



Commentaries and Applied Research for
Practitioners and Educators

1. Goods and Services Tax:
Some Implications for
New Zealand Farm Businesses
Based on the U.K. Experience.

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Goods and Services Tax:
Some Implications for
New Zealand Farm Businesses
Based on the U.K. Experience

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GOODS AND SERVICES TAX: SOME IMPLICATIONS FOR
NEW ZEALAND FARM BUSINESSES BASED ON THE
U.K. EXPERIENCE

1. Introduction

The introduction of a Goods and Services Tax in New Zealand has aroused concern amongst farmers about its impact on them. The purpose of this article is to describe the operation of a similar tax in the United Kingdom and how it affects British farmers. Some suggestions about how G.S.T. will affect New Zealand farmers will be made in the light of the U.K. experience.

2. Value Added Tax

The U.K. Government introduced a Value Added Tax (V.A.T.) on 1 April 1973. V.A.T. is a tax on general consumer expenditure and is charged at a specified rate on business transactions and on imports. Most business transactions in the U.K. are liable to V.A.T. and are called taxable supplies. A person who makes taxable supplies above a certain value is a taxable person and must be registered for V.A.T. When a taxable supply is made, the supply is called the output and the V.A.T. which must be charged on it is the supplier's output tax. If the supplier's customer is registered for V.A.T. then the supply is his/her input and the tax is his/her input tax. When the sum of a registered person's output tax is greater than the sum of his input tax then the person must pay the difference to the Government. Where the reverse is the case, i.e. the input tax is greater than the output tax, the Government refunds the difference to the registered person. This latter case could occur because the business' taxable supplies are less than its taxable inputs during the period or because the supplies are taxed at a lower rate than the inputs from which they are made.

2.1 Rates of Tax

The rates at which V.A.T. are levied are set by the Government. Some taxable supplies are taxed at zero rate, notably human foodstuffs, clothes and domestic heating, but the rest are taxed at a positive rate or rates.

These positive rates have varied from 8 per cent to 25 per cent, but the latter rate only applied to consumer durables and leisure equipment, with other taxable supplies being taxed at 8 per cent. Currently there is only one positive rate of V.A.T. of 15 per cent. This is known as the standard rate.

2.2 Registration

Anyone in business making taxable supplies has to be registered for V.A.T. The only exception is where the value of the person's supplies, his taxable turnover, is below a prescribed limit. The only benefit that a person derives from not being registered is that he does not need to fill in V.A.T. returns.

A non-registered person is otherwise at a disadvantage because he cannot reclaim the V.A.T. that is charged on his inputs. This means that the net cost of his inputs is greater by the unclaimable V.A.T. than his registered competitor's inputs. The non-registered person cannot recoup this extra cost by adding V.A.T. to his outputs as this is illegal. Neither can he sell his output at a higher price than a registered competitor's pre V.A.T. output price.

2.3 Administration

V.A.T. is administered by the U.K. Customs and Excise. The registered person must keep records (see below) and send in returns to the Customs and Excise at specified intervals with payment where he estimates that tax is due. If tax is owed to the registered person the Customs and Excise will refund the balance due within one month of receipt of the return.

Officers of the Customs and Excise visit the registered person's principal place of business from time to time to check records and accounts and to ensure that the calculation and payment of V.A.T. is correct. They also give any advice needed about the tax. The officers have the power to enter business premises at any reasonable time and require information about supplies of goods and taxable supplies of

services. In the latter case this information is limited to the payment made for the supply of the service and the name and address of the recipient. They can require to see trading and profit and loss accounts and balance sheets relating to the business, and make copies of them if necessary. A person who disagrees with a decision made by the Customs and Excise may ask them to discuss or review it. That person also has the right of appeal to an independent (of the Customs and Excise) V.A.T. Tribunal.

2.4 Recording

All taxable persons are required to keep and preserve certain records and accounts under schedule 7 of the Value Added Tax Act, 1983. The records do not have to be kept in any set way but they must include details of all taxable goods and services which are received or supplied in the course of business. They must be kept up to date and must be in sufficient detail to allow accurate calculation of the amount of V.A.T. that has to be paid to, or claimed from, the Customs and Excise. The Customs and Excise have the power to direct the records to be changed if they are unsatisfactory. The periods covered by the V.A.T. records must coincide with the period covered by the tax return.

The period covered by the V.A.T. return is called a tax period. The return must be submitted not later than one month after the end of the tax period. The return must be submitted even if there is no tax due. The standard tax period is three months, but the registered person can ask for monthly tax periods if he normally expects to receive repayments of tax from the Customs and Excise.

Failure to make a return, failing to pay tax and making false returns are all offences for which penalties may be imposed by the Courts. If a return is not made when due, or is if it incomplete, the Commissioners of Customs and Excise have powers to assess the amount of tax that is owed to them. They can recover tax that is due or distrain the registered persons' assets in lieu.

2.5 Invoices

When a taxable supply is made to a registered person, the supplier must (unless he is not registered) give his customer a tax invoice. This is a document setting out inter alia the supplier's name, address and registration number, the customer's name and address, the quantity of goods or extent of the service, the charge made excluding V.A.T. and the rate of V.A.T. per unit, the total charge made for the goods excluding V.A.T., the rate of any cash discount and the total V.A.T. payable. Where the goods are supplied direct to the general public a tax invoice is not necessary unless requested. These tax invoices generally substitute for existing invoices in the pre V.A.T. system. They can be required as proof of payment of the tax by the Customs and Excise and should always be retained. Only a registered person can issue a tax invoice. It is an offence to knowingly use an invoice from an unregistered person to reclaim V.A.T.

3. V.A.T. and Agriculture

3.1 Additional Administration

There can be no doubt that V.A.T. has imposed a cost on agriculture in the U.K. Farmers and growers have been required to keep extra records in order to comply with the V.A.T. legislation. This has involved at the least extra time in the office and in many cases additional expenditure on recording services. In some cases the recording has been 'grafted on' to the existing cash book system while in others a completely new, parallel, set of records have been kept for V.A.T. purposes alone. In the former approach a cash book has extra columns to show the V.A.T. paid or charged and the different classes of taxable goods and services. The sum of these columns adds up to total cash expenditure or revenue. These details are required for the V.A.T. return.

The analysis of the expenditure or revenue to its various headings can be done net or gross of V.A.T. Analysis net of V.A.T. is favoured for management purposes because some items are subject to the tax and others

are not. Failure to do this would lead to distortions. Further distortion to the figures will be caused whenever the tax rates are altered if this procedure is not followed. On the other hand the analysis gross of V.A.T. is acceptable for income tax purposes. The payments/refunds to or from the Customs and Excise of the tax are shown as additional items in the profit and loss account.

When the registered person wishes to record the tax on the invoice date rather than on the date of payment, then a separate set of accounts is frequently required. This latter approach ensures that V.A.T. is paid to, or reclaimed from, the Customs and Excise sooner than if the date of payment (the cash book approach) is used as the tax point.

A typical layout that enables incorporation of V.A.T. recording into an existing cash book is shown in Table 1.

Table 1 A Typical Cash Book Layout for Incorporating VAT

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	etc.
Gross Payments	Exempt Inputs	Zero Rated Inputs	Standard Rated Inputs	VAT	Feed	Seed	Fertilizer	

Columns (b), (c), (d) and (e) are required for V.A.T. purposes and in total equal column (a). For management purposes columns (e), (f), (g), (h), etc. will also total column (a). Where a separate record of V.A.T. transactions is required, only the first five columns are needed.

3.2 Effect on Cash Flows

Most agricultural outputs being foodstuffs are zero rated and therefore do not attract V.A.T. The main exception is wool which attracts V.A.T. at the standard rate. A greater proportion of horticultural output is standard rated because of its non-edible nature, e.g. flowers, bulbs, nursery stock, etc. On the other hand many, but not all, inputs are standard rated. Some important zero rated items are animal feeding stuffs, seed and live animals. The provision of labour by an employee is not considered a service and is therefore exempt from V.A.T. Rents,

property taxes and insurance premiums are also exempt. It is not possible to state exactly how much V.A.T. is raised in agricultural inputs and outputs each year because of the complex system of rating and exemption, however the data in Tables 2 and 3 give some indication of the figures involved. The outputs and inputs are not adjusted for valuation changes and are therefore cash flows. Payments to family labour and farm partners are excluded. Standard rated taxable inputs are some ten times greater than standard rated taxable outputs in the U.K. Agricultural and Horticultural sectors. This means that most farmers never pay any V.A.T. to the Customs and Excise. Instead they receive refunds of the excess V.A.T. that they have paid. Somewhat paradoxically this situation operates to their disadvantage. In the periods when their input tax

Table 2 U.K. Agricultural Cash Flows 1986 (Forecast) and Associated VAT

	Cash Flow £ million	Standard Rated Items £ million	VAT Levied (estimated) £ million
Output			
Farm Crops	3234	0	0
Horticulture	1324	275	41.25
Livestock	4156	0	0
Livestock Products	3055	85	12.75
Other (grants etc.)	473	0	0
	----	---	----
Total output	12242	360	54.00
	-----	---	-----
Inputs			
Feedingsuffs	2689	0	0
Seeds	284	0	0
Fertilizers	818	818	122.7
Livestock	176	0	0
Machinery Repairs, Fuel etc.	951	858	128.70
Farm Maintenance	276	276	41.40
Miscellaneous	1245	880	132.00
Capital Investment	961	961	144.15
Hired labour	1365	0	0
Interest (excl. land purchase)	704	0	0
	----	----	----
	9469	3793	568.95
	-----	-----	-----

Table 3 Summary of Tax Collections and Payments in U.K. Agriculture 1986
(estimates)

	£ million
Total tax collected on outputs	54.00
Total tax paid on inputs	568.95

Net payment of VAT to Customs & Excise	514.95

exceeds their output tax, the vast majority, they are out of pocket for the period between the payment of the invoice and the receipt of the refund from the Customs and Excise. This period can be as long as four months, i.e. the three month tax period plus the month's delay between submission of the claim and its payment. This means that many farmers choose monthly tax periods to speed up the refund of the V.A.T. despite the extra administrative expense. Those farmers with sufficiently small taxable turnovers have the problem of weighing the extra cost of recording involved with registration against the excess V.A.T. that they can only reclaim if they are registered.

3.3 Difficulties with Multiple Rates of Tax

The existence of two taxable rates, zero and standard, caused considerable concern on the introduction of V.A.T. Particular concern was expressed about the difficulty in determining the correct rate to be applied to cull stock sold at markets, some of which would go for human consumption and be zero rated and some which would go for pet food and therefore be standard rated. In the event the problem is resolved by all sales being treated as though they are for human consumption. The pet food manufacturer charges the standard rate of V.A.T. on his output, but does not pay input tax. This arrangement is administratively convenient and does not affect the amount of V.A.T. collected by the Customs and Excise. The pet food manufacturer pays more V.A.T. than he would had he paid V.A.T. on his input, but the farmer pays an equivalent sum less than he would had he charged V.A.T. on his output. Other examples abound - potato chips are standard rated but French Fries are zero rated.

3.4 Effect on Cost of Inputs and Value of Outputs

The introduction of V.A.T. has not increased the cost of inputs to the

farmer, nor has it reduced the value of his sales. When inputs are bought the V.A.T. is added on to the cost by the registered supplier. The farmer is entitled to set this input tax against any output tax that he himself charges. Since this will almost always be less than the value of his input tax, he will be able to reclaim it. Even if he collects more output tax than he pays input tax, the input tax will reduce the amount of V.A.T. that has to be paid to the Customs and Excise. This means that the net cost of the input to the farmer is unaffected by the tax. The only exception to this is the farmer who is not registered. He has to pay the V.A.T. on his inputs but cannot reclaim it. He cannot charge any extra for his output because it does not incur V.A.T. This is because his client (who is registered), will be indifferent to whether he buys from a registered or non-registered supplier. If the supplier is registered the client can reclaim the tax, if the supplier is not registered then the client will only pay the pre-tax price. The net cost to the client is identical in either situation. The non-registered person will only have an advantage if his customers were themselves non-registered. He can then sell his goods at less than the tax inclusive price, but more than his competitors' pre-tax price. This is rare in agriculture because of the zero rating of most agricultural produce.

4. Some Implications for New Zealand Farmers

4.1 Cash Flows

The situation for New Zealand farmers will be different from that in the U.K. for a very important reason. Since food will be subject to a positive rate of G.S.T., the average farmer will collect more output tax than he will pay input tax. He will therefore pay the surplus tax to the Government. However, the farmer will not have to pay the surplus tax to the Government immediately. He will have the use of this surplus tax to reduce his borrowing or to invest elsewhere until it is due for payment. This is the reverse of the situation in the U.K. The benefit to the individual farmer will depend upon the length of time between making tax returns and the distribution of his purchases and sales throughout the year.

Providing he has a taxable surplus in each period, the longer the period between returns the more he will benefit from the interest free loan effect. However the benefit will vary from farmer to farmer and it is possible that with a particularly adverse cash flow the farmer could be worse off. This will happen if expenditure occurs mainly early in the period and the returns occur towards the end.

Table 4 shows how the choice of tax period will affect the average surplus tax that the farmer will owe and the benefit this will give him for every one per cent interest rate that he pays on his borrowing (or receives on his investments).

It is assumed that the farmer has a surplus G.S.T. for the whole year of \$12,000 and that this is distributed evenly throughout the year. If the tax period is one month then the surplus tax collected during the month will be \$1,000. The average surplus for the month will be half that figure or \$500. In addition, interest will be earned on the whole of the previous month's surplus tax from the end of that month to the date when it is paid to the Government. This period is assumed to be one month.

Table 4 The Effect of Surplus GST on the Cash Position of a Business

Interval between payment of surplus GST (months)	1	2	3
Average surplus GST collected in month (\$)	500	500	500
Accumulated surplus GST collected in previous months (£)	1000	2000	3000
Average surplus GST for each payment period (\$)	1500	2000	3500
Annual benefit per 1 per cent interest (\$)	15	20	25

Where the interval between payment of the surplus is one month, the average reduction in borrowing/increase in investment will be \$1,500 per

year. If the interval is extended to two months, the average surplus available is \$2,000 per year. If the payment period is three months, the average surplus increases to \$2,500 and so on. The returns on these additional sums of money for each one per cent interest are shown in the final rows of Table 4. A farmer collecting an average surplus of \$12,000 GST which he repays quarterly would therefore earn \$375 per year if his interest rate is 15 per cent.

4.2 Exports

Where produce is sold for export, then it will be effectively zero rated. The exporter will not add G.S.T. to the value of the product and his liability to pay G.S.T. to the Government will be correspondingly reduced. A person who exports the majority of his produce could find himself facing similar cash flow problems to those faced by U.K. farmers. However, where the produce is sold to an intermediary who could either distribute to the domestic market or export it, then it seems likely that the farmer or grower will be able to charge G.S.T. on all his output. It will be the exporter who will not charge G.S.T. on the produce and who will have to reclaim the surplus of his input tax over and above his output tax from the Government.

4.3 Recording

The New Zealand farmer will certainly have to increase his recording to comply with the requirements of G.S.T., but there may be spin offs from this improved book-keeping in the management sphere. Manual recording systems should prove perfectly adequate so there will be little specific need to invest in computerised systems unless the farmer is keen to adopt that technology anyway. If he is, computer based recording systems will carry out all the calculations needed quickly and simply.

It remains to be seen to what extent the farmer will be involved in supplying tax invoices for his sales. In the U.K. the most common situation has been for the person buying or handling the produce to do the

invoicing. Thus the wool merchant prepares the tax invoice for the farmer from whom the wool is being bought. This is known as 'self-billing'. The farmer then receives a payment for the wool plus the output tax. It is his responsibility to account for the tax. Where goods are sold through a market, the auctioneer prepares the necessary invoices for both the buyer and the seller.

One further book-keeping complication arises at this stage. Before the introduction of G.S.T. the farmer could record sales net of commission and other charges, and not need to concern himself with contra entries. However, these deductions will be classified as taxable inputs and will therefore be subject to G.S.T. The gross value of the sales and the associated output tax will have to be recorded and the charges with their associated input tax will have to be shown as a cost. This will involve the use of contra entries in the farm records.

An example is shown in Table 5. In this case the farmer sells 100 store lambs through a Stock and Station agent for \$12 a head. The agent charges 4.75 per cent commission. G.S.T. is levied at 10 per cent. As can be seen, the total of the entries in the bank and contra columns will equal the total of the entries in the G.S.T. and output or input columns.

Table 5 The Treatment of Contra Items Subject to G.S.T.

<u>Revenue</u>			
Banked \$	Contra \$	Output GST \$	Sheep etc. \$
1257-30	62-70	120-00	1200-00

<u>Expenditure</u>			
Paid cheque \$	Contra \$	Input GST \$	Commission etc. etc. \$
0-00	62-70	5-70	57-00

5. Conclusion

The introduction of G.S.T. should not pose any real administrative problem for New Zealand farmers apart from the need for some extra recording. In contrast to the U.K. situation the introduction of the tax should probably improve the farmer's cash flow position. His business will benefit from any resultant cuts in marginal income tax rates - providing he makes enough profit to pay tax - but he will find that his personal expenditure will rise.

Because his tax bill for any given level of profit will be much smaller the temptation to purchase replacement capital items to defray tax payments will not be so strong. It may well be that the most significant advantage of the introduction of G.S.T. could be a more orderly investment programme by farmers.