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ED0164: GST and the costs of sale associated with mortgagee sales

Introduction

1. The New Zealand Law Society (Law Society) appreciates the opportunity to comment on draft interpretation statement ED0164 *GST and the costs of sale associated with mortgagee sales* (Exposure Draft).
2. The Law Society agrees with the analysis and conclusions reached by the Commissioner in paragraphs 1 to 24 of the Exposure Draft to the extent that exempt financial services are supplied by a mortgagee.
3. However, the Law Society does not agree with the conclusion reached by the Commissioner at paragraph 27 of the Exposure Draft that a mortgagee that makes zero rated supplies of financial services under the "business to business financial services rules" (sections 11A(1)(q) or 11A(1)(r) of the Goods and Services Tax Act 1985 (GST Act) which apply as a consequence of an election being made under section 20F), is not entitled to deduct input tax for costs associated with a mortgagee sale.

Comments

4. Registered persons are entitled to deduct input tax under the GST Act pursuant to section 20(3) and 20(3C) to the extent to which GST is incurred on goods or services acquired for use in making taxable supplies.
5. In reaching the conclusion that no input tax deduction is available for mortgagees who make taxable supplies of financial services under the business financial services rules, the Commissioner appears to have focussed solely on the effect of section 5(2) of the GST Act, which deems the supply of the property to be a taxable supply made by the mortgagor, subject to limited exceptions.
6. At paragraph 26 of the Exposure Draft, the Commissioner states:

"Input tax deductions may be made to the extent goods and services are used for making those [zero rated] supplies under the business to business financial services

rules. However, the effect of section 5(2) is that the goods sold are deemed to be supplied in the course or furtherance of a taxable activity carried on by the mortgagor. **There is no scope to suggest that the same goods are contemporaneously supplied in the course or furtherance of a taxable activity being carried on by the mortgagee".** (Emphasis added)

7. While the Law Society agrees that section 5(2) does not in itself provide a basis for a mortgagee to recover input tax on costs associated with a mortgagee sale, the Law Society disagrees with the Commissioner's statement that no input tax deduction is available on account of there being no scope to say that the same goods are contemporaneously supplied in the course or furtherance of a taxable activity carried on by the mortgagee.
8. The courts have clearly recognised in cases such as *Suzuki New Zealand v CIR* (2001) 20 NZTC 17,096 that a single activity may give rise to more than one taxable supply for GST purposes, made to more than one person.
9. Accordingly, the fact that the sale of the property is deemed to be a supply made by the mortgagor in the course of any taxable activity the mortgagor may have, is not in the Law Society's view determinative of whether that same sale can give rise to a taxable supply made by the mortgagee in the course of the mortgagee's taxable activity.
10. A mortgagee does not incur costs associated with the sale of the mortgaged property to make the supply of the mortgaged property in and of itself. Instead, mortgagee sales are undertaken to recover amounts owing to a mortgagee under the debt security for which the mortgaged property is the security.
11. The payment or collection of interest, principal or any other amount whatsoever in respect of a debt security issued by such a person is a financial service pursuant to section 3(1)(ka) of the GST Act.
12. Where a mortgagee has made an election under section 20F of the GST Act, the Law Society therefore considers that a mortgagee sale can give rise to two separate but related supplies:
 - a. A supply of the property which is deemed to be a taxable supply (subject to limited exceptions) made by the mortgagor under section 5(2) of the GST Act; and
 - b. A supply of financial services made by the mortgagee under section 11A(1)(q) or 11A(1)(r) of the Act (as a consequence of section 3(1)(ka)), where the mortgagee is recovering payment of a debt security that has been issued by a mortgagor by a registered person that makes no less than 75% taxable supplies by receiving payment for the property.¹
13. The supply referred to above as being made by a mortgagee will clearly be made in the course of the mortgagee's activity of supplying financial services and will therefore be a taxable supply where the mortgagee's activity involves the making of zero-rated financial services.
14. That a mortgagee makes a mortgagee sale in the course of its activity of supplying financial services has been recognised by the Commissioner at paragraphs 20 to 24 of the Exposure

¹ Or is part of a group that makes no less than 75% taxable supplies.

Draft, and at paragraph 17 of the Exposure Draft the Commissioner has reproduced a statement to similar effect made by Judge Barber at paragraph 72 of his judgment in *Case Y2 23 NZTC (2007) 13,017*.

15. Paragraph 72 of the judgment reads as follows:

"The disputant is not entitled to input deductions with respect to its sale of the property as mortgagee. The express language of section 17 of the GST Act provides that, in a section 17 Special Return, the disputant must pay the full amount of output tax, without any deduction for input tax. There is nothing in the scheme and purpose of the Act which supports input tax deductions being available for the deemed supply. **At the time of the deemed sale, the disputant was carrying on exempt supplies, and accordingly, input tax deductions are not available.**" (Emphasis added; the last sentence was omitted from paragraph 17 of the Exposure draft).

16. It is clear that the reason Judge Barber considered input tax credits were not available in *Case Y2* was that the supplies of financial services made by the mortgagee were exempt supplies. No such impediment exists for mortgagees that realise mortgaged property to recover payment for a debt security issued by a registered person that makes no less than 75% taxable supplies.

17. Accordingly, for the reasons outlined above it is the Law Society's view that mortgagees who make zero rated supplies of financial services are entitled to deduct input tax under sections 20(3) and 20(3C) of the Act in respect of GST incurred on goods and services they acquire to facilitate the payment via the sale of the secured property.

Recommendation

18. The Law Society recommends that the Commissioner amend the Exposure Draft, to provide that input tax credits are available for costs associated with a mortgagee sale where a mortgagee makes zero rated supplies of financial services under the business to business financial services rules.

Conclusion

19. This submission was prepared with assistance from the Law Society's Tax Law Committee. If you wish to discuss this further please do not hesitate to contact the committee convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours sincerely



Chris Moore
President