Inland Revenue
Te Tari Taake

INTERPRETATION STATEMENT: IS 20/05

GOODS AND SERVICES TAX – SUPPLIES OF RESIDENCES AND OTHER REAL PROPERTY

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated. Relevant legislative provisions are reproduced in the appendix to this Interpretation Statement.

Contents

Summary

1. This statement applies where a private residence is included as part of a wider supply of land. Where this occurs, s 5(15) deems the residence to be a separate supply from the rest of the land. The separate supplies need to be considered independently for GST purposes. This statement uses the term "residence" for the different types of premises mentioned in s 5(15).

2. Section 5(15) applies where a supply includes:

   - a principal place of residence; or
   - a supply referred to in s 14(1)(d).

3. "Principal place of residence" means premises occupied as the person's main residence. However, it does not have to be the vendor's own residence. It is the vendor's use of the property that is determinative, not the purchaser's intention. Section 14(1)(d) treats the sale of certain dwellings as an exempt supply, where the dwelling has been used exclusively for residential rental purposes for the preceding 5 years.

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4. If a residence is included in a supply that includes other real property, s 5(15) deems there to be two (or more, if more than one residence is being supplied) separate supplies. A common example would be farm sales, where s 5(15) treats the farmhouse (provided it meets the definition of residence) and the rest of the farm as two separate supplies for GST purposes.

5. The separate supplies are treated individually for GST purposes. It is often assumed that the supply of the residence is exempt or non-taxable and the supply of the other real property is taxable and subject to GST. However, this is an oversimplification and the treatment depends on the facts:

- A supply of a principal place of residence where the residence is used by the vendor in a taxable activity will be a taxable supply made in the course or furtherance of the taxable activity and subject to GST under s 8(1). The supply will be taxable at the standard rate or *may* be zero-rated if the compulsory zero-rating rules apply.
- A supply of a principal place of residence where the residence is exclusively private in nature and is not used by the vendor in a taxable activity is not a taxable supply.
- A supply of a principal place of residence which has been used solely by the vendor for making exempt supplies of residential rental accommodation is an exempt supply.
- A supply referred to in s 14(1)(d) is an exempt supply.
- A supply of the other real property used by the vendor in a taxable activity *may* be a zero-rated supply under the compulsory zero-rating rules or as a supply of a going concern.

6. Where s 5(15) applies so the supplies are considered individually for GST purposes, the consideration must be apportioned between the supplies. This enables the parties to identify the correct amount of GST payable on the transaction and to calculate any adjustments under ss 21–21H. To value the residence, it must be properly identified. For farmhouses, it may not be clear where the boundary of the farmhouse ends and where the farmland begins. When apportioning consideration between the two supplies, a farmhouse includes appurtenances (ie, things belonging to and used with the residence and included within its curtilage).

7. Any apportionment must reflect the respective values of the residence and the surrounding land. The onus of proof that an apportionment is fair and reasonable is on the person seeking to rely on the apportionment, whether that is the vendor or purchaser. A valuation may be needed to satisfy this onus. In cases of doubt or where there are significant amounts of consideration, the parties should obtain a valuation from a registered valuer.

8. When the supplier and recipient are GST registered, the same apportionment as set out in the tax invoice for any taxable supplies will apply to both parties. Ideally, this should be negotiated between the parties and agreed at the time of supply.

9. This statement updates and replaces IS2824 "GST – Supplies of dwellings and other real property" (*Tax Information Bulletin* Vol 8, No 6 (October 1996): 1), which dealt with the apportionment between, and the valuation of, supplies of dwellings and other real property for GST purposes. The principles applying to valuations in IS2824 remain largely unchanged.

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Introduction

10. IS2824 was published in October 1996, shortly after subss 5(15)–(19) were enacted. The provisions were introduced in response to the Court of Appeal's decision in *CIR v Coveney* (1995) 17 NZTC 12,193 (CA) and to deal with an issue that arose under the former "principal purpose" rules.

11. Prior to the enactment of s 5(15), the Act did not have a provision for splitting a single supply that was partly taxable and partly non-taxable (or exempt) – such as where a private dwelling was acquired as part of the purchase of a farm. A GST input tax credit was allowed if the goods and services had been acquired for the "principal purpose" of making taxable supplies. Dwellings acquired as part of a wider purchase of land were an anomaly because often the principal purpose of the dwelling was non-taxable private use, but the purchase of the land as a whole would satisfy the principal purpose test.

12. The implementation of s 5(15) meant the supply of a dwelling was treated separately from the supply of the rest of the land. It would not give rise to an input tax deduction unless the dwelling itself had been acquired for the principal purpose of making taxable supplies. Subsections 5(15)–(19) essentially reversed the *Coveney* decision and are consistent with the Commissioner's position before the *Coveney* decision. Another effect was that the dwelling and other real property must be valued separately.

13. Since IS2824 was published there have been numerous changes to the legislation, including the removal of the principal purpose rule for assets acquired after 1 April 2011. This statement discusses how the current s 5(15) and related provisions apply.

Application of subss 5(15), (16) and (18)

14. Subsections 5(15), (16) and (18) state:

> (15) When either of the following supplies are included in a supply, they are deemed to be a separate supply from the supply of any other real property that is included in the supply:
>
> (a) a supply of a principal place of residence:
>
> (b) a supply referred to in section 14(1)(d).
>
> (16) Where a registered person has claimed a deduction in accordance with section 20(3) in respect of the supply of a dwelling, any subsequent supply by the registered person of—
>
> (a) the dwelling; or
>
> (b) any land or other part of the dwelling that has ceased or will by reason of the supply cease to be appurtenant to or enjoyed with the dwelling,—
>
> will, for the avoidance of doubt but subject to subsections (17), (18), and (19)(b), be deemed to be a taxable supply.
>
> …
>
> (18) Where a registered person has claimed a deduction in accordance with section 20(3) in respect of a proportion of a dwelling, the supply of that dwelling shall be deemed to be a taxable supply only to the extent that the proportion claimed bears to the whole dwelling

15. Subsections 5(15)–(19) were a suite of provisions introduced specifically to deal with *Coveney*-type situations where a person could take advantage of the old principal purpose rule to claim GST input tax for a dwelling (which would otherwise be exempt or non-taxable). The purpose of subss 5(16) and (18) was to collect

GST output tax from those who had already claimed a pre-s 5(15) input tax deduction.

16. Section 5(15) can apply to a residence where there is the supply of other real property included in the supply. The word "other" requires a different or another item of real property distinct from the residence referred to. Where s 5(15) applies, the vendor will need to treat the two (or more) supplies as separate for GST purposes.

17. Section 5(16) provides that where a person has claimed GST for a dwelling, any subsequent supply will be deemed taxable. This is subject to s 5(18), which restricts the deemed taxable supply to the proportion of GST input tax claimed. These provisions were part of the legislative response to the *Coveney* decision. The taxpayers in *Coveney* had claimed a GST input tax deduction for their dwelling because it was part of a wider supply. Subsections 5(16) and (18) ensured that taxpayers in this position will be liable for GST output tax on disposal of the dwelling. Under the previous principal purpose approach, if the dwelling was subsequently supplied separately it would likely be a non-taxable supply. This is because a dwelling is not likely to be used principally for making taxable supplies and so the supply of the dwelling would not be in the course or furtherance of a taxable activity under s 8(1). Consequently, subss 5(16) and (18) were required to deem a subsequent supply of the dwelling as a taxable supply. With the passage of time these provisions are likely to only be relevant to a small number of taxpayers.

18. Subsections 5(17) and (19)(b) were exceptions to s 5(16). These provisions effectively allowed a person to otherwise account for the GST they had claimed on their dwelling. Section 5(17) has been repealed and s 5(19) only applies where a person made an election before 1 August 1996. Consequently, these provisions are not discussed in this statement.

Amendments to s 5(15)

19. When first enacted in 1995, s 5(15) referred to "a dwelling":

> (15) Where a dwelling is included in a supply, the supply of that dwelling is deemed to be a separate supply from the supply of any other real property included in the supply

20. Since 1995 there have been the following relevant changes:

- The Taxation (GST and Remedial Matters) Act 2010 amended:
  - s 5(15) so the phrase "principal place of residence" replaced the word "dwelling" and a new definition of "principal place of residence" was added to s 2; and
  - the definition of "dwelling" in s 2(1) (see appendix) was amended to change it from a wide definition focused on the nature of the building to a narrower definition based on the nature of the supply.
- Before the 2010 version of s 5(15) came into effect it was amended by the Taxation (Tax Administration and Remedial Matters) Act 2011. The 2011 amendments included the:
  - addition of clause (b); and
  - removal of the reference to s 5(15) in the definition of "principal place of residence".
- From 1 April 2011, the apportionment and adjustment rules changed so that deductions are now based on the use (or intended use) of the asset in making taxable supplies, rather than the former principal purpose test.

21. The changes to the legislation have been significant but s 5(15) still largely operates in the same way. For example, if a farm sale includes a farmhouse (used as a residence), then there will be two separate supplies.

Application of s 5(15)

22. Section 5(15) applies to either a supply of:

- a principal place of residence; or
- a dwelling to the extent it is a supply referred to in s 14(1)(d).

Principal place of residence

23. "Principal place of residence" is a term that can have slightly different meanings depending on the context. In the definition of "dwelling" the phrase "principal place of residence" is intended to mean premises supplied as accommodation to a person who occupies them as their main residence for the duration of an agreement. In the context of the zero-rating provisions, the "principal place of residence" is intended to indicate land used by its owner or their relatives as their main place of residence.

24. References to specific provisions (including s 5(15)) in the previous s 2 definition of "principal place of residence" were removed to avoid confusion about when the different meanings apply. "Principal place of residence" is now defined only for the purposes of "dwelling":

> **principal place of residence**, in the definition of **dwelling** means a place that a person occupies as their main residence for the period to which the agreement for the supply of accommodation relates

25. The Commissioner discussed the term in IS 17/08: "GST – Compulsory zero-rating of land rules (general application)" (*Tax Information Bulletin* Vol 29, No 10 (November 2017): 17) and considered:

- The phrase "principal place of residence" in s 5(15)(a) refers to a place occupied as a person's main residence. The plain meaning of the phrase indicates a person may have more than one residence, but at any point in time they can have only one **main** residence.
- Because the provision refers to a person's main residence, the application of s 5(15)(a) is not restricted to a place occupied as the vendor's main residence. It is possible for a vendor to supply a principal place of residence that is not their own residence (eg, a house that has been lived in by a farm manager).
- Section 5(15)(a) is concerned with the supply of a principal place of residence. Therefore, for the purposes of s 5(15), the current use of the property is determinative rather than the purchaser's intended use of the property. This is in contrast to how the phrase is used in the compulsory zero-rating rules, which focuses on the purchaser's (or their relative's) intended use of the land.
- The inquiry in s 5(15)(a) is objective, based on the available information.

26. "Principal place of residence" as used in s 5(15) is different from the term "dwelling" used in previous versions of s 5(15). While the changes in terminology can be confusing, where a person occupies a residential property as their home it will usually be both a "dwelling" and a "principal place of residence". That said, there are some differences in the definitions; notably a "dwelling" will usually

require quiet enjoyment as that term is used in s 38 of the Residential Tenancies Act 1986 and does not include a property that is a "commercial dwelling" (defined in s 2 of the Act). These differences mean there will be some exceptions where a property is a principal place of residence but not a dwelling. By using the phrase "principal place of residence" and not "dwelling", s 5(15)(a) will apply to properties such as homestays (a commercial dwelling in the s 2 definition) provided the property is a person's principal place of residence.

27. Whether a property is a "principal place of residence" will be a matter of fact. For example, a farmhouse supplied to sharemilkers will likely be a principal place of residence (and it could also be a supply of a dwelling under s 14(1)(d)). Conversely, where farm lodgings are supplied to fencing contractors for the duration of their job, this is not the supply of a principal place of residence. The contractors only stay in the property for a relatively short period because it is not convenient to travel back to their homes in town. Similarly, a property exclusively rented out as farmstay accommodation on a peer-to-peer website will be used as short-stay holiday accommodation and the guests will not be using the property as their principal place of residence. Consequently, s 5(15)(a) will not apply to deem a separate supply of such a property.

Supply within s 14(1)(d)

28. This provision treats the sale of a dwelling that has been **used exclusively** for making exempt supplies of residential rental accommodation for the preceding 5 years, as an exempt supply. The dwelling can have been supplied as residential rental accommodation by way of hire, a service occupancy agreement or a licence to occupy. However, it still must be a supply of a "dwelling" (as defined in s 2), which means, amongst other things, it must be a person's "principal place of residence" (as defined in s 2).

29. Section 14(1)(d) is discussed in detail in IS 07/01: "GST treatment of sale of long-term residential rental properties" (*Tax information Bulletin* Vol 19, No 5 (June 2007): 16). There have been a number of changes to the GST Act since IS 07/01 was published (see [20]), however some of the analysis remains relevant, in particular s 14(1)(d):

- applies where the property is used for residential purposes and for no other purpose for the required period;
- can apply even if the property is vacant for periods during the 5 years (eg, while attempts are made to find a tenant); and
- only applies where the vendor uses the property for residential purposes for 5 years. It does not apply where different owners have rented the property out over a 5-year period.

Summary

30. Section 5(15) applies where a supply includes a principal place of residence or a supply within s 14(1)(d). When considering this issue, the focus is on the vendor's use of the property rather than the purchaser's intended use. Section 5(15) can apply to both owner-occupied homes and rental properties.

GST on the separate supplies

31. If s 5(15) deems there to be two or more separate supplies, then each supply is considered individually. The supply of the residence is most likely an exempt or non-taxable supply and the supply of the other real property is likely subject to

GST. However, this is not always the case. For example, the supply of the residence may be subject to GST under s 8(1) because it is a supply in the course or furtherance of a taxable activity, and the supply of the other real property may be zero-rated. In some cases, the separate supplies may be subject to the same GST treatment (eg, both supplies are taxable under s 8(1)).

32. Section 5(15) applies whenever a principal place of residence is supplied with other real property. A common example of s 5(15) applying is to farm sales where the farmhouse (provided it is a residence) is treated as a separate supply from the rest of the farm. It will also apply in other situations, such as where there are residential flats above a commercial property. Section 5(15) can also apply where there are two houses on a single property and one house is used as a principal place of residence and one is not. For example, a registered person lives in the main house but has a separate cottage on their property that they use solely for their taxable activity of making taxable supplies of short-stay accommodation via a peer-to-peer website. Where s 5(15) applies, the vendor needs to treat the two supplies as separate. The next section of the statement considers the treatment of the separate supplies.

Supplies of a principal place of residence

33. The supply of a principal place of residence will usually be a non-taxable supply and not subject to GST because it is a supply of a private home. It will not generally form part of a registered person's taxable activity. However, where a principal place of residence is used in a registered person's taxable activity, then the supply is chargeable with GST under s 8(1), at either the standard rate or zero rate.

34. Section 8(1) imposes GST output tax when the supply is in the **course or furtherance of a taxable activity**. As noted, a residence is usually used as a private home and so any separate supply of that residence will not usually be in the course or furtherance of a taxable activity. However, s 8 may apply where the residence being supplied is used as part of a business. Accordingly, it is necessary to consider whether a supply of a residence in such circumstances will be in the course or furtherance of a taxable activity.

35. Case law supports the view that "in the course or furtherance of a taxable activity" can include the one-off sale of capital items that a registered person uses in their taxable activity (*Case K55* (1988) 10 NZTC 453, *Hibell v CIR* (1991) 13 NZTC 8,195 (HC) and *CIR v Dormer* (1997) 18 NZTC 13,446 (HC)). Further, the property supplied does not need to be the "usual" good supplied by the taxpayer for it to come within the scope of the taxpayer's taxable activity (*Case K55, Case N43* (1991) 13 NZTC 3,361 and *Case V16* (2002) 20 NZTC 10,182). Whether property comes within the scope of a taxable activity is a matter of fact and will depend on the "use" or "involvement" of the property in the taxable activity (*Case V16, Case K55*). In *Case K55*, this was characterised as there being a "discernible nexus" between the activity and the supply.

36. IS 20/04 *GST treatment of short-stay accommodation* (Inland Revenue, June 2020) discusses whether a disposal will be "in the course or furtherance" of a person's taxable activity of supplying short-stay accommodation. That item contains a more detailed discussion of the term "course or furtherance" but, in short, a supply of a residence can be in the course or furtherance of a taxable activity even though it is a one-off sale and not the usual type of good supplied by the person. In the short-stay accommodation context, if a property is used to make taxable supplies of short-stay accommodation, the subsequent disposal of the property will be in the course or furtherance of the taxable activity and subject to GST output tax under

s 8(1) (and potentially subject to an adjustment under s 21F if there has been both taxable and non-taxable use).

37. Whether a supply is within the scope of s 8(1) will ultimately be a question of fact based on the use of the residence. For example, if a farmhouse is not used in a taxable activity, s 8(1) will not apply. On the other hand, if a GST-registered farmer is claiming an automatic 20% deduction for farmhouse expenses based on IS 17/02: "Income tax – deductibility of certain expenses attributable to a farm dwelling" (*Tax information Bulletin* Vol 29, No 4 (May 2017): 82) then there is an expectation that the property is being used 20% of the time in the taxable activity. Consequently, any sale of the farmhouse would be a supply in the course or furtherance of the taxable activity and subject to GST under s 8(1) (with an adjustment available under s 21F).

Supplies under s 14(1)(d)

38. A supply of a residence under s 14(1)(d) will be an exempt supply and will not be subject to GST.

Zero-rating rules

39. The zero-rating rules may apply to one or more of the separate supplies created by s 5(15). Section 11(1)(mb) provides for compulsory zero-rating where:

- both the supplier and recipient are GST-registered;
- the property will be used to make taxable supplies; and
- it will not be lived in as a principal place of residence by the recipient or their relatives.

40. An example where the compulsory zero-rating (CZR) rules might apply, is where a registered person sells their property comprising their home and a cottage used solely to supply short-stay accommodation on a peer-to-peer website. In that situation, s 5(15) deems there to be a supply of the registered person's home, and a separate supply of the cottage. If the sale is to a GST-registered purchaser who does not intend to reside in the cottage and will continue supplying short-stay accommodation, that supply may be zero-rated under s 11(1)(mb). For further detail on the application of the CZR rules refer to IS 17/08: "GST – Compulsory zero-rating of land rules (general application)" (*Tax Information Bulletin* Vol 29, No 10 (November 2017): 17).

41. On the sale of a farm between registered persons it is likely that the sale of the farm will meet the requirements of the CZR rules and be zero-rated. However, the supply of a farmhouse is less likely to meet the requirements as it will not necessarily be used to make taxable supplies (see above) but in any event, it may be used as a principal place of residence by the recipient or their relatives. If the CZR rules do not apply to the farmhouse, then it is likely to be either:

- a standard rated supply, if used in the taxable activity; or
- not subject to GST if used to make exempt supplies or not otherwise used in the taxable activity.

42. In some circumstances, a transaction can be zero-rated under s 11(1)(m) where a taxable activity is sold as a going concern. Unlike the CZR rules, the parties may choose whether to zero-rate the supply of a going concern. The interaction of the going concern rule and the CZR rules is also discussed in IS 17/08.

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Apportionment and valuation issues

43. When s 5(15) applies, the vendor will be making two or more supplies. Depending on the circumstances those supplies will be taxable, non-taxable or exempt.

Identifying the residence

44. To value the residence and apportion the purchase price between the supplies, the extent of the principal place of residence must be identified. In the case of farmhouses this can be difficult because the land and buildings belonging to the farmhouse are not always clearly delineated from the rest of the farm. For other types of property (like flats above business premises) the residence might include rights to use common areas. The Commissioner considers it is reasonable for the purposes of s 5(15) that a principal place of residence also includes any appurtenances belonging to or used with it. While the phrase "principal place of residence" is not defined in the GST Act for the purposes of s 5(15), including appurtenances with a residence is consistent with the definition of "dwelling" in s 2(1), and in particular with para (b)(ii) of the definition that provides that a dwelling includes "any appurtenances belonging to or used with the premises".

45. The meaning of "appurtenances" in the context of the Act was considered in *Norfolk Apartments Ltd v CIR* (1995) 17 NZTC 12,212 (CA) and briefly in *Wairakei Court Ltd v CIR* (1999) 19 NZTC 15,202 (HC) (both cases concerned retirement villages). These cases and the term "appurtenance" are discussed in detail in IS 15/02: "Goods and services tax – GST and retirement villages" (*Tax Information Bulletin* Vol 27, No 11 (December 2015): 6). While IS 15/02 deals with retirement villages, the underlying principles apply to all properties.

46. The Court of Appeal in *Norfolk* refers to the English authorities (*Methuen-Campbell v Walters* [1979] 1 All ER 606 and *Trim v Sturminster Urban District Council* [1938] 2 All ER 168). The *Trim* case considered the word "appurtenances" in a statutory definition of "house". It held that it has its natural meaning and could not extend to cover land outside the curtilage of the house. Farmland adjacent to the house was not an appurtenance. In *Methuen-Campbell* the issue was whether a paddock adjoining the garden of a dwelling-house was within the curtilage and an appurtenance to the house. A fence separated the paddock from the garden, although access had once been available through a now boarded-up gate in the fence. The Court considered the *Oxford English Dictionary* definition of curtilage as "a small court, yard, or piece of ground attached to a dwellinghouse and forming one enclosure with it" and considered what is within the curtilage is a question of fact in each case. In that case the paddock did not form part of the curtilage, being well apart from the house and physically separated from the garden.

47. IS 17/02: "Income tax – deductibility of certain expenses attributable to a farm dwelling" (*Tax information Bulletin* Vol 29, No 4 (May 2017):82) discussed the identification of "curtilage" in the context of farmhouses:

> 98. The term "curtilage" refers to the land surrounding the farmhouse that is used primarily for private purposes. The curtilage may be fenced (like a backyard) or not. If the curtilage is not fenced, the Commissioner will accept a reasonable estimate of the curtilage and its value. The curtilage must be taken into account when determining the value of the farmhouse as a proportion of the overall value of the farm. This is because the curtilage is generally used for private purposes and is not used in the farming business. The extent of the curtilage, and its value, must be measured on a fair and reasonable basis. The Commissioner will accept a valuation, a reasonable estimate of the value of the curtilage, or an apportionment based on land area (ie, on a value/cost per hectare basis). Any apportionment needs to be calculated on a reasonable basis and recognise the land value of the curtilage will often be proportionately higher than the rest of the farm.

48. Whether land or buildings are appurtenant to a house and contained within its curtilage is based on both physical aspects (ie, proximity to the house and separation from the house) and also on the use to which the land or buildings are put. Something will be an appurtenance where its use and enjoyment forms part of the use and enjoyment of the residence and where it belongs to the residence so that it is not physically separated from the dwelling (eg, by distance or by a fence or a hedge). To determine the extent of a principal place of residence, the facts of each case need to be examined to work out the physical area and any other rights reasonably belonging to and used with the residence.

49. For example, a landscaped garden surrounding a residence that includes a swimming pool and tennis court will be appurtenant to the residence and within its curtilage. While the pool and tennis court may be fenced for safety reasons they are still within the residence's curtilage, belong to and are used as part of the use of the residence. However, a fenced horse paddock, (such as in *Methuen-Campbell*), is not appurtenant to a residence as it is physically separated from the residence, so it does not "belong" to the residence and it is not used as part of using the residence. It is not within the residence's curtilage.

Tax invoices

50. The tax invoice for any taxable supplies made by the vendor should state the consideration for those taxable supplies and the amount of tax charged or included in the consideration (see s 24(3)). If the parties have not agreed the separate consideration for the taxable supplies, the total consideration for the whole transaction will need to be apportioned between the taxable supplies and the other non-taxable or exempt supplies.

Valuation

51. Where the consideration needs to be apportioned between the separate supplies the onus of proof that the apportionment and the method adopted to reach that apportionment are fair and reasonable in the circumstances, is on the party seeking to rely on the apportionment.

52. Section 10(18) states that if a taxable supply is not the only matter to which a consideration relates, the supply is deemed to be for such part of the consideration as is properly attributable to it.

53. While s 10(18) refers to the amount of consideration that is properly attributable to the supply, s 3A(3)(d) limits the GST input tax claimable to the lesser of the tax fraction of the purchase price or the tax fraction of the open market value of the supply. This may apply in s 5(15) situations where the purchaser claims a secondhand goods GST input tax deduction on a non-taxable supply. For example, where the sale of the residence is non-taxable (because the vendor only uses it privately and not in their taxable activity) and the purchaser subsequently claims a secondhand goods GST input tax deduction (because the purchaser intends to use the residence for taxable purposes). The amount of the GST input tax deduction is limited to the lesser of the tax fraction of the purchase price or open market value. Where open market value is lower, or there is no agreed apportionment of the purchase price, the open-market value will be the default.

54. Hansen J briefly considered s 10(18) in *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685. He found there was no separate supply and so it was unnecessary to consider the value of those zero-rated supplies. However, he went on to make the following obiter comments:

> [67] As concluded in the *Smiths City* case (para 25 above), s 10(18) of the Act suggests that the value of a separate supply is what is "properly attributable" to it. Other provisions of the Act indicate that the **open market value of the service is an appropriate basis on which to fix value**.
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> Section 4(2) provides:
>
> > "For the purposes of this Act, the open market value of any supply of goods and services at any date shall be the consideration in money which the supply of those goods and services would generally fetch if supplied in similar circumstances at that date in New Zealand, being a supply freely offered and made between persons who are not associated persons."
>
> Section 10(2)(b) provides:
>
> > "Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of:
> >
> > ...
> >
> > (b) To the extent that the consideration for the supply is not consideration in money, the open market value of that consideration."
>
> [68] When it is possible, I see no reason why values should not initially be assessed on the basis of the actual cost of providing the separate supply, plus a reasonable allowance for profit. In this case that would not be possible as agents are remunerated by a commission which itself would have to be apportioned between marketing and promotional services provided to the [sic] International and services provided solely or in part to the students. However, ultimately, **the appropriate value for a separate supply would have to be tested against the market**. I accept Mr Willox's submission that the value of a separate supply could not exceed the sum which a hypothetical consumer would be prepared to pay.
>
> [Emphasis added]

55. Sections 10(18) and 3A(3)(d), and Hansen J's comments in *Auckland Institute* (although obiter) support the view that the amount paid for a residence and other real property supplied together should be the amount properly attributable to each supply, being the open market value. Where GST-registered non-associated parties agree the purchase price through negotiations, there is an assumption that this will be the open market value. Where the parties are associated, then subs 3A(3)(a)–(c) limit the GST input tax, often to the lesser of input tax on the purchase price or open market value. However, the onus of proof that an apportionment is correct is on the person seeking to rely on the apportionment. Even when the purchase price is agreed, obtaining a valuation to support apportionment should be considered, particularly in cases of doubt or involving significant amounts of consideration.

56. A valuation may be necessary to identify the market value when:

- a GST-registered vendor and purchaser cannot agree on the respective values of the residence and the other real property; or
- a GST-registered vendor needs to issue a tax invoice and the sale and purchase agreement does not apportion the consideration.

57. Even where no GST is payable on the transaction (eg, where the supply of the residence is non-taxable and the other real property is subject to the CZR rules), a valuation of the separate supplies is still necessary. For instance, the CZR rules require that:

- the vendor keeps certain records including details of the consideration received for the supply (see s 75(3B)); and
- the purchaser identifies the nominal amount of GST chargeable on the supply (ie, the GST if the transaction was not zero-rated) (see s 20(3J)).

58. Moreover, either party may need to value the separate supplies so they can calculate adjustments required under ss 21–21H. For instance, in the case of a farm sale, there might be future change-of-use adjustments if the purchaser plans to use the farmhouse for making taxable supplies.

59. The method of valuation depends on the circumstances of the case. The method adopted should best reflect the market value of the property in the circumstances. For example, an apportionment based solely on land area is unlikely to be acceptable if it is reasonable for the value of the residential land to be proportionately higher than the rest of the land. This can be the case with farms – see IS 17/02 (at [47]). For farms, sometimes it may be more reasonable to value the residence by comparison with sales of residential properties in nearby rural townships, than by applying the per hectare farmland valuation across the board. Ultimately, the onus is on the taxpayer to demonstrate they have used a fair and reasonable basis for their apportionment in the circumstances.

60. A supply forming part of a larger transaction should not be over or under-valued at the expense of another supply in the same transaction. Valuations should be applied to the total consideration on a pro-rata basis. This might be relevant where separate valuations are obtained for separate supplies or if a valuation does not align with the actual purchase price. More information on applying valuations on a pro-rata basis is provided in QB 09/06: "GST – Apportionment of the cost of bare land for the purposes of a change-in-use adjustment" (*Tax Information Bulletin*, Vol 22, No 6, (July 2010: 21)).

61. Ideally, a valuation should be made by a registered valuer and any valuation relied upon needs to identify the method of valuation and reasons for adopting that method. In cases of doubt or significant consideration, Inland Revenue may insist on a valuation by a registered valuer. If registered persons are in doubt as to whether they need to obtain a valuation from a registered valuer, they should contact their tax adviser.

Examples

62. The following examples are included to assist in explaining the application of the law. Example 1 is adapted and updated from the example in IS2824.

Example 1 - Sale of farm with two farmhouses

The properties

A GST-registered farmer negotiates to sell a 225-hectare farm that includes two farmhouses.

The farmer and his family occupy the main farmhouse. A fenced garden area of 4,000 square metres surrounds the farmhouse that includes a chicken coop, the vegetable garden and various small sheds. There is an adjacent paddock of 5,000 square metres, known as the "home paddock".

Farm employees and their families occupy the second farmhouse (and it has been rented to various employees and their families for more than 5 years). It is fenced on two sides, has a hedge on one side and a stream running along the fourth side. The area within these boundaries measures 4,750 square metres. The area includes a garage, a mower shed, a few trees and a washing line. There is no garden.

The application of s 5(15)

Section 5(15) applies to the supply of the farm property. It deems the supply of each of the residences and the balance of the farmland and buildings to be

separate supplies. This is because the two farmhouses are the principal places of residence of the families that live in them. The second farmhouse is also a supply subject to s 14(1)(d).

For the main farmhouse, this is used by the farmer in the farming operations. Following IS 17/02: "Income tax – deductibility of certain expenses attributable to a farm dwelling", the farmer has been claiming 20% of the expenses relating to the property for income tax purposes – as well as claiming GST input tax on these expenses. On this basis, the farmhouse is used in the farmer's taxable activity and is subject to GST under s 8(1) on sale (with an adjustment under s 21F).

The second farmhouse has at various times been rented or made available under a service occupancy agreement to farm employees. This means that the second farmhouse has been used for making exempt supplies and so no GST input tax was claimable on it. As it was used for making exempt supplies, it is excluded from forming part of the farmer's taxable activity under s 6(3)(d). In any event, it would be an exempt supply under s 14(1)(d). Therefore, the second farmhouse is not subject to GST on sale.

Identifying the extent of the properties

The physical area of the residence in each case is as follows:

- Main farmhouse — 4,000 square metres. The home paddock is not part of the curtilage of the farmhouse. The area is physically divided off from the farmhouse. It is reasonable to treat the fenced area immediately surrounding the farmhouse as its curtilage.
- Second farmhouse — 4,750 square metres. Although fairly large, it is reasonable to treat this area as appurtenant to the farmhouse. This area is physically divided off from the surrounding farmland by both artificial and natural features.

Valuation and apportionment of purchase price

Anticipating selling the property, the farmer has recently had the farm independently valued by a registered valuer. The valuation (exclusive of GST) shows:

- Farmland and farm improvements – $1.4 million
- Main farmhouse – $250,000
- Second farmhouse – $200,000
- Total value = $1.95 million

The farmer negotiates to sell the farm for $2 million plus GST, to a GST-registered purchaser who is acquiring the farm to carry on a taxable activity of farming. The parties are not treating this as the sale of a going concern, however the CZR rules will apply to the supply of the farm (but not the farmhouses).

In finalising the terms of the sale and purchase agreement, the parties agree that the purchase price shall be apportioned between the farm as to $1.5 million and the two farmhouses as to $500,000. The split between the two farmhouses is agreed as being $300,000 for the main farmhouse and $200,000 for the second farmhouse. (The purchaser is prepared to accept this price and the apportionment, having received their own valuation.)

The sale and purchase agreement includes the following details:

- Apportionment of consideration:
  - Farm – $1.5 million (plus GST of $0 as zero-rated)
  - Main farmhouse – $300,000 (plus GST of $45,000 as standard rated)
  - Second farmhouse - $200,000 (plus no GST as exempt)
- Total price including GST – $2,045,000

GST output tax of $45,000 is payable on the transaction, with an adjustment made under s 21F for GST input tax not claimed on the main farmhouse. GST input tax may be claimable by the purchaser on the main farmhouse to the extent that it is used in their taxable activity, and the CZR rules require them to identify the nominal amount of GST on the farm – in this case $225,000 ($1.5 million x 15%).

Example 2 - Sale of section with home and holiday cottage

Petunia and Vernon own a section next to Lake Wakatipu. On the section is a three-bedroom house and a separate holiday cottage. The house is used solely as their private residence. The holiday cottage is accessed via a private driveway. It has a white picket fence on three sides and drops away to the lake on the other side. The cottage is used as a dedicated short-stay rental property. It is well maintained, in a prime location and is advertised on various websites. It is used year-round by skiers, trampers and overseas holiday makers. The holiday cottage's turnover is $70,000 a year and so Petunia and Vernon are registered for GST.

Petunia and Vernon told an estate agent friend that they were thinking of retiring and their friend told them they could get $2 million for the property in the current market. They mentioned this to Luna who has previously shown an interest in the property. The parties are interested but want to know the GST implications before they go any further.

The Act treats the supply of a principal place of residence and other property as separate supplies. The three-bedroom house is used by Petunia and Vernon as their principal place of residence and so is treated separately from the holiday cottage for GST purposes.

The three-bedroom house is not used in the taxable activity and will not be subject to GST output tax when sold. There may be GST implications in the future if Luna decided to also use the house to make supplies of accommodation. However, on sale there is no GST output tax liability for Petunia and Vernon.

The holiday cottage is used in the taxable activity to make taxable supplies and will be subject to GST output tax. If Luna remains unregistered (because she intends to make fewer supplies and stay below the $60,000 threshold) then GST would be payable at the standard rate. However, it is more likely that Luna will be GST registered in which case the compulsory zero-rating rules may apply. GST will apply at 0% if the holiday cottage will be used to make taxable supplies and it will not be lived in as a principal place of residence by Luna or her relatives.

In many cases prudent parties (or their lenders) will require a valuation from a registered valuer. In this case they decide they will want a valuation. This is a good idea because even though they do not return any GST there are still record keeping requirements on Petunia and Vernon. Luna is also required to identify the nominal amount of GST chargeable on the supply of the holiday cottage (ie, the GST if the transaction was not zero-rated). Moreover, the valuations could be important for Luna if her use of either property changes and she is required to calculate change in use adjustments.

Example 3 – Sale of shop and flat

Rita is selling a giftshop she has owned and operated for the last ten years. Above the giftshop is a two-bedroom flat with a separate accessway. When she first purchased the property, she lived in the flat but for the last 8 years she has rented it out to tenants.

Rita is GST registered and is selling the business and property to a GST registered purchaser who will continue to operate the giftshop.

Section 5(15) will apply to split the supplies – the giftshop and the two-bedroom flat. The GST treatment of these supplies is as follows:

- The supply of the giftshop will be subject to GST but at 0% because the compulsory zero-rating rules will apply. This is because the parties are both GST-registered and the purchaser is intending to continue to make taxable supplies.
- The supply of the flat is not subject to GST as it does not form part of Rita's taxable activity.

References

Subject references

GST
Supplies of residences
Apportionment

Legislative references

Goods and Services Tax Act 1985, ss 2 ("dwelling", "principal place of residence", "commercial dwelling"), 3A(3), 5(15)–(19), 8(1), 10(18), 11(1)(m), 11(1)(mb), 14(1)(d), 20, 21, 21F, 21G, 21H, 24(3), 75(3B)
Residential Tenancies Act 1986
Taxation (GST and Remedial Matters) Act 2010
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Case references

Auckland Institute of Studies Ltd v CIR (2002) 20 NZTC 17,685
Case K55 (1988) 10 NZTC 453
Case M64 (1990) 12 NZTC 2,363
Case N43 (1991) 13 NZTC 3,361
Case V16 (2002) 20 NZTC 10,182
CIR v Coveney (1995) 17 NZTC 12,193 (CA)
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Methuen-Campbell v Walters [1979] 1 All ER 606
Norfolk Apartments Ltd v CIR (1995) 17 NZTC 12,212 (CA)
Re Red Lion Inn Ltd [1979] 2 NZLR 668 (SC)
Trim v Sturminster Urban District Council [1938] 2 All ER 168
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Other references

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IS 17/08: "Goods and services tax – Compulsory zero-rating of land rules", *Tax Information Bulletin* Vol 29, No 10 (November 2017): 17
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Inland Revenue
Te Tari Taake

Appendix – Legislation

Goods and Services Tax Act 1985

1. Section 2(1) definitions, relevantly include:

dwelling, for a person—

(a) means premises, as defined in section 2 of the Residential Tenancies Act 1986,—

(i) that the person occupies, or that it can reasonably be foreseen that the person will occupy, as their principal place of residence; and

(ii) in relation to which the person has quiet enjoyment, as that term is used in section 38 of the Residential Tenancies Act 1986; and

(b) includes—

(i) 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 meets the requirements of paragraph (a)(i):

(ii) any appurtenances belonging to or used with the premises:

(iii) despite paragraph (a)(ii), a residential unit in a retirement village or rest home when the consideration paid or payable for the supply of accommodation in the unit is for the right to occupy the unit; and

(c) excludes a commercial dwelling

commercial dwelling—

(a) means—

(i) a hotel, motel, homestay, farmstay, bed and breakfast establishment, inn, hostel, or boarding-house:

(ii) 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, as that term is used in section 38 of the Residential Tenancies Act 1986:

(iii) a convalescent home, nursing home, rest home, or hospice:

(iv) a camping ground:

(v) premises of a similar kind to those referred to in subparagraphs (i) to (iv); and

(b) excludes—

(i) a hospital except to the extent to which the hospital is a residential establishment:

(ii) a dwelling referred to in paragraph (b)(iii) of the definition of dwelling

2. Section 3A(3)(d), relevantly states:

3A Meaning of input tax

(1) Input tax, in relation to a registered person, means—

(a) tax charged under section 8(1) on a supply of goods or services acquired by the person:

(b) tax levied under section 12(1) on goods entered for home consumption under the Customs and Excise Act 2018 by the person:

(c) an amount determined under subsection (3) after applying subsection (2).

(2) In the case of a supply by way of sale to a registered person of secondhand goods situated in New Zealand, the amount of input tax is determined under subsection (3) if—

(a) the supply is not a taxable supply; and

(b) the supply is not—

(i) a supply of goods previously supplied to a registered person who has entered them for home consumption under the Customs and Excise Act 2018, whether the person is registered at the time they enter the goods for home consumption or later; and

(ii) a supply of goods made by a non-resident, whether or not they made the earlier supply referred to in subparagraph (i); and

(c) the goods acquired by the person for making taxable supplies are either—

(i) not charged with tax at the rate of 0% under section 11A(1)(q) or (r); or

(ii) charged with tax at the rate of 0% under section 11A(1)(q) or (r) and, before the acquisition, have never been owned or used by the person or an associated person.

(3) The amount of input tax is—

...

(d) if the supplier and the recipient are not associated persons and the supply is not the only matter to which the consideration relates, the lesser of—

(i) the tax fraction of the purchase price; and

(ii) the tax fraction of the open market value of the supply;

...

3. Section 8(1) provides:

8 Imposition of goods and services tax on supply

(1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

4. Section 11(1)(mb) provides:

11 Zero-rating of goods

(1) A supply of goods that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

(mb) the supply wholly or partly consists of land, being a supply—

(i) made by a registered person to another registered person who acquires the goods with the intention of using them for making taxable supplies; and

(ii) that 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); or

5. Section 14(1) provides:

14 Exempt supplies

(1) The following supplies of goods and services shall be exempt from tax:

...

(c) the supply of accommodation in any dwelling by way of—

(i) hire; or

(ii) a service occupancy agreement; or

(iii) a licence to occupy:

(d) the supply, being a sale, by any registered person in the course or furtherance of any taxable activity of—

(i) any dwelling; or

(ii) the reversionary interest in the fee simple estate of any leasehold land, —

that has been used by the registered person for a period of 5 years or more before the date of the supply exclusively for the making of any supply or supplies referred to in paragraph (c), (ca), or (cb):

6. Section 21F provides:

21F Treatment on disposal

(1) This section applies when a registered person—

(a) acquires goods or services in relation to which they do not have a full deduction, taking into account any adjustments made to input tax in adjustment periods after acquisition; and

(b) subsequently disposes, or is treated as disposing, of the goods or services in the course or furtherance of a taxable activity.

(2) The person must make a final adjustment of an amount calculated using the formula—

tax fraction × consideration × (1 − (actual deduction ÷ full input tax deduction)).

(3) For the purposes of the formula in subsection (2), —

(a) **tax fraction** has the meaning given in section 2(1), unless subsection (7) applies to the disposal:

(b) **consideration** is the amount of consideration received, or treated as received, for the supply:

(c) **actual deduction** is the amount of deduction already claimed, taking into account adjustments made up to the date of disposal:

(d) the amount, when added to any deduction already claimed, must not be more than the amount of the **full input tax deduction** on acquisition referred to in section 21D(2).

...