Interpretation Statement: IS 08/01

GST – ROLE OF SECTION 5(14) OF THE GOODS AND SERVICES TAX ACT 1985 IN REGARD TO THE ZERO-RATING OF PART OF A SUPPLY

Summary

1. All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

2. This statement sets out the Commissioner's view of the interpretation of section 5(14). It concludes that section 5(14) does not operate by itself to create standard- and zero-rated supplies, but rather is applied after it has been determined that:

   - there is "a supply" that is charged with goods and services tax (GST) at the standard rate under section 8; and

   - the applicable provision in section 11, 11A, 11AB, or 11B ("the zero-rating provisions") requires that part of a supply be charged with GST at the rate of zero percent.

3. Section 5(14) is applied with the result that the zero-rated part is to be treated as being a separate supply for the purposes of the Act.

4. This statement considers only the interpretation of section 5(14). It does not consider the principles of apportionment that have been developed by the courts. These principles are used to determine whether a "package" of goods and/or services is a single supply, or consists of two or more supplies, for the purposes of the Act: see, for example, *Auckland Institute of Studies v CIR* (2002) 20 NZTC 17,685 (HC); *CIR v Smiths City Group Ltd* (1992) 14 NZTC 9,140 (HC).

Background

5. The Commissioner is aware confusion exists about the correct interpretation of section 5(14). Section 5(14) provides:

> If a supply is charged with tax under section 8, but section 11, 11A, 11AB or 11B requires part of the supply to be charged at the rate of 0%, that part of the supply is treated as being a separate supply.

6. There are two competing views of the role of section 5(14).

   - Section 5(14) applies after part of a supply has been zero-rated under the zero-rating provisions, and requires that the zero-rated part of a supply be treated as a separate supply.

   - Section 5(14) operates by itself to divide a supply into its standard-rated and zero-rated parts, and requires that these parts be treated as separate supplies. These separate supplies are then zero-rated under the zero-rating provisions.

7. The competing views affect when section 5(14) is applied and the availability of zero-rating. Under the first view, section 5(14) applies only if the relevant zero-rating provision requires part of the supply to be zero-rated. If the relevant zero-rating provision does not, section 5(14) cannot apply and the whole supply must be charged with GST at the standard-rate.

8. Under the second view, section 5(14) would apply even if the relevant zero-rating provision does not by itself require part of the supply to be zero-rated. Section 5(14) would enable the zero-rated parts of the supply to be isolated and then treated as separate supplies under the Act. The zero-rating provisions would then be applied to zero-rate these supplies.

Legislation

9. Sections 5(1) and 5(14) provide:

> **5 Meaning of the term supply**
>
> (1) For the purposes of this Act, the term **supply** includes all forms of supply.
>
> …
>
> (14) If a supply is charged with tax under section 8, but section 11, 11A, 11AB or 11B requires part of the supply to be charged at the rate of 0%, that part of the supply is treated as being a separate supply.

10. Before it was amended in 2000 and 2003, section 5(14) provided:

> For the purposes of this Act, where a supply is charged with tax in part under section 8 of this Act and in part under section 11 of this Act, each part shall be deemed to be a separate supply.

11. Section 8(1) provides:

> **8 Imposition of goods and services tax on supply**
>
> (1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 12.5 percent on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after the 1st day of October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

12. Sections 11, 11A, 11AB and 11B list the circumstances in which taxable supplies of goods and services must be charged with GST at the rate of zero percent. The zero-rating provisions provide that a "supply" must be zero-rated, but it is possible that only part of a supply must be zero-rated. It is a matter of statutory interpretation whether the relevant zero-rating provision provides for part of a supply to be zero-rated. It is noted that some of the zero-rating provisions expressly indicate that part of a supply can be zero-rated by using the words "to the extent that". These provisions are set out below.

11A Zero-rating of services

(1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

…

(b) the services are the transport of passengers from a place in New Zealand to another place in New Zealand to the extent that the transport is by aircraft, as defined in section 2 of the Civil Aviation Act 1990, and is international carriage for the purpose of that Act; or

…

(c) the services, including ancillary transport activities such as loading, unloading and handling, are the transport of goods from a place in New Zealand to another place in New Zealand to the extent that the services are supplied by the same supplier as part of the supply of services to which paragraph (a)(ii) or (a)(iii) applies; or

…

(ma) the services relate to goods under warranty to the extent that the services are—

(i) provided under the warranty; and

(ii) supplied for consideration that is given by a warrantor who is a non-resident, not a registered person and who is outside New Zealand at the time the services are performed; and

(iii) in respect of goods that were subject to tax under section 12(1); or

…

(o) the services are the acceptance of an obligation to refrain from pursuing or exercising in whole or in part rights listed in paragraph (n) to the extent that the rights are for use outside New Zealand; or …

11B Zero-rating of some supplies by territorial authorities, some supplies involving contributions to local authorities

…

(1B) If a supply under section 5(7B) of goods and services by a local authority to a registered person is chargeable with tax under section 8, the supply must be charged at the rate of 0% to the extent that the contribution made by the registered person to the local authority consists of land.

Analysis

Ordinary meaning of the words

13. Section 5(14) provides:

> If a supply is charged with tax under section 8, but section 11, 11A, 11AB or 11B requires part of the supply to be charged at the rate of 0%, that part of the supply is treated as being a separate supply.

14. The ordinary meaning of some of the words of section 5(14) appear to be clear. The words "[i]f a supply is charged with tax under section 8" indicates that section 8 has been applied and a supply has been identified that is charged with GST at the standard rate.

15. The words "that part of the supply is treated as being a separate supply" state the result of section 5(14) being applied: the zero-rated part of the supply is deemed to be a separate supply for the purposes of the Act.

16. The meaning of the words "but section 11, 11A, 11AB or 11B requires part of the supply to be charged at the rate of 0%" is less clear.

17. The words "to be charged", being in the future tense, can be read as indicating that the zero-rating provisions have not yet been applied. According to this interpretation, section 5(14) is referred to **after** it has been found that there is a supply charged with GST at the standard rate under section 8 and **before** the zero-rating provisions are applied. Section 5(14) refers the person applying the Act to determine whether any part of the supply comes within any of the zero-rating provisions. If there is such a part, section 5(14) is applied to deem that part to be a separate supply and the zero-rating provisions are then applied to zero-rate this new supply.

18. However, this interpretation appears inconsistent with the words "section 11, 11A, 11AB or 11B **requires** part of the supply" (emphasis added) to be zero-rated. These words suggest that whether part of a supply must be zero-rated is governed by the zero-rating provisions **alone** without reference to section 5(14). When section 5(14) is read as a whole these words qualify the words "to be charged": the zero-rating provisions have been applied to zero-rate part of the supply, but that part has not been treated as a separate zero-rated supply for the purposes of the Act.

19. According to this interpretation, section 5(14) is referred to **after both** section 8 and the zero-rating provisions have been applied. Section 5(14) is applied only if the applicable zero-rating provision requires that part of the supply be zero-rated. Section 5(14) then gives effect to the zero-rating of part of the supply required under the applicable zero-rating provision by deeming the zero-rated part to be a separate supply.

20. This analysis of the ordinary meaning of section 5(14) indicates that the words "but section 11, 11A, 11AB or 11B requires part of the supply to be charged at the rate of 0%" can be interpreted to support two competing views of section 5(14). However, the ordinary meaning of the words seems to be that section 5(14) gives effect to the zero-rating of part of a supply required under the zero-rating provisions, rather than the view that section 5(14) operates by itself to create standard- and zero-rated supplies.

Scheme of the Act

21. Section 8(1) is the core provision by which GST at the standard rate is imposed on supplies of goods and services in New Zealand that have been made by a

registered person in the course or furtherance of a taxable activity carried on by that person.

22. Section 5(1) defines "supply" for the purposes of the Act, and the rest of section 5 details particular circumstances that give rise to supplies.

23. Section 8 is subject to the zero-rating provisions, which list the circumstances in which taxable supplies of goods and services must be charged with GST at the rate of zero percent.

24. The view that section 5(14) operates by itself to create standard- and zero-rated supplies is arguably consistent with the role of section 5 in defining the "supply" for the purposes of the Act. According to this view, section 5(14) isolates the zero-rated parts of a supply, and then requires these parts to be treated as separate supplies for the purposes of the Act. Under this interpretation, section 5(14) would assist in defining the "supply" for the purposes of the Act.

25. However, interpreting section 5(14) as giving effect to zero-rating of part of a supply required under the zero-rating provisions is also arguably consistent with the scheme of the Act. According to this interpretation, it would be first determined whether the supply is charged with GST at the standard rate under section 8. If section 8 applies, it would then be determined whether the supply must be zero-rated under the zero-rating provisions. It seems logical for the zero-rating provisions to be applied after section 8 has been applied, because they negate the effect of the tax liability established under section 8. Section 5(14) is then applied only if part of the supply has been zero-rated under the zero-rating provisions.

26. On this basis, section 5(14) has the role of clarifying the status of any zero-rated part of a supply. The Act refers to "a supply" or "the supply" throughout, in particular when defining "input tax", "output tax", and "taxable supply". Without section 5(14) deeming the zero-rated part to be "a supply", it could be unclear whether the zero-rated part must be taken into account in calculating "input tax", "output tax", and a "taxable supply".

27. This purpose is also consistent with the fact that section 5 defines the term "supply" for the purposes of the Act. On this basis, section 5(14) would define what "a supply" is, where "part of a supply" has been zero-rated under the zero-rating provisions, by deeming the zero-rated part of a supply to be a separate supply.

Case law

28. No case law exists on the current wording of section 5(14). There is case law on section 5(14) as it was enacted before its 2000 amendment ("the earlier section 5(14)").

29. The earlier section 5(14) provided:

> For the purposes of this Act, where a supply is charged with tax in part under section 8 of this Act and in part under section 11 of this Act, each part shall be deemed to be a separate supply.

30. The earlier section 5(14) was repealed and substituted by the current section 5(14) by section 86(9) of the Taxation (GST and Miscellaneous Provisions) Act 2000 with application on and after 10 October 2000. The current section 5(14) was amended by section 153 of the Taxation (Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Act 2003 by inserting "11AB".

31. The amendments under the 2000 and 2003 Acts reflected that new zero-rating provisions (ie, sections 11A, 11AB and 11B) had been inserted into the Act. The earlier section 5(14) referred to "where a supply is charged with tax in part under section 8 of this Act and in part under section 11". The 2000 amendment replaced this with "[i]f a supply is charged with tax under section 8, but section 11, 11A, 11AB or 11B requires part of the supply to be charged at the rate of 0%". This change may reflect that the wording of the earlier section 5(14) was incorrect insofar as it suggested that section 11 "charged [part of a supply] with tax". The reference in the current section 5(14) to the zero-rating provisions requiring part of the supply "to be charged at the rate of 0%" more accurately describes the effect of these provisions.

32. Despite the different wording, there are clear similarities between the wording of the earlier section 5(14) and the current section 5(14). Therefore, the case law on the earlier section 5(14) may be relevant to interpreting the current section 5(14).

33. The earlier section 5(14) was referred to by the Court of Appeal in *CIR v Coveney* (1995) 17 NZTC 12,193 (at pages 12,195–12,196) and the Taxation Review Authority in *Case S27* (1995) 17 NZTC 7,189. However, in these judgments, the earlier section 5(14) was not material to the decision and was only restated without further analysis.

34. The High Court decision in *Coveney v CIR* (1994) 16 NZTC 11,328 contains the most extensive discussion of the earlier section 5(14). In this decision the Commissioner submitted that the Act expressly contemplates apportionment when there has been a composite supply of second-hand goods. In his submissions, the Commissioner relied on, amongst other provisions of the Act, sections 10(18) and 5(14) read together.

35. Fraser J rejected the Commissioner's submissions concerning sections 5(14) and 10(18). His Honour recognised that sections 5(14) and 10(18) both dealt expressly with taxable supplies and that apportionment of one sort or another was clearly contemplated, but held (at pages 11,334–11,335):

> Sections 5(14) and 10(18) are applicable to particular circumstances and I do not agree that they provide a basis for determining that in other circumstances to which the sections do not apply, and for which a separate regime is prescribed, the Commissioner is required or permitted to apportion the supply into separate component parts and to deal with them as if they were separate supplies.

36. It is considered that Fraser's J comment that section 5(14) clearly contemplates apportionment casts little light on its interpretation, as it does not indicate whether the authority to apportion derives from section 5(14) or from section 11 (as then enacted). Earlier in the judgment, Fraser J stated "[b]y s5(14) where a

supply is charged with tax in part under s8 and in part under s11, each part is deemed to be a separate supply" (at page 11,334). This comment also does not assist in interpreting the current section 5(14) because it merely restates the earlier section 5(14) without further analysis.

37. Elsewhere in the judgment, Fraser J stated (at page 11,335):

> I think that *C of IR v Smiths City Group Ltd* is to be distinguished from the present case. The Court there was dealing with a taxable supply, partly taxed under s8 and partly under s11. Apportionment was seen as appropriate on the basis of s 10(18). Section 5(14) provides that where a supply is charged with tax in part under s8 and in part under s11, each part is deemed to be a separate supply.

38. This comment could be read as suggesting that *CIR v Smiths City Group Ltd* (1992) 14 NZTC 9,140 is relevant to interpreting section 5(14). However, section 5(14) was not mentioned in *Smiths City Group*. This supports the view that Fraser J did not intend his reference to section 5(14) to be considered relevant to his reasons for distinguishing the *Smiths City Group* decision. *Smiths City Group* and section 5(14) appear to have been mentioned in the same paragraph because both section 10(18) (which *Smiths City Group* did consider) and section 5(14) were mentioned together in the Commissioner's submissions.

39. In the Taxation Review Authority decision in *Case Q46* (1993) 15 NZTC 5,227, Barber DJ stated (at page 5,233):

> I also note that s 5(14) reads:
>
> For the purposes of this Act, where a supply is charged with tax in part under section 8 of this Act and is [sic] part under section 11 of this Act, each such part shall be deemed to be a separate supply.
>
> This enables apportionment or separate valuation of each supply.

40. The above comment could be interpreted as supporting both the view that section 5(14) operates by itself to create standard- and zero-rated supplies and the view that section 5(14) gives effect to zero-rating of part of a supply as required under the zero-rating provisions.

41. If the former interpretation of the comment is correct, *Case Q46* is arguably of little persuasive weight. Barber DJ did not provide reasons for the comment. The comment is moreover obiter, because Barber DJ did not use section 5(14) to create standard- and zero-rated supplies. His Honour referred to the earlier section 5(14) only in order to demonstrate that the Act contemplated apportionment.

Conclusion

42. The Commissioner's view of the interpretation of section 5(14) is that it applies after it has been determined that:

- there is "a supply" that is charged with GST at the standard rate under section 8; and

- the applicable zero-rating provision requires that part of a supply be charged with GST at the rate of zero percent.

43. Section 5(14) is then applied with the result that the zero-rated part is to be treated as being a separate supply for the purposes of the Act.

44. The Commissioner acknowledges that the view that section 5(14) operates by itself to create standard- and zero-rated supplies can be seen as consistent with the scheme of the Act. However, the Commissioner considers that the view that section 5(14) gives effect to zero-rating of part of a supply required by the zero-rating provisions is to be preferred. This view is supported by the ordinary meaning of section 5(14), is consistent with the scheme of the Act and is not inconsistent with the case law on the earlier section 5(14).

Example

45. ABC Ltd, a non-resident company, supplies a New Zealand resident a computer system with a warranty to repair any defects that appear within 12 months. A defect appears in the computer system within the 12-month period. The New Zealand resident asks ABC Ltd to repair the computer system under the warranty and to upgrade it at the same time. The New Zealand resident pays ABC Ltd for the cost of the upgrade. ABC Ltd contracts with its preferred computer specialist in New Zealand to provide the repairs and to upgrade the computer system. The computer specialist invoices ABC Ltd for the supply of services it provided in repairing and upgrading the computer system.

46. Section 11A(1) requires that a supply of services be zero-rated where:

> (ma) the services relate to goods under warranty to the extent that the services are—
>
> (i) provided under the warranty; and
>
> (ii) supplied for consideration that is given by a warrantor who is a non-resident, not a registered person and who is outside New Zealand at the time the services are performed; and
>
> (iii) in respect of goods that were subject to tax under section 12(1); or

47. For the purposes of the example, it is assumed that all the requirements of section 11A(1)(ma) are satisfied and no other zero-rating provisions apply and that there is only one supply for the purposes of section 8.

48. The words "to the extent that" in section 11A(1)(ma) indicate that zero-rating of part of the supply is required. Consequently, the supply of services by the computer specialist to ABC Ltd is divided under section 11A(1)(ma) into the part that represents the repairing of the computer system under the warranty, which must be zero-rated, and the part that represents the upgrading of the computer system, which must be standard-rated. Section 5(14) is then applied to deem the zero-rated part of the supply to be a separate supply for the purposes of the Act.

Submissions received

49. Submissions received by Inland Revenue on the exposure draft of this item raised issues concerning the relationship between the item and two other matters.

50. Some submissions queried the relationship between the item and the exercise of determining whether a "package" of goods and/or services is a single supply, or comprises two or more supplies, for the purposes of the Act. The latter exercise involves identifying the supply or supplies to which section 8(1) and the zero-rating provisions are applied. It is undertaken before section 5(14) is applied, so does not concern the interpretation of this provision. For this reason paragraph 4 above now more clearly states that the item is not concerned with the principles of apportionment that the courts have developed to assist them to determine whether a "package" of goods and/or services is a single supply, or comprises of two or more supplies, for the purposes of the Act.

51. Some submissions queried when the zero-rating provisions require part of the supply to be zero-rated. The exposure draft of this item suggested that Parliament intended part of a supply to be zero-rated only when the zero-rating provision contains "apportioning language" such as "to the extent that". However, it is now acknowledged that this view may be too restrictive. Consequently, paragraph 12 above states that whether the relevant zero-rating provision authorises part of a supply to be zero-rated is a matter of statutory interpretation.