



Inland Revenue
Te Tari Taake

OS 17/01: GST and costs associated with mortgagee sales

Introduction

Operational statement 15/01 has been reviewed with regard to a mortgagee who is subject to the business to business financial services rules. The revised statement now reflects at paragraphs 23 to 26 that the Commissioner believes that such mortgagees can claim an input tax deduction for costs associated with mortgagee sales.

Transitional position

We are aware that we are changing our position with regard to input tax claims for taxpayers under the business to business financial services rules from that set out in Operational Statement OS 15/01. This means that going forward a mortgagee who has made a formal election under section 20F to be subject to the business to business zero-rating rules can claim input tax deductions for costs associated with a mortgagee sale.

A registered person who, while having made an election under section 20F, has not claimed input tax deductions for costs associated with a mortgagee sale, can:

- Request that the Commissioner amend the relevant assessment under section 113 of the Tax Administration Act 1994. The Commissioner will consider such requests on a case by case basis applying the approach outlined in the Standard Practice Statement on section 113 (SPS 16/01 – Requests to amend assessments); or
- Claim the input tax deduction in a subsequent period under the proviso to section 20(3) (provided the requirements of the proviso are met).

The Commissioner's general practice (as outlined in the SPS 16/01) is that where a registered person is able to make the required correction themselves in a later period, Inland Revenue will not expend resources considering whether to exercise the section 113 discretion to amend the original statement. However, a decision has been made that even though the taxpayer may be able to make the required amendment in a later return under section 20(3), in these cases this will not be a factor in determining whether to consider a request to amend the original assessment under section 113. This is a departure from the general practice outlined in SPS 16/01.

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

This Operational Statement sets out the Commissioner's position on GST input tax claims in relation to the costs of sale associated with mortgagee sales, namely:

- (i) Whether the mortgagee's costs of sale can be deducted prior to the calculation of GST due; and
- (ii) Whether a mortgagee can claim input tax on a mortgagee sale for the costs associated with the mortgagee sale; and

- (iii) Whether a mortgagee can claim input tax on the costs associated with the mortgagee sale where the sale is subject to the business to business financial services rules; and
- (iv) Whether a mortgagor can claim input tax on a mortgagee sale for the costs of sale incurred by the mortgagee.

Application

This Operational Statement applies from 6 September 2017 and sets out the Commissioner's position in relation to the Goods and Services Tax Act 1985. It replaces OS 15/01 *GST and the costs of sale associated with mortgagee sales* (October 2015).

Discussion

Whether the mortgagee's cost of sale can be deducted prior to the calculation of GST due

1. The term "costs of sale" in this statement refers to expenses that are occasioned by the mortgagee sale. Examples of such expenses are legal fees, valuation fees and real estate advertising and commission. The term "costs of sale" does not include money that is owed under the mortgage such as the interest or principal of the mortgage.
2. Section 5 deems a supply to take place in specific situations. In particular, section 5(2) deals with a sale in satisfaction of debt situation. It provides for there to be a supply by the defaulting person (the mortgagor) where the goods (the mortgaged property) are sold under a power exercisable by another person (the mortgagee) under the terms of the mortgage agreement. As there is a supply under a mortgagee sale, GST is to be charged pursuant to section 8 or section 11.
3. It should be noted that section 5(2)(a) and (b) provide for exceptions where a sale in satisfaction of debt would not be deemed a supply.
4. Section 5(2) alone does not aid in determining whether or not GST is to be calculated on the sale price inclusive of the costs of sale. It has to be read in conjunction with section 17.
5. Section 17 requires a person selling goods in a sale in satisfaction of a debt to perform certain duties.
6. Section 17(1)(a) states that the person selling the goods (whether or not GST registered) must furnish a return to the Commissioner in the prescribed form. The prescribed form is the *Goods and services tax return for goods sold in satisfaction of debt* (IR 373). This is referred to as the "special return" in this statement.
7. The special return must be furnished on or before the date set out in section 17(1B). Sales made in any month must be returned by the 28th of the following month except where the sale is made in either November or March, in which case they must be returned by the following 15th January and 7th May respectively.
8. The person selling the goods must at the same time, pay to the Commissioner the amount of tax that was charged on the supply and furnish to the person whose goods were sold, details of the information in the special return pursuant to sections 17(1)(c).
9. Section 17(2) deems the amount of tax charged on the supply to be tax payable and recoverable as a debt that is due to the Crown.

Section 185 Property Law Act 2007 and section 17 Goods and Services Tax Act 1985

10. Section 185(1)(a) of the Property Law Act 2007, by way of section 185(2), provides for the proceeds from the mortgagee sale to be applied to amounts reasonably paid or advanced by the mortgagee with a view to realisation of the security. This is the equivalent provision to the now repealed section 104 of the Land Transfer Act 1952. However, section 104 and its successor section 185 of the Property Law Act 2007 are not relevant to the question of who must pay the GST on mortgagee sales. The Privy Council's judgment in *Edgewater Motel Limited v Commissioner of Inland Revenue (2004) 21 NZTC 18,664* dealt with this issue. Paragraph [10] of the Privy Council judgment was the response to Counsel for Edgewater's submission that GST was not an expense occasioned by the sale. It reads:

[10]. ...There is no conflict between s 17 and s 104 of the 1952 Act because s 17 does not purport to interfere with the order of priorities laid down by s 104. It does not say that the mortgagee must pay the GST out of the proceeds of sale or of any particular fund. It simply says that he must pay the GST. As s 17(2) says, it creates a debt. The Crown has no concern with how the payment of this debt affects the distribution of the proceeds of sale. In claiming payment of the GST, the Crown is not seeking to assert a priority in the distribution of the assets of the mortgagor, any more than an estate agent instructed by the mortgagee and claiming commission on the sale. The claim lies directly against the mortgagee.

11. Paragraph [12] of the Privy Council judgment then goes on to say:

[12] Once the mortgagee has paid the GST, the question of the priority of his claim for reimbursement will arise. Their lordships consider that it is "plainly an expense occasioned by the sale" within the meaning of para (a). It is an obligation imposed upon the mortgagee by virtue of his having sold the property. He is therefore entitled to deduct it from the proceeds before payment of his own debt and is accountable to subsequent encumbrancers only for the balance.

12. The Privy Council is saying that the GST liability lies with the mortgagee, and is not dependent on any priority to the sale proceeds. Section 185 of the Property Law Act 2007 simply provides that the mortgagee is entitled to reimbursement of their costs from the proceeds of sale ahead of other claims on the proceeds including that of the mortgagee itself.
13. There is no ability for the costs of sale related to a mortgagee sale to be deducted prior to the calculation of GST output tax due under section 17.

Whether a mortgagee can claim input tax in a mortgagee sale for the costs associated with the mortgagee sale

14. A mortgagee is not able to claim input tax incurred on costs associated with the mortgagee sale.
15. *Case Y2 23 NZTC (2007) 13,017* is directly on point and confirms the Commissioner's view. Judge Barber of the Taxation Review Authority found at paragraph [72]:

The disputant is not entitled to input tax deductions with respect to its sale of the property as mortgagee. The express language of s 17 of the GST Act provides that, in a s 17 Special Return, the disputant must pay the full amount of output tax, without any deduction for input tax. There is nothing in the scheme and purpose of the Act which supports input tax deductions being available for the deemed supply.

16. This confirms the Commissioner's position. One argument to the contrary is that the mortgagee acts as the mortgagor's agent in a mortgagee sale and therefore the

mortgagee is entitled to claim input tax on the sold property. However, it is Inland Revenue's view that the relationship between a mortgagee and a mortgagor is one of creditor and debtor. The mortgagee acts on their own behalf when exercising a power of sale.

17. Usually, the mortgagee sale occurs through a power exercised by the mortgagee as agreed in the mortgage agreement because of the mortgagor's default in the mortgage payments. Consequently, the mortgagee cannot purport to claim input tax on the costs of sale as agent for the mortgagor.
18. For the mortgagee to be permitted to claim input tax for costs associated with the mortgagee sale, the costs would have to be incurred in the course or furtherance of a taxable activity undertaken by the mortgagee. The mortgaged property would have to have been supplied in the course or furtherance of a taxable activity undertaken by the mortgagee. Putting aside the fact that section 5(2) deems the mortgaged property to be supplied in the course or furtherance of the mortgagor's taxable activity, in some cases the mortgagee may argue an indirect connection with some other activity that the mortgagee is GST registered for. This matter was also considered in Case Y2. It was felt that this indirect connection is incidental to a mortgagee's activity of providing financial services. And in that case, the provision of financial services was an exempt supply (section 14) and not part of a taxable activity (section 6).
19. "Financial services" is defined in section 3(1)(ka) for the relevant purpose of this statement to mean "the payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security, equity security, participatory security, credit contract, contract of life insurance superannuation scheme, or futures contract."
20. "Debt security", defined in section 3(2) means any interest in or right to be paid money that is, or is to be, owing by any person; but does not include a cheque. Therefore, the collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security is the provision of a financial service which is an exempt supply.
21. A mortgage is simply security for the repayment of a debt. It satisfies the definition of "debt security" as the mortgagee has the right to be paid money owed by the mortgagor under the mortgage.
22. Therefore, a mortgagee whose activity is as a lender would be considered to be carrying on an exempt activity. As such, the mortgagee would be unable to claim input tax from the mortgagee sale. This is subject to section 11A(1)(q) of the GST Act, which is discussed next.

Whether a mortgagee making a mortgagee sale that is subject to the business-to-business financial services rules can claim input tax for the costs associated with that mortgagee sale

23. Sections 11A(1)(q) and 11A(1)(r) allow financial service providers that are registered for GST to zero-rate supplies of financial services to their customers (or in the case of a group of companies, the group's customers) that are registered for GST if the level of taxable supplies made by the customers, in a given 12-month period, is equal to or exceeds 75% of their total taxable supplies for the period. Section 20C and sections 20D to 20F support the financial services rules.
24. Input tax deductions may be made to the extent goods and services are used for making those supplies under the business to business financial services rules.

However, the effect of section 5(2) is that the goods sold are deemed to be supplied in the course or furtherance of a taxable activity carried on by the mortgagor.

25. There is an argument that the expenses are not directly or indirectly related to a mortgagee's money lending activity. The Commissioner believes that even though the sale of the property is deemed to be supplied by the mortgagor, the steps undertaken to protect the securities and sell the properties is part of the mortgagees money lending taxable activity.
26. As such, an input tax deduction is available to a mortgagee for costs associated with a mortgagee sale made under the business to business financial services rules. The costs are directly related to the money lending taxable by the mortgagee.

Whether the mortgagor can claim the input tax credits on the sale costs directly incurred by the mortgagee

27. As the mortgagee is the recipient of the supply in these circumstances, the mortgagor cannot claim the input tax. Section 3A(1)(a) defines input tax as tax charged under section 8(1) on a supply of goods or services acquired by the registered person. The recipient of the supply of these services is the mortgagee and the purpose of the sale is for the mortgagee to receive the amount or part of the amount owing on the mortgage. The mortgagor may ultimately receive the net proceeds of the sale, if there are any, but it cannot be said that the mortgagor is the recipient of the costs.

Conclusions

28. A mortgagee in a mortgagee sale cannot deduct the costs of sale before calculating the GST due under section 17 of the Goods and Services Tax Act 1985.
29. A mortgagee cannot claim input tax for the costs associated with a mortgagee sale.
30. A mortgagee who is a registered person and makes a mortgagee sale that is subject to the business-to-business supply of financial services rules is able to claim input tax for the costs associated with that mortgagee sale.
31. A mortgagor cannot claim input tax for the costs, incurred by the mortgagee, associated with a mortgagee sale.

This Operational Statement is signed on 6 September 2017.

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