DavidCo Limited
CHARTERED ACCOUNTANTS

Level 2, Shortland Chambers
70 Shortland Street, Auckland
PO Box 2380, Shortland Street
Auckland 1140
T +64 9 921 6885
F +64 9 921 6889
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

RECENT DEVELOPMENTS IN GST

CONTENTS: **Paragraph Nos.**

1. The GST rate 1 – 2
2. Developments in GST since 2011 3 – 9
3. GST registration threshold and cancellation of registration 10 – 14
4. Apportionment rules (for acquisitions from1 April 2011) 15 – 34
    4.1 Changes affecting recipients of supplies of services from non-residents 27 – 28
    4.2 Changes affecting providers of financial services 29 – 33
    4.3 Mixed-use assets 34
5. Changes affecting land transactions 35 – 55
    5.1 New definition of land 37 – 39
    5.2 Zero-rated supplies of land 40 – 49
    5.3 Concurrent use of land 50 – 53
    5.4 Separate supply of residential accommodation 54 – 55
6. Supplies involving more than two persons 56 – 64
7. Supply of accommodation in a dwelling 65 – 73
8. Non-profit bodies 74 – 77
9. Mixed-use assets 78 – 109
    9.1 What is a mixed-use asset 79 – 82
    9.2 Application dates of GST rules 83 – 84
    9.3 Interaction with income tax exemptions 85 – 87
    9.4 Apportionment formula 88 – 95
    9.5 What happens at acquisition 96 – 98
    9.6 Post-acquisition adjustments 99 – 103
    9.7 Inland Revenue example of GST adjustment for mixed-use assets 104 – 105
    9.8 Other adjustments: disposals and pre-registration acquisitions 106 – 108
    9.9 Application of the apportionment rules depends on a number of variables 109

CONTENTS: (continued) **Paragraph Nos.**

10. Non-residents' ability to claim input tax deductions 110 – 139
10.1 The new GST grouping rules 111 – 114
10.2 The new timing rules for entry and exit 115
10.3 The new GST registration requirements for non-residents 116 – 117
10.4 The new rules for cancellation of GST registration 118 – 124
10.5 The new rules for non-residents claiming deductions 125 – 127
10.6 The GST accounting basis for non-residents 128 – 133
10.7 Zero-rating of certain goods supplied to an unregistered non-resident 134 – 135
10.8 Non-resident registrants claiming GST on importation 136 – 139
11. Miscellaneous recently enacted changes: 2012 – 2014 140 – 180
11.1 Late payment fees subject to GST 144 – 146
11.2 Liquidators cannot change from payments to invoice basis 147 – 148
11.3 Payment from a foreign insurer not consideration for a supply 149 – 152
11.4 LTCs can be part of a GST group 153
11.5 Participation in a prize competition is a supply of services 154 – 158
11.6 Opt out provision to the agency rules 159 – 164
11.7 GST records kept offshore by approved data storage provider 165 – 167
11.8 Change of accounting basis for certain local authorities 168 – 169
11.9 Agreements to hire with option to purchase are hire purchase agreements 170 – 180
12. Income tax effects of GST adjustments 181 – 189
12.1 Income adjustment for GST 182 – 183
12.2 Deductions for GST adjustments 184 – 187
12.3 Cost of depreciable property 188 – 189
13. GST treatment of directors' fees 190 – 196
14. Zero-rating services supplied to non-residents 197 – 219
14.1 The draft Immigration IS: zero-rating of visa application services 199 – 203
14.2 The Immigration IP: GST treatment of immigration and other services 204 – 208
14.3 The new rule exempting minor presence in New Zealand 209 – 210
14.4 Switching off backdating of tax residence for purposes of the GST tests 211 – 215
14.5 Apportionment 216 – 218
14.6 Reasonably foreseeable 219

CONTENTS: (continued) **Paragraph Nos.**

15. Bodies corporate GST registration 220 – 237
- 15.1 Bodies corporate issues paper 221 – 229
- 15.2 Bodies corporate discussion document 230 – 233
- 15.3 The new proposed amendments in the R&D Tax Bill 234 – 237

16. GST remedial issues – issues paper 238 – 246
- 16.1 Apportionment rules: deemed supply of land on disposal 239 – 242
- 16.2 Supplies by a company to an associated natural person 243 – 244
- 16.3 Credit notes when GST incorrectly charged 245 – 246

17. Inland Revenue publications concerning GST 247 – 390
- 17.1 QB 13/03 Compulsory acquisition of land is a "supply by way of sale" 248 – 255
- 17.2 QB 14/03: Transfer of interest in a partnership 256 – 265
- 17.3 QB 14/06: Hire firm security bonds 266 – 268
- 17.4 BR Pub 14/06: Payments by parents or guardians to state schools 269 – 281
- 17.5 QB 14/10: Whether a binding contract always establishes a supply 282 – 285
- 17.6 QB 14/13: Lotteries, raffles, sweepstakes and prize competitions 286 – 297
- 17.7 QB 14/14: Late return charges (including library fines and parking fines) 298 – 302
- 17.8 BR Pub 15/01 and BR Pub 15/02: Secondhand goods and fishing quota etc. 303 – 315
- 17.9 BR Pub 15/03: Legal services provided to non-residents relating to land 316 – 326
- 17.10 Exposure draft of operational statement: GST on costs of mortgagee sales 327 – 333
- 17.11 Draft Interpretation Statement: GST and retirement villages 334 – 372
- 17.12 Draft QB: Non-profit bodies – Registration and accounting for GST 373 – 390

18. Recent court cases involving GST 391 – 473
- 18.1 Lessor remained liable for GST on lease payments 392 – 393
- 18.2 Time of supply of newly subdivided land 394 – 404
- 18.3 Input tax restriction applies to supplies between associated persons 405 – 415
- 18.4 No input tax where vendor and purchaser had common shareholder 416 – 433
- 18.5 Company owned by trust associated with shareholder in trustee company 434 – 448
- 18.6 GST on inbound tourism facilitation services to non-resident cruise lines 449 – 473

1. THE GST RATE

1. The current rate, since 1 October 2010, is 15%.

2. Before 1 October 2010, it was 12.5%.

2. DEVELOPMENTS IN GST SINCE 2011

3. The developments relating to GST can be broadly divided into 3 main areas:

   (a) GST law changes (and proposed GST law changes);

   (b) Inland Revenue publications on GST; and

   (c) Tax cases involving GST.

4. The GST law changes that apply from 1 April 2011 are mainly contained in the *Taxation (GST and Remedial Matters) Act 2010* ("the GST Act 2010") passed on 20 December 2010. Further changes are contained in:

   (a) The *Taxation (Tax Administration and Remedial Matters) Act 2011* ("the Tax Administration Act 2011") that received the Royal assent on 29 August 2011;

   (b) The *Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012* ("the Annual Rates Tax Act 2012"), with a date of assent of 2 November 2012;

   (c) The *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013* ("the Assets Expenditure Tax Act 2013") with a date of assent of 17 July 2013;

   (d) The *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* ("the Employee Allowances Tax Act 2014") with a date of assent of 30 June 2014; and

   (e) The *Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Bill* ("the R&D Tax Bill 2015") introduced on 26 February 2015.

5. The legislated changes up to and including the Employee Allowances Tax Act 2014 relate to:

   (a) The Apportionment Rules (including a number of remedial amendments) affecting, among others, recipients of services supplied by a non-resident [s. 8(4B)], and providers of financial services. Note: The changes to the Apportionment Rules generally do not apply to acquisitions made before 1 April 2011, subject to specific exceptions, notably land – see further at **paragraph 15** below.

   (b) Land Transactions between registered persons. The changes apply to transactions from 1 April 2011 onwards. There have been a number of remedial amendments. Refer to **paragraph 35** onwards below.

   (c) Supplies involving more than two persons, where the purchaser nominates a third person as the recipient. The changes apply to transactions from 1 April 2011 onwards. Refer to **paragraph 56** onwards below.

   (d) The supply of accommodation in a dwelling. New definitions of "dwelling" and "commercial dwelling" apply to supplies made from 1 April 2011 onwards. Refer to **paragraph 65** below. Further amendments relating to these changed definitions concern:

(i) Confirming that accommodation in a retirement village can continue to be dwellings under the new definitions of "dwelling" and "commercial dwelling"; and

(ii) Limiting input tax deductions arising from the changed definitions of "dwelling" and "commercial dwelling".

(e) A number of other changes, notably GST on late payment fees and an amendment affecting non-profit bodies that account for GST on a payments or a hybrid basis and make supplies in excess of $225,000. (This latter change is a concession that applies from 21 December 2010.)

(f) The GST rules for mixed-use assets. Refer to **paragraph 78** onwards below.

(g) The GST rules to allow a non-resident to claim input tax deductions on the strength of a taxable activity outside New Zealand. Refer to **paragraph 110** onwards below.

(h) Other changes including making prize competitions subject to GST and allowing an opt-out of the agency rules. Refer to **paragraph 154** onwards below.

(i) Hire-purchase agreements to include agreements to hire with an option to purchase. Refer to **paragraph 170** onwards below.

(j) The GST treatment of directors' fees – Inland Revenue followed up the legislation by releasing a draft public ruling on 25 March 2015 – see further at **paragraph 190** below.

(k) Relaxing the requirements for zero-rating services to non-residents who are temporarily present in NZ on unrelated matters – see further at **paragraph 197** below.

6. Some of the above-listed GST law changes were foreshadowed in *GST remedial issues – An officials' issues paper* ("the Remedial Issues Paper") released in December 2012. However, three of the law changes proposed in the Remedial Issues Paper have not been proceeded with (refer to **paragraph 238** onwards below):

(a) Specifically excluding deferred settlement land transactions from being hire-purchase agreements.

(b) Excluding supplies by a company to an associated natural person from being taxable supplies.

(c) Requiring a credit note to be provided when a supply has been incorrectly treated as subject to GST, when no GST should have been charged.

7. The proposed law changes in the R&D Tax Bill 2015 concern bodies corporate. The Government has announced the removal of the requirement for bodies corporate to compulsorily register for GST. Refer to **paragraph 234** onwards below. This is a move to address the uncertainty and confusion that resulted from the previous Inland Revenue publications on the subject:

(a) The issues paper released in May 2013: *IRRUIP7: Bodies Corporate – GST registration* ("the bodies corporate issues paper");

(b) The discussion document released in June 2014: *GST treatment of bodies corporate – A government discussion document* ("the bodies corporate discussion document"); and

(c) The *Commissioner's interim operational position for GST and Bodies Corporate* ("the interim operational position") released immediately after the discussion document in June 2014.

8. Inland Revenue has issued a number of other publications concerning GST that are discussed in this GST section:

(a) The amendment in the Employee Allowances Tax Act 2014 referred to in paragraph 5(k) above, concerning relaxing the requirements in order to zero-rate services to non-residents, follows from *The GST treatment of immigration and other services – An officials' issues paper* ("the Immigration IP") released in June 2013, which set out various issues arising from submissions on the draft Interpretation Statement on the same topic ("the draft Immigration IS") released in April 2012 – discussed in **paragraph 197** onwards;

(b) QB 13/03 *Goods and service tax – Whether a compulsory acquisition of land is a "supply by way of sale* published in Tax Information Bulletin Vol. 25, No. 7, August 2013, starting on page 97 – discussed in **paragraph 248** onwards;

(c) QB 14/03: *GST – Transfer of interest in a partnership*, published in *Tax Information Bulletin* Vol. 26, No. 5, June 2014, starting on page 57 – discussed in **paragraph 256** onwards;

(d) Product Ruling – BR Prd 14/08 *Body Corporate 358851* released on 8 August 2014 and published in *Tax Information Bulletin* Vol. 26 No. 8, September 2014, page 4, concerning the GST treatment of payments received by unit owners from an insurance payment received by the body corporate – discussed in *Weekly Comment* 13 February 2015;

(e) QB 14/06: *GST – Hire firm security bonds*, published in in *Tax Information Bulletin* Vol. 26, No. 7, August 2014, starting on page 131 – discussed in **paragraph 266** onwards;

(f) Public Ruling – BR Pub 14/06: *Payments made by parents or guardians of students to State Schools – GST treatment*, published in *Tax Information Bulletin* Vol. 26, No. 9, October 2014, starting on page 3 – discussed in **paragraph 269** onwards;

(g) QB 14/10: *Goods and services tax – Whether a binding contract always establishes a transaction giving rise to a supply for section 9(1) purposes*, published in *Tax Information Bulletin* Vol. 26, No. 10, November 2014 starting on page 32 – discussed in **paragraph 282** onwards;

(h) QB 14/13: *GST – Lotteries, raffles, sweepstakes and prize competitions*, published in *Tax Information Bulletin* Vol. 27, No. 1, February 2015 – discussed in **paragraph 286** onwards;

(i) QB 14/14: *GST – Late return charges (including library fines and parking overstay charges)*, published in *Tax Information Bulletin* Vol. 27, No. 1, February 2015 – discussed in **paragraph 298** onwards;

(j) Public Rulings BR Pub 15/01 and BR Pub 15/02: *Secondhand goods input tax deductions – fishing quota, coastal permits and certificates of compliance*, published in *Tax Information Bulletin* Vol. 27, No. 2 March 2015 – discussed in **paragraph 303** onwards;

(k) Public Ruling BR Pub 15/03 GST - *Legal services provided to non-residents relating to transactions involving land in New Zealand*, published in Tax Information Bulletin Vol. 27, No. 3 April 2015 – discussed in **paragraph 316** onwards;

(l) On 13 February 2015 Inland Revenue released Exposure Draft ED0164 of Operational Statement: *GST and the costs of sale associated with mortgagee sales*, which updates and

will replace OS 005 *GST and the costs of sale associated with mortgagee sales* published in *Tax Information Bulletin* Vol. 16, No. 3, April 2004 – discussed in **paragraph 327** onwards;

(m) On 25 February 2015 Inland Revenue released draft Interpretation Statement INS0109: *Goods and services tax – GST and retirement villages* which updates and will replace IS 10/08 *Retirement villages – GST treatment* published in *Tax Information Bulletin* Vol. 22, No. 11, December 2010 – discussed in **paragraph 334** onwards;

(n) On 18 March 2015 Inland Revenue released Draft QWB00078: *Goods and services tax – Non-profit bodies – Registration, accounting for GST, and deregistration*, with a deadline for comment of 24 April 2015 – discussed in **paragraph 373** onwards;

(o) On 25 March 2015 Inland Revenue released Draft public ruling PU00202: *GST – Directors' fees* with a deadline for comment of 8 May 2015, which updates BR Pub 05/13 *Directors' fees and GST* published in *Tax Information Bulletin* Vol. 17, No. 7, September 2005 – discussed in **paragraph 197** onwards.

9. There have been a number of recent tax cases concerning GST. The following are briefly discussed in this GST section:

(a) Taxation Review Authority, *TRA 007/12*, [2014] NZTRA 08, concerning whether a lessor remained liable for GST on lease payments after the lease payments had been assigned to a finance company – discussed at **paragraph 392** onwards;

(b) Taxation Review Authority, *TRA 023/12*, [2014] NZTRA 10 on a dispute regarding whether the time of supply of newly subdivided land was before or after the GST rate increased from 12.5% to 15% on 1 October 2010 – discussed at **paragraph 394** onwards;

(c) Taxation Review Authority, *TRA 008/14*, [2014] NZTRA 15, concerning whether the input tax deduction restrictions on supplies between associated persons applied to a supply of a dwelling which became subject to GST due to the changed definitions from 1 April 2011 – discussed at **paragraph 405** onwards;

(d) Taxation Review Authority, TRA 02/10, [2015] NZTRA 01, where input tax credits were disallowed because the vendor and the purchaser were associated persons – discussed at **paragraph 416** onwards;

(e) High Court, *Concepts 124 Limited v Commissioner of Inland Revenue* [2014] NZHC 2140, concerning whether a company owned by a trust was associated with a company owned by the shareholder of the trustee company – discussed at **paragraph 434** onwards;

(f) High Court, *ID Tours New Zealand Limited v Commissioner of Inland Revenue* [2015] NZHC 483, concerning whether advice and services provided to non-resident cruise lines, incentive houses and travel agents could be zero-rated – discussed at **paragraph 449** onwards.

3. GST REGISTRATION THRESHOLD AND CANCELLATION OF REGISTRATION

10. The current GST registration threshold is $60,000 and every person who carries on a taxable activity and is not registered, becomes liable to be registered under s. 51(1) of the GST Act:

(a) At the end of any month where the total value of supplies made in New Zealand in that month and the preceding 11 months in the course of carrying on all taxable activities has

exceeded $60,000 (unless the total value of supplies in the immediately following 12 months will not exceed $60,000).

(b) At the beginning of any month where there are reasonable grounds for believing that the total value of supplies to be made in New Zealand in that month and the following 11 months will exceed $60,000, unless the $60,000 threshold is going to be exceeded only because of:

(i) The ending, or substantial and permanent reduction in size or scale of any taxable activity; or

(ii) The replacement of any plant or other capital asset; or

(iii) The supply to non-residents who are physically present in New Zealand of telecommunications services supplied by a non-resident supplier that are treated as being supplied in New Zealand either because persons physically in New Zealand initiated the supply (s. 8(6)) or because the services are invoiced to a physical address in New Zealand (s. 8A)).

11. Regardless of whether a person is liable to be registered, s. 51(3) allows any person to voluntarily register if the person is carrying on a taxable activity or intends to carry on a taxable activity. This currently applies equally to residents and non-residents.

12. The rules for cancellation of registration are contained in s. 52. Under s. 52(1), a registered person ceases to be liable to be registered *at any time* where the Commissioner is satisfied that in the 12 months beginning from that time taxable supplies will not exceed the registration threshold. [s. 52(1)].

13. When a registered person ceases to carry on all taxable activities:

(a) The Commissioner must be informed within 21 days and the Commissioner will cancel the person's registration from the last day of the taxable period in which all taxable activities ceased [s. 52(3)]; or

(b) The Commissioner may, even if not notified, cancel the person's registration:

(i) From the last day of the taxable period in which he is satisfied that all taxable activities have ceased [s. 52(5)]; or

(ii) From the date of the person's registration if he is satisfied that no taxable activities were in fact carried on [s. 52(5A)].

14. For non-residents, s. 52(7) stipulates that the 'taxable activities' referred to in s. 52(5) and 52(5A) are taxable activities carried on in New Zealand. (Note: from 1 April 2014, s. 52(7) applies only to a non-resident person who is not registered under the new s. 54B – see **paragraph 119** onwards below.)

4. APPORTIONMENT RULES APPLYING FROM 1 APRIL 2011

(Refer to the PDF attachment *The GST Apportionment Rules* for all the details)

15. The principal purpose test for making taxable supplies has gone. From 1 April 2011, input tax can only be claimed to the extent that goods and services are acquired to make taxable supplies. Goods and services used by non-profit bodies are treated as if they are used to make taxable supplies, unless they are used to make exempt supplies.

16. The input tax claim, at acquisition, or upon importation, is based on the *percentage intended use* to make taxable supplies. Amendments in 2012 resulted in input tax credits upon importation being specifically denied in two situations where it might have been possible for an input tax credit to be claimed twice on the same goods:

    (a) Effective from 14 September 2011 a secondhand goods input tax credit is not allowed when a non-resident supplies goods to a New Zealand resident (for example by leasing goods to a New Zealand resident) and subsequently the non-resident (or another non-resident) supplies the same goods to a New Zealand resident again (for example, by way of sale of the previously leased goods);

    (b) Persons in New Zealand who are involved in delivering goods or arranging delivery are denied an input tax deduction for goods that they are arranging the delivery for or simply delivering.

17. Post-acquisition adjustments must be made to limit the input tax claimed to *percentage actual use*. The total input tax that can be claimed cannot exceed the input tax paid at acquisition.

18. Adjustments are not required if the consideration for any exempt supplies will not exceed 5% of the total consideration for all supplies, and also will not exceed $90,000. In such cases, the full input tax can be claimed on acquisition.

19. The ***adjustments need to be made annually*** at the registered person's balance date. A concession applies to ensure the first adjustment period is at least 12 months after acquisition: the adjustment date can be, either the first balance date after acquisition, or the first balance date at least 12 months after acquisition. Subsequent adjustments are made at 12-month intervals. The adjustments are included in the GST return for the taxable period that covers the adjustment date.

20. For goods and services other than land***, limits apply, to the number of adjustments*** that need to be made, based on the GST-exclusive value. For goods and services that cost up to $5000 no annual adjustments are required. Two annual adjustments are required for goods and services that cost between $5000 and $10,000. Five annual adjustments are required where the cost is between $10,000 and $500,000, and 10 annual adjustments must be made if the cost exceeds $500,000. From 30 June 2014, the date of assent of the Employee Allowances Tax Act 2015, a compulsory one-off "wash up" adjustment must be made when goods or services for which apportionment adjustments were made are devoted entirely to a taxable or a non-taxable use. Refer to **paragraph 23** below.

21. There is ***no limit to the number of adjustments for land***. However, the "wash-up" adjustment eliminates the need for further adjustments after the land is devoted entirely to a taxable or a non-taxable use. Refer to **paragraph 23** below.

22. In all cases, ***an additional final adjustment must be made on disposal of the relevant goods***. This is in addition to the annual adjustments. Effective from 2 November 2012, if goods are disposed of before the required number of annual adjustments have been made, the final adjustment period before disposal ends on the date before disposal. In the latter case, adjustments are required for both the final adjustment period and the date of disposal.

23. ***A special wash-up rule applies when goods and services subject to apportionment are subsequently applied completely to taxable or non-taxable use***. Effective from 30 June 2014, if a person's use of the goods or services changes in an adjustment period to either total

taxable use or total non-taxable use for an unbroken period of up to two years – i.e. the remainder of the adjustment period in which use was changed and the following adjustment period, a wash-up adjustment must be made at the end of the second adjustment period as follows:

(a) When the use changes to total non-taxable use, there is a claw-back, as output tax, of all the input tax on the supply that has previously been claimed, including adjustments made up to the end of the adjustment period in which the wash-up adjustment is made; and

(b) When the use changes to total taxable use, a full input tax deduction is allowed (including any input tax paid by the recipient of a zero-rated supply of land), reduced by input tax already claimed.

24. ***Rules are not set down for how to determine intended use or actual use, except for motor vehicles and land***. The general requirement is that the determination that is used "provides a fair and reasonable result". For motor vehicles and land:

(a) Motor vehicle log books used for income tax purposes can be used to determine both percentage intended use and percentage actual use of a motor vehicle;

(b) Special rules apply when the same area of land is used for making concurrent taxable and non-taxable supplies – see **paragraph 50** below.

25. ***These changes do not apply to goods and services acquired before 1 April 2011, subject to the following three exceptions***:

(a) The new rules apply to goods and services acquired before 1 April 2011 by a person who became GST registered on or after 1 April 2011. Input tax claims will be allowed under the new rules for the goods and services acquired pre-registration, including those that cost $5,000 or less, where:

(i) The person has been charged GST on the goods; or

(ii) GST has been charged on importation; or

(iii) The goods are secondhand goods that have either always been in New Zealand or have had GST charged on importation

Note that the rule that limits the input tax claim to the amount charged by the supplier when the supplier and the recipient are associated does not apply to imported or secondhand goods.

(b) The new rules apply to goods and services acquired or produced before 1 April 2011, by a person who is mandatorily required to be GST registered under section 51(1) (i.e. not voluntarily registered) who acquired or produced the goods and services for the principal purpose of making non-taxable supplies, but because of the changes to the definitions of "dwelling" and "commercial dwelling", the goods or services are treated as being used to make taxable supplies from 1 April 2011. However, as a result of amendments in the Employee Allowances Tax Act 2015:

(i) The goods and services will need to have been acquired after the introduction of GST – i.e. on or after 1 October 1986 and before 1 April 2011; and

(ii) Mandatory GST registration will not apply where the registration threshold is breached by aggregating unrelated taxable supplies with supplies of a "dwelling" or a "commercial dwelling" under the new definitions – see **paragraph 73** below.

(c) The new rules apply to goods and services acquired by a registered person before 1 April 2011 for which no input tax was deducted before 1 April 2011 and for which no adjustments were made or required to be made under the old rules before 1 April 2011.

26. ***The old rules continue to apply to all other goods and services acquired or produced before 1 April 2011***, but the number of adjustments that need be made are limited, based on market value or book value on 1 April 2011, subject to the "wash-up" rule discussed in paragraph 23 above. No adjustments can be made after 1 April 2011 for goods and services with a value of $5,000 or less. No adjustments need be made after 1 April 2013, for goods and services valued at between $5,000 and $10,000. For goods and services valued in excess of $10,000, no adjustments are required after 1 April 2016. Land is an exception: there is no limit to adjustments for land acquired before 1 April 2011, subject to the "wash-up" rule discussed in **paragraph 23** above.

4.1 Changes affecting recipients of supplies of services from non-residents

(Refer to pages 9 and 27 of the PDF attachment *The GST Apportionment Rules*)

27. The changes when services are acquired from a non-resident are:

(a) The intended use must be estimated; there is no longer any reference to a 12-month period before or after the taxable period in which the services are acquired.

(b) If intended exempt supplies exceed 5% (i.e. if taxable supplies are intended to be less than 95%), there is a deemed supply of the whole of the services acquired, and output tax is payable on the whole of the services acquired from a non-resident. A corresponding input tax deduction can be claimed only in relation to the percentage intended use to make taxable supplies. Previously a full input tax deduction could be claimed if the principal purpose was to make taxable supplies.

(c) The position is similar to making a one-off adjustment for non-taxable supplies at acquisition under the old rules. The option to spread the output tax adjustment, either period by period or annually, has been eliminated.

(d) If there is a deemed supply at acquisition, the required number of adjustment calculations, depending on the value of the services, must be made for all future adjustment periods.

(e) If there was no deemed supply at acquisition, adjustment calculations must still be done, to check that the percentage actual use to make taxable supplies remains at least 95%. Under the old rules there were no post-acquisition requirements.

(f) If the percentage actual taxable use determined at the end of an adjustment period falls below 95%, there is a deemed supply on the <u>last</u> day of the relevant adjustment period. A corresponding input tax deduction can be claimed for the percentage of actual taxable use, and the required number of further adjustments must be made.

28. These rules also apply, (as they did previously), to cost allocations by non-residents to NZ residents. It will be important to decide on a determination which best reflects the actual percentage taxable use.

4.2 Changes affecting providers of financial services

(Refer to pages 8 and 26 of the PDF attachment *The GST Apportionment Rules*)

29. The special rules that allow providers of financial services to zero-rate them still apply. The special input tax deduction for supplies from one financial services provider to another is also still available. These rules sit outside the framework of the new Apportionment Rules, as they relate to taxable periods, not adjustment periods.

30. As a result, registered persons who principally make supplies of financial services are given some latitude in choosing a method of apportionment. However, the method must be agreed with the Commissioner, and must have regard to the tenor of the apportionment rules.

31. A supplier of financial services will probably need to take the following actions when goods and services are acquired:

    (a) Identify persons with at least 75% taxable supplies, to whom financial services are supplied (there is no change here from the previous position).

    (b) Determine the proportion of financial services that can be zero-rated due to being supplied to such persons (there is no change here from the previous position).

    (c) Determine the percentage intended use to make taxable supplies (including supplies of zero-rated financial services) and claim an input tax deduction.

    (d) Make further adjustments as necessary under the apportionment rules.

32. If financial services are provided to another supplier of financial services, the rules in s. 20C must be followed to calculate the input tax deduction (there is no change here from the previous position).

33. Further adjustments may be necessary unless agreed otherwise with the Commissioner.

4.3 Mixed-use assets

(Refer to pages 12 and 29 of the PDF attachment *The GST Apportionment Rules*)

34. A special rule will apply to the determination of the input tax deduction available for mixed-use assets in the adjustment periods following acquisition. The rule applies to supplies that are not acquired solely for income-earning use, or solely for private use, based on the income tax definitions that are to apply to mixed-use assets from 1 April 2013 onwards. The GST rules will apply to supplies of mixed-use assets that are land or improvements to land from 17 July 2013 onwards, and to supplies of mixed-use assets that are boats and other watercraft and aircraft from 1 April 2014.

5. CHANGES AFFECTING LAND TRANSACTIONS

35. Refer to the PDF attachment *GST Land Transaction Rules* and pages 11, 20, 23, 24, and 28 of the PDF attachment *The GST Apportionment Rules* for a detailed comparison of the old and new rules. The changes apply to supplies made on or after 1 April 2011. However, if a binding agreement was entered into before that date, a supplier can choose to apply the old rules.

36. The practical implications of these changes are not easy to see. Both suppliers and recipients need to tread very carefully, when considering the GST implications of a land transaction.

5.1 Definition Of Land

(See page 3 of the PDF attachment *GST Land Transaction Rules*)

37. There is a definition of "land" in the GST Act that applies only for the purposes of the *zero-rating of land rules* (a defined term meaning specific provisions setting out the zero-rating of land rules and requirements). Under this definition, "land" includes a share in the share capital of a flat-owning or office-owning company, as defined in s. 121A of the *Land Transfer Act 1952*.

38. The application of this definition is limited to the zero-rating of land rules, and the nominated persons rules. The definition will not apply to determine what "land" is: for the purpose of deciding whether the number of adjustments are limited or unlimited, or in relation to applying the rule for the concurrent use of land to make taxable and non-taxable supplies (unless a contrary tax position has been taken before 29 August 2011, the date of assent of the *Tax Administration Act 2011*).

39. An assignment or surrender of an interest in land must be zero-rated, but only if the other requirements for zero-rating are met. In addition:

    (a) Effective from 30 June 2014, the supply of an interest in land by way of a procurement of a lease is a supply of land for zero-rating purposes (such as where a lease is not assigned, instead the vendor of a business procures a lessor to enter into a lease with the purchaser of the business); and

    (b) A standard commercial lease will not be zero-rated (where a contemporaneous or advance payment is less than 25% of the consideration, or where there is no contemporaneous or advance payment).

5.2 Zero-rated Supplies Of Land

(Refer to pages 4 to 7 of the PDF attachment *GST Land Transactions Rules*)

40. A supply that wholly or partly consists of land, by a registered person supplier, to a registered person recipient, must be zero-rated if:

    (a) The recipient intends to use the land to make taxable supplies; and

    (b) The recipient does not intend using the land as a "principal place of residence" (while this is a defined term, an amendment in the *Tax Administration Act 2011* means that the definition will not apply to the zero-rating rule; so for zero-rating purposes the term will take its ordinary meaning – i.e. essentially the recipient's main residence).

41. Services that are supplied as part of the supply of land must be zero-rated as well.

42. If the land is supplied to a person nominated by the other party to the contract, the person to whom the land is actually supplied (the nominated person) is treated as the recipient, for the purposes of the zero-rating of land rules.

43. The recipient must provide a written statement to the supplier stating that the two conditions for zero-rating (see **paragraph 40** above) will be met. However, where the supply is made to a nominated person, the written statement can be provided either by the nominated person or by the person who is the recipient under the contract for supply (the nominator), and in the latter case, the written statement must be based on the nominator's expectations of the nominated person's circumstances. An agent of an undisclosed principal must provide the written statement on behalf of the principal.

44. The recipient's GST registration number must be provided to the supplier by the settlement date. In the case of an unregistered agent of an undisclosed principal, the agent can provide the agent's tax file number instead. In that case, the supplier needs to maintain a record of the agent's tax file number.

45. The zero-rating rule also applies to mortgagee sales, if the mortgagor would have zero-rated the supply.

46. A supplier has no further obligations after a zero-rated supply is made. If a supply is incorrectly zero-rated, it is the recipient who must make the corrections. The recipient is treated as the supplier, and must account for output GST.

47. Under the apportionment rules, the recipient must calculate the GST that would have been charged if GST had been added to the consideration (i.e. 15% of the consideration - referred to as the "nominal GST component"). The nominal GST component must be calculated on the entire zero-rated supply, including any services supplied as part of that supply.

48. Output tax is payable on acquisition, by the recipient of a zero-rated supply of land, equal to the proportion of the nominal GST component that relates to non-taxable use. Further adjustments must be made for any changes in non-taxable use.

49. A purchaser must treat an incorrectly zero-rated supply as a supply to itself and output tax must be paid. A corresponding input tax credit will be available if the purchaser is a registered person and the land was acquired to make taxable supplies.

5.3 Concurrent Use Of Land

(Refer to page 14 of the PDF attachment *GST Land Transactions Rules*)

50. The method for determining the "percentage actual (taxable) use" of the same area of land that is simultaneously used to make concurrent taxable and non-taxable supplies is specified in the apportionment rules. It involves calculating "taxable use" as a percentage of "total use". For this purpose, the market value of the land (or if the land is sold in the adjustment period, the price paid) is treated as a proxy for "taxable use". "Total use" is the market value of the land plus rent – either the actual rent charged, or imputed rent at market value.

51. An additional adjustment downwards of "percentage actual use" is required when there are whole months of non-taxable use.

52. The extended definition of "land" in s. 2 does not apply to this rule under an amendment contained in the *Tax Administration Act 2011*.

53. Effective from 2 November 2012, concurrent use of land means the simultaneous use of the same area of land for making concurrent taxable and non-taxable supplies. Therefore, this rule will not apply when land is used for both taxable and non-taxable purposes, but that use either relates to different parts of the land or is not simultaneous.

5.4 Separate Supply Of Residential Accommodation

(Refer to pages 20 to 21 of the PDF attachment *GST Land Transactions Rules*)

54. Where any of the following supplies are included in a supply, they are deemed to be a separate supply from any other real property that is included in the supply:

(a) A supply of a principal place of residence (as that phrase is ordinarily interpreted – its meaning is not limited to the definition of the phrase in s. 2 of the GST Act);

(b) The supply, by way of sale, by a registered person in the course or furtherance of any taxable activity of:

(i) Any dwelling (under the new definition, which requires it to be a principal place of residence – see **paragraph 65** onwards below) or

(ii) The reversionary interest in the fee simple estate of any leasehold land,

Providing that for at least 5 years prior to the sale the registered person supplier has used the dwelling exclusively for making supplies of residential accommodation, or the leasehold land has been used for the principal purpose of accommodation in a dwelling erected on the land.

55. Where a registered person has claimed an input tax deduction on the supply of a dwelling, any subsequent supply of "the dwelling" or land that has ceased to be enjoyed with the dwelling will be a taxable supply, under s. 5(16).

6. SUPPLIES INVOLVING MORE THAN TWO PERSONS

56. From 1 April 2011, specific rules apply where a supplier enters into a contract to supply goods and services to a recipient, and the recipient (the nominator) directs the supplier to provide the goods and services to a third person ("the nominated person").

57. The GST consequences depend on:

(a) Who pays for the supply; and

(b) Whether the supply consists, wholly or partly, of land.

58. A supply that consists wholly or partly of land, as defined in s. 2, is always treated as having been made to the nominated person.

59. For other supplies:

(a) If the recipient pays for the supply, the supply is treated as having been made to the recipient.

(b) If the nominated person pays for the supply, the supply is treated as having been made to the nominated person.

(c) If the recipient and the nominated person each pay for part of the supply, the supply is treated as having been made to the recipient, unless the recipient and the nominated person agree in writing that the supply is made to the nominated person. No such agreement can be made if the recipient has claimed input tax on the supply.

60. The rule that required a supply to be treated as made to the nominated person if the registration status of the nominator and the nominee was different (one registered and the other not registered) has been repealed. The change does not apply if a contrary tax position relating to an input tax deduction had been taken in the period between 1 April 2011 and 14 September 2011 (the date of introduction of the Bill that preceded the Annual Rates Tax Act 2012).

61. The agency provisions override these rules. If the recipient, or the nominated person, is acting as an agent for someone else (the "principal"), the supply is treated as having been made to the principal. However, a new rule that applies from 17 July 2013 allows a principal and agent who are both registered persons to opt-out of the agency provisions – see **paragraph 159** below.

62. If a supply of land to a nominated person is to be zero-rated under s. 11(1)(mb), either the nominated person must provide the required statement in writing to the supplier, or the recipient of the supply under the contract (the nominator) must provide the required statement in writing, on behalf of the nominated person, based on the recipient's expectations of the nominated person's circumstances. If the supply of land is to an agent, the agent must supply the statement in writing on behalf of the principal.

63. Further, for zero-rated supplies of land, the nominated person's GST registration number, or in the case of an agent of an undisclosed principal the agent's GST registration number, must be provided to the supplier by the settlement date. If an unregistered agent is acting on behalf of an undisclosed principal, the agent can simply provide the agent's tax file number to the supplier by the settlement date.

64. Another new rule that applies to supplies of land limits the input tax that can be claimed to the total output tax paid, where a supply wholly or partly consists of land, and is part of an arrangement involving more than two associated parties and more than one supply.

7. SUPPLY OF ACCOMMODATION IN A DWELLING

65. The definition of a "dwelling" that applies to supplies made on or after 1 April 2011 is significantly different from the previous definition. (Refer to pages 15 to 21 of the attached PDF *GST Land Transaction Rules*.) The new definition of dwelling requires it to be a "principal place of residence" as defined in the GST Act. The previous definition referred to "used predominantly as a place of residence".

66. "Principal place of residence" is defined in the GST Act as meaning a place that a person occupies as their main residence, for the period to which the agreement for the supply of accommodation relates.

67. The definition of dwelling is probably most relevant to distinguishing exempt supplies of residential accommodation from taxable supplies. The new definition results in a much stricter (narrower) approach to determining residential accommodation that is an exempt supply.

68. As noted in **paragraph 54** above, the supply of a principal place of residence must be treated as a separate supply from the supply of any other land included in a bundle of supplies. The supply of a dwelling that is an exempt supply (because the supplier has used it exclusively to provide residential accommodation for at least 5 years prior to sale) must also be treated as a separate supply.

69. The definition of a "commercial dwelling" has also changed effective from 1 April 2011. A commercial dwelling specifically includes serviced apartments.

70. A recent amendment to the "dwelling" definition has clarified that accommodation in retirement villages and residential rest homes will continue to be treated as "dwellings" for GST purposes. The requirement in the new definition of "dwelling" that "the person has quiet

enjoyment, as that term is used in s. 38 of the *Residential Tenancies Act 1986*" had raised concerns regarding whether accommodation in a retirement village or a residential rest home would continue to be regarded as a "dwelling" for GST purposes. A new paragraph (b)(iii) has been inserted into the "dwelling" definition which provides that despite the requirement for quiet enjoyment, a residential unit in a retirement village or rest home when the consideration paid or payable for the supply of accommodation in the unit is for the right to occupy the unit is a "dwelling" for GST purposes.

71. A corresponding exclusion from the definition of "commercial dwelling" provides that a "dwelling" under paragraph (b)(iii) of the dwelling definition is excluded from being a commercial dwelling.

72. Despite the change, taxpayers who had previously interpreted the rules as requiring the supply of dwellings in retirement villages as taxable supplies could irrevocably choose to either:

    (a) Continue to treat the supplies as taxable supplies in their GST returns for a period starting before 1 April 2015; or

    (b) Change to treating the supplies as exempt supplies, and make appropriate adjustments under the apportionment rules, but they will not be required to apply the mandatory one-off "wash-up" adjustment discussed in **paragraph 23** above.

73. An input tax deduction is available, to persons who are required to be registered (i.e. not voluntarily registered), for a supply that was treated as exempt when they acquired it, but which is now a taxable supply due to the changes in the definitions of "dwelling" and "commercial dwelling". However, two changes have been made in connection with this rule:

    (a) First, in order to claim input tax deductions the goods or services affected by the changed definitions of "dwelling" and "commercial dwelling" need to have been acquired after the introduction of GST – i.e. on or after 1 October 1986 and before 1 April 2011. This restriction on input tax deductions applies to tax positions taken after 22 November 2013, the date of introduction of the Bill that preceded the Employee Allowances Tax Act 2014.

    (b) Second, persons who have some other activity with a turnover below the registration threshold, who are pushed over the registration threshold due to the changed definitions of "dwelling" and "commercial dwelling" may choose not to treat a supply of accommodation in a dwelling affected by the amendments as a taxable supply, providing the new supplies by themselves did not exceed the $60,000 threshold. This could apply if either:

        (i) Other potentially taxable supplies were previously made below the $60,000 threshold and the newly taxable supplies caused total taxable supplies to exceed the threshold; or

        (ii) The person was already previously GST-registered and had to include the newly taxable supplies as part of the GST registration, although the newly taxable supplies were, by themselves, lower than the $60,000 threshold.

8. NON-PROFIT BODIES

74. Section 20(3K) is a special rule that allows non-profit bodies input tax deductions on all goods and services other than those used to make exempt supplies. The apportionment rules, however, allow input tax deductions only for goods and services actually used to make

taxable supplies. Therefore, some uncertainty has arisen regarding the application of the rule in s. 20(3K).

75. Effective from 1 April 2011, an amendment to s. 20(3K) in s. 190(1) of the Employee Allowances Tax Act makes the concession in s. 20(3K) effective in relation to the definitions of "percentage actual use" and "percentage intended use" in the apportionment rules. Therefore, goods and services used by non-profit bodies will be treated as used to make taxable supplies, unless they are used to make exempt supplies.

76. From 1 April 2014, the input tax deduction available under s. 20(3K) to non-profit bodies will be limited to non-profit bodies that are resident in New Zealand. This amendment is because non-residents can register and recover GST based on taxable activities outside New Zealand from 1 April 2014.

77. An additional concession applies, from 21 December 2010, to a non-profit body that accounts for tax payable on a payments, or on a hybrid, basis. The supply of goods and services, for a consideration of more than $225,000, can be made without having to account for the tax payable on an invoice basis, provided that:

    (a) The recipient is not a registered person; and

    (b) The recipient does not intend using the goods and services to carry on a taxable activity, or intends to do so only after full consideration for the supply is paid.

9. MIXED-USE ASSETS

(Refer to the PDF attachment *The GST Mixed-use Assets Rules*)

78. The Assets Expenditure Tax Act enacted on 17 July 2013 contains the GST rules that apply to mixed-use assets. The rules need to be read in conjunction with the income tax rules in new subpart DG of the *Income Tax Act 2007*. The details of the rules are set out in the PDF attachment *The GST Mixed-Use Assets Rules*.

9.1 What is a mixed-use asset

79. The assets involved (including related items, accessories etc.) are of 3 types:

    (a) Land, including improvements to land, whatever the cost;

    (b) Ships, boats or crafts used in navigation on or under water with a cost or initial market value of $50,000 or more; and

    (c) Aircraft with a cost or initial market value of $50,000 or more.

80. The "mixed-use" refers to the fact that:

    (a) The asset must be used: defined as "active use for its intended purpose; and

    (b) The use, in the income year, must be "mixed":

        (i) It must be used partly to derive income; and

        (ii) Part of the use must be 'private use' – as defined; and

        (iii) There must be a period of non-use of at least 62 days in the income year (or 62 working days if the asset is typically used only on working days).

81. There are some specified exclusions, notably residential properties, where the only income-earning use is as a long-term residential property.

82. Also, the rules do not apply to a company, other than a 'close company' as defined (refer to page 5 of the attached PDF).

9.2 Application dates of GST rules

83. The GST rules:

    (a) Apply to supplies made, on or after 1 April 2014, of boats and aircraft and related goods; and

    (b) Apply to supplies of land or improvements to land from 17 July 2013 - the date of assent of the Assets Expenditure Tax Act – although the income tax changes took effect from the 2013-14 income year.

84. This means if a person purchased a bach in 2012 and has apportioned their input tax claims under the existing rules, the mixed-use asset rules would not apply to that bach, but would apply to goods and services (such as rates, insurance and furnishings) acquired after the rules were enacted.

9.3 Interaction with the income tax exemptions

85. Submitters on the Bill that introduced the legislation were of the view that the GST apportionment rules should not apply when a person takes advantage of the exemption option for income tax purposes.

86. However, officials' views were that most people that qualify for the income tax exemption will do so because they derive significantly less than $60,000 a year in income from the asset. Therefore, if GST has to be charged on a supply when the turnover from the asset is less than $60,000 per annum, the person is voluntarily registered, or has deliberately included the asset in the same structure as a larger taxable activity, or is self-employed and owns the asset in their personal name.

87. Therefore, the GST rules will apply even where the income may be exempt for income tax purposes. This also has implication for the apportionment formula, as discussed in **paragraph 88** onwards below.

9.4 Apportionment formula

88. The apportionment formula requires expenditure on a mixed-use asset to be divided into 3 categories:

    (a) Expenditure on which a full input tax deduction will be available: this will be expenditure related solely to the income-earning use of the asset, from which no personal benefit could reasonably be expected, or that is required to meet a regulatory requirement for use in deriving income, and excluding any repairs and maintenance expenditure.

    (b) Expenditure on which no input tax deduction will be available: this will be expenditure related solely to the private use of the asset by the person who owns, leases, licenses or otherwise has the asset or by a person associated with them (regardless of any income derived), or any use where the income derived from that use is less than 80% of the

market value amount (meaning the arm's length price in the open market, as defined in s. DG 3(5) of the *Income Tax Act 2007*).

(c) Mixed-use expenditure: which will be all other expenditure including expenditure on acquiring the asset and repairs and maintenance expenditure (referred to from here on as "mixed-use expenditure").

89. Input tax on the first two categories of expenditure listed above is not apportioned under the GST formula applying to mixed-use assets in new s. 20G(1).

90. For a registered person, all income, including income derived from "private use" where the income is less than 80% of market value, will give rise to a GST output tax liability. The question is whether input tax on expenditure related solely to the "private use" will be fully deductible under the "general" GST input tax rules. For example, if an asset is being used privately where the income derived is 60% of market value, and there is a major accident resulting purely from that private use, the input tax relating to the resulting expenditure on repairs would conceivably be fully deductible under the "general" input tax rules.

91. The input tax deduction for "mixed-use expenditure" is calculated based on the proportion of "income-earning days" to "income-earning plus private days":

(Input tax on asset) x (income-earning days)/(income-earning days + private days)

92. The actual period of non-use is immaterial. It is only the periods of use – income earning or private use – that are relevant. Also, while the formula refers to "days" as the measurement yardstick but some other unit of measurement, such as hours, or nights, or anything else, can be used if that provides a fair and reasonable result.

93. "Income-earning days" is the total number of days in the period on which the person supplies the asset for use and derives a consideration for the supply, whether at, above, or below *market value* as that term is defined in s. DG 3(5) of the *Income Tax Act 2007*. It also includes:

(a) Any days treated as "income-earning" for income tax purposes;

(b) Days the asset is unavailable for use because someone else reserved it; and

(c) Days on which an FBT liability arises.

94. It is noted in *Tax Information Bulletin Vol. 25 No. 9 (October 2013)* on page 21 that:

"It is important to note that, if the owner supplies the asset to an associated person, s. 10(3) will generally require them to treat the supply as being made at market value. This will require output tax to be paid on the supply, but it will also be treated as "income-earning" for the purposes of calculating entitlement to input tax deductions. Similarly, if the supply is a fringe benefit, s. 21I will apply to deem consideration to have been received – this will also be an income-earning day."

95. "Private days" will be all other days when the asset is used that are not "income-earning days".

9.5 What happens at acquisition

96. For an acquisition that is not zero-rated under s. 11(1)(mb), the "standard" apportionment rules in s. 20(3G) and s. 20(3H) will apply:

    (a) Under s. 20(3G), a person must estimate at the time of acquisition how they intend to use the goods or services, choosing a determination method that provides a fair and reasonable result; and

    (b) The determination must be expressed as a percentage of the total use; that percentage then becomes the "*percentage intended use*" under s. 21G(1)(b) – (note that the definition of "percentage intended use" in s. 21G has been extended to apply to the mixed-use formula in s. 20G, therefore, the percentage intended use will be based on the result that the formula in s. 20G would produce; and

    (c) The input tax deduction must be determined based on the percentage intended use using the formula in s. 20(3H):

        (i) (Full input tax deduction) x (percentage intended use)

        (ii) Full input tax deduction is, under s. 20(3I), the total amount of input tax on the supply.

97. The input tax deduction upon acquisition, for a zero-rated supply of a mixed-use asset that includes land to which s. 20G applies, must be determined under s. 20(3JB)(a)(i) (the wording in that section is identical to the wording in s. 20(3J)(a)(i)):

    (a) The purchaser must, at the time of acquisition, identify the nominal amount of tax that would be chargeable on the value of the supply, as if the value were equal to the consideration charged for the supply, at the rate set out in s. 8(1) – (note that this is referred to in s. 20(3J)(a)(i) as the nominal GST component) – this will be 15% multiplied by the acquisition price (based on *Example 4* on page 35 of *Tax Information Bulletin Vol. 23 No. 1 (February 2011)* in which s. 20(3J) is explained;

    (b) The purchaser must then, under s. 20(3G), estimate at the time of acquisition how they intend to use the goods or services, choosing a determination method that provides a fair and reasonable result; the determination is expressed as a percentage of the total use: the *percentage intended use* as defined in s. 21G(1)(b); the percentage intended use will be based on the result that the formula in s. 20G would produce;

    (c) The purchaser must then account for output tax under s. 20(4) for the proportion of the nominal GST component for any non-taxable use of the goods and services, under s. 20(3J)(a)(iii).

98. Despite officials agreeing that the relationship between s. 20G and s. 20(3J) should be clarified, unfortunately, there has been no clarification other than the insertion of paragraph (a)(i) in s. 20(3JB), which appears to require input tax to be calculated as the nominal GST component in s. 20(3J)(a)(i). (Section 20(3JB)(a)(iii) refers to "account for input tax", and not "account for output tax" as in s. 20(3J)(a)(iii).)

9.6 Post-acquisition adjustments

99. Post-acquisition, new s. 20(3JB)(b) requires adjustments to be made under proposed new s. 20G(4) and (5). An amendment to s. 20(3J)(b) requires the post-acquisition adjustments to be made under s. 20G for the taxable supply of a zero-rated mixed-use asset.

100. The general rules for determining the first and subsequent adjustment periods and the number of adjustment periods will apply.

101. At the end of an adjustment period, a person must ascertain whether an adjustment is required to be made for any difference between the supply of the asset for the period and the actual use of the asset for making taxable supplies.

102. If an adjustment is required:

    (a) The person must calculate the percentage actual use under the apportionment formula in s. 20G(1) as set out in paragraph 16 above;

    (b) Compare the percentage actual use with the percentage intended use or previous actual use, as applicable; and

    (c) Make an adjustment for any percentage difference under s. 21D(3):

        (i) If the percentage difference is positive – i.e. the actual use exceeds the intended use or previous actual use, claim an additional deduction under s. 20(3)(e); or

        (ii) If the percentage difference is negative – i.e. the actual use is less than the intended use or previous actual use, pay output tax equal to the difference under s. 21A.

103. For the purpose of the post-acquisition adjustment calculation under s. 20G(5), all expenditure on the mixed-use asset is aggregated and included in the adjustment. The de minimis rules in s. 21(2)(c) and (d) – under which differences of less than 10% are ignored if the adjustment would not exceed $1,000 - apply to the aggregated amount: not to individual items of expenditure.

9.7 Inland Revenue example of GST adjustment for mixed-use assets

104. Inland Revenue has posted an example of "GST adjustment for mixed-use assets" on its website.

105. The example has been also set out on pages 17-18 of the PDF attachment *The GST Mixed-use Assets Rules*.

9.8 Other apportionment adjustments: disposals and pre-registration acquisitions

106. When a mixed-use asset is disposed of, s. 20G(7) states that s. 8 and 21F apply to the disposal of the asset, treating the disposal as in the course or furtherance of a taxable activity.

107. Refer to the separate PDF attachment *The GST Apportionment Rules*, pages 20 – 21 for the details. In summary:

    (a) If the goods or services were not acquired as part of a supply that was zero-rated under s. 11(1)(mb), a final input tax adjustment is made to compensate for the proportion of the output tax on disposal that corresponds to the input tax not claimed as a deduction; and

    (b) If the goods or services were acquired as part of a supply that was zero-rated under s. 11(1)(mb), a final input tax adjustment is made to compensate for the proportion of the output tax on disposal that corresponds to the input tax not claimed based on the previous actual use of the asset in the adjustment period before the period in which the disposal occurs.

108. The rules on pre-registration acquisitions have been amended to accommodate the mixed-use assets rules. An amendment to s. 21B(2) requires the post-registration adjustment to be made under the rules in s. 20G, with the first adjustment period starting on the date of acquisition and ending on the first balance date after use of the goods or services to make taxable supplies.

9.9 Application of the GST apportionment rules depends on a number of variables

109. The application of the GST apportionment rules to mixed-use assets will depend on a number of variables, including:

    (a) Whether the asset was acquired pre- or post-1 April 2011 (to determine the application of the transitional rules in s. 21H – refer to the PDF attachment *The GST Apportionment Rules*, page 33).

    (b) Whether the asset was previously exempt but is now taxable due to changes to the definitions of "dwelling" and "commercial dwelling" (to determine if s. 21HB applies – refer to the PDF attachment *GST Land Transactions Rules*, pages 18-19).

    (c) Whether the supply of the asset was zero-rated under s. 11(1)(mb) (refer to the PDF attachment *GST Land Transactions Rules*, pages 4-7).

    (d) Precisely what expenditure corresponds to mixed-use of the asset.

    (e) The details of the mixed-use assets rules themselves.

10. NON-RESIDENTS' ABILITY TO CLAIM INPUT TAX DEDUCTIONS

110. The Assets Expenditure Tax Act contains new GST rules to allow certain non-resident businesses to register for GST and claim input tax deductions for GST incurred on approximately the same basis as a resident registered person. The rules apply from 1 April 2014. Sections 194 and 195 of the Employee Allowances Tax Act also contain some minor remedial amendments.

10.1 The new GST grouping rules

111. The rules as enacted, following the review by the Finance and Expenditure Committee, are substantially different in some respects from the rules that were initially proposed. The most significant alteration from the rules as initially proposed is that cross-border groups will be allowed. In the rules as originally proposed, non-residents registered under proposed section 54B would only be able to group-register with other companies registered under that section (in other words, form wholly non-resident groups).

112. Officials' concern, as stated in pages 103-104 of the *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* ("the Officials' Report") was that:

    "If cross-border groups were allowed, when a representative member filed a GST return on behalf of the group, it would be possible for what are effectively GST refunds to non-residents to be masked by the activities of a broader group that included New Zealand residents. Grouping with a New Zealand resident could also be used by non-residents as a method of accounting for GST on an invoice basis – a basis that is more susceptible to fraud because GST refunds are provided on invoices issued, rather than cash paid."

113. Officials accepted that there are sometimes legitimate reasons for forming cross-border groups and recommended that:

   (a) Only non-residents that make *no* taxable supplies in New Zealand can register for GST under new s. 54B – the requirement now contained in s. 54B(1)(d)(i) is that the non-resident person is not carrying on a taxable activity in New Zealand, or intending to carry on a taxable activity in New Zealand; and

   (b) Non-residents that make taxable supplies in New Zealand under the compulsory registration threshold would not be able to use s. 54B but would be able to voluntarily register under the existing registration provisions. This voluntary registration option would also apply to a non-resident that either did or did not make taxable supplies and wished to form a group with companies that made taxable supplies: new s. 54B(1)(d)(ii) provides that the non-resident person is not, and does not intend to become, a member of a group of companies that is carrying on a taxable activity in New Zealand; and

   (c) If a non-resident registered under section 54B starts making taxable supplies, they will be treated as being registered under the existing domestic rules: new s. 54B(2) provides that if a non-resident person who is registered under s. 54B starts making taxable supplies, or becomes a member of a group of companies that is making taxable supplies, they are treated as:

      (i) Registered on the date specified by the Commissioner under s. 54B(1); and

      (ii) Not being registered under s. 54B from the date on which they start making taxable supplies, or the date on which they join the group, as applicable.

114. It is stated in the Officials' Report that:

   "This would give a non-resident the option of either registering under section 54B or joining a group with a New Zealand resident and that group would be subject to the standard rules. The advantage of this solution is that non-residents that chose to group-register with a New Zealand company would have to show that any input deductions claimed were linked to taxable supplies made in New Zealand (rather than their worldwide business) in order to access refunds. This is consistent with the current situation and officials do not consider there is a significant revenue risk attached to it. On the flip side, the solution still allows non-residents in a pure refund position to register under the proposed rules and claim input deductions based on their worldwide supplies."

10.2 The new timing rules for entry and exit

115. Consistent with the new distinction between non-residents who can register under the new rules and those who cannot (due to making taxable supplies in New Zealand or are part of a New Zealand group of companies), s. 54B(3) states that for timing purposes, the following days are treated as the end of a taxable period:

   (a) The day on which a non-resident person ceases to be eligible to be registered under s. 54B; and

   (b) The day on which a non-resident person who is otherwise registered becomes registered under s. 54B.

10.3 The new GST registration requirements for non-residents

116. The complete new rules for GST registration of non-residents in s. 54B are that the Commissioner may register a non-resident who has not become liable to be registered under s. 51(1) if the Commissioner is satisfied that then person meets the following requirements:

    (a) The non-resident is registered for a consumption tax in their country of residence, or if that country does not have a consumption tax, *or has a consumption tax that does not apply to the non-resident person's activities, the non-resident has a level of activity in a country or territory* that would render them liable to be registered in New Zealand under s. 51(1) if they were carrying out the taxable activity in New Zealand (because the value of their supplies would exceed the registration threshold); and

    (b) The amount of the non-resident's input tax for the first taxable period after the date of registration in New Zealand is likely to be more than $500; and

    (c) The non-resident's taxable activity does not involve a *performance* of services in relation to which it is reasonably foreseeable that the *performance* of the services will be received in New Zealand by a person who is not GST-registered; and

    (d) The non-resident:

        (i) Is not carrying on a taxable activity in New Zealand, or intending to carry on a taxable activity in New Zealand; and

        (ii) Is not, and does not intend to become, a member of a group of companies that is carrying on a taxable activity in New Zealand.

117. In relation to the requirement referred to in paragraph 116(a) above, officials agreed with a submission that the person may live in a jurisdiction that has a consumption tax, but not be required to register for that tax because their activities are outside the tax base. Therefore, officials considered the wording should be amended so that a non-resident can register in New Zealand if their country of residence has a consumption tax that does not apply to their activities, but they have a level of activity that would render them liable to be registered in New Zealand.

10.4 The new rules for cancellation of GST registration

118. The new rules for cancellation of a non-resident's registration are contained in s. 54C, which provides that the existing cancellation rules in s. 52 apply to the cancellation of a non-resident's registration under s. 54B, as modified by s. 54C. Under s. 52(5) and s. 52(5A), the Commissioner may, even if not notified, cancel the person's registration:

    (a) From the last day of the taxable period in which he is satisfied that all taxable activities have ceased [s. 52(5)]; or

    (b) From the date of the person's registration if he is satisfied that no taxable activities were in fact carried on [s. 52(5A)].

119. The existing rule in s. 52(7) that the 'taxable activities' referred to in s. 52(5) and 52(5A) are taxable activities carried on in New Zealand is to apply only to non-resident persons who are not registered under the new s. 54B. Therefore, non-residents who are registered under s. 54B will not be required to de-register if taxable activities are not carried on in New Zealand.

120. Section 54C expands on the Commissioner's powers to cancel registration under s. 52(5) and 52(5A). The Commissioner may cancel a non-resident's registration if:

    (a) The Commissioner is satisfied that the non-resident no longer meets the requirement in s. 54B(1)(a) - that the non-resident is registered for a consumption tax in their country of residence, or if that country does not have a consumption tax, *or has a consumption tax that does not apply to the non-resident person's activities, the non-resident has a level of activity in a country or territory* that would render them liable to be registered in New Zealand under s. 51(1) if they were carrying out the taxable activity in New Zealand (because the value of their supplies would exceed the registration threshold); or

    (b) The non-resident has not filed a return or has filed late returns for 3 consecutive taxable periods, in which case:

        (i) The cancellation date is the last day of the second period (as amended in s. 195(1) of the Employee Allowances Tax Act); and

        (ii) The non-resident and associated persons will be barred from becoming GST-registered again under s. 54B (as amended in s. 195(2) of the Employee Allowances Tax Act) for at least 5 years from the date of cancellation.

121. The requirement in the rules as originally introduced that a New Zealand registered person who becomes non-resident be deregistered if the requirements of s. 54B(1) are not met after becoming non-resident has been removed.

122. When a non-resident ceases to be a registered person, new s. 5(3B) states that:

    (a) Goods that are part of the assets of the non-resident's taxable activity, that are present in New Zealand at the time the non-resident ceases to be registered, are treated as supplied by the non-resident in the course of the taxable activity immediately before the cessation of registration; and

    (b) Services that would be *performed* in New Zealand as part of the non-resident's taxable activity, at the time the non-resident ceases to be registered, are treated as *performed* by the non-resident in the course of the taxable activity immediately before the cessation of registration. (The rules as originally introduced referred to a "supply" of services.)

123. It is stated in the Officials' Report that s. 5(3B) is intended to be concessionary. Without it, officials consider there is an argument that a non-resident that registered for GST and the deregistered would need to account for output tax on the value of its worldwide assets. Therefore, the purpose of s. 5(3B) is to limit New Zealand's taxing right to goods and services that logically form part of the non-resident's New Zealand activities (if there are any). However, officials considered that output tax on services that have already been supplied in accordance with the time of supply rules should be returned, even though the non-resident will only be registered on a payments basis. The services caught by this provision should be the services performed in New Zealand prior to deregistration.

124. The market value rule in s. 10(7A) – that the consideration for the supply is treated as being the open market value of the supply - applies to supplies treated as made under s. 5(3B).

10.5 The new rules for non-residents claiming deductions

125. Under new s. 20(3L), *a non-resident person who is registered under s. 54B* may deduct input tax to the extent to which the goods or services are used for, or are available for use in,

making taxable supplies, *treating all supplies made by the person as if they were made and received in New Zealand*.

126. This rule means that if a non-resident makes supplies that would be exempt supplies if made in New Zealand, input tax cannot be deducted to the extent that such supplies are made.

127. However, a concession has been introduced for suppliers of financial services. Under new s. 20(3M), a non-resident person who is registered under s. 54B and who principally makes supplies of financial services may, for the purposes of calculating the amount of input tax, choose to use a fair and reasonable method of apportionment agreed with the Commissioner as set out in existing s. 20(3E) – in other words, the same rule that applies to New Zealand resident suppliers of financial services.

10.6 The GST accounting basis for non-residents

128. New s. 19(1B) states that a non-resident person who is registered under s. 54B must account for tax payable on a payments basis. New s. 19A(1)(iv) requires the Commissioner to direct a non-resident person to account for tax payable on a payments basis.

129. It is stated on page 45 of the *Commentary* on the Bill at the time it was introduced that this rule "is designed to limit the possibility of a non-resident claiming a refund on the basis of invoices provided by registered residents on which no payment is made and, therefore, no GST is paid". Note, however, that this will only apply to non-residents registered under s. 54B, and not to non-residents making taxable supplies in New Zealand or who are registered as part of a group of companies.

130. *For a non-resident person who is registered under s. 54B* (amendment proposed in clause 170 of the November 2013 Tax Bill), new s. 46(1B) extends the period from 15 days to 90 days after the non-resident's GST return was received by the Commissioner for the purposes of:
    (a) Refunds to be paid by the Commissioner;
    (b) The period within which the Commissioner must give a request for information concerning a return; and
    (c) The period within which the Commissioner must give notice of an intention to investigate the return or withhold payment.

131. It is stated in the Officials' Report that:

    "Officials consider the 90-day period to be appropriate. There is an increased fraud risk associated with providing refunds to non-residents. This risk exists because, unlike residents, Inland Revenue has limited ability to accurately track down and recover money from non-residents when a refund is released in error.

    Having a longer timeframe for releasing refunds is considered preferable to having a shorter timeframe that the Commissioner may be more inclined to extend if doubts exist over the legitimacy of a claim. Officials consider that 90 days is a more realistic timeframe to allow the Commissioner to adopt a considered opinion on whether a refund will be released."

132. A related change to s. 120C of the *Tax Administration Act 1994* will mean that use of money interest on GST refunds to a non-resident will not start from 15 days after a non-resident provides a GST return.

133. There are no special rules for taxable periods for non-residents, so the usual rules will apply.

10.7 Zero-rating of certain goods supplied to an unregistered non-resident

134. New s. 11(1)(p) provides for goods supplied to an unregistered non-resident recipient to be zero-rated if those goods are: jigs, patterns, templates, dies, punches, and similar machine tools to be used in New Zealand solely to manufacture goods that will be for export from New Zealand.

135. Officials declined a submission that the start date of this rule be brought forward from 1 April 2014 on the basis that:

    "Officials consider these changes form a package of cross-border initiatives with the proposed registration system for non-residents mentioned above. For that reason, it is considered desirable for both rules to be effective from the same date."

10.8 Non-resident registrants claiming GST on importation

136. An amendment in the Employee Allowances Tax Act 2014 addresses officials concern with a potential fiscal risk whereby the new rules that enabled non-residents to register for GST would allow them to sell high-value goods to New Zealand private consumers without the net imposition of GST.

137. This would happen if the non-resident was the importer of the goods so that the non-resident is liable for the GST on importation. The non-resident would then be able to claim an input tax deduction for the GST paid on importation. However, there would be no corresponding output tax liability because the goods were offshore at the time of supply.

138. Effective from 1 April 2014, the date on which the non-resident registration rules came into force, new sections 20(3LB) and (3LC) limit the ability of GST-registered non-residents to claim input tax deductions for GST paid on importation. When the non-resident acts as importer, the New Zealand recipient of the good will be treated as if they had paid the GST and will be entitled to an input tax deduction if the good is imported as part of a taxable activity.

139. The new sections will not apply if the non-resident is the actual recipient of the good, unless the non-resident is merely delivering the good to another person in New Zealand.

11. MISCELLANOEUS RECENTLY ENACTED CHANGES: 2012 - 2014

140. Apart from the enacted changes relating to the apportionment rules, the land transactions rules, changes relating to the supply of accommodation in a dwelling (including dwellings in retirement villages), supplies involving nominated persons, rules affecting non-profit bodies, mixed-use assets rules and registration rules for non-residents, all of which have been discussed earlier in this section, there a number of other miscellaneous changes that have been enacted in recent years.

141. There were four other changes enacted in the Annual Rates Tax Act 2012:

    (a) Late payment fees subject to GST (discussed at **11.1** below);

    (b) Liquidators and receivers cannot change from a payments basis to an invoice basis (discussed at **11.2** below);

(c) Payment from a foreign insurer for loss in the course of a taxable activity is not consideration for a supply of taxable services (discussed at **11.3** below);

(d) LTCs can be part of a GST group (discussed at **11.4** below).

142. There were four other changes enacted in the Assets Expenditure Tax Act 2013:

(a) Participation in a prize competition is a supply of services (discussed at **11.5** below);

(b) Opt-out provision to the agency rules (discussed at **11.6** below);

(c) GST records kept offshore by an Inland Revenue-approved data storage provider (discussed at **11.7** below);

(d) Change of accounting basis for certain local authorities (discussed at **11.8** below).

143. The Employee Allowances Tax Act 2014 contained the following additional amendments:

(a) An amendment to ensure that agreements to hire that include an option to purchase will be treated as hire purchase agreements for GST purposes (discussed at **11.9** below);

(b) Amendments to the GST treatment of directors' fees, which are discussed in **section 13** below in conjunction with the draft (at the time of writing) ruling on GST on directors' fees;

(c) Amendments to allow services to non-residents to be more easily zero-rated by permitting a minor presence in New Zealand and by switching off the tax residence backdating rule, which are discussed in **section xx** below in conjunction with the Inland Revenue draft interpretation statement and issues paper on GST and immigration services released in 2012 and 2013 respectively.

11.1 Late Payment Fees Subject to GST

144. Sections 5(25) & (26) provide that an amount charged for the late payment of an account is treated as being consideration for a supply of services in the course or furtherance of a taxable activity, whether it is described as a fee, penalty, or other charge.

145. However, this rule does not apply to penalty or default interest, or a charge in the nature of penalty or default interest, imposed under a contract for the supply of goods and services, or under an enactment.

146. This rule generally applies for taxable periods ending on or after 1 April 2003. However, it does not apply to late payment fees charged on or before 31 December 2012 if, before 14 September 2011 – the date of introduction of the *Annual Rates Tax Bill* – a regular practice had been adopted of not charging GST on late payment fees.

11.2 Liquidators and Receivers Cannot Change From Payments to Invoice Basis

147. Section 19(3B) prevents a liquidator, receiver, or administrator of a registered person who accounts for tax payable on a payments basis to change to an invoice basis so as to claim input tax credits for supplies received for which no payment has been made.

148. The amendment applies to applications for a change to a registered person's accounting basis received on or after 2 November 2012, the date of assent of the Annual Rates Tax Act 2012.

11.3 Payment from a foreign insurer for loss in the course of a taxable activity

149. The general rule in s. 5(13) is that a payment received under the contract for a loss incurred in the course or furtherance of a taxable activity is deemed to be consideration received for a taxable supply of services.

150. Paragraph (c) to the proviso in s. 5(13) provides that where a supply of insurance services was subject to GST only because of the rule in s. 8(4B) on imported services (i.e. insurance services acquired from a non-resident and applied less than 95% towards a taxable activity), a payment received under the contract for a loss incurred in the course or furtherance of a taxable activity will not be deemed to be consideration received for a taxable supply of services.

151. The corresponding general rule in s. 20(3)(d) is that the tax fraction of a payment made by a registered person pursuant to a contract of insurance may be deducted as input tax.

152. A corresponding insertion as s. 20(3)(d)(vi) provides that the tax fraction of any payment made pursuant to a contract of insurance cannot be deducted as input tax if the supplier of the contract of insurance was not required to account for output tax on the supply.

11.4 LTCs can be part of a GST group

153. The GST grouping rules were amended so as to include company groups that contain one or more LTCs.

11.5 Participation in a prize competition is a supply of services

154. Effective from 17 July 2013, the date of assent of the Assets Expenditure Tax Act, s. 5(10) has been amended so that it clearly includes the provision of prize competitions as a supply of services for GST purposes. Section 5(10) (as replaced) provides that an amount of money paid by a person to participate in gambling (including a New Zealand lottery) or in a prize competition is treated as a payment for the supply of services by the following:

    (a) For gambling, by the person, society, licensed promoter, or organiser who under the *Gambling Act 2003* conducts the gambling: or

    (b) For a prize competition, by the person who conducts the prize competition.

155. Section 10(14) has been correspondingly replaced with a new section that refers to both gambling and prize competitions. The consideration under s. 10(14) (as replaced) is the total amounts in money received in relation to the supply by the person who conducts the gambling or the prize competition, less the amount of prizes paid or payable in money in relation to the supply. The consideration for organisers of prize competitions is, therefore, the money received less the prizes paid or payable in money.

156. There is a definition of "prize competition" in s. 2, which is a scheme or competition:

    (a) For which direct or indirect consideration is paid to a person for conducting the scheme or competition; and

    (b) That distributes prizes of money or in which participants seek to win money; and

    (c) For which the result is determined:

(i) By the performance of the participant of an activity of a kind that may be performed more readily by a participant possessing or exercising some knowledge or skill; or

(ii) Partly by chance and partly by the performance of an activity as described in (c)(i) above, whether or not it may also be performed successfully by chance.

157. The definition of "prize competition" as initially proposed was amended following a submission. It is stated in the *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* ("the Officials' Report") that:

"Changing the wording of the amendment as suggested above would slightly widen the definition of a prize competition. It would mean that a competition whose organiser receives funding to run that competition from a person other than a participant could meet the definition of a prize competition. This could, for example, happen if funding for the competition was received from advertisers, or sponsors. Officials see no policy reason to deny people in this situation of the benefit of the proposed change."

158. The time of supply for a prize competition under s. 9(2)(e) (as replaced) is aligned with the rule for gambling, and is the date on which the first drawing or determination of the prize competition commences.

11.6 Opt-out provision to the agency rules

159. Effective from 17 July 2013, the date of assent of the Assets Expenditure Tax Act, s 60(1B) allows a principal and an agent who are both registered persons to agree in writing that s. 60(1B) applies to a particular supply, or a type of supply, that is then treated as two separate supplies: a supply from the principal to the agent, and a separate supply from the agent to the recipient treating the agent as if they were the principal for the purpose of the supply.

160. This rule when it was initially proposed included a requirement for the principal to account for the tax on the supply to the agent under s. 60(1B) on an invoice basis, so that there is no loss of revenue if the agent defaults on payment. However, officials backed away from this requirement following submissions. It is stated in the Officials' Report that:

"Although the GST Act does not allow a principal to issue a tax invoice in relation to a supply if the agent has issued a tax invoice in relation to that supply, officials now understand that in practice, multiple invoices are commonly issued in agency situations. This is wider than the problem which prompted this amendment, namely large computer systems automatically issuing invoices when goods are sent out, and therefore technically being in breach of the one-invoice requirement. This situation could equally also arise where smaller taxpayers use agents to sell items for them.

In light of submission received on this amendment, officials are of the view that some of these additional requirements could be impractical for some principals and agents. The requirement for the principal to account for the supply on an invoice basis, and the inability of the principal to claim a bad debt deduction if the customer paid the agent were included in the bill as a GST protection measure. Otherwise a GST liability could be avoided by interposing an agent into a transaction, and then having the agent disappear before meeting their GST obligation."

161. Section 26(3) denies the principal a bad debt deduction if the agent has been paid for the supply. Officials refused to back down on this requirement, stating that this is "an important

protection against taxpayers creating agency relationships in order to take advantage of this section".

162. Other submissions noted that:

    (a) There is currently no definition of an agent in the GST Act. It is uncertain whether this provision will only apply to persons acting as agents in supplying goods and services, or also to those merely acting in the capacity of a paying or collecting agent;

    (b) As currently drafted, the section only applies to parties in a full agency relationship. The provision should be extended to apply to situations where an intermediary facilitates supplies to a third party on behalf of a principal;

    (c) The section should be amended to also include any purchases by the agent to be treated in the same manner for GST purposes.

163. Officials' response was that these matters were not raised during the policy development process, and would need further research and analysis before being implemented.

164. Some submitters also noted that the legislation does not refer to the treatment of a commission derived by the agent, and the provision should include wording to deal with the GST treatment of a commission paid to an agent. However, officials' response was that a commission derived by a NZ resident agent would be subject to GST and there was not a sufficient case for further clarification.

11.7 GST records kept offshore by an Inland Revenue-approved data storage provider

165. Effective from 2 November 2012, the date of assent of the corresponding income tax amendments, sections 75(3BA), (6) & (7) allow an Inland Revenue-approved data storage provider to hold a registered person's records at places outside New Zealand.

166. This amendment aligns the GST provisions with the corresponding provisions for income tax and certain other records covered by amendments to the *Tax Administration Act 1994* enacted in late 2012.

167. The Commissioner is to publish guidelines relating to the administration and implementation of this rule.

11.8 Change of accounting basis for certain local authorities

168. Under s. 87, from 1 July 2013, a local authority referred to in the *Goods and Services Tax (Local Authorities Accounting on Payments Basis) Order 2009* must account for tax payable on an invoice basis.

169. The tax payable on the change of accounting basis can be spread evenly over a period of 72 months commencing on 1 July 2013.

11.9 Agreements to hire with an option to purchase are hire-purchase agreements

170. The definition of a "hire purchase agreement" for GST purposes has important GST implications. Where goods are supplied under a "hire purchase agreement", the supply is deemed to take place, under s. 9(3)(b) of the GST Act, at the time the agreement is entered into. Whereas when goods are supplied under an "agreement to hire", the supplies take place,

under s. 9(3)(a), period-by-period at the earlier of the time when payments become due or are received.

171. An “agreement to hire” excludes, under s. 9(3)(c), an agreement under which the property in the goods passes to the bailee (i.e. the lessee) or which expressly contemplates that the property will pass to the bailee. This exclusion will not apply if the lessee merely has the option of acquiring the goods. In such circumstances if the agreement is not a “hire purchase agreement” as defined, the supplies are deemed to be made periodically.

172. Apparently, it was always the policy intent that where the lessee has the option of acquiring the goods, the supply, for GST purposes, should take place at the time the agreement is entered into. The definition of “hire purchase agreement” has been amended so as to achieve this.

173. For GST purposes, s. 2 of the *Goods and Services Tax Act 1985* (“the GST Act”) provides that “hire purchase agreement” has the same meaning as in s. YA 1 of the *Income Tax Act 2007* (“the Income Tax Act”), except that the exclusion in paragraph (f) of the income tax definition (of hire purchase agreements where the property that is the subject of the agreement is livestock or bloodstock) does not apply (i.e. for GST purposes such agreements remain hire purchase agreements).

174. With effect from 1 April 2008, an amendment, in s. 144(20) of the Employee Allowances Tax Act has resulted in paragraph (a)(i) of the income tax definition of “hire purchase agreement” being replaced by:

    “An agreement under which goods are let or hired with an option to purchase, however the agreement describes the payments:”

175. It is noted in the TIB item that this amendment means the definition of “hire purchase agreement” has been broadened to include any contract where the person has an option to purchase.

176. An additional amendment, in s. 144(21) of the Employee Allowances Tax Act clarifies that agreements of the kind described in paragraphs (a)(i) or (a)(ii) – which latter paragraph refers to “an agreement for the purchase of goods by instalment payments” – being treated as hire purchase agreements even if the property in the goods passes absolutely to the purchaser at the time of the agreement or before delivery of the goods.

177. Despite the 1 April 2008 effective date, a “savings” provision in s. 144(45) of the Employee Allowances Tax Act applies to taxpayers who took a tax position between 1 April 2008 and the date of introduction of the Bill (22 November 2013), by adopting the pre-amendment income tax definition of “hire purchase agreement” for GST purposes.

178. A second amendment was proposed in *GST remedial issues – An officials’ issues paper* (the “GST IP”), released in December 2012, for deferred settlement land transactions to be removed from the hire purchase definition, so as to remove the requirement for the up-front payment of GST, and be replaced with an anti-avoidance rule.

179. The anti-avoidance rule was thought necessary because the amendment would have meant that output tax on a long-term sale and purchase agreement for land would not need to be returned until the date of settlement (although GST will be returned on interim payments made before the date of settlement). However, a full input tax deduction could potentially be claimed on the acquisition of the property. The suggested solution was to amend s. 19D of the

GST Act to require a registered supplier of a transaction involving a deferred settlement of land and periodic payments to account for GST on the supply at the time the agreement is entered into, rather than periodically.

180. This second proposed amendment has not been proceeded with, and deferred settlement land transactions are not being explicitly removed from the hire purchase definition.

12. INCOME TAX EFFECTS OF GST ADJUSTMENTS

181. The *Income Tax Act 2007* has been amended so as to take account of GST adjustments under the apportionment rules for income tax purposes.

12.1 Income Adjustment For GST

182. Under s. CH 5(1) of the *Income Tax Act 2007*, an adjustment taken into account under s. 20(3)(e) of the GST Act (adjustments for actual use higher than previous actual or intended use, and for input tax adjustments upon disposal) is income in the income year in which the amount is calculated.

183. This does not apply to adjustments made in relation to a capital asset (see further below).

12.2 Deductions For GST Adjustments

184. Under s. DB 2 of the *Income Tax Act 2007*, a person is allowed a deduction for "deductible output tax" to the extent to which:

    (a) A deduction is allowed for expenditure incurred in acquiring or producing the goods or services; or

    (b) A deduction is allowed for an amount of depreciation loss for the goods or services.

185. This does not apply to an adjustment made in relation to capital asset

186. A depreciation loss is quantified by reference to the cost of an item of depreciable property under s. EE 54 of the *Income Tax Act 2007* (see further below).

187. A new definition of "deductible output tax" applies for the purposes of sections DB 2 and EE 54, being the sum of, as applicable:

    (a) Output tax charged on a supply a registered person is treated as making for:

        (i) A supply of land that has been incorrectly zero-rated.

        (ii) A supply of services from a non-resident when no deduction is available for any input tax on the acquisition of the services.

        (iii) Adjustments under the old apportionment rules.

    (b) Input tax that is not deductible at acquisition under the new apportionment rules.

    (c) Output tax payable at acquisition by a recipient of a zero-rated supply of land to the extent the land is not used for making taxable supplies.

(d) Output tax payable in adjustment periods following acquisition under the new apportionment rules.

(e) Output tax payable in respect of a supply of a fringe benefit.

12.3 Cost Of Depreciable Property

188. An adjustment to the cost of depreciable property is required under s. EE 54 the Income Tax Act 2007 corresponding to the GST adjustments made. The cost of depreciable property is reduced by any adjustment made in the income year under s. 20(3)(e) of the GST Act.

189. The cost of an item is increased by any deductible output tax the person has for the income year.

13. GST TREATMENT OF DIRECTORS' FEES

190. Inland Revenue released a draft public ruling PU00202: *Goods and Services Tax – Director's Fees* on 25 March with a deadline for comment of 8 May 2015. The draft ruling updates the previous ruling BR Pub 05/13 to include the effects of the amendments to s. 6 of the GST Act by s. 187 of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act* 2014, effective from 30 June 2014.

191. The amendments are discussed in *Weekly Comment* 20 February 2015. They are primarily aimed at correcting the GST treatment of the situation where an employee of a company acts as a director on behalf of the employing company and remits the director's fees received to the company. The employing company will have to account for GST, however, before the amendments effective 30 June 2014, the paying company could not get a corresponding input tax deductions because the payments were apparently to an individual acting as a director and no GST was visibly charged.

192. From 30 June 2014 the director's fees paid by the paying company are treated as a payment for a supply by the company employing the director, and a GST input tax deduction can be claimed.

193. The special GST rules that apply to directors' fees are discussed in the draft ruling. In order for a director to charge GST they must be registered and be carrying on a taxable activity. There are essentially three requirements for there to be a taxable activity: there must be an activity, that is carried on continuously or regularly by the person, involving supplies to another person for a consideration.

194. However, acting as a director cannot be a taxable activity by itself because s. 6(3)(b) excludes "any engagement, occupation, or employment under any contract of service or as a director of a company" from being a taxable activity.

195. There are two exceptions to this rule:

(a) Section 6(5) provides that a person who, in carrying on a taxable activity accepts a position as a director, is treated as supplying their services as a director in the course or furtherance of that taxable activity.

(b) Section 6(4), which applies from 3 June 2014, provides that if a director is paid a director's fee in circumstances where they are required to account for the fee to their

employer, the fee is treated as consideration for a supply of services by the employer to the payer of the fee.

196. The discussion in the draft ruling follows the scheme of s. 6(3) to 6(5) in relation to directors' fees:

    (a) Where a person contracts to be a director of a company and has not accepted the position as part of carrying on a taxable activity, the engagement as a director is excluded from being a taxable activity under s. 6(3)(b) and no GST will be charged and no GST input tax can be claimed by the company that pays the fees;

    (b) Where a person contracts to be a director of a company and has accepted the position as part of carrying on a taxable activity, the exception in s. 6(5) will apply and the services as a director are treated as being supplied in the course of furtherance of the taxable activity, and GST will be charged and GST input tax can be claimed by the company that pays the fees;

    (c) Where a third party contract with a company to supply the services of a director, there may be either a single supply, or two supplies:

        (i) Where the person who is engaged by the third party to be a director of a company has not accepted the position as part of carrying on a taxable activity, the transaction between the director and the third party is not a supply for GST purposes because the engagement as a director is excluded from being a taxable activity under s. 6(3)(b), and there will only be a single supply for GST purposes between the third party and the company: GST will be charged by the third party and GST input tax can be claimed by the company in relation to any fees paid to the third party;

        (ii) Where the person who is engaged by the third party to be a director of a company has accepted the position as part of carrying on a taxable activity, the transaction between the director and the third party is a supply for GST purposes because the exception in s. 6(5) will apply and the services as a director are treated as being supplied in the course of furtherance of the taxable activity, and there will only be two separate supplies for GST purposes: one between the director and the third party in relation to which GST will be charged by the director and input tax can be claimed by the third party, and a second supply between the third party and the company in relation to which GST will be charged by the third party and GST input tax can be claimed by the company;

    (d) Where a person contracts to be a director of a company and has accepted the position in a capacity as an employee of another company, the exception in s. 6(4) will apply and director's fees paid are treated as consideration for a supply of services by the employer company, and the employer company will have to return output GST on the director's fees and GST input tax can be claimed by the company that pays the fees;

    (e) Where a persons accepts a position as a director of a company in a capacity as a partner in a partnership, the services are deemed to be supplied by the partnership and not the partner, under s. 57(2)(b), and the partnership will be required to account for GST on the fees received and GST input tax can be claimed by the company that pays the fees.

14. ZERO-RATING SERVICES SUPPLIED TO NON-RESIDENTS

197. Two related changes have been made, effective from 30 June 2014, to allow services supplied to non-residents to be zero-rated even though such non-residents visit New Zealand during the period during which the services are being provided. These changes follow from *GST on immigration services* ("the draft Immigration IS") released in April 2012, and *The GST treatment of immigration and other services – An officials' issues paper* ("the Immigration IP") issued in June 2013.

198. The changes relate to s. 11A(1)(k) under which services must be zero-rated when supplied to a person who:

    (a) Is a non-resident; and

    (b) Is outside New Zealand at the time the services are performed.

14.1 The draft Immigration IS: zero-rating of visa application services

199. The draft Immigration IS concerned the circumstances in which visa application services provided to a non-resident can be zero-rated under section 11A(1)(k) of the *Goods and Services Tax Act 1985* ("the GST Act").

200. The main focus was on the meaning of the phrase "at the time the services are performed". If the entire supply cannot be zero-rated, the secondary questions are:

    (a) Whether the supply can be apportioned into standard-rated and zero-rated parts; and

    (b) The implications of the time of supply rule for periodic payments in section 9(3).

201. In reference to the draft Immigration IS, it is stated in paragraph 1.12 on page 2 of the Immigration IP that:

    "The statement concluded that immigration services may be zero-rated, provided the recipient of the supply is a non-resident and remains outside New Zealand at the time the services are performed. If the recipient comes to New Zealand over the period during which the services are performed, the entire supply of services must be standard-rated, unless it is possible to apportion the supply."

202. In *Weekly Comment* 9 May 2012, it was suggested that the phrase "at the time the services are performed" could be interpreted as meaning the time of supply: the time at which the services can be billed. Inland Revenue disagrees with that approach to interpreting the phrase for the following reason stated in paragraph 2.10 on page 5 of the Immigration IP:

    "… there would be clear avoidance opportunities if the status of the recipient was determined at one particular point in time – that is, at the time of invoicing or payment for services. For example, in order to avoid the tax, the recipient could ensure he or she is outside New Zealand at the one point of time when the person's status was determined."

203. In *Weekly Comment* 9 May 2012, the case of *C of IR v White Heather Caravans Limited* (1992) 14 NZTC 9,113 (CA) was referred to. That case concerned the time when goods were supplied under section 84 which deals with supplies before and after the introduction of the GST legislation. I noted that the arguments in the draft Immigration IS did not easily accord with the wording in s. 84.

14.2 The Immigration IP: GST treatment of immigration and other services

204. The Immigration IP cast the net wider than merely visa application services. It is recognised in paragraph 1.13 on page 2 that:

"The issues raised in response to the draft interpretation statement and the solutions suggested in this paper have wider implications. Therefore, the problems and suggested solutions have been framed in general terms and are not specific to the immigration service industry."

205. In the Immigration IP, the phrases "the period between the time the services commence and the time the services are completed" and "the period of supply" appear to be used interchangeably and mean the same thing (refer to paragraphs 2.6 to 2.10 on pages 4-5). The stated "two main policy reasons why the rule looks at the period of supply" are:

(a) It is consistent with the destination principle – i.e. GST is charged in the jurisdiction where the services are consumed; a practical way of looking at where services are consumed is to look at the person's residence and presences during the period the services are supplied; and

(b) There would be avoidance opportunities if the status of the recipient was determined at one particular point of time (as already noted).

206. However, it is acknowledged that the rule requires the supplier to have knowledge of the recipient's physical location and the recipient's status during the period of service, and this can be difficult if the service is provided over an extended period of time.

207. The suggested solution was that services supplied to non-residents remain zero-rated even if the non-resident visits New Zealand, as long as the non-resident's presence in New Zealand is not in connection with the services performed.

208. An example was provided of a non-resident individual visiting New Zealand for a job interview to comply with the visa requirement of having a job offer. If the interview was arranged by the immigration consultant, the conclusion is that the presence in New Zealand would be directly in connection with the services. However, if the individual had independently arranged the interview, the presence in New Zealand would not be in connection with the services. The distinction would depend on the facts in each case.

14.3 The new rule exempting minor presence in New Zealand

209. Section 11A(3B) inserted by s. 189(2) of the Employee Allowances Tax Act 2014, applies from 30 June 2014 and provides that:

"For the purpose of subsection (1)(k), outside New Zealand, for a natural person, includes a minor presence in New Zealand that is not directly connected with the supply."

210. It is noted in *Tax Information Bulletin* Vol. 26, No. 7, August 2014, pages 95-102 ("the TIB item") that:

"The policy rationale behind the new section is to deal with situations when it is unreasonable for the supplier to be aware that the non-resident is in New Zealand during the time the services are performed, and therefore, whether the services should be zero-rated. In practice, if the supplier is unaware of the person's presence in New Zealand, it is less likely that the presence is directly connected with the services being performed.

The requirement that the presence be "minor" is to ensure the non-resident is predominantly outside New Zealand while the services are being performed. If the non-resident is present in New Zealand for most of the time the services are being performed (despite the fact that the presence may be unrelated to the services being performed) the person's presence will not be considered as minor, and therefore, the services cannot be zero-rated."

14.4 Switching off backdating of tax residence for the purposes of the GST test

211. It is recognised, in Chapter 4 of the Immigration IP, that a non-resident could retrospectively become resident during the period when services are being supplied through the retrospective application of the income tax "count test" of tax residence.

212. Section YD 1 of the *Income Tax Act 2007* deals with the residence of natural persons. Sections YD 1(3) to (6) provide as follows:

(3) A person is a New Zealand resident if they are personally present in New Zealand for more than 183 days in total in a 12-month period.

(4) If subsection (3) applies, the person is treated as resident from the first of the 183 days until the person is treated under subsection (5) as ceasing to be a New Zealand resident.

(5) A person treated as a New Zealand resident only under subsection (3) stops being a New Zealand resident if they are personally absent from New Zealand for more than 325 days in total in a 12-month period.

(6) The person is treated as not resident from the first of the 325 days until they are treated again as resident under this section.

213. Officials' preferred solution was that the retrospective application of the tax residence rules be switched off in relation to the application of s. 11A(1)(k) of the GST Act. What was suggested was that the recipient's status as a New Zealand resident would apply on a prospective basis (from day 183, as opposed to from day 1).

214. Effective from 30 June 2014 (the date of assent), the amendment contained in s. 185(3) of the Employee Allowances Tax Act has resulted in sections YD 1(4) and (6) being "switched off" when determining the residence of natural persons for GST purposes, and tax residence or non-residence for GST purposes, therefore, applies prospectively from the date on which tax residence or non-residence is triggered for income tax purposes, as follows:

(a) Tax residence for GST purposes starts on the day immediately following the day that triggers tax residence under s. YD 1(3) (i.e. the day immediately following 183 days presence in New Zealand in a 12-month period); and

(b) Tax residence ceases for GST purposes on the day immediately following the day that triggers non-residence under s. YD 1(5) (i.e. the day immediately following 325 days of absence from New Zealand in a 12-month period).

215. It is noted in the TIB item that:

"It is important to note that the day-count rules are not the only rules for determining an individual's tax residency status, and the amendment does not affect the application of the "permanent place of abode" test."

14.5 Apportionment

216. Officials were of the view, following submissions made in respect of the draft Immigration IS, that in some situations it may be possible to apportion the supply between the zero-rated and standard-rated portions.

217. It was noted that, following the decision in *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685 (HC), there is a general ability to apportion zero-rated parts of a supply under the GST Act where, on the facts, there is a true distinction between parts of a supply. This ability to apportion is restricted to circumstances when, as a matter of fact and degree, a sufficient distinction exists between the different parts of the transaction to make it reasonable to separate them.

218. Where supplies can be treated as a series of supplies under s. 9(3)(a), it will be necessary to determine the correct GST treatment for each successive supply.

14.6 Reasonably foreseeable

219. Officials considered whether a "reasonably foreseeable" test is required, similar to the test in s. 11A(2)(a) (which refers to the performance of services being received in New Zealand). While they believe this would bring greater certainty, they recognise the difficulty in applying a subjective test, and they expect that "in the majority of situations a test of this nature may not be necessary". This test has not been legislated.

15. BODIES CORPORATE GST REGISTRATION

220. The Government has announced the removal of the requirement for bodies corporate to compulsorily register for GST by the introduction of proposed law changes in the R&D Tax Bill 2015. The history behind the proposed amendments is as follows:
    (a) In May 2013 Inland Revenue released *IRRUIP7: Bodies Corporate – GST registration* ("the bodies corporate issues paper");
    (b) Immediately following that, the Commissioner issued an initial interim operational position *Commissioner's interim operational position on GST registration by Bodies Corporate*;
    (c) In June 2014 Inland Revenue released *GST treatment of bodies corporate – A government discussion document* (the bodies corporate discussion document");
    (d) Immediately following the release of the discussion document in June 2014 the Commissioner issued a second interim operational position *Commissioner's interim operational position for GST and Bodies Corporate*.

15.1 Bodies corporate Issues Paper

221. A body corporate looks after common property in apartment blocks. The body corporate is a separate legal entity from the owners, who are its members. It establishes funds to cover required and optional expenditure and levies the owners for the amounts needed.

222. The basic premise in the bodies corporate issues paper is that the High Court decision in *Taupo Ika Nui Body Corporate v CIR* (1997) 18 NZTC 13,147 is wrong, and sets an incorrect

precedent. In that case, the High Court held that there was no taxable activity and therefore the body corporate was not required to register for GST.

223. The *Taupo Ika Nui* case was decided under the *Unit Titles Act 1972*. This has been replaced by the *Unit Titles Act 2010*. One potentially relevant difference is that under the 2010 Act common property of a unit title development is owned by the body corporate on behalf of the proprietors, who are the beneficial owners. Under the 1972 Act proprietors owned the common property as tenants in common.

224. The conclusion in the Bodies Corporate IP is that a body corporate supplies services to the owners for a consideration, and conducts a taxable activity. Therefore, there will be a liability to register for GST if the value of supplies exceeds the GST threshold of $60,000.

225. It was stated that this conclusion is not undermined by the fact that that the services arise from a statutory obligation. This is supported by the decisions in *Turakina Maori Girls College Board of Trustees and others v CIR* (1993) 15 NZTC 10,032, *Pacific Trawling Limited and another v Chief Executive of the Ministry of Fisheries and another* (2005) 22 NZTC 19,204, *Rotorua Regional Airport Ltd v CIR* (2010) 24 NZTC 23,979 and *Body Corporate, Villa Edgewater CTS 23092 v FCT* 2004 ACT 2056.

226. It was contended that the case law, apart from *Taupo Ika Nui*, supports registration on the basis that the levies charged to owners are consideration for supplies made to the owners. This is supported by *Nell Gwynn House Maintenance Fund Trustees v Customs and Excise Commissioners* [1999] 1 All ER 385 (HL), *Eastbourne Town Radio Cars Association v Customs and Excise Commissioners* [2001] UKHL 19, *Manor Forstal Residents Society Limited v The Commissioners; New Ash Green Village Association Limited v The Commissioners* (1976) VATTR 63 and *Villa Edgewater*.

227. The circumstances were distinguished from *CIR v NZ Refining Co Limited* (1997) 18 NZTC 13,187 or *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075, where the consideration was not linked to the supply.

228. The only conflicting authority noted is the only New Zealand case that is right on point: *Taupo Ika Nui*. The conclusion in the bodies corporate issues paper is that the case was wrongly decided.

229. The bodies corporate issues paper includes a diagram contrasting 3 situations:

    (a) Where the owners of the property engage external contractors directly, and there is no interposed body corporate: the cost to the owners is the GST-inclusive cost charged by the contractors.

    (b) Where external contractors are engaged by an interposed body corporate that is not GST-registered, the amount charged to the body corporate is the GST-inclusive cost charged by the external contractors, and this cost is passed on to the owners by levies that reflect the GST-inclusive cost.

    (c) Where external contractors are engaged by an interposed body corporate that is GST-registered, the amount charged to the body corporate is the GST-inclusive cost charged by the external contractors; the body corporate can claim an input tax deduction that is offset by the GST output tax charged to the owners; the cost to the owners will reflect the GST-inclusive cost charged by the external contractors

15.2 Bodies corporate discussion document

230. The proposal in the bodies corporate discussion document was to prohibit bodies corporate from registering for GST by introducing a new exemption in s. 14 under which supplies by a body corporate would be exempt from GST, effective from 6 June 2014 (the date of the release of the discussion document).

231. A proposed "look-through" rule, which would also have applied from 6 June 2014, would have allowed an owner to claim GST input tax deductions on goods and services supplied through the body corporate which the owner uses to make taxable supplies.

232. Under the proposals in the discussion document:

    (a) Previously GST-registered bodies corporate would have been required to deregister from 6 June 2014 with consequent output GST liabilities. Inland Revenue warned in the interim operational position that deregistration could result in common property and other goods that the body corporate acquired and still held being deemed to be provided to the body corporate and subject to output GST. This would not include individual units or flats, as they are property owned by the members of the body corporate and not by the body corporate itself.

    (b) Bodies corporate GST-registered before 6 June 2014 did not need to deregister pre-6 June 2014, but were required to backdate GST registration to the time supplies exceeded $60,000 and they initially became liable to be registered, so that they were consistently GST-registered pre-6 June 2014, subject to a concession that limited backdating to the first taxable period after 1 April 2010.

233. The interim operational position sought to address the confusion resulting from a proposed law change with a past effective date, although the law changes had not even been introduced into Parliament:

    (a) GST-registered bodies corporate had to continue filing GST returns and unregistered bodies corporate could apply to be GST-registered;

    (b) GST refunds could be claimed, but once the law changed refunds relating to post-6 June 2014 had to be repaid and would be subject to use-of-money interest, and any output GST paid would be refunded;

    (c) Bodies corporate registered before 6 June 2014 could apply to have their registration backdated consistent with the proposed backdating rule;

    (d) The proposed "look-through" rule would not be applied until it was actually enacted.

15.3 The new proposed amendments in the R&D Tax Bill

234. The June 2014 proposals were very confusing. The Government has now decided to clarify that services provided by bodies corporate are supplies for consideration for goods and services tax (GST) purposes and give bodies corporate the option to register for GST. According to draft legislation in the R&D Tax Bill, this is to be done as follows:

    (a) First, under proposed s. 5(8A), the value of levies and other amounts received by a body corporate from its members is treated as consideration for services supplied. This rule applies from when GST commenced on 1 October 1986.

(b) Second, such consideration is excluded for the purpose of determining whether the mandatory registration threshold of $60,000 is exceeded, under proposed s. 51(1B). However, a body corporate will be required to register if it receives consideration exceeding the threshold for making supplies to third parties (i.e. supplies to non-members).

(c) Third, a body corporate that applies after 26 February 2015 (the date of introduction of the Tax Bill) to voluntarily register for GST, will, under proposed s. 51(5B), be GST-registered effective from the date of the application (i.e. backdating registration will not be allowed), and it must stay GST-registered for at least 4 years, under proposed s. 52(9).

(d) Fourth, if a body corporate applies to be voluntarily registered, the value of its funds on the date it becomes registered is treated as consideration for supplies made on the date it becomes registered, under s. 5(8AB) and output GST must be paid. This rule applies from 26 February 2015 (the date of introduction of the R&D Tax Bill).

(e) Fifth, if a body corporate is GST-registered – either because it is liable to be registered because it makes supplies to non-members in excess of the registration threshold or it decides to voluntarily register – all supplies become subject to GST, including supplies to members, because proposed s. 5(8A) treats funds received from members as consideration for supplies.

(f) Sixth, a body corporate that is GST-registered on 26 February 2015 (the date of introduction of the R&D Tax Bill) that applies to be deregistered following the introduction of the new voluntary registration rules will be deregistered with effect on or after the date of the deregistration application, under proposed s. 52(8).

(g) Seventh, the deemed supply of "common property" (which has the same meaning as in the *Unit Titles Act 2010*) by a body corporate upon deregistration has a zero value, under a proposed amendment to s. 10(7A). This rule applies from 26 February 2015 (the date of introduction of the R&D Tax Bill).

(h) Finally, retirement villages are not subject to these rules because their supplies are different from those made by a typical body corporate. The proposed definition of a "body corporate" in s. 2 excludes "a body corporate of a retirement village registered under the *Retirement Villages Act 2003*".

235. In relation to the proposed new rule in s. 5(8AB) imposing a GST output tax liability on funds held at the time of registration, it is noted in the *Commentary* to the Bill that:

"A body corporate's "funds" include all cash and non-cash investments held by the body corporate. The new rule is intended to ensure a body corporate cannot restructure its cash reserves to avoid the application of output tax upon registration. "Funds" will include a body corporate's operating account, long-term maintenance fund, contingency fund and any capital improvement fund (see definition of "fund" under the Unit Titles Act 2010). Any financial investments held by the body corporate are also included (see section 130 of the Unit Titles Act 2010)."

236. In relation to funds held at the time of deregistration it is noted in the *Commentary* that:

"A body corporate seeking to deregister will not be refunded any GST paid on its funds held at the time of deregistration. This is consistent with the treatment of other registered taxpayers leaving the GST system. There is also likely to be a point on the "save and spend" cycle of a body corporate's activities when its accumulated funds are very low and it can exit the GST base with limited financial impact."

237. There is no "look-through" rule, as proposed in the June 2014 discussion document which would allow an owner to claim GST input tax deductions on goods and services supplied through the body corporate which the owner uses to make taxable supplies, if the body corporate does not register for GST.

16. GST REMEDIAL ISSUES – ISSUES PAPER

238. *GST remedial issues - An officials' issues paper* was released in December 2012. Most of the remedial matters discussed have been legislated in the Employee Allowances Tax Act 2014. However, three of the issues discussed have not been been enacted:

(a) Apportionment rules: output tax on the disposal of land;

(b) Supplies by a company to an associated natural person; and

(c) Credit notes when GST incorrectly charged.

16.1 Apportionment rules: deemed supply of land on disposal

239. An issue identified in the GST IP was that when a person uses land for making taxable supplies and then fully devotes it to a non-taxable purpose before disposal, the person will arguably not be disposing of the land in the course or furtherance of their taxable activity, and, therefore, there is no output tax liability on the sale.

240. The suggested solution, which was targeted on land, was to extend the scope of s. 5(16) so that it applies to all subsequent supplies of land when input tax has been claimed (at present s. 5(16) applies only to dwellings).

241. The proposal was to replace s. 5(16), so that it would apply to a supply of "land or a dwelling" for which a registered person has a deduction under s. 20(3). A subsequent supply of all or part of the land or dwelling, or appurtenances belonging to or used with the dwelling, would be treated as a taxable supply. The supplier would be required to charge output tax and also perform the existing final adjustment on disposal calculation in section 21F.

242. However, there were a number of serious objections to this proposal. Officials considered that submitters had raised valid concerns over the practical application of this proposed amendment, particularly the GST implications of selling essentially private land where a relatively small input tax deduction had been claimed in the past. Officials considered the new wash-up rule and the general anti-avoidance provision would address many of the concerns underlying the proposed amendment to s. 5(16). Therefore, this proposal has not been proceeded with.

16.2 Supplies by a company to an associated natural person

243. The issue identified in the GST IP is that under the present rules there is an interpretation that would allow a company to claim full input tax on assets that are provided to owners for private use. The supply to the owner is an associated supply, to which the market value rules apply and for which the company would be required to return output tax.

244. The suggested solution was to amend the definition of "percentage actual use" in s. 21G(1) so as to exclude associated supplies from being "taxable supplies" when the recipient of the supply is a natural person. There would need to be a corresponding output tax amendment to

ensure that output tax did not have to be paid on the associated supply. The interaction with the fringe benefit rule in s. 21I would also need to be considered to ensure there is not effective double taxation by denying input tax deductions and charging output tax on the fringe benefit. This suggestion has not been included in the legislation.

16.3 Credit notes when GST incorrectly charged

245. The issue identified in the GST IP concerns circumstances where a supply has been incorrectly treated as subject to GST, when no GST should have been charged. The credit and debit note provisions do not necessarily require a credit note or debit note to be issued in such circumstances. Therefore, the supplier could arguably receive a windfall gain in terms of a refund of GST incorrectly accounted for, without having to refund the GST paid to the purchaser because a credit note is not required.

246. The suggested solution was to amend s. 25(1) to clarify that it also applies in situations where the GST treatment of a supply has been incorrectly accounted for. Consequential amendments to s. 25(3) were also suggested. However, this suggestion has not been included in the legislation.

17. INLAND REVENUE PUBLICATIONS CONCERNING GST

247. There have been a number of Inland Revenue publications relating to GST in recent years. What follows is a summary of the issues discussed in publications issued since 2013 that have been reviewed in *Weekly Comment* articles.

17.1 QB 13/03: Whether compulsory acquisition of land is a "supply by way of sale"

248. In August 2013, Inland Revenue released *Question We've Been Asked QB 13/03* ("the QWBA"), on whether a compulsory acquisition of land is a "supply by way of sale". The specific question was whether:

    (a) A compulsory acquisition of land under the *Public Works Act 1981* ("PWA 1981") is a "supply" for GST purposes; and

    (b) If so, whether it is a "supply by way of sale" such that the recipient is entitled to a secondhand goods input tax deduction under ss 3A(2) and 20(3) of the GST Act where the supplier is not registered.

249. The answer is that a compulsory acquisition under the PWA 1981 is a "supply" for GST purposes, and this applies equally to compulsory acquisitions under the *Canterbury Earthquake Recovery Act 2011*:

    (a) Where the supply is made by a registered person, it will generally be zero-rated under s. 11(1)(mb); and

    (b) Where land is compulsorily acquired from an non-registered person, the recipient will be entitled to a secondhand goods input tax deduction if the other requirements of ss. 3A(2) and 20(3) are met.

250. The starting point is that the meaning of "supply" for GST purposes is wide enough to include both active and passive senses: in *Databank Systems Ltd v CIR* (1987) 9 NZTC 6,213, Davison CJ considered that "supply" meant "to furnish with or provide", and the definitions in the

Concise Oxford English Dictionary of "provide include "make available for use; supply", and of "furnish" include "be a source of; provide".

251. However, South African and Australian case law establishes that for there to be a supply there must be an act on the part of the supplier. In addition, comments by Judge Willy in *Case* T22 (1997) 18 NZTC 8,124, made in the context of a compensation payment, could suggest that a compulsory acquisition is not a supply.

252. These authorities are not conclusive, and the context and purpose of the term "supply" are then considered in the QWBA. It is noted that in *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116, (2009) 24 NZTC 23,236, the Supreme Court noted that GST was intended to be as non-distortionary as possible, and that it would be inconsistent with the scheme of the legislation if a registered person from whom land was compulsorily acquired were entitled to an input tax deduction on acquisition, but not required to account for output tax. On this basis, the conclusion is reached that a compulsory acquisition is a "supply".

253. In looking at whether a compulsory acquisition is a "sale", the meaning of "sale" is briefly considered. *In Smith v FCT* (1932) 48 CLR 178, Rich J considered that the word "sale" did not have a precise meaning and that in some contexts the essence of a sale was the conversion of property into money.

254. In the context of s. 3A(2) of the GST Act, a sale is a supply. Where the supplier and recipient are not associated persons and the supply is the only matter to which the consideration relates, the amount of the input tax deduction is, under s. 3A(3)(e) based on the consideration in money for the supply. Therefore, the amount of the input tax deduction where a compulsory acquisition is made would be based on the compensation paid for the acquisition.

255. The conclusion reached is again based on the policy underlying the secondhand goods input tax deduction and the principle from *Glenharrow* that there should be GST neutrality for a registered person. It is noted that allowing a secondhand goods input tax deduction recognises that as the non-registered supplier was charged GST on the acquisition of the goods, the consideration for the goods includes a notional GST component.

17.2 QB 14/03: Transfer of interest in a partnership

256. Question We've Been Asked QB 14/03 *GST – Transfer of interest in a partnership* covers the situation where an interest in a partnership is transferred from one partners to another new or existing partner.

257. A partnership is a "separate person" for GST purposes. This is despite the general law position that an unincorporated body of persons does not have a legal personality separate from its members. For GST purposes, an unincorporated body of persons, which is defined in s. 2 of the GST Act as including a partnership, is a separate person for GST purposes.

258. Therefore, if the only taxable activity a person is involved in is that carried on by a partnership, the person cannot register for GST.

259. A distinction is drawn between changes in the members of a partnership and transfers of interests in a partnership. Under s. 57(2)(e) of the GST Act, any change between members of a partnership has no effect for GST purposes. However, it is possible to have a change in

partnership interests (through a rearrangement) even though there may be no change in the members.

260. Whether or not a supply of an interest in a partnership is subject to GST depends on:

(a) Whether the supplier is GST-registered in respect of a taxable activity; and

(b) Whether the supply is made in the course or furtherance of that taxable activity; and

(c) Whether the supply is a taxable or an exempt supply.

261. It is noted in QB 14/03 that the supply of a partnership interest will be a supply of a chose in action and, therefore, the supply of a service. It is not a supply of the underlying assets, and the nature of the underlying assets does not affect the characterisation of the supply as a standard-rated, exempt, or zero-rated supply. For example, the transfer of an interest in a land-owning partnership would not be zero-rated under s, 11(1)(mb) of the GST Act.

262. When an interest in a partnership is supplied by an existing partner, there will be a taxable supply for GST purposes if:

(a) The partner is registered for GST in their own right, because they carry on some other taxable activity (because the partner cannot register for GST for the activities of the partnership); and

(b) The interest in the partnership is supplied in the course or furtherance of that other taxable activity – i.e. the partnership interest is held, and then transferred, in the course or furtherance of the taxable activity carried on by the partner in their individual capacity, or the partner could carry on a taxable activity of buying and selling partnership interests; and

(c) The supply is not an exempt supply – i.e. the supply of the partnership interest is not a supply of a participatory security or an equity security.

263. The supply of a partnership interest will be the supply of a participatory security, as defined in s. 3(2) of the GST Act and, therefore, an exempt supply if:

(a) The partnership interest is an interest or right to participate in the capital, assets, earnings, or other property of any person (in the Commissioner's view this requirement is met); and

(b) It is not an equity security (in which case it is separately exempt), a debt security, money or a cheque (and these requirements will be met as a partnership interest is not a right to be paid money that is owing, and is neither "money" nor "cheques"); and

(c) The partnership interest is a contributory scheme as defined in section 2 of the *Securities Act 1978* (repealed), which is a scheme that involves the investment of money and involves more than 5 investors or the manager manages other such arrangements (in the Commissioner's view an interest in a partnership that involves an investment in money and meets the size threshold will meet this requirement).

264. The supply of an interest in a partnership will be the supply of an equity security, as defined in s. 2 of the GST Act, if it is an interest in or right to share in the capital of a body corporate. The Commissioner's view is that a limited partnership registered under s. 51 of the *Limited Partnerships Act 2008* is a separate legal person and a "body corporate" for the purposes of the GST Act.

265. QB 14/03 contains 3 fairly simple examples that illustrate the above principles.

17.3 QB 14/06: Hire firm security bonds

266. Question We've Been Asked QB 14/06 *GST – Hire firm security bonds* concerns the GST treatment of a bond that is forfeited. The initial payment of the bond has no GST effect because there are no services supplied for the bond.

267. When a hire firm retains some, or all, of a bond, the GST answer will depend on whether there is a relevant supply and then on whether, or at what point, a payment is made for that identified supply:

    (a) If a bond is retained to pay additional hire charges when goods are returned late, that is consideration for a supply and GST will be payable. The supplier (the hire firm) must provide a debit note that meets the requirements of s. 25(3)(b), and make the relevant adjustment in the GST return for the period in which it became apparent that the output tax originally returned was incorrect.

    (b) The same applies if the hire agreement provides that extra charges will be incurred and forfeited from the bond if the goods are used in a particular way.

    (c) If a bond is retained to compensate for damage to hired goods, or because the hired goods are not returned at all, that is not consideration for a supply, but a payment of damages, and GST will not apply consistent with the Commissioner's view in *GST Treatment of Court Awards and Out of Court Settlements* published in *Tax Information Bulletin* Vol. 14, No. 10, October 2002, page 21.

    (d) If the hire firm and the customer agree that the customer will buy the goods, GST will apply to that sale in the ordinary way with the hire firm issuing a tax invoice to the customer in the appropriate period.

268. Five examples are provided to illustrate the circumstances described above. Retention of part or all of the bond to compensate for repairs to damaged goods (example 2), goods not returned (example 3) and breach of hire conditions (example 5) is not consideration for a supply and no GST is payable. The application of the bond towards an additional hire period (example 1) or towards the purchase of the goods by the customer (example 4) will be consideration for a supply and GST will be payable.

17.4 BR Pub 14/06: Payments by parents or guardians to state schools

269. Public Ruling BR Pub 14/06 *Payments by parents or guardians of students to state schools – GST treatment* concerns the circumstances in which such payments would constitute consideration for a supply and, therefore, be subject to GST.

270. Section 2 of the *Goods and Services Tax Act 1985* ("the GST Act") provides that:

    (a) "Consideration" in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body; and

    (b) "Consideration in money" includes consideration expressed as an amount of money.

271. BR 14/06 contains a discussion of the meaning of "consideration". It is noted that:

(a) In *Turakina Maori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032 (CA) McKay J noted that the supply could be to a person other than the person who provides the consideration. Likewise, the value of the supply is to be measured by the consideration, whether or not the consideration is provided by the person to whom the service is supplied. It is not necessary that there should be a contract between the supplier and the person providing the consideration, so long as the consideration is "in respect of, in response to, or for the inducement of, the supply".

(b) The case of *The Trustee, Executors and Agency Co NZ Ltd v CIR* (1997) 18 NZTC 13,076 (HC) is referred to as providing support for the view that the supply could be made by someone other than the person who receives the payment, providing "there is sufficient proximity between the supply and payment".

(c) Not all payments will be consideration:

(i) There must be a sufficient relationship between a payment and a supply of goods and services, and a distinction is drawn between a payment for a supply, and a payment in respect of a taxable activity. In *CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187 (CA) Blanchard J said "It is necessary … to distinguish between supplies and the taxable activity … in the course of which they are made."

(ii) It is not sufficient that the person who receives the payment carries out some activity that has the effect of benefiting either the person making the payment or some other person. In *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075 (CA) a payment by the Crown to a trust established to promote economic development in the Chatham Islands was not consideration because the trustees were fulfilling their fiduciary duties under the trust, and the payment was not an inducement for the performance of services by the trustees.

(d) The legal arrangements between the parties will be very important. Blanchard J commented in the *Chatham Islands* case that because GST is a tax on transactions, it is necessary to pay close attention to the legal nature of what has been done.

272. In deciding whether a payment by a parent or guardian to a State school is a consideration for a supply, it is necessary to look into what such schools can actually charge parents for. Education Circular 2013/06 issued on 13 June 2013 prohibits Boards of Trustees of state and integrated schools from making any compulsory charges, other than attendance dues payable to proprietors of integrated schools and charges for voluntary purchase of goods and services from state schools. All other "charges" are essentially requests for donations, and are not compulsory.

273. Under s. 3 of the *Education Act 1989*, everyone who is not an international student (that is, generally, a New Zealand citizen or resident) is entitled to free enrolment and free education at any state school during the period beginning on their 5th birthday and ending on the 1st of January after their 19th birthday.

274. Under s. 35(1) of the *Private Schools Conditional Integration Act 1975*, students enrolled at an integrated school are entitled to free education on the same terms and conditions as students enrolled at other state schools. However, the proprietors of an integrated school may require payment of attendance dues as a condition of enrolment and attendance. The money received from attendance dues can be used only for improvements to the school buildings and

associated facilities as may be required by any integration agreement, for capital works, and to meet mortgage repayments relating to the school premises.

275. The policy of the *Education Act 1989* is to decentralise the administration of education so that Boards of Trustees of schools are responsible for the control and management of the schools. However, school Boards have an obligation to provide education that complies with the requirements of the national education guidelines. Every school must have a school charter, which establishes the missions, aims, objectives, directions and targets of the school Board that will give effect to the Government's national education guidelines and the Board's priorities.

276. The Commissioner's view, therefore, is that there is an insufficient relationship between any payments and the supply of education services. The supply of education services is not conditional on payment being made by parents and as students have a statutory right to receive education services in a state school free of charge if they are domestic students, there is an insufficient relationship between the payments and the supply of education services to which there is a statutory entitlement.

277. The situation is distinguished from that in *Television NZ Ltd v CIR* (1994) 16 NZTC 11,295 (HC) where payments the Department of Maori Affairs made to the Broadcasting Council for the purpose of a training scheme operated by the Broadcasting Council for Maori trainees were held to be payments for a supply for services, despite Television NZ's argument that it had a statutory obligation to promote the greater involvement of Maori as employees of the Broadcasting Council. There was a contractual obligation to provide the services, and the fact the supply was in accordance with the statutory obligations of the Broadcasting Council did not affect the conclusion that a supply was made under the contract.

278. In contrast, the payments made by parents are not made for any particular purpose and the school Boards do not undertake any obligations in return for payment. While there is an expectation that the amounts will be used for education purposes, school Boards have a considerable degree of autonomy as to how their funds are used. In any case, following the *Chatham Islands* and *Turakina* cases, how the amounts paid are used is not the test of whether a supply is made for the payment.

279. Moreover, there will be no supply of education services for a consideration even if a representation is made that education services would be withheld if payment is not made. This is because the true legal position is that education services would be provided whether or not the payment was made.

280. However, there will be a taxable supply if the supply made is outside the scope of the statutory entitlement and there is a sufficient relationship between the supply and the payment. This will be the case where students have a choice as to whether to receive the supply – for example, the optional purchase of materials such as workbooks and charges for in-school voluntary activities such as lunchtime sport or education outside the classroom opportunities.

281. In such cases, GST will be payable and the fact that, under s. 5(6) of the GST Act, Government grants to the school are a supply for GST purposes, does not affect any separate supply the Board makes to parents. The Court of Appeal recognised in *Suzuki NZ Ltd v CIR* [2001] NZCA 144, (2001) 20 NZTC 17,096 (CA) that when performance obligations under two separate contracts overlap a supply for GST purposes can occur simultaneously under both contracts.

17.5 QB 14/10: Whether a binding contract always establishes a supply

282. It is noted in QB 14/10 that the operation of s. 9(1) does not depend on the actual making of a supply. However, when a supply has not been made, it must be established that there is a transaction giving rise to a supply in order for a payment of a deposit or the issue of an invoice to trigger a time of supply.

283. There is not a great deal of discussion regarding what constitutes a binding contract. It is stated that "a binding contract is one where the requirements of the contract are satisfied". Reference is made to the requirements being offer and acceptance, an intention to be bound and certainty as to the essential terms of the contract, and to some supporting case law including *Wilmott v Johnson* [2003] NZCA 309, [2003] 1 NZLR 649 (CA). The case concerns a sale to a trust and contains a good discussion of the principles underlying when parties become bound by a contract.

284. It is noted that there will usually be a transaction giving rise to a supply for s. 9(1) purposes where a binding contract exists under which the supplier has an obligation to make a supply, and reference is made to some supporting case law including *Rob Mitchell Builder Ltd (in liquidation) v National Bank of New Zealand* [2003] NZCA 276, (2004) 21 NZTC 18,397 (CA). In that case it was held that a supply of land had been made prior to the company going into liquidation when the agreement became unconditional and the deposit, which had previously been held by the agent as stakeholder, was released to the company's solicitors.

285. There are three situations considered in QB 14/10 in which a binding contract will not establish a transaction giving rise to a supply:

    (a) When the making of the supply is factually or legally impossible from the outset: In *TRA 024/07* [2009] NZTRA 11, *Case Z16* (2009) 24 NZTC 14,179, the disputants did not have ownership of the property and, therefore, could not make the sale. A recipient does not have to cancel the contract in order for it to be ineffective, and a court will not enforce performance.

    (b) When the making of a supply becomes factually or legally impossible: the events discussed occurring after a contract that might make it impossible include when the goods did not come into existence (because they did not end up getting made as anticipated), or when a vendor did not obtain ownership of the property to be sold, as in *Ch'elle Properties (NZ) Ltd v CIR* (2004) 21 NZTC 18,618 (HC).

    (c) When the contract is used to commit fraud, or is a sham or some other legally ineffective contract: for example, if the supplier never intended to make the supply, or a contract is a sham, as discussed in IG 12/01: Goods and services tax; income tax – 'sham', published in Tax Information Bulletin Vol. 24, No. 7, August 2012, p.3.

17.6 QB 14/13: Lotteries, raffles, sweepstakes and prize competitions

286. Question We've Been Asked QB 14/13 *Goods and services tax – Lotteries, raffles, sweepstakes and prize competitions* concerns the supply of services in the form of a lottery, raffle, sweepstake or prize competition, and incorporates legislative changes that apply from 17 July 2013, under which cash prize amounts are allowed to be deducted when calculating the consideration for the supply of prize competition services.

287. Section 5(10) of the *Goods and Services Tax Act 1985* ("the GST Act") provides that an amount of money paid by a person to participate in gambling (including a New Zealand lottery) or in a prize competition is treated as a payment for a supply of services by the following:

    (a) For gambling, by the person, society, licensed promoter, or organiser who under the *Gambling Act 2003* conducts the gambling;

    (b) For a prize competition, by the person who conducts the prize competition.

288. The important point is that it is not the prizes that are supplied, but the gambling services (in the case of a lottery, raffle or sweepstake) or the prize competition services (when conducting a prize competition). Therefore, the rules relating to the supply of the prizes are irrelevant. For example, s. 14(1)(b), under which the supply of donated goods or services by a non-profit body is exempt from tax, will not apply to exempt the supply of prize competition services even if donated goods are used as prizes.

289. QB 14/13 contains a discussion of what constitutes "gambling" under the *Gambling Act 2003*. It is noted that definition of "gambling" in s. 4(1) of the *Gambling Act 2003* does not expressly include a lottery, raffle or sweepstake. However, the Commissioner considers that lotteries, raffles and sweepstakes fall within the definition of "gambling" and are therefore subject to s. 5(10)(a) of the GST Act.

290. Section 2(1) of the GST Act contains a new definition of "prize competition". For GST purposes, "prize competition" includes competitions where the participant pays to enter and is competing for a cash prize and where the result is determined by the performance of participants of a particular kind of activity.

291. If the supplier of gambling services or a prize competition (as defined) is a GST registered person (which includes a person who is liable to be GST registered), they will need to account for GST for the supply of those services.

292. The supplier is the person or organisation conducting the gambling or the prize competition that people are paying to participate in. This is the person or organisation ultimately running the lottery, raffle, sweepstake or prize competition (i.e., the person or organisation on whose behalf the tickets are being sold). It is noted that in the case of state schools, often it will be the Board of Trustees. If they are GST-registered, they will need to account for GST on any lotteries, raffles, sweepstakes or prize competitions they conduct.

293. There are specific time of supply rules in s. 9(2)(e):

    (a) For an amount of money paid to participate in gambling, the date on which the first drawing or determination of a result commences (except for an instant game played by a gaming machine, in which case the normal time of supply rules apply); and

    (b) For an amount of money paid by a person to participate in a prize competition on the date on which the first drawing or determination of the prize competition commences.

294. Under s. 10(14)(a) and (b), the consideration for the supply of gambling or prize competition services is the amount paid by the participants in the gambling or prize competition, less any prizes paid and payable in money. It is only prizes in money that can be deducted. If the prizes in a lottery, raffle, sweepstake or prize competition are non-cash prizes, then the consideration for the supply is simply the amount paid by the participants to participate.

295. However, if non-cash prizes in a lottery, raffle, sweepstake or prize competition are purchased by the supplier, then an input tax deduction may be available for any GST component of the cost of those prizes. A non-profit body can claim input tax on goods or services acquired for other than making taxable supplies (but not exempt supplies) under s. 20(3K). If non-cash prizes are donated goods or services, then no input tax deduction can be claimed because no GST was paid for the prize.

296. It is noted that running a raffle, lottery, sweepstake or prize competition has a number of GST implications:

    (a) There may be a requirement to register for GST if the value of supplies exceeds the $60,000 threshold;

    (b) A GST-registered organisation's accounting system must be able to separate the GST from the takings for gambling and prize competitions that are covered by the rules (as opposed to other fundraising activities which may not be);

    (c) Input tax may be claimed on costs associated with running a raffle, lottery, sweepstake or prize competition;

    (d) There may potentially be tax invoicing requirements.

297. Three examples are provided which illustrate the facts that:

    (a) A GST-registered organisation must account for GST on prize competitions and gambling;

    (b) Only prizes in cash may be deducted from the consideration for the supply; and

    (c) Input tax may be deducted on non-cash prizes, providing they are not donated goods or services.

17.7 QB 14/14: Late return charges (including library fines and parking fines)

298. Question We've Been Asked QB 14/14 *Goods and services tax – Late return charges (including library fines and parking overstay charges)* generally concludes that in most cases a late return charge will be subject to GST because the legal arrangements entered into between the parties will characterise the charge as additional consideration for the supply of a borrowed item.

299. Late return charges are distinguished from late payment charges. Late payment charges are amounts businesses charge for the late payment of an account. Under s. 5(25) and s. 5(26), a late payment charge will be subject to GST if the underlying supply to which that payment relates is subject to GST.

300. The Commissioner considers the law in this area to be well settled. The late return charge is either consideration for a supply or not. QB 14/14 refers to the discussion in QB 14/06 *GST – Hire firm security bonds*, which sets out the principles to be applied (see paragraph 19 onwards below).

301. It is noted that a late return charge can be characterised in at least two ways: as consideration for a taxable supply or as a payment for a breach of contract:

    (a) The Commissioner considers that in most cases, a charge imposed under a contract for the late return of a borrowed item will be characterised as consideration for the supply of the borrowed item and will be subject to GST. This view is supported by the decisions by the United Kingdom VAT Tribunal in *Leigh t/a Moor Lane Video* (1990) 5 BVC 757 and by

the Tax Court of Canada in *Acme Video Inc v R* [1995] GSTC 49. In both cases, a late return charge imposed for the late return of video films was held to be consideration for the supply of the borrowed item. This will be the case even if the original supply was for no consideration (a library book, for example).

(b) A charge imposed under a contract for breaching the terms of that contract, however, will not be subject to GST.

302. Four examples are provided. Examples 3 and 4, both of which deal with car parking, are meant to distinguish between additional charges for supplies and additional charges for a breach of contract. The distinguishing feature in the examples is the warning provided to users of the carparks:

(a) In Example 3, a failure to display a valid unexpired ticket results in a charge of $50 per day for parking: therefore, the $50 is consideration for the supply of services; and

(b) In Example 4, the terms and conditions state that a failure to display a valid unexpired ticket will result in the issue of a parking violation notice requiring the payment of a $100 fine, and the car may be towed: therefore, the $100 is a payment for breaching the contract and is not a consideration for the supply of parking services.

17.8 BR Pub 15/01 and BR Pub 15/02: Secondhand goods and fishing quota etc.

303. Public Rulings BR Pub 15/01 and BR Pub 15/02: *Secondhand goods input tax deductions – fishing quota, coastal permits and certificates of compliance* concern whether an input tax deduction will be available to a GST-registered buyer when an unregistered seller sells their fishing quota, coastal permits or certificates of compliance.

304. Section 20(3) of the GST Act provides that a person may deduct input tax paid in relation to the supply of secondhand goods to the extent that a payment in respect of that supply has been made during the taxable period.

305. The fundamental requirement is that fishing quota, coastal permits or certificates of compliance must be “secondhand goods”. Therefore, they must firstly be “goods” and the goods must be “secondhand”.

306. The GST definition of “goods” in s. 2 includes all kinds of real and personal property, but excludes choses in action, money and electronic products. It is necessary to examine the nature of fishing quota, coastal permits and certificates of compliance to see if they meet the definition.

307. Fishing quota that are considered in the ruling are individual transferable quota and annual catch entitlements as defined in s. 2 of the Fisheries Act 1996. An individual transferable quota generates an “annual catch entitlement” on the first day of the fishing year. The annual catch entitlement confers the immediate right to catch fish in a given year. An individual transferable quota and the annual catch entitlement may be transferred together or separately. An owner may sell their annual catch entitlement while retaining the individual transferable quota, which will generate another annual catch entitlement in the following year. Individual transferable quota can be used as security and have interests registered against them.

308. The courts have confirmed that both individual transferable quota and annual catch entitlements are property:

    (a) In *NZ Fishing Industry Association (Inc) v Minister of Fisheries* (CA 82/97, 22 July 1997) Tipping J stated at 16 that "quota are undoubtedly a species of property".

    (b) In *Sanford Ltd v NZ Recreational Fishing Council Inc* [2008] NZCA 160 (CA) a fishing quota was stated to be a "property right".

309. The conclusion in the ruling is that fishing quota and annual catch entitlements are property and they have the fundamental characteristics in that they are capable of being owned and the rights of ownership are capable of being transferred.

310. However, both individual transferable quota and annual catch entitlement also have the fundamental characteristic of a chose in action, in that the right cannot be taken into physical possession. The right to catch fish can be distinguished from actually catching the fish, and in *Antons Trawling Co Ltd v Smith* [2003] 2 NZLR 23 (HC) Baragwanath J stated at [5] that individual transferable quota are statutory choses in action.

311. Therefore, the exclusion for choses in action applies to fishing quota and annual catch entitlements, and they are not "goods" for GST purposes. Therefore, no secondhand goods input tax deduction can be claimed when they are acquired from an unregistered seller.

312. A coastal permit is a resource consent to do something in a coastal marine area that would otherwise contravene certain provisions of the Resource Management Act 1991. If an activity may be lawfully carried out without a resource consent, a certificate of compliance must be applied for instead.

313. Section 122(1) of the *Resource Management Act 1991* states that "a resource consent is neither real nor personal property". The conclusion in the ruling is that this restriction applies generally. Therefore, coastal permits and certificates of compliance are not "goods" for GST purposes.

314. As fishing quota, coastal permits and certificates of compliance are not "goods" for GST purposes, they cannot be secondhand goods, and a secondhand goods input tax deduction is not available.

315. The commentary on the rulings includes a brief discussion on the meaning of "secondhand". In *Case N16* (1991) 13 NZTC 3,142, Judge Barber accepted that the two key concepts underlying whether something is secondhand are previous ownership and previous use. The Court of Appeal confirmed this view in *LR McLean & Co Ltd v CIR* (1994) 16 NZTC 11,211. The Court also confirmed that it is not sufficient that the goods were previously owned. The more relevant factor is whether the goods have been previously used.

17.9 BR Pub 15/03: Legal services provided to non-residents relating to land

316. Public Ruling BR Pub 15/03 GST - *Legal services provided to non-residents relating to transactions involving land in New Zealand* states that legal services relating to land in New Zealand supplied to a non-resident who is not in New Zealand at the time the legal services are performed are zero-rated under s. 11A(1)(k) of the Goods and Services Tax Act 1985 ("the GST Act").

317. Section 11A(1)(k) provides for the zero-rating of services supplied to a non-resident who is outside New Zealand at the time the services are performed, other than services which are:

    (i) Supplied directly in connection with:

        (A) Land situated in New Zealand or any improvement to the land; or

        (B) Moveable personal property, other than choses in action, temporarily imported goods or goods in transit through New Zealand, situated in New Zealand at the time the services are performed; or

    (ii) The acceptance of an obligation to refrain from carrying on a taxable activity, to the extent that the activity would have occurred within New Zealand.

318. The meaning of the phrase "supplied directly in connection with" is discussed and several cases are referred to:

    (a) In *Case E84* (1982) 5 NZTC 59,441 it was stated: "It is clear that no hard and fast rule can be or should be applied to the interpretation of the "in connection with". Each case depends on its own facts."

    (b) In *Auckland Regional Authority v CIR* (1994) 16 NZTC 11,080 (HC) the supply of airport terminal services and garbage disposal charges were held to be "ancillary" to the supply of international transportation, and therefore could not be zero-rated. It is stated in the ruling that the case suggests a service may not be directly in connection with an item (international travel) even if it could not have been performed without the existence of that item.

    (c) In *Wilson & Horton Ltd v CIR* (1994) 16 NZTC 11,221 (HC) the "one step removed" criterion was introduced. Goods in New Zealand that were the subject of advertising were held to be "at least one step removed from the services supplied by the newspaper proprietor" and therefore could be zero-rated. The analogy provided by the judge was of painting services for a ship (which would be directly in connection with) as opposed to services provided to passengers or crew (which would not be directly in connection with the vessel).

    (d) In *CIR v Suzuki New Zealand Ltd* (2000) 19 NZTC 15,819 (HC) the repair services to motor vehicles in New Zealand provided by the importer were held to be equivalent to "painting the ship" in the analogy given in *Wilson & Horton*. It was not necessary for the non-resident to own the property.

    (e) In *Malololailai Interval Holidays New Zealand Ltd v CIR* (1997) 18 NZTC 13,137 (HC), the judge noted that the use of the "directly" narrows the scope of the phrase "directly in connection with". Consequently, marketing services supplied in New Zealand were held to be "one step removed" from being directly in connection with the land in Fiji. However, services that have a physical effect on the land such as gardening or repairs or improvements to land are directly in connection with land.

    (f) In *Case T54* (1998) 18 NZTC 8,410, services including filming in New Zealand that resulted in the supply of a videotape produced and supplied overseas were held to be not directly in connection with moveable personal property in New Zealand, because the personal property in question, the videotape, did not exist at the time the filming occurred in New Zealand. It was noted in the case that it would not be possible to argue that land did not exist before legal services were provided.

319. Based on the above, the following conclusions are drawn:

    (a) Legal services relating to transactions involving the sale and purchase of land in New Zealand are "one step removed" from the actual sale and purchase transaction. Therefore, they can be zero-rated.

    (b) The same reasoning applies to legal services relating to transactions involving the lease, licence or mortgage of land in New Zealand, or legal services relating to easements, management agreements, construction agreements, trust deeds, guarantees and other agreements concerning land in New Zealand.

    (c) Legal representation in disputes relating to land in New Zealand are also one step removed from the land and can be zero-rated.

320. Section 11A(1)(k) requires the non-resident recipient of the supply to be outside New Zealand at the time the services are performed. Sections 11A(2), 11A(3) and 11A(3B) expand on this requirement.

321. Section 11A(2) is an anti-avoidance provision, which is designed to ensure that services actually consumed in New Zealand are not able to be zero-rated simply through a non-resident contracting for the supply of such services. This covers situation such as the one in *Wilson & Horton* in which New Zealand sellers benefited from advertisements place by non-residents. It will also cover payments by non-residents for services consumed by expatriates in New Zealand and fees paid by non-residents for education services consumed in New Zealand.

322. Sections 11A(3) and 11A(3B) provide concessions for "minor presence" in New Zealand – s. 11A(3) in relation to non-resident companies and unincorporated bodies, and s. 11A(3B) in relation to natural persons. Services can continue to be zero-rated despite a "minor presence" in New Zealand, providing the presence is not effectively in connection with the supply of the services (in the case of non-resident companies or unincorporated bodies) or not directly in connection with the supply of the services (in the case of non-resident natural persons).

323. The meanings of the phrases "minor presence" and "effectively connected" are considered in the ruling.

324. It is noted that "minor" is a relative expression. A minor presence is a presence that is relatively small or unimportant or incidental to the services being supplied. In determining whether a presence is minor, the relative size or importance of the presence of the entity or person when compared with the presence of the New Zealand supplier must be considered. This will involve a consideration of, inter alia, the relative numbers of people connected with the supply, the amount of time spent in connection with the supply by those people and the relative importance of the people to the services being supplied.

325. It is noted that the phrase "effectively connected" is broader then the phrase "directly in connection with". The supply can be more than one step removed from the presence. If the presence is attributable to the supply in question, then it is very likely that the presence will be effectively connected with that supply.

326. An example is provided of a US resident who comes to New Zealand temporarily. He returns to the US and continues to negotiate to buy land. The legal services can be zero-rated provided he is outside New Zealand when they are performed or he has only a minor presence in New Zealand that is not directly in connection with the supply of the services.

Unfortunately, there is no indication of whether the facts given will amount to a minor presence or something more.

17.10 Exposure draft of operational statement: GST and costs of mortgagee sales

327. Mortgagee sales are a special type of supply dealt with in sections 5(2) and 17 of the *Goods and Services Tax Act 1985* (the "GST Act"):

   (a) Section 5(2) states that the sale by the mortgagee is a supply by the mortgagor in the course or furtherance of the mortgagor's taxable activity (unless the mortgagor provides written confirmation to the mortgagee that the sale is not a taxable supply or the mortgagee determines based on information available that the sale by the mortgagor would not be a taxable supply);

   (b) Section 17 requires the mortgagee to make a special GST return (in Form IR373) by the 28th of the month following the month of sale, and pay the GST on the supply, and the mortgagor and the mortgagee are to exclude the supply from any other GST return they make.

328. The first issue discussed is the price on which the GST is to be calculated. The particular question addressed is whether the mortgagee's costs of sale can be deducted before calculating the output GST on the sale. This question is answered in the negative because:

   (a) In the Court of Appeal decision in *Commissioner of Inland Revenue v Edgewater Motel Ltd* [2002] NZCA 293, (2002) 20 NZTC 17,984 the use by Blanchard J of phrases like "by imposing a tax on the sale transaction" and "by way of deduction from the purchase price" clearly indicate that the full sale price is the relevant consideration for GST purposes (the discussion in OS 005); and

   (b) The Privy Council stated, in *Edgewater Motel Limited v Commissioner of Inland Revenue* [2004] UKPC 44, 21 NZTC 18,664, that the GST claim is directly against the mortgagee and is not dependent on any priority to the sale proceeds (the discussion in ED 0164).

329. The *Edgewater Motel* case was not specifically concerned with the purchase price on which GST is to be calculated. Rather, the issue was the order in which the GST was to be paid and the ranking of the GST payable relative to the debt owed to the mortgagee. Following the order of priorities listed in s. 104(1) of the *Land Transfer Act 1952* (and its successor s. 185 of the *Property Law Act 2007*), both the Court of Appeal and the Privy Council held that GST is "an expense occasioned by the sale" which the mortgagee is entitled to deduct from the sale proceeds before payment of his own debt (in other words, the GST had priority over the debt).

330. The second issue discussed is the ability of the mortgagee to claim input tax deductions on the costs associated with the sale. There are three reasons advanced to support the Commissioner's view that the mortgagee cannot claim input tax deductions:

   (a) The right to be paid money is a "debt security" as defined in s. 3(2) and the collection of any amount relating to a debt security is the provision of a financial service, which is an exempt supply in terms of s. 14 of the GST Act, and even if there is an indirect connection with some other taxable activity of the mortgagee any such indirect connection is incidental to the activity of providing financial services;

(b) The mortgagee acts on their own behalf by exercising rights conferred by the mortgage agreement, and is not acting as the agent of the mortgagor, so s. 5(2) cannot be used to support an argument that input tax deductions are available as agent of the mortgagor;

(c) *GST - Disputant not entitled to input tax deductions regarding sale of property as mortgagee* [2006] NZTRA 12, *Case Y2* NZTC (2007) 13,017 confirms that the express language of s. 17 provides that in the special return required under that section the mortgagee must pay the full amount of the output tax without any deduction for input tax.

331. The business-to-business rules ("b-to-b rules") in sections 11A(1)(q) and 11A(1)(r), which allow a financial services business to deduct input tax when supplies are made to a business that makes at least 75% taxable supplies, had been newly legislated when OS 005 was issued and there was merely a statement that the conclusion that the mortgagee was carrying on an exempt activity was "subject to the newly enacted section". Therefore, the question of whether the b-to-b rules allowed an input tax deduction was left open in OS 005.

332. The discussion in ED0164 negates an input tax deduction because s. 5(2) states the supplies are made in the course or furtherance of a taxable activity by the mortgagee. Therefore the b-to-b rules have no application.

333. The last point discussed in ED0164 (which was not discussed in OS 005) is whether the mortgagor is able to claim input tax deductions on costs incurred by the mortgagee. The answer is in the negative, because the mortgagee is the recipient of the supply, and the mortgagor is not the person who acquired the services. The mortgagee incurs the costs in the course of exercising their own rights.

17.11 Draft Interpretation Statement: GST and retirement villages

334. Draft Interpretation Statement INS0109: *Goods and services tax – GST and retirement villages* released on 25 February 2015 will update and replace IS 10/08 *Retirement villages – GST treatment* published in *Tax Information Bulletin* Vol. 22, No. 11 (December 2010).

335. IS 10/08 pre-dated the new apportionment rules and the new land transactions rules. These are now covered in this revision. However, transitional rules affecting retirement village operators when moving from the previous sets of rules to the new rules are not covered in the revised statement.

336. There are three main areas covered:

(a) The GST treatment of supplies made by retirement villages to their residents;

(b) The entitlement of retirement village operators to claim input tax deductions; and

(c) The GST treatment of land purchased or sold by retirement villages.

337. Retirement villages provide accommodation and community facilities to residents. Care and other services may also be provided. The Commissioner has concluded, based on research into the types of arrangements entered into and a range of contracts, that the main legal structures used to provide occupation rights are sales of units, and leases or licenses of units or accommodation.

338. Based on the research conducted, the typical financial flows are described in INS0109 as follows:

    (a) **Upon entry**: A lump sum payment which is the purchase price of the unit or an interest-free loan or refundable deposit;

    (b) **Additional fees upon entry (or exit)**: A facilities fee or amenities contribution, either paid up-front upon entry or deducted from the repayment upon exit; the retirement village is either entitled to take the fee up-front or may be entitled to a portion of it per year over a period of years;

    (c) **Periodic fees**: For village overheads such as rates, insurance, security, management and maintenance;

    (d) **Additional periodic fees**: If additional services are required such as laundry, nursing and meals;

    (e) **Upon exit**: A repayment of the entry deposit or loan, or the purchase price of repurchasing the unit, but the repayment is often less than the entry payment, and residents may only be entitled to any capital gain on the sale of the unit if a higher entry payment was made;

    (f) **Additional fees upon exit**: Possibly additional fees for refurbishment of the unit and a termination fee for the legal costs of granting the occupation right.

339. The principles stated by Richardson J in *Marac Life Assurance Ltd v CIR* (1986) 8 NZTC 5,086 (CA) apply to determine the nature of the supplies made by retirement villages. It is the legal arrangements actually entered into and carried out that are most relevant, not the broad substances of the arrangements. The legal rights and duties actually created are crucial, and the surrounding circumstances are only relevant insofar as they help to understand the setting in which the legal arrangements were entered into.

340. Retirement villages typically supply a package of services, so the issues discussed in *Auckland Institute of Studies v CIR* (2002) 20 NZTC 17,685 (HC) are relevant in determining the extent to which the package could be considered to be a single supply. The supply must be looked at from the perspective of the customer and the focus must be on the supply actually made, and not on whether it would be possible to separate it into several different supplies: *Commissioners of Customs and Excise v British Telecommunications Plc* [1999] UKHL 3, [1999] 3 All ER 961 (HL).

341. The supplies made by retirement villages could include:

    (a) The provision of financial services in the form of:

        (i) Debt securities through the issue or allotment of loans, deposits and repayment obligations; and

        (ii) Participatory securities through the provision of entitlements to participate with other residents in the enjoyment of the village facilities;

    (b) The supply of accommodation by way of a lease or licence;

    (c) The supply of common areas and shared facilities;

    (d) The provision of operating and maintenance services; and

    (e) The supply of care services.

342. The Commissioner considers that a retirement village provides separate supplies of financial services, being:

    (a) The issue or allotment of a debt security; and

    (b) The issue of a participatory security.

343. The Commissioner considers that a retirement village provides a separate supply of a financial service in the form of the issue or allotment of a debt security when it accepts an obligation to repay a resident any portion of the entry payment or to repurchase a unit (but not if the retirement village merely has an option to repurchase the unit). The reasoning in INS0109 is as follows:

    (a) Debt security in s. 3 of the GST Act means any interest in or right to be paid money that is, or is to be, owing by any person: therefore, a resident's right to repayment of the entry deposit is a debt security;

    (b) An arrangement under which a unit was sold on the basis that a retirement village would repurchase the unit at a specified price was held to be debt security by the Privy Council in *Culverden Retirement Village Ltd v Registrar of Companies* [1996] UKPC 50, [1997] 1 NZLR 257: therefore, a retirement village's obligation to repurchase a unit is a debt security (however, a mere option to repurchase will not result in a debt security because there is no obligation to pay); and

    (c) A retirement village issues or allots a debt security when it accepts a prospective resident's offer: therefore, a retirement village provides a supply in the form of a financial service.

344. The Commissioner regards the issue or allotment of a debt security by a retirement village as a separate supply from the supply of accommodation and other services for the following reasons:

    (a) The situation can be distinguished from that in *CIR v Gulf Harbour Development Ltd* (2004) 21 NZTC 18,915, where the Court of Appeal found that the supply of a share, ownership of which conferred the right to membership of a golf club, was a single supply of a financial service – i.e. the share, which was an equity security.

    (b) The conclusion that the supply by a retirement village of a debt security is separate from the supply of accommodation is supported by the finding of the Privy Council in *Culverden* that the purchaser acquired two rights: the right to occupy the unit and the right to be repaid the price paid for the unit.

345. The Commissioner considers that a retirement village provides a separate supply of a financial service in the form of the issue of a participatory security when it provides residents with rights to common areas and facilities to be enjoyed in common with other residents. The reasoning in INS0109 is as follows:

    (a) A participatory security for GST purposes is an interest to "participate in any capital, assets, earnings or other property" and also a right that forms part of a "contributory scheme";

    (b) The conclusion that the provision of rights to share common areas and facilities amounts to the issuance of a participatory security is supported by case law: in *Fenton v Pakuranga Park Village Trust* (1998) 3 NZ ConvC 192,681 (CA) the Court of Appeal held that the obligation under residents' licenses not to alter the basic scope and nature of the facilities was owed to residents as a group; in *Norfolk Apartments Ltd v CIR* (1995) 17 NZTC 12,003

(HC) a licence for an apartment in a retirement village was held to be a participatory security;

(c) The provision of rights to share common areas and facilities could form part of a contributory scheme if the retirement village involved more than five residents.

346. The provision of a financial service is an exempt supply. Services that are reasonably incidental and necessary to the supply of financial services are also exempt supplies. However:

(a) Insofar as the provision of a debt security is concerned, the Commissioner does not accept that the supply of accommodation or other services is reasonably incidental and necessary to the supply of financial services by way of the debt security, because, debt securities are supplied to provide funding for the development of the retirement village, whereas the supply of accommodation and care facilities are separate core activities of a retirement village; and

(b) Insofar as the provision of a participatory security is concerned, to the extent that the participatory security results in the supply of a right to accommodation for a concessional or nil consideration, the supply of accommodation is, if it is not itself an exempt supply, an "associated supply" as defined in s. 2, which is excluded by s. 14(1B) from being an exempt supply through being part of a financial service, following the amendment to address the court's finding in the *Gulf Harbour* case (see **paragraph 344(a)** above).

347. The question of the consideration for the financial services is addressed as follows:

(a) The Commissioner considers that the principal under a debt security is not to be treated as consideration for the supply of a debt security because it is effectively just a supply of money, therefore, the purchase price of a unit or the loan or deposit paid upon entry is not consideration for a debt security;

(b) Where a participatory security confers a right to receive the supply of accommodation, and that accommodation is a taxable supply of a commercial dwelling, the consideration for that accommodation must be separately determined under the rules relating to an associated supply and, therefore, the question is what is the consideration for that accommodation, rather than what is the consideration for the participatory security.

348. The Commissioner considers that the supply of accommodation is an essential feature of a retirement village contract, and involves the following elements:

(a) The supply of a place to live;

(b) The right to use common areas and facilities, which are:

(i) Appurtenances belonging to or used with the premises under paragraph (b)(ii) of the definition of "dwelling" in s. 2 (the Commissioner considers that the basis for the decisions in *Norfolk* and *Wairakei Court Ltd v CIR* (1999) 19 NZTC 15,202 (HC) is that the right to use common areas was an appurtenance (rather than the common areas themselves); or

(ii) Part of the supply of accommodation in any case, because without access to the common areas it would not be possible to exercise the right to occupy the dwellings;

(c) Maintenance services to keep the unit and the village facilities in good repair;

(d) Transport services, if any, supplied as part of the package of services.

349. The consideration for the supply of accommodation includes:

    (a) The facilities fee or amenities contribution, which can be paid:

        (i) Up-front, in which case the supply is made at the time of the payment, regardless of whether the fee accrues to the retirement village over a period; or

        (ii) By deduction from the refundable loan or deposit upon termination, in which case there is a payment by way of set off under the principal in *Re Harmony & Montague Tin & Copper Mining Co Ltd (Spargo's Case)* (1873) 8 Ch App 407 (CA) and the supply is made at the time of the set off;

    (b) Periodic fees (which could include payments for other services, such as care services, in which case the consideration for the other services must be separated out);

    (c) Refurbishment costs and other termination charges if resident have to pay for refurbishment of their units on termination of occupation and that obligation is carried out by the retirement village (excluding costs incurred by a retirement village on its own account, such as costs of marketing a unit and obtaining a replacement resident and legal costs of preparing a new lease or licence).

350. Whether the consideration is for a taxable or an exempt supply depends on whether the supply of the accommodation is "the supply of accommodation by way of hire, service occupancy agreement or licence to occupy in a dwelling", which is an exempt supply under s. 14(1)(c).

351. The definition of "dwelling" in s. 2 was amended so that the requirement for "quiet enjoyment" would not exclude dwellings in retirement villages. Paragraph (b)(iii) of the definition includes "a residential unit in a retirement village or rest home when the consideration paid or payable for the supply of accommodation in the unit is for the right to occupy the unit". A dwelling under paragraph (b)(iii) is excluded from being a commercial dwelling.

352. The focus must be on the terms of the agreement under which residents obtain a right to occupy a unit in a retirement village (generally a lease or a licence) to decide whether the consideration is for the right to occupy the dwelling.

353. The Commissioner considers that the ordinary meaning of paragraph (b)(iii) suggests that the consideration must be solely for right to occupy the unit. In *Wairakei* a package of services that included accommodation in a studio unit and nursing care was not excluded from being a commercial dwelling whereas accommodation in a stand-alone villa was excluded from being a commercial dwelling. Therefore, the Commissioner considers that paragraph (b)(iii) will not apply to units whose residents are required to purchase care packages.

354. Where the supply is within the meaning of paragraph (b)(iii), the right to use common areas and facilities, maintenance services and transport services will all form part of the exempt supply.

355. The provision of accommodation in a "commercial dwelling" is a taxable supply. The definition of 'commercial dwelling" includes convalescent homes, nursing homes, rest homes and hospices, and establishments of a similar kind. The definition also includes a services apartment manages or operated by a third party for which services in addition to the supply

of accommodation are provided and in relation to which a resident does not have quiet enjoyment.

356. It is noted that in order for an establishment to be similar to a convalescent home or a nursing home, it need not be exactly the same. In *Case L75* (1989) 11 NZTC 1,435, the premises were not the same as a hotel or motel, but shared some significant defining features which qualified them as a commercial dwelling. The Commissioner considers that the defining features of establishments like nursing homes is that they provide both accommodation and care.

357. A serviced apartment could potentially be either a dwelling or a commercial dwelling, depending on whether the consideration paid by the resident includes care services.

358. A retirement village could make both taxable supplies (by supplying accommodation in commercial dwellings) and exempt supplies (by supplying accommodation in dwellings). There will need to be an assessment made of the proportion of taxable and exempt supplies.

359. The provision of debt securities and participatory securities is not relevant to the determination of taxable versus exempt supplies, because they do not relate to the intended use of a building or other assets.

360. A full input tax deduction is allowed for a good or service that is intended to be used solely for making taxable supplies, such as the supply of commercial dwellings or care services. The Commissioner considers that to the extent that part of a community centre (such as kitchens, restaurants and nursing stations) is used for the preparation and provision of meals and the provision of nursing care, such an area would be used solely for the making of taxable supplies.

361. No input tax deduction is allowed for a good or service that is intended to be used solely for making exempt supplies, such as supplies of accommodation in a dwelling or a financial services. The Commissioner does not accept that the provision of accommodation in dwellings could be regarded as part of larger taxable supplies in the sense that they are a means of obtaining residents who eventually move into commercial dwellings where care services are available (i.e. the provision of such a "catchment" does not constitute a taxable supply).

362. Where goods and services are use for making both taxable and exempt supplies, the apportionment rules will apply.

363. Upon acquisition, the retirement village operator must estimate how they intend to use the goods or services:

    (a) For goods and services relating to a common area used for making both taxable and exempt supplies, the Commissioner considers the uses must be apportioned under s. 20(3G) choosing a determination that produces a fair and reasonable result, with taxable use expressed as a percentage of total use: any records available can be used, or previous experience and patterns if they are unchanged, or other methods, or even indirect methods based on turnover or profit for overheads that are not directly referable to particular supplies (*Tax Information Bulletin* Vol. 23, No. 1, February 2011, page 34).

    (b) When constructing the village, the Commissioner considers that construction costs can be apportioned based on the overall plan – for example, if the plan is to provide 70% commercial dwellings and 30% dwellings, then the taxable/exempt apportionment could

be 70/30, subject to there being objective factors to support the stated intentions, such as the nature of the development permitted by the resource consent, the disclosure statement required to be provided to prospective residents, and the form of the occupation right agreement intended to be entered into with residents.

364. At the end of each adjustment period, it is necessary to compare the actual use with the intended use. Where construction costs have been apportioned based on a plan, the Commissioner considers that "actual use" will be different, and an adjustment would be required, only if the plan itself has changed. Providing that is not the case, the apportionment can continue to be made based on the plan, until completion.

365. The other apportionment rules apply as follows:

    (a) The number of adjustments follow the apportionment rules: no limit for land, and the number of adjustment periods for other assets limited based on cost;

    (b) If a good or a service is devoted entirely to a taxable or non-taxable use, the wash-up adjustment in s. 21FB must be performed;

    (c) The concurrent use of land apportionment rule in s. 21E will only apply if the retirement village operator is in the business of buying and selling retirement villages, and the dwellings are leased or licensed in the interim; vertical stacking of commercial dwellings and ordinary dwellings does not amount to concurrent use in the context of s. 21E, and neither does the common use of land for a taxable and an exempt purpose, because s. 21E requires the complete use of the relevant land for each purpose;

    (d) Where a good or services used for a mixed purpose is disposed of, the final input atx calculation under s. 21F must be performed.

366. Where land is purchased by a GST-registered (prospective or current) retirement village operator from another registered person, the Commissioner is of the view that the zero-rating of land rule applies even if the purchaser plans to use the land only partly to make taxable supplies.

367. This will be the case when a retirement village operator acquires land with the intention of putting both dwellings and commercial dwellings on the land. The Commissioner contends that the phrase "for making taxable supplies" is not limited to situations where the operator intends to use the land solely for making taxable supplies.

368. Moreover, the taxable supplies do not have to be made in the first adjustment period. The supply of land can be zero-rated where the operator's overall aim or plan is to use the land wholly or partly for making taxable supplies and the plan is sufficiently well developed.

369. This means that, as the recipient of a zero-rated supply of land, the retirement village operator must identify the nominal GST component, determine the extent to which the land is to be used for making taxable supplies, and account for output tax on the proportion of the nominal GST component that corresponds to the non-taxable use, under s. 20(3J).

370. If the land is not zero-rated, the retirement village operator will need to determine the input tax deduction available under the apportionment rules.

371. When a retirement village operator purchases or sells an existing retirement village that has dwellings on it, it will be necessary to determine to what extent there is a separate supply of:

    (a) A principal place of residence under s. 5(15)(a); or

(b) A dwelling that has been supplied exclusively as a dwelling for a period of five years or more before the date of sale of the land.

372. INS0109 contains three examples:

(a) **Example 1** concerns the establishment of a retirement village with licensed units that are mixture of dwellings (80%) and commercial dwellings (20%): the conclusions are consistent with the discussion above – i.e. that the retirement village operator must pay output tax under s. 20(3J) for the zero-rated supply, input tax deductions are not available in relation to the construction of the dwellings, and supplies used for common areas must be apportioned 80/20.

(b) **Example 2** concerns the establishment of a retirement apartment complex consisting of dwellings on land acquired from a non-registered seller: no input tax can be claimed on acquisition, and input tax can only be claimed on goods and services to the extent they relate to the specific provision of care services.

(c) **Example 3** concerns a rest home complex that is expanded to include villas where the rest home, which is a commercial dwelling, was acquired from a GST-registered seller as a zero-rated supply of land: the inclusion of the exempt villas will mean that a change of use adjustment must be made (which could potentially be based on turnover).

17.12 Draft QB: Non-profit bodies – Registration and accounting for GST

373. The draft QB is about the implications of a non-profit body voluntarily registering for GST in circumstances where:

(a) The main activities involve obtaining and distributing donated goods, and running free assistance programmes for the community and raising funds for that purpose;

(b) The main assets are two buildings: one acquired in 1975 used for administration and for storing and distributing donated goods, and the other a hall acquired in 1989 used for meetings and for hiring out to members of the community; and

(c) The total value of supplies relating to hiring out a hall for use by members of the community is around $25,000 per year.

374. In order to register for GST the non-profit body must carry on a taxable activity. There is a discussion on the three requirements for there to be a taxable activity: there must be an activity, that is carried on continuously or regularly by the person, involving supplies to another person for a consideration.

375. The non-profit body in the draft QB meets these requirements in supplying the hall for a consideration. Therefore, the non-profit body is carrying on a taxable activity by making supplies in the form of hiring of the hall for consideration, and it can register for GST.

376. It is noted that in order to remain GST-registered, the non-profit body must continue to carry on a taxable activity. It must continue to make some supplies (other than exempt supplies) of goods and services for a consideration.

377. It is noted that the supply of donated goods and services by a non-profit body is an exempt supply under s. 14(1)(b) of the GST Act. Under s. 6(3)(d), a taxable activity excludes any activity to the extent to which it involves the making of exempt supplies. Consequently, the distribution of donated goods is not part of the taxable activity of the non-profit body.

378. Therefore, if the non-profit body was to cease hiring out the hall, its taxable activity will have ceased even if it continued to distribute donated goods. Under s. 52(3), it must notify the Commissioner within 21 days of its taxable activity having ceased. Alternatively, under s. 52(5), the Commissioner can cancel its GST registration if the Commissioner is satisfied the non-profit body is not carrying on a taxable activity.

379. The non-profit body will have to charge GST on the supply of the hall and return output GST. It will not have to charge GST on the distribution of the donated goods, which is an exempt supply.

380. The general rule in s. 20(3C) is that input tax deductions can be claimed to the extent to which goods and services are used for, or available for use in, making taxable supplies. In addition, under s. 21B a registered person may make an adjustment to claim input tax deductions for goods or services acquired before registration, to the extent that those goods or services are used for making taxable supplies and GST has been charged on them.

381. A special rule in s. 20(3K) applies to input tax deductions for non-profit bodies that are resident in New Zealand. They may treat goods or services used, other than to make exempt supplies, as being used for making taxable supplies.

382. In the circumstances of the non-profit body in the QB, input tax deductions may be claimed on all goods and services, other than those used for making exempt supplies. The examples given are goods and services used to refurbish the hall (directly used for making taxable supplies) and goods or services used to organise the free community assistance programmes (used to make supplies other than exempt supplies).

383. No input tax deductions may be claimed on goods or services used to make supplies of the donated goods. The example given is of goods or services used in relation to the administration building that is used for storing and distributing donated goods. Some apportionment will be required of input tax to the extent it relates to the making of exempt supplies (i.e. the extent to which the building is used to store and distribute the donated goods).

384. In addition, providing that GST was charged on the acquisition of the hall in 1989 and a tax invoice is held, the non-profit body can make an adjustment under the apportionment rules, under s. 21B, for the first adjustment period after it becomes GST-registered. The first adjustment period would be treated as starting on the date the hall was acquired and ending on the first balance date after the non-profit body registers for GST.

385. Furthermore, because the hall is not used to make exempt supplies, it is treated as being wholly used to make taxable supplies. Therefore, the "wash-up" calculation in s. 21FB can be performed to claim all input tax on the basis that the use of the hall has changed to solely taxable use.

386. If the non-profit body ceases having a taxable activity, it must deregister. In that case, any goods or services forming part of the assets of the taxable activity carried on by the non-profit body are deemed to be supplied in the course of that taxable activity immediately before deregistration.

387. The value of this supply is generally determined under s. 10(7A) as the open market value of the supply. However, for goods and services acquired before 1 October 1986, the value of the

deemed supply is, under s. 10(8), the lesser of the cost of the goods and services to the supplier and the open market value of that supply.

388. The conclusion in the QB is that the non-profit body must pay output GST on both buildings: the hall (on which GST input tax can be claimed) and the administration building (in relation to which no input tax can be claimed).

389. Because the administration building was acquired before 1 October 1986, the value of the deemed supply is the lesser of cost and open market value. The input tax adjustment under s. 21F that is normally available upon deregistration, to compensate for unclaimed input tax, will not apply. No final input tax adjustment can be made under s. 21F because no input tax was charged on acquisition.

390. This is a particularly harsh result and is an issue that will need to be carefully considered by a non-profit body that is considering registering for GST.

18. RECENT COURT CASES INVOLVING GST

391. There have been a number of court cases relating to GST in recent years. What follows is a summary of recent GST cases that have been reviewed in *Weekly Comment* articles.

18.1 Lessor remained liable for GST on lease payments

392. Taxation Review Authority, *TRA 007/12*, [2014] NZTRA 08, concerning whether a lessor remained liable for GST on lease payments after the lease payments had been assigned to a finance company.

393. The lessor assigned its rights under lease agreements to a finance company. It claimed input tax deductions on the leased equipment, but did not return any output GST on the grounds that the finance company was liable. The TRA found the taxpayer remained liable for the output GST on the lease payments.

18.2 Time of supply of newly subdivided land

394. The time of supply for GST purposes was the reason for the dispute in *TRA 023/12*, [2014] NZTRA 10. The AB Family Trust was engaged in the subdivision of land and entered into agreements for the sale and purchase of four Lots of land before the subdivision had been completed. Each agreement was conditional upon the issue of a certificate of title and upon satisfying s. 225 of the *Resource Management Act 1991* ("the RMA"). Deposits were paid into the Trust's lawyers' trust account to be held by that firm as stakeholder.

395. Before the GST rate increased to 15% on 1 October 2010, the Trust issued documents dated 29 September 2010 purporting to be GST tax invoices. The Commissioner alleged they were not invoices because there was no obligation to pay at that time. The Commissioner maintained the supply occurred when the stakeholder status ended and the deposits were held on the Trust's behalf. This occurred in November 2010, when notice that the certificates of title had been issued was received by the lawyers, who advised the Trust accordingly.

396. The time of supply for GST purposes is set out in s. 9(1) of the *Goods and Services Tax Act 1985* ("the GST Act") as follows:

"Subject to this Act, for the purposes of this Act a supply of goods and services shall be deemed to take place at the earlier of the time an invoice is issued by the supplier or the recipient or the time any payment is received by the supplier, in respect of that supply."

397. An invoice is defined in s. 2 of the GST Act as " a document notifying an obligation to make payment". The Commissioner submitted that it is not enough for an invoice to notify someone of a conditional or contingent obligation.

398. The Commissioner's submissions included a discussion about the differing views expressed in the High Court in *Shell New Zealand Holding Co Ltd v Commissioner of Inland Revenue* (1993) 15 NZTC 10,136 (HC) and the Court of Appeal in *Shell New Zealand Holding Co Ltd v Commissioner of Inland Revenue* [1994] 3 NZLR 276 (CA). In the High Court, Heron J thought an "immediate liability for payment is contemplated". In the Court of Appeal Richardson J stated that "… it is both unnecessary and uncommon in practice for commercial invoices to specify time for payment … The time for payment is not part of the definition (of "invoice")".

399. The Trust contended that:
    (a) From the time the purchasers signed the agreements and paid the deposits the agreements were a "legally binding obligation" on the purchasers and the vendor, and it was at this stage that the obligation to make payment arose;
    (b) By the date the invoices were issued, the Trust and the purchasers had rights of specific performance because an equitable interest in the land was created on receipt of the deposit, at which time the Agreements were able to be sued upon and obligations existed on the Trust and the purchasers to complete the sale and purchase; and
    (c) The time of supply can be triggered when an agreement is still subject to s. 225(1) of the RMA.

400. The Commissioner contended that:
    (a) There is no debt due while a contract is still conditional;
    (b) An agreement subject to s. 225 of the RMA was conditional, following the Court of Appeal decision in *Steele v Serepisos* (2005) 7 NZCPR 145 (CA) and the Supreme Court decision in *Steele v Serepisos* (2006) NZSC 67: In the Supreme Court Tipping J noted that s. 225(1) was permissive insofar as it allowed contracts to be entered into prior to the deposit of the plan but necessarily subject to its deposit.
    (c) There can be no obligation to make payment until there is a debt due: the deposit was not payable to the Trust, but was payable to the "stakeholder";
    (d) As long as a contract remained conditional, no purchase price was payable, no supply had taken place and no tax invoice could lawfully be issued, following *R v Hawken* (2006) 22 NZTC 19,876 (CA).

401. Judge AA Sinclair agreed with the Commissioner that the obligation to make payment referred to in the definition of "invoice" must be a present obligation even if payment is made at a future date. There cannot be an obligation to make payment until there is a debt due, and there cannot be a debt due until the supplier has completed all that is required to demand payment. The Supreme Court in *Steele v Serepisos* held that and agreement subject to s. 225(1) of the RMA was conditional.

402. The Judge also noted that the deposit could not trigger a time of supply while it was held by a person as a stakeholder, following CIR v Dormer (1997) 18 NZTC 13,446 (HC).

403. The Judge found that the documents purporting to be invoices issued in September 2010 were not invoices for the purposes of the GST Act because there was no obligation to make payment while the Agreements remained conditional.

404. However, once the agreements became unconditional in November 2010, the time of supply was triggered when the stakeholder status ended and the deposits were held on behalf of the Trust. At that point the requirements of the contracts were satisfied and the contracts were binding on the Trust and the purchasers.

18.3 Input tax restriction applies to supplies between associated persons

405. The issue in *TRA 008/14* was whether a disputant company could claim an input tax deduction of $119,628.07 in respect of a property that had become a taxable supply from 1 April 2011 due the changed definitions of "dwelling" and "commercial dwelling".

406. The facts were that Mr. X, who owned 99% of the shares in the disputant company, initially purchased the property in February 2005 from an unregistered person for $635,000. Mr. X himself was not GST-registered. After making substantial capital improvements in excess of $300,000, Mr. X sold the property in 2007 to the disputant company for $1,100,000. The purchase price was supported by an independent valuation.

407. The property was used to provide short-term rental accommodation. The property was treated as a "dwelling" for GST purposes and the supply of the property was, therefore, GST-exempt prior to 1 April 2011. The supply of the property became a taxable supply from 1 April 2011 because it was not principally used as someone's residence.

408. The disputant company claimed an input tax deduction under s. 21HB, which allows an input tax deduction to the extent a deduction was not made under the rules that previously applied. The Commissioner disallowed the deduction under the rule that restricts input tax deductions on supplies made between associated persons.

409. The Commissioner's view is that the transfer of the property from Mr. X restricts the input tax deduction, under s. 3A(3)(a) to the amount of GST included in the original cost of the property to Mr. X. As there was no GST charged on the supply to Mr. X, the disputant company cannot claim any input tax deduction.

410. An input tax deduction is permitted by s. 21HB(2) and (3) which state that:

> "(2) Input tax in relation to the acquisition referred to in subsection (3) may be deducted under section 20(3C) to the extent to which a deduction has not been made under the old apportionment rules.
>
> (3) The person must treat the goods or services as acquired on 1 April 2011 at the original cost of the supply."

411. These provisions were interpreted differently by the Commissioner and the disputant:

(a) The Commissioner contended that they meant that the original acquisition transaction is treated as having occurred on 1 April 2011; but

(b) The disputant maintained that s. 21HB(3) implies that there is a deemed supply on 1 April 2011 and the cost of the original supply is a GST-inclusive consideration for the purposes of the deemed supply.

412. Judge AA Sinclair agreed with the Commissioner for the following reasons:

(a) The reference to "the supply" in s. 21HB(3) is a reference to the original acquisition transaction;

(b) Hence, the original acquisition transaction is "the supply" in relation to which it is necessary to determine the amount of the input tax deduction available;

(c) The reference in s. 21HB(2) to "to the extent to which a deduction has not been made" lends support to the view that "the supply" is the original supply;

(d) If it was intended that s. 21HB(3) was meant to refer to a different supply, that would have been explicitly stated;

(e) Input tax on an acquisition from an associated person is restricted to the lesser of the input tax on the original supply and the input tax on the sale transaction; and

(f) There was no evidence to support the view that Parliament had intended to change this approach in relation to properties that became subject to GST because of the changed definitions of "dwelling" and "commercial dwelling".

413. An amendment to s. 21HB(1) contained in s. 192(2) of the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014* appears to lend support for the Commissioner's and Judge AA Sinclair's interpretations. As stated on page 101 of Tax Information Bulletin Vol. 26, No. 7, August 2014:

"However, an unintended effect of the transitional rule was that suppliers affected by the definition changes could arguably claim input tax deductions for accommodation acquired before the introduction of GSRT on 1 October 1986. This is contrary to the policy rationale underlying the rule as this outcome would allow suppliers to claim input tax for property acquired when no GST was incurred."

414. The amendment limits the input tax that may be claimed to costs incurred between 1 October 1986 and 1 April 2011. This amendment implies that it is the original supply in relation to which it is necessary to determine the GST input tax deduction available.

415. The disputant complained about, and Judge sympathised with, the fact that the subsequent sale of the property would attract output GST. Apart from anything else, the case once again shows that transactions between associated persons can give rise to inequitable results, and that is within the legislative design to protect the tax base.

18.4 Input tax disallowed because vendor and purchaser had common shareholder

416. Cas*e TRA 02/10* [2015] NZTRA 01, concerned the GST definition of when two companies are associated under s. 2A(1)(a) of the *Goods and Services Tax Act 1985* ("the GST Act"). The High Court judgment in *Concepts 124 Limited v Commissioner of Inland Revenue* [2014] NZHC 2140, which had just been handed down while the case was being heard had a deciding influence. The *Concepts* case is discussed from paragraph 434 below.

417. The disputant company ("the Disputant") purchased a block of land for development from X Land Holdings Ltd and claimed GST input tax totalling $505,550.60. The Commissioner disallowed the claim on the grounds that:

    (a) The purchaser and the vendor were associated under s. 2A(1)(a)(iii) of the GST Act, which states that two companies are associated if a group of persons "has control of each of those companies by any other means whatsoever"; or

    (b) The arrangement was a tax avoidance arrangement, for which a shortfall penalty for abusive tax avoidance was imposed.

418. The ownership structure was complicated and is helpfully summarised by the judge in two appendices to the judgment: Appendix A and Appendix B. The important aspect is the fact that the shares in the vendor and the purchaser were held by trustee companies in trust for seemingly unrelated beneficiary companies, although the two trustee companies were commonly owned:

    (a) The shares in the Disputant company were held by X Nominees Ltd on trust for X Construction Ltd. The shares in the trustee, X Nominees Ltd, were 100% owned, through two intermediate companies, by X Management Ltd.

    (b) The shares in the vendor company were held, through an intermediate company, by X Management Ltd, on trust for X Foundries Ltd.

419. As the judge eventually found, the complications in the structure appeared to have been designed to cause a break in association so as to allow the claim for input tax, thereby constituting tax avoidance. However, the case contains a useful discussion on the meaning of control "by any other means whatsoever".

420. As noted, the shares in the Disputant were held on trust for X Construction Ltd, which was 99% owned by X Ventures Ltd, which was in liquidation and had been struck off the Register of Companies in 1996. Therefore, the Crown had legal control, or if X Ventures Ltd was reinstated to the Register then under s. 330 of the Companies Act 1993, the company reverted to the shareholders from the date it was struck off.

421. The shares in the vendor were held on trust for X Foundries Ltd, and the shares in this company were in turn held on trust for Mr. and Mrs. M who lived in the United States.

422. The Commissioner argued that despite the separate ownership, both companies were controlled by the common director, Mr. R. It was noted at [66] that:

    "The Commissioner further submits that the complicated ownership structure adds to the uncertainty of a conclusion based on legal control. She contends that the purported ultimate beneficial owners of the Disputant and the Vendor may be able to 'pull the levers' but not have anything happen at the other end of the chain."

423. The judge stated the general rule is that a person controls a company if they have the majority of votes at a general meeting of the company. In *Mendes v The Commissioner of Probate Duties (Vict)* [1967] HCA 23, [1967] 122 CLR 152, Windeyer J said:

    "For the purposes of the revenue laws a member of a company who holds enough shares to give a majority of votes at a general meeting has "control" of the company. That is the general rule. Control in that sense means the capacity to carry an ordinary resolution at a general meeting."

424. The judge noted that the argument that "controlling interest" equated to beneficial ownership was rejected in *British American Tobacco Company Limited v IRC* [1943] AC 335 (HL) where Viscount Simon said:

  "I find it impossible to adopt the view that a person who (by having requisite voting power in a company subject to his will and ordering) can make the ultimate decision as to where and how the business of the company shall be carried on and who thus has, in fact, control of the company's affairs, is a person of whom it can be said that he has not in this connection got a controlling interest in the company."

425. The fact that shares were held on trust was considered irrelevant for determining whether the shareholder had control of the company in *IRC v J Bibby & Sons Ltd* [1945] 1 All ER 667 (HL), where the Court said:

  "When the section speaks of directors having a controlling interest in a company, what it is immediately concerned with in using the words "controlling interest" is not the extent to which the individuals are beneficially interested in the profits of the company … but the extent to which they have vested in them the power of controlling by votes the decisions which will bind the company in the shape of resolutions passed by the shareholders in general meeting …

  For the purpose of such a test the fact that a vote-carrying share is vested in a director as trustee seems immaterial. …"

426. A test similar to "control by any other means whatsoever" was considered in *Himley Estates Limited v Commissioners of Inland Revenue* (1932) 17 TC 367 (HC). Lord Hanworth MR suggested that the test may be referring to circumstances where the voting power is in the hands of persons who are subservient by some means to another person. In that case, the measure and value of those "other means" should indicate that the exercise of the authority given under the articles of association is in the hands of those persons.

427. The judge referred to the example of such control referred to by Clifford J in the *Concepts* case, where he stated:

  "… control by any other means is … control by means other than through voting interests/shareholders voting rights. For example, a person, including a company, could obtain control of another company by a range of contractual mechanisms whereby voting interests/shareholder voting rights held by other persons were in fact controlled by that person."

428. The judge did note that in *Case K54* (1988) 10 NZTC 444, it was suggested that control could be decided as a matter of fact if it is not capable of being resolved as a matter of law. Further, as noted in *S. Berendsen Ltd v Inland Revenue Commissioners* [1957] 2 All ER 612 (CA), the effectiveness of legal control could be questioned if "the man at the far end who pulls the lever would pull it in vain, because the mechanism was so complicated that no discernible effect would be seen at the other end of the machine".

429. Despite the latter comments, the judge concluded that the case law is well established that control refers to legal control, and the other forms of control are the alternative means of legal control through contractual mechanisms referred to by Clifford J, and not factual control. The judge concluded that the Disputant and the Vendor were not associated through "control by any other means".

430. In this case, the judge followed the precedent in *Concepts* and decided the companies were associated under s. 2A(1)(a)(i) of the GST Act through common ownership despite the existence of the trusts. The decision in *Concepts* is discussed from paragraph 434 below.

431. The rest of the case concerned whether there was an arrangement to avoid tax. In finding that there was tax avoidance the judge noted that:

    (a) Parliamentary contemplation in relation to transactions between associated persons was to limit the availability of GST input tax deductions on such transactions;

    (b) The elaborate ownership structure had been conceived principally to break the association between the Disputant and Vendor companies to obtain the input tax deduction without the limit contemplated by Parliament;

    (c) The parties had "gone to such efforts to minimse their formal association" that a high degree of contrivance, pretence and artificiality is evident in the transaction";

    (d) There were several unrealistic features, including the facts that:

        (i) The transaction was not settled in accordance with the documentation; and

        (ii) There was no mortgage taken over the property which was extraordinary in a sale to an unrelated third party;

    (e) The payments were made by a series of cheque swaps and journal entries; and

    (f) The sale proceeds ended up being held by a company in a contractual relationship with the Disputant instead of by the Vendor.

432. For the purpose of imposing shortfall penalties, the Disputant was found to have taken an abusive tax position, and also a tax position that failed to meet the standard of being "about as likely as not to be correct".

433. The Disputant was found liable for shortfall penalties for taking an abusive tax position.

18.5 Company owned by a trust associated with shareholder in trustee company

434. The High Court judgment dated 5 September 2014 in *Concepts 124 Limited v Commissioner of Inland Revenue* [2014] NZHC 2140, concerning whether a company owned by a trust was associated with a company owned by the shareholder of the trustee company.

435. The case was an appeal from the Taxation Review Authority decision *Case 11/2013* [2013] NZTRA 11, (2013) 26 NZTC 2-010. In *Case 11/2013* the TRA had found that control through a corporate trustee of a company that was a trust asset constituted control "by any other means whatsoever", which was sufficient to create an association with another company that was not held through the trust.

436. The facts in the case were that the taxpayer, Concepts 124 Ltd ("Concepts") had claimed a GST input tax deduction based on the price of $8,034,750 paid to Ormiston Residential Ltd ("Ormiston"), a company 75% owned by a trust, the Flatbush Holdings Trust ("FBH Trust"). Ormiston was not registered for GST. It had acquired the property for $847,000, including GST of $94,111.12.

437. The corporate trustee of the FBH Trust was Flatbush Holdings Limited ("Flatbush"). Mr. Cummings owned all the shares in Flatbush. He also owned all the shares in Concepts, and he was the sole director of both companies.

438. The Commissioner argued that Concepts and Ormiston were associated persons and, therefore, the GST input tax deduction could only be claimed on the price originally paid by Ormiston of $847,000.

439. Two companies will be associated under s. 2A(1)(a) of the *Goods and Services Tax Act 1985* ("the GST Act") if a group of persons:

   (i) Has voting interests in each company of 50% or more; or

   (ii) Has market value interests in each company of 50% or more, if a market value circumstance exists; or

   (iii) Has control of each company by any other means whatsoever.

440. Before the TRA it was acknowledged by both the Commissioner and the disputant that, because of the existence of the Trust, Concepts and Ormiston could not be associated under s. 2A(1)(a)(i) because Mr. Cummings did not hold 50% or more of the voting interest in both companies. FBH Trust owned 75% of the voting interest in the seller, Ormiston. The Commissioner accepted that the beneficial ownership of the seller company's shares had been separated from the legal ownership, which altered the capacity in which the trustee company, Flatbush, held the shares and made them trust property.

441. Clifford J, in the High Court, disagreed and his analysis may be summarised as follows:

   (a) Section 2A(1)(a)(i) makes no reference, directly or indirectly, to shares held on trust;

   (b) The phrase "voting interests" defined in sections YA 1 and YC 2(1) of the Income Tax Act 2007 means shareholder decision-making rights "held" by the person, and "held" is not qualified by reference to whether the shares are legally owned only (as when held in trust) or legally and beneficially owned (as when held personally);

   (c) The "economic interests" concept under which ownership by a trust is distinguished from ordinary direct ownership does not apply to the determination of control;

   (d) For the purposes of the continuity provisions (i.e. the ability to carry forward and use tax losses) the trustees of a trust are treated, under s. YC 9, as the same notional single person (other than a company) with the effect that, in the case of a corporate trustee, there is no "look-through" to the shareholders of the corporate trustee;

   (e) However, this modification did not apply to the general rule defining when two companies are associated – in Clifford J's view this was a deliberate approach because economic interests are not relevant to determining control of a company, therefore, the notional single person rule applied only to attribute economic interests, and not to the attribution of control, which rested with the shareholders in the corporate trustee.

442. Clifford J found that Concepts and Ormiston were associated because there was a group of persons (Mr. Cummings qualified as a "group of persons") who had voting interest in each company of more than 50%. Mr. Cummings' voting interest in Ormiston could be traced through the corporate trustee in which he held all the shares.

443. With the greatest of respect, I find this reasoning ignores the rule of association between a trust and a company that it owns.

444. For income tax purposes, under s. YB 3(5) of the Income Tax Act 2007, for the purposes of determining the association between a company and a person other than a company, "a person other than a company includes a company acting in its capacity as a trustee of a trust".

445. Therefore, Flatbush is, for income tax purposes, in relation to its shareholding of 75% in Ormiston held on behalf of the FBH Trust, a person other than a company. In that capacity, Flatbush is associated with Ormiston for income tax purposes.

446. Section YB 3(5) is not referred to in the GST Act. However, Clifford J's analysis traces the legislative history of income tax provisions in order to arrive at the conclusion that it is possible to trace through a corporate trustee to determine control by its shareholders. If, for income tax purposes, Flatbush is associated with Ormiston under a separate rule of association between a company and a person other than a company, Ormiston cannot be associated with Concepts, for income tax purposes, under the 50% or more commonality of shareholding rule.

447. It is difficult to see why there would have been a different intention on the part of legislators for GST purposes. The omission of any reference to s. YB 3(5) appears to have been an oversight. (Incidentally, the arguments in the case involved s. YC 9, which is also not referred to in the GST Act.)

448. In any case, Clifford J agreed with the TRA that Mr. Cummings controlled Ormiston through his holding the power of appointment and removal of trustees of the FBH Trust. Interestingly, the income tax rule of association between a trustee and person with the power of appointment is also missing from s. 2A of the GST Act. Otherwise, Ormiston and Concepts would have been associated under the tripartite rule, through their common association with Mr. Cummings.

18.6 Inbound tourism facilitation services to non-resident cruise lines subject to GST

449. The High Court judgment in *ID Tours New Zealand Limited v Commissioner of Inland Revenue* [2015] NZHC 483 was given on 16 March 2015. The case was an appeal of the Taxation Review Authority decision in *TRA 05/12* [2014] NZTRA 13.

450. The case concerned whether GST applied to fees charged by ID Tours for advisory tourism services and "on the ground" services provided to cruise lines, incentive houses (who arrange employee reward travel packages) and to a UK travel agent.

451. The principal business activity involved providing logistics and activity planning advice to, and making bookings on behalf of, cruise ships that visit New Zealand. The process commenced with a Request for Proposal ("RFP"), which set out available tourist activities, port infrastructure, costs of recommended activities and the fee charged by ID Tours. Then cruise lines selected their preferred tourist programmes, requested an outline of how the excursions would work within their time frames, and offered the excursions to passengers.

452. The cruise lines asked ID Tours to make bookings based on sales to passengers. ID Tours charged its own fee based on all products sold by a ship. After the visit, the cruise line sent ID Tours a "self invoice" for checking, detailing the programmes purchased and ID Tours' fees. Once checked, the invoice was paid by the cruise line's head office and ID Tours then paid the New Zealand suppliers.

453. Similar types of arrangements were entered into with incentive houses. The process commenced with an RFP. Once accepted, ID Tours might be asked to make bookings, payments and contract with local suppliers. The arrangements were generally 85% pre-paid, with the remaining 15% paid if the incentive house was satisfied with the product or service. ID Tours facilitated the payments of the deposits to local suppliers and was invoiced for the

remaining 15% by the suppliers (although the suppliers knew the remainder would be paid by the incentive houses). ID Tours charged a fee related to the value of each programme.

454. ID Tours also made bookings with New Zealand suppliers on behalf of a UK travel agent, typically for independent, individual travellers. The UK travel agent issued ID Tours with vouchers for payment. The invoices from the local suppliers were sent to ID Tours and the vouchers were used to make the payments to suppliers. Apparently local suppliers knew the invoices should be sent to ID Tours because that facilitated the payment of the account.

455. ID Tours maintained that it was entitled to zero-rate the supply of its services under s. 11A(1)(k) of the *Goods and Services Tax Act 1985* ("the GST Act"), under which services supplied to a person who is a non-resident and who is outside New Zealand at the time the services are performed must be zero-rated.

456. The High Court considered that this would certainly be the case if ID Tours was found to be acting as the agent of non-resident principals in relation to its "on the ground" activities. The TRA had also first considered whether there was an agency relationship and the High Court agreed that was the correct approach.

457. Section 60 of the GST Act deals with agents. The general rule is that where an agent makes a supply of goods and services for and on behalf of a principal of that agent, that supply is deemed to be made by that principal and not by that agent. The corollary is that where a registered person makes a taxable supply of goods and services to an agent who is acting on behalf of a principal for the purposes of that supply, that supply is deemed to be made to that principal and not to that agent.

458. However, an agent and a principal can agree in writing that s. 60(1B) applies so that there are two separate supplies: one to the agent and the other from the agent to the principal, and in such cases, the agent is treated as the principal for GST purposes.

459. In this case there was no written agency agreement. If there was an agency relationship, it was implied and had to be inferred from the facts and circumstances of the case. Therefore, the Court approached the question in terms of the principles that applied to infer legal arrangements where there was no written documentation.

460. If there was no agency relationship, and ID Tours acquired the "on the ground" activities in its own right, it was necessary to decide whether ID Tours should charge GST on its invoices to the non-resident recipients of ID Tours' services. In this case there would be two sets of contracts: one between ID Tours and the local supplier and one between ID Tours and overseas operator.

461. The GST Act contains a specific rule concerning the imposition of GST, in s. 8(2B), which is relevant in the circumstances and overrides s. 11A(1)(k). It states that to the extent to which a supply of services consists of the facilitation of inbound tour operations, the supply is chargeable with GST and s. 11A does not apply to that part of the supply.

462. Services consisting of the facilitation of inbound tour operations are defined in s. 8(2F) as meaning the services that a registered person provides in packaging 1 or more domestic tourism products and services in New Zealand and selling them outside New Zealand to a non-resident person. The tourism products and services may include accommodation, meals, transport, and other activities.

463. Therefore, if there was no agency relationship and the services supplied by ID Tours fell within the ambit of s. 8(2B), they could not be zero-rated under s. 11A(1)(k).

464. The High Court approached the question of whether there was an agency relationship by first setting out the principles determining what the Court should have regard to, and then deciding whether that amounted to a relationship of agency:

   (a) When construing the true nature of a transaction for GST purposes it is the legal arrangements actually entered into and the rights and duties created by those arrangements that are relevant: *Commissioner of Inland Revenue v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA).

   (b) Where there is no written documentation or where it is ambiguous it is appropriate for the Court to have regard to the surrounding circumstances: *Masport Ltd v Morrison Industries Ltd* CA 392/92, 31 August 1993.

   (c) Where the parties have not specified the nature of their relationship, the courts will consider what a reasonable person would conclude based on the relevant facts: *XXX v Commissioner of Inland Revenue* [2014] NZTRA 13.

   (d) Where the question at issue involves more than one contractual arrangement between different parties, in assessing who supplies what to whom regard must be had to all the circumstances in which the transaction or combination of transactions takes place: *The Commissioners for Her Majesty's Revenue and Customs Commissioners v Aimia Coalition (formerly Loyalty Management UK Ltd)* [2013] UKSC 42.

465. The parties involved in a transaction in this case are the overseas operator, ID Tours and the local tourism supplier. In deciding whether ID Tours acted as the agent of the overseas operator, the Court referred to the definition of the concept of agency in Burrows, Finn and Todd *Law of Contract in New Zealand* (4th ed, Lexis Nexis, Wellington, 2012) as follows:

   (a) The essential characteristic of an agent is that he is invested with a legal power to alter the principal's legal relations with third parties: the principal is under a correlative liability to have his legal relations altered.

   (b) Whether an agency relationship can be shown ultimately turns on the particular facts of the case.

   (c) The relationship of principal and agent produces effects of two quite different kinds:

      (i) First, it creates an obligation between the principal and the agent under which each acquires in regard to the other certain rights and liabilities;

      (ii) Secondly, when acted upon by the agent, it leads to the creation of privity of contract between the principal and the third party.

   (d) A contract made with a third party by the agent in the exercise of his or her authority is enforceable both by and against the principal.

466. The High Court noted at [67] that in this case:

   "… (ID Tours) offers to provide certain advisory and on the ground services to the overseas operator in exchange for a fee. That is the consideration between the overseas operator and (ID Tours). (ID Tours) then contacts the local tourism providers and offers them payment in exchange for provision of tourism products or services to the non-resident tourists. That is the consideration between (ID Tours) and the domestic tourism providers."

467. The High Court concluded that ID Tours is not the agent of the overseas operators for the following reasons:

    (a) The payment process suggested that ID Tours formed two separate contractual relationships: ID Tours was the supplier of its advisory and on the ground services to the overseas operator which the overseas operator paid ID Tours for, and ID Tours was recipient of the products and services of the local supplier which ID Tours paid for but only after receipt of the payment from the overseas operator.

    (b) It was irrelevant that ID Tours did not consume the products of the local suppliers – the only question was whether it acquired them.

    (c) When it calculated its fee ID Tours did not distinguish between its advisory and other services, which supported the finding that it acquired domestic tourism products in its own right and then sold them to the overseas operator.

    (d) If a local supplier was not paid, the question would be against whom the supplier would have a claim for breach of contract: ID Tours would probably pay the supplier out of its own pocket (apparently due to its desire to protect its own reputation), whereas an agent is not legally obliged to pay the debts of its principal.

    (e) The fact that ID Tours used the UK travel agent's vouchers to pay local suppliers did not mean that payment was being made by the UK travel agent: the voucher only represented the method of payment and the supplier could arguable bring a successful claim against ID Tours.

468. The High Court noted that while ID Tours may have believed that it acted on behalf of the overseas operators that was not necessarily the true legal position. It was noted that invoices from local suppliers or other evidence from the overseas operators could have potentially assisted in showing on whose behalf ID Tours contracts with local suppliers and against whom the supplier is likely to enforce its contractual rights if it is not paid for whatever reason. On the available evidence the conclusion was that ID Tours was not the agent of the overseas operators.

469. As noted in paragraph 462, under s. 8(2F) services that consist of the facilitation of inbound tour operations must contain three elements:

    (a) They must be provided by a registered person;

    (b) The services must be provided in packaging one or more domestic tourism products and services (which may include, but are not limited to, accommodation, meals, transport, and other activities) in New Zealand; and

    (c) The registered person must sell them outside New Zealand to a non-resident person.

470. The High Court considered the meaning of "packaging" as defined in the New Shorter Oxford English Dictionary, 4th Edition, as follows:

    (a) A package is a set of interdependent or related abstract entities; a group of related objects viewed as a unit; and

    (b) Packaging is the action, process or manner of making something up into a package.

471. The High Court found that ID Tours offered a package consisting of:

    (a) The provision of advice related to why New Zealand should be selected as a destination and what activities are available to the particular persons who are coming; and

(b) "On the ground" services involving:

(i) Purchasing domestic products and services by negotiating deals with local suppliers and making bookings and transport arrangements as required; and

(ii) Paying for the domestic products and services by facilitating payment for all the products and services it purchased.

472. The High Court agreed with the TRA in finding that the advisory services were simply a marketing activity and, therefore, part of the package. They were provided purely for the purpose of obtaining the ability to purchase domestic tourism products and services. The package could only be sold when the overseas operator bought the advice of ID Tours. Therefore, advisory services and the "on the ground" services were "a group of related objects viewed as a unit".

473. The High Court concluded that ID Tours is an inbound tour operator for the purposes of s. 8(2B) of the GST Act and its advisory services were chargeable with GST.