

## **SALE OF TENANTED COMMERCIAL PROPERTY – TRANSFER OF A GOING CONCERN FOR GST PURPOSES**

In the course of acting for vendors and purchasers of commercial property, we are often asked to structure the transaction and the documents to ensure that the GST payable on the purchase price is zero rated (so that the GST content is nil).

The significant advantage to purchasers is in terms of cash-flow. Paying GST at 12.5% on top of the purchase price can leave the purchaser's business with a big hole in its bank balance, until that amount is refunded following the purchaser's next GST return. Sometimes purchasers have to borrow the GST and incur interest and other administrative costs.

The advantage to vendors is that the transaction may be more attractive to potential purchasers, possibly achieving a better sale price for the vendor.

### **Transfer of a Going Concern**

Under the Goods and Services Tax Act 1985 ("the Act"), GST must be charged at 0% where there is a transfer from one GST registered person to another of a going concern.

A going concern is any taxable activity (such as a business) that is capable of separate operation (i.e. can be carried on independently of any other business). It must be transferred with all goods and services necessary for its continued operation. The vendor must carry on the business up until the date of the transfer to the purchaser so that the business remains active and operating at the time of the transfer and the transfer is virtually seamless.

In the case of a sale of commercial property, it is essential that the property (or a large proportion of it) is tenanted and that the purchaser takes the property subject to the existing lease or leases. The taxable activity or business that is then transferred as a going concern is a commercial leasing business.

The Courts apply a strict test when determining whether or not the property is "tenanted". In a recent case, the Court of Appeal found that for a property to be "tenanted" and the sale of it to thereby be the transfer of a going concern, the tenant must have the right to exclusive occupation of the property.

### **Time of Supply**

The activity or business must be a going concern at the time of supply, which is the earlier of the date of the document notifying an obligation to make payment and the date of payment of the purchase price. A Sale Agreement that is unconditional on signing notifies the purchaser of an obligation to make payment. So too does the presentation of a GST invoice for the purchase price or any other document communicating the obligation. Remember also that the date of supply may not necessarily be the settlement date under the Sale Agreement.

The tenancy must be in place prior to the date of supply. An agreement with a tenant for a lease commencing after the time of supply may not suffice.

### **Agreement to be in writing**

In order to qualify for zero-rated GST there are two additional, essential requirements. Firstly, the vendor and the purchaser must agree in writing that the sale is the supply of a going concern. Most commonly, this agreement is found in an express term of the Sale Agreement. For this reason it is important to seek legal advice on the terms of the Sale Agreement prior to entering into it. Afterwards, it may be too late to classify the sale as a transfer as a going concern on which GST is charged at the rate of 0%.

### **Intention**

Secondly, it must be the parties' intention that the sale is of a taxable activity or business that is capable of being carried on as a going concern by the purchaser. It does not matter what the purchaser intends to do with the business after he or she has bought it. For GST, the issue is what was supplied.

The best evidence of intention is to express it as a term of the Sale Agreement. Again, we recommend that advice be sought prior to entering into the Sale Agreement. If there is a clear expression of intention in the Sale Agreement the Courts are unlikely to look at extraneous circumstances to draw a different inference.

### **Both parties to be registered**

At the time of supply both parties must be a "registered person" under the Act. The simplest way to achieve this is to ensure that, at the time of supply (invoice or payment) both parties have applied for and been granted a GST registration number by the Commissioner of Inland Revenue. It does not matter if a party is not registered for GST at the time the Sale Agreement is entered into .

Under the Act, a "registered person" includes a person or entity who is liable to be registered. A person is liable to be registered at the beginning of the month where its taxable supplies for the 12 months from the beginning of that month will exceed \$40,000. This is useful in circumstances where there is insufficient time for a purchaser to register for GST prior to the date of supply. However, it is usually possible to obtain a GST number within 48 hours of making the application.

### **Resident in New Zealand**

The supply must be made in New Zealand. If the supplier (the vendor) is resident in New Zealand the supply is deemed to be made in New Zealand. If the supplier is a non resident but the property is in New Zealand then the supply is made in New Zealand.

### **Fall-Back Position**

If the parties mistakenly treat the sale as a transfer of a going concern, the Act allows the vendor to increase the purchase price by the amount of GST at 12.5%, provided that the Sale Agreement does not provide otherwise.

There should always be fall-back provisions in the Sale Agreement to deal with a situation where the IRD subsequently rules that the sale is not a transfer of a going concern.

For example, the standard form of Sale Agreement produced by the Auckland District Law Society refers to the purchase price being "plus GST" or "inclusive of GST" and if neither is deleted the purchase price is "inclusive of GST". This is very dangerous for the vendor. If the parties have not turned their minds to the situation where the IRD rules the sale is not a transfer of a going concern and have not made any amendments to the standard form Agreement, then the purchase price is inclusive of GST and the vendor is liable to account to the IRD for GST at the rate of 12.5%. This results in a loss to the vendor of approximately 11% of the sale price.

### **Standard Form Sale Agreement**

The pre-printed general terms of the standard form Sale Agreement provide for the transfer of a going concern by stating that if the property is tenanted (as evidenced by details inserted under the heading "Tenancies" on the particulars page) then the parties agree that the transfer is a going concern. As highlighted above, these clauses will not adequately classify the sale as a transfer of a going concern in every case where that is intended.

### **Summary**

In our experience, the standard form Sale Agreement is very often used in transactions involving the sale of a commercial property that is tenanted. It is important to seek advice prior to entering

into the Sale Agreement to ensure that the necessary special terms and conditions have been added so that the sale will be classified as the transfer of a going concern, and to provide for a fall-back position if it is not.

When advice is obtained at this time and the requisite factual situation exists, it is usually very simple to meet the administrative requirements to classify the sale as a transfer of a going concern. Depending on the circumstances, the consequences for the vendor and the purchaser of a failure to meet those requirements can be dire and the outcome can be very different to what was intended.