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A special report from
Policy and Strategy, Inland Revenue

GST and services connected with land

This special report provides early information on changes to the Goods and Services Tax Act 1985, recently enacted in the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017.

The changes apply goods and services tax (GST) to a wider range of services, particularly professional services, supplied to non-residents who are outside of New Zealand and which closely relate to land in New Zealand. The new rules will similarly ensure that, when these services are provided in relation to land outside New Zealand (whether to residents or to non-residents), they are not charged with GST.

Information in this special report precedes full coverage of the new legislation, which will be published in the June edition of the *Tax Information Bulletin*.

Application date

The new rules came into force on 1 April 2017.

Key features

Scope of the new GST rules for services connected with land

From 1 April 2017, GST will apply to an expanded range of services, particularly professional services, which are closely related to land in New Zealand. These services will be zero-rated where they relate to land outside New Zealand.

The new rules supplement the existing “directly in connection” with land test by adding an additional test.

Services relating to land in New Zealand

Under the expanded rules, GST will apply to services that are supplied in connection with land in New Zealand and which are “intended to enable or assist a change in the physical condition, or ownership or other legal status” of the land.

Services relating to land outside New Zealand

Supplies of services that are directly in connection with land outside New Zealand are already zero-rated under the current GST legislation. The new test extends the zero-rating treatment to services supplied in connection with land outside New Zealand when they are intended to enable or assist a change in the physical condition, ownership or other legal status of the land.

Application of the new test

The requirement that the services be supplied in connection with land (as described in the amendments) is intended to differentiate between services that have a close connection with specific land (such as those relating to the purchase of a specific property) that can therefore be regarded as consumed in New Zealand, and services that relate to land more generally (such as seeking general advice on land law or the housing market in New Zealand).

Under the new test, the relevant services must be intended to enable or assist a change in the physical condition, ownership or other legal status of the land or improvement. The reference to “services intended to enable or assist a change in physical condition” ensures that services that form an integral part of a process of physically changing the land, but do not do so themselves (such as engineering or architectural services), are captured.

By adding to services connected with land services which are “intended to enable or assist a change in the... ownership or other legal status of the land”, a variety of professional services (such as legal or real estate agents’ services as part of a land transaction) are expected to be included because the intended outcome is to change the legal nature of the land, even though the services do not involve any physical change or connection to the land.

This will ensure that the GST treatment stems from the location of the land as a proxy for where the services are effectively consumed (consistent with the destination principle and with international practice), rather than the location or residence status of the recipient of the services. This also better aligns the treatment of services provided to non-resident purchasers of New Zealand land so that these services will be subject to GST at 15%, consistent with similar services provided to resident purchasers.

Background

New Zealand’s GST is a tax on consumption and a key concept underpinning the GST framework is the destination principle. Under this principle, supplies of goods and services are taxed in the jurisdiction where the goods and services are consumed. This means that services supplied to non-residents who are outside New Zealand will generally be either zero-rated or not included in the GST base. This is based on the presumption that the goods or services will be consumed overseas.

There is an exception to this for services supplied directly in connection with land. In this situation, the most appropriate place of taxation is the jurisdiction where the land is located. Hence, services supplied to non-residents who are outside New Zealand at the time the services are performed are not zero-rated when the services are supplied directly in connection with land situated in New Zealand. Based on the same principle, services that are

supplied directly in connection with land *outside* New Zealand are zero-rated (GST levied at 0%).

These rules for taxing land-related services are consistent with the “place of taxation” rules set out in the OECD’s *International VAT/GST Guidelines* (“the *Guidelines*”). The *Guidelines* suggest that taxing rights over certain services connected with land may be allocated to the jurisdiction where the property is located. In particular, the *Guidelines* suggest that this treatment may be appropriate for:

- supplies of immovable property itself or the right to use that property;
- supplies of services physically provided to the immovable property itself; and
- other supplies of services with a very close, clear and obvious link or association with the property.¹

In the case of a number of services in the third category above, Inland Revenue’s interpretation (based on the leading cases *Malololailai Interval Holidays New Zealand Ltd v Commissioner of Inland Revenue* (1997) 18 NZTC 13,137 and *Wilson & Horton Ltd v Commissioner of Inland Revenue* (1994) 16 NZTC 11,080) is not consistent with the *Guidelines*. The “directly in connection” test has been interpreted more narrowly than may have been intended by the original policy: therefore a number of services in the third category are unlikely to satisfy the “directly in connection” test.

This has resulted in the potential exclusion of professional services such as architectural, real estate or legal services, which are supplied with the intention of facilitating a change in the legal or physical nature of the land, but do not involve a more physical intervention with the land.

In addition, the New Zealand interpretation of the “directly in connection” test is not aligned with the international approach. Misalignment with the approaches of other countries gives rise to a risk of some services being taxed in more than one jurisdiction, or not being taxed in any jurisdiction at all.

The new rules are designed to ensure that New Zealand’s legislation reflects the policy intent and international practice. They also better align the treatment for non-resident purchasers of New Zealand land with that for resident purchasers.

¹ Guideline 3.8.

Detailed analysis

References are to the Goods and Services Tax Act 1985 unless stated otherwise.

Scope of the new GST rules for services connected with land

The general place of supply rules

The GST Act imposes GST on goods and services supplied in New Zealand. The Act adopts a broad set of rules to determine whether a good or service is considered to be supplied in New Zealand.

If a New Zealand-resident person supplies services, the supply is treated as having been made in New Zealand, and is therefore subject to GST. Where a non-resident person supplies services, the starting point is that the supply is treated as having been made outside New Zealand, and is therefore not subject to New Zealand GST.

However, under section 8(3), services supplied by a non-resident are treated as having been supplied in New Zealand (and are therefore subject to GST) if:

- the services are physically performed in New Zealand by a person who is in New Zealand at the time of performance (section 8(3)(b)); or
- the services are “remote services” supplied to a person resident in New Zealand (section 8(3)(c)).²

Rules applying zero-rating to supplies of services to non-residents

The place of supply rules in section 8 are followed by a range of exclusions that determine whether the supply is zero-rated or exempt rather than taxed at the normal 15% rate.

Subject to a few exceptions (for example, services directly connected with land or with moveable personal property), section 11A(1)(k) applies to zero-rate supplies of services made in New Zealand to non-residents who are outside New Zealand at the time the services are performed. New section 11A(1)(k)(i) excludes from zero-rating services that are supplied in connection with land in New Zealand (or with an improvement to New Zealand land) and which “are intended to enable or assist a change in the physical condition, ownership or other legal status” of the land, in addition to services which are supplied directly in connection with land situated in New Zealand.

² Note that there are exceptions for services supplied by non-residents to GST-registered businesses. Section 8(4) provides that if a supply (that is not of a remote service) is made to a GST-registered business for the purposes of carrying on their taxable activity, the services are considered to be supplied outside New Zealand, and therefore not subject to GST, unless the parties agree that GST will apply. Section 8(4D) similarly provides that if remote services are supplied to a GST-registered business for the purposes of carrying on their taxable activity, the services are treated as having been supplied outside New Zealand. The services are therefore not subject to GST unless the non-resident supplier chooses to treat the services as being made in New Zealand (no agreement is required between the supplier and recipient for this purpose). If the supplier chooses to treat the supply of remote services as being made in New Zealand, the supply will be zero-rated under section 11A(1)(x).

Hence, under the new test, services relating to land located in New Zealand will not be zero-rated but will be subject to GST at the standard rate of 15% when:

- their supply is directly in connection with land or an improvement to the land (the current test); or
- their supply is in connection with land in New Zealand or an improvement to the land, and are intended to enable or assist a change in the physical condition, ownership or other legal status of the land or improvement.

Example 1

Serj is a non-resident who owns a parcel of land in Andersons Bay, Dunedin. He initially intended to have a house constructed on it as his own personal home for when he moves to New Zealand. However, his immigration plans have fallen through, so he now intends to sell the land. He arranges by email for the New Zealand land to be advertised for sale in a New Zealand newspaper. The supply by the newspaper of advertising services does not qualify for zero-rating under section 11A(1)(k), as the exclusion in paragraph (i) applies: the advertising services are supplied in connection with New Zealand land and are intended to assist a change in the ownership status of the land. The newspaper must therefore add 15% GST to the cost of advertising Serj's property.

Example 2

Cynthia is a British resident who is looking at buying a holiday home in New Zealand. While still based in her home in London, she seeks general information from a New Zealand-based property valuation firm on the range of property market values for each region that she is considering in order to determine which areas are affordable for her budget. She also engages a New Zealand-based accountancy firm to advise her on the general tax implications of investing in land in New Zealand.

Cynthia decides to submit a tender (through a real estate agent) for an empty lot of land in the Coromandel, where she intends to build a holiday home. Before submitting the tender, she engages a New Zealand-based solicitor to provide her with legal advice and undertake the conveyancing work. She again phones the property valuation firm – this time to ascertain the market value of the Coromandel property. After her tender is accepted by the vendor, she hires a New Zealand architect to draw up the building plans.

The supply of property valuation services (relating to the New Zealand housing market generally by region) and the provision of general advice relating to the tax implications of investing in New Zealand property are both zero-rated under section 11A(1)(k). This is because neither of these services are directly connected with land, nor do they have a sufficient nexus with any specific piece of New Zealand land to be “intended to enable or assist a change in the physical condition, or ownership or other legal status” of land in New Zealand.

However, the conveyancing and architectural services, the services provided by the real estate agent and the valuation services specifically relating to the Coromandel property do not qualify for zero-rating under section 11A(1)(k), as the exclusion in paragraph (i) applies. These services are supplied in connection with specific land in New Zealand and are intended to assist or enable a change in the ownership status or physical condition of that land. These supplies are therefore charged with GST at 15%.

Even if Cynthia's tender had not been accepted by the vendor, the legal and valuation services relating to the Coromandel property would, on an objective assessment of Cynthia's intention in respect to the Coromandel property, still be charged with GST at 15% because they are *intended* to assist a change in the ownership status of the land. Similarly, if Cynthia had decided not to proceed with constructing a building on the site after the plans were drawn up, the architectural services would still be charged with GST at 15% as they are related to specific land and were, at the time of supply, intended to assist a change in the physical condition of the land.

Example 3

Gary is a non-resident who is interested in buying a house in New Zealand. During his search on the internet, he finds ten different properties of interest to him. To help him compare each property, he places an order through the website of a New Zealand property valuation firm for an electronic set of valuation reports for each property that he is interested in. Each report includes a valuation generated by an electronic algorithm, based on recent sales of properties which are both nearby and comparable to the property for which the valuation is requested.

Although the valuation services do relate to specific land in New Zealand (each valuation report ordered is for a specific title of land), the valuation services cannot objectively be said to be intended to enable or assist a change in the legal nature or ownership status of any of those specific titles of land, as it would be reasonable to assume that Gary does not have a specific intention to purchase all ten properties. (In this case, the property valuation services would be considered to be too many steps removed from the process of changing the ownership status of any one of those ten specific properties.) The supply of property valuation services is therefore zero-rated under section 11A(1)(k) (as they would have been under the existing “directly in connection” test).

Example 4

Nehal is an Australian resident who is looking to invest in New Zealand real estate. During his search on the internet, he discovers a large lot of empty land in the Northern Wellington area which he thinks would be perfect for subdividing and constructing two large multi-storey houses. He hires Tamati, a New Zealand resident, to act as his agent in tendering for the property.

The tender submitted by Tamati for the land is successful, and from his home in Sydney Nehal begins planning for developing the land. He hires Paul, a New Zealand-resident lawyer based in Wellington to perform the conveyancing and subdivision work. When construction begins, Nehal hires a Wellington-based on-site construction supervisor, Rachel, to ensure that the work is done in accordance with building codes and that all of the necessary documentation is produced. Nehal also engages a Wellington-based structural engineering firm to carry out independent anti-seismic evaluations during the later stages of the construction work to ensure the structural soundness of the two buildings.

GST is charged at 15% on Tamati, Paul and Rachel’s services, as well as the services supplied by the engineering firm. Tamati and Paul’s services are supplied in connection with land in New Zealand and are intended to enable a change in the legal status of the land. The on-site construction supervision and engineering services are supplied in connection with land in New Zealand and are intended to assist a change in the physical condition of the land or improvements to the land.

Example 5

Aiko is a Japanese resident who is considering investing in commercial property owned by B Co., a New Zealand company which owns a range of other assets in addition to the commercial property. From her office in Tokyo, Aiko engages a New Zealand-based accounting firm that offers audit and assurance services to audit B Co.'s financial accounts. B Co.'s financial statements include the details of the rental yield of the commercial property.

Because the audit services could be used as a means of deriving a valuation of the commercial property owned by B Co., this scenario may appear to be similar to the situation outlined in Example 2 where a real estate valuation for a specific property was obtained with the intention of changing the ownership status of the land in New Zealand. However, the services concerned here are the audit of the company accounts of B Co. (as opposed to being valuation services more directly related to the land owned by B Co.). As such, the services do not have a sufficient nexus with the land to meet the new legislative test for services supplied in connection with land in New Zealand.

The audit services are therefore zero-rated under section 11A(1)(k) (as they would have been under the existing "directly in connection" test).

Zero-rating of services supplied in connection with land outside New Zealand

Amended section 11A(1)(e) extends zero-rating beyond the existing "directly in connection" test to services that are supplied in connection with land situated outside New Zealand, and which are intended to enable or assist a change in the physical condition, ownership or other legal status of the land.

Example 6

Maraina is looking to purchase an apartment in Brussels so that she can be closer to Melissa, her twin sister. Maraina engages a New Zealand-resident lawyer, Gordon, to act for her in a transaction to acquire an apartment. Gordon's services are in connection with land outside New Zealand and are intended to enable a change in the legal nature of the offshore land. His services are therefore zero-rated under section 11A(1)(e).

Maraina's residency status or location does not affect the application of the rule for services connected with land outside New Zealand.

Table 1 provides an indication of the usual treatment of some common services under the new GST rules for services connected with land.

Table 1: GST treatment of common services connected with land – some examples

Type or purpose of services	Examples	GST treatment
Intended to enable or assist a change in the physical condition of land	<ul style="list-style-type: none"> • Construction • Earthworks 	Covered by the existing “directly in connection” test
	<ul style="list-style-type: none"> • Architectural services • Engineering • Construction supervision 	Covered by the new test
Intended to enable or assist a change in the ownership or other legal status of land	<ul style="list-style-type: none"> • Real estate services • Legal services, for example conveyancing • Valuation services • Advertising or marketing services 	Covered by the new test
General services not connected to a specific piece of land	<ul style="list-style-type: none"> • Valuation services for the general property market • General legal services, for example advice on the tax implications of investing in land 	Not covered by the new test