



A READER ASKS:

“I have heard that there have been GST changes to Sale and Purchase of Land Agreements. What are the implications?”

Ask an expert GST and ADLS



STORY

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The GST rules changed in April 2011 to bring in compulsory zero-rating in many cases where supplies of land are concerned. The changes intended to protect the tax coffers. Prior to the change, land transactions were subject to GST at 15%. The supplier would charge GST, and the purchaser would claim back the GST. The only problem is – the system was prone to fraud.

Phoenix fraud

What clever operators did was to set up phoenix companies – ones that would appear, then disappear as it suited the owners. Usually, these nefarious operators would already have a company that owned land, but the company either had no other assets or was already in trouble. The company would then sell the land. The

purchaser (also a nefarious operator) would claim 15% on the cost of the land, and the IRD would pay out on this. However, the vendor would not return the GST, and when the IRD came knocking, they could not find anyone or any cash. No-one knows how much money the IRD missed out on, but it could have been a lot.

The Government, therefore, changed the rules in April 2011. From that date, most sales of land between registered persons have been zero-rated. There is some confusion about what this means. Most people think that it means that GST does not apply to the sale. That is not right. GST does actually apply to the sale, but only at 0%.

Builders caught out

One problem with the rule change was the way the standard ADLS/REINZ sale and purchase agreement (which documents virtually all land sales) was written. The problem with the form was that it allowed the purchaser to change the price that was agreed after the vendor was locked in. And yes, you guessed right, the purchaser would reduce the price by doing some very quick manoeuvring.

For example, a builder decides to buy some sections off the developer for some spec homes. From the developer's point of view, they have two types of customers – the builder and also some mums and dads buying sections for themselves.

Now, the developer does not want to worry mums and dads about GST. All the developer wants is for them to turn up with the cash on the day. The developer, therefore, sells it to them on an inclusive GST basis. What the developer is saying is, look, mums and dads, I will take care of the GST, don't you worry about it at all.

The price may be, say \$350,000 including GST. If the developer sells to mum and dad, then the developer returns GST on the sale

price, they end up with \$304,307 with the rest being paid to the IRD.

However, if the builder goes and signs one of these deals, i.e. on an inclusive of GST basis, thinking their building company can claim back the GST, then the transaction will actually be zero-rated, because the building company and the developer are both GST registered, and the developer will get to keep the entire \$350,000. Not a good outcome for the builder and this is where the manoeuvring came in.

What the builder may do in that situation is quickly nominate themselves individually in their own name, an unregistered person, to complete the transaction. This would mean the developer has to charge GST at 15% and ends up only keeping \$304,307 out of the deal. The builder then sells the land to the building company at \$350,000 on the same day, and the building company can claim the GST back because it has been purchased from an unregistered person.

In November, however, the ADLS/REINZ brought out a new standard sale and purchase agreement form. What that now says is that in a situation where you nominate someone with a different GST character than the named purchaser, GST will be charged on top of the price, and it will no longer be GST inclusive. In other words, in the above example, after the builder's manoeuvring, instead of paying \$350,000 and claiming back the GST, they will pay \$402,500. This means the developer still ends up with the \$350,000. The builder can still sell in its own name to their building company and claim this GST back but is in the same position as if they did not do any manoeuvring, with a cost of \$350,000 exclusive of GST.

The moral of the story

Get someone to review the contract before signing it. Not doing so can be costly.

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