

Avoiding cash costs and mistakes

Lessons from ten years of
GST compulsory zero-rating
on transactions involving land

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Introduction

The first of April 2021 marked ten years since the compulsory zero-rating (CZR) GST rules for land transactions were introduced. Even though CZR is now better understood by the market, there have been some challenges along the way.

Here we examine the main lessons learnt and the key ‘watch outs’ for all parties involved in property transactions.

A bold step – the introduction of CZR

On 1 April 2011 most sales of land (and buildings) between GST-registered persons became zero-rated for GST purposes under rules referred to as CZR of land transactions. If the CZR rules apply the land transaction must be zero-rated, whereas previously GST at 15% applied.

CZR was designed to prevent abusive GST arrangements – typically referred to as “phoenix” fraud – under which the vendor (sometimes in financial distress) does not pay output tax to Inland Revenue but the purchaser claims a GST refund. There were suggestions the annual GST revenue leakage was in the tens of millions of dollars.

Various measures were debated over the years to combat the abuse, with the Government eventually settling for a CZR model. The CZR rules only deal with abusive arrangements in the context of business-to-business (B2B) transactions and no changes were made to the existing rules for business-to-consumer (B2C) transactions (for example, property developer to private individual).

Importantly, CZR did not change the GST treatment of private transactions in respect of land and residences - no GST applies. CZR also did not change the GST treatment of sales by GST-registered sellers to private (or unregistered) parties - e.g. GST at 15% is charged on a sale from a developer to a private purchaser. In addition, a GST-registered purchaser who purchases land from an unregistered party can claim a GST deduction if the property is used in a taxable activity.

Lessons from the first ten years of CZR

Ten years has shown that despite a number of issues arising around CZR, the CZR model has proved to be the best GST policy choice to address the abuse.

CZR fundamentally shifted the GST risk on transactions involving land (and buildings) from the Inland Revenue to the parties. This was not fully appreciated by parties involved with CZR transactions or parties who sought to claim a GST deduction in respect of a land purchase. One key risk factor at play is that under CZR the GST position of one party depends on the GST profile or information of the other party, which is a unique feature of CZR. This unique aspect must be carefully managed to avoid cash costs on account of GST payable or GST not claimable (that has not been factored into the price).

The legislative drafting was not perfect at the outset and this resulted in some initial tension points. The interaction between CZR and the GST standard rating rules on commercial leases (and the application of CZR in relation to irregular or one-off payments under leases) is not neatly drafted in the GST legislation. Over the years there have been several amending statutes to fine tune the operation of the CZR rules and more are expected.

Real estate agents and valuers have, at times, found the CZR rules challenging e.g. where the GST information about the parties changed (or such information was not known) or the property was used for mixed purposes. As an example, the sale of a farm and farmhouse can be treated as two separate transactions for GST purposes even though there is a single legal title transferred - different GST outcomes can apply to each portion.

Valuers also found “GST inclusive” and “plus GST” (or “plus GST (if any)”) expressions tricky at times e.g. if the property is used for mixed purposes or the buyer and seller have different GST profiles.

Unfortunately, the biggest failing that we regularly see in relation to CZR is the lack of attention by the parties to proper execution of contracts and information requirements. This has resulted in cash costs, time delays, failed deals, or a combination.

Regrettably, several cases have gone to court and many more were settled out of court – these cases have been civil cases involving the parties rather than the Commissioner of Inland Revenue.

CZR has been a dynamic area of GST with constant changes and practical pitfalls. It's vital for each party to fully understand the impact of CZR on the land and non-land assets included in a deal, as the commercial structure of the deal could impact the GST outcomes. For example, some deals may attract 15% GST on non-land assets whereas other deals may result in zero-rating on all assets (and services) if land is included in the overall transaction.





Tips for vendors

- A vendor MUST have the contractual right to gross up for GST at 15% “if” CZR does not apply (e.g. if the purchaser is GST-registered but the nominee/transferee is not GST-registered).
- A vendor needs to check that all of the information required to be disclosed by the purchaser is provided.
- A vendor also needs to insist on changes about the purchaser’s (or nominee’s) particulars to be advised in a timely fashion, and the vendor’s lawyers need to address this as part of the settlement process.
- A vendor needs to complete the front page question on the ADLS/REINZ real estate contract (about being GST-registered in respect of the transaction), and if the answer is “No” (i.e. not GST-registered) the purchaser/nominee can consider claiming a GST deduction (if the land will be acquired as part of taxable activity).

Tips for purchasers

- A purchaser needs to hold the vendor to account in relation to the front page question on the ADLS/REINZ real estate contract (about GST registration) and be absolutely clear about the vendor’s GST position.
- The primary intent of CZR is to prevent a GST deduction being claimed in respect of a B2B land purchase. Inland Revenue has been scrutinising GST deductions on land transactions. If a land deal involves a purchaser (or nominee) seeking to claim GST they will need to do their due diligence on the vendor (to confirm they are not GST-registered or not selling as part of their taxable activity), and the contract or other information exchanged needs to evidence this.
- A purchaser (or nominee) who acquires land/buildings and later changes use from taxable to exempt (e.g. residential letting, independent living accommodation) must pay GST after settlement under the GST adjustment rules (this GST is not claimable). This concept is not well understood and has resulted in cash costs.
- If it transpires after settlement that the transaction was not covered by CZR but the parties treated it as zero-rated (for example, because the purchaser informed the vendor the CZR criteria were met), then the purchaser has the GST liability under the GST Act and not under contract. This is another unique feature of the rules.

Tips for all parties

- If the property is used for mixed purposes (e.g. farm and farmhouse, motel and residence, bed and breakfast), GST complications can arise if the parties do not apply the GST rules properly. Care is required in respect of property valuations if the property is used for mixed purposes - the valuation protocols (and GST expressions) may not always match the GST treatment.
- The conveyancing/settlement process must be robust. As part of this process, lawyers for each party must ensure that GST and CZR are adequately dealt with in the contract and up to and including settlement. A contracting party (and their lawyers) needs to be able to make necessary adjustments if the other party’s particulars change.
- Contract terms, information exchanged and pricing expressions should be double - even triple - checked before issuing the final settlement statement and completing settlement.
- The parties must take proper advice and fully understand the GST consequences of their transaction.

Extra care required for CZR

The biggest lesson with CZR is that extra care is required when executing deals. Parties also need to take proper advice, and anything short of a very high standard will result in problems and may lead to cash costs.

- Get advice early on the treatment of GST in respect of your land transaction or development project.
- Work with an advisor who can provide comparative case studies on GST treatment and who can navigate the landscape to avoid costly mistakes.
- You and your lawyers need to double check documentation is correct and the other party’s GST information.
- Check GST pricing expressions and that they match the expected GST treatment.



How we can help

PwC's Indirect Tax team works closely with PwC Legal and has extensive technical experience and in-depth knowledge over a range of sectors and industries, including the property, financial services, retail, retirement and health, telecommunications, energy, government, and tertiary education sectors. This specialist knowledge means that our team can provide practical advice to help manage GST issues. We would be delighted to share our experience managing CZR to help your organisation navigate the process and manage transaction risk.



Eugen Trombitas
Partner
Indirect Tax and GST
eugen.x.trombitas@pwc.com



Catherine Francis
Director
Indirect Tax
catherine.d.francis@pwc.com



Annabel Duncan
Senior Manager
Indirect Tax
annabel.k.duncan@pwc.com



Ian Rowe
Director
Indirect Tax
ian.rowe@pwc.com



Nicky Harrison
Director
Property and real estate, PwC Legal
nicky.c.harrison@pwc.com



pwc.co.nz

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