



White Paper - N°12

Demystifying GST on Residential Property Sales

Covisory

Introduction

It never ceases to amaze us how many times we get asked questions regarding GST on residential property. While in theory GST should not apply to privately owned residential land, there are several situations where it does. In this whitepaper we shall set out for you the practical implications of dealing with GST regarding residential property.

Firstly, some definitional issues: when we talk about someone being not GST registered, that means they are either not registered for GST at all or alternatively that they are registered for GST but the property which they are transacting, either buying or selling, is not to be used as part of their GST activity.

This means it is effectively outside of their GST activity and it is as if they are unregistered persons. This applies whether they are buying or selling a property.

1 Purchasing residential property

- 1.1 Let us start with the purchaser's side of the transaction. Assuming the purchaser is not GST registered and there is a non-registered vendor of the property, then clearly GST is not chargeable nor is it claimable. This is the usual situation for a transaction between two private parties. An example would be buying and selling a family home.
- 1.2 In these cases, page 1 of the agreement for sale and purchase of real estate would clearly note that the vendor is not GST registered. As the vendor is not registered for GST, the buyer is not required to complete schedule 1 on the Auckland District Law Society standard sale and purchase agreement for real estate.
- 1.3 The purchase price should be stated as 'inclusive of GST (if any)'.
- 1.4 If the purchaser is not registered for GST and the vendor is, then GST will apply. This could be the situation where a private individual is buying a new family home from a building company, i.e., a completed house and land package.
- 1.5 In this case, the vendor is required to charge and account for 15% GST on the sale. That is because it is part of their GST activity. Page 1 of the sale and purchase agreement will therefore note that the vendor is GST registered and should include their GST registration number.
- 1.6 The purchase price should be stated as "including GST (if any)". The reason for this is that the buyer does not want to sign up to buy a property for say \$100, and then find that they need to pay \$15 of GST on top of this, i.e., \$115 in total. All the buyer cares for are that they are paying \$115 which includes GST.

- 1.7 For the vendor, they will need to be aware of the “Time of Supply” rules. Typically, the vendor will be on an invoice basis, likely two monthly return cycle for GST. They will be required to account for GST at the earlier of invoice or payment.
- 1.8 Practically this is when the contract goes unconditional, and the vendor can get their hands on the deposit because that equates with payment. The vendor is required to account for GST on the whole of the sale price, not just the deposit they receive, if they are on an invoice basis.
- 1.9 The above does not apply if there is a progressive supply with periodic payments, i.e., progress payments are made as milestones are completed on the building of the house on the property.

2 GST Registered Purchaser

- 2.1 If a GST registered purchaser is buying a property from another GST registered vendor, then the compulsory zero rating provisions would apply. The sale is automatically GST zero rated where the vendor is selling it as part of their GST taxable activity and the purchaser is buying it as part of their GST taxable activity.
- 2.2 The key here, as purchaser, is not to overpay for the property. Assuming the property is worth \$115 as an open market supply, that would include GST at 15%. Here the property should transact at \$100, being \$115 less GST of \$15. The vendor is not required to account for \$15 of GST nor can the purchaser claim it back. If the purchaser were to pay \$115 GST zero rated, they would be paying too much for the property.
- 2.3 Ideally, the sale and purchase agreement should state “plus GST (if any)”. Both the purchaser and the vendor need to ensure that the agreement is correctly completed. The vendor needs to state that they are GST registered and provide their GST number on page 1, while the purchaser needs to complete schedule 1 noting that they are also GST registered and intend to acquire it as part of their GST taxable activity. If a property is to be nominated to a party who will be GST registered, that should also be completed and noted on schedule 1.
- 2.4 Where things typically get more interesting and more problematic is where we have a non-GST registered vendor and a GST registered purchaser. Think of the situation where Mum and Dad, not registered for GST, are selling their family home to a property developer who intends to knock it down and build 6 townhouses on it. In this case the purchaser is clearly GST registered but the vendor is not.
- 2.5 Even though Mum and Dad are not required to charge GST on the sale, the purchaser is still able to claim back a notional 15% GST input on what is called a GST secondhand goods claim. Even if the purchaser is on an invoice basis, they can only claim it back as they make physical payments, i.e., on a cash basis.
- 2.6 Naturally, the purchaser is paying \$115 and expects to claim back \$15. However, the real risk here is that the purchaser does not really know whether the vendor should or should not be registered for GST. When they file their GST return and claim the input for the purchase price of the land, the IRD will invariably audit the transaction and review the vendor’s GST status. Sadly, often the IRD will find that the vendor should have been GST registered, something which they either ought to have known or where blindly ignorant to.

- 2.7 This is where things get problematic. Under the sale and purchase agreement, the purchaser must sue the vendor for misrepresentation of the fact that they were not GST registered. We have been involved in too many cases with facts like this. It is not the IRD's problem, it is a contractual issue between the vendor and purchaser.
- 2.8 In some cases, we have seen lawyers insert clauses that expressly confirm that the vendor is not GST registered, and that the purchaser is specifically relying on that fact to make an input claim and thus confirming the liability of the vendor if the IRD denies the purchaser a GST secondhand goods input claim. Sadly, we have also been expert witnesses in court on several cases where the purchaser did turn out to be GST registered, and the IRD declined the purchaser their GST input.
- 2.9 In terms of the wording in the sale and purchase agreement, this is also problematic. It would usually be "including GST (if any)". Naturally if the vendor was registered, then the supply becomes compulsory zero rated. This is where the indemnity kicks in and the claim is made against the vendor.
- 2.10 Even with warranties and indemnities, if you must sue to recover the funds it may take years in which case the 15% GST secondhand goods input that you were counting on to partially fund the development of the property will not be available and can cause real hardship to some GST registered purchasers who are relying on that funding to complete the development.
- 2.11 Also, as a GST registered purchaser claiming a GST secondhand goods input claim, just note that a smart financier will typically require that funding to be paid back against the borrowing on the property if the full purchase price is being initially funded by the financier.

3 Vendor

- 3.1 The position for the vendor is generally less troublesome than for the purchaser because you do not have the equivalent of a secondhand goods input claim.
- 3.2 As outlined above, typically a vendor will be on an invoice basis so they need to be cognizant of the fact that when the contract goes unconditional, they will need to account for GST on the whole of the supply not just on the deposit they receive, most of which will be taken up by the real estate agent as commission.
- 3.3 Given that GST is 15/115 of the sale price, and the deposit may only be 5% or 10%, the vendor may be required to dip into their own pocket to fund the GST unless settlement occurs before the due date for GST payment. This is something to consider from a timing viewpoint. It is always good to have the settlement quite quickly after the unconditional date if it is around the time that the GST would be due.
- 3.4 As a GST registered vendor, if you are making a supply to a GST registered purchaser, you are more agnostic as to whether the sale price is \$100 or \$115, i.e., if the purchaser gets it wrong you make a 15% windfall gain. Technically, you would want to sell the property for \$115 including GST if any. If the purchaser is GST registered, they should seek for the purchase price to be reduced to \$100 rather than the \$115. However, not all purchasers are knowledgeable or smart.

- 3.5 When selling to an unregistered purchaser, theoretically the sale and purchase agreement should state “including GST (if any)”. The purchaser does not suddenly need to discover they need to pay 15% extra on settlement that they were not expecting. Better to be upfront and clear about this.

4 Conclusion

- 4.1 Theoretically this is all quite simple. But practically it is a matter of understanding the implications of the various choices that are open to buyers and sellers of property where one or more parties are GST registered.
- 4.2 This is particularly the case when a GST registered buyer is acquiring land from an unregistered vendor. We have seen far too many cases where the vendor technically should have been GST registered and as a result the IRD denies the purchaser their GST input claim.
- 4.3 Court action ensues, a long delay before the refund is ultimately awarded by the court, often to only find that the vendor is impecunious and pleads poverty or bankruptcy.
- 4.4 It is our advice that it is always better to have a chartered accountant or tax specialist review the sale and purchase agreement in each situation before you sign it.
- 4.5 Better to be safe than sorry in court.

About Covisory

The Covisory Group specialise in International and Domestic Tax Services, Trust Management, Succession Planning, Strategic and Business Planning, Accounting Services and Business Valuations.

Established in 2007, The Covisory Group has grown from one business to four with a diversity of clients. Covisory clients are owners of family businesses, operating both in New Zealand and globally. Our team of specialists work either one-on-one or alongside our clients' team of professional advisers to develop appropriate short- and long-term solutions.

We build strong relationships with our clients based around trust, accessibility, and responsiveness. There is no 'one size fits all' about our services. Our solutions are bespoke to each client, drawing on our up-to-date specialist knowledge and our years of experience. providing one-on-one expert advice.

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