EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

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QUESTIONS WE'VE BEEN ASKED

GST – goods purchased on deferred payment terms

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This Question We've Been Asked explains when a person registered for GST on a payments basis can claim an input tax deduction for goods purchased on deferred payment terms.

Key provisions

Goods and Services Tax Act 1985, ss 2 ("hire purchase agreement"), 5(5), 9(1), (2), and (3), 19A, 20(3) and (3C)

Income Tax Act 2007, s YA 1 ("hire purchase agreement")

Fair Trading Act 1986, s 36B

REPLACES: "Payments made by instalments – accounting for GST on payments basis", *Tax Information Bulletin* Vol 6, No 4 (October 1994): 6.

Question

When can a person registered for GST on a payments basis claim an input tax deduction for goods purchased on deferred payment terms?

Answer

Generally, a person registered for GST on a payments basis can claim input tax deductions only when and to the extent that payment has been made. This includes goods purchased under a standard sales agreement or goods purchased on a buy now, pay later basis.

However, if the person has entered into a hire purchase agreement for the purchase of goods, they can claim the full input tax deduction in the taxable period in which they enter into the agreement instead of when the instalment payments are made.

If the agreement is a layby sales agreement, the person can claim an input tax deduction only in the taxable period in which property in the goods is transferred, typically after the final payment has been made.

Summary – for payments basis persons	
Type of agreement	**When input tax deduction can be claimed**
Standard sales agreement	When and to the extent that payment has been made.
Buy now, pay later agreement	When and to the extent that payment has been made.
Hire purchase agreement	In the taxable period in which the agreement is entered into.
Layby sales agreement	In the taxable period in which property in the goods is transferred, typically after final payment has been made.

Explanation

Introduction

1. A person who is registered for GST on an invoice basis can usually claim a full input tax deduction in the taxable period in which the invoice is issued. Therefore, they get the timing benefit of an upfront input tax deduction even though payment might not occur until later, in a different taxable period.

2. The Commissioner has been asked whether a person who is registered for GST on a payments basis can also claim a full input tax deduction upfront for goods purchased on deferred payment terms. The answer to this question depends on how the sales agreement is classified.

3. This Question We've Been Asked (QWBA) considers the timing of input tax deductions for persons registered for GST on a payments basis, when they purchase goods under:
   - a standard sales agreement;
   - a buy now, pay later agreement;
   - a hire purchase agreement; and
   - a layby sales agreement.

4. This QWBA focuses on persons who account for GST on a payments basis. However, it may also be useful for persons who account for GST on a hybrid basis. Under a hybrid basis, input tax is deducted on a payments basis and output tax is returned on an invoice basis. Therefore, the input tax treatment under a payments basis is the same as the input tax treatment under a hybrid basis.

5. This QWBA replaces "Payments made by instalments – accounting for GST on payments basis", *Tax Information Bulletin* Vol 6, No 4 (October 1994): 6.

6. Three examples at the end of this item in [42] illustrate the concepts discussed.

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

Payments basis and the time of supply

8. A person's GST accounting basis determines when an input tax deduction can be claimed for the purpose of filing a GST return.

9. Where a payments basis is adopted and the general time of supply rule in s 9(1) applies, or the time of supply rules in s 9(3)(a) or (aa) or (6) apply, an input tax deduction can be claimed only when, and to the extent, that a payment has been made in that taxable period (ss 19A and 20(3)(b)(i)). This means that when payments are made by instalments, an input tax deduction can only be claimed on each payment after it has been made.

10. However, in some circumstances a person using a payments basis may be able to claim an input tax deduction before payment takes place. This occurs where goods are purchased under a hire purchase agreement. The time of supply for a hire purchase agreement is when the agreement is entered into and not when instalment payments are made (s 9(3)(b)).

11. Where goods are purchased under a layby sales agreement, a person using a payments basis may be prevented from claiming an input tax deduction until the final payment due under an agreement has been made. The time of supply for a layby sales agreement is when property in the goods is transferred to the purchaser, usually on final payment (s 9(2)(c)). This outcome is obviously less advantageous from a timing perspective.

Classifying deferred payment agreements

12. A person can purchase goods on deferred payment terms in many ways. To apply the time of supply rules correctly, it is necessary to classify the sales agreement. This classification determines when a person using the payments basis can deduct input tax. The terms and conditions of sales agreements vary so each agreement should be considered separately.

Standard sales agreements

13. A standard sales agreement may permit a purchaser to defer payment. For example, a purchaser buys goods and agrees to pay for them in instalments over an agreed period. Delivery of the goods might occur immediately or once the final instalment payment has been made.

14. Store credit accounts are an example of a standard sales agreement offering deferred payment terms. A purchaser buys goods on store credit and defers paying their account until later in the year. Some stores offer account holders up to 50 days of interest-free credit.

GST treatment

15. If the agreement is not a hire purchase agreement or a layby, then the general time of supply rule for payments basis persons applies. This means the registered person can claim an input tax deduction only when and to the extent that payment has been made in that taxable period (ss 9(1) and 20(3)(b)(i)). If payment is by way of instalments, the purchaser can deduct only the portion of input tax that relates to the payment actually made (*Nicholls v CIR* (1999) 19 NZTC 15,233 (CA)). Example 1 illustrates this type of agreement.

Buy now, pay later agreements

16. "Buy now, pay later" agreements are essentially a subset of standard sales agreements. They are addressed separately because of their increasingly popularity as a method of purchasing goods on deferred payment terms. Under such agreements, the purchaser gets immediate possession and ownership of the goods and pays for them in instalments. The terms are often interest-free, but other charges likely apply. The retailer receives payment from the "buy now, pay later" provider and that provider assumes all the risks should the purchaser fail to make any payments. New Zealand's main "buy now, pay later" providers are Afterpay, Humm, Genoapay, Laybuy[1], Klarna and Zip.

GST treatment

17. As with standard sales agreements, if the buy now, pay later agreement is not a hire purchase agreement or a layby, the general time of supply rule for payments basis persons applies. This means the registered person can claim an input tax deduction only when and to the extent that payment has been made in that taxable period (ss 9(1) and 20(3)(b)(i)). If payment is by way of instalments, the purchaser can deduct only the portion of input tax that relates to the payment actually made (*Nicholls v CIR* (1999) 19 NZTC 15,233 (CA)). Example 3 illustrates this type of agreement.

[1] Not to be confused with "layby" discussed from [33].

Hire purchase agreements

Definition of "hire purchase agreement"

18. The definition of "hire purchase agreement" in s 2 refers to the definition of "hire purchase agreement" in s YA 1 of the Income Tax Act 2007.

19. Paragraph (a)(ii) of the definition of hire purchase agreement is relevant for goods sold on deferred payment terms.[2] It defines a hire purchase agreement" as an agreement for the purchase of goods by instalment payments, however the agreement describes the payments, where the person who agrees to purchase the goods is given possession of them before the total amount payable has been paid. This type of agreement is known as a conditional sale agreement.

20. In summary, an agreement will be a hire purchase agreement if:

- it is an agreement for the purchase of goods by instalment payments;
- the purchaser is given possession of the goods before the total amount payable has been paid;
- the agreement is at retail; and
- property in the goods passes absolutely to the purchaser after delivery of the goods.

21. These features are summarised below. For more detail on when an agreement is a hire purchase agreement, see PUB00357 "GST and finance leases" (draft).

Agreement for the purchase of goods by instalment payments

22. A hire purchase agreement is an agreement for the purchase of goods by instalment payments. "Instalment" is not a defined term in the Act, so it is helpful to consider its ordinary meaning. The *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) defines "instalment" as:

> **instalment** n. **1** a sum of money due as one of several equal payments for something, spread over an agreed period of time.

23. "Several" is defined as:

> **several** det. & pron. more than two but not many.

[2] Paragraph (a)(i) concerns agreements where goods are let or hired with an option to purchase. This QWBA concerns only the sale of goods on deferred payment terms, so para (a)(i) is not considered.

24. Based on the definitions in the *Concise Oxford English Dictionary,* "instalment payments" could mean at least three equal payments of money. However, the *Oxford English Dictionary* (online ed, 2nd edition, Oxford University Press, 1989, accessed 8 September 2021) defines instalment more broadly:

> The arrangement of the payment of a sum of money by fixed portions at fixed times; …
>
> The payment, or the time appointed for payment, of different portions of a sum of money, which, by agreement of the parties, instead of being payable in the gross, at one time, is to be paid in parts, at certain stated times. …
>
> Each of several parts into which a sum payable is divided, in order to be paid at different fixed times; a part of a sum due paid in advance of the remainder. …

25. This definition suggests that instalment payments do not need to be for equal amounts. An instalment payment is a payment of a portion of a total amount. This is consistent with the nature of hire purchase agreements. There is usually a deposit upfront, some instalments and, occasionally, a larger 'balloon' payment at the end.

26. In a tax context, Parliament has accepted that two payments will constitute instalments. The definition of "An extra pay" in s RD 7(1) of the Income Tax Act 2007 explains that it means a payment that (among other things) is "made in 1 lump sum or in 2 or more instalments". Similar provisions referring to payments being made in two or more instalments are ss CZ 3(1), RE 21(3) and RF 13(2) of the Income Tax Act 2007.

27. The view that "instalment payments" means two or more payments is also supported by case law, including the leading case on this type of hire purchase agreement, *Lee v Butler* [1893] 2 QB 318 (CA). In that case, the taxpayer agreed to make two instalment payments.

28. The ordinary meanings and case law support the view that "instalment payments" as used in the definition of "hire purchase agreement" mean at least two payments. These payments do not need to be for equal amounts. Therefore, for a sales agreement to be a hire purchase agreement it must require payment in two or more instalments.

Purchaser is given possession of goods before the total amount payable is paid

29. Under a hire purchase agreement, the purchaser must be given possession of the goods before the total amount payable is paid. Possession is usually provided upfront, when the agreement is entered into.

Property in the goods passes absolutely to the purchaser after delivery of the goods

30. Under a hire purchase agreement, property remains with the supplier until the goods have been delivered to the purchaser **and** the total amount payable has been paid.

Agreement is "at retail"

31. Finally, the agreement must be "at retail". The Commissioner considers that a hire purchase agreement is made "at retail" when the purchaser is the ultimate or end-user of the goods.[3]

GST treatment

32. If an agreement is a hire purchase agreement, then the time of supply rule in s 9(3)(b) applies. Section 9(3)(b) states that where goods and services are supplied under a hire purchase agreement, the supply is deemed to take place at the time the agreement is entered into.

33. The effect of ss 9(3)(b) and 20(3)(b)(iii) is that a person who is registered for GST on a payments basis can claim an input tax deduction in the taxable period in which they enter into the agreement, before any instalment payments are made. This overrides the general time of supply rule for payments basis persons and provides them with a timing advantage. Example 2 considers a hire purchase agreement.

Layby sale agreements

34. A layby sale agreement is another way for a person to purchase goods on deferred payment terms. Laybys are different to hire purchase agreements because the purchaser does not typically get possession of the goods until full payment has been made.

Definition of "layby sale agreement"

35. Section 5(5) refers to the definition of "layby sale agreement" in s 36B of the Fair Trading Act 1986. This section defines a layby sale agreement as an agreement (whether described as a layby sale agreement or not) between a supplier and a consumer for the supply of goods on terms (either express or implied) that the:

[3] See IS XX/XX PUB00357 "GST and finance leases" (draft) from [36].

- consumer will not take possession until all or a specified portion of the total price has been paid; and
- price is to be paid in three or more instalments or two or more instalments if the agreement specifies it is a layby sale agreement (noting that a deposit is considered an instalment).

36. In addition, an agreement will not be a layby sale agreement if the goods supplied have a purchase price of more than $30,000.

GST treatment

37. Under s 5(5), a layby sale agreement will constitute a supply when the goods are delivered and property is transferred to the purchaser.

38. Section 9(2)(c) states that the time of supply for a layby sale agreement is when property in the goods is transferred to the purchaser. This will usually be when the goods are collected or delivered and the final instalment payment has been made.

39. Therefore, the purchaser can claim an input tax deduction only in the taxable period in which property in the goods is transferred, not when the agreement is entered into or when instalment payments are made. This is the same outcome for payments basis and invoice basis persons and is less advantageous from a GST timing perspective than for goods purchased under a hire purchase agreement. Example 3 considers a layby sale agreement.

Deductibility of input tax – s 20(3C)

Proposed amendment to s 20(3C)

Section 20(3C) states that input tax may be deducted to the extent to which the goods or services are used for or are available for use in making taxable supplies.

Clause 21(4) of the Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Bill contains an amendment to s 20(3C). The amendment clarifies that input tax may also be deducted to the extent to which the goods or services are **expected to be used for** or are available for use in making taxable supplies. This means input tax can be deducted even if the person does not have physical possession of the goods at the time of supply, provided the person expects to use those goods to make taxable supplies in future.

The amendment will apply retrospectively and come into force on 1 April 2011. The following paragraphs are drafted based on the wording of the proposed amendment.

40. The amount of input tax that a registered person can deduct is limited by s 20(3C). Section 20(3C) permits an input tax deduction only to the extent that the goods are:

- used for or are available for use in making taxable supplies; or
- expected to be used for or available for use in making taxable supplies (provided the supplier is not associated with the registered person).

41. Therefore, a purchaser can deduct input tax only to the extent that the goods purchased will be used, available for use or expected to be used in making taxable supplies.

42. The goods do not need to be in the purchaser's physical possession before an input tax deduction can be claimed. This means if there is a delay between the agreement being entered into and the goods being delivered (whether because of a delay in sourcing the goods or because the goods are being manufactured) an input tax deduction may still be available to the purchaser. Provided the goods are expected to be used to make taxable supplies, s 20(3C) will be satisfied. Example 1 explains how s 20(3C) applies.

Examples

43. The following three examples explain how the law applies to payments basis persons where goods are purchased on deferred payment terms.

Example 1: Standard sales agreement

Connor needs to purchase fertiliser for his dairy farm in Southland. His farming activity is registered for GST on a two-monthly payments basis aligned with his 31 March balance date.

On 27 May, Connor enters into a sales agreement to purchase fertiliser from Fertiliser Ltd. Under the terms of the agreement, Connor agrees to pay $36,000 (including GST) in three instalments on 27 June, 27 July and 27 August. Fertiliser Ltd offers this deal to Connor interest-free and with no deposit required. Once final payment is made, Fertiliser Ltd will deliver the fertiliser to Connor's farm during the first week of September.

The agreement between Connor and Fertiliser Ltd is a straightforward sales agreement. It is not a hire purchase agreement because full payment occurs before Connor receives possession of the goods. It is also not a layby sale agreement because the price of the goods exceeds the $30,000 threshold.

As Connor is registered for GST on a payments basis, he can deduct input tax only to the extent that payments have been made in the taxable period.

The total amount of GST on the sale of the fertilizer is $4,695.65. When Connor files his GST return for the June–July taxable period, he can claim an input tax deduction of $3,130.43. When he files his GST return for the August–September taxable period, he can claim the remaining $1,565.22 of input tax.

Section 20(3C) is satisfied because the goods are expected to be used to make taxable supplies. The fact Connor does not have physical possession of the goods until September does not prevent him from claiming an input tax deduction in the June–July taxable period.

Example 2: Hire purchase agreement

Naretta owns and operates a cattle farm. Her farming activity is registered for GST on a payments basis and has a 31 March balance date. She files two-monthly GST returns.

Naretta needs a new hay baler for her farm. Cash flow is tight, so she decides to purchase the baler from Hay Balers Ltd under a hire purchase agreement. Under the terms of the agreement, Naretta gets immediate possession of the baler and agrees to pay the purchase price of $30,000 (including GST) by way of five instalment payments: a deposit and four further monthly instalment payments. Naretta enters into the agreement on 20 March and gets immediately possession of the baler. The GST component of the purchase price is $3,913.05.

The benefit of entering into a hire purchase agreement is that Naretta can claim an immediate input tax deduction for the full amount of GST of $3,913.05 in her February–March GST return. Had she entered into a straightforward sales agreement, she would be able to claim an input tax deduction only to the extent that she had made a payment in the taxable period.

Example 3: Layby sales agreements and "buy now, pay later" agreements

Lochie owns and operates an apple orchard. His orchard activity is registered for GST on a two-monthly payments basis aligned with his 31 March balance date.

Lochie's ride-on lawnmower has broken down, and he needs to purchase a new one. He finds a replacement model at his local farm equipment store, Farming Stuff Ltd. The new mower is $9,000 (including GST), and Farming Stuff Ltd offers several finance options, including traditional layby and a "buy now, pay later" option.

If Lochie chooses the layby option (offered interest-free), he must make eight payments over eight weeks before Farming Stuff Ltd will deliver the mower to him. He will be unable to claim an input tax deduction until the mower is transferred to him on final payment.

Alternatively, Lochie could take up the "buy now, pay later" option. This option is also interest-free, and Lochie must make eight payments over eight weeks. The advantage with this option is that Lochie gets immediate ownership and possession of the mower. As this is a straightforward sales agreement, Lochie can deduct input tax only to the extent that payments have been made in the taxable period.

Lochie chooses the "buy now, pay later" option as he needs the mower immediately to cut the grass between the apple trees before summer. He enters into the agreement on 20 September and makes his first payment on that date. The total amount of GST on the sale of the mower is $1,173.90.

In October, when Lochie files his GST return for the August–September taxable period, he claims an input tax deduction for the first two payments made in September. The amount of input tax on the two September payments is $293.48. The remaining input tax deduction on the six payments made in October and November is $880.42. Lochie can claim this amount when he files his GST return for the October–November taxable period.

Lochie gets a slight GST timing advantage by taking the "buy now, pay later" option over a layby. This is because Lochie can claim a $293.48 input tax deduction in his GST return for August–September. However, under a layby he could deduct the input tax only after the final payment is made in the October–November taxable period.

Draft items produced by the Tax Counsel Office represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

References

Legislative references

Fair Trading Act 1986, s 36B

Goods and Services Tax Act 1985, ss 2 ("hire purchase agreement"), 5(5), 9(1), (2), (3), (6), 19A, 20(3) and (3C)

Income Tax Act 2007, ss CZ 3(1), RD 7(1), RE 21(3), RF 13(2), YA 1 ("hire purchase agreement")

Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Bill, cl 21(4)

Case references

Lee v Butler [1893] 2 QB 318 (CA)

Nicholls v CIR (1999) 19 NZTC 15,233 (CA)

Other references

IS XX/XX PUB00357 "GST and finance leases" (draft).

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About this document

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