

## Interpretation Statement IS 10/03

### **GST: TIME OF SUPPLY – PAYMENTS OF DEPOSITS, INCLUDING TO A STAKEHOLDER**

This interpretation statement considers certain aspects of the time of supply rule in section 9(1) of the Goods and Services Tax Act 1985, particularly in regard to situations involving the payment of a deposit. The conclusions reached are summarised below.

The Commissioner previously published a policy statement "GST: general time of supply rules – receipt of deposits" in *Tax Information Bulletin*, Vol. 6, No. 7, (December 1994). As from 27 May 2010 this interpretation statement withdraws and replaces that earlier statement.

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

#### **Summary**

1. Section 9(1) provides that a supply is deemed to take place at the earlier of:
  - the time an invoice is issued by the supplier or the recipient in respect of that supply; or
  - the time any payment is received by the supplier in respect of that supply.

Note that this statement deals only with the time of supply where payment is received and does not consider the issue of an invoice. In any particular situation, the issue of an invoice could cause the time of supply to be triggered.

2. Before section 9(1) will apply, it is necessary to establish there is a transaction giving rise to a supply that is chargeable with GST. Section 9(1) is a timing-only provision, and it will only apply to fix the time of supply if there is a transaction giving rise to a supply. In determining whether a transaction giving rise to a supply exists, the legal arrangements entered into between the parties must be considered. Where there is a binding contract, such a transaction is assumed. Where there is no contract, the existence of a transaction giving rise to a supply will be established where there are reciprocal obligations between the parties.
3. A deposit constitutes "any payment". Where a supplier receives a deposit under a contract, the time of supply will be triggered under section 9(1). This applies equally to conditional or unconditional contracts.
4. Where a deposit is paid to a person as stakeholder, there will have been no receipt by the supplier and the time of supply will not be triggered. A supplier may be a stakeholder.

5. A stakeholder relationship requires agreement by all parties. A person cannot declare himself or herself a stakeholder unilaterally. A stakeholder holds the deposit on behalf of both parties and owes a contractual or quasi-contractual obligation to both parties. The intention of the parties, determined from all the circumstances, will establish in which capacity a person receives a deposit.
6. Where there is no binding contract, it must be shown that the payment is for the supply of goods or services, whether the physical supply takes place now or in the future. Where this is the case, the receipt of the payment by the supplier will trigger the time of supply.

## Background

7. In the Commissioner's previously published statement, referred to above, the Commissioner considered that the supplier of goods and services could not act as a stakeholder. A stakeholder had to be an independent third party.
8. Since the publication of that statement, the High Court released its decision in *CIR v Dormer* (1997) 18 NZTC 13,446. That decision provides authority for a supplier to be a stakeholder.
9. The Commissioner has decided to review the application of the time of supply rules in section 9(1) to the receipt of deposits and to provide some guidance on the requirements for a person to be acting as stakeholder.

## Legislation: Goods and Services Tax Act 1985

10. "Consideration" is defined in section 2(1) as:

**Consideration**, in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body:
11. Section 5(1) provides:

For the purposes of this Act, the term "**supply**" includes all forms of supply.
12. Section 6(1)(a) provides:

For the purposes of this Act, the term **taxable activity** means—  
(a) Any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:
13. Section 8(1) provides:

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 12.5 percent on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after the 1st day of 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.

14. Section 9(1) provides:

Subject to this Act, for the purposes of this Act a supply of goods and services shall be deemed to take place at the earlier of the time an invoice is issued by the supplier or the recipient or the time any payment is received by the supplier, in respect of that supply.

## Analysis

### **Section 9(1)**

15. The general rule for determining the time of supply is set out in section 9(1), which provides:

Subject to this Act, for the purposes of this Act a supply of goods and services shall be deemed to take place at the earlier of the time an invoice is issued by the supplier or the recipient or the time any payment is received by the supplier, in respect of that supply.

16. Therefore, under section 9(1) a supply is deemed to take place at the earlier of:
- the time an invoice is issued by the supplier or the recipient in respect of that supply; or
  - the time any payment is received by the supplier in respect of that supply.
17. Before section 9(1) will apply, it is necessary to establish there is a transaction giving rise to a supply that is chargeable with GST. In determining whether such a transaction exists, the legal arrangements entered into between the parties must be considered. See *CIR v Databank Systems Ltd* (1989) 11 NZTC 6,093 (CA), (1990) 12 NZTC 7,228 (PC); *Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325; *Pine v CIR* (1998) 18 NZTC 13,570; *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075; *CIR v Capital Enterprises Ltd* (2002) 20 NZTC 17,511.
18. Section 9(1) is a timing-only provision and will only apply to fix a time of supply if there is a transaction giving rise to a supply. If there is no supply (whether it is performed now or in the future), then section 9(1) cannot operate.
19. Durie J, in *CIR v Capital Enterprises Ltd*, said (at p 17,519):
- [49] Section 9 does no more than fix a time of supply for the purposes of the Act, as the section says. The purpose of the Act is to tax the supply of goods and services in the course of trade. In furtherance of that purpose s 9 appears to be no more than a mechanical provision to assist the imposition and collection of that tax by determining such matters as when tax becomes payable or deductible (see Richardson P in *Pine v CIR* (1998) 18 NZTC 13,570 (CA) at p 13,573).

20. This statement considers the application of section 9(1) to the payment of deposits. For the purposes of the following discussion, it is assumed that an invoice has not been issued prior to the receipt of any payment.
21. The application of section 9(1) is discussed below in relation to the payment of a deposit in the following different circumstances:
  - A payment made under an unconditional contract
  - A payment made under a conditional contract
  - A payment made when no contract exists

***A payment made under an unconditional contract***

22. The discussion in this part of the statement deals with the most common scenario; that is, deposits paid under contracts where agreement has been reached between the parties on all terms and only performance of the contract remains to be concluded. In other words, there are no conditions or other matters that could affect a contract's execution. Note that the position of payments made under agreements subject to conditions (that is, conditional contracts), is dealt with later in this statement.
23. The Commissioner's view is that where a deposit is paid under an unconditional contract the position is straightforward. There is a supply and the deposit is paid in respect of that supply. Section 9(1) will deem the time of supply to be when the deposit is received by the supplier. This will be so even if the goods or services have not been physically supplied or performed at that time. This view is supported by the cases discussed below.
24. In *Case L67* (1989) 11 NZTC 1,391, the issue was whether a subdivider of land had to pay GST on the full sale price of sections of land at the time of selling them at auction or at the later time when the subdivider could provide title to the purchaser and complete settlement. Barber DJ concluded that GST on the full sale price had to be paid on the day of the auction and signing of the contract and payment of the deposit. Section 9(1) deemed the supply to have taken place on that day. There was a binding contract from the outset and only performance of the contract, or final implementation, was delayed until title was available.
25. In *Case N24* (1993) 13 NZTC 3,196, the taxpayer had entered into an agreement to sell a property. The agreement became unconditional on 18 August 1987 and the deposit was paid in two instalments on 19 August and 5 November 1987. The taxpayer did not return GST on the sale, claiming that because of the share market crash and the failure of the purchaser to obtain public subscriptions it was unlikely the purchaser would be able to complete the purchase. The purchaser did fail to complete on settlement date (28 February 1988) and the contract was cancelled on 22 August 1988. The taxpayer retained the deposit as damages for breach of contract.

26. Barber DJ confirmed his reasoning in *Case L67* and, although the question before him was only whether the taxpayer should have returned GST on the amount of the deposit, he noted that the taxpayer should have returned GST on the full value of the supply that took place on 19 August 1987 when the first deposit was paid. The taxpayer was deemed by section 9(1) to have made the supply on that date. The fact that the contract was later cancelled and the supply of the property did not take place, did not avoid the GST liability on the deemed supply of 19 August 1987.
27. In *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685, tuition fees were paid to the supplier under a contract. The supplier was entitled to a small portion of the fees immediately and the balance had to be held in trust until after the student had attended a course for more than seven days. Hansen J applied *Case L67* and *Case N24* and held that the receipt of the first amount by the supplier triggered the time of supply for the full value of the supply. The supplier had received a payment in respect of the supply of the services and section 9(1) applied.

*Another view*

28. Another view is that the payment of a deposit under an agreement will not comprise "payment" that triggers the time of supply until completion and payment of the full amount under the agreement. This view focuses on the purpose of a deposit and claims that until completion a deposit is simply a surety.
29. General case law establishes that a deposit serves two purposes. A deposit is part payment of the purchase price and it is a guarantee that the purchaser means business: *Howe v Smith* (1884) 27 ChD 89; *Soper v Arnold* (1889) 14 App Cas 429 [note that if difficulties are experienced in accessing copies of these two cases, copies are available from the Office of the Chief Tax Counsel on request]; *Martin v Finch* [1923] NZLR 570. The view is that a deposit's primary purpose is as a guarantee or surety on the purchaser's behalf and that it does not become part payment of the purchase price until the agreement has been completed.
30. However, the Commissioner considers the better view is that a deposit does constitute "any payment" within the words of section 9(1). Although the New Zealand judiciary has not addressed this issue directly, there is significant authority confirming that a deposit constitutes "any payment": for example, *Case L67*; *Case N24*; *Auckland Institute of Studies Ltd v CIR*; *Barratt v CIR* (1995) 17 NZTC 12,372, 12,377; *CIR v Dormer* (1997) 18 NZTC 13,446, 13,458; *Rob Mitchell Builder Ltd (in liq) v National Bank of New Zealand Ltd* (2004) 21 NZTC 18,397, para 4.
31. Some commentators claim that support for the alternative view can be found in the High Court of Australia decision in *FCT v Reliance Carpet Co Pty Ltd* [2008] HCA 22. However, the Australian decision has little persuasive value in this context because of the significant differences in

the relevant legislation. The High Court of Australia noted the distinction itself when it commented that no assistance was to be derived by that court from a consideration of the treatment of deposits in the New Zealand taxation system.

32. On the other hand, the United Kingdom VAT cases provide strong support for the view that a deposit is part payment of the purchase price in this context and constitutes a payment received in respect of the supply. See, for example, *MH Caine* (1987) 3 BVC 1,325; *Bethway & Moss Ltd* (1988) 3 BVC 718; *Regalstar Enterprises* (1988) 3 BVC 866; *Bruce Banks Sails Ltd* (1990) 5 BVC 1,357; *Bristol Bathroom Co Ltd v C&E Commrs* [1991] 3 C.M.L.R. 947; *C&E Commissioners v Moonrakers Guest House Ltd* [1992] BTC 5,077; *Simplelink Ltd t/a Homecare Exteriors* [1995] BVC 1,372; *Kirtley t/a Encore International* [1995] BVC 1,520; *Hollybourne Hotels Ltd* [2002] BVC 4,030. The United Kingdom Revenue has also adopted this approach: See HM Revenue & Customs notice, VATTOS5120 – Actual tax points: Payments: Deposits and pre-payments.
33. The Commissioner considers the better view is that the receipt of a deposit by the supplier under an unconditional agreement is the receipt of “any payment” and will trigger the time of supply under section 9(1).

#### *Deposit – payment for different supply*

34. As stated above, the legal arrangements between the parties must be analysed in order to identify the supply. There may be situations where, on a careful consideration of the facts, it is determined there is more than one supply taking place, that is, there is a supply that occurs before the main supply (“a preliminary supply”). This might occur, for example, in the case of a wedding function where a preliminary supply relating to the securing of a particular date takes place before the main supply of the actual function. However, it is considered that this situation would be unusual. In *Kirtley t/a Encore International* it was held that deposits paid to book a function were in the nature of part payments of the full amount due under the contract and triggered the tax point (time of supply). A similar decision was reached in *Hollybourne Hotels Ltd* in relation to deposits received by hotels for wedding receptions and functions.
35. It is clear from decisions such as *Auckland Institute of Studies Ltd v CIR*, *Case L67* and *Case N24* that a supply cannot simply be divided into several parts. The question of whether a payment is made for a preliminary supply, separate from the main supply, will always depend on the facts in each particular case and a determination of the true legal arrangements entered into by the parties.

#### ***A payment made under a conditional contract***

36. This part of the statement deals with the receipt of a deposit by a supplier under a conditional contract.

*Meaning of "conditional contract"*

37. A useful summary of the current state of New Zealand law in relation to conditional contracts is in *Laws NZ*, Contract para 154:

New Zealand Courts have developed a body of law concerning conditional contracts in which the term "condition" refers to a contingent condition; this is a provision in an agreement that contemplates that the legal effect of, or the parties' obligations under, the agreement will be altered in some way on the occurrence or non-occurrence of the contemplated contingency. In many older cases conditions were simply classified as "conditions precedent" or "conditions subsequent", a practice which led to real confusion in case law. The term "condition subsequent" is still commonly used without such a reference point and generally refers to a contingency which is to occur, or not, at some point after a binding contract has been entered and on which the continuation of contractual obligations depend; this means that a failure to fulfil the condition will bring the contract to an end at that point or will give to one or both parties the option to bring the contract to an end. The term "condition precedent" was particularly productive of confusion since a condition might be a contingency required to occur before an agreement came to have contractual force or alternatively a contingency which was to occur after the contract was entered into but before some aspect of performance was required. There has been judicial criticism of the use of the terms "condition subsequent" and "condition precedent" unless the discussion of the condition in question makes it clear what precisely it is that the condition is precedent to or subsequent to. It is therefore now more common for the Courts to concern themselves with the effect of the particular condition before them on the particular contract; however, it is possible to formulate general rules which indicate the likely effect of such common conditions as making agreements subject to contract or subject to finance or subject to solicitor's approval.

38. Criticism of the terms "condition precedent" and "condition subsequent" occurred in the judgment of Cooke J (as he then was) in the Court of Appeal decision in *Hunt v Wilson* [1978] 2 NZLR 261 at p 267. His Honour then reiterated this sentiment in *Robertson Enterprises Ltd v Cope* [1989] 3 NZLR 391 at p 393.
39. These authorities suggest that the more appropriate method of analysis is to focus on the nature of the condition to determine whether the condition prevents the formation of a binding contract or whether the condition suspends some right or obligation until the condition is satisfied.
40. A conditional offer or conditional acceptance would not result in a binding contract: *Reporoa Stores Ltd v Treloar* [1958] NZLR 177; *Buhrer v Tweedie* [1973] 1 NZLR 517; *Frampton v McCully* [1976] 1 NZLR 270. Agreements that are "subject to contract" or "subject to the drawing up of a formal contract" are not binding contracts if it can be inferred that the parties did not intend to be bound until the formal agreement had been signed: *Carruthers v Whitaker* [1975] 2 NZLR 667. There is a difference between that kind of condition and a condition that suspends some right or obligation under an already binding contract until the condition is satisfied. If a condition of the latter kind is not satisfied, the contract is or may be terminated, but in the meantime there is a binding

agreement: *Provost Developments Ltd v Collingwood Towers Ltd* [1980] 2 NZLR 205; *Connor v Pukerau Store Ltd* [1981] NZLR 384.

41. The key distinction is between conditions that must be satisfied before there will be a binding contract and conditions that suspend some right or obligation under an already existing binding contract until the condition is satisfied. For the purposes of this statement, any reference to a conditional agreement is to an agreement subject to the latter type of condition. In other words, a conditional agreement is an existing binding agreement that is subject to conditions.

*Receipt of payment by supplier under conditional contract*

42. In most circumstances, the position under a conditional contract is the same as under an unconditional contract. As a binding contract exists, there is a supply and any payment made is in respect of that supply. A deposit received by the supplier will trigger the time of supply under section 9(1).
43. Very few New Zealand cases have dealt with the issue of the time of supply in relation to the payment of a deposit under a conditional contract. Those that do provide some support for the conclusion that receipt of a deposit by a supplier under a conditional contract will trigger the time of supply. However, the decisions all deal with payment of the deposit to a stakeholder, rather than to the supplier directly. This reflects the fact that, in practice, it would not be common for a purchaser to pay a deposit directly to a supplier when a contract is still conditional.

*Receipt of payment by a stakeholder*

44. In many cases a deposit will be paid to a person to hold it as stakeholder until an agreement becomes unconditional. This situation is most common in relation to the supply of land. Where a deposit is paid to a stakeholder, the supplier will not have received any payment and the time of supply will not have been triggered.
45. The only New Zealand case to consider the issue of a stakeholder in a GST context in any depth is *CIR v Dormer* (1997) 18 NZTC 13,446. The case involved a husband and wife farming partnership, registered for GST, which sold some land. The Commissioner assessed the partnership for GST on the sale. The TRA found for the taxpayers, holding that as the land was owned by the husband, who was not registered for GST, no GST was payable on the sale. In case it was later held that the partnership had made the supply, the TRA also found that the time of supply was the date the deposit was paid by the purchaser to the vendor's agent.
46. On appeal, the High Court agreed with the TRA that no GST was payable on the sale of the property because the partnership did not own the land. However, Salmon J also went on to consider the TRA's finding in relation to the time of supply.

47. Salmon J held that a deposit is not received by a supplier as long as any person holds it as stakeholder, whether that person is the supplier or an independent third party. A deposit will not be received unless the supplier, or the supplier's agent, receives it for his or her own benefit, or, in the case of a deposit paid to an agent, for the principal's benefit. His Honour concluded that the obligation to hold the deposit as stakeholder means the deposit is not received for the supplier's benefit, even if the stakeholder is the supplier. As a payment must be received by the supplier in order for the time of supply to be triggered, receipt by a stakeholder will not trigger the time of supply. The circumstances of each case will determine in which capacity a person holds funds.
48. In *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685 (at p 17,699) Hansen J agreed with the analysis and conclusion in *CIR v Dormer* that there could be no receipt of a payment by the supplier for the purposes of section 9 when the recipient of the payment was obliged to hold the funds as stakeholder. His Honour stated that a deposit is not received until the supplier or his agent receives it for his own benefit.
49. The position of a stakeholder in a GST context was also mentioned briefly in *CIR v Bhanabhai* (2005) 22 NZTC 19,533 at p 19,357. In a discussion on the requirements of a vendor to account for GST as soon as a purchaser has made the first payment, Laurenson J noted that the one exception was if the deposit was held by a stakeholder. In *Ch'elle Properties (NZ) Ltd v CIR* (2004) 21 NZTC 18,618 at p 18,621, Rodney Hansen J also noted that payment included payment of a deposit unless held by the recipient as stakeholder.
50. Thus, the decision in *Dormer* established that the receipt of a payment by a stakeholder means the supplier has not received payment within the provisions of section 9(1). This is the case whether the stakeholder is the supplier or an independent third party. In order for a supplier to "receive" payment within the terms of section 9(1), the supplier must have received the payment for his or her own benefit. An obligation to hold as stakeholder means a supplier has not received payment for his or her own benefit and this will prevent receipt.
51. In some cases a deposit paid may be stated to be non-refundable. If the facts show that the supplier is entitled to the deposit from the moment of payment, then the supplier will have received payment and the time of supply will have been triggered. However, if the deposit is paid to a stakeholder and the facts show that the deposit cannot be applied to the supplier's benefit until the happening of a specific event, such as on the cancellation of the contract, then the stakeholder rules will apply. The time of supply will not be triggered until that particular event occurs and the stakeholder obligations are therefore at an end. At that time the supplier will have received the payment for his or her own benefit and time of supply will have occurred.

52. Stakeholder obligations most commonly end at the time the contract becomes unconditional. However, the specific event which ends a stakeholding relationship is determined by the terms of the particular stakeholding agreement. For example, in circumstances where the solvency of a supplier is in question, the purchaser may negotiate to ensure the stakeholding relationship continues beyond the unconditional date to the date of settlement. Where the stakeholding obligations continue and the supplier has not received any payment for his or her own benefit (and providing an invoice has not been issued), the time of supply will not have occurred and the supplier will not have to account for GST. Note that a purchaser in this situation would also be unable to claim an input tax credit until the time of supply was triggered.
53. In some cases a third party stakeholder may also be the agent of the supplier, for example, a real estate agent or solicitor. If the third party receives the payment in its capacity as stakeholder, then it will not have received the money in its capacity as the supplier's agent and the supplier will not have received payment. The only exception to this will be if the third party stakeholder pays or applies the payment to the supplier or for the supplier's benefit during the period of the stakeholding in error. This may occur, for example, where the stakeholder mistakenly believes the relevant event has taken place (such as the contract becoming unconditional) or the stakeholder accedes to a unilateral request by the supplier. As the supplier is not acting in any stakeholder capacity, the supplier will have received payment for the purposes of section 9(1).
54. As discussed below, a stakeholder relationship requires agreement between all the parties. If a third party stakeholder mistakenly makes payment to the supplier, the supplier cannot unilaterally impose stakeholder obligations on himself or herself. Therefore, nothing prevents the supplier from having received the payment. This is consistent with the fact that if a stakeholder pays the deposit to the supplier in breach of its stakeholding obligations, the recourse for the purchaser is with the stakeholder: see, for example, *Hastingwood Property Ltd v Saunders Bearman Anselm* [1991] Ch 114.
55. The next part of this statement considers what is required to show that a person is holding a payment as stakeholder.

#### *Requirements of a stakeholder*

56. The cases show the essential requirement for a stakeholder relationship is the existence of an agreement between the parties. A person cannot establish himself or herself as a stakeholder unilaterally.
57. A stakeholder's obligations are determined by agreement between the parties and the stakeholder. Under that agreement, a stakeholder is required to hold the funds until a defined event takes place. That event establishes who is entitled to the money. The parties have no proprietary interest in the funds until that event takes place.

58. A person who holds money as a stakeholder does not act as agent for either party. A stakeholder, in their capacity as stakeholder, holds the funds for both parties and owes a contractual or quasi-contractual obligation to both parties. This is the case even if the person acting in the capacity of stakeholder is also acting in the capacity of agent for one or other of the parties.
59. The cases establish that, in ordinary circumstances, a stakeholder (unless he or she is a real estate agent or solicitor) is entitled to retain any interest earned on the funds while they are in his or her possession. Equally, a stakeholder is liable for any loss suffered. Note that in practice, however, the entitlement to interest may be dealt with as a term of the stakeholding agreement between the parties and who is entitled to the interest on the deposit may therefore vary. For example, entitlement to the interest may be determined in favour of the supplier if settlement proceeds and in favour of the purchaser if it does not, or it may be applied to the purchase price on behalf of the purchaser. In general this will not occur until settlement. Note that if the supplier as stakeholder is entitled to the interest and the interest is applied to the purchase price, the interest will constitute a payment *received by the supplier in respect of the supply* and the time of supply will be triggered.
60. The consent of both parties is necessary to vary a stakeholder's obligations.
61. The intention of the parties, determined from all the circumstances, will establish in which capacity a person receives the money.
62. The existence of a separate bank account in which the funds are placed (although not a legal requirement) combined with clear written confirmation of the stakeholder relationship will generally support the contention that a person is a stakeholder.
63. See, for example, *Potters (a firm) v Loppert* [1973] 1 All ER 658; *Neate v Manchester Home Centre Ltd* 22 April 1989, Tipping J, HC Christchurch CP343/89; *Vahora v Tse* (1999) 4 NZ ConvC 192,923; *Rockeagle Ltd v Alsop Wilkinson (a firm)* [1991] 4 All ER 659; Treitel, *The Law of Contract*, 11<sup>th</sup> ed, Sweet & Maxwell, London, 2003, at p 526; *Bowstead and Reynolds on Agency*, 17<sup>th</sup> ed, Sweet & Maxwell, London, 2001, at para 9-026; and McMorland, *Sale of Land*, 2<sup>nd</sup> ed, Cathcart Trust, Auckland, 2000, para 7.05.

#### ***A payment made when no contract exists***

64. The discussion in this part of the statement considers the situation where a payment has been made but there is no binding contract.
65. As stated earlier in this statement, the legal arrangements between the parties must be considered in determining whether a supply exists. Where a binding contract exists and a payment is made pursuant to that contract, there is an automatic assumption that a supply exists.

However, a supply need not necessarily be made under a contract. The crucial question is not whether there is a contract, but whether there is a supply.

66. In the absence of a binding contract there is no automatic assumption of a transaction giving rise to a supply. It is necessary, therefore, to consider whether there has in fact been a supply that is chargeable with GST. Has the payment received been made **for** a supply?

#### *Consideration*

67. Where a payment is made, it is necessary to establish a link between the payment and a supply, that is, that the payment constitutes "consideration" for a supply. To satisfy the definition of "consideration", the payment must be made in respect of, in response to, or for the inducement of that supply. The mere receipt of payment will not necessarily indicate the existence of a taxable supply. Not all payments received by a registered person in the course of their taxable activity will be for supplies. If there is no supply, the payment cannot be consideration. See, for example, *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075; *CIR v NZ Refining Co* (1997) 18 NZTC 13,187.
68. While it is necessary for there to have been a supply of something, the supply need not be made to the person who makes the payment: *Turakina Maori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032 at p 10,036.
69. There is a practical necessity for a sufficient connection between the payment and the supply, but a strict contractual analysis does not need to be undertaken in order to link a payment to a supply. See *NZ Refining Co Ltd* at p 13,193; *Turakina* at p 10,036.
70. The GST definition of consideration has been interpreted in the High Court as wider than the common law meaning: *The Trustee, Executors and Agency Co NZ Ltd v CIR* (1997) 18 NZTC 13,076, at p 13,085. However, it has also been made clear that while the statutory definition of consideration in the GST Act is wider than the contract law meaning, the definition does not remove the contract law requirement for an element of reciprocity to be present within a transaction in order for the payment to be "consideration" for a supply: *Taupo Ika Nui Body Corporate v CIR* (1997) 18 NZTC 13,147 at p 13,150.
71. The focus of the GST legislation, therefore, is on establishing a nexus between the supply and payment. As Blanchard J said in *NZ Refining Co Ltd* (at p 13,193), "to constitute consideration for a supply the payment must be **for** that supply" (emphasis added).

#### *Reciprocal obligations*

72. The cases emphasise the necessity for reciprocal obligations between the parties. If a supply cannot be connected to the payment by reciprocal obligations, it cannot be said the payment is consideration for the supply.

There must be reciprocal obligations between the parties to make payment and to make a supply of goods or services for the payment. A payment made merely in the hope that a supply would be made is not sufficient to constitute consideration. See *NZ Refining Co Ltd; Taupo Ika Nui Body Corporate; Chatham Islands Enterprise Trust; CIR v Suzuki* (2000) 19 NZTC 15,819.

73. The Commissioner considers that the requirement for reciprocal obligations will generally be satisfied if it can be shown that payment has been made by one party **for** the supply of goods or services by another party, whether performance of the supply takes place concurrently or in the future. Where this is the case, there will be a transaction giving rise to a supply and the receipt of the payment by the supplier will trigger the time of supply in relation to that supply.
74. An example of a payment made where there were no reciprocal obligations can be seen in the UK VAT decision in *Nigel Mansell Sports Co Ltd* [1991] BVC 718. In that case the taxpayer held a franchise for Ferrari motorcars. There was a long waiting list for such cars. The taxpayer had taken "deposits" from potential customers who wished to purchase a Ferrari. At the time when the "deposit" was paid, the customer would specify the model, type, colour, etc of the Ferrari that the customer wished to purchase. When a car that corresponded to the customer's requirements became available, the customer might be sent an order form and would then be asked to pay a deposit of 10 percent of the purchase price. That deposit was taken to include the initial sum "deposited". The issue was whether the time of supply arose when the initial payment was made. The tribunal considered that section 5(1) of the Value Added Tax Act 1983 (UK) (the equivalent of section 9(1)) did not have the effect that the tax point (the time of supply) was when the initial payment was made. At that point there was only an agreement to make an agreement, which did not give rise to a supply. The initial payment by the potential customer did not give rise to any rights. Therefore, the tribunal considered that the initial payment did not constitute a payment in respect of any supply.
75. In the unusual circumstances of that case, therefore, it was held that the payment by the potential customer was not for a supply. The payment did not provide the customer with anything. The facts did not evidence any firm commitment on the part of either party to the arrangement – the company was not obliged to offer the potential customer a vehicle, and the customer was under no obligation to purchase a vehicle should one be offered. This was not merely a case of a payment in respect of a supply that might not happen in the future because of particular circumstances (as would be the more common position), but rather it was not a payment in respect of a supply at all.
76. The Commissioner considers this would not be a common situation and, indeed, the United Kingdom HM Revenue & Customs has recognised that

*Nigel Mansell* turns on its rather unusual circumstances and in most cases should be distinguishable on its facts: see HM Revenue & Customs notice VATTO5130 – Actual tax points: payments: Exceptions to normal treatment of deposits and pre-payments.

77. The issue of whether a payment is made “in respect of, in response to, or for the inducement of” a supply is one that must be determined on the facts of each case. There must be a supply made or to be made in order for a payment to constitute consideration.

## **Examples**

### ***Example 1***

78. Romeo, a GST-registered person, manufactures iron railings for balconies. On 12 June he enters into an agreement with Juliet to supply an Elizabethan style railing for her balcony. Juliet pays a deposit of 20 percent on the same day. Delivery of the railing is not to take place until 12 August. Payment of the balance of the purchase price is to be made on delivery. Romeo has a 30 June balance date, a two-month taxable period, and accounts on an invoice basis.
79. The time of supply will be triggered on 12 June when Romeo receives payment of the deposit. Therefore, for the purposes of accounting for GST, the supply takes place in the taxable period ending 30 June. Romeo will have to account for the output tax on the full value of the supply by 28 July, even though he will not receive the balance of the purchase price until delivery of the railing.
80. Note that if Romeo accounted on a payments basis, he would only have to account for output tax on the deposit received, not on the full value of the supply, by 28 July. Assuming the balance of the price was paid by Juliet on delivery on 12 August, he would then have to account for the output tax on that amount by 28 September, in relation to the taxable period ended 31 August.

### ***Example 2***

81. Othello, a property developer, enters into a conditional agreement to sell a property to Iago. Iago pays a deposit to Desdemona Real Estate Ltd on 25 May 2009. Under the terms of the REINZ–ADLS agreement, the deposit is held by Desdemona Real Estate Ltd as stakeholder and the stakeholding ceases when the agreement becomes unconditional or is cancelled or avoided. The agreement becomes unconditional on 29 May 2009. Pursuant to section 123 of the Real Estate Agents Act 2008, Desdemona Real Estate Ltd is required to hold the deposit for 10 working days from the date of receipt and as a result it does not pay the deposit to Othello until 8 June. Othello has a standard balance date, a two-month taxable period, and accounts on an invoice basis.

82. The time of supply will be triggered on 29 May 2009 when the agreement becomes unconditional. From that point, Desdemona Real Estate Ltd will be holding the deposit not as stakeholder, but as agent for Othello. In these circumstances, Othello will have received payment for the purposes of section 9(1) and the time of supply will be triggered. Othello will have to account for the output tax on the full value of the supply for the period ending 31 May 2009.

**Example 3**

83. Hamlet Ltd operates an exclusive hotel, Denmark House. It receives a booking request from Ophelia in April to book three nights' accommodation over Labour Weekend. Hamlet Ltd requires Ophelia to pay one night's accommodation charge as a deposit. If Ophelia cancels more than 48 hours before her booking, she will receive a full refund. If she cancels after that time, she will forfeit her deposit.
84. The time of supply will be triggered on receipt of the deposit by Hamlet Ltd. There is a transaction giving rise to a supply and therefore the receipt of any payment (the deposit) in respect of that supply (the accommodation) will trigger the time of supply under section 9(1). That the deposit may be refundable is irrelevant to the question of whether the time of supply has been triggered. It is also irrelevant that the supply has not actually taken place at the time of the receipt of the deposit.

**Example 4**

85. Assume the same facts as in Example 3 above, but Hamlet Ltd immediately places the deposit received from Ophelia into a separate account with a third party and claims that the third party is holding the money as stakeholder until the non-refundable period of 48 hours before the start of Ophelia's booking has been reached.
86. The time of supply will still be triggered on receipt of the deposit by Hamlet Ltd. Having received a deposit, a supplier cannot unilaterally decide that the deposit will be held by a third party as a stakeholder. There must be a contractual basis for the stakeholder relationship, i.e. all parties must agree to the stakeholder relationship.
87. Note that if it was agreed by all parties that Ophelia would pay the deposit directly to the third party to hold as stakeholder, then the time of supply would not be triggered. This situation would be similar to that in Example 2 of a deposit paid to a real estate agent to hold as stakeholder.

**Example 5**

88. Benedict and Beatrice are celebrating their 50th wedding anniversary in three months' time with a function at Dogberry House. An agreement is signed setting out the number of guests, menu, alcohol, and entertainment and specifying the cost to be \$5,000. It is acknowledged that details must be finalised no later than one week before the date of

the function. Dogberry House requires the couple to make a payment of \$500 to confirm the booking. Dogberry accounts for GST on an invoice basis.

89. The amount paid will constitute a deposit in relation to the supply of the function. Therefore, receipt of the \$500 from Benedict and Beatrice will trigger the time of supply for Dogberry House and it will have to account for output tax on the \$5,000, even though the actual supply will not be made for three months. In the event that changes are later made to any of the details which then necessitate an adjustment to the cost of the function, Dogberry House may make an adjustment to the amount of its previously returned output tax under section 25.

### **Example 6**

90. Portia is getting married in 18 months' time. She thinks she would like to hold her wedding function at Shylock Castle. She meets with the functions manager to consider the services the castle can provide, and it is agreed that the wedding will be held at the castle on the date she requests. No arrangements are made as to the nature of the wedding function at this time, with the castle simply agreeing to hold the date for Portia. Portia must confirm the arrangements for her wedding within six months of the chosen date in order to secure the date beyond that time. Portia pays \$500 to Shylock Castle to hold the date she wants. The cost of the wedding will be reduced by this amount if the wedding function goes ahead. The amount paid is refundable at any time up to six months before the wedding.
91. In this situation, it is considered that Shylock Castle has received a payment in respect of a supply of services, being a chose in action, namely Portia's right to hold her wedding at the castle on the date booked. This is a separate supply from that of the function itself. Shylock Castle will have to account for output tax on the \$500 only at this time.
92. This can be contrasted with the situation in the *Nigel Mansell* case discussed in the body of this statement. In the unusual circumstances of that case, the finding of fact was that the payment did not secure anything for the customer. In contrast, Portia has secured the date for her function.