



WEEKLY COMMENT: FRIDAY 13 MARCH 2015

1. This week I look at draft Interpretation Statement INS0109: *Goods and services tax – GST and retirement villages* released on 25 February 2015 which is to update and replace IS 10/08 *Retirement villages – GST treatment* published in *Tax Information Bulletin* Vol. 22, No. 11 (December 2010).
2. IS 10/08 pre-dated the new apportionment rules and the new land transactions rules. These are now covered in this revision. However, transitional rules affecting retirement village operators when moving from the previous sets of rules to the new rules are not covered in the revised statement.
3. There are three main areas covered:
 - (a) The GST treatment of supplies made by retirement villages to their residents;
 - (b) The entitlement of retirement village operators to claim input tax deductions; and
 - (c) The GST treatment of land purchased or sold by retirement villages.
4. Retirement villages provide accommodation and community facilities to residents. Care and other services may also be provided. The Commissioner has concluded, based on research into the types of arrangements entered into and a range of contracts, that the main legal structures used to provide occupation rights are sales of units, and leases or licenses of units or accommodation.
5. Based on the research conducted, the typical financial flows are described in INS0109 as follows:
 - (a) **Upon entry:** A lump sum payment which is the purchase price of the unit or an interest-free loan or refundable deposit;
 - (b) **Additional fees upon entry (or exit):** A facilities fee or amenities contribution, either paid up-front upon entry or deducted from the repayment upon exit; the retirement village is either entitled to take the fee up-front or may be entitled to a portion of it per year over a period of years;
 - (c) **Periodic fees:** For village overheads such as rates, insurance, security, management and maintenance;
 - (d) **Additional periodic fees:** If additional services are required such as laundry, nursing and meals;

- (e) **Upon exit:** A repayment of the entry deposit or loan, or the purchase price of repurchasing the unit, but the repayment is often less than the entry payment, and residents may only be entitled to any capital gain on the sale of the unit if a higher entry payment was made;
- (f) **Additional fees upon exit:** Possibly additional fees for refurbishment of the unit and a termination fee for the legal costs of granting the occupation right.

GST treatment of supplies made by retirement villages

- 6. The principles stated by Richardson J in *Marac Life Assurance Ltd v CIR* (1986) 8 NZTC 5,086 (CA) apply to determine the nature of the supplies made by retirement villages. It is the legal arrangements actually entered into and carried out that are most relevant, not the broad substances of the arrangements. The legal rights and duties actually created are crucial, and the surrounding circumstances are only relevant insofar as they help to understand the setting in which the legal arrangements were entered into.
- 7. Retirement villages typically supply a package of services, so the issues discussed in *Auckland Institute of Studies v CIR* (2002) 20 NZTC 17,685 (HC) are relevant in determining the extent to which the package could be considered to be a single supply. The supply must be looked at from the perspective of the customer and the focus must be on the supply actually made, and not on whether it would be possible to separate it into several different supplies: *Commissioners of Customs and Excise v British Telecommunications Plc* [1999] UKHL 3, [1999] 3 All ER 961 (HL).
- 8. The supplies made by retirement villages could include:
 - (a) The provision of financial services in the form of:
 - (i) Debt securities through the issue or allotment of loans, deposits and repayment obligations; and
 - (ii) Participatory securities through the provision of entitlements to participate with other residents in the enjoyment of the village facilities;
 - (b) The supply of accommodation by way of a lease or licence;
 - (c) The supply of common areas and shared facilities;
 - (d) The provision of operating and maintenance services; and
 - (e) The supply of care services.

Provision of financial services

- 9. The Commissioner considers that a retirement village provides separate supplies of financial services, being:
 - (a) The issue or allotment of a debt security; and
 - (b) The issue of a participatory security.

10. The Commissioner considers that a retirement village provides a separate supply of a financial service in the form of the issue or allotment of a debt security when it accepts an obligation to repay a resident any portion of the entry payment or to repurchase a unit (but not if the retirement village merely has an option to repurchase the unit). The reasoning in INS0109 is as follows:
- (a) Debt security in s. 3 of the GST Act means any interest in or right to be paid money that is, or is to be, owing by any person: therefore, a resident's right to repayment of the entry deposit is a debt security;
 - (b) An arrangement under which a unit was sold on the basis that a retirement village would repurchase the unit at a specified price was held to be debt security by the Privy Council in *Culverden Retirement Village Ltd v Registrar of Companies* [1996] UKPC 50, [1997] 1 NZLR 257: therefore, a retirement village's obligation to repurchase a unit is a debt security (however, a mere option to repurchase will not result in a debt security because there is no obligation to pay); and
 - (c) A retirement village issues or allots a debt security when it accepts a prospective resident's offer: therefore, a retirement village provides a supply in the form of a financial service.
11. The Commissioner regards the issue or allotment of a debt security by a retirement village as a separate supply from the supply of accommodation and other services for the following reasons:
- (a) The situation can be distinguished from that in *CIR v Gulf Harbour Development Ltd* (2004) 21 NZTC 18,915, where the Court of Appeal found that the supply of a share, ownership of which conferred the right to membership of a golf club, was a single supply of a financial service – i.e. the share, which was an equity security.
 - (b) The conclusion that the supply by a retirement village of a debt security is separate from the supply of accommodation is supported by the finding of the Privy Council in *Culverden* that the purchaser acquired two rights: the right to occupy the unit and the right to be repaid the price paid for the unit.
12. The Commissioner considers that a retirement village provides a separate supply of a financial service in the form of the issue of a participatory security when it provides residents with rights to common areas and facilities to be enjoyed in common with other residents. The reasoning in INS0109 is as follows:
- (a) A participatory security for GST purposes is an interest to “participate in any capital, assets, earnings or other property” and also a right that forms part of a “contributory scheme”;
 - (b) The conclusion that the provision of rights to share common areas and facilities amounts to the issuance of a participatory security is supported by case law: in *Fenton v Pakuranga Park Village Trust* (1998) 3 NZ ConvC 192,681 (CA) the Court of Appeal held that the obligation under residents' licenses not to alter the basic scope and nature of the facilities was owed to residents as a group; in *Norfolk Apartments Ltd v CIR* (1995) 17 NZTC 12,003 (HC) a licence for an apartment in a retirement village was held to be a participatory security;
 - (c) The provision of rights to share common areas and facilities could form part of a contributory scheme if the retirement village involved more than five residents.

13. The provision of a financial service is an exempt supply. Services that are reasonably incidental and necessary to the supply of financial services are also exempt supplies. However:

- (a) Insofar as the provision of a debt security is concerned, the Commissioner does not accept that the supply of accommodation or other services is reasonably incidental and necessary to the supply of financial services by way of the debt security, because, debt securities are supplied to provide funding for the development of the retirement village, whereas the supply of accommodation and care facilities are separate core activities of a retirement village; and
- (b) Insofar as the provision of a participatory security is concerned, to the extent that the participatory security results in the supply of a right to accommodation for a concessional or nil consideration, the supply of accommodation is, if it is not itself an exempt supply, an “associated supply” as defined in s. 2, which is excluded by s. 14(1B) from being an exempt supply through being part of a financial service, following the amendment to address the court’s finding in the *Gulf Harbour* case (see **paragraph 11(a)** above).

14. The question of the consideration for the financial services is addressed as follows:

- (a) The Commissioner considers that the principal under a debt security is not to be treated as consideration for the supply of a debt security because it is effectively just a supply of money, therefore, the purchase price of a unit or the loan or deposit paid upon entry is not consideration for a debt security;
- (b) Where a participatory security confers a right to receive the supply of accommodation, and that accommodation is a taxable supply of a commercial dwelling, the consideration for that accommodation must be separately determined under the rules relating to an associated supply and, therefore, the question is what is the consideration for that accommodation, rather than what is the consideration for the participatory security.

The supply of accommodation

15. The Commissioner considers that the supply of accommodation is an essential feature of a retirement village contract, and involves the following elements:

- (a) The supply of a place to live;
- (b) The right to use common areas and facilities, which are:
 - (i) Appurtenances belonging to or used with the premises under paragraph (b)(ii) of the definition of “dwelling” in s. 2 (the Commissioner considers that the basis for the decisions in *Norfolk and Wairakei Court Ltd v CIR* (1999) 19 NZTC 15,202 (HC) is that the right to use common areas was an appurtenance (rather than the common areas themselves); or
 - (ii) Part of the supply of accommodation in any case, because without access to the common areas it would not be possible to exercise the right to occupy the dwellings;
- (c) Maintenance services to keep the unit and the village facilities in good repair;
- (d) Transport services, if any, supplied as part of the package of services.

16. The consideration for the supply of accommodation includes:

(a) The facilities fee or amenities contribution, which can be paid:

- (i) Up-front, in which case the supply is made at the time of the payment, regardless of whether the fee accrues to the retirement village over a period; or
- (ii) By deduction from the refundable loan or deposit upon termination, in which case there is a payment by way of set off under the principal in *Re Harmony & Montague Tin & Copper Mining Co Ltd (Spargo's Case)* (1873) 8 Ch App 407 (CA) and the supply is made at the time of the set off;

(b) Periodic fees (which could include payments for other services, such as care services, in which case the consideration for the other services must be separated out);

(c) Refurbishment costs and other termination charges if resident have to pay for refurbishment of their units on termination of occupation and that obligation is carried out by the retirement village (excluding costs incurred by a retirement village on its own account, such as costs of marketing a unit and obtaining a replacement resident and legal costs of preparing a new lease or licence).

Exempt supplies of accommodation

17. Whether the consideration is for a taxable or an exempt supply depends on whether the supply of the accommodation is “the supply of accommodation by way of hire, service occupancy agreement or licence to occupy in a dwelling”, which is an exempt supply under s. 14(1)(c).

18. The definition of “dwelling” in s. 2 was amended so that the requirement for “quiet enjoyment” would not exclude dwellings in retirement villages. Paragraph (b)(iii) of the definition includes “a residential unit in a retirement village or rest home when the consideration paid or payable for the supply of accommodation in the unit is for the right to occupy the unit”. A dwelling under paragraph (b)(iii) is excluded from being a commercial dwelling.

19. The focus must be on the terms of the agreement under which residents obtain a right to occupy a unit in a retirement village (generally a lease or a licence) to decide whether the consideration is for the right to occupy the dwelling.

20. The Commissioner considers that the ordinary meaning of paragraph (b)(iii) suggests that the consideration must be solely for right to occupy the unit. In *Wairakei* a package of services that included accommodation in a studio unit and nursing care was not excluded from being a commercial dwelling whereas accommodation in a stand-alone villa was excluded from being a commercial dwelling. Therefore, the Commissioner considers that paragraph (b)(iii) will not apply to units whose residents are required to purchase care packages.

21. Where the supply is within the meaning of paragraph (b)(iii), the right to use common areas and facilities, maintenance services and transport services will all form part of the exempt supply.

Taxable supplies of accommodation

22. The provision of accommodation in a “commercial dwelling” is a taxable supply. The definition of “commercial dwelling” includes convalescent homes, nursing homes, rest homes and hospices, and establishments of a similar kind. The definition also includes a services apartment managed or operated by a third party for which services in addition to the supply of accommodation are provided and in relation to which a resident does not have quiet enjoyment.
23. It is noted that in order for an establishment to be similar to a convalescent home or a nursing home, it need not be exactly the same. In *Case L75 (1989) 11 NZTC 1,435*, the premises were not the same as a hotel or motel, but shared some significant defining features which qualified them as a commercial dwelling. The Commissioner considers that the defining features of establishments like nursing homes is that they provide both accommodation and care.
24. A serviced apartment could potentially be either a dwelling or a commercial dwelling, depending on whether the consideration paid by the resident includes care services.

Input tax deductions when both taxable and non-taxable supplies are made

25. A retirement village could make both taxable supplies (by supplying accommodation in commercial dwellings) and exempt supplies (by supplying accommodation in dwellings). There will need to be an assessment made of the proportion of taxable and exempt supplies.
26. The provision of debt securities and participatory securities is not relevant to the determination of taxable versus exempt supplies, because they do not relate to the intended use of a building or other assets.
27. A full input tax deduction is allowed for a good or service that is intended to be used solely for making taxable supplies, such as the supply of commercial dwellings or care services. The Commissioner considers that to the extent that part of a community centre (such as kitchens, restaurants and nursing stations) is used for the preparation and provision of meals and the provision of nursing care, such an area would be used solely for the making of taxable supplies.
28. No input tax deduction is allowed for a good or service that is intended to be used solely for making exempt supplies, such as supplies of accommodation in a dwelling or a financial services. The Commissioner does not accept that the provision of accommodation in dwellings could be regarded as part of larger taxable supplies in the sense that they are a means of obtaining residents who eventually move into commercial dwellings where care services are available (i.e. the provision of such a “catchment” does not constitute a taxable supply).
29. Where goods and services are used for making both taxable and exempt supplies, the apportionment rules will apply.

30. Upon acquisition, the retirement village operator must estimate how they intend to use the goods or services:
- (a) For goods and services relating to a common area used for making both taxable and exempt supplies, the Commissioner considers the uses must be apportioned under s. 20(3G) choosing a determination that produces a fair and reasonable result, with taxable use expressed as a percentage of total use: any records available can be used, or previous experience and patterns if they are unchanged, or other methods, or even indirect methods based on turnover or profit for overheads that are not directly referable to particular supplies (*Tax Information Bulletin* Vol. 23, No. 1, February 2011, page 34).
 - (b) When constructing the village, the Commissioner considers that construction costs can be apportioned based on the overall plan – for example, if the plan is to provide 70% commercial dwellings and 30% dwellings, then the taxable/exempt apportionment could be 70/30, subject to there being objective factors to support the stated intentions, such as the nature of the development permitted by the resource consent, the disclosure statement required to be provided to prospective residents, and the form of the occupation right agreement intended to be entered into with residents.
31. At the end of each adjustment period, it is necessary to compare the actual use with the intended use. Where construction costs have been apportioned based on a plan, the Commissioner considers that “actual use” will be different, and an adjustment would be required, only if the plan itself has changed. Providing that is not the case, the apportionment can continue to be made based on the plan, until completion.
32. The other apportionment rules apply as follows:
- (a) The number of adjustments follow the apportionment rules: no limit for land, and the number of adjustment periods for other assets limited based on cost;
 - (b) If a good or a service is devoted entirely to a taxable or non-taxable use, the wash-up adjustment in s. 21FB must be performed;
 - (c) The concurrent use of land apportionment rule in s. 21E will only apply if the retirement village operator is in the business of buying and selling retirement villages, and the dwellings are leased or licensed in the interim; vertical stacking of commercial dwellings and ordinary dwellings does not amount to concurrent use in the context of s. 21E, and neither does the common use of land for a taxable and an exempt purpose, because s. 21E requires the complete use of the relevant land for each purpose;
 - (d) Where a good or services used for a mixed purpose is disposed of, the final input atx calculation under s. 21F must be performed.

Land purchased or sold by retirement villages

33. Where land is purchased by a GST-registered (prospective or current) retirement village operator from another registered person, the Commissioner is of the view that the zero-rating of land rule applies even if the purchaser plans to use the land only partly to make taxable supplies.
34. This will be the case when a retirement village operator acquires land with the intention of putting both dwellings and commercial dwellings on the land. The Commissioner contends

that the phrase “for making taxable supplies” is not limited to situations where the operator intends to use the land solely for making taxable supplies.

35. Moreover, the taxable supplies do not have to be made in the first adjustment period. The supply of land can be zero-rated where the operator’s overall aim or plan is to use the land wholly or partly for making taxable supplies and the plan is sufficiently well developed.
36. This means that, as the recipient of a zero-rated supply of land, the retirement village operator must identify the nominal GST component, determine the extent to which the land is to be used for making taxable supplies, and account for output tax on the proportion of the nominal GST component that corresponds to the non-taxable use, under s. 20(3J).
37. If the land is not zero-rated, the retirement village operator will need to determine the input tax deduction available under the apportionment rules.
38. When a retirement village operator purchases or sells an existing retirement village that has dwellings on it, it will be necessary to determine to what extent there is a separate supply of:
- (a) A principal place of residence under s. 5(15)(a); or
 - (b) A dwelling that has been supplied exclusively as a dwelling for a period of five years or more before the date of sale of the land.

Examples

39. INS0109 contains three examples:
- (a) **Example 1** concerns the establishment of a retirement village with licensed units that are mixture of dwellings (80%) and commercial dwellings (20%): the conclusions are consistent with the discussion above – i.e. that the retirement village operator must pay output tax under s. 20(3J) for the zero-rated supply, input tax deductions are not available in relation to the construction of the dwellings, and supplies used for common areas must be apportioned 80/20.
 - (b) **Example 2** concerns the establishment of a retirement apartment complex consisting of dwellings on land acquired from a non-registered seller: no input tax can be claimed on acquisition, and input tax can only be claimed on goods and services to the extent they relate to the specific provision of care services.
 - (c) **Example 3** concerns a rest home complex that is expanded to include villas where the rest home, which is a commercial dwelling, was acquired from a GST-registered seller as a zero-rated supply of land: the inclusion of the exempt villas will mean that a change of use adjustment must be made (which could potentially be based on turnover).



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