Inland Revenue
Te Tari Taake

Date of issue

Deadline for comment: 12 Nov 2019. Please quote reference: PUB00352.

QUESTION WE'VE BEEN ASKED

QB 19/XX
Changing GST treatment after reducing the previously agreed consideration

This QWBA explains how the GST treatment of a supply can be adjusted if a supplier accounted for output tax incorrectly.

Key provision
Goods and Services Tax Act 1985: s 25(1)(b) and (2)

Question

If a supplier determines they have incorrectly accounted for GST on a supply, can they make an adjustment under s 25 or are they limited to amending their return?

Answer

Where the previously agreed consideration is reduced by the amount of the GST incorrectly charged, s 25 will allow an adjustment only of an amount equal to GST on the amount by which the consideration is reduced.

The GST treatment may be totally reversed only if the assessment for the period in which the GST was accounted for is amended under s 113 of the Tax Administration Act 1994 or if s 113A allows the error to be corrected.

Explanation

1. This Question We've Been Asked (QWBA) addresses the situation where:
   - a supplier charged and accounted for GST at the standard rate on a supply;
   - the supplier later establishes that they incorrectly interpreted the legislation and should not have treated the supply as a taxable supply; and
   - the supplier then agrees to reduce the previously agreed consideration for the supply by an amount equal to the amount of the GST charged.
2. Section 25 applies where, as a result of any or more of the events described in s 25(1):
   - a tax invoice was issued for the incorrect amount of tax; or
   - the supplier has accounted for the incorrect amount of output tax.

3. The events described in s 25(1) include an alteration in the previously agreed consideration: s 25(1)(b). Where a supplier has accounted for excess output tax as a result of the relevant event, the supplier is allowed a deduction for the amount calculated under s 25(2)(b): ss 20(3)(a)(iii) and (b)(iv). The deduction is allowed in the period in which it has become apparent that the output tax accounted for was incorrect.

What deduction is allowed under s 25(2)(b)?

4. If a supplier discovers that a supply was incorrectly treated as a taxable supply and subsequently agrees to reduce the previously agreed consideration by an amount equal to the GST incorrectly charged, the adjustment calculated under s 25(2)(b) is limited to an amount equal to GST incorrectly accounted for as a result of the reduction in the consideration. The fact that the consideration was reduced because GST was incorrectly charged on the supply is not relevant because the reason for the reduction in the consideration is irrelevant. Therefore, the adjustment calculated under s 25(2)(b) would be an amount equal to GST on the difference between the original consideration and the reduced consideration.

5. The extent to which s 25 permits the GST treatment to be changed depends on the event that has resulted in the incorrect amount of output tax being accounted for. For example, as GST is not chargeable unless a supply is made (or deemed to be made), where a supply is cancelled or goods or services are returned after output tax on the supply was accounted for, the excess output tax accounted for as a result of the cancellation of the supply or the return of the goods or services would be the difference between the output tax accounted for and zero: ss 25(1)(a) and (c).

How should a supplier correct the GST treatment of the supply?

6. If a supplier reduced the consideration for a supply that was incorrectly treated as a taxable supply, unless the tax discrepancy is below the threshold in s 113A(1) or 113A(4) of the Tax Administration Act 1994 (the TAA), the GST treatment of the supply may be corrected only if the Commissioner exercises her discretion under s 113 of the TAA to amend the assessment for the period in which GST was accounted for.

7. The Standard Practice Statement 'Requests to amend assessments' (SPS16/1) outlines the Commissioner's practice in exercising her discretion to amend assessments. Section 113A is explained in TIB Vol 31 No 3 (May 2019).

Examples

8. The following examples explain how the law applies.

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Examples

Example 1 – Supplier gives a discount

Two years ago ABC Ltd issued a tax invoice for $115 showing GST of $15 for a supply of services. ABC Ltd accounted for output tax of $15 for the supply. ABC Ltd has now agreed to reduce the consideration to $100 because the recipient is not satisfied about the quality of the services supplied.

ABC Ltd is allowed a deduction for the excess output tax accounted for as a result of the reduction in the consideration. That amount is $1.96, which is the difference between the output tax actually accounted for (GST on $115 = $15) and the output tax chargeable on the reduced consideration (GST on $100 = $13.04).

ABC Ltd is allowed the deduction for $1.96 in the taxable period in which the consideration was reduced.

Example 2 – Supplier reduces consideration because GST incorrectly charged

Five years ago, XYZ Ltd issued a tax invoice for $115 showing GST of $15 for a supply. XYZ Ltd accounted for output tax of $15 for the supply. XYZ Ltd has now ascertained that the supply should not have been treated as a taxable supply because it was an exempt supply.

XYZ Ltd now decides to reduce the consideration charged for the supply to try to recover all of the GST overpaid. It agrees with the recipient of the supply to reduce the consideration by an amount equal to the GST charged, so that the consideration is reduced to $100.

However, the excess output tax accounted for as a result of the reduction in the consideration is only $1.96 (as with Example 1). XYZ Ltd is only entitled to adjust the GST treatment to that extent as a result of s 25(1)(b) applying.

To change the GST treatment of the whole supply:

- XYZ Ltd must ask the Commissioner to exercise her discretion under s 113 of the Tax Administration Act 1994 to amend the assessment for the taxable period in which XYZ Ltd accounted for output tax on the supply; and
- the Commissioner must agree to exercise her discretion.

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References

Subject references

Goods and services tax

Other references

SPS 16/01 "Requests to amend assessments" TIB Vol 28 No 4 (May 2016)

"Modernising tax administration – Core aspects of the Tax Administration Act" TIB Vol 31 No 3 (May 2019)

Legislative references

Goods and Services Tax Act 1985: ss 20(3), 25(1) and (2)

Tax Administration Act 1994: ss 109, 113

We would appreciate your initial feedback on this item, which you can provide through three quick questions.
Detailed submissions can be emailed to public.consultation@ird.govt.nz