Inland Revenue
Te Tari Taake

[UNCLASSIFIED]

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

Deadline for comment: **31 March 2021**

Please quote reference: **PUB00256**

Send feedback to Public.Consultation@ird.govt.nz

QUESTIONS WE'VE BEEN ASKED > GENERAL ISSUES

When does s 5(23) of the Goods and Services Tax Act 1985 apply to shift GST liability to the purchaser of land?

Issued: XX

Publication number QB XX/XX

There is a provision in the Goods and Services Tax Act 1985 (s 5(23)) that may apply to shift GST liability to the purchaser of land if the supply has been incorrectly zero-rated. This Question We've Been Asked explains when s 5(23) will apply.

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

Key provisions

Goods and Services Tax Act 1985 – ss 5(23), 11(1)(mb) and 78F

RELATED ITEM:

- IS 17/08 *Goods and services tax – Compulsory zero-rating of land rules (general application)* (Inland Revenue)

Question

When does s 5(23) of the Goods and Services Tax Act 1985 apply to shift GST liability to the purchaser of land?

Answer

Section 5(23) will apply to shift GST liability to the purchaser of land where the parties have treated the zero-rating provision (s 11(1)(mb)) as applying, but after settlement it is found that it doesn't apply. The parties' GST treatment of the transaction is as set out in the sale and purchase agreement for the land. Section 5(23) won't apply to shift the liability to the purchaser if the vendor zero-rates the transaction in their GST return contrary to the treatment the parties have contractually agreed.

Explanation

What are the compulsory zero-rating rules?

1. The compulsory zero-rating (CZR) rules in the GST Act may apply to supplies that include land, where the parties are both GST registered persons. The requirements for the rules to apply are set out at [3]. If the CZR rules apply, the supply must be zero-rated.

2. The CZR rules were introduced to improve the efficiency of the GST system, and to protect the tax base from "phoenix schemes". Phoenix schemes typically involve land being sold between associated entities. The purchaser receives a refund of GST in relation to the supply, but the vendor deliberately winds up their entity before paying the GST output tax. Under the CZR rules, this can't be done, because the supply is charged with GST at the rate of 0% rather than the standard rate of 15%.

3. The CZR rules will apply if:

   - the supply wholly or partly consists of land;
   - the vendor is GST registered at the time of settlement (or will be registered, or will be treated as being registered, at that time);
   - the supply is made by the vendor in the course or furtherance of their GST taxable activity;

- the purchaser is GST registered at the time of settlement (or will be registered, or will be treated as being registered, at that time);
- the purchaser acquires the goods (which includes land) supplied with the intention of using them (in whole or in part) for making taxable supplies; and
- none of the land included in the supply is intended to be used as a principal place of residence by the purchaser or a relative of theirs.

These requirements for zero-rating land supplies are set out in s 11(1)(mb).

4. The CZR rules are discussed in detail in IS 17/08 *Goods and services tax – Compulsory zero-rating of land rules (general application)*.

What information does the purchaser have to provide?

5. If a supply wholly or partly consists of land, the GST Act requires the purchaser to provide certain information to the vendor at or before settlement (s 78F). The purchaser has to tell the vendor whether at the settlement date they:

   - are or expect to be a GST registered person;
   - are acquiring the land (and any other goods that are part of the supply) with the intention of using it for making taxable supplies; and
   - intend to use the land as a principal place of residence – either for themselves or for a relative.

   Note: *for these rules, relatives are people connected to you by blood relationship (within two degrees of relationship); marriage, civil union or de facto relationship (including people connected by blood relationship to your spouse or partner); or adoption (including people adopted by someone with whom you have a first degree relationship). See s 2A(1)(c) and (6).*

6. The purchaser has to provide the information whether they are GST registered or not. And the information has to be provided in writing. The vendor can't waive the requirement for the purchaser to provide the information.

7. Usually the information is provided in a schedule to the written sale and purchase agreement. For example, if the Auckland District Law Society and Real Estate Institute of New Zealand (ADLS/REINZ) standard form agreement for sale and purchase

agreement is used,[1] completion of schedule 1 will cover the GST information requirements.

8. The GST treatment (whether zero-rated or standard-rated) needs to be determined based on the circumstances at the time of settlement (s 11(8B)). The vendor can rely on the s 78F GST information the purchaser has provided in determining the tax treatment of the supply.

9. If the purchaser's GST circumstances change between the contract being signed and the settlement date, they should notify the vendor in writing of the changed circumstances. This ensures the vendor can apply the correct GST treatment to the sale.

When does the GST treatment need to be corrected?

10. As noted at [8], the GST treatment (whether zero-rated or standard-rated) needs to be determined based on the circumstances at the time of settlement (s 11(8B)). But sometimes the correct GST treatment of a supply may not be established until after settlement. The correct GST treatment is a question of fact, and may differ from what the parties agreed.

11. If GST has been incorrectly invoiced or accounted for, this can usually be corrected by the vendor issuing a debit note or a credit note.

12. For example, the debit or credit note mechanism can be used to correct the GST position in the following situations:

    - If the vendor has issued a GST invoice (whether standard-rating or zero-rating the supply) and the purchaser subsequently advises the vendor after this, but before settlement, that that their GST circumstances have changed.
    - If the supply was incorrectly standard-rated and the correct GST treatment is not established until after settlement (for example if the purchaser failed to tell the vendor about a change in their GST circumstances before settlement).

[1] *Agreement for sale and purchase of real estate (10th edition)* (Auckland District Law Society and Real Estate Institute of New Zealand Inc, 2019).

13. The debit and credit note mechanism is set out in s 25 of the GST Act – it is explained in IS 17/08.

14. However, if the supply has been incorrectly treated as zero-rated rather than standard-rated (for example, if the purchaser's s 78F notice was incorrect and the vendor relied on it) and the transaction has been settled, then the situation may be dealt with by s 5(23). Section 5(23) shifts the GST liability to the purchaser, by treating them as making a taxable supply of the land (and any other goods) on the date of settlement.

When will s 5(23) apply?

15. Section 5(23) says:

> (23) If section 11(1)(mb) [the CZR provision for land] **is treated as applying** to a supply of goods and, after the date on which the relevant transaction is settled, it is found that the provision does not apply, the recipient of the supply is treated as if they were a supplier making, on the date of settlement, a supply of those goods that is chargeable with tax under section 8(1).
>
> [Emphasis added]

16. So, s 5(23) will apply if:

- s 11(1)(mb) has been treated as applying to the supply of land, to zero-rate the supply; and
- after settlement it is found that s 11(1)(mb) doesn't apply.

17. This will generally be because one of the requirements of s 11(1)(mb) (set out at [3]) turns out not to have been met, when the parties thought it would be.

18. As noted at [13], when s 5(23) applies, the GST liability is shifted to the purchaser, by treating them as making a taxable supply of the land (and any other goods) on the date of settlement. This provision aims to ensure that purchasers of land can't avoid paying GST to the vendor (effectively reducing the purchase price) by purporting to be GST registered and acquiring the land for making taxable supplies, when they are not. (See *GST remedial issues – An officials' issues paper* (Inland Revenue, December 2012), at [5.1]).

19. So, for example, if the s 78F information a purchaser provides to the vendor is incorrect and the vendor relies on it and settles the transaction on that basis, s 5(23) will apply.

What are the GST implications of s 5(23) applying?

20. Under s 5(23), the purchaser will be treated as though they were the vendor, making the supply on the date of settlement. This means they are liable for the GST on the supply.

21. If a purchaser who is treated as a supplier under s 5(23) is not GST registered on the settlement date, they are treated as if they were, and they have to apply for registration (s 51B(4)). If they don't, the Commissioner can register them for GST (s 51(4)(b)).

22. Where there is a deemed supply under s 5(23), the purchaser can't claim an input tax deduction in relation to the supply, unless they're entitled to stay GST registered (or they become GST registered at a later date) and they use the relevant goods (the land) for making taxable supplies (s 20(4B)).

23. Once the purchaser has accounted for GST under s 5(23), they can request that the Commissioner cancel their GST registration if they're not otherwise required to be registered (s 51B(5)).

24. Usually, when a person's GST registration is cancelled, they have to account for output tax on any goods and services that form part of a taxable activity they've carried on (s 5(3)). But this doesn't apply if the purchaser:

    - asks for their GST registration to be cancelled by the end of the taxable period in which they've accounted for GST on the supply they're treated as making under s 5(23); or
    - submits that s 5(3) shouldn't apply, and the Commissioner agrees.

What happens if the vendor zero-rates the supply contrary to the GST information the purchaser provided?

25. An issue that has arisen occasionally, and that we've been asked to clarify our position on, is whether s 5(23) will apply to shift the GST liability to the purchaser of land where the vendor zero-rates the transaction in their GST return either:

    - contrary to what the purchaser has told them about their GST circumstances; or
    - when the purchaser hasn't provided enough information under s 78F for the vendor to determine the correct treatment.

26. As noted at [15], s 5(23) will apply if the zero-rating provision (s 11(1)(mb)) has been "treated as applying" to the supply, and after settlement it is found to not apply. So, what happens when the vendor unilaterally treats the supply as zero-rated depends on what it means for the CZR provision to have been **treated as applying** to the supply.

Who needs to have treated the compulsory zero-rating provision as applying?

27. The requirement in s 5(23) for the CZR provision to have been treated as applying to the supply can be read in two ways. It could mean that:

    - **the vendor** has treated the CZR provision as applying (ie, when they file a GST return that shows the supply as zero-rated); or
    - **the parties** have treated the CZR provision as applying (ie, they have agreed in their sale and purchase agreement that the supply is to be zero-rated because the GST information the parties each provided under the agreement confirms that the CZR requirements are met).

28. The meaning of legislation is determined by considering the text in light of the purpose of the legislation (s 5(1) of the Interpretation Act 1999).

29. The relevant ordinary meaning of "treat"[2] is:

> v. **1** behave towards or deal with in a certain way.

30. This ordinary meaning doesn't help identify **who** has to have treated the CZR provision as applying to the supply of land, for s 5(23) to potentially apply. There is also no case law that helps determine the meaning of "treated" in the context of the CZR provision.

Arguments that it is <u>the vendor's</u> treatment of the supply that matters

31. As noted at [19], "treated as applying" in s 5(23) could be read as meaning that **the vendor** has treated the CZR provision as applying to the supply (ie, when they file a GST return that shows the supply as zero-rated).

32. The vendor will issue a tax invoice (usually at settlement), and will subsequently file a GST return accounting for the supply. Each of these documents will record that the vendor has either zero-rated or standard-rated the supply. The vendor is, therefore, *treating the CZR provision as either applying or not applying* in issuing an invoice and in filing a GST return. This treatment by the vendor could potentially be inconsistent with the GST treatment agreed by the parties in the contract. For example, there have been

[2] *Concise Oxford English Dictionary*, 12th edition.

instances where vendors have issued invoices zero-rating the supply and the purchaser has not been well-advised and has accepted this.

33. Section 78F(3) states that the supplier (the vendor) may rely on the GST information from the purchaser (see from [5]) "in determining the tax treatment of the supply".

34. Arguably, the word "treated" in s 5(23) should be read similarly, and consistently with what it means in s 78F(3) – that is, that "treated as applying" means **the vendor** has treated the CZR provision as applying to the supply of land.

35. The relevant credit and debit note provision (s 25(1)(ab)) may also arguably suggest that it's the vendor's treatment of the supply that matters. This is because that provision uses the words "treatment of the supply" in the context of what the supplier has done (ie, their invoice has provided for the incorrect amount of GST being charged, or their return has accounted for an incorrect amount of output tax).

Arguments that it is the parties' treatment of the supply that matters for s 5(23)

36. As noted at [19], "treated as applying" in s 5(23) could also be read as meaning that **the parties** have treated the CZR provision as applying to the supply (ie, they have agreed in their sale and purchase agreement that the supply is to be zero-rated because the GST information the parties have each provided under the agreement confirms that the CZR requirements are met).

37. As mentioned at [20], the Interpretation Act 1999 says that the meaning of legislation is determined by considering the text in light of the purpose of the legislation. It can be relevant to consider the social, commercial or other objective of an enactment in determining what its purpose is. This was noted by the Supreme Court in *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] 3 NZLR 767.

38. The parliamentary materials from when s 5(23) was introduced don't provide any strong indication of the provision's intended scope. The commentary to the first reading of the bill that introduced s 5(23) referred to the provision applying if an unregistered purchaser provided incorrect information to the vendor. But this was based on the original proposed wording in the bill, which specifically referred to that situation. The wording was subsequently broadened, and s 5(23) can apply irrespective of the reason the CZR provision was incorrectly treated as applying.

39. It's difficult to imagine that Parliament could have intended that GST liability could be shifted to a purchaser who has provided the correct information about their GST circumstances to the vendor. Such an outcome would seem particularly peculiar in the context of a provision that is part of the CZR rules, which as noted at [2] were aimed at protecting the tax base from phoenix schemes – where the vendor deliberately winds

up their entity before paying GST output tax. It doesn't seem likely that Parliament intended to allow vendors to get around paying GST by simply unilaterally zero-rating the supply and in doing so shifting the liability to the purchaser.

40. Arguably, this is a situation where a court would look at the broader commercial context. Part of that broader context is that sale and purchase agreements for land invariably contain detailed terms about the GST treatment of the transaction, based on the GST information the parties both provide under the contract. Under standard sale and purchase agreements for land, the parties agree whether the transaction is zero-rated. This could arguably support a view that the s 5(23) requirement for the CZR provision to have been treated as applying means **the parties** have treated the CZR provision as applying.

The Commissioner's view – s 5(23) requires the parties to have treated the CZR provision as applying

41. Section 5(23) is not clear on **who** has to have treated the CZR provision as applying to the supply of land, for s 5(23) to potentially apply. It's possible to read "treated as applying" in s 5(23) as meaning either that **the vendor has** or that **the parties have** treated the CZR provision (s 11(1)(mb)) as applying to the supply.

42. There are arguments for both interpretations. In the Commissioner's view the better interpretation is that s 5(23) requires **the parties** to have treated the CZR provision as applying. This interpretation has regard to the legislative context and the purpose of the CZR rules. It also has regard to the broader commercial context of land sales, including the fact that sale and purchase agreements for land invariably set out detailed GST terms and the parties' agreement to the zero-rating or standard-rating of the transaction.

43. On this interpretation, the unilateral action of a vendor zero-rating a land sale in their GST return, contrary to what the purchaser has told them about their GST circumstances, would **not** result in the GST liability being shifted to the purchaser under s 5(23). Similarly, if a vendor zero-rates a land sale in their GST return when the purchaser has not provided the required GST information to support that, s 5(23) would not apply in the event the zero-rating turns out to be incorrect.

44. The Commissioner considers that s 5(23) can only apply where the parties have contractually agreed that the supply will be zero-rated under s 11(1)(mb), but it is determined after settlement that s 11(1)(mb) doesn't apply because the parties' GST information turns out to be incorrect, and the supply should have been standard-rated.

Note: A remedial amendment is proposed to be included in an upcoming tax Bill (planned to be introduced before this QWBA is finalised) to ensure s 5(23) won't apply to shift GST liability to the purchaser if the transaction has been incorrectly zero-rated when it was in fact a non-taxable supply (for example, if the vendor is retrospectively deregistered effective from a date before settlement of the sale). This issue was discussed in *GST policy issues – An officials' issues paper* (Inland Revenue, 2020). This proposed amendment will be referred to in the finalised QWBA, as it will be in a Bill by that stage.

Examples

45. The following examples illustrate situations in which s 5(23) will apply to shift the GST liability to the purchaser, and where it won't apply.

Example 1 – Purchaser incorrectly advises that they meet the requirements for zero-rating – s 5(23) applies

George enters into a sale and purchase agreement to buy land for $1.5 million (plus GST if any) from a GST-registered vendor who is selling the land as part of their GST activity.

In the GST schedule to the sale and purchase agreement, George states that he is GST registered, will be using the land for making taxable supplies, and won't be using the land as a principal place of residence for himself or a relative. The contract reflects that because the zero-rating conditions have been met, the supply is zero-rated. The supply is settled on this basis.

After settlement it's determined that George shouldn't have been GST registered at settlement, as he was not carrying on a taxable activity. As a result, the supply was incorrectly treated by the parties as zero-rated when it should have been standard-rated.

Section 5(23) **will apply** here because:

- **the parties** have treated s 11(1)(mb) (the zero-rating provision) as applying to the supply – the terms of the contract (based on the information the parties provided in the contract) reflect that the zero-rating requirements are met; and
- after settlement it was found that the zero-rating provision doesn't apply because the requirements were not met at settlement.

The implications for George are as follows:

- He has to apply for GST registration.
- He has to file a GST return including GST output tax based on the value of the deemed supply (the $1.5 million sale price). The GST output tax is $225,000:

  $1.5 million x 15% = $225,000

- He can't claim an input tax deduction in relation to the supply.

Once George has accounted for the GST, he can ask the Commissioner to cancel his GST registration.

Example 2 – Vendor incorrectly returning a sale as zero-rated, contrary to the GST information the purchaser provided under the contract – s 5(23) doesn't apply

Andrea enters into a sale and purchase agreement to buy land from a GST-registered vendor who is selling the land as part of their GST activity.

In the GST schedule to the sale and purchase agreement, Andrea states that she isn't GST registered. The contract reflects that because the zero-rating conditions haven't been met, the supply is standard-rated.

However, when the draft settlement documents are exchanged, they show the vendor proposing to issue a GST invoice recording the supply as zero-rated. Andrea doesn't realise the implications of this, and the sale is settled on that basis.

After settlement it is determined that the zero-rating provision (s 11(1)(mb)) doesn't apply because Andrea wasn't GST registered at settlement. The vendor should have issued a GST invoice standard-rating the supply and paid GST output tax on the sale.

Section 5(23) **won't apply** here to shift the GST liability to Andrea because **the parties** haven't treated s 11(1)(mb) (the zero-rating provision) as applying to the supply – the terms of the contract (based on the information the parties provided in the contract) are clear that the zero-rating requirements aren't met so the supply is standard-rated.

References

Legislative references

Goods and Services Tax Act 1985 – ss 2A(1)(c) and (6), 5(3), 5(23), 11(1)(mb), 11(8B), 20(4B), 25, 51(4)(b), 51B(4) and (5) and 78F

Interpretation Act 1999 – s 5(1)

Case references

Commerce Commission v Fonterra Co-operative Group Ltd [2007] 3 NZLR 767 (SC)

Other references

Agreement for sale and purchase of real estate (10th edition) (Auckland District Law Society and Real Estate Institute of New Zealand Inc, 2019)

Concise Oxford English Dictionary, 12th edition (Oxford University Press, 2011)

GST policy issues – An officials' issues paper (Inland Revenue, 2020)

GST remedial issues – An officials' issues paper (Inland Revenue, December 2012)

IS 17/08 *Goods and services tax – Compulsory zero-rating of land rules (general application)* (Inland Revenue)

About this document

"Questions We've Been Asked" (QWBAs) are issued by the Tax Counsel Office. QWBAs deal with specific tax issues we have been asked about, which may be of general interest to taxpayers. While they set out the Commissioner's considered views, QWBAs are not binding on the Commissioner. However, taxpayers can generally rely on them when determining their tax affairs. See *Status of Commissioner's advice* (Inland Revenue, December 2012). It is important to note that a general similarity to examples in a QWBA will not necessarily lead to the same tax result. Each case must be considered on its own facts.