CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

DavidCo Limited
CHARTERED ACCOUNTANTS

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

WEEKLY COMMENT: FRIDAY 8 JULY 2022

1. On 8 March 2022, *GST apportionment and adjustment rules – An officials' issues paper* ("the GST IP 2022) was released for consultation. Submissions close on 27 April 2022.

2. Last week I reviewed a summary of the proposed reforms and the election to exclude an asset and rounding options proposed. This week I review the sale of dwellings, land developed and sold by residential property developers and other proposals to simplify the apportionment rules.

Whether the sale of dwellings should be an exempt or separate supply

3. As an alternative to the election to exclude houses from a taxable activity, officials have proposed making the sale of a dwelling by a registered person who had not developed the property an exempt supply. A dwelling would include a person's principal place of residence, residential rental properties, and holiday homes. The effects would be that:

   (a) There would be no GST output tax on disposal of the property; and

   (b) There would be no GST input tax deduction for the purchase of, or capital improvements to, the property.

4. This is to deal with the issue identified by officials, and referred to in last week's *Weekly Comment*, that a GST-registered person who uses a private home for business purposes may be unaware that GST would be payable on a portion of the selling price of the home, and are not accounting for GST on its disposal.

5. A registered person would still be able to claim and apportion input tax for operating expenses, such as electricity or internet services provided to a home office, to the extent to which they are used to make taxable supplies. Officials note that this could potentially add complexity by introducing a capital/revenue expenditure boundary into the GST Act, although the boundary could be the same as that used for income tax purposes. This would mean that if an input qualified as a revenue expense for income tax (as opposed to a capital improvement to the dwelling), an input tax deduction could be claimed for GST purposes to the extent the input was used to make taxable supplies.

6. Officials acknowledge that this option:

   (a) Would require new definitions of dwellings that will be exempt when sold, and dwellings that would be taxable (such as properties developed by property developers); and

(b) Would add complexity and uncertainty to the GST rules for land.

7. Therefore, they have suggested this new type of exempt supply of land may not be necessary if the election to treat an asset as not part of a taxable activity is introduced.

8. Officials suggest that a new definition of "dwelling" could be based on paragraph (a) of the Income Tax Act definition of "dwelling", which is "any place configured as a residence or abode, whether or not it is used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place." The existing GST definition is unsuitable because it is focused on the accommodation received by the occupant and, therefore, would, for example, exclude holiday homes. Dwellings sold by developers would remain a taxable supply and some potential rules are discussed in paragraphs 13 - 20 below.

9. Officials propose that if a new rule is adopted to make supplies of dwellings exempt, the supply of short-term guest accommodation services by a GST-registered person would remain subject to GST and input tax deductions could be claimed on operating expenses such as cleaning, property managers, rates, insurance and repairs. This would also be the case if the election method was adopted to exclude capital assets such as dwellings from being taxable supplies.

10. Another option proposed by officials is to deny input tax deductions on the purchase of a holiday home or on capital improvements, unless annual taxable supplies met the $60,000 registration threshold (ignoring supplies to associated persons and to close family members).

11. Where land that includes a dwelling is sold, officials propose an extension to the existing rule in s 5(15) so that the dwelling is treated as a separate supply. Under s 5(15), the supply of a dwelling is a separate exempt supply if the dwelling is a principal place of residence or has been used exclusively to make exempt supplies for at least 5 years. Officials propose expanding the rule so that it applies to a wider range of dwellings, such as holiday homes. This would mean that:

    (a) Farmhouses and curtilage would continue to be regarded as the supply of a separate asset that could be a non-taxable or exempt supply, while the surrounding farmland, which is used to make taxable supplies, would be a taxable supply of land;

    (b) A residential dwelling with an attached retail shop or medical practice should be considered a separate supply to the business premises (the rationale here is apparently that significant physical modifications would have been made to construct a shop or medical practice);

    (c) Where worker or employee accommodation is supplied on business premises (for example, a hotel that provides accommodation for the manager and staff members), officials propose that the GST treatment of the dwelling would follow the GST treatment of the accommodation services (see paragraph 9 above regarding registered persons being able to elect to treat the accommodation services in these cases as being either all taxable or all exempt supplies based on the predominant type of accommodation provided).

12. In relation to the possible application date of a new exempt supply rule for dwellings, officials note that:

    (a) It would apply prospectively from a certain date after the new rules were enacted, such as April 2023;

    (b) The exempt supply rule would not apply to registered persons who had claimed an input tax deduction already for the purchase of a dwelling, unless they elected to exclude the dwelling and paid GST output tax to do so, as discussed in last week's *Weekly Comment*;

    (c) Managing dwellings purchased before the application date that remained taxable supplies and dwellings purchased after the application date which would be exempt supplies could be complex and confusing for taxpayers, tax advisors and Inland Revenue, meaning this option could be difficult to implement.

Land developed and sold by residential property developers

13. Officials are concerned that:

    (a) There is a risk that a GST-registered person could claim a full input tax deduction on the purchase of land they intend to develop and sell as new or improved housing, but they do not proceed with the development and end up holding the property for a long time rather than selling it and returning GST; and

    (b) The current GST apportionment rules applying to properties concurrently used for development and sale and residential renting in the interim are overly complex, resulting in some potentially rentable houses to be left untenanted.

14. Therefore, officials have suggested that:

    (a) A full input tax deduction upon purchase be available to GST-registered property developers, regardless of whether it is a new housing development or renovation of existing housing;

    (b) No GST apportionment of the purchase price would be required, but:

        (i) Holding costs such as insurance and rates would need to be apportioned; and

        (ii) Expenses directly attributable to the exempt supply of accommodation in a dwelling, such as property management services, cleaning, and repairs to damage caused by tenants, would remain non-deductible for GST input tax purposes.

15. An alternative proposal is for property developers to return the GST fraction on actual rent or deemed rent (if owner-occupied in the interim), in which case, no apportionment of holding costs or any expenses would be required.

16. Officials note that land subject to the above rules would need to be defined separately from other land. A suggested option is to use the definition proposed for land the interest limitation rules would not apply to, being land:

    (a) Held as part of a business described in s CB 7 of the *Income Tax Act 2007* (which applies to an existing land business as well as persons associated with the existing business, which could include new GST-registered persons used to buy and develop the land); and

(b) Involved in an undertaking or scheme of development, division or building for the purpose of creating new build land – in which case a full input tax deduction would be available, but only from the time the undertaking or scheme commences (to mitigate the risk of land being left undeveloped after an input tax deduction has been claimed).

17. The latter case would apply where land is not bought as part of an existing business as described in s CB 7, but is bought with an intention of developing the land. A full input tax deduction would be available once the development activity had commenced, Officials suggest evidence of this could include having lodged a building consent or a resource consent with the local authority for a development, or having begun to incur development costs, such as expenses for draftspersons, surveyors or engineering services.

18. To further mitigate the risk that a property for which a full input tax deduction has been claimed is not developed and sold, but just held for a long period, officials propose a 36-month time limit within which the land must be sold and, if not, be deemed to have been disposed of at market value. An extension could be applied for, upon providing sufficient evidence, for example, that the property was being actively marketed for sale. In that case, the property would have to be disposed of within the extended period or be deemed to be disposed of.

19. The proposed application date for these new land development proposals is 1 April 2023, assuming the new rules have been enacted by then.

20. Build-to-rent developers are unable to claim GST input tax deductions. Officials have expressed a view that, from a GST policy perspective, there does not appear to be a good rationale for build-to-rent developers being able to deduct their input tax and receive a GST concession that is not available to other residential landlords or owner-occupiers (who are charged GST on their costs).

Other options for simplifying the GST apportionment rules

21. For assets that remain subject to the apportionment rules, officials have suggested the following changes, which would apply prospectively from a specified date after the new rules have been enacted, such as 1 April 2023.

22. Apart from the principal purpose test for assets costing less than $5,000, as discussed in last week's *Weekly Comment*, officials have proposed reducing the number of adjustment periods as follows:

(a) For assets costing less than $20,000 excluding GST: 2 adjustment periods, plus an adjustment when the assets are sold, which would mean that the current 5 adjustment periods would apply to assets costing between $20,000 and $500,000;

(b) For land: 10 adjustment periods, which would mean that the current 10 adjustment periods for assets costing more than $500,000 would also apply to land.

23. The wash-up rule in s 21FB allows a change to 100% taxable or non-taxable use after measurement at two consecutive balance dates. Officials have suggested that:

(a) Where a person acquires assets before GST registration that are subsequently applied 100% to a taxable activity, the wash-up calculation should be permitted at the end of the first adjustment period; and

(b) The wash-up calculation applies to permanent changes of less than 100%, for example, if a person's use changed to 50 percent taxable and they expected this percentage to remain stable for the foreseeable future, they would be able to perform the wash-up calculation to claim 50 percent of the input tax deductions, and this wash-up would be performed at the end of the adjustment period in which the permanent change in use occurs.

24. Officials have proposed that the mixed-use asset rules in s 20G be repealed, and the general apportionment rules apply to any remaining mixed-use assets, because:

(a) They only apply to certain assets, such as holiday homes, aircraft and yachts and only when their use is a mixture of private days, taxable days and at least 62 unused days; and

(b) Many such mixed-use assets could be excluded from a taxable activity by election or deemed to be non-taxable if their taxable use was less than 20%, under the proposals in the GST IP 2022.

25. Officials have proposed repealing the concurrent use of land rules in s 21E as the rules proposed in the GST IP 2022 for land developed by residential property developers would apply instead. In other situations where land is used to make taxable and non-taxable supplies:

(a) The supplies could be apportioned on a time and/or space basis; or

(b) The registered persons could apply to Inland Revenue for approval to use a more practical alternative apportionment method (as discussed in paragraph 27 below).

26. For registered persons currently using the concurrent use of land rules to transition to the new rules:

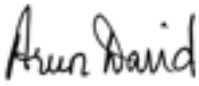
(a) One option would be to allow such registered persons to apply the proposed special rules for residential property developers in the GST IP 2022 that would allow a 100 percent deduction for land that is being developed but generally requires the land to be sold within 36 months of claiming the full deduction (see paragraph 14 above); or

(b) If the registered person's taxable use of the land did not involve developing and selling the land (for example, they could be in the process of converting a residential property into a commercial building or clearing it to build / widen a road), they would also be able to apply to the Commissioner of Inland Revenue to agree an alternative apportionment method.

27. Officials propose widening the range of approved apportionment methods through the removal of the requirement that the alternative method has to "have regard to the tenor of" the default apportionment rules and formula, while retaining the more general requirement that the alternative method simply provides "a fair and reasonable method" of apportionment. This change would:

(a) For example, allow small periods of rental use to be treated as a taxable activity with GST being returned, so that input tax does not have to be apportioned in such circumstances.

(b) Be complementary to the amendment in s 23(2) of the *Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022*, effective from 30 March 2022, removing the $24 million turnover threshold in section 21(4B), which now allows all GST-registered persons to apply to the Commissioner to use an alternative apportionment method.



Arun David, Director,
DavidCo Limited