



WEEKLY COMMENT: FRIDAY 16 JANUARY 2015

1. I am going to start my review of the GST developments by looking at time of supply issues. As noted last week:
 - (a) Inland Revenue published QB 14/10: *Goods and services tax – Whether a binding contract always establishes a transaction giving rise to a supply for section 9(1) purposes* in *Tax Information Bulletin* Vol. 26, No. 10, November 2014 p. 32; and
 - (b) In *TRA 023/12*, [2014] NZTRA 10, the Taxation Review Authority had to decide whether the time of supply of newly subdivided land was before or after the GST rate increased from 12.5% to 15% on 1 October 2010. One of the issues in the case was the time at which the Agreements became binding.

Rule for establishing time of supply

2. The time of supply for GST purposes is set out in s. 9(1) of the *Goods and Services Tax Act 1985* (“the GST Act”) as follows:

“Subject to this Act, for the purposes of this Act a supply of goods and services shall be deemed to take place at the earlier of the time an invoice is issued by the supplier or the recipient or the time any payment is received by the supplier, in respect of that supply.”
3. Inland Revenue stated in IS 10/03 *GST: Time of supply – payments of deposits, including to a stakeholder*, published in *Tax Information Bulletin* Vol. 22, No. 6, July 2010:

“Before section 9(1) will apply, it is necessary to establish there is a transaction giving rise to a supply that is chargeable with GST. Section 9(1) is a timing-only provision, and it will only apply to fix the time of supply if there is a transaction giving rise to a supply. In determining whether a transaction giving rise to a supply exists, the legal arrangements entered into between the parties must be considered. Where there is a binding contract, such a transaction is assumed. Where there is no contract, the existence of a transaction giving rise to a supply will be established where there are reciprocal obligations between the parties.”

QB 14/10

4. It is noted in QB 14/10 that the operation of s. 9(1) does not depend on the actual making of a supply. However, when a supply has not been made, it must be established that there is a transaction giving rise to a supply in order for a payment of a deposit or the issue of an invoice to trigger a time of supply.

5. There is not a great deal of discussion regarding what constitutes a binding contract. It is stated that “a binding contract is one where the requirements of the contract are satisfied”. Reference is made to the requirements being offer and acceptance, an intention to be bound and certainty as to the essential terms of the contract, and to some supporting case law including *Wilmott v Johnson* [2003] NZCA 309, [2003] 1 NZLR 649 (CA). The case concerns a sale to a trust and contains a good discussion of the principles underlying when parties become bound by a contract.
6. It is noted that there will usually be a transaction giving rise to a supply for s. 9(1) purposes where a binding contract exists under which the supplier has an obligation to make a supply, and reference is made to some supporting case law including *Rob Mitchell Builder Ltd (in liquidation) v National Bank of New Zealand* [2003] NZCA 276, (2004) 21 NZTC 18,397 (CA). In that case it was held that a supply of land had been made prior to the company going into liquidation when the agreement became unconditional and the deposit, which had previously been held by the agent as stakeholder, was released to the company’s solicitors.
7. There are three situations considered in QB 14/10 in which a binding contract will not establish a transaction giving rise to a supply:
 - (a) When the making of the supply is factually or legally impossible from the outset: In *TRA 024/07* [2009] NZTRA 11, *Case Z16* (2009) 24 NZTC 14,179, the disputants did not have ownership of the property and, therefore, could not make the sale. A recipient does not have to cancel the contract in order for it to be ineffective, and a court will not enforce performance.
 - (b) When the making of a supply becomes factually or legally impossible: the events discussed occurring after a contract that might make it impossible include when the goods did not come into existence (because they did not end up getting made as anticipated), or when a vendor did not obtain ownership of the property to be sold, as in *Ch’elle Properties (NZ) Ltd v CIR* (2004) 21 NZTC 18,618 (HC).
 - (c) When the contract is used to commit fraud, or is a sham or some other legally ineffective contract: for example, if the supplier never intended to make the supply, or a contract is a sham, as discussed in IG 12/01: Goods and services tax; income tax – ‘sham’, published in *Tax Information Bulletin Vol. 24, No. 7, August 2012, p.3.*

GST treatment when a transaction giving rise to a supply is not established

8. If the making of a supply is factually or legally impossible from the outset, or the contract is a sham or legally ineffective, there will be no supply and consequently, no time of supply for the purposes of s. 9(1).
9. When the making of a supply becomes factually or legally impossible, there could be a supply initially, and the GST treatment will depend on whether the supply became impossible in the same GST period as the supply was made under s. 9(1), or in a later GST period:
 - (a) If the supply becomes factually or legally impossible after the time of supply under s. 9(1) has been triggered, but during the same taxable period, no supply can be attributed to that taxable period under s. 20. There is no supply. To the extent that the view expressed in *Question We’ve Been Asked: GST consequences of a cancelled contract* published in *Tax Information Bulletin Vol. 17, No. 4, May 2005, p. 26* is inconsistent with this it should not be relied on.

- (b) If the supply becomes factually or legally impossible after the time of supply under s. 9(1) has been triggered, and in a later taxable period, there will be a supply, and s. 25 will apply to reverse the GST consequences in the taxable period when it becomes apparent that the supply could not be made.
10. In the latter case, even if the supply is initially accounted for correctly, the Commissioner has the right to withhold a GST refund if the Commissioner investigates the return or the Commissioner becomes aware the contract cannot proceed before the refund is paid. This is because any refund would be immediately recovered: *Riccarton Construction Ltd V CIR* [2010] NZHC 813, (2010) 24 NZTC 24,191 (HC).

Examples

11. There are five examples provided in QB 14/10. Interestingly, the examples refer to three issues that are not discussed in the main body:
- (a) Whether an invoice can be issued “in respect of that supply” as required by s. 9(1);
 - (b) Whether a deposit payment can be made “in respect of that supply”; and
 - (c) The need for an amendment to an assessment under s. 113 of the *Tax Administration Act 1994* (“the TAA”).
12. These issues are considered in *TRA 023/12* discussed below. The examples in QB 14/10 are as follows:
- (a) **Example 1:** A contract to sell the Auckland Harbour Bridge will not establish a transaction giving rise to a supply because the Bridge is in public ownership. An invoice cannot be issued and even if issued, it will not meet the s. 2 definition of “invoice”. If incorrect GST returns have been filed, the assessment will require amendment under s. 113 of the TAA.
 - (b) **Example 2:** An invoice is issued and a deposit paid under a contract to acquire a unique movie car that has, unbeknown to the parties, been destroyed in a fire. The contracts are void on the grounds of a common mistake and neither the invoice nor the deposit can be “in respect of that supply”. If incorrect GST returns have been filed, the assessment will require amendment under s. 113 of the TAA.
 - (c) **Example 3:** A company grants a licence to use a patent when it did not hold any rights in the patent. The making of a supply is impossible. An invoice cannot be issued and even if issued, it will not meet the s. 2 definition of “invoice”. If incorrect GST returns have been filed, the assessment will require amendment under s. 113 of the TAA.
 - (d) **Example 4:** A supply of computers could not be made because the supplier could not obtain the equipment. No invoices were issued or deposits paid. There is no supply and if incorrect GST returns have been filed, the assessment will require amendment under s. 113 of the TAA.
 - (e) **Example 5:** A car being imported from Japan for which an invoice has been issued and a deposit received falls off the boat in rough seas. A supply has been made and a credit note will need to be issued under s. 25(3) of the GST Act. It is noted that if it comes to the Commissioner’s attention that the transaction cannot proceed before the refund is paid, the refund will be withheld.

NZTRA 10: AB Family Trust v CIR

13. The time of supply for GST purposes was the reason for the dispute in *TRA 023/12*, [2014] NZTRA 10. The AB Family Trust was engaged in the subdivision of land and entered into agreements for the sale and purchase of four Lots of land before the subdivision had been completed. Each agreement was conditional upon the issue of a certificate of title and upon satisfying s. 225 of the *Resource Management Act 1991* (“the RMA”). Deposits were paid into the Trust’s lawyers’ trust account to be held by that firm as stakeholder.
14. Before the GST rate increased to 15% on 1 October 2010, the Trust issued documents dated 29 September 2010 purporting to be GST tax invoices. The Commissioner alleged they were not invoices because there was no obligation to pay at that time. The Commissioner maintained the supply occurred when the stakeholder status ended and the deposits were held on the Trust’s behalf. This occurred in November 2010, when notice that the certificates of title had been issued was received by the lawyers, who advised the Trust accordingly.
15. As noted in paragraph 2, the time an invoice is issued can trigger the time of supply. An invoice is defined in s. 2 of the GST Act as “ a document notifying an obligation to make payment”. The Commissioner submitted that it is not enough for an invoice to notify someone of a conditional or contingent obligation.
16. The Commissioner’s submissions included a discussion about the differing views expressed in the High Court in *Shell New Zealand Holding Co Ltd v Commissioner of Inland Revenue* (1993) 15 NZTC 10,136 (HC) and the Court of Appeal in *Shell New Zealand Holding Co Ltd v Commissioner of Inland Revenue* [1994] 3 NZLR 276 (CA). In the High Court, Heron J thought an “immediate liability for payment is contemplated”. In the Court of Appeal Richardson J stated that “... it is both unnecessary and uncommon in practice for commercial invoices to specify time for payment ... The time for payment is not part of the definition (of “invoice”)”.
17. The Trust contended that:
 - (a) From the time the purchasers signed the agreements and paid the deposits the agreements were a “legally binding obligation” on the purchasers and the vendor, and it was at this stage that the obligation to make payment arose;
 - (b) By the date the invoices were issued, the Trust and the purchasers had rights of specific performance because an equitable interest in the land was created on receipt of the deposit, at which time the Agreements were able to be sued upon and obligations existed on the Trust and the purchasers to complete the sale and purchase; and
 - (c) The time of supply can be triggered when an agreement is still subject to s. 225(1) of the RMA.
18. The Commissioner contended that:
 - (a) There is no debt due while a contract is still conditional;
 - (b) An agreement subject to s. 225 of the RMA was conditional, following the Court of Appeal decision in *Steele v Serepisos* [2005] NZCA 236, (2005) 7 NZCPR 145 (CA) and the Supreme Court decision in *Steele v Serepisos* (2006) NZSC 67: In the Supreme Court Tipping J noted that s. 225(1) was permissive insofar as it allowed contracts to be entered into prior to the deposit of the plan but necessarily subject to its deposit;
 - (c) There can be no obligation to make payment until there is a debt due: the deposit was not payable to the Trust, but was payable to the “stakeholder”;

- (d) As long as a contract remained conditional, no purchase price was payable, no supply had taken place and no tax invoice could lawfully be issued, following *R v Hawken* (2006) 22 NZTC 19,876 (CA).
19. Judge AA Sinclair agreed with the Commissioner that the obligation to make payment referred to in the definition of “invoice” must be a present obligation even if payment is made at a future date. There cannot be an obligation to make payment until there is a debt due, and there cannot be a debt due until the supplier has completed all that is required to demand payment. The Supreme Court in *Steele v Serepisos* held that an agreement subject to s. 225(1) of the RMA was conditional.
20. The Judge also noted that the deposit could not trigger a time of supply while it was held by a person as a stakeholder, following *CIR v Dormer* (1997) 18 NZTC 13,446 (HC).
21. The Judge found that the documents purporting to be invoices issued in September 2010 were not invoices for the purposes of the GST Act because there was no obligation to make payment while the Agreements remained conditional.
22. However, once the agreements became unconditional in November 2010, the time of supply was triggered when the stakeholder status ended and the deposits were held on behalf of the Trust. At that point the requirements of the contracts were satisfied and the contracts were binding on the Trust and the purchasers.



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