

QUESTION WE'VE BEEN ASKED QB 13/03

GOODS AND SERVICES TAX – WHETHER A COMPULSORY ACQUISITION OF LAND IS A “SUPPLY BY WAY OF SALE”

All legislative references are to the Goods and Services Tax Act 1985 (GST Act) unless otherwise stated.

This Question We've Been Asked applies in respect of ss 3A, 5(1), 8(1), 11(1)(mb), and 20(3).

Question

1. We have been asked whether:
 - a compulsory acquisition of land under the Public Works Act 1981 (PWA 1981) is a “supply” for GST purposes; and
 - if so, whether it is a “supply by way of sale” such that the recipient is entitled to a second-hand goods input tax deduction under ss 3A(2) and 20(3) of the GST Act where the supplier is not registered.

Answer

2. A compulsory acquisition of land under the PWA 1981 is a “supply” for GST purposes from the land owner to the Crown or local authority. Where such a supply is made by a registered person, it will generally be zero-rated under s 11(1)(mb).
3. Land compulsorily acquired from a non-registered person under the PWA 1981 will be a “supply by way of sale” for the purposes of ss 3A(2) and 20(3). The recipient (the Crown or local authority) will be entitled to an input tax deduction for the amount paid for the acquisition of that land (provided the other requirements of ss 3A(2) and 20(3) are met).
4. It is noted that, while this QWBA analyses compulsory acquisitions under the PWA 1981, the above answer also applies to compulsory acquisitions of land under the Canterbury Earthquake Recovery Act 2011.

Explanation

Background

5. The Minister of Lands or a local authority has the power under the PWA 1981 to acquire land under an agreement with the owner of the land or, where an agreement cannot be reached, under a compulsory acquisition. Where land is compulsorily acquired under the PWA 1981, the person whose land is acquired is entitled to full compensation from the Crown or local authority.
6. Public authorities and local authorities will be registered for GST. Consequently, the recipient of any compulsorily acquired land will be a registered person. There has been confusion about whether an input tax deduction is allowed when land is compulsorily acquired.

Meaning of “supply”

7. The New Zealand courts have not considered whether a supply requires an act on the part of the supplier. “Supply” has a wide meaning with potentially both active

and passive senses. It is, therefore, necessary to consider the context and purpose of the GST Act to determine whether “supply” was intended to be limited to situations where there was an act on the part of the supplier. The GST Act was intended to be comprehensive and as non-distortionary as possible. This purpose is consistent with compulsory acquisitions being supplies for GST purposes.

8. GST is chargeable on the **supply** of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person: s 8(1).
9. Under s 5(1), supply “includes all forms of supply”. In *Case S84* (1996) 17 NZTC 7,526, Judge Barber considered that the effect of s 5(1) was that virtually any transaction constitutes a supply (at 7,533):

Section 5(1) defines “supply” to include all forms of supply. Accordingly, virtually any transaction constitutes a supply; but a supply is only subject to GST if it is made in the course or furtherance of a taxable activity (s 8).

10. At issue is whether a supply for GST purposes requires an act on the part of the supplier. If so, then a compulsory acquisition would not be a supply.
11. In *Databank Systems Ltd v CIR* (1987) 9 NZTC 6,213, Davison CJ considered that in the context of s 5(1) “supply” meant “to furnish with or provide”. The definitions of “provide” and “furnish” in the *Concise Oxford English Dictionary* include “make available for use; supply” (provide) and “be a source of; provide” (furnish). The meaning of “supply” is, therefore, wide enough to include both active and passive senses.
12. New Zealand courts have not expressly considered whether a supply requires an act on the part of the supplier.
13. Comments made by Judge Willy in *Case T22* (1997) 18 NZTC 8,124 may be taken to suggest that a compulsory acquisition of property from a taxpayer could not amount to a supply. However, that case did not involve a compulsory acquisition of property. Rather, the Government passed legislation preventing the taxpayer from operating a marron farm, which it was previously permitted to do. Subsequent to that, the Government made a payment to the taxpayer in full and final settlement to any claim related to those events. The case is, therefore, concerned with a compensation payment, rather than a compulsory acquisition of property.
14. South African and Australian authority establishes that for there to be a supply, there must be an act on the part of the supplier. These cases support the view that a compulsory acquisition of land under the Public Works Act, which occurs because the Governor-General makes a proclamation, does not involve a supply of the land: *Shell's Annandale Farm (Pty) Ltd v Commissioner for South African Revenue Service* (1999) 62 SATC 97; *Shaw v Director of Housing (No 2)* (2001) ATC 4,054. However, cases decided under other indirect tax legislation are not necessarily applicable in interpreting the New Zealand GST Act, although they may be helpful: *CIR v Databank Systems Ltd* (1989) 11 NZTC 6,093; *CIR v Gulf Harbour Development Ltd* (2004) 21 NZTC 18,915.
15. UK legislation provides that a compulsory acquisition for which compensation is paid is a supply, but one case has suggested that even without an express provision, a compulsory acquisition would have been a supply: *Landau* [1996] BVC 2,577.
16. In *Shell's Annandale Farm*, Davis J acknowledged that the ordinary meaning of “supply” included a passive sense, but found that it was necessary to consider the text and purpose of the Act as a whole. He considered that in the context of the South African value-added tax legislation, a “supply” required some act on the part of the supplier.

17. Even where the meaning of the text of the legislation is clear, it is necessary to cross-check the plain meaning against the purpose of the legislation to comply with s 5 of the Interpretation Act 1999. The Interpretation Act 1999 makes the text and purpose the key drivers of statutory interpretation. Further, consideration of the context and purpose is essential where the meaning is not clear on the face of the legislation: *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] 3 NZLR 767 (SC). As “supply” can be used in active and passive senses, it is necessary to consider contextual matters and the scheme and purpose of the New Zealand legislation to decide whether “supply” requires an act on the part of the supplier.

Context and purpose

18. GST is imposed on the supply of goods and services by a registered person in the course or furtherance of a taxable activity by reference to the value of the supply (the consideration for the supply): ss 8(1) and 10. In *CIR v Databank Systems Ltd* (1989) 11 NZTC 6,093, Richardson J commented that the definitions of the terms used in s 8(1) (“supply”, “goods”, “services”, “registered person” and “taxable activity”) breathed comprehensiveness into the legislation. Richardson J also said that a feature of the legislation in this regime compared with that in other indirect tax regimes was its breadth of coverage and limited number of exemptions.
19. “Consideration” is relevantly defined in the Act as:
- in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person ...
20. For payment to be consideration for a supply, a sufficient connection must exist between the supply and the payment: *CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187; *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075. The supply need not be made to the person providing consideration and consideration need not be paid under a contract between the supplier and the person providing the consideration, so long as a connection exists between the supply and the payment: *Turakina Maori Girls’ College Trust Board v CIR* (1993) 15 NZTC 10,032; *NZ Refining Co*; *Chatham Islands Enterprise Trust*. In determining whether the necessary relationship exists, the legal nature of the transaction and the rights and obligations of the parties need to be considered: *NZ Refining Co*; *Chatham Islands Enterprise Trust*.
21. As the definition of “consideration” contemplates that a supply need not be made under a contract (the making of which requires an act on the part of the supplier), the definition provides some support for the argument that a “supply” does not require an act on the part of the supplier. However, for a payment to be consideration there must be an element of reciprocity in the relationship between the supplier and the recipient and a sufficient connection between a supply and a payment. In the context of a compulsory acquisition, a sufficient connection exists between the transfer of the land and the payment made by the Crown or local authority for the acquisition of that land. The right to compensation arises only because the land is taken. The payment is, therefore, in response to the acquisition of the land.
22. The definition of “supplier” refers to “the person who makes the supply” of goods and services. The definition of “make” in the *Concise Oxford Dictionary* includes “bring about or perform; cause”. The use of the word “makes” in the definition of “supplier” indicates that “supply” in the GST Act has an active connotation. However, this factor must be weighed against other contextual matters.

23. Although not exactly analogous, there are examples where the GST Act deems a supply to be made although there is no act by the supplier in respect of the supply. For example, a person must pay registration fees, licence fees and road user charges to be entitled to operate a motor vehicle (or certain motor vehicles) on the road. These fees are treated as consideration for a supply of services by the New Zealand Transport Agency: s 5(6A) and (6B); see also s 5(6C), (7B), and (7C)).
24. Deeming can be used to extend the meaning of a term. However, deeming can also be used to put beyond doubt a particular meaning that might otherwise be uncertain. Therefore, it is possible that Parliament did not intend to extend the concept of supply beyond the circumstances in which these specific provisions apply. The alternative argument, which the court in *Landau* suggested, is that provisions deeming a supply to be made in certain circumstances were included for the avoidance of doubt and are not intended to limit the concept of "supply". Although of limited analytical weight, the inclusion of these deeming provisions means it is not possible to argue that Parliament intended that GST would be imposed only in circumstances where a supply is voluntary. These provisions and s 5(1), which provides that "supply" includes all forms of supply, suggest that Parliament intended that "supply" should be given a wide interpretation and should encompass almost any type of transaction under which a person acquires goods or services.
25. A "transaction" can include any dealings with property (*Littman v Barron* (1952) 33 TC 373) and can be a unilateral activity (*Greenberg v IR Commrs* [1971] 3 All ER 136; *Case K60* (1988) 10 NZTC 487). A compulsory acquisition is a transaction within that meaning, being a dealing with property involving the acquisition by the Crown or the local authority of title to land owned by another person.
26. In *Glenharrow Holdings Ltd v CIR* (2009) 24 NZTC 23,236, the Supreme Court noted that GST was intended to be as non-distortionary as possible, and that to that end GST was intended to be broad-based, efficient and neutral. A governing principle of the GST Act is that GST is paid by the ultimate consumer and is neutral for registered persons, who collect GST on behalf of the Crown (see *L R McLean & Co Ltd v CIR* (1994) 16 NZTC 11,211). To achieve neutrality, registered persons are allowed input tax deductions for their purchases. The legislation contemplates that there will be a balancing out of or netting off of the GST components of sales and purchases made by a registered person. If a registered person obtained an input tax deduction on the acquisition of land and was not required to account for GST on the land's disposal, the person would receive a gain that the legislation does not contemplate. Therefore, it would be inconsistent with the scheme of the legislation if a registered person from whom land was compulsorily acquired were entitled to an input tax deduction on the acquisition of the land but not required to account for GST on compensation for the land where the land was compulsorily acquired. [Although the zero-rating rules have changed the position for supplies of land between registered persons, ultimately when the land is sold to an unregistered person, GST will be payable. In any event, it is considered that the general principle is still relevant.]
27. It would be inconsistent with the principles of neutrality and efficiency that underlie the broad definitions of the main concepts in the GST Act ("goods", "services", "supply" and "taxable activity"), if a different GST outcome occurred depending on whether an agreement for sale and purchase was entered into or whether land was compulsorily acquired. Whether the land is acquired under an agreement entered into with the owner of the land or under a compulsory acquisition, land is acquired by the Crown in return for payment.

28. If "supply" were limited to transactions where there was an act on the part of the supplier, it would create an anomaly in that compulsory acquisitions would be outside the GST net (although a compulsory acquisition of land would have the same legal and economic effect as an agreement for the purchase of the land). Such an interpretation is not required on a literal interpretation. Further, the scheme and purpose of the legislation supports the view that the treatment should be the same. GST is intended to be imposed on the value added at every stage by which goods and services reach the ultimate consumer. Therefore, it is considered that the better view is that the GST treatment should be the same whether the supplier has taken some action that results in another person receiving goods or services or whether a person receives goods or services without there being an act by the supplier.
29. The interpretation of "supply" remains relevant in considering whether a second-hand goods deduction (which requires a supply by way of sale) would be allowable where land is acquired from a non-registered person.

Supply by way of sale

30. Whether a compulsory acquisition is a "sale" depends on the context in which the term "sale" is used. The context of the GST Act is not decisive about whether a compulsory acquisition is a "supply by way of sale". However, allowing a second-hand goods deduction is more consistent with the policy of allowing input tax deductions for second-hand goods, because it achieves GST neutrality.
31. Case law shows that whether a compulsory acquisition is a "sale" depends on the context of the legislation in which the term "sale" is used: *John Hudson & Co Ltd v Kirkness* (1955) 36 TC 28; *Ridge Nominees Ltd v IRC* [1961] 3 All ER 1,108.
32. In *Smith v FCT* (1932) 48 CLR 178 and *Coburg Investment Co Pty Ltd v FCT* (1960) 12 ATD 242, the court considered that a compulsory acquisition of land was a sale. In *Smith*, Rich J considered that the word "sale" did not have a precise meaning and that in some contexts the essence of a sale was the conversion of property into money. In *Coburg Investment*, the issue was whether a compulsory acquisition was a sale of land for the purpose of the equivalent of s CB 6 of the Income Tax Act 2007. Windeyer J considered that the provision should be read in the light of the principle that if property is acquired for the purpose of sale (rather than for the purpose of retaining it as an income-producing capital asset), the surplus received when it is realised is income. Under that principle it is irrelevant whether the realisation occurred as a result of compulsion or voluntarily. See also *FCT v Salenger* 88 ATC 4,449, where the court found that, where a sale is made under a contract, mutual consent is required. However, a sale is not necessarily made under a contract.
33. New Zealand case law established that a compulsory acquisition of land is not a sale for the purpose of the predecessor of s CB 6. In *Public Trustee v CIR* [1961] NZLR 1,034, Hutchison J did not consider that a wider meaning of "sale" applied in the particular context. However, Hutchison J accepted that in a suitable context a sale for income tax purposes could include a compulsory acquisition (at 1,044). *Public Trustee* was followed in *Railway Timber Co Ltd v CIR* [1977] 1 NZLR 655 and *Duff v CIR* (1979) 4 NZTC 61,420. (The legislation has since been amended so that a disposal of land for the purpose of these provisions now includes a compulsory acquisition.)
34. The fact New Zealand case law establishes that a compulsory acquisition is not a sale for income tax purposes does not necessarily mean that "sale" should be interpreted in the same way for GST purposes. The meaning to be given to "sale" depends on the context in which it is used. It is, therefore, necessary to consider the context in which "sale" is used in s 3A(2).

35. A sale is a supply. Section 3A(2) refers to "a supply by way of sale". "By way of" means "in the form of": *Concise Oxford Dictionary*. A supply for GST purposes need not be made under a contract: *Turakina*.
36. Section 3A(3)(a)–(d), which relates to the determination of the amount of a second-hand goods input tax credit, refers to "the purchase price" as a basis for determining the amount of the input tax credit. A possible argument is that compensation paid under a compulsory acquisition cannot be described as a purchase price. Therefore, the legislation contemplates a second-hand goods input tax deduction could not be obtained for a compulsory acquisition. However, in *Horn v Sunderland Corporation* [1941] 1 All ER 480 (CA), Scott LJ considered that "purchased" was synonymous with "taken" and that the compensation paid for compulsorily acquired land was a purchase price (at 492).
37. Also, the paragraphs in s 3A(3) that refer to the purchase price are unlikely to apply where a compulsory acquisition is made. Section 3A(3)(a)–(c) applies where the supplier and the recipient are associated persons. The Crown or a local authority is unlikely to be an associated person of any person from whom land may be compulsorily acquired. Section 3A(3)(d) applies where the supply is not the only matter to which the consideration relates. This is also unlikely to be relevant in the context of a compulsory acquisition.
38. Where the supplier and recipient are not associated persons and the supply is the only matter to which the consideration relates, the amount of the input tax deduction is based on the consideration in money for the supply: s 3A(3)(e). Therefore, the amount of the input tax deduction where a compulsory acquisition is made would be based on the amount of the compensation paid for the acquisition.
39. Originally, a second-hand goods input tax deduction was allowable on a supply that was not a taxable supply. *Public Information Bulletin* 181 (June 1989) set out commentary on the Goods and Services Tax Amendment Act 1989. The bulletin explains that before the amendment, a registered person could have obtained a second-hand goods input tax deduction on goods that were leased. The bulletin also explains that the words "supply by way of sale" were inserted in the definition of "input tax" in the GST Act to ensure the second-hand goods input tax deduction was not obtained where a registered person did not obtain ownership of the goods. Therefore, the limitation of the second-hand goods input tax deduction to supplies by way of sale was not intended to introduce a requirement for consent from the supplier to the supply before there could be a sale. The words "supply by way of sale" were added to ensure a second-hand goods input tax deduction could be obtained only where the recipient acquired ownership of the goods. The definition of "sale" referred to in the bulletin refers to an exchange of a commodity for money. This exchange occurs under a compulsory acquisition.
40. The allowance of an input tax deduction in respect of a compulsory acquisition of land is consistent with the policy underlying the second-hand goods input tax deduction. Allowing a second-hand goods input tax deduction recognises that as the non-registered supplier was charged GST on the acquisition of the goods, the consideration for the goods includes a notional GST component. The allowance of an input tax deduction to a registered person who purchases second-hand goods from a non-registered person achieves GST neutrality for the registered person: *Glenharrow*. Supplies of land between registered persons are now zero-rated. However, there are still GST consequences where land is supplied either by or to an unregistered person. Allowing a second-hand goods input tax deduction is also consistent with the treatment of land that is acquired by agreement under s 17 of the PWA 1981.

41. Although, it is not completely free from doubt, on balance, the Commissioner's view is that, in the context of the GST legislation, a compulsory acquisition is a supply by way of sale.

Interpretation Statement

42. The Interpretation Statement "GST treatment of court awards and out of court settlements: IS3387" *Tax Information Bulletin* Vol 14, No 10 (October 2002) states the proposition that "[t]he concept of supply is active; to supply is to furnish or provide".
43. The principle referred to above was not central to the matters considered in the Interpretation Statement. In the Commissioner's view, the conclusions reached in the Interpretation Statement are still correct. However, to the extent that the analysis in the Interpretation Statement suggests that the concept of "supply" is always active, the Commissioner now considers that it is incorrect.

Examples

44. The following examples are included to help explain the application of the law.

Example 1 – unregistered landowner

45. Bob is not registered for GST. Bob owns a 400m² block of land. The local district council requires Bob's land to undertake some local work. Bob does not want to sell his land to the council. The council compulsorily acquires Bob's land under the PWA 1981 and pays him \$400,000 (the market value of the land).
46. Bob is not GST registered, so there are no GST implications for him. The council is GST registered. The transfer of the land from Bob to the council is a "supply by way of sale" for the purposes of ss 3A(2) and 20(3). The council is entitled to an input tax deduction (provided the other requirements of ss 3A(2) and 20(3) are met).

Example 2 – registered landowner

47. Charles carries on a taxable activity of farming and is registered for GST. Charles owns 100 hectares of land. The local council requires 100m² of Charles' land to widen an adjacent road. Charles does not wish to sell his land to the council. The council compulsorily acquires Charles' land under the PWA 1981 and pays him \$40,000 (the market value of the land).
48. The transfer of the land from Charles to the council is a "supply". The supply is of land, so it will be zero-rated under s 11(1)(mb).

References

Related rulings/statements

"GST treatment of court awards and out of court settlements: IS3387" *Tax Information Bulletin* Vol 14, No 10 (October 2002)

Subject references

Compulsory acquisition
Supply

Supply by way of sale

Legislative references

Goods and Services Tax Act 1985: ss 2
("consideration", "supplier"), 3A, 5, 8,
11(1)(mb), 20(3)
Public Works Act 1981

Case references

Case K60 (1988) 10 NZTC 487
Case S84 (1996) 17 NZTC 7,526
Chatham Islands Enterprise Trust v CIR (1999) 19 NZTC 15,075
CIR v Gulf Harbour Development Ltd (2004) 21 NZTC 18,915
CIR v NZ Refining Co Ltd (1997) 18 NZTC 13,187
Coburg Investment Co Pty Ltd v FCT (1960) 12 ATD 242
Commerce Commission v Fonterra Co-operative Group Ltd [2007] 3 NZLR 767 (SC)
Databank Systems Ltd v CIR (1987) 9 NZTC 6,213; (1989) 11 NZTC 6,093
Duff v CIR (1979) 4 NZTC 61,420
FCT v Salenger 88 ATC 4,449
Glenharrow Holdings Ltd v CIR (2009) 24 NZTC 23,236 (SC)
Greenberg v IR Commrs [1971] 3 All ER 136

Horn v Sunderland Corporation [1941] 1 All ER 480 (CA)
John Hudson & Co Ltd v Kirkness (1955) 36 TC 28
Landau [1996] BVC 2,577
Littman v Barron (1952) 33 TC 373
L R McLean & Co Ltd v CIR (1994) 16 NZTC 11,217
Public Trustee v CIR [1961] NZLR 1,034
Railway Timber Co Ltd v CIR [1977] 1 NZLR 655
Ridge Nominees Ltd v IRC [1961] 3 All ER 1,108
Shaw v Director of Housing (No 2) (2001) ATC 4,054
Shell's Annandale Farm (Pty) Ltd v Commissioner for South African Revenue Service (1999) 62 SATC 97
Smith v FCT (1932) 48 CLR 178
Turakina Maori Girls' College Trust Board v CIR (1993) 15 NZTC 10,032

Other references

Public Information Bulletin 181 (June 1989)