

GST – Things to watch out for

GST is charged by GST-registered persons on the supply of goods and services in the course of a taxable activity.

GST – impact on cash flow

- The impact of any transaction on the cash flow should be considered before entering into it.
- Generally, GST improves cash flow, because you will accumulate and hold the tax periodically paid to IRD for an average of 2 months.
- This effect is enhanced for retailers, who sell for cash and purchase on credit, but diminished if the terms of trade are reversed.
- GST favours early collection of debts by suppliers, and full use of any credit period offered (in the absence of prompt payment discounts).

Common problems

There are common GST problems that you should be aware of to avoid any disadvantage. Some of these are discussed below.

Payment of deposits

The effect of the payment of a deposit for goods and services is often not recognised for GST purposes. Given that GST is generally payable at the time an invoice is issued or at the time any payment is received from a customer (whichever comes first), the payment of a deposit will generally result in a supply being deemed to have been made at that time for GST purposes.

Therefore, as the supply is made at the time the deposit is paid, the full GST for the supply must be accounted for at this time. It is irrelevant that the deposit may represent only a small part of the total price and may not even be enough to cover the GST.

For example, in a sale and purchase transaction for \$112,500 (including GST), the purchaser may be required to pay a deposit of \$11,250 (10%). On payment of the deposit, the supplier will be required to account for GST of \$12,500 (being the GST on the total supply). The supplier will have received \$11,250 and paid out \$12,500, resulting in a net cash outflow of \$1,250.

In such situations, the contract or agreement between the parties should consider and provide for payment of sufficient deposit to match the GST that will have to be accounted for.

Court-awarded damages and settlements

The area of court-awarded damages and settlements made out of court is also of some concern. For example, where a party to a contract has not satisfied its obligations under the contract and the court awards damages to the other party, the question arises as to how GST should be accounted for in relation to the amount awarded.

Generally, the nature of the transaction to which the claim relates would indicate whether there is any liability for GST, ie where a damages award relates to the non-payment by the purchaser for a taxable supply of goods and services, it would seem that there will be a GST liability.

However, if the non-payment had related to an exempt supply of goods and services, no GST liability would arise. Where such situations occur, it is often difficult to determine the nature of the underlying supply and the nature of the damages that are being awarded.

Where a GST liability does arise, the supplier is required to account for GST at the time the amount was awarded or settled and, as this factor may not have been considered, the amount may not compensate for this. Similarly, if GST was not considered at the time the amount was awarded or settled, the cost to the payer could be lower than intended, as an input tax refund could be available to them.

However, these problems may be avoided if adequate consideration is given to GST at the time the amount of damages or the settlement is calculated.

It should also be noted that in some circumstances the damages or settlement paid may not be regarded as consideration for any supply of goods or services. In these circumstances, there will be no GST consequences arising from the payment of the damages or settlement.

Transactions in the nature of hire

Hire purchase transactions are another area where problems commonly arise.

Where a supply of goods and services is under a hire purchase agreement, the supply is deemed to occur for GST purposes when the agreement is made, and the full GST must be accounted for at this time.

A hire purchase agreement can be compared with an agreement to hire, where a supply arises each time a payment becomes due or is received, and the GST is payable only on those instalment payments.

For GST purposes, the term 'hire purchase agreement' has the same meaning as defined in the Hire Purchase Act 1971. As this term is defined very widely, situations often arise where transactions are mistakenly considered to be agreements to hire when in fact they are hire purchase agreements. The resulting mistake is an underpayment of GST, in that GST is incorrectly partially accounted for each time a payment becomes due or is received, rather than in full when the agreement is entered into.

To avoid such mistakes, transactions in the nature of leases, rents, hire by instalments, etc require careful consideration for GST purposes.

Zero-rating

The zero-rating of certain supplies of goods and services often raises difficult questions, eg you may believe that the sale of an asset should be zero-rated and, therefore, not charge GST to the buyer. However, if the sale should not be zero-rated, and GST should have been charged, you will have to account for GST output tax to IRD.

This unexpected cost may not necessarily be recoverable from the buyer (depending on the contract). Alternatively, GST may mistakenly be charged on a supply of goods and services when the supply should have been zero-rated. In this situation, the buyer will have paid GST to the supplier but will not be able to claim an input tax deduction. The supplier will have incorrectly paid output tax to IRD but will be able to claim this back.

This problem has been alleviated, to an extent, for the supply of a taxable activity as a going concern. It is provided in the GST Act 1985 that where the parties agree in writing that the supply is zero-rated as a going concern, and the contract or agreement does not provide for a price increase because of GST if it is not so zero-rated, and the supply is in fact not zero-rated, the supplier may increase the consideration for the supply by the amount of GST at the standard rate.

There may still be a delay for a supplier in recovering such GST amounts, eg if there is a dispute as to whether or not the supply comes within the zero-rating provision. It may still be beneficial to include an express provision within the contract that also provides for the time at which the supplier can recover the GST.

The application of zero-rating is not abundantly clear in a number of areas. In the past, there has been considerable uncertainty as to the zero-rating of taxable activities sold as a going concern. In particular, the question arose as to what is, or is not, a going concern. There is now a statutory definition of 'going concern'.

These uncertainties cause practical difficulties in the concluding of business transactions and contracts, as the GST considerations are not the same for each party. Also, the disadvantage suffered by one party may result in an advantage to the other. It is clearly important that purchasers and vendors fully consider GST before finalising transactions.

See us first

If you consider that any of the issues contained in this fact sheet may affect you.

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