. Transactions entered into before this date, are subject to the old rules for a period of time depending on their GST exclusive book value or market value. You may choose which to use.

- If the amount is \$5,000 or less, no adjustment under the old rules is required after 1 April 2011
- If the amount is more than \$5,000 but not more than \$10,000, no adjustment under the old rules may be made after 1 April 2013.
- If the amount is more than \$10,000, no adjustment under the old rules may be made after 1 April 2016.

Once the time limit for an asset is reached, the person must stop making any adjustments for change-in-use in respect of that asset.

Your annual accounts questionnaire may need to be updated to cope with the rules listed below.

Some of the following looks formidable. Generally, if the original GST input claim is reasonably accurate, no adjustments are going to be needed until the asset is sold.

When you get used to the rules you'll soon tell if you need to perform the calculations.

The new GST apportionment rules

The new GST apportionment rules work like this:

When you buy an asset, which is to be used partly for taxable supplies and partly for non taxable supplies, take a reasonable guess at the proportion applicable to each activity. Say 70% of the use of an asset is expected to apply to the taxable activity, claim 70% of the input tax. You now keep records to determine the actual use. Suppose it turns out the actual use is 60% for taxable supplies. You have to adjust the input tax claim - see "Calculating the adjustments" below. When the asset is sold, there is a wash up - also covered below.

Calculating the adjustments

You have to undertake two tests:

1. Has the change in use been 10 percentage points or more?
2. Is the amount of the adjustment more than \$1,000?

Suppose you buy a car for \$115,000 with 6 months to go before the end of the year and you choose to end your first adjustment period at the balance date six months after purchase. You estimate private use at 30% and claim 70% of the input tax. In the first 6 months the log book shows actual business use at 59.9%. You are now at the end of an adjustment period. Make an output tax adjustment to reduce your claim to 59.9%. This is $(70.0\% - 59.9\%)$ of \$15,000 = \$1,575.

In the second year business use increases to 65%. Here is the calculation for the second year:

(Actual % business for 6 months out of 18) plus (actual % business for 12 months out of the 18)

$$(59.9\% \times 6/18) + (65\% \times 12/18) = 20\% + 43.3\% = 63.3\%$$

Compare this result with your original claim or your previous adjustment. You claimed 70% and then adjusted down to 59.9%.

63.3% is less than 10 percentage points from 59.9% and on this basis no further adjustment is needed. However, would the adjustment be more than \$1,000? It is $63.3\% - 59.9\% = 3.4\%$. 3.4% of \$15,000 = \$510, which is less than \$1,000. No adjustment is required. You will get an adjustment when you sell.

In the fourth year (taking business use at say 55% for year 3 and 45% for year 4) it goes like this:

$$(59.9\% \times 6/42) + (65\% \times 12/42) + (55\% \times 12/42) + (45\% \times 12/42) = \text{etc}$$

When the car is sold you don't pay 100% of the output tax to IRD. Suppose your overall claim has been 40% of the GST input tax, you will pay only 40% of the output tax on sale.

Adjustment periods – new rules

The number of periods for which adjustments are needed varies based on the value of the item or its estimated useful life. The default adjustment bands are:

- \$5000 and under - no adjustment needed.
- \$5,001 to \$10,000 – two adjustments.
- \$10,001 to \$500,000 – five adjustments.
- \$500,001 or more – ten adjustments.

There is no limit in respect of land.

As an alternative, you may use the number of years of useful life of an asset as shown in the IRD Depreciation rates.

The adjustment calculations are done based on the number of months involved. Each time you go back to square one and recalculate what the adjustment should have been.

Many small businesses will not know how the adjustments work until they get their annual accounts done. There is therefore a choice. Suppose you buy a car part way through a year. You can either run your first adjustment period to the end of the tax year or to the end of the following tax year (assuming no change of annual balance date).

Land used simultaneously for taxable and non taxable purposes

Developers often purchase land with a house on it. They rent the house until they are ready to develop that piece of the land. From 1 April 2011 you are going to need the market value of the land at the time of **each** adjustment. Divide this by the market value of the land at the time of the adjustment plus the rental earned (or rental which should be earned if the house is empty). This gives you the extent to which the land is being used for taxable supplies. Multiply by a hundred to get the percentage. Thus you may find you get a figure of 93%. Therefore pay IRD 7% of the input tax claimed.

To work out the adjustment for the second period, you make two adjustments:

1. Get the market value of the property again.
2. Work out the rent charged (or could have been charged) from the time of purchase.

Divide 1 by the sum of 1 and 2. This is the percentage taxable use. Keep making adjustments like this each year, progressively adjusting the GST claimed, until the property is sold. When it is sold, you find out if all the GST claimed has been recovered. If it has you get all the adjustments back. If not you get a proportionate share back.

You continue to apply the old rules to properties bought prior to 1 April 2011.