

A special report from the
Policy Advice Division of Inland Revenue

Changes to the GST rules

This special report provides early information about the main changes to the GST rules relating to land transactions that were included in the recently enacted Taxation (GST and Remedial Matters) Act 2010. The report precedes full coverage of the new legislation that will appear in a *Tax Information Bulletin* to be published early next year.

Zero-rating land transactions

Background

In November 2009, the Government released the discussion document, *GST: Accounting for land and other high-value assets*, which proposed a number of changes to the GST Act that would address certain GST base risks and improve the operation of the GST system more generally. The main risk to the tax base identified in the discussion document was “phoenix” fraud schemes, typically between associated entities, that involve Inland Revenue refunding GST to one party with no corresponding payment being made by the vendor because the vendor deliberately winds up their business before making payment.

The discussion document recommended a domestic reverse charge. However, most submitters expressed a preference for zero-rating as it would give rise to fewer compliance costs. That is the option that has now been adopted since, under this mechanism, the accounting obligations of the parties would in most situations remain virtually unchanged from the previous legislation.

Key features

GST-registered vendors will be required to charge GST at the rate of 0% on any supply to a registered person involving land, or in which land is a component, if at the time of settlement:

- the recipient intends to use the goods for making taxable supplies; and
- the supply is not a supply of land intended to be used as the principal place of residence of the recipient or a relative of the recipient.

Other features of the new rules include:

- a definition of “land” which largely follows the definition used for income tax purposes but which excludes most commercial leases;

- an obligation for the purchaser to advise of their registration status and intentions in respect of the land; and
- special rules to deal with situations when a supply is either incorrectly zero-rated or incorrectly standard-rated.

Application date

The new rules will apply to goods supplied on or after 1 April 2011.

For transactions entered into before 1 April 2011 but for which the time of supply is on or after that date, the supplier has the option of treating the transaction as being governed by either the current GST rules or the new rules (section 11(1)(8C)).

Detailed analysis

Determining zero-rating

New section 11(1)(mb) provides that a GST-registered person must zero-rate a supply if the supply wholly or partly consists of land, and:

- is made to another registered person; and
- the recipient acquires the goods with the intention of using them for making taxable supplies; and
- the supply is not a supply of land intended to be used as a principal place of residence of the recipient of the supply or a person associated with them under section 2A(1)(c) (that is, their relative).

To be a zero-rated supply, the above conditions for zero-rating must be satisfied at the time of settlement of the transaction (new section 11(8B)). If any of these conditions are not satisfied at the time of settlement, the supply should be taxed at 15%.

If land is supplied as part of a larger supply, the whole supply is zero-rated. For example, if land is supplied as part of a business being sold as a going concern, under the new rules the supply of the going concern is zero-rated in its entirety. To ensure that the zero-rating rules apply to services supplied as part of a transaction that includes land, new section 5(24) treats these services as a supply of goods.

The requirement that the recipient must intend to use the goods for making taxable supplies may be satisfied even if the recipient does not intend to use the goods wholly for making taxable supplies. Thus, the supply may be zero-rated in its entirety even if the recipient intends to use the goods partly for making non-taxable supplies. It should be noted, however, that in these circumstances the purchaser will be liable to account for the output tax on the non-taxable use of the goods under new section 20(3I) (see the section of this special report on the new apportionment rules for more details).

The zero-rating rules do not apply to supplies of land intended to be used as a principal place of residence of the recipient of the supply or a relative of the recipient (section 11(1)(mb)(ii). If a “principal place of residence” is included in a larger supply of real property, amended section 5(15) requires the supplier to treat the supply of the residence as a separate supply from the supply of any other real property included in the supply. These provisions clarify that a supply of the principal place of residence is not subject to the zero-rating rules. This should prevent registered persons, such as sole traders, from using their GST-registered status to zero-rate the purchase of their family home.

Meaning of “land”

A supply will only be zero-rated under section 11(1)(mb) if it is a supply of land. A new definition of “land” in section 2(1) of the GST Act includes an estate or interest in land, a right that gives rise to an interest in land and an option to acquire land or an estate or interest in land.

“Land” includes the ground within the territory of New Zealand, whether below or above the water, and things of a permanent nature situated on the ground, such as buildings or any other structures that become a fixture and thus part of the land. “Land” does not simply mean the physical ground, but the nature of the right involved in the ownership of land.

In common law, all land is held by the Crown and rights in respect of land held by subjects are derived directly or indirectly from the Crown. The bundle of rights held by subjects in respect of land is described as “an estate in land”. The largest estate possible is an estate in fee simple but any number of smaller estates may exist at the same time as an estate in fee simple, and each of those estates may be sold or otherwise dealt with.

Estates may be freehold or less than freehold, for example leasehold. For the purposes of the new rules, leases are excluded from the definition provided that they are leases of dwellings or they are commercial leases for which:

- the supply is made periodically; and
- 25% or less of the total consideration specified in the agreement, in addition to any regular payments is paid or payable under the agreement in advance of or contemporaneously with the supply being made.

The exclusion will ensure that commercial leases that do not require high one-off payments and which are unlikely to be used for phoenix fraud purposes are not caught by the new rules. The definition also expressly excludes mortgages.

Although a person who has an estate will often have a right of immediate possession of the land, it is not a necessary component of having an estate in land. For example, an estate may exist if it gives a person a right of possession at some future time or is contingent on an event that may or may not take place.

An “interest” in land includes both legal and equitable estates. By including equitable estates in land, the definition includes interests in land that are recognised and enforceable under the rules of equity – for example, equitable easements or restrictions on the use of land.

One of the rights that may be granted by a person with a legal interest in land is a “profit a prendre” – that is, a right to enter another person’s land and take some profit from the soil. Common examples of profit a prendre are the right to mine for minerals or a right to harvest timber.

“Land” also includes a right or an option to acquire land or an estate or interest in land.

Lastly, the new definition includes a share in the share capital of a flat-owning or office-owning company, as defined in section 121A of the Land Transfer Act 1952. This aims to prevent such structures being used for fraudulent purposes.

Disclosure requirements

A supply that wholly or partly consists of land is a zero-rated supply if, at the date of settlement, the recipient is a registered person, acquires the goods with the intention of using them for making taxable supplies, and the supply is not a supply of land intended to be used as a principal place of residence of the recipient or their relative.

New section 78F seeks to assist the supplier in identifying this information in order to apply the correct GST treatment. Thus, if a supply wholly or partly consists of land, section 78F(2) requires the purchaser to provide, at or before settlement, a written statement to the supplier whether at the date of settlement:

- they are, or expect to be, a registered person; and
- they are acquiring the goods with the intention of using them for making taxable supplies; and
- they do not intend to use the land as a principal place of residence for them or a person associated with them under section 2A(1)(c) (their relative).

This information must be provided to the supplier in writing. It is expected that the requirements of this section will be incorporated into standard sale and purchase agreements. In that case, the written statement could simply be by way of ticking (or not) the relevant criteria.

Since the tests in section 11(1)(mb) must be satisfied on settlement for the zero-rating rules to apply, the information provided by the purchaser may be provided on a prospective basis – that is, on the basis of the best prediction of the recipient’s circumstances at the time of settlement. For example, if a purchaser is not registered for GST but intends to register before settlement, they may indicate on their statement that they expect to be registered for GST. Furthermore, if the purchaser who contracts with the supplier does not intend to receive the land themselves but nominates or intends to nominate a third party to receive the supply, the purchaser may make representations on behalf of the nominated person (section 78F(5)).

If a supply of land is made by a lender to whom section 5(2) applies, the purchaser must provide the information required by section 78F to the lender rather than the borrower – for example, the mortgagee under a mortgage sale.

Supplier's obligations

Having received a written statement from a purchaser, the supplier may rely on the statement to either standard-rate or zero-rate the supply (section 78F(3)). If the statement indicates that the conditions in section 11(1)(mb) are or will be met, the supplier may zero-rate the supply. If the statement indicates otherwise the supplier may standard-rate the supply..

In some circumstances, the vendor may believe that the information provided by the purchaser is not accurate. In these situations, the legislation provides flexibility for the vendor to adopt the GST treatment that they consider to be correct. For example, if, in contrast to the purchaser's claims the vendor is aware that the purchaser will use the property in question as their principal place of residence, they may but are not obliged to choose to standard-rate the supply. In a commercial transaction it is reasonable to assume that the vendor is unlikely to unilaterally adopt a GST treatment different from the one indicated by the purchaser's representation without first consulting the purchaser.

Once a written statement is provided, the supplier is not required to make any further enquiries regarding the purchaser's circumstances.

If the purchaser either refuses or for any other reason has not provided a written statement regarding their GST registration status and intentions in respect of land, the supplier should standard-rate the transaction.

Record-keeping requirements

If a supply is zero-rated under section 11(1)(mb), new section 75(3B) requires the supplier to maintain sufficient records to enable the following particulars in relation to the supply to be ascertained:

- the name and address of the recipient; and
- the registration number of the recipient; and
- a description of the land; and
- the consideration for the supply.

Consequences of incorrect GST treatment

In some situations, the GST treatment of the transaction elected by the supplier may be found to be incorrect. The consequences of this will depend on whether the mistake is discovered before or after settlement.

Correction of GST treatment before settlement

For a supply to be zero-rated, the conditions for zero-rating in section 11(1)(mb) must be satisfied at the time of settlement. Since the time of supply may occur before a transaction is settled, the supplier will need to determine whether the supply should be standard-rated or zero-rated at that earlier time. As discussed earlier, this determination will usually be made on the basis of the written statement provided by the purchaser.

Before settlement the parties may become aware that the GST treatment applied to the transaction thus far is not correct.

For example, on signing the sale and purchase agreement the purchaser may have informed the supplier that they will be registered at the time of settlement. The supplier zero rates the transaction as a result. Before settlement, the purchaser may decide to nominate a third person to settle the transaction. The nominated person indicates that they will not be registered at the time of settlement.

Conversely, the parties may become aware of circumstances that indicate that a transaction should be zero-rated rather than standard-rated.

In both cases, since the crystallisation of the correct GST treatment in respect of the supply occurs at the time of settlement, the new zero-rating rules do not impose any obligations on the parties to change the initial GST treatment of the supply before settlement. Nevertheless, the parties may voluntarily agree to correct the GST treatment to avoid the consequence of being incorrect, as outlined below.

If GST has already been accounted for to Inland Revenue by the supplier, the correction may be done under section 25 of the GST Act, which allows the supplier to issue a credit note to adjust the tax payable by the supplier. Thus, if a supply was standard-rated when it should have been zero-rated, the supplier will be able to deduct the GST already paid to Inland Revenue and the purchaser will be required to account for the amount of any deduction incorrectly claimed in respect of the supply. Alternatively, if a supply was zero-rated when it should have been standard-rated, the supplier would be required to account for the GST. Generally the purchaser will not be able to claim a deduction in respect of the supply since if they are registered for GST and intend to use the goods in making taxable supplies (requirements for obtaining a deduction), standard-rating is unlikely to be the correct treatment.

Section 25 has been amended by the Taxation (GST and Remedial Matters) Act to explicitly allow suppliers to issue debit and credit notes in the context of the zero-rating rules.

Example 1

Max, a registered vendor, agrees to sell land to Geoff for \$500,000 plus GST, if any. Geoff informs Max that he does not expect to be registered for GST at the time of settlement and does not have any intention to use the land for taxable purposes.

Before settlement, Max issues a tax invoice on the basis that the GST of \$75,000 is chargeable in respect of the supply. The tax invoice triggers the time of supply and Max accounts for the amount of GST to Inland Revenue.

Following the time of supply but before settlement, Geoff tells Max that he has decided to nominate Paul to settle the transaction. Paul informs Max that he will be registered for GST at the time of settlement, will use the land for making taxable supplies and will not use it as his or his relative's principal place of residence.

The parties want to ensure that the correct GST is achieved before settlement. Therefore, Max issues a credit note under section 25 and deducts the amount of GST already paid to Inland Revenue (\$75,000).

Example 2

Robert, a GST-registered property developer, agrees to sell land to Graeme, who is not registered for GST, for \$1 million plus GST, if any. In the sale and purchase agreement Graeme specified that on settlement he will be registered for GST, will acquire the property with the intention of using it for making taxable supplies and will not use it as his or his relative's principal place of residence. As a result, the parties treat the supply as zero-rated under section 11(1)(mb).

Before the date of settlement, Robert issues a tax invoice, thereby triggering the time of supply. Since Robert treats the transaction as zero-rated, he does not account for any GST to Inland Revenue.

Following the time of supply but before settlement, Graeme informs Robert that his circumstances have changed and that he will not be registered for GST at the date of settlement. As a result, the correct GST treatment of the transaction would be to standard-rate the supply.

The parties want to ensure that the correct amount of GST is accounted for before settlement. Robert issues a debit note under section 25 and accounts to Inland Revenue for the GST amount of \$150,000. Since Graeme is not registered for GST, he is not able to claim any input tax deduction.

Correction of GST treatment after settlement

In some situations the correct GST treatment may be unknown until after the transaction has been settled. The consequences of incorrectly standard-rating or incorrectly zero-rating the supply are set out below.

Supply incorrectly standard-rated

When a supply that should have been zero-rated is incorrectly standard-rated and the GST has been accounted for to Inland Revenue, the supplier will be required to use the credit note mechanism in section 25 to deduct the GST paid in respect of the supply. The purchaser would then be required to account for output tax in relation to any amount of input tax that they have incorrectly claimed in respect of the supply.

Example 3

Sarah, a registered vendor, agrees to sell land to Brent for \$200,000 plus GST, if any. Brent informs Sarah that he does not expect to be registered for GST at the time of settlement and does not have any intention to use the land for taxable purposes.

Before settlement, Sarah issues a tax invoice on the basis that GST of \$30,000 is chargeable in respect of the supply. The tax invoice triggers the time of supply and Sarah accounts for the amount of GST to Inland Revenue.

Before settlement, owing to changes in Brent's circumstances, he registers for GST. He also intends to use the land for making taxable supplies and does not intend to use it as his principal place of residence.

The parties settle the transaction. Since at the time of settlement all conditions in section 11(1)(mb) for zero-rating were satisfied, the supply should have been zero-rated rather than standard-rated.

Following settlement, Sarah issues a credit note under section 25 and deducts the amount of GST already paid to Inland Revenue (\$30,000). Since Brent has not claimed an input tax deduction, he is not required to account for output tax in relation to the credit note adjustment.

Supply incorrectly zero-rated

When at any time after a transaction is settled it is found that the supply should have been standard-rated rather than zero-rated, new section 5(23) will treat the purchaser, at the date of settlement, as making a supply of the goods in question at the standard rate. The value of the supply under section 5(23) will be equal to the amount of the consideration for the original supply. Since the supply is treated as being made at the date of settlement of the underlying supply, the purchaser may be subject to use-of-money interest with any applicable penalties calculated from that date.

If the purchaser who is required to account for tax under section 5(23) is not registered for GST, they will be treated as registered from the date of the supply under section 5(23) and must apply to be GST-registered (new section 51B(4)). If the purchaser fails to apply for registration, the Commissioner of Inland Revenue will be able to force their registration.

New section 20(4B) denies a deduction to the person who is treated under section 5(23) as a supplier of goods. However, the person may be able to claim a deduction for the supply at a later date if they register for GST and use the relevant goods for making taxable supplies.

Once GST is accounted for, the purchaser may request that the Commissioner cancel their registration (new section 51B(5)). Under section 5(3) a person cancelling their registration must ordinarily account for the output tax on any goods and services forming part of the assets of a taxable activity carried on by the person. This rule could result in unfair and unintended consequences if it applied to deregistration of a person who was required to register under section 51B(4). Therefore, new section 51B(6) renders section 5(3) inapplicable if:

- the person seeks cancellation of their registration by the end of the taxable period in which they have accounted for the output tax under section 5(23); or
- the Commissioner agrees that section 5(3) should not apply.

Example 4

Isla agrees to acquire land for \$1 million plus GST, if any. In a written statement provided to the supplier, Isla indicates that she is registered for GST, intends to use the land for making taxable supplies and will not use it as her or her relatives' principal place of residence. On the basis of these representations, the supplier zero-rates the transaction.

The transaction is settled on 1 July 2011. At the time the settlement Isla is not registered for GST.

Following settlement, Isla is treated as making a supply of the land on 1 July 2011 and has to account for the GST at the standard rate. Since Isla is not registered for GST, she must apply to be registered.

Once registered, Isla must account for the GST under section 5(23) on the value equal to the consideration for the original supply:

$$\text{\$1m} \times 15\% = \text{\$150,000}$$

Isla will not be able to claim an input tax deduction on the payment made under section 5(23) as this is denied under section 20(4B).

In the same taxable period in which she accounts for the output tax under section 5(23), Isla asks the Commissioner to cancel her registration. The Commissioner confirms the deregistration. By application of section 51B(6)(a), Isla is relieved from the requirement to pay any additional tax under section 5(3) on deregistration.

Transactions involving associated persons

An amendment has been made to section 3A (meaning of “input tax”) to limit input tax deductions for second-hand goods in relation to land acquired as part of an arrangement involving more than two associated parties and more than one supply (new subsection (3B)). If the section applies, the amount of input tax for the supply is limited to the amount accounted for as output tax for all supplies that are part of the arrangement. This section is necessary to ensure that the zero-rating rules are not circumvented by arrangements involving second-hand goods deductions.

New apportionment rules

For GST purposes, the amount of an input tax deduction that can be claimed by a GST-registered purchaser for acquired goods and services should relate to the taxable use of the goods and services.

This is achieved by allowing GST-registered persons to claim a full input tax deduction for GST paid on goods and services acquired for the principal purpose of making taxable supplies.

If the goods and services acquired for the principal purpose of making taxable supplies are used partly or entirely for another purpose – for example, for private and exempt purposes (non-taxable purposes), the GST Act treats the non-taxable use of goods and services as a taxable supply by the registered person, and output tax is charged accordingly.

Conversely, goods and services acquired principally for a non-taxable purpose (for which the GST-registered person is not entitled to an input tax deduction) could be partly or entirely used to make taxable supplies. In these circumstances, the GST Act allows a deduction to reflect that taxable use.

This approach of taxing the “self supply” of goods and services ignores the original input tax deduction claimed by the GST-registered person as the change-in-use adjustments do not relate to the amount of the deduction claimed on acquisition. This is because the use of goods and services for a non-principal purpose is deemed to be a supply which is separate from the purchase transaction.

Another aspect of the GST rules is that there is no statutory limit on the maximum number of adjustments that have to be made, so the number of adjustments required can be excessive relative to the amounts involved. In addition, since change-in-use adjustments do not relate to the amount of the initial input tax deduction, the value of adjustments that a person is required to make can potentially amount to more than the original GST paid on the purchase. Conversely the value of the deduction received by means of change-in-use adjustments can sometimes exceed the amount of GST originally paid.

Because of the detachment between the initial input tax claimed on acquisition and the subsequent change-in-use adjustments, the rules for imposing GST on mixed use assets have not been sufficiently clear for many taxpayers.

Other issues concerning the current approach were raised by the Court of Appeal decision in *Lundy* (2005) 22 NZTC 19 at 637, which involved land being used concurrently for taxable (advertised for sale) and non-taxable (generating rental income) purposes.

Proposals to reform the change-in-use adjustments rules were initially outlined in an officials’ issues paper, *Options for strengthening GST neutrality in business-to-business transactions*, released in June 2008. In the 2009 discussion document, *GST: Accounting for land and other high-value assets*, the Government proposed to replace the change-in-use adjustment approach with one that would apportion input tax deductions in line with the actual use of the goods and services. The new apportionment rules contained in the Taxation (GST and Remedial Matters) Act 2010 have therefore been the subject of extensive consultation and incorporate various amendments that arose during the policy development process.

Overall, the new rules are intended to reduce compliance costs for businesses by being simpler and requiring fewer adjustments.

Key features

The new rules replace the current adjustment approach with an approach that apportions input tax deductions in line with the actual use of the goods and services. In summary, the rules operate as follows:

- On acquisition, unless an exclusion applies, the portion of a deduction that a registered person can claim must correspond with the portion of the asset's use that is intended for taxable purposes.
- In subsequent years, a person may be required to adjust the deduction claimed if the extent to which the asset is used for taxable purposes is different from the intended taxable use of the asset. A number of exemptions are introduced to relieve a person from the requirement to make an adjustment if the amount of tax involved in the adjustment is low.
- The maximum number of adjustments that a person may be required to make varies according to the asset's value or estimated useful life of the asset.
- Special "wash-up" rules apply when goods and services that have been subject to the apportionment rules are sold or the person deregisters.
- Special rules also apply to assets used concurrently for taxable and non-taxable purposes.

Application dates

The new rules will apply to goods and services acquired after 1 April 2011.

For goods and services acquired before 1 April 2011, registered persons will be required to continue making change-in-use adjustments under the current rules. The obligation to make adjustments will, however, be limited by new section 21G for all supplies other than those that wholly or partly consist of land:

- For goods or services whose market value or book value on 1 April 2011 is \$5,000 or less, no adjustment under the old rules may be made after 1 April 2011.
- For goods or services whose market value or book value on 1 April 2011 is more than \$5,000 but not more than \$10,000, no adjustment under the old rules may be made after 1 April 2013.
- For goods or services whose market value or book value on 1 April 2011 is more than \$10,000, no adjustment under the old rules may be made after 1 April 2016.

Once the time limit for an asset is reached, the person must stop making any adjustments for change-in-use in respect of that asset.

Detailed analysis

Apportionment of input tax on acquisition

Acquisition of standard-rated goods and services

Under new section 20(3C), a purchaser will be able to deduct input tax on the acquisition of goods and services to the extent to which the goods or services are used for, or are available for use in, making taxable supplies.

In determining the extent to which goods or services are used for making taxable supplies, a person must estimate on acquisition how they intend to use the goods or services, and choose a determination method that provides a fair and reasonable result (new section 20(3F)). The estimate could be made on the basis of any records that are available, previous experience, business plans or other suitable methods. The method of working out the extent of intended taxable use will largely depend on the nature of the goods and services in question. For example, if the asset is a car which is intended to replace an existing car used in the business, the logbook for the previous car could be a reasonable method of stipulating the intended use of the purchased car provided patterns of use were largely unchanged.

The estimated intended taxable use of the goods or services will determine the proportion of the input tax that can be deducted (new section 20(3G)).

New section 20(3D) is a de minimis provision to relieve recipients from the obligation to apportion input tax on the acquisition of goods or services in certain circumstances. In a similar way to the current rules, recipients will not be required to apportion input tax if they make both taxable and exempt supplies and have reasonable grounds to believe that the total value of their exempt supplies in the first adjustment period¹ will be no more than the lesser of \$90,000 or 5% of the total consideration for all taxable and exempt supplies.

Example 1

John acquires a car for \$23,000 (including GST of \$3,000) to replace his existing car. The car will be used both in John's business as a sole trader and for private purposes.

The logbook kept by John for his old car shows that in the previous year he used the car 70% of the time for business purposes. Since John does not expect this ratio to substantially change in the future, he estimates that he will use the new car 70% for taxable purposes. Consequently, on acquisition John claims 70% of the available input tax using the formula in section 20(3G):

$$\$3,000 \times 70\% = \$2,100$$

¹ "First adjustment period" is defined in section 21F(2)(a) as a period that starts on the date of acquisition and ends on the date as the person chooses that either corresponds to the person's first balance date that falls after the date of acquisition or to the person's first balance date that falls at least 12 months after the date of acquisition. See more on "adjustment periods" later in this report.

Example 2

Safe Life Ltd (SL) is an insurance company that provides mostly life insurance policies (exempt supplies), but also provides a range of other insurance covers (taxable supplies). SL purchases 100 computers for a total consideration of \$240,000 (including GST of \$31,304).

On acquisition, SL may only claim the portion of the input tax that corresponds with the intended taxable use of the computers. SL estimates that in the 12 months prior to the purchase, 70% of all its supplies were exempt supplies of life insurance policies and 30% of its supplies were taxable supplies of other insurance covers. As a result, SL determines that the computers will be used 30% of the time for the purpose of making taxable supplies and claims 30% of the input tax paid in respect of the computers:

$$\$31,304 \times 30\% = \$9,391$$

Example 3

A corner dairy spends \$6,000 (exclusive of GST) on renovations.

The major part of the dairy's business involves making taxable supplies. However, the dairy also runs a debtors' account and charges interest on any late payments (exempt supplies). Since the total value of the interest charged (exempt supplies) in the first adjustment period is expected to be no more than the lesser of \$90,000 or 5% of the total consideration for all taxable and exempt supplies made by the dairy, the dairy is not required to apportion the input tax in relation to the renovations.

Acquisition of zero-rated goods and services

The Taxation (GST and Remedial Matters) Act 2010 introduces new rules that require suppliers of land, or supplies that include land, to charge GST on the supply at the rate of zero percent in certain circumstances.

New section 20(3I) provides special rules that will allow recipients of zero-rated supplies to determine the GST component of a zero-rated acquisition and account for any non-taxable use of the goods. In the absence of the special rule, any non-taxable use of the land would remain unaccounted for.

Thus, on the acquisition of a zero-rated asset, the purchaser will be required to perform the following steps:

Identify the nominal amount of tax

First, the purchaser must identify the nominal amount of tax (the "nominal GST component") that would be chargeable on the value of the supply if the zero-rating rules did not apply and the supply was subject to the standard rate of GST.

Determine the intended use of the supply

The purchaser must then determine as a percentage the extent to which they intend to use the goods for making taxable supplies.

Account for output tax, if any

If the person estimates that they will not use the asset solely for making taxable supplies, the person must account as output tax for the proportion of the nominal GST component that is attributable to the non-taxable use of the goods.

Example 4

Safe Life Ltd (SL) from Example 2 acquires new headquarters for \$30 million. There was no GST included in the supply as it is subject to the new zero-rating rules.

On acquisition, SL has to apply the rules in section 20(3I) as follows:

1. Identify the amount of tax that would be chargeable on the value of the supply if the supply was subject to the standard rate of GST (the nominal GST component):

$$(30\text{m} \times 15\% = \$4,500,000)$$

2. Determine the extent to which they intend to use the headquarters for making taxable supplies.

(SL estimates that 30% of its activity involves making taxable supplies.)

3. Account for the proportion of the nominal GST component that is attributable to the non-taxable use of the goods as an output tax:

$$\$4,500,000 \times 70\% = \$3,150,000$$

SL has to account for output tax of \$3,150.00 in respect of the acquisition of the new headquarters.

Example 5

Eric purchases a building for \$3 million. The supply to Eric is zero-rated.

Eric intends to rent the ground floor of the building to commercial tenants, and the upper floors of the building to residential tenants.

On acquisition, Eric has to apply the rules in section 20(3I):

1. Identify the amount of tax that would be chargeable on the value of the supply if the supply was subject to the standard rate of GST (the nominal GST component):

$$\$3\text{m} \times 15\% = \$450,000$$

2. Determine the extent to which he intends to use the building for making taxable supplies.

Eric determines that he intends to use the building 60% in making taxable supplies (rent to commercial tenants) and 40% in making exempt supplies (rent to residential tenants).

3. Account for the proportion of the nominal GST component that is attributable to the non-taxable use of the goods as output tax:

$$\$450,000 \times 40\% = \$180,000$$

Eric has to account for output tax of \$180,000 on acquisition of the building.

Subsequent adjustments for change-in-use

The new rules seek to achieve as much “first instance” accuracy as possible by requiring taxpayers to make fair and reasonable estimates on the intended taxable and non-taxable uses of acquired goods and services. In an “adjustment period” following the initial input tax deduction claim, taxpayers may, however, be required to make further adjustments if the *actual* taxable use of an asset is different from its *intended* taxable use.

“Adjustment period”

An “adjustment period” (described in new section 21F(2)) is a period at the end of which a person is required to estimate whether an adjustment for a subsequent change-in-use is required. The first adjustment period is a period that starts on the date of acquisition and ends on the date as the person chooses that either corresponds to the person’s first balance date that falls after the date of acquisition or to the person’s first balance date that falls at least 12 months after the date of acquisition. All subsequent adjustment periods will be annual periods that start on the day after the end of the earlier adjustment period and end on the last day of the equivalent taxable period in which the first adjustment period ended.

Example 6

Mary purchases a car on 1 February 2012. Mary’s balance date falls on 31 March.

The first adjustment period in respect of the car is, at Mary’s option, either:

1. the period from 1 February 2012 to 31 March 2012; or
2. the period from 1 February 2012 to 31 March 2013.

If Mary has chosen option 1 as her first adjustment period, the second adjustment period will run from 1 April 2012 to 31 March 2013.

If Mary has chosen option 2 as her first adjustment period, the second adjustment period will run from 1 April 2013 to 31 March 2014.

Number of adjustment periods

There will be a maximum number of adjustment periods for which adjustments will be required to be made. The default method for identifying the maximum number of adjustment periods is in new section 21F(3)(a) and requires the taxpayer to apply the following GST-exclusive bands of goods and services:

- \$5,001 to \$10,000 – two adjustments.
- \$10,001 to \$500,000 – five adjustments.
- \$500,001 or more – ten adjustments.

Alternatively, taxpayers will be able to select the maximum number of adjustments by reference to the estimated useful life of the asset as specified in the Tax Depreciation Rates Determinations set by the Commissioner under section 91AAF of the Tax Administration Act 1994 (new section 21F(3)(b)).

There will be no limit to adjustment periods in relation to land (new section 21F(4)).

Exclusions from the obligation to make adjustments in an adjustment period

No subsequent change-in-use adjustment will be required for goods and services acquired for the GST-exclusive value of \$5,000 or less (new section 21(2)(b)).

Example 7

Sherry, a graphic designer, purchases a computer for \$3,999 (including GST of \$522) to use both for business and private purposes. She estimates that she will use the computer 80% for taxable purposes and claims a deduction of \$418 (80% of \$522).

Since the GST-exclusive value of the computer is less than \$5,000, Sherry will not be required to make any adjustments for change-in-use in any of the subsequent adjustment periods.

For assets with a value of more than \$5,000, no adjustment will be required in the relevant adjustment period if the recipient makes both taxable and exempt supplies and the total value of their exempt supplies in the adjustment period to which the adjustment relate is no more than the lesser of \$90,000 or 5% of the total consideration for all taxable and exempt supplies for that adjustment period (new sections 21(2)(a) and 20(3)(d)).

Identifying whether there is substantial change in the use of the goods and services

If the above exclusions do not apply, new sections 21A and 21B provide that, at the end of an adjustment period, a person must compare the percentage actual use of goods or services with:

- the percentage intended use of the goods or services (if no previous adjustment has been made); or
- the previous actual use (if the goods or services have been subject to a previous adjustment).

The “percentage actual use” is defined in section 21F(1)(a) as the extent to which the goods or services are *actually* used by the person for making taxable supplies. It is calculated from the date of acquisition to the end of the relevant adjustment period. The estimate must be expressed as a percentage.

The “percentage intended use” is defined in section 21F(1)(b) as the extent to which the goods or services are *intended* to be used by the person for making taxable supplies, estimated at the time of acquisition. The estimate must be expressed as a percentage.

The “previous actual use” is defined in section 21B(b)(i) as the percentage actual use in an earlier period that is the most recent period in which an adjustment has been made.

If the percentage intended use or previous actual use of goods or services is equal to the percentage actual use, the person will not be required to make an adjustment in the relevant adjustment period.

If the percentage actual use of goods or services differs from the percentage intended use or previous actual use, the person will be required to make an adjustment in an adjustment period only if the difference between the amounts is 10 percentage points or more or the monetary value of the adjustment is more than \$1,000 (new section 21(2)(c)).

Calculating adjustments

If none of the exclusions mentioned above apply, the person will need to account for a change-in-use.

New section 21C sets out how to calculate the amount of a change-in-use adjustment for the adjustment period. This will be done by applying the formula:

$$\text{Full input tax deduction} \times \text{percentage difference}$$

The “full input tax deduction” is the total amount of input tax on the supply. In situations where goods were acquired subject to the zero-rating rules, “full input tax deduction” will include any nominal GST component as calculated under section 20(3I).

The “percentage difference” is defined in section 21F(1)(c) as the difference between the percentage actual use and either the percentage intended use or the previous actual use if the person has already made an adjustment in respect of the asset in an earlier adjustment period.

Example 8: Identifying percentage actual use and percentage intended/previous actual use

Peter acquires a luxury boat for \$800,000 plus GST. On acquisition, Peter estimated that the boat would be used 100% for chartering – a taxable purpose – and claimed the full input tax deduction. However, in later periods Peter uses the boat partly for private purposes.

Based on the value of the boat, Peter determines that there will be five adjustment periods. In those adjustment periods, Peter uses the boat as follows:

- in the first adjustment period – 100% for taxable purposes;
- in the second adjustment period – 80% for taxable purposes;

- in the third adjustment period – 83% for taxable purposes;
- in the fourth adjustment period – 50% for taxable purposes; and
- in the fifth adjustment period – 90% for taxable purposes.

The first adjustment period is a period of six months. All subsequent adjustment periods are periods of 12 months.

None of the exclusions apply to this situation. The question is: what are the use percentages that Peter has to compare at the end of each adjustment period?

First adjustment period

Percentage intended use – 100%

Percentage actual use – 100%

Second adjustment period

Previous actual use – 100%

Percentage actual use – 86.6%

$$(100\% \times 6/18) + (80\% \times 12/18) = 33.3 + 53.33 = 86.6\%$$

In the above calculations, figures “6” and “12” represent, respectively, the length of the first and second adjustment periods expressed in months. The figure “18” represents the total number of months since the acquisition of the boat.

Third adjustment period

Previous actual use – 86.6%

Percentage actual use – 85.2%

$$(100\% \times 6/30) + (80\% \times 12/30) + (83\% \times 12/30) = 20\% + 32\% + 33.2\% = 85.2\%$$

Fourth adjustment period

Previous actual use – 86.6%

Percentage actual use – 75.2%

$$(100\% \times 6/42) + (80\% \times 12/42) + (83\% \times 12/42) + (50\% \times 12/42) = 14.3\% + 22.9 + 23.7\% + 14.3\% = 75.2\%$$

Fifth adjustment period

Previous actual use – 75.2%

Percentage actual use – 78.4%

$$(100\% \times 6/54) + (80\% \times 12/54) + (83\% \times 12/54) + (50\% \times 12/54) + (90\% \times 12/54) = 11.1\% + 17.8\% + 18.4\% + 11.1\% + 20\% = 78.4\%$$

It should be noted that Peter will be required to account for adjustments to Inland Revenue in the second, third, fourth and fifth adjustment periods as in each of those periods either the percentage difference is more than 10 percentage points or the monetary value of the adjustments is more than \$1,000. Hence, Peter may not rely on the exclusion in section 21(2)(c).

Special rule for concurrent use of land

Under the new apportionment approach, the portion of a deduction that a person should be entitled to must correspond with the extent to which the asset is used for taxable purposes. In most situations, an asset may only be used for either taxable or non-taxable purposes at one point in time. For example, at any given time a motor vehicle may be used by a person for making deliveries of goods and services or for taking the person’s children to school – but usually not both at the same time.

In some circumstances, however, an asset may be used for taxable and non-taxable purposes at the same point in time – for example, a property developer may supply a house as a dwelling for a few months while advertising the house for sale. Thus, for the duration of the rental period, the asset is not only fully committed to the taxable activity (the sale), but is also simultaneously fully committed to the exempt activity (residential rental income).

Section 21D provides a formula that will assist taxpayers in apportioning between concurrent uses of land. It also allows taxpayers to apply to the Commissioner for an alternative approach should the formula not be workable in their circumstances.

Section 21D(3) requires a registered person to calculate the extent to which the land is used for making taxable supplies by using the formula:

$$\frac{\text{Consideration for taxable supply}}{\text{Total consideration for supply}} \times 100\%$$

The “consideration for taxable supply” is defined in section 21D(4)(a) as either the amount derived on a disposal of the land or, if the land has not been disposed of, the market value of the land at the time of the adjustment.

The “total consideration for supply” is defined in section 21D(4)(6) as the sum of the amount of the “consideration for the taxable supply” described above and:

- the amount of all rental income derived from the supply of a dwelling since the land was acquired; and
- if no rental income is paid or payable in relation to the non-taxable use of land, the market value of rental income that would have been derived from the time of acquisition of the land if rental had been charged.

New section 21D(5) specifies that the market value must be used in determining “consideration for the taxable supply” and/or “total consideration for supply” if amounts derived under those definitions are by associated persons or are not arm’s-length amounts.

New section 21D(5B) provides that if the market value of the land or rental income is not readily identifiable, the person may use another method to provide a fair and reasonable estimate of the market value.

Example 9

Sandy, a property developer, constructed two similar residential houses, House A and House B, next to each other. The construction cost of each house is \$230,000 (including GST of \$30,000). Sandy intends to sell both properties on completion (a taxable use) and therefore claims a full deduction on the GST incurred on construction.

Sandy is unable to sell the property immediately on completion. Therefore, while still advertising the houses for sale, she:

- rents out House A and receives rental income of \$26,000 in the first adjustment period; and
- moves into House B and lives there rent-free.

At the end of the first adjustment period, Sandy sells House B for \$360,000.

Adjustment at the end of the first adjustment period – House A

Since Sandy used the house concurrently for taxable (advertising for sale) and exempt (supplying a residential dwelling) purposes, she uses the formula in section 21D(3) to identify the actual taxable use of the property in the first adjustment period.

The “consideration for taxable supply” is either the amount derived on a disposal of the land or, if the land has not been disposed of, the market value of the land at the time of the adjustment. Sandy has not disposed of House A, but ascertains that the market value of the house is approximately the same as for House B – \$360,000.

The “total consideration for supply” is the amount of the “consideration for the taxable supply” (\$360,000) and the amount of all rental income (\$26,000) derived from the supply of the dwelling since the land was acquired – \$386,000.

Therefore, Sandy’s taxable use of the house is:

$$\frac{\$360,000}{\$386,000} \times 100 = 93\%$$

Sandy has therefore deducted 7% more input tax than she should have and has to account for this to Inland Revenue:

$$\$30,000 \times 7\% = \$2,100$$

Adjustment at the end of the first adjustment period – House B

Since Sandy used the house concurrently for taxable (advertising for sale) and private (residential) purposes, she has to use the formula in section 21D(3) to identify the actual taxable use of the property in the first adjustment period.

The “consideration for taxable supply” is the amount derived on a disposal of the house – \$360,000.

Since Sandy did not rent out House B, but still used it for non-taxable purposes, the “total consideration for supply” is the amount of the “consideration for the taxable supply” (\$360,000) and the market value of the rental income that she would have derived if she had rented out the property. Sandy estimates that she would have received \$26,000 of rental income.

Therefore, Sandy’s taxable use of the house is:

$$\frac{\$360,000}{\$386,000} \times 100 = 93\%$$

Sandy has therefore deducted 7% more input tax than she should have and has to account this amount Inland Revenue:

$$\$30,000 \times 7\% = \$2,100$$

In both cases it should be noted that Sandy may be able to recover some or all of the unclaimed input tax if she later disposes of the houses in the course of her taxable activity (see section below “adjustment on disposal”).

An additional formula (section 21D(6)) estimates the extent of taxable use of the land if the land has, at any time, been used solely for making non-taxable supplies. The formula is:

$$\frac{\text{Months}}{\text{Total months}} \times \text{result as calculated under the formula in section 21D(3)}$$

“Months” is defined in section 21D(7) (a) as the number of months since acquisition in which all or part of the land is used to some extent for making taxable supplies. “Total months” is defined in section 21D(7)(b) as the total number of months since acquisition.

By taking into account the solely non-taxable use of the land, the formula will reduce the extent of the taxable use of the land calculated under the formula in section 21D(3).

Example 10

The facts are the same as in Example 9. Assume that the length of the first adjustment period was 12 months.

In the second adjustment period, Sandy continues both letting out and advertising for sale House A. However, six months after the start of the second adjustment period, Sandy stops advertising House A for sale as she decides to permanently rent it out.

In the second adjustment period, she receives rental income of \$30,000. The market value of House A at the time of the adjustment is still \$360,000.

At the end of the second adjustment period, Sandy uses the formula in section 21D to identify the taxable use of the house. For the purposes of the second adjustment period, the “total consideration for supply” is the sum of the market value of the house and all rental income received since the land was acquired:

$$\frac{\$360,000}{\$416,000} \times 100 = 86.5\%$$

However, because the house has been used for six months solely for making non-taxable supplies, she has to apply the formula in section 21D(6):

$$\frac{18}{24} \times 86.5\% = \mathbf{64.8\%}$$

Sandy’s percentage actual use of House A in the second adjustment period is 64.8%. The percentage actual use must be compared with the “previous actual use”, that is with the percentage actual use as determined in the most recent period in which an adjustment has been made. For Sandy, the previous actual use will be 93%. Sandy has therefore deducted 28.2% more input tax than she should have and has to account for this to Inland Revenue:

$$\$30,000 \times 28.2\% = \$8,460$$

Adjustment on disposal

When a registered person disposes of, or is treated as disposing of, goods or services in the course of a taxable activity and has not claimed a full input tax deduction, new section 21E allows them to claim an additional amount of input tax.

The amount of deduction available on disposal of goods or services will be calculated under the formula:

$$\text{tax fraction} \times \text{consideration} \times (1 - \text{actual deduction/full input tax deduction})$$

For the purposes of the formula section 21E(3) provides that;

- “Tax fraction” has the meaning given in section 2(1). For the purposes of the 15% GST rate, the tax fraction is 3/23.
- “Consideration” is the amount of consideration received, or treated as received, for the supply.
- “Actual deduction” is the amount of deduction already claimed, taking into account adjustments made up to the date of disposal.

The amount calculated under the formula, when added to any deduction already claimed, must not be more than the total amount of the input tax on the supply (or the nominal GST component, if the supply was zero-rated).

Example 11: Appreciating asset

Same facts as in Example 10.

The total input tax on the construction costs that relate to House A is \$30,000. Sandy claimed 64.8% of the total input tax – \$19,440.

At the beginning of the third adjustment period, Sandy sold the house to Nigel for \$320,000 inclusive of GST.

Since Sandy has not claimed the full input tax in respect of the construction cost incurred in respect of the property, she may use section 21E to make a final adjustment of the input tax:

$$\frac{3}{23} \times \$320,000 \times (1 - \$19,440/\$30,000) = \$14,692$$

The resulting amount of \$14,692, when added to the deduction already claimed (\$19,440), is more than the total amount of the input tax on the supply (\$30,000). Therefore, the amount of the adjustment that may be claimed by Sandy will be limited to \$10,560.

Example 12: Depreciating asset

Charles acquired a car for \$46,000 (inclusive of GST of \$6,000) and claimed 70% of the input tax (\$4,200). Having used the car for the intended purpose for three years, Charles sells it for \$30,000 inclusive of GST.

Since Charles has not claimed the full input tax in respect of the car and the car was sold in the course of the taxable activity, he may use section 21E to make a final adjustment of the input tax:

$$\frac{3}{23} \times \$30,000 \times (1 - \$4,200/\$6,000) = \$1,174$$

The amount of the adjustment to be claimed in respect of the taxable disposal of the vehicle is \$1,174.

Example 13: Master example

John, the sole trader in Example 1, acquired a vehicle for \$20,000 plus \$3,000 GST. On acquisition, John claimed 70% of the input tax – \$2,100.

Since the GST-exclusive value of the car falls between \$10,001 to \$500,000, he has to monitor the use of the car for five adjustment periods.

In the first adjustment period (a period of 12 months), the entries in the logbook kept by John indicate that he used the car 55% in his business (taxable use).

In the second adjustment period (also a period of 12 months), John used the car 65% in his business.

In the third adjustment period (a period of 12 months), John withdrew the car from the use in the business and used it solely for private purposes.

In the fourth adjustment period, John sold the car for \$10,000 inclusive of GST.

First adjustment period

At the end of the first adjustment period, John has to determine whether he may rely on the exclusions in either section 21(2)(a) (minimal exempt supplies) or section 21(2)(b) (the value of the supply) to avoid any change in use adjustments. John determines that the exclusion does not apply.

John therefore has to determine whether the use of the car in the first adjustment period corresponds with the intended taxable use of the car as estimated on acquisition. To do this he must compare the percentage actual use of the car with the percentage intended use of the car.

The logbook kept by John in respect of the car indicated that the taxable use of the car accounted for 55% of its total use. On acquisition, John predicted that he would use the car 70% for taxable purposes. Since the difference between the intended taxable use and the actual taxable use is more than 10%, John may not rely on the exclusion in section 21(2)(c) and has to make an adjustment for change-in-use.

Using the formula in section 21C, John calculates the amount of the deduction that he has to return to Inland Revenue as output tax:

$$\$3,000 \times 15\% = \$450$$

Second adjustment period

For the purposes of the adjustment in the second adjustment period, the percentage actual use must be calculated from the date of acquisition to the end of the relevant adjustment period. John used the car for taxable purposes 55% in the first adjustment period of 12 months and 65% in the second adjustment period of 12 months. Overall, over two years, John used the car 60% for taxable purposes:

$$(55\% \times 12/24) + (65\% \times 12/24) = 60\%$$

The percentage actual use must be compared with the “previous actual use”, that is with the percentage actual use as determined in the most recent period in which an adjustment has been made. For John, the previous actual use will be 55%, as this was the actual use of the car at the end of the first adjustment period.

Since the difference between the percentage actual use (60%) and the previous actual use (55%) of the car is less than 10 percentage points, John will not be required to account for the amount of the adjustment if the monetary value of the adjustment is less than \$1,000.

John calculates that the value of the adjustment is less than \$1,000 using the formula in section 21C:

$$\$3,000 \times 5\% = \$150$$

Third adjustment period

John calculates the percentage actual use of the car after three adjustment periods:

$$(55\% \times 12/36) + (65\% \times 12/36) + (0\% \times 12/36) = 18.3\% + 21.7\% + 0 = 40\%$$

The percentage actual use is 40%. This percentage has to be compared with the previous actual use. Since John did not make an adjustment in the previous (second) adjustment period, the “previous actual use” will be the percentage actual use in a period that is the most recent period in which an adjustment has been made. John made an adjustment in the first adjustment period where his percentage actual use was 55%. This percentage will therefore become John’s previous actual use for the purposes of the adjustment in the third adjustment period.

Since the difference between the percentage actual use (40%) and the previous actual use (55%) of the car is more than 10 percentage points, John has to account to Inland Revenue for the over-claimed amount of the deduction. The amount of the output tax to be accounted for is:

$$\$3,000 \times 15\% = \$450$$

Fourth adjustment period

In the fourth adjustment period, John sold the car in the course of his taxable activity for \$10,000. As John has not claimed the full deduction in respect of the car, he may claim an additional amount of the adjustment on disposal under section 21E calculated as follows:

$$3/23 \times \$10,000 \times (1 - \$1,200/\$3,000) = \$783$$

John may claim a deduction of \$783 in respect of the taxable disposal of the car.

Entitlement to input tax deduction *for* goods and services acquired *before* registration

New rules have also been introduced that may allow a registered person to claim input tax deductions for goods and services purchased by them before registration.

These will apply in the following circumstances:

- before becoming a registered person, the person acquired goods or services that were chargeable with GST at the standard rate; and
- at the time of the registration or at a later time, the person used the goods or services for making taxable supplies; and
- the original cost of the goods or services, excluding GST, was \$5,000 or less.

If these conditions are met, a registered person will be able to claim a deduction for the goods and services purchased by them before registration if they hold a tax invoice in relation to the supply as required by section 20(2) or have adequate records that enable the identification of the particulars of an invoice as required by section 24(3).

To claim a deduction, the registered person must make an adjustment for change-in-use under sections 21 and 21A. The ordinary rules for apportionment of input tax would, however, be modified to treat the first adjustment period as the period that starts on the date of the acquisition of the goods or services and ends on the first balance date that falls after the person becomes registered for GST and uses the goods or services for making taxable supplies.

Following the determination of the length of the first adjustment period, the person must identify the percentage actual use of the goods or services in that period, using a method that provides a fair and reasonable result. This percentage actual use would then be compared with the percentage intended use (which will be 0% as the person will not have claimed any deduction on the acquisition). The resulting “percentage difference” will be used to claim an adjusted amount of the deduction under section 21C.

This rule allows goods and services acquired by a person before their registration to enter the proposed apportionment regime. As a consequence, the asset will become subject to the same apportionment rules as any other asset purchased by the registered person.

Example 14

On 1 January 2012, Craig, an unregistered person, acquires a car for \$23,000 (including GST of \$3,000). For the next two years Craig uses the car solely for private purposes.

On 1 January 2014, Craig registers for GST and starts using the car solely for business purposes. Craig’s next balance date is 31 March 2014.

Craig has retained the tax invoice received on the purchase of the car. Since the value of the car on the acquisition was more than \$5,000, Craig may claim a deduction for the car under section 21AB.

Craig's first adjustment period in respect of the car will be treated as the period that starts on the date of the acquisition of the goods or services and ends on the first balance date that falls after the person becomes registered for GST and uses the goods or services for making taxable supplies – that is, from 1 January 2012 to 31 March 2014.

During that period (a total of 27 months), Craig used the car 0% for taxable purposes for 24 months (1 January 2012 to 31 December 2013) and 100% for taxable purposes for three months (1 January 2014 to 31 March 2014). Therefore, his total taxable use in the first adjustment period will be:

$$(0\% \times 24/27) + (100\% \times 3/27) = 11\%$$

At the end of the first adjustment period, Craig can claim \$330 (11% of the initial input tax of \$3,000).

Subsequent adjustment periods

The maximum number of adjustments that have to be made for goods and services of value between \$10,000 and \$500,000 is five.

Therefore, if Craig continues owning the car he may be required to make four additional adjustments. If he sells the car in the course of his taxable activity, he may be entitled to an additional deduction under the wash-up mechanism in section 21E.

Application to acquisitions from associated persons

New section 3A(3C) amends the application of section 21AB for goods or services acquired from an associated person. In these situations, the amount of input tax on goods or services that may be claimed by the person must not be more than the amount accounted for as output tax by the associated supplier of the goods or services.

Transactions involving nominations

Nominee transactions ordinarily involve a purchaser nominating another person (a nominee) to receive goods and services and/or settle the transaction.

New rules introduced by the Taxation (GST and Remedial Matters) Act 2010 are intended to provide greater certainty for transactions involving nominees by adopting an “economic substance” approach. The rules are not intended to apply to transactions that involve other structures, such as assignments, novations, or agency arrangements.

Key features

New section 60B clarifies the GST treatment of transactions involving nominations – when a contractual purchaser nominates another person (a nominee) to receive the goods or services from the contractual vendor.

In these circumstances, the GST treatment will depend on which party provides payment for the supply of goods or services. In respect of transactions involving land, however, the supply will always be treated as being made by the supplier to the nominee.

Application dates

The new rules will apply to supplies made on or after 1 April 2011.

Detailed analysis

Effect of nomination on a supply

New section 60B applies when a person (person A) enters into a contract to supply goods and services to another person (person B) and person B directs person A to provide the goods and services to a nominated person (person C) who is not party to the contract.

The section does not apply to situations involving supplies made to or by agents, as these situations are governed by section 60 of the GST Act. Also, the new rule does not apply to assignments or novations.

The GST treatment of a supply will depend on the exact circumstances of the transaction.

Contractual purchaser and nominated person have the same registration status

If a contractual purchaser (person B) and the nominated person (person C) are both registered or both not registered for GST, the treatment of the supply will depend on which party provides consideration for the supply:

- If person B pays the full consideration for the supply, the supply is treated as a supply from the supplier (person A) to person B and the existence of person C is ignored (section 60B(2)).

- If person C pays the full consideration for the supply, the supply is treated as a supply from person A to person C and the existence of person B is ignored (section 60B(3)).
- If person B and person C each pay part of the consideration for the supply, the supply is treated as a supply from person A to person B. However, person B and person C may agree in writing that the supply is to be treated as a supply made to person C. No such agreement can be made if person B has claimed an input tax deduction in relation to the supply (section 60B(4)).

Contractual purchaser and nominated person have different registration status

If the registration status of a contractual purchaser differs from the registration status of the nominated person (that is, one party is registered for GST and another party is not registered for GST), the supply is always treated as a supply from the supplier to the nominated person.

Nominee transactions that involve land

If a supply wholly or partly consists of land, the supply is always treated as made by the supplier to the nominated person. This is intended to provide consistency with fact that the zero-rating rules apply at the time of settlement.

Record-keeping requirements

The nomination rules in section 60B affect the tax invoice requirements. In normal circumstances, a taxpayer must have a tax invoice to claim an input tax deduction. In transactions involving nominations, a nominee may not have the requisite tax invoice as it may have been issued to the purchaser. In these circumstances, new section 24(7B) requires a nominee to maintain records that would allow the name and address of the supplier, the date of payment for the supply, a description of the goods and services supplied, and the consideration for the supply to be ascertained.

New section 20(2)(e) further specifies that a nominee may use the records kept in accordance with section 24(7B) as documentation to claim a deduction of input tax.

Supplies of accommodation

Accommodation provided by GST-registered persons is generally taxable unless it is expressly treated as an exempt supply. The GST Act exempts the supply of accommodation in a “dwelling”, but not accommodation that is in a “commercial dwelling”. The main reason for exempting the supply of accommodation in a dwelling from GST, as described in the 1985 *White Paper on Goods and Services Tax*, was to ensure that those in rental accommodation were not disadvantaged compared with owner-occupiers. For this reason, the definition was intended to apply to situations when there was a reasonable level of substitutability between renting and owning a home. This goal was arguably not being achieved because of the potentially wide interpretation of the definition of “dwelling”.

In addition, the boundary between the definitions of “dwelling” and “commercial dwelling” could have resulted in different suppliers of essentially the same type of accommodation having their supplies treated differently for GST purposes, depending on whether particular aspects of the definitions were satisfied.

The Taxation (GST and Remedial Matters) Act 2010 amends the definitions of “dwelling” and “commercial dwelling” to provide a clearer boundary between the definitions.

Key features

The amendments narrow the definition of “dwelling” and update the list of accommodation that is treated as being in a “commercial dwelling”.

For accommodation to be in a “dwelling” the relevant premises must be occupied by the recipient as their principal place of residence or it must be reasonably foreseeable that this will be the case. The recipient must also be entitled to quiet enjoyment of the property. Accommodation supplied to boarders will also be treated as a supply of accommodation in “dwelling”.

The current definition of “commercial dwelling” is amended by expanding the list of types of accommodation that are to be treated as such to include homestays, farmstays, bed and breakfast accommodation and certain serviced apartments.

Application dates

The new definitions will apply for supplies of accommodation made on or after 1 April 2011.

Detailed analysis

Definition of “dwelling”

The definition of “dwelling” in section 2(1) of the GST Act has been amended to include premises that the person occupies, or that it can reasonably be foreseen that the person will occupy, as their principal place of residence (paragraph (a)(i)), and of which the person has “quiet enjoyment” (paragraph (a)(ii)).

The term “premises” is defined by reference to section 2 of the Residential Tenancies Act 1986, and therefore includes:

- any part of any premises; and
- any land and appurtenances, other than facilities; and
- any mobile home, caravan, or other means of shelter placed or erected upon any land and intended for occupation on that land.

A definition of a “principal place of residence” is included in the GST Act and means a place that a person occupies as their main residence for the period to which the agreement for the supply of accommodation relates. For example, if accommodation is supplied for six months, to be considered as being in a “dwelling”, the accommodation must be the recipient’s principal place of residence, or be reasonably foreseen as being so, for that period.

For a supply to be a supply of accommodation in a “dwelling”, the person must also have “quiet enjoyment” of the premises as the term is used in section 38 of the Residential Tenancies Act 1986. This means that the person must be entitled to enjoyment of the premises without interruption by the landlord or any person claiming by, through, or under the landlord or having superior title to that of the landlord. Moreover, the landlord must not cause or permit any interference with the reasonable peace, comfort, or privacy of the tenant in their use of the premises.

Paragraph (b) of the definition of “dwelling” extends the definition to include accommodation provided to a person who is occupying the same premises, or part of the same premises, as the supplier of the accommodation and who occupies the premises as their principal place of residence. The intention of this paragraph is to include supplies of accommodation to boarders who reside in the same premises as their landlords and who may not meet the “quiet enjoyment” test.

Finally, a supply will not be a supply of accommodation in a “dwelling” if it is a supply of accommodation in a “commercial dwelling”.

Definition of “commercial dwelling”

The definition of “commercial dwelling” in the GST Act provides a list of types of accommodation covered. The amended list adds supplies of the following types of accommodation:

- homestays;
- farmstays;
- bed and breakfast establishments; and
- a serviced apartment managed 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.

The last inclusion ensures that all managed serviced apartments are treated in the same manner, irrespective of the structure adopted to provide the accommodation. This position was previously uncertain.