

5. RATING FOR 2003/04 – GST TREATMENT OF RATE REMISSIONS

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The purpose of this report is to recommend a change in the transaction treatment of rate remissions from 1 July 2003 following rulings from the Inland Revenue Department and the Audit Office. The change in treatment will affect the disclosure in the Annual Plan for 2003/04.

BACKGROUND

The new Local Government (Rating) Act 2002 (the “Act”) has changed the processes required for rating from 1 July 2003, in particular the treatment of rate remissions.

Section 86 states:

“Recording remitted rates:

The local authority must record the remitted rates—

- (a) on the rates record for the rating unit as paid on the due date; and*
- (b) in accounting documents (within the meaning of section 223H(3) of the Local Government Act 1974) as paid by the local authority on behalf of the ratepayer in accordance with the relevant objective in the remission policy.”*

Recently the IRD and the Audit Office have issued rulings which prescribe the process for remissions. This process now requires that the literal meaning of “... paid by the local authority on behalf of the ratepayer ...” be followed. As a consequence the Council will face the probability of paying for and not being able to claim GST on rates that are remitted; that is on rates that do not exist.

This process precludes the Council from the standard commercial approach to reduce income, by the issue of a credit note when reducing the rates charge and thereby also reduce the GST liability.

In essence, for the Council to claim back the GST content of remissions, it must have a GST tax invoice in the name of the Council. The legislation words “... paid by the local authority on behalf of the ratepayer ...” mean that the GST tax invoice remains in the ratepayer name, and that the Council merely makes a payment off that account.

The December 2002 report to the Strategy and Finance Committee forewarned this may be an issue.

LEGISLATIVE CHANGE REQUIRED TO FIX THE PROBLEM

This problem was advised to the Select Committee at the Bill stage, and has subsequently been raised with the Minister on two occasions. We believe the submission was rejected by the Department of Internal Affairs as they thought the process of remission would be handled by the Council raising a credit note. However the legislation wording is unusual and prescriptive. The IRD have picked up on the legislation wording and have ruled accordingly. In our opinion the ruling cannot change unless the legislation changes. The change, as recommended to the Minister, is simple and would achieve a satisfactory outcome both for the process and accountability.

The change suggested by the Council to the Minister is:

This Council requests that Section 86 (b) be amended by both deletion and addition of text:

- “(b) in accounting documents (within the meaning of section 223H(3) of the Local Government Act 1974) as paid by the local authority **against the rating unit’s rate liability** ~~on behalf of the ratepayer~~ in accordance with the relevant objective in the remission policy. **A rates invoice shall be issued to the local authority for the rates remitted and a credit note issued to the ratepayer.**”*

We have received acknowledgements from the Minister but no change has been made to date. We understand from LGNZ that the Department of Internal Affairs is addressing this issue with the IRD and LGNZ are keeping a watching brief and will take the issue up again if a satisfactory outcome is not obtained. In the meantime the Council must adopt a revised process.

THE RATES PROCESS AND THE NEW REMISSION PROCESS

By way of explanation, (the relevant part of) the rating process includes the following steps:

- Rate Assessment – this is the Rating Unit's liability for rates:
 - Issued in October each year by the Council.
 - This is not a request to pay, merely an information notice.
 - It is based on the underlying rateability of the Rating Unit, before any remissions.
- Rates Invoice – this is the bill to the ratepayer
 - It is the GST invoice for rates
 - Issued four times per annum reflecting the rates instalments policy
 - They reflect the assessment liability plus any additional penalties for late payment.
- Rate Receipts – issued when the rates as invoiced are paid

As a result of the recent rulings on rates remission, the current process is as follows:

- The Rates Invoice remains in full in the name of the ratepayer and is not withdrawn.
- The remitted amount must appear as a 'payment' of rates invoiced.
- As the ratepayer receives the Rates Tax Invoice in full, he/she is entitled to an input tax deduction for the whole of the GST of that invoice (including if any, that remitted) if registered for GST.
- The remission is not a reduction of rates invoiced, merely a reduction of that due by the ratepayer.
- Remissions will be made as a remission grant, analysed by purpose or objective.
- The Council pays (credits) to the ratepayer debtor account the remitted sum as if the Council were making a cash payment of rates on behalf of the ratepayer. The remission is recorded on the ratepayer's rate account.
- The Council, in remitting rates, is not entitled to claim benefit of any of the GST assessed.

Therefore it follows that if the Council remits the GST inclusive rates, the Council cannot claim a GST refund. This becomes an additional cost to the Council.

A copy of the Council's existing Rate Remission Policy as published in the Annual Plan is attached for reference.

REMISSION TREATMENT NOW PROPOSED

The remission treatment now proposed is determined by the impact on each of the land groupings subject to the remission policy in the draft Annual Plan. In some cases it is proposed that there will no longer be a rate remission as such. It is no longer in the Council's interests to make a rate remission to some organisations.

Where rate remissions are no longer made, the Council will generally conclude that a grant is appropriate to assist the general objectives of the 'not for profit' organisation. These will be outside of the remission policy and process and will be called a 'Rates Grant'.

The following revised remission/grant treatment is proposed, based on land groups:

1. Council land used for public good

Examples include parks, libraries, Art Gallery etc. These are generally non rateable properties liable for Water & Sewerage rates only. The Draft Annual Plan Remission Policy (Remission 5, page 184) shows an intention to fully remit rates on this group.

The recommended new process is as follows:

- The Council should pay the rates in full rather than action a remission.
- If granted, a rates remission would cost the Council the GST inclusive figure and so no advantage to the Council occurs. This should not be pursued.
- The GST on the rates paid can offset the GST on rates invoiced.
- The Annual Plan expenditure will increase by the rates payable and secondly by rates revenue growth.

Net cost to the Council, as a result of the new process for this land group, is zero. The increase in rates income is offset by the rates expense in parks, property etc.

2. Council land used for Housing

There are 2,600 housing units owned by the Council. These are fully liable for all rates including CRC rates. The Draft Annual Plan Remission Policy (Remission 5, page 184) shows an intention to fully remit rates on this group.

The recommended new process is as follows:

- The Council should pay the rates in full rather than action a remission grant.
- The net cost is the same under rates payment as under rates remission grant, the GST inclusive cost is made to the Housing Account.
- It is unreasonable to ask the CRC to remit its share of rates when the Council is paying its rates.
- GST charged to the Housing Account cannot be recovered as Housing is an exempt supply.

Net cost to the Council as a result of the new process for this land group is estimated to be \$234,000. The increase in rates expenditure is GST charged on the CCC rates levied and the CRC rates GST inclusive.

3. Land used by 'not for profit' community organisations for public good purposes

Examples include clubs, associations, churches etc, for sport or community benefit. These are generally either fully non rateable properties (water and sewerage rates only) or rated 50/50, that is 50% fully rateable (all rates including CCC General rates and CRC rates) and 50% non rateable (liable for water and sewerage rates only).

The Draft Annual Plan Remission Policy (Remission 4, page 18) shows an intention to remit rates leaving a liability for 50% of the service rates of water, sewerage, and where payable, 50% of land drainage. This is a category of ratepayers who are probably mostly GST registered and who are potential candidates for Council community grants generally.

A rates grant is preferred over a rate remission as the dollar value of the transaction is the same but the Council would have an advantage under a general grant of claiming a donation tax deduction. There is at least one upside to this confusing saga.

The organisations in this group could be confused about the Council's reasons for this changed treatment and an apparent bureaucratic process of charging and then making grants to cover part payment. It is intended that a letter explaining the process will be sent to all organisations affected.

The GST involved amounts to approximately \$40,000

The recommended new process is as follows:

- There should be no rates remission actioned for this group.
- The Council may make a rates grant to the organisation to assist in the general 'not for profit' objectives of the organisation.
- The grant would not include any GST and would be limited to part of the rates levied.
- The organisation would be expected to pay the rates as invoiced in full, net of any rates grant.
- The GST on the full rates paid can recovered by the organisation (assuming they are registered).
- The Annual Plan expenditure will increase by the grants proposed and by rates revenue growth. The net effect will be nil as rates income budget will be increased and the rates grant budget increased.

4. Remission of Rates Penalties

Rates penalties include GST and are imposed for late payment. The Draft Annual Plan Remission Policy (Remission 1, 2, and 3, page 181 to 182) shows an intention to remit penalties where the preconditions are met. It proposes to make a rates remission to remit the penalties as per the Draft Remission Policy. It is now proposed that penalties will not be imposed where it is known that a remission would automatically occur (under the policy). There is no point in suffering the loss of GST.

Residential ratepayers and others who are not registered for GST should have the GST inclusive penalty remitted. Registered GST ratepayers will have the GST exclusive portion remitted. It would be unfair to both remit the penalty including GST and allow the ratepayer to claim the GST from the IRD.

In doing this it is assumed that all residential ratepayers are not GST registered (or that the rates are an exempt supply) and that all other (rural, commercial, and non rateable) ratepayers are registered and that the land use is for a taxable supply. There will be a process that allows a ratepayer to claim a higher remission if the ratepayer certifies in a written declaration that the GST content of the rates penalty cannot be claimed from the IRD.

The recommended new process is as follows:

- The Council should action a rates remission for the GST inclusive penalty remitted for residential ratepayers and others who certify that GST cannot be recovered from the IRD.
- The Council should action a rates remission for the GST exclusive penalty remitted for all other ratepayers unless the GST content of the remission is less than \$30 in which case an inclusive remission is allowed.
- The Annual Plan expenditure will increase by the remissions proposed offset by higher rates revenue through treating remission penalties as an expense rather than a deduction from rates revenue.

It should be noted that some penalties are generally remitted where there is a dispute involved. There is an expectation that GST registered ratepayers will pay the GST portion of penalties.

It is estimated that the net cost to Council will be in the order of \$70,000, being a loss of GST.

5. Remission of excess water charges and other rates where the Council considers it just and equitable

The Draft Annual Plan Remission Policy (Remission 6, page 184) shows an intention to remit rates where the preconditions are met. Examples include inappropriate UAGCs imposed and excess water charge allowance not utilised for properties in common use. Where it is not possible to suppress the additional charges it is proposed to make a rates remission grant to remit as per the Draft Remission Policy.

Residential ratepayers and others who are not registered for GST should have the GST inclusive UAGC and rates remitted, and registered GST ratepayers should have the GST exclusive portion remitted, subject to the \$30 GST content rule. It would be unfair to both remit the penalty including GST and allow the ratepayer to claim the GST from the IRD.

The assumptions and process in 3 above will be made.

Conclusion

- The Council should action a rates remission grant for the GST inclusive rates remitted for residential ratepayers and others who certify that GST cannot be recovered from the IRD.
- The Council should action a rates remission grant for the GST exclusive rates remitted for all other ratepayers subject to the \$30 GST content rule.
- The Annual Plan expenditure will increase by the remission grants proposed and by rates revenue growth from recognition of the full value of all rates imposed.

OTHER CHANGES PROPOSED

There are several changes necessary to the draft rating policies to efficiently meet the new IRD and Audit Office rulings. They are:

A. Uniform Annual General Charge

The rate types definition on page 175 referring to UAGC's will be amended by inserting the term "The Council may impose a UAGC on every separately used or inhabited rating unit provided such UAGC will not be subject to a rate remission under the policy".

B. Rate penalties not imposed where the Council believes there will be a remission granted.

The policy on page 180 will be amended to recognize that no penalty will be imposed where it is virtually certain a remission will be granted under the remission policy.

C. All remission statements to include the term "The Council may allow a remission" rather than 'will grant a remission'.

This is to allow discretion as to remission treatment and to allow no remission but contemplate a general grant instead.

SUMMARY

Because of the way the rating legislation has been drafted, the Council will incur a GST cost of approximately \$180,000 and extra housing rates of \$140,000.

A process has been devised whereby all categories of ratepayers who the Council wishes to receive a rate remission, will be paid grants for the rates to be remitted and this will be credited to their rate accounts. Rate penalties and other charges will be remitted for only the GST exclusive portion of the penalty for categories of ratepayers who are likely to be GST registered. These ratepayers will remain liable for the GST component of such penalties and charges.

Staff

Recommendation: That the amended remission treatment proposed above be adopted and that the Annual Plan Subcommittee be advised of the recommended changes to the draft Annual Plan that will be necessary as a result of the changes recommended, ie:

1. The Council will pay rates on Council land, where previously remissions were allowed.
2. Remissions to public good ratepayers will be replaced by rates grants.
3. Penalty remissions will be made by GST inclusive remissions to residential sector ratepayers and net of GST remissions to others except where:
 - (a) The GST content of the remission is less than \$30, in which case a GST inclusive remission may be granted.
 - (b) Where the ratepayer certifies in writing that they are not able to claim the GST on the remission.
4. The rate types definition on page 175 referring to UAGCs will be amended by inserting the term "The Council may impose a UAGC on every separately used or inhabited rating unit provided such UAGC will not be subject to a rate remission under the policy".
5. The policy will be amended to recognise that no penalty will be imposed where it is virtually certain a remission will be granted under the remission policy.
6. All remission statements to include the term "The Council may allow a remission" rather than 'will grant a remission'.

Chair's

Recommendation: That the above recommendation be adopted.