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Land Transactions

Despite the economic downturn and the changes to associated persons legislation, property transactions continue to take place, and tax issues still need to be considered. We discuss some of the more recent tax issues arising in relation to land transactions.

Beneficial Interest

For tax purposes, it is the sale of the beneficial interest in land that is relevant, rather than the transfer of legal title itself. The title to land can be held as trustee or agent under contract, and often we have to explain to IRD that a transfer is simply a change on the title but not a transfer of the underlying interest. For lawyers, the key aspect here is to document the transaction appropriately.

When the associated persons provisions were set to change there were a number of transfers of property that had to be completed before the effective date of 6 October 2009. In certain cases it was desirable to sell a portion of the subject property to a development entity, yet the subdivision of that land was not going to be completed before 6 October 2009 and there was doubt an unconditional sale could be triggered.

One option was to transfer the unsubdivided legal title to the purchaser but for the purchaser to hold the beneficial interest of the area to be retained by the vendor as bare trustee on the vendor's behalf. When the new subdivided titles became available the purchaser would transfer one title into the name of the vendor. For tax purposes, the appropriate tax treatment is a sale of the beneficial interest only.

This approach has recently been adopted by the High Court in *Junior Farms Ltd v CIR* (CIV 2009 -404-2870). In that case the whole of the land was sold to the purchaser with the vendor "buying back" 14 ha for \$100 and on selling it to the Council for \$3m. IRD treated the buyback as a separate transaction and acquisition with the intention of resale giving rise to income of \$2.9m.

The taxpayer appealed on the basis there was no sale of the beneficial interest in the 14 ha to the purchaser, and therefore no reacquisition of the 14 ha from the purchaser. The sale to the Council was a sale of land the vendor had owned for 20 years and was not taxable. The Court agreed with the taxpayer.

Partition Agreements

Partition agreements are useful when it is desirable to acquire land which is to have two uses, say one part for development and the other for long term investment. Certainly it is unwise to have a single entity acquire the entire property and seek to isolate the two activities.

A partition agreement will provide for the flexibility of having two entities jointly acquire the property, and for a subdivision to be undertaken in terms of the partition agreement. Each party acquires a separate beneficial interest which will be identified in the partition agreement and represented by a separate title in their respective names upon subdivision.

If you have any comments on this issue or suggestions for future topics, please contact Keith Turner on (09) 309 6505 or email keitht@nsatax.co.nz

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Some thought needs to be given as to how the subdivision work and expenditure is borne, and how GST affects the respective purchasers. Depending on the transaction, associated person issues may arise, such as whether the investment entity is affected by the ten year rule, or is able to acquire an original acquisition date beyond the ten years

GST Registered Vendors of Land – The New Rules in Action

GST registered vendors of land have traditionally been advised to contract on a plus GST basis, and the position has not changed under the compulsory zero rating land provisions.

Take the following recent example. A GST registered vendor sells bare land to a GST registered purchaser on a GST inclusive basis. The addendum to the sale and purchase agreement which covers the GST use of the property is not completed.

The GST registered purchaser later strikes a deal to sell the bare land contemporaneously at the same price to a non GST registered purchaser who intends to build the family home on the land. The price is again GST inclusive. As it currently stands it is the first GST registered purchaser who will be out of pocket for the GST content.

Realising this, the GST registered purchaser decides to cancel the on sale and nominate the non GST registered purchaser to complete the sale. The original GST registered vendor receives advice of the nomination the day before settlement, and confirmation the nominee is not GST registered and intends to use the land as a principal place of residence.

Has the GST registered purchaser passed the GST problem back to the vendor? Arguably yes, by providing the vendor with the GST status details of the nominee before settlement the vendor is fully informed of the change in basis of the sale before settlement and therefore section 5(23) does not apply to force register the nominee and be responsible for the GST.

It is likely the nominee would not be happy with this uncertainty and may balk at taking this position. If they were persuaded to accept this action, the vendor may take the position they do not accept the nomination and continue to treat the sale as zero rated. It would then be a matter of whether the IRD would pick up the parties' different treatment in an audit.

This example shows some of the uncertainties that can still arise with land and GST, and that all of this would not have arisen had the vendor chosen to contract on a plus GST basis.

Keith Turner**Disclaimer**

This newsletter is not intended to provide an exhaustive or comprehensive statement of tax law and it should not be relied on or used as the basis for any decision or legal action. Detailed professional advice should always be sought in order to verify the applicability of the relevant legislation to the specific case.