PRODUCT RULING - BR Prd 13/07

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by the Ministry of Business, Innovation and Employment (MBIE).

Taxation Laws

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

This Ruling applies in respect of ss 5 and 8 and the definition of “consideration” in s 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the charging of an annual levy (Levy) on liable telecommunication operators by the Minister of the Crown (Minister) for the time being responsible for the administration of the Telecommunications Act 2001 (Telecommunications Act) under the Telecommunications Operators (Commerce Commission Costs) Levy Regulations 2011 (2011 Levy Regulations). The Arrangement ensures the cost the Commerce Commission (Commission) incurs in regulating telecommunications operators is paid, in part, by telecommunications operators.

The Levy is collected by MBIE (the Ministry responsible for administering the Telecommunications Act for the Minister).

The Commission is a Crown entity listed in sch 1 pt 3 of the Crown Entities Act 2004, it is resident in New Zealand for GST purposes and is a “registered person” as that term is defined in s 2(1).

Further details of the Arrangement are set out in the paragraphs below.

Background

1. In March 2000 a Ministerial inquiry into telecommunications was established to assess the regulatory regime for telecommunications and recommend any changes. Following the inquiry, the Government announced it was establishing a new regulatory framework for the telecommunications industry that would include the establishment of a Telecommunications Commissioner in the Commission. A levy imposed on the telecommunications industry would meet the general costs of the Commission (including the Telecommunications Commissioner) incurred in carrying out its telecommunications-specific regulatory functions.

2. In May 2001, the Telecommunications Bill 2001 (2001 Bill) was introduced into Parliament and referred to the Commerce Select Committee for consideration. The Explanatory Note to the 2001 Bill relevantly stated that:

> Thirdly, the position of a new specialist Telecommunications Commissioner is established within the Commission. The Telecommunications Commissioner's main functions will be to-
>
> - make determinations on disputes over designated services and specified services in accordance with the processes set out in *Part 2*; and
> - report to the responsible Minister on the desirability of regulating additional services in accordance with a process contained in *Schedule 3*; and
> - undertake key costing and monitoring activities under *Part 3* relating to telecommunications service obligations.
>
> ...
>
> *Subpart 2* deals with preliminary matters about the Commission, which will have an important role in the context of designated services and specified services (*Part 2*) and telecommunications service obligations (*Part 3*).
>
> In particular, *subpart 2*-
>
> - provides for the appointment of a specialist Telecommunications Commissioner as a member of the Commission (clause 9):
> - specifies when the Telecommunications Commissioner will be involved in performing the functions of the Commission under this Bill, and specifies the number of other members of the Commission who will be involved in performing those functions (clause 10):
> - specifies the provisions of the Commerce Act 1986 that apply to the Bill:
> - provides that the Commission's costs in performing its functions under the Bill will be met by prescribing levies payable by prescribed telecommunications providers.

3. The Commentary to the 2001 Bill, as reported back from the Commerce Committee, stated that the Telecommunications Commissioner's funding "is based on an industry levy". The Commentary to the 2001 Bill relevantly stated:

> **Industry levy**
>
> The committee agrees it is appropriate that the Commerce Commission's new functions be funded by an annual levy on telecommunications services providers, in accordance with regulations. The committee notes that dispute resolution (determinations) will be paid for by the parties to the dispute.

> To ensure a smooth transition to the new system, government member's recommend the annual levy be raised retrospectively in its first year, to cover establishment costs. Government and Green members also recommend the Minister be required to consult with the industry prior to setting a levy.
>
> ...
>
> **Accountability arrangements**
>
> The Telecommunications Commissioner will be funded from Vote Communications and there will be a Memorandum of Understanding between the Ministry of Economic Development and the Commerce Commission covering this and other outputs the ministry is funding. The Minister of Communications had indicated that he expects the Commission to consult with industry in setting its telecommunications budget. The Government's position is that the budget process and the Commission's annual report to Parliament will be expected to keep the Telecommunications Commissioner's costs under control. It is also expected that the Commission will consult directly with industry on its work plan and budget to help address any industry concerns.

4. The Telecommunications Act was enacted on 19 December 2001. The industry levy was imposed by the *Telecommunications Operators (Commerce Commission Costs) Levy Regulations 2002* (2002 Levy Regulations) with application from the financial year commencing 1 July 2001. Essentially, the 2002 Levy Regulations provided for the Telecommunications Commissioner’s annual estimated costs to be met by telecommunications operators. The costs were apportioned by reference to each operator’s annual revenues attributable to services offered by means of a “public switched telephone network” (PSTN) as that term is defined in the Telecommunications Act. Once the Telecommunications Commissioner’s actual costs were identified in the Commission’s annual audited financial statements, under-payments had to be met by each telecommunications operator and over-payments were repaid.

5. Following a stocktake of the New Zealand telecommunications industry, the Government introduced the Telecommunications Amendment Bill 2006 (2006 Bill). The 2006 Bill contained additional regulatory functions and powers to be performed by the Commission. It also enhanced the ability of the Commission to intervene to best promote the development of competition in telecommunications markets. The amendments in the 2006 Bill included:

   - introducing a standard terms determination process that would allow the Commission to simultaneously set access terms and conditions for regulated services for multiple access seekers, access providers or both.
   - providing for a formal undertakings process that allowed the Commission to accept and enforce voluntary supply commitments from access providers in lieu of regulation.
   - improving the regulated service access codes regime.
   - empowering the Commission to continuously monitor the performance and development of the telecommunications sector and its markets; and
   - providing for the Commission to have regard to statements of government economic policies when exercising its powers.

   The 2006 Bill was passed in December 2006.

6. The Cabinet Policy Committee paper relating to the Telecommunications Stocktake (POL Min (06) 7/9) recognised that the additional functions to be performed by the Commission would result in additional costs, but anticipated that these costs would be recoverable via the Levy. The paper relevantly stated that:

> **FISCAL IMPLICATIONS**
>
> 146 There will be budgetary implications arising from the proposals in order to ensure the Commerce Commission is adequately resourced to ensure effective competition.
>
> ...
>
> 148 The majority of the costs incurred by the Commission should be recoverable from the telecommunications industry via the industry levy and it is likely that any additional funding will be fiscally neutral.

7. Amendments introduced to the Telecommunications Act 2001 by the Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011 added further regulatory functions to be carried out by the Commission and the Telecommunications Commissioner relating to the structural separation of Telecom. Following the enactment of the Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011, the 2002 Levy Regulations were revoked and replaced by the 2011 Levy Regulations.

Telecommunications Act 2001

8. Section 3(1) of the Telecommunications Act states that the main purpose of the Telecommunications Act is to regulate the supply of telecommunications services. Section 3(1) of the Telecommunications Act states:

> **3 Purpose**
>
> (1) The main purpose of this Act is to regulate the supply of telecommunications services.

9. Section 9 of the Telecommunications Act specifies that there must be a Telecommunications Commissioner. Section 9 of the Telecommunications Act relevantly states:

> **9 Appointment of Telecommunications Commissioner**
>
> (1) There must be a Telecommunications Commissioner.
>
> (2) The Telecommunications Commissioner is a member of the Commission as provided in section 9(3) of the Commerce Act 1986.
>
> (3) Subject to subsection (4), the Telecommunications Commissioner must be appointed by the Governor-General on the recommendation of the Minister.
>
> ...

10. The Telecommunications Commissioner is a member of the Commission appointed under s 9(3) of the Commerce Act 1986.

11. Section 11(3) of the Telecommunications Act states that the Governor General (acting on the recommendation of the Minister) may pass regulations requiring the payment of levies. The levies must be paid to the Minister by telecommunications operators. These levies must be used to defray the Commission's costs for the functions it performs under the Telecommunications Act. Under s 11(1) of the Telecommunications Act,

every service provider, or class of service providers, specified in regulations made under s 11(3) must pay to the Minister, in each financial year, a levy of an amount stated in, or calculated or set or reset in accordance with, those regulations for, or in connection with,—

- the performance of the Commission's functions and duties under the Telecommunications Act; and
- the exercise of the Commission's powers under the Telecommunications Act.

12. Section 11 of the Telecommunications Act states:

> **11 Levy**
>
> (1) Every service provider, or class of service providers, specified in regulations made under subsection (3) must pay to the Minister, in each financial year or part financial year (as the case may require), a levy of an amount stated in, or calculated or set or reset in accordance with, those regulations for, or in connection with,—
>
> (a) the performance of the Commission's functions and duties under this Act; and
>
> (b) the exercise of the Commission's powers under this Act.
>
> (2) Subsection (1) applies irrespective of the fact that the regulations are made and come into effect after the date on which the financial year or part financial year commences.
>
> (3) The Governor-General may, by Order in Council made on the recommendation of the Minister, make regulations—
>
> (a) specifying the amounts of levies payable under this section:
>
> (b) providing for the method by which those levies will be calculated:
>
> (c) specifying the criteria and other requirements by and against which those levies will be set or reset:
>
> (d) specifying the financial year or part financial year to which those levies apply:
>
> (e) providing for the payment and collection of those levies:
>
> (f) exempting any service provider or class of service providers from paying levies under this section:
>
> (g) providing for waivers or refunds of the whole or any part of any levy paid by any service provider or class of service providers under this section.

13. Section 14 of the Telecommunications Act provides for a late payment penalty for non–payment of the Levy and states:

> **14 Late payment of levy**
>
> (1) If any service provider liable to pay the levy fails to pay the whole amount of that levy by the date specified in regulations made under section 11(3) or section 12(4), the service provider must pay interest on the unpaid amount at the rate of 1.5% per month calculated from the date payment is due.
>
> (2) Interest will be calculated in monthly instalments for each month, or part of each month, that the payment is due.
>
> (3) The amount of any unpaid levy or interest is recoverable in any court of competent jurisdiction as a debt due to the Crown.

Telecommunications Operators (Commerce Commission Costs) Levy Regulations 2011

14. The Explanatory Note to the 2011 Levy Regulations states that they impose levies on telecommunications operators to cover the costs incurred by the Commission in performing and exercising its functions, powers, and duties under the Telecommunications Act (except certain determinations, where costs are required to be met by parties to the determination, and litigation).

15. Regulation 5 of the 2011 Levy Regulations states that every liable telecommunications operator during all or part of a financial year must pay the Levy for that financial year to the Minister. Regulation 5 of the 2011 Levy Regulations states:

> **5 Levy on telecommunications operators**
>
> Every person who is a telecommunications operator during all or part of a financial year must pay a levy for that financial year to the Minister.

16. Regulation 6 of the 2011 Levy Regulations states that the Levy must be collected annually. The due date is 30 working days after the Commission's final liability allocation determination for the financial year is publicly notified under s 87 of the Telecommunications Act. Regulation 6 of the 2011 Levy Regulations states that:

> **6 How and when levy must be paid**
>
> (1) The Minister must collect the levy annually.
>
> (2) The due date for each payment is the 30th working day after the Commission's final liability allocation determination for the financial year is publicly notified under section 87 of the Act.

17. Regulation 7 of the 2011 Levy Regulations states that the total sum of the Levy to be collected from liable telecommunications operators is calculated by reference to the costs of the Commission for, or in connection with, the performance and exercise of its functions, powers, and duties under the Telecommunications Act. These costs are identified as such in the Commission's audited financial statements for the relevant financial year. However, this figure cannot be higher than the amount of Crown revenue appropriated for that financial year within Vote Communications for the non-departmental output class that authorises expenses to be incurred for, or in connection with, the Commission's performance and exercise of its functions, powers, and duties under the Telecommunications Act. Regulation 7 states that:

> **7 Basis of calculation of levy**
>
> (1) The levy payable for the financial year must be calculated by the Minister as follows:
>
> $$\frac{a}{b} \times c$$
>
> where—
>
> a is the amount of the telecommunications operator's final qualified revenue
>
> b is the sum of all telecommunications operators' final qualified revenue

c is the amount of the Commission's costs for the financial year, as specified in subclause (2).

(2) The amount of the Commission's costs for the financial year is the amount—

(a) identified in the Commission's audited financial statements for the financial year as the costs of the Commission for, or in connection with, the performance and exercise of its functions, powers, and duties under the Act; but

(b) that does not exceed the total amount appropriated for that financial year within Vote Communications for the non-departmental output class that authorises expenses to be incurred for, or in connection with, the Commission's performance and exercise of its functions, powers, and duties under the Act; and

(c) that does not include—

(i) any costs of the Commission in relation to a determination or application for a determination that are met by the parties to the determination under section 55 of the Act; and

(ii) any costs of the Commission in relation to a determination that are met by a TSO provider under section 94A or 94B of the Act; and

(iii) costs of litigation incurred for, or in connection with, the Commission's performance and exercise of its functions, powers, and duties under the Act.

Overview of some of the Commission’s functions, duties and powers under the Telecommunications Act that are (retrospectively) funded by the Levy

18. The Levy covers the amount of all the costs of the Commission for, or in connection with, the performance and exercise of its functions, powers, and duties under the Telecommunications Act that are identified as such in the Commission’s audited financial statements for the financial year. The only exception to this are those costs specifically excluded by reg 7(2)(c) of the 2011 Levy Regulations (refer para 17 above). The costs the Commission incurs, ultimately paid for by the Levy, relate to a number of different activities. Neither the 2011 Levy Regulations nor the Telecommunications Act explicitly itemise the expenses that the Levy is intended to pay.

19. The following is an overview of some (but not all) of the regulatory functions, duties and powers performed or exercised by the Commission under the Telecommunications Act that the Levy is intended to (retrospectively) fund:

Market monitoring and information dissemination

- Monitoring competition in, and the performance and development of, telecommunications markets.

- Producing various monitoring reports on a regular basis. These include monitoring reports on telecommunications markets generally and broadband performance specifically. The Commission must make available all reports, summaries or information relating to its monitoring activities.

Reviews and studies

- Section 9A(1)(b) of the Telecommunications Act 2001, as amended in December 2006, empowers the Commission to proactively conduct inquiries, reviews and studies into any matter relating to the telecommunications industry or the long-term benefits of end-users of the telecommunications services within New Zealand.

- This power enables the Commission to take a strategic view of any matter that relates to the telecommunications industry. The Commission must make available all reports, summaries or information relating to its reviews and studies.

The Standard Terms Determination process

- The Standard Terms Determinations (STD) process enables the Commission to make a determination on how a designated or specified service must be supplied with reference to all access seekers and providers of the service. The Commission may, on its own initiative, initiate the STD process for any of the designated or specified services in sch 1 of the Telecommunications Act. Where the Commission's costs for an STD are not met by the parties (under s 55(2) of the Telecommunications Act), they will be recoverable via the Levy. The key events in the STD process are as follows:

    - Commission initiates standard terms development process
    - Commission holds scoping workshop
    - Commission issues notice calling for standard terms proposal from access provider
    - Access provider submits standard terms proposal by specified date
    - Commission advises of receipt of standard terms proposal
    - Interested parties provide submissions on standard terms proposal
    - Commission issues draft standard terms determination
    - Interested parties provide submissions on draft standard terms determination
    - Commission holds conference or consultation with persons other than the parties to the determination (optional)
    - Commission issues standard terms determination.

Reviews and clarifications of Standard Terms Determinations

- The Commission may, on its own initiative, commence a review at any time of all, or any, of the terms specified in a STD.

Structural separation of Telecom

- The Commission has the overall role of monitoring the broader effects of the Telecom separation arrangements. It also uses information from the independent oversight group, Telecom and other sources to identify either breaches or the potential for breaches, of the undertakings by Chorus. Telecom and Chorus are defined terms in the Telecommunications Act.

- The Commission has the explicit role of enforcing compliance with the Telecommunications Act and can make recommendations to the Minister if it considers variations and exemptions to undertakings by Chorus are required.

- The 2011 amendments to the Telecommunications Act introduced a requirement for the Commission to maintain a register of those users to whom Chorus may supply telecommunications services. This is known as the register of non-retail users. The Commission has processes to manage applications to add names to the register, inform people about these applications, and receive complaints about the inclusion of users on the register.

Information disclosure requirements

- The Telecommunications Act contains formal requirements for Telecom and access providers to provide a broad range of information to the Commission for publication. This ensures a wide range of people are informed about the operation and behaviour of prescribed businesses that provide prescribed services. This enables the Commission to monitor and facilitate compliance with prescribed applicable access principles, as those terms are defined in the Telecommunications Act.

Schedule 3 investigations

- The Commission is responsible for matters relating to regulation-making powers for designated services and specified services. This includes conducting formal investigations into whether sch 1 of the Telecommunications Act (Designated services and specified services) should be altered, following the procedure contained in sch 3 of the Telecommunications Act (Procedure for altering regulated services) and reporting the Telecommunications Commissioner's recommendation to the Minister.

Telecommunications Service Obligations

- The Commission administers the Telecommunications Service Obligations (TSO) deeds.

Information disclosure by local fibre companies with undertakings

- Under the 2011 amendments to the Telecommunications Act, local fibre companies building the ultrafast broadband fibre network and Chorus's copper network are required to disclose specified information to the Commission.

Industry Codes

- Draft telecommunications access codes must be submitted to the Commission for approval by the Telecommunications Industry Forum under sch 2 of the Telecommunications Act.

Undertakings

- The Commission must agree to the terms and conditions of any undertaking made by an access provider under sch 3A of the Telecommunications Act that provides a mechanism for an access provider to supply a service to all access seekers on a voluntary basis that avoids the need for and the costs of regulation.

Administering the Telecommunications Development Levy

- The Commission administers the Telecommunications Development Levy.

Telephone number portability

- The Commission is responsible for regulating local and cellular telephone number portability services under the Telecommunications Act.

Charging, Collection and Allocation of the Levy

20. At the beginning of the financial year the Commission's costs for its functions under the Telecommunications Act are set within Vote Communications as non-departmental output expenses. The “Performance Information for Appropriations – Vote Communications” document for the 2012/2013 year (<http://www.treasury.govt.nz/budget/2012/ise/v1/ise12-v1-pia-commun.pdf> accessed 12 February 2013) (Vote Communications document) states that the scope of the appropriation is as follows:

> **Enforcement of Telecommunications Sector Regulation (M88)**
>
> *Scope of Appropriation*
>
> The regulation and monitoring of telecommunication services in accordance with the Telecommunications Act 2001.

21. The Vote Communications document sets out specific “Output Performance Measures and Standards” that the Commission must satisfy when carrying out its function of regulating and monitoring telecommunications services under the Telecommunications Act. These include:

- Number of determinations (includes determinations, clarifications, reviews and amendments).

- Percentage of stakeholders who find the Commission determinations and supporting reasons clear.

- Number of reports completed (monitoring reports, summary and analysis reports, information disclosure reports, ministerial reports).

- Number of substantial pieces of advice provided to officials to inform policy design.

- Percentage of stakeholders who rate [the Commission's] reports good or above.

- Percentage of reports completed by the set date.

- Number of compliance assessments completed.

- Number of enforcement cases taken.

- Percentage of compliance assessments completed by the set date.

22. For the Ministry, the Levy revenue and the Commission's appropriations are completely separate for GST purposes and they go through separate bank accounts.

23. The appropriation funding is drawn down from Treasury by the Ministry and paid to the Commission GST inclusive as and when required. The Commission brings the appropriation funding to charge as a GST inclusive revenue stream from the Crown. The Commission has the input tax credit on its operating expenses to offset against its GST output tax liability. The Ministry does not return input tax on the appropriation funding paid to the Commission.

24. At the end of the financial year, the Commission's costs for its functions under the Telecommunications Act are outlined in its audited financial statements. The 2011/12 Annual Report for the Commission states, at 57:

> **Cost allocation** – Direct costs are charged directly to outputs within an appropriation. Personnel costs are allocated to outputs based on time records. The indirect costs of support groups, and corporate overhead costs are charged to outputs based on the budgeted relative time records of each output.
>
> **Goods and Services Tax (GST)** – All items in the financial statements are presented exclusive of GST, except for receivables and payables, which are presented on a GST inclusive basis. ...

25. The Minister then calculates the Levy with reference to reg 7 of the 2011 Levy Regulations and the Commission's actual (GST exclusive) costs, as identified in the Commission's audited financial statements. The Ministry (on behalf of the Crown) invoices and collects the Levy revenue for the Commission. The Levy is paid retrospectively, by all liable telecommunications operators to the Ministry, into the Ministry's Crown bank account. The Ministry then passes the Levy revenue to Treasury. This revenue stream is accounted for by the Ministry (on behalf of the Crown) and not by the Commission.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

a) The Levy does not constitute “consideration” (as defined in s 2(1)) for any “supply” (as defined in s 5) of goods and services by the Crown.

b) The Levy paid by liable telecommunications operators under the Telecommunications Act is not subject to GST under s 8.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 6 June 2013 and ending on 6 June 2016.

This Ruling is signed by me on the 6th day of June 2013.

Fiona Heiford
Manager (Taxpayer Rulings)