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WEEKLY COMMENT: FRIDAY 30 JANUARY 2015

1. This week I continue looking at GST developments. I am going to look at 2 draft public rulings released for public consultation in November 2014. Both draft rulings are reissues of previously issued rulings:

   (a) Draft Public Ruling PUB0207 *GST – legal services provided to non-residents relating to transactions involving land in New Zealand* is a reissue of BR Pub 10/09 *Legal services provided to non-residents relating to transactions involving land in New Zealand* published in *Tax Information Bulletin* Vol. 22, No. 9, October 2010, which expires on 20 May 2015. Minor amendments have been made to reflect the introduction of s. 11A(3B); and

   (b) Draft item PUB00212 *Goods and Services Tax – Fishing quota – Secondhand goods input tax deductions / Goods and Services Tax – Coastal permits and certificates of compliance – Secondhand goods input tax deduction* contains two draft rulings, which are a reissue of BR Pub 09/04 and BR Pub 09/05. The rulings are to apply for an indefinite period beginning on 1 July 2014. The changes reflect the new "use" or "available for use" test and a clarification of the law by the New Zealand courts on the nature of fishing quota since the original rulings were issued.

GST on legal services to non-residents for transactions involving land

2. Draft Public Ruling PUB0207 *GST – legal services provided to non-residents relating to transactions involving land in New Zealand* states that legal services relating to land in New Zealand supplied to a non-resident who is not in New Zealand at the time the legal services are performed are zero-rated under s. 11A(1)(k) of the *Goods and Services Tax Act 1985* ("the GST Act").

3. Section 11A(1)(k) provides for the zero-rating of services supplied to a non-resident who is outside New Zealand at the time the services are performed, other than services which are:

   (i) Supplied directly in connection with:

      (A) Land situated in New Zealand or any improvement to the land; or

      (B) Moveable personal property, other than choses in action, temporarily imported goods or goods in transit through New Zealand, situated in New Zealand at the time the services are performed; or

   (ii) The acceptance of an obligation to refrain from carrying on a taxable activity, to the extent that the activity would have occurred within New Zealand.

4. The meaning of the phrase "supplied directly in connection with" is discussed and several cases are referred to:

   (a) In *Case E84* (1982) 5 NZTC 59,441 it was stated: "It is clear that no hard and fast rule can be or should be applied to the interpretation of the "in connection with". Each case depends on its own facts."

   (b) In *Auckland Regional Authority v CIR* (1994) 16 NZTC 11,080 (HC) the supply of airport terminal services and garbage disposal charges were held to be "ancillary" to the supply of international transportation, and therefore could not be zero-rated. It is stated in the ruling that the case suggests a service may not be directly in connection with an item (international travel) even if it could not have been performed without the existence of that item.

   (c) In *Wilson & Horton Ltd v CIR* (1994) 16 NZTC 11,221 (HC) the "one step removed" criterion was introduced. Goods in New Zealand that were the subject of advertising were held to be "at least one step removed from the services supplied by the newspaper proprietor" and therefore could be zero-rated. The analogy provided by the judge was of painting services for a ship (which would be directly in connection with) as opposed to services provided to passengers or crew (which would not be directly in connection with the vessel).

   (d) In *CIR v Suzuki New Zealand Ltd* (2000) 19 NZTC 15,819 (HC) the repair services to motor vehicles in New Zealand provided by the importer were held to be equivalent to "painting the ship" in the analogy given in *Wilson & Horton*. It was not necessary for the non-resident to own the property.

   (e) In *Malololailai Interval Holidays New Zealand Ltd v CIR* (1997) 18 NZTC 13,137 (HC), the judge noted that the use of the "directly" narrows the scope of the phrase "directly in connection with". Consequently, marketing services supplied in New Zealand were held to be "one step removed" from being directly in connection with the land in Fiji. However, services that have a physical effect on the land such as gardening or repairs or improvements to land are directly in connection with land.

   (f) In *Case T54* (1998) 18 NZTC 8,410, services including filming in New Zealand that resulted in the supply of a videotape produced and supplied overseas were held to be not directly in connection with moveable personal property in New Zealand, because the personal property in question, the videotape, did not exist at the time the filming occurred in New Zealand. It was noted in the case that it would not be possible to argue that land did not exist before legal services were provided.

5. Based on the above, the following conclusions are drawn in the ruling:

   (a) Legal services relating to transactions involving the sale and purchase of land in New Zealand are "one step removed" from the actual sale and purchase transaction. Therefore, they can be zero-rated.

   (b) The same reasoning applies to legal services relating to transactions involving the lease, licence or mortgage of land in New Zealand, or legal services relating to easements, management agreements, construction agreements, trust deeds, guarantees and other agreements concerning land in New Zealand.

(c) Legal representation in disputes relating to land in New Zealand are also one step removed from the land and can be zero-rated.

6. Section 11A(1)(k) requires the non-resident recipient of the supply to be outside New Zealand at the time the services are performed. Sections 11A(2), 11A(3) and 11A(3B) expand on this requirement.

7. Section 11A(2) is an anti-avoidance provision, which is designed to ensure that services actually consumed in New Zealand are not able to be zero-rated simply through a non-resident contracting for the supply of such services. This covers situation such as the one in *Wilson & Horton* in which New Zealand sellers benefited from advertisements place by non-residents. It will also cover payments by non-residents for services consumed by expatriates in New Zealand and fees paid by non-residents for education services consumed in New Zealand.

8. Sections 11A(3) and 11A(3B) provide concessions for "minor presence" in New Zealand – s. 11A(3) in relation to non-resident companies and unincorporated bodies, and s. 11A(3B) in relation to natural persons. Services can continue to be zero-rated despite a "minor presence" in New Zealand, providing the presence is not effectively in connection with the supply of the services (in the case of non-resident companies or unincorporated bodies) or not directly in connection with the supply of the services (in the case of non-resident natural persons).

9. The meanings of the phrases "minor presence" and "effectively connected" are considered in the ruling.

10. It is noted that "minor" is a relative expression. A minor presence is a presence that is relatively small or unimportant or incidental to the services being supplied. In determining whether a presence is minor, the relative size or importance of the presence of the entity or person when compared with the presence of the New Zealand supplier must be considered. This will involve a consideration of, inter alia, the relative numbers of people connected with the supply, the amount of time spent in connection with the supply by those people and the relative importance of the people to the services being supplied.

11. It is noted that the phrase "effectively connected" is broader then the phrase "directly in connection with". The supply can be more than one step removed from the presence. If the presence is attributable to the supply in question, then it is very likely that the presence will be effectively connected with that supply.

12. An example is provided of a US resident who comes to New Zealand temporarily. He returns to the US and continues to negotiate to buy land. The legal services can be zero-rated provided he is outside New Zealand when they are performed or he has only a minor presence in New Zealand that is not directly in connection with the supply of the services. Unfortunately, there is no indication of whether the facts given will amount to a minor presence or something more.

Fishing quota and coastal permits: no secondhand goods input tax deductions

13. Draft item PUB00212 *Goods and Services Tax – Fishing quota – Secondhand goods input tax deductions / Goods and Services Tax – Coastal permits and certificates of compliance – Secondhand goods input tax deduction* concerns whether an input tax deduction will be

available to a GST-registered buyer when an unregistered seller sells their fishing quota, coastal permits or certificates of compliance.

14. Section 20(3) of the GST Act provides that a person may deduct input tax paid in relation to the supply of secondhand goods to the extent that a payment in respect of that supply has been made during the taxable period.

15. The fundamental requirement is that fishing quota, coastal permits or certificates of compliance must be "secondhand goods". Therefore, they must firstly be "goods" and the goods must be "secondhand".

16. The GST definition of "goods" in s. 2 includes all kinds of real and personal property, but excludes choses in action, money and electronic products. It is necessary to examine the nature of fishing quota, coastal permits and certificates of compliance to see if they meet the definition.

17. Fishing quota that are considered in the ruling are individual transferable quota and annual catch entitlements as defined in s. 2 of the *Fisheries Act 1996*. An individual transferable quota generates an "annual catch entitlement" on the first day of the fishing year. The annual catch entitlement confers the immediate right to catch fish in a given year. An individual transferable quota and the annual catch entitlement may be transferred together or separately. An owner may sell their annual catch entitlement while retaining the individual transferable quota, which will generate another annual catch entitlement in the following year. Individual transferable quota can be used as security and have interests registered against them.

18. The courts have confirmed that both individual transferable quota and annual catch entitlements are property:

    (a) In *NZ Fishing Industry Association (Inc) v Minister of Fisheries* (CA 82/97, 22 July 1997) Tipping J stated at 16 that "quota are undoubtedly a species of property".

    (b) In *Sanford Ltd v NZ Recreational Fishing Council Inc* [2008] NZCA 160 (CA) a fishing quota was stated to be a "property right".

19. The conclusion in the ruling is that fishing quota and annual catch entitlements are property and they have the fundamental characteristics in that they are capable of being owned and the rights of ownership are capable of being transferred.

20. However, both individual transferable quota and annual catch entitlement also have the fundamental characteristic of a chose in action, in that the right cannot be taken into physical possession. The right to catch fish can be distinguished from actually catching the fish, and in *Antons Trawling Co Ltd v Smith* [2003] 2 NZLR 23 (HC) Baragwanath J stated at [5] that individual transferable quota are statutory choses in action.

21. Therefore, the exclusion for choses in action applies to fishing quota and annual catch entitlements, and they are not "goods" for GST purposes. Therefore, no secondhand goods input tax deduction can be claimed when they are acquired from an unregistered seller.

22. A coastal permit is a resource consent to do something in a coastal marine area that would otherwise contravene certain provisions of the Resource Management Act 1991. If an activity may be lawfully carried out without a resource consent, a certificate of compliance must be applied for instead.

23. Section 122(1) of the *Resource Management Act 1991* states that "a resource consent is neither real nor personal property". The conclusion in the ruling is that this restriction applies generally. Therefore, coastal permits and certificates of compliance are not "goods" for GST purposes.

24. As fishing quota, coastal permits and certificates of compliance are not "goods" for GST purposes, they cannot be secondhand goods, and a secondhand goods input tax deduction is not available.

25. The commentary on the rulings includes a brief discussion on the meaning of "secondhand". In *Case N16* (1991) 13 NZTC 3,142, Judge Barber accepted that the two key concepts underlying whether something is secondhand are previous ownership and previous use. The Court of Appeal confirmed this view in *LR McLean & Co Ltd v CIR* (1994) 16 NZTC 11,211. The Court also confirmed that it is not sufficient that the goods were previously owned. The more relevant factor is whether the goods have been previously used.

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