

## **QUESTION WE'VE BEEN ASKED QB 16/02**

### **GST – WHAT IS THE CORRECT RATE OF GST TO CHARGE ON LEGAL SERVICES PROVIDED TO NEW ZEALAND RESIDENT OWNERS OF LAND BEING COMPULSORILY ACQUIRED?**

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

This Question We've Been Asked is about ss 8 and 11.

Section 66 of Part 5 of the Public Works Act 1981 provides that the owner of land compulsorily taken can recover reasonable legal costs incurred. It has been drawn to the Commissioner's attention that there is some doubt about the correct rate of GST to be charged on legal services supplied to New Zealand resident owners of land that is being compulsorily acquired. The argument for zero-rating the legal services supplied is that the supply of the land is the only supply made by the land owner to which the compensation for the legal fees incurred can relate. As the supply of the land to the relevant body will be zero-rated under s 11(1)(mb), so should the supply of the legal services.

#### **Question**

1. At what rate should GST be charged on legal services provided by legal professionals to New Zealand resident land owners in the process of their land being compulsorily acquired?

#### **Answer**

2. When the legal services are supplied by a GST registered person, GST will be charged under s 8(1) at the standard rate of 15%.
3. The same conclusion will apply to the supply of other services obtained by the New Zealand resident owner of land being compulsorily acquired by the Crown or local authority, eg valuation or surveying services.
4. Section 66 of the Public Works Act 1981 provides that the owner can recover reasonable costs incurred when their land is compulsorily acquired by the Crown or local authority. This includes reasonable valuation and legal fees or costs incurred in respect of the land taken or acquired. Similarly, s 62 of the Canterbury Earthquake Recovery Act 2011 and cl 80 of the Greater Christchurch Regeneration Bill 2015 each provide that the owner can recover actual costs incurred when their land is compulsorily acquired. While the Crown or local authority may pay the invoices issued by the services providers, the services are supplied to the landowner.

#### **Explanation**

##### **Background**

5. This item applies to legal services provided to a New Zealand resident owner of land that is to be compulsorily acquired by the Crown or a local authority under the Public Works Act 1981. When land is compulsorily acquired, the land owner is entitled under the Public Works Act 1981 to full compensation from the relevant body for any loss or injury suffered. This will include compensation for any

reasonable legal fees incurred by the land owner in the process of the land being acquired by the relevant body.

## Analysis

6. Section 8(1) requires a registered person to charge GST on the (non-exempt) supply of goods and services made in New Zealand in the course or furtherance of a taxable activity carried on by the registered person. The rate of GST charged is 15% unless ss 11–11B require the GST to be charged at a rate of 0%. The provision being relied on to zero-rate the supply of legal services to land owners is s 11(1)(mb), which reads as follows:

### 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

...

7. It is well established that GST is a tax on transactions (*CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA) at 13,193). The statutory provisions are directed at the contractual arrangements between the supplier and the recipient of the supply (*Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA) at 12,328). As Durie J stated in *CIR v Capital Enterprises Limited* (2002) 20 NZTC 17,511 (HC) at [50]:

The position seems rather to be that the Act taxes transactions at a given point in the transaction but the question of who are the parties is determined by reference to the general principles of the relevant contract law. Certainly **I can see no basis for divorcing the supply and receipt of goods and services for the purposes of the Act from contractual relationships**. A contract may be formed by the simple act of supplying and receiving. Equally, the Act [sic] of supplying and receiving may arise as part of a larger contractual arrangement. Ms Norris is undoubtedly correct in submitting that **the core provisions of the Act, ss 6–10, are directed to contractual arrangements between the suppliers and the recipients of the supply** (and see *Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA) and in particular Richardson J at p 12,328, Penlington J at p 12,335 and McKay J at p 12,333; *Director-General of Social Welfare v De Morgan* (1996) 17 NZTC 12,636 at p 12,641). It follows, as Ms Norris submitted, that **the tax attaches to the supply to the person who at contract can require its performance**. [Emphasis added]

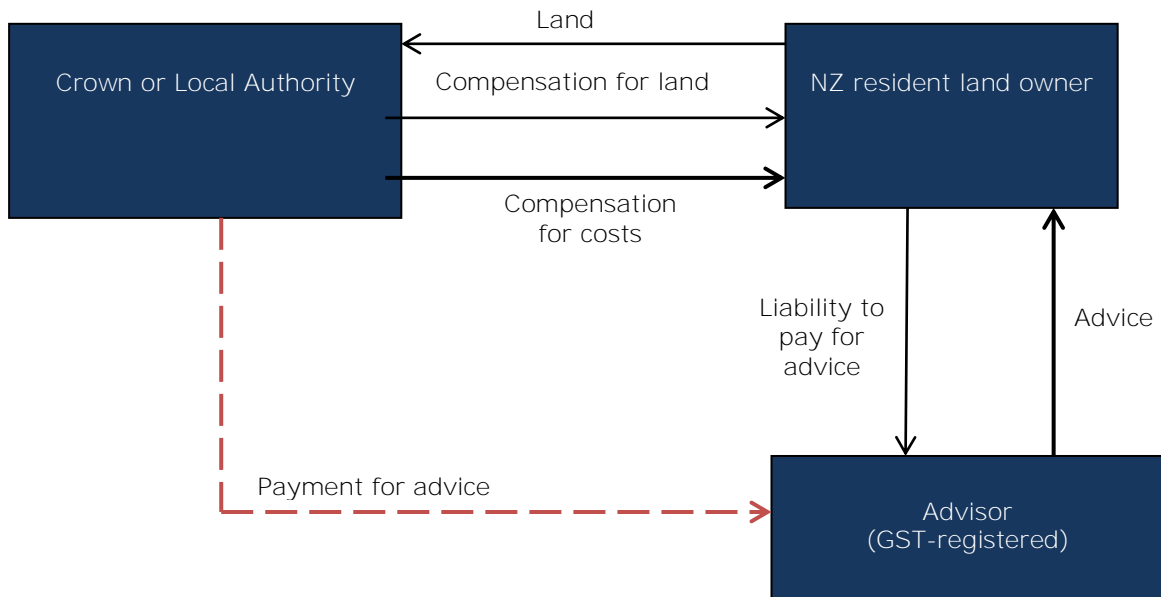
8. The focus on contractual relationships means that the nature of the supply for GST purposes will be determined with reference to the rights and obligations created between the parties to the contract (*New Zealand Refining* (CA) at 13,192; *Rotorua Regional Airport Ltd v CIR* (2010) 24 NZTC 23,979 (HC) at [50]). The application of the statutory provisions will not be determined with reference to anyone who is not party to the contract (*Wilson & Horton* (CA) at 12,333).

### **What are the contractual relationships between the parties?**

9. The Commissioner considers that the contractual relationship is between the legal professional, as supplier of legal services, and the land owner, as recipient of that supply. The Crown or the local authority, as the case may be, is not a party to this contract. The supply of legal services is a separate supply from the supply of the land by the owner to the Crown or local authority. The Crown or local authority does not instruct the legal professional to provide legal services to the land owner. Consequently, the Crown or local authority cannot require

performance of the transaction. This is so despite their statutory obligation under Part 5 of the Public Works Act 1981 to compensate the land owner for the reasonable or actual loss incurred in obtaining the legal advice.

10. The contractual and other relationships may be illustrated as follows:



—————> Legal / contractual flow

- - - - -> Possible cash flow

**What is the correct GST treatment?**

11. Because the contractual relationship is between the legal professional and the land owner, the nature of the supply will be determined under that contract. The services supplied by the legal professional under the contract will be legal advice or other related services. While the advice or other services supplied will relate to the compulsory acquisition of the land by the Crown or local authority, the supply does not “wholly or partly [consist] of land” as required under s 11(1)(mb). This is because the supplier – the legal professional – is not supplying the land. Rather, the supply made by the legal professional wholly consists of legal advice or other related services. In this light, s 11(1)(mb) is not relevant.

12. Therefore, s 11(1)(mb) does not apply to zero-rate the supply of legal services to the owner of the land that is being compulsorily acquired by the Crown or local authority. This means that the rate of GST to be charged by the legal professional to the New Zealand resident land owner is the standard rate under s 8(1) of 15%.

**What if the Crown or local authority pays the fees directly to the legal professional?**

13. That the Crown or local authority may pay the legal fees directly to the legal professional does not alter the conclusion that GST is charged at the standard rate of 15% on the supply of the legal services to the owner of the land being acquired (*Turakina Maori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032 (CA) at 10,036). The Crown or local authority’s obligation is to compensate the land owner for the reasonable or actual costs incurred in obtaining the legal services.

## References

### Related rulings/statements

QB 13/03: *Goods and Services Tax – whether a compulsory acquisition of land is a “supply by way of sale”*

### Subject references

GST, imposition of tax, zero-rating, compulsory acquisition of land

### Legislative references

Canterbury Earthquake Recovery Act 2011 s 64

Goods and Services Tax Act 1985: ss 8 and 11(1)(mb)

Greater Christchurch Regeneration Bill 2015: cl 82

Public Works Act 1981, s 66

### Case references

*CIR v Capital Enterprises Limited* (2002) 20 NZTC 17,511 (HC)

*CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA)

*Rotorua Regional Airport Ltd v CIR* (2010) 24 NZTC 23,979 (HC)

*Turakina Maori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032 (CA)

*Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA)