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What does “including GST (if any)” mean?

Quite often we come across clients who have entered into an agreement to purchase property believing that where the price is stated as “including GST (if any)”, the price includes GST at the rate of 15%, thus entitling them to a GST input tax deduction. Unfortunately this is incorrect.

The phrase “including GST (if any)” simply means that, if GST is to be charged on the transaction, then it has been included in the purchase price, otherwise no GST is included in the purchase price. It does not mean that GST has been included in the purchase price.

It is important to understand this difference, as it can result in unsuspecting purchasers paying more for goods or services than they were expecting by not being entitled to a GST input tax deduction. This is especially so now that a supply of land can be zero-rated for GST purposes.

Whether GST is charged on a transaction depends on the type of goods and services being supplied and the GST status of the vendor. Generally, GST will be charged by a GST registered person on a supply of goods and services that is not an exempt supply (e.g. financial services). If a person is not GST registered or makes an exempt supply, no GST will be charged.

For example, if ABC Limited is registered for GST and sells a widget for \$115 including GST (if any) the purchaser would pay \$115 to ABC Limited. This would include GST of \$15. If ABC Limited is not registered for GST and sells a widget for \$115 including GST (if any), the purchaser would still pay \$115 to ABC Limited but there would be no GST included in the price.

In the above example, the purchaser is not entitled to claim a GST input tax deduction simply on the basis that the price is stated as “including GST (if any)”. If the purchaser is GST registered and acquired the widget for use in a taxable activity, then any GST input tax deduction is restricted to the amount of GST charged on the transaction by the vendor. Where ABC Limited is registered for GST the purchaser could claim \$15 as a GST input tax deduction. However, no GST input tax deduction could be claimed where ABC Limited was not registered for GST. This is despite the fact that the price was stated as “including GST (if any)”.

It should be noted that in some instances the purchaser may be entitled to a GST secondhand goods input tax deduction where the vendor is not GST registered. Special rules apply in this case.

From 1 April 2011 certain supplies of land between GST registered persons are compulsorily zero-rated for GST purposes. Where the purchase price is stated as “including GST (if any)” and the zero-rating provisions apply, then GST will be charged at 0% on the transaction. In this instance the vendor will not charge GST, meaning the purchaser will not be entitled to claim a GST input tax deduction. Once again, this is despite the fact that the price is stated as “including GST (if any)”.

Our advice is that before you enter into an agreement to purchase property where the purchase price is stated as “including GST (if any)”, discuss with the vendor their GST status so you are aware whether GST will be charged on the transaction, and if it is, whether you are entitled to claim a GST input tax deduction. If you are unsure let us review the sale and purchase agreement before you sign it.

Pitfalls of GST compulsory zero-rating

From 1 April 2011 the GST rules were amended so that all transactions involving land between GST-registered parties are subject to GST at 0%. This is the case if at the time of settlement:

- The purchaser intends to use the land for making taxable supplies; and
- The land is not intended to be used as the principal residence of the purchaser or an associate.

We have already seen instances of abuse of these rules by purchasers where the price in the agreement is stated as “including GST (if any)”.

Some vendors have entered into the agreement believing there will be no GST to pay to the IRD as the transaction will be compulsorily zero-rated. However, before settlement the purchaser deregisters for GST or nominates an unregistered entity to acquire the land. As the purchaser will not be GST registered at the time of settlement the compulsory zero-rating rules do not apply and the vendor will have to pay 3/23rd of the purchase price to the IRD as GST. This leaves them out of pocket by the amount of the GST.

It may be possible that, after settlement the purchaser or nominee registers for GST and claims a change in use input tax claim. This essentially entitles them to claim an input tax credit for the GST charged on the transaction. The purchaser ends up paying a lower purchase price than if the transaction was compulsory zero-rated.

The overall effect is that a transaction that should be compulsorily zero-rated is subject to GST at 15%, for the benefit of the purchaser but to the detriment of the vendor.

Our advice is that vendors should enter into agreements for the sale and purchase of land on a "plus GST (if any)" basis. Also, before entering into an agreement for the sale and purchase of land both the vendor and purchaser should establish the GST status of the other party and their intentions, to ensure it is clear how GST will apply to the transaction. This then needs to be clearly documented in the agreement.

If you are buying or selling land and want to ensure no nasty GST surprises arise please contact us to review the sale and purchase agreement.

Tax Avoidance—Revenue Alert

Tax avoidance is coming under increased scrutiny by the Inland Revenue Department after their recent success in the Supreme Court against Christchurch orthopedic surgeons, Messrs Penny and Hooper. Following this decision the IRD has issued Revenue Alert 11/02 (RA 11/02). This outlines the circumstances in which the IRD will consider that diverting personal services income, by structuring activities through an associated entity, amounts to a tax avoidance arrangement.

Messrs Penny and Hooper previously traded as sole traders but subsequently restructured to operate through a

company and trust structure. Through this structure they paid themselves a below market salary. This resulted in a significant reduction in tax paid by the taxpayers, which the IRD argued was tax avoidance. The Supreme Court agreed with the IRD's stance.

It is the IRD's view that income substantially generated by the direct personal skills, experience or labour of an individual should generally be subject to tax in the hands of that individual.

Inland Revenue is concerned at structures where the income is generated from the supply of services provided by individuals and which have a combination of the following factors:

- The controllers of the business arrange for an entity, such as a trading trust or company, to operate and own the business. The operating entity engages or employs them (or contracts for their services);
- Where the business has been transferred, the business operates substantially as it did before;
- The business may not in substance be operated according to the terms of the arrangements entered into;
- The degree to which the individual service providers or their family ultimately control the entity, its economic product and cash flows from the business;
- Whether there is a redistribution of the underlying income from the entity to the person or to family members; and

- The extent to which, as a consequence of the arrangement, significant tax benefits are obtained

The IRD have stated their focus is on the more artificial arrangements and they are more likely to examine arrangements where the total remuneration and profit distributions received by the individual service provider is less than 80% of the total distributions received by the controller, his/her family and associated entities.

The IRD acknowledge that in some years there may be particular reasons as to why the controllers of the business may not be adequately remunerated. Examples of this include:

- Adverse business conditions mean that the business' profits are down but most of those profits are still paid out to the individual service providers;
- It is financially prudent to retain some profits in the business because it is anticipated that the business may experience financial difficulties in the near future;
- The profits are set aside to acquire business assets in the next financial year:

There may be other non-tax reasons why a business might pay the individual less than an arm's-length party would receive over the short-term. However, in those circumstances, care should be taken, as the IRD would expect to see no significant distributions being made to entities associated with the individual.

If you believe you will be affected by this Revenue Alert we suggest that you call us to discuss your options.



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