

GST - WHEN THE SUPPLY OF LEASEHOLD LAND IS AN EXEMPT SUPPLY

PUBLIC RULING - BR Pub 08/01

Note (not part of ruling): This ruling is essentially the same as public ruling BR Pub 01/01 which was published in *Tax Information Bulletin*, Vol 13, No. 4 (April 2001) and applied until 31 January 2006. This was a reissue of BR Pub 96/7 which was published in *Tax Information Bulletin*, Vol 7, No. 12 (April 1996). This ruling will apply for an indefinite period beginning on 1 February 2006.

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Law

This Ruling applies in respect of section 14(1)(ca) of the Goods and Services Tax Act 1985.

The Arrangement to which this Ruling applies

This Ruling applies to the supply of leasehold land, in exchange for rent, by a registered person.

This Ruling applies to what are generally referred to as ground leases, where the lease or rental payable under the terms of the lease relate solely to the use of land. The ruling does not apply to any leases of land together with improvements associated with that land.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement in the following manner.

In respect of the supply of leasehold land by way of rental:

- Where the leasehold land that is the subject of the supply is only used for the principal purpose of accommodation in a dwelling erected on that land, the supply is exempt from GST;
- Where the leasehold land that is the subject of the supply is not used, to any degree, for the principal purpose of accommodation in a dwelling erected on that land, the supply is not exempt from GST;
- Where the leasehold land that is the subject of the supply is used for the principal purpose of accommodation in a dwelling erected on that land and for another use, the supply is exempt from GST to the extent that the leasehold land is used for the principal purpose of accommodation in a dwelling erected on that land, irrespective of whether the predominant use of the land is for the principal purpose of accommodation in a dwelling erected on that land;
- Where the leasehold land that is the subject of the supply is used for the principal purpose of accommodation in a dwelling erected on that land and for another use, the apportionment of the value of the supply between the exempt and non-exempt uses must be made on the basis of allocating that proportion of the supply that is properly attributable to

the exempt supply.

- Where a lease is entered into for leasehold land, and that land is to be used for the principal purpose of accommodation in a dwelling erected on that land, the supply of that leasehold land pursuant to the lease (or the relevant portion of the lease) is not exempt until the dwelling has been erected.

The words “not being a grant or sale of the lease of that land” in section 14(1)(ca) refer to any payment made for:

- The creation of a leasehold interest in that land, other than a payment of rent; or
- The sale of the leasehold interest in the land.

The period for which this ruling applies

This ruling will apply to a supply of leasehold land by way of rental for an indefinite period beginning on 1 February 2006.

This ruling is signed by me on the 23rd day of June 2008.

Susan Price
Director Public Rulings

COMMENTARY ON PUBLIC RULING BR Pub / 08/01

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 08/01 (“the ruling”).

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR Pub 96/7 (*Tax Information Bulletin*, Vol 7, No. 12 (April 1996)) and BR Pub 01/01 (*Tax Information Bulletin*, Vol 13, No. 4 (April 2001)). The Commissioner’s view in this ruling is not intended to differ from the previous rulings. Any changes between this ruling and the previous rulings are only intended to assist the reader’s understanding.

A note as to legislative history

This ruling and commentary refers to section 14(1)(ca) of the Goods and Services Tax Act 1985. That section was originally enacted (pursuant to section 12(1) of the Goods and Services Tax Amendment Act 1986 and with effect from 3 December 1985, the date of enactment of the principal Act) as section 14(ca).

The Taxation (GST and Miscellaneous Provisions) Act 2000 amended section 14 and made it section 14(1) (with the subsidiary changes that section 14(ca) became section 14(1)(ca), section 14(c) became section 14(1)(c), etc). This was necessary due to the enactment of the new sections 14(2) and 14(3).

In this commentary, sections 14(ca) and sections 14(1)(ca) will consistently be referred to as section 14(1)(ca). Therefore, where necessary references to section 14(1)(ca) should be read as a reference to section 14(ca).

Similarly, section 14(1)(c) of the Act should be read as, where appropriate, section 14(c).

Background

Section 14(1)(ca) exempts from GST the supply of leasehold land by way of rental, to the extent that that land is used for the principal purpose of accommodation in a dwelling erected on that land. The section expressly excludes from the exemption any grant or sale of the lease of the land.

In the Commissioner’s view, section 14(1)(ca) applies to the supply of leasehold land by way of rental when it is supplied separately from any buildings or other improvements to that land. This form of lease is commonly known as a “ground lease”. Under a ground lease the rental is generally based on the unimproved value of the land. In such cases the head lessor owns the land, and the head lessee usually owns the buildings and any other improvements to the land.

Section 14(1)(ca) was inserted into the Act [originally as section 14(ca)] by section 12(1) of the Goods and Services Tax Amendment Act 1986. That amendment was effective from 3 December 1985, being the date of enactment of the principal Act and prior to the commencement of GST.

The amendment was enacted to correct a deficiency in the principal Act. In the absence of the amendment, residential lessees of leasehold land would have had to pay GST on their ground

lease rental payments. This was seen as inequitable when compared with the position of residential owners of freehold properties, who generally do not pay GST on the acquisition of a private home, and lessees of residential accommodation. The supply of residential rental accommodation is GST exempt under section 14(1)(c). Section 14(1)(ca) was therefore intended to provide an extension to the section 14(1)(c) exemption.

There had been some uncertainty regarding the scope and effect of the section 14(1)(ca) exemption. In particular, when there is a supply of leasehold land that is used for both commercial and residential purposes. Further, uncertainty also occurred regarding the meaning of the words “not being a grant or sale of the lease of that land” in section 14(1)(ca).

Hence, public binding rulings BR Pub 96/7 and BR Pub 01/01 were issued by the Commissioner to clarify the position. This public binding ruling is not intended to change the Commissioner’s view of section 14(1)(ca) as expressed in those rulings. Rather, any changes are intended to clarify the Commissioner’s view.

Legislation

Section 14(1) exempts certain supplies from GST. Section 14(1)(ca) exempts:

The supply of leasehold land by way of rental (not being a grant or sale of the lease of that land) to the extent that that land is used for the principal purpose of accommodation in a dwelling erected on that land:

Section 14(1)(c) also exempts:

The supply of accommodation in any dwelling by way of -

- (i) Hire; or
- (ii) A service occupancy agreement; or
- (iii) A licence to occupy:

Section 2 defines “dwelling” as meaning:

... any building, premises, structure, or other place, or any part thereof, used predominantly as a place of residence or abode of any individual, together with any appurtenances belonging thereto and enjoyed with it; but does not include a commercial dwelling:

Section 10(18) states:

Where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.

Application of the legislation

Section 14(1)(ca) exempts “the supply of leasehold land by way of rental ... to the extent that that land is “used” for the principal purpose of accommodation in a dwelling erected on that land”. The Commissioner’s view is that this means that to the extent that leasehold land is “used”, by the lessee, “for the principal purpose of accommodation in a dwelling erected on that land” the supply of that land is exempt.

The word “used” in section 14(1)(ca) refers to the actual physical use of the land. The reason for this interpretation is briefly set out below.

The *Shorter Oxford Dictionary*, 5th edition, Volume 2, (2002), gives the first meanings of “use” as the “Act of using, fact of being used. The action of using something, the fact or state of being used...”.

The meaning of “used” in paragraph (ca) was also considered inter alia in *Case N22 (1991) 13 NZTC 3,187* by Judge Bathgate who said:

For instance in sec 14(ca) reference is made to the purpose for which land may be held; in that paragraph reference is to “... land which is used for the principal purpose of accommodation ...”, which is to be distinguished from goods, “applied” for a particular purpose. The “use” of goods, as opposed to the “application” of goods would seem to connote their direct, physical involvement, or use.

This is consistent with the scheme and purpose of section 14(1)(ca) which was to provide an extension to the section 14(1)(c) exemption, by exempting the supply of leasehold land when it is “used” for residential accommodation purposes.

The term “principal purpose of accommodation in a dwelling” refers to the use to which the dwelling, erected on the leasehold land, or a portion of the leasehold land, is being put. It does not refer to the use to which the leasehold land is being put as a whole. Therefore, it is not necessary for the principal purpose to which the leasehold land is being put to be accommodation in a dwelling. It is sufficient if part of the leasehold land is being used for “the principal purpose of accommodation in a dwelling erected on that land”.

Therefore, in applying section 14(1)(ca) to any ground lease, the use or uses to which the leasehold land is being put must be considered. Such consideration will allow the extent to which the supply of the leasehold land is exempt to be determined. When all the land and any buildings erected on that land are used for the principal purpose of accommodation in a dwelling, the full rental in respect of the ground lease is exempt from GST. When all the land and any buildings erected on that land are used for commercial or other non-dwelling purposes, the ground lease is subject to GST.

When leasehold land and any building erected on that land are used in part for the principal purpose of accommodation in a dwelling and in part for commercial or other non-exempt purposes, the ground lease is only exempt to the extent that the use to which the leasehold land is being put relates to the provision of accommodation in a dwelling. This requires apportioning the ground lease rental and imposing GST only on that part of the rental that relates to the non-exempt purpose(s).

Alternative interpretation

It is also arguable that section 14(1)(ca) only exempts the supply of leasehold land when all the land is used for the principal purpose, i.e., more than 50%, of accommodation in a dwelling. The exemption then only applies to the extent that the land is so used. For example, the ground lease rental of land on which a building is situated that is used as to 75% for accommodation and 25% for offices, is exempt from GST as to 75%. However, the ground lease rental of land on which a building is situated that is used as to 25% for accommodation and 75% for offices, is not exempt from GST.

While this is an arguable interpretation, the Commissioner considers that it is unduly narrow and restrictive, and that the interpretation that has been adopted (and expressed in the Ruling)

better effects the purpose of the section. The Commissioner's view is that the primary focus of the provision is on that portion of the land that is used for accommodation purposes, rather than, as the alternative interpretation proposes, the predominant use of the land as a whole. To limit the exemption to only those instances where accommodation in a dwelling is the primary, or predominant, use to which the land being put would be to effectively ignore the apportionment requirement. It is considered that the better view is that the purpose of the section is to exempt from GST that element of total use that relates to the principal purpose of accommodation and that this purpose is best effected by a broad interpretation.

Apportionment

Section 14(1)(ca) is silent as to the correct way to apportion the lease payments in respect of the supply of the leasehold land between the exempt and non-exempt uses. The section only states that the supply is exempt "to the extent" that the use to which the land is being put is the exempt use.

Section 10(18) of the Act also deals with the apportionment of consideration between exempt and taxable supplies. However, that section similarly does not specify the basis for determining the apportionment – rather it simply deems the taxable supply to be for that part of the consideration as is properly attributable to it.

It is the Commissioner's view that it is not possible to specify a method of apportionment that must be applied in all instances. The appropriate method must be determined on a case by case basis, taking into account the provisions of the lease and bearing in mind that section 14(1)(ca) requires the apportionment to be undertaken taking into account the uses to which the land is being put.

The following examples are intended to be indicative only of the approach that may be taken to apportionment:

- a six-storey building is erected on leasehold land. Calculated on the basis of the floor area used, 60% was used for offices, 20% for a restaurant and the remaining 20% for residential apartments. The residential apartments are used for the principal purpose of private accommodation in a dwelling. Pursuant to section 14(1)(ca), 20% of the ground lease rental is exempt from GST.
- an area of rural leasehold land is used, on an area basis, as to 90% for grazing and 10% for a house and its curtilage. That house is used for the principal purpose of accommodation in a dwelling. Pursuant to section 14(1)(ca), 10% of the ground lease rental is exempt from GST.),

In some cases, the ground lease rental may be expressly calculated with reference to the different uses to which the land is to be put. For example:

- a person leases ten hectares of rural land. A term of the lease is that one hectare can be used to erect a dwelling, but the remaining nine hectares must be left as pasture. The lease further provides that the pasture is to be leased at the rate of \$10 per hectare per week, while the remaining land is leased at \$50 per week. While the total rent payable under the lease is \$140 per week, \$50 will be GST exempt.

A grant or sale of the lease of that land

The words “not being a grant or sale of the lease of that land” create an exception to the exemption under the main body of section 14(1)(ca). The words in section 14(1)(ca) “not being a grant or sale of the lease of that land” refer to any payment made for:

- The creation of a leasehold interest in that land, other than a payment of rent; or
- The sale of the leasehold interest in the land.

Any grant or sale by the head lessor (owner of the land) of a ground lease of that land, where the ground lease is exempt from GST to the extent that it is used for the principal purpose of supplying accommodation in a dwelling, is not exempt from GST. Whether GST is payable on the sale or grant depends on whether the sale or grant is made in the course or furtherance of a taxable activity carried on by the head lessor.

Examples

The following examples do not form part of the Ruling.

Example 1

A, a GST registered person, owns a vacant piece of land. She leases that land to S who constructs a building that is used to carry on her business as a drycleaner. The building occupies the entire piece of land, leaving only a narrow alley providing access to the rear entrance. No part of the land is used for the principal purpose of accommodation in a dwelling and therefore no part of the supply from A to S is exempt.

Example 2

S constructs an apartment above her drycleaning business and rents it to E. The floor area of the apartment is exactly the same as that of the drycleaners, so 50% of the ground rent charged by A to S is GST exempt.

Example 3

S sold her drycleaning business and the building, including the apartment, to E. E negotiated a new ground lease with A. 50% of the ground rent was exempt as it related to the apartment.

In addition to the ground lease rental payments, in order to facilitate the negotiation of the new lease E agreed to make a one off payment to A of \$5,000. None of that payment is exempt from GST as it relates to the grant of the lease and is excluded from the exemption.