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WEEKLY COMMENT: FRIDAY 13 MAY 2016

1. The *Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill* ("the Bill") was introduced on 3 May. It includes the GST law changes proposed in *GST – Current issues – An officials' issues paper* (the "GST Issues Paper") released by Inland Revenue last September.
2. I commenced looking at the proposed GST law changes last week. This second week I look at services directly in connection with land, the GST treatment of commercial leases and certain associated payments and the application of the zero-rating of land rules to non-profit bodies.

Services directly in connection with land

3. Effective from 1 April 2017, it is proposed that s. 11A(1)(k)(i)(A) is being replaced with:

   "Services which are supplied directly in connection with a parcel of land situated in New Zealand, or with an improvement to such land, or are supplied in connection with such land or improvement and are intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land or improvement".

4. It is stated in the *Commentary on the Bill* ("the Commentary") that this is to ensure that a wider range of services, and in particular professional services that closely relate to land in New Zealand, are subject to GST.
5. It is also proposed that at the same time, s. 11A(1)(e) is replaced with:

   "The services are supplied directly in connection with a parcel of land situated outside New Zealand, or with an improvement to such land, or are supplied in connection with such land or improvement and are intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land or improvement".

6. This will allow the same wider range of services to be zero-rated when supplied in connection with land outside New Zealand.
7. The change is designed to override the current position set out in BR Pub 15/03, based on case law - *Malololailai Interval Holidays New Zealand Ltd v CIR* (1997) 18 NZTC 13,137 and *Wilson & Horton Ltd v CIR* (1994) 16 NZTC 11,221, which is that legal services relating to transactions that involve the change of ownership of land, such as the drafting of agreements for the sale and purchase of land are zero-rated on account of being "one step removed" from being directly in connection with land. These services merely bring about or facilitate a transaction with a direct effect on land.
8. Officials expressed the view in the GST issues Paper that in considering whether the connection to land has been satisfied, a better approach may be to instead look at the

service in the broader context of the purpose or objective that it serves, rather than looking to whether the service itself has a direct legal or physical effect on land.

9. Based on what is stated in the GST Issues Paper, it would appear that the following services would be regarded as having such a sufficiently close connection with land that they could be considered to be consumed where the land is located:

   (a) The assessment of the risk or integrity of land;

   (b) Intermediation in the sale or lease of land, including by real estate agents and property managers;

   (c) Architectural or design engineering services that relate to a particular site, including the drawing up of plans for a building or part of a building;

   (d) Legal services relating to transactions involving the transfer of title to land or the establishment or enforcement of an interest in land (such as the drafting of agreements for the sale and purchase of land, lease agreements or construction agreements).

10. Services listed in the GST Issues Paper which would continue to be zero-rated, as not considered to be supplied directly in connection with land because they do not clearly relate to designated land in New Zealand, would include services such as:

   (a) Advice or information about property prices or investment in the property market in general;

   (b) Market research relating to the economic viability of a particular project;

   (c) Architectural services which do not relate to a particular site;

   (d) Advice on the tax implications of investing in property generally; and

   (e) A service where the part of the service that relates to land is only an incidental aspect of the supply, for example, when legal services are provided to establish a trust that will subsequently hold land.

11. Submissions were sought on whether there should be a "savings" provision for tax positions adopted prior to 1 April 2017, because officials felt there are possible concerns in relation to the treatment before that date. However, no savings provision has been included.

Zero-rating of land – commercial leases

12. A number of technical issues have been identified in relation to the rules governing when commercial leases and certain associated payments, will or will not be zero-rated. The proposed amendments are to apply from 1 April 2011, the date on which the rules came into force, except for an amendment that extends the rules to apply to non-profit bodies, which will come into force on the date of enactment.

Zero-rating commercial leases: first issue – payments from a tenant to the landlord

13. Section 11(8D)(a) states that a supply that is an assignment or surrender of an interest in land, is a supply under s. 11(1)(mb) if it meets the requirements set out in that section. Officials have stated that s. 11(8D)(a) clearly applies to payments from a landlord to a tenant for a surrender of a lease, but it was also meant to apply to payments from a tenant to a landlord, and this is not so clear from the wording.

14. Proposed new s. 11(8D)(ab) will provide that a supply that is a surrender of a right to a payment under an agreement for the supply of an interest in land (i.e. where a tenant pays the landlord for the surrender of the landlord's right to payment under the lease) will be

zero-rated under s. 11(1)(mb) if the supply of the interest in land meets the requirements for zero-rating under that section.

15. This amendment is to come into force on 1 April 2011.

Zero-rating commercial leases: second issue – when leases are standard-rated

16. Section 11(8D)(b) sets out when a supply of a lease will be standard-rated – i.e. when s. 11(1)(mb) will not apply to a lease. It is a difficult rule to understand and apply. The present rules states the supply of lease will not be zero-rated under s. 11(1)(mb) if:

    - The supply is made periodically; and
    - Any payment under the lease agreement either in advance, or during the lease term:
        (i) Totals 25% or less of the consideration specified in the agreement; and
        (ii) Relates to the longer of 1 year and the shortest possible fixed term of the agreement; and
        (iii) Is not itself a regular payment under the agreement.

17. Officials are concerned that:

    (a) The words "supply is made periodically" does not exactly match the wording in s. 9(3), which refers to "an agreement which provides for periodic payments". Therefore, there is scope to argue that the requirement that the "supply is made periodically" means there have to be a series of separate supplies, rather than periodic payments under a lease, in order for a lease to be standard-rated.

    (b) The focus of the test for standard-rating is on the size of a payment, the period it relates to, and it not being a regular payment. However, this could allow the test to be passed for 1 payment, whereas another payment may not pass the test – i.e. the test could be circumvented.

    (c) Where a payment in excess of 25% of the total consideration is made, and the lease ceases to be standard-rated, the present wording suggests that the impact may be retrospective (i.e. apply to earlier payments), whereas the intention was that only the large one-off payment and future payments would be zero-rated.

18. Proposed new s. 11(8D)(b) provides for a lease that would otherwise be zero-rated under s. 11(1)(mb) to be standard-rated, if:

    - It is made under an agreement providing for periodic payments for the supply; and
    - For the purposes of a payment paid or payable under the lease agreement:
        (i) Each amount payable under the agreement that is not a regular payment is anticipated, when the agreement is entered, to be 25% or less of the consideration specified in the agreement; and
        (ii) The payment, if not a regular payment, is 25% or less of the consideration specified in the agreement; and
        (iii) Each amount that is paid or payable before the payment, and is not a regular payment, is 25% or less of the consideration specified in the agreement; and
        (iv) The consideration specified in the agreement is treated as being the amount of consideration calculated for the agreement and the longer of 1 year and the shortest possible fixed term of the agreement.

19. The new wording will:

    (a) Align the requirement for periodic payments with the wording in s. 9(3);

    (b) Initially make the focus of the test the anticipated payments under the lease (if the payments are anticipated to breach the requirement, then the whole lease cannot be standard-rated);

    (c) Make each payment the focus of the test, with a payment and subsequent payments not being standard-rated if a payment fails to meet the requirement of 25% or less of the total consideration (prior payments will remain zero-rated).

20. This amendment is to come into force on 1 April 2011.

Zero-rating commercial leases: third issue - procurement of a lease

21. Currently, s. 11(8D)(c) states that "a supply of an interest in land by way of a procurement by a third party of an existing lease is a supply under s. 11(1)(mb) if it meets the requirements set out in that subsection."

22. Officials are concerned the wording is not clear enough. Officials stated in the GST issues Paper that the reason for the procurement is because the existing lease is incapable of being assigned, so it is necessary that the vendor (the current tenant) arranges a new lease between the purchaser (the prospective tenant) and landlord.

23. In addition, it is stated in the Commentary that the current rule is intended to apply to arrangements when a lease is novated – where, by agreement of all the parties, an existing lease between landlord and tenant is replaced with a new lease between the landlord and a new tenant – and the incoming tenant provides consideration to the outgoing tenant. This may occur because the lease could not be assigned. The existing section may not achieve this outcome.

24. The proposed replacement s. 11(8D)(c) provides for a supply by a lessee to be zero-rated under s. 11(1)(mb) if:

    (a) The supply is to a person who is not the lessor; and

    (b) The supply is made under an arrangement that consists of the lessee's surrender to the lessor of the lease and the supply by the lessor under another lease agreement to a person other than the lessee; and

    (c) The supplies of the interest in land under the lease agreements meet the requirements for zero-rating in s. 11(1)(mb).

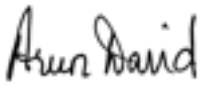
25. This amendment is to come into force on 30 June 2014.

Application of zero-rating of land rules to non-profit bodies

26. It is noted in the GST issues Paper that the zero-rating of land rules do not apply to the purchase of land by a GST-registered non-profit entity, which purchases the land for use in its non-profit activities. The supply is instead standard-rated, in which case the supplier must return GST and the non-profit body may deduct this amount.

27. Proposed new s. 11(8D)(d) states that a registered person who is a non-profit body that is resident in New Zealand and acquires land is treated, to the extent to which the person acquires the land with an intention of using it other than for making exempt supplies, as acquiring the land with the intention of using it for making taxable supplies.

28. It is stated in the Commentary that this new rule would mean a GST-registered non-profit body resident in NZ would be treated as acquiring the land for the purpose of making taxable supplies, except to the extent it is acquiring it for making exempt supplies, for the purpose of the compulsory zero-rating land rules. This would allow the supply of the land to be zero-rated and the "reverse charge" rule for zero-rated land in s. 20(3J) would apply to the extent the land is partially used to make exempt supplies.
29. This amendment would come into force on the date of enactment.



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