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TAX INFORMATION Bulletin

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Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

A list of the items we are currently inviting submissions on can be found at **www.ird.govt.nz**. On the homepage, click on "Public consultation" in the right-hand navigation. Here you will find drafts we are currently consulting on as well as a list of expired items. You can email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

You can also subscribe to receive regular email updates when we publish new draft items for comment.

Below is a selection of items we are working on as at the time of publication. If you would like a copy of an item please contact us as soon as possible to ensure your views are taken into account. You can get a copy of the draft from **www.ird.govt.nz/public-consultation/** or call the Senior Technical & Liaison Advisor, Office of the Chief Tax Counsel on 04 890 6143.

Ref	Draft type/title	Description/background information	Comment deadline
ED0185	Draft SPS: Notification of a pending audit or investigation	This statement sets out the Commissioner's practice for notifying taxpayers of a pending audit or investigation or advising them that one has begun. For many taxpayers, notification of an audit will be by letter without any prior contact by Inland Revenue on the matter.	22 April 2016

IN SUMMARY

Questions we've been asked

QB 16/01: Income tax, Working for Families Tax Credits - principal caregiver - dependent child - primary responsibility for day-to-day care - meaning of "temporary basis"

This item considers whether a person looking after a child on a temporary basis can become eligible to receive Working for Families Tax Credits (WfFTC). The item provides guidance on the "principal caregiver" and "dependent child" requirements. It concludes that generally a person who is caring for a child on a temporary basis would not be eligible for WfFTC because they would probably not meet the principal caregiver requirement, and also the child would likely not be their dependent child.

BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR 715)*. You can download this publication free from our website at **www.ird.govt.nz**

PUBLIC RULING - BR PUB 16/01: GOODS AND SERVICES TAX – LOCAL AUTHORITY RATES APPORTIONMENTS ON PROPERTY TRANSACTIONS WHERE THE RATES HAVE BEEN PAID BEYOND SETTLEMENT – IMPLICATIONS FOR VENDOR

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of ss 8 and 10 and the definition of "consideration" in s 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the sale and purchase of real estate between a GST-registered vendor and a GST-registered or unregistered purchaser. The vendor has prepaid local authority rates beyond the date of settlement of the transaction. The vendor is supplying the property in the course or furtherance of their taxable activity.

Because the rates have been prepaid, the settlement statement apportions the rates between the vendor and the purchaser. On the settlement date, the purchaser is required to pay their share of the rates paid by the vendor, in addition to the purchase price for the real estate.

Section 14(1)(d) does not apply to the supply of the property.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The payment by the purchaser for their apportioned share of the prepaid rates (covering the period from the time of settlement) is part of the "consideration" (as defined in s 2(1)) for the supply of the property by the vendor.
- Under s 8, GST is chargeable on the supply of the property by a registered vendor by reference to the value of the supply. The value of that supply under s 10(2) includes the purchase price and the amount of the prepaid rates apportionment paid by the purchaser to the vendor.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 September 2015.

This Ruling is signed by me on 18 February 2016.

Susan Price

Director, Public Rulings

PUBLIC RULING - BR PUB 16/02: GOODS AND SERVICES TAX – LOCAL AUTHORITY RATES APPORTIONMENTS ON PROPERTY TRANSACTIONS WHERE THE RATES HAVE BEEN PAID BEYOND SETTLEMENT – IMPLICATIONS FOR PURCHASER

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of ss 8, 10 and 20(3C) and the definition of "consideration" in s 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the sale and purchase of real estate between a GST-registered or unregistered vendor and a GST-registered purchaser. The vendor has prepaid local authority rates beyond the date of settlement of the transaction. The purchaser acquires the property to use, or to be available to use, in making taxable supplies.

Because the rates have been prepaid, the settlement statement apportions the rates between the vendor and the purchaser. On the settlement date, the purchaser is required to pay their share of the rates paid by the vendor, in addition to the purchase price for the real estate.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The payment by the purchaser for their apportioned share of the prepaid rates (covering the period from the time of settlement) is part of the "consideration" (as defined in s 2(1)) for the supply of the property by the vendor.
- If the purchaser is entitled to an input tax deduction on the supply of the property, then the purchaser can claim an input tax deduction (to the extent to which the property is used for, or is available for use in, making taxable supplies) on the total amount of consideration for the supply.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 September 2015.

This Ruling is signed by me on 18 February 2016.

Susan Price

Director, Public Rulings

PUBLIC RULING - BR PUB 16/03: GOODS AND SERVICES TAX – LOCAL AUTHORITY RATES APPORTIONMENTS ON PROPERTY TRANSACTIONS WHERE THE RATES ARE IN ARREARS – IMPLICATIONS FOR VENDOR

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of ss 8 and 10 and the definition of "consideration" in s 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the sale and purchase of real estate between a GST-registered vendor and a GST-registered or unregistered purchaser. The local authority rates for the property are in arrears on the settlement date and the parties have agreed that the purchaser will pay the outstanding amount. The vendor is supplying the property in the course or furtherance of their taxable activity.

Because the rates are in arrears and the parties have agreed that the purchaser will pay the outstanding amount to the local authority, the settlement statement provides a credit to the purchaser for the vendor's share of the outstanding amount.

Section 14(1)(d) does not apply to the supply of the property.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Where the vendor allows a credit against the purchase price for unpaid rates, the consideration (as defined in s 2(1)) for the vendor's supply of the property to the purchaser is the amount received by the vendor from the purchaser (being the purchase price less the credit against the purchase price), together with the amount of the outstanding local authority rates that the purchaser has agreed to discharge.
- Under s 8, GST is chargeable on the supply of the property by a registered vendor by reference to the value of the supply. The value of the supply under s 10(2) includes the amount received by the vendor from the purchaser, as well as the amount of the outstanding local authority rates that the purchaser has agreed to discharge.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 September 2015.

This Ruling is signed by me on 18 February 2016.

Susan Price

Director, Public Rulings

PUBLIC RULING - BR PUB 16/04: GOODS AND SERVICES TAX – LOCAL AUTHORITY RATES APPORTIONMENTS ON PROPERTY TRANSACTIONS WHERE THE RATES ARE IN ARREARS – IMPLICATIONS FOR PURCHASER

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of ss 8, 10 and 20(3C) and the definition of "consideration" in s 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the sale and purchase of real estate between a GST-registered or unregistered vendor and a GST-registered purchaser. The local authority rates for the property are in arrears on the settlement date and the parties have agreed that the purchaser will pay the outstanding amount. The purchaser acquires the property to use, or to be available to use, in making taxable supplies.

Because the rates are in arrears and the parties have agreed that the purchaser will pay the outstanding amount to the local authority, the settlement statement provides a credit to the purchaser for the vendor's share of the outstanding amount.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Where the vendor allows a credit against the purchase price for unpaid rates, the consideration (as defined in s 2(1)) for the vendor's supply of the property to the purchaser is the amount received by the vendor from the purchaser (being the purchase price less the credit against the purchase price), together with the amount of the outstanding local authority rates that the purchaser has agreed to discharge.
- If the purchaser is entitled to an input tax deduction on the supply of the property, then the purchaser can claim an input tax deduction (to the extent to which the property is used for, or is available for use in, making taxable supplies) on the total amount of consideration for the supply.

The period or income year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 24 September 2015.

This Ruling is signed by me on 18 February 2016.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULINGS BR PUB 16/01 TO BR PUB 16/04

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Rulings BR Pub 16/01, BR Pub 16/02, BR Pub 16/03 and BR Pub 16/04 ("the Rulings").

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

Summary

1. The Rulings address the question of how apportionments of local authority rates made in property transactions should be treated for GST. BR Pub 16/01 and BR Pub 16/02 apply to situations where the rates have been prepaid by the vendor beyond the settlement date. BR Pub 16/03 and BR Pub 16/04 apply to situations where the local authority rates for the property are in arrears on the settlement date and the parties have agreed that the purchaser will pay the outstanding rates, in exchange for a credit against the settlement amount for the vendor's share of the outstanding rates. BR Pub 16/01 and BR Pub 16/03 consider the GST implications for the vendor. BR Pub 16/02 and BR Pub 16/04 consider the GST implications for the purchaser.
2. This commentary explains the conclusions reached in the Rulings. After providing a brief introduction and setting out the relevant legislation, this commentary discusses:
   - **Consideration for a supply:** This part of the commentary discusses key principles regarding "consideration" – namely that "consideration" has a wide meaning and that a statutory obligation to a third party does not amount to "consideration".
   - **GST treatment of transactions where the rates are prepaid:** This part of the commentary explains the GST treatment where the rates have been prepaid beyond settlement. It explains that the payment of the rates apportionment to the vendor by the purchaser forms part of the total consideration for the supply of the property.
   - **GST treatment of transactions where the rates are in arrears:** This part of the commentary explains the GST treatment where the rates are in arrears at settlement and the vendor allows a credit against the purchase price for unpaid rates. It explains that the consideration for the vendor's supply of the property to the purchaser is the amount received by the vendor from the purchaser (being the purchase price less the credit against the purchase price), together with the amount of the outstanding local authority rates that the purchaser has agreed to discharge.
3. After the legal analysis, the commentary provides examples of a range of different property sale situations. The examples include discussion of how the Rulings apply to each situation, as well as model settlement statements and tax invoices.
4. The relevant legislation is set out in the appendix to the Rulings.

Background

5. Section 5(7) requires local authorities to charge GST on rates.
6. Local authorities (that is, city and district councils and some regional councils) charge ratepayers rates in advance under the Local Government (Rating) Act 2002. On the sale and purchase of land, a vendor may pass on to a purchaser the amount of rates that relate to the period of the purchaser's occupation of the land. Apportionment is usually provided for in the sale and purchase contract.
7. Confusion exists about whether the GST-inclusive or GST-exclusive rates amount should be apportioned and whether vendors should seek to recover a GST-inclusive rates amount from purchasers. The Rulings, and this commentary, seek to remove this confusion by explaining the effect of the rates apportionment on the amount of consideration the vendor receives.
8. The Rulings are reissues of BR Pub 10/10–10/13, which expired on 23 September 2015 (the expired rulings). The Rulings and commentary are essentially the same as the expired rulings. However, certain legislative amendments enacted after the expired rulings were issued affect the Rulings or commentary or both. The two main legislative changes to note are:
   - The definition of "input tax" in s 3A has been amended to remove the "principal purpose" test. It has been replaced with a new "use, or available for use" test under s 20(3C). That section, introduced from 1 April 2011, provides that input tax may be deducted to the extent to which the goods or services are used for, or are available for use in, making taxable supplies. BR Pub 16/02 and BR Pub 16/04, and the relevant examples, accordingly refer to the new "use, or available for use" test in the Act, rather than the previous "principal purpose" test.
   - Section 11(1)(mb) applies to supplies made on or after 1 April 2011. It zero-rates supplies consisting wholly or partly of land if:

- both the vendor and the purchaser are GST registered; and
- the purchaser intends to use the goods for making taxable supplies; and
- the purchaser does not intend to use the land as a principal place of residence for themselves or any relative (as determined under s 2A(1)(c)).

In determining the tax treatment of the supply of land, the vendor may rely on the written statement that the purchaser is required to give them under s 78F. The statement must address the three points set out above and must also provide the purchaser's registration number.

The commentary and the relevant examples in the Rulings reflect the application of s 11(1)(mb).

Application of the Legislation

9. This part of the commentary explains the reasoning behind the Rulings. It begins by outlining some general principles regarding "consideration". Following this, it discusses the two different situations to which the Rulings apply – where rates are prepaid and where rates are in arrears. Finally, the commentary considers the effect of ss 11(1)(mb), 11(1)(m) and 5(15) on the application of the Rulings.

Consideration for a supply

Wide definition of "consideration"

10. "Consideration" is very widely defined in the Act. The definition of "consideration" in s 2(1) includes any payment made, whether by the recipient of the supply or by any other person. Therefore, consideration is not limited to payments made by the recipient of the supply.

11. Case law has also established that:
    - It is not crucial that the payment be made to the supplier; it is sufficient that the payment (or any act of forbearance if that were relevant) be made in respect of, in response to, or for the inducement of the supply. Accordingly, if A makes a supply of goods and services to B and in response, at the request of A, B pays an amount of money to C, then there is still an amount of consideration for the supply of goods and services.
    - Consideration may be voluntary or involuntary.
    - The statutory meaning of "consideration" is wider than the contract law meaning.
    - For a payment to be "consideration" there must, however, be a sufficient relationship between the making of the payment and the supply of goods and services.

Statutory obligation to a third party does not amount to "consideration"

12. Although "consideration" is a wide concept, case law has established that where the recipient of a supply is required by law to undertake an obligation to a third party, then any discharge of that obligation by the recipient is not the provision of consideration for the supply. Conversely, where the recipient has no such statutory obligation, then any discharge of the obligation by the recipient is part of the consideration for the supply: *The Trustee, Executors and Agency Co NZ Ltd v CIR* (1997) 18 NZTC 13,076 (HC); *Iona Farm Ltd v CIR* (1999) 19 NZTC 15,261 (HC).

13. In *Trustee, Executors and Agency Co*, the High Court found that the payment of rates by a lessee was part of the consideration for the supply of land by way of lease. An important part of that conclusion was Chisholm J's finding that the lessor trust was the occupier of the farm property. Therefore, the lessor trust was primarily liable for rates levied against the farm. The lessee had no statutory obligation to pay the rates. Therefore, the lessee's payment of the rates to the local authority was a payment on behalf of the trust and was part of the consideration for the supply.

14. In the later decision of the High Court in *Iona Farm Ltd*, Young J found that the open market rental (the relevant concept for determining the consideration for the supply in that case) for a farm exceeded the GST registration threshold. The threshold was exceeded without taking into account any rates that the lessee was paying. Even so, his Honour noted that the Commissioner had sought to suggest that the rates that the lease required the lessees to pay should be treated as part of the consideration for the lease, relying on the decision in *Trustee, Executors and Agency Co*. His Honour noted that the lease in *Iona Farm* was for a period longer than 12 months, so the primary rating liability lay on the lessee (and not the lessor). In that respect, the case was distinguishable from the *Trustee, Executors and Agency Co* case. Accordingly, because the lessee already had a legal obligation under statute to pay the rates, agreeing to pay them in an agreement with the lessor could not be consideration for the supply.

Where the rates are prepaid

15. The Commissioner considers that apportionments of prepaid rates are a part of the consideration for the vendor's supply of land.

16. A sale of land is a supply of goods for GST purposes. As a matter of contract, the vendor and purchaser can agree to any price for the land (including any

apportionments). The Agreement for Sale and Purchase of Real Estate (9th edition, 2012), approved by the Real Estate Institute of New Zealand and Auckland District Law Society, is widely used in property transactions. It records the purchase price that the parties have agreed on for the property. The Agreement provides at cl 3.5 that the vendor shall prepare a "settlement statement". This is defined in cl 1.1(21) as follows:

> a statement showing the purchase price plus any GST payable by the purchaser in addition to the purchase price, less any deposit or other payments or allowances to be credited to the purchaser, together with apportionments of all incomings and outgoings apportioned at the possession date.

17. The settlement statement usually records the apportionment of rates that the parties have agreed on. Such an apportionment is an amount to be paid *in addition* to the purchase price recorded in the Agreement. It forms part of the consideration the purchaser provides to obtain the property from the vendor.

18. Clause 3.8 of the Agreement requires that the purchaser shall pay the balance of the purchase price, interest and "other moneys", if any, on the settlement date. The Commissioner considers that any rates apportionments recorded on the settlement statement are "other moneys".

19. Another widely used agreement is the Real Estate Institute of New Zealand Inc Agreement for Buying and Selling Real Estate (REINZ Agreement). Clause 23.1 of the REINZ Book of Standard Clauses accompanying the REINZ Agreement similarly states that:

> A settlement statement must include, among other things:
>
> - the price
> - the amount of the price already paid (including the deposit)
> - adjustments for any outgoings like rates (but not insurance premiums)
> - adjustments for any incomings like rent
> - the GST that must be paid (if any)
> - the amount due on settlement.

20. The Commissioner considers that the payment of rates apportionments by the purchaser to the vendor forms part of the consideration for a single supply. Rates apportionments are paid in respect of, in response to, or for the inducement of the supply of land. An agreement to apportion rates does not create a supply to the purchaser from the vendor separate from the supply of the real property. This is because no good or service, separate from the real property, is furnished or provided to the purchaser by the vendor for that payment.

21. Although the purchaser may experience a benefit from the vendor paying the rates for a period in which the purchaser will own the property, that benefit is not a supply. For there to be a supply, there must be a supply of something. Here the purchaser has no liability to pay rates until they are personally sent a rates assessment and/or invoice for the property. The vendor has not supplied to the purchaser a forbearance from having to pay rates, since the purchaser never had an obligation to pay those rates. Therefore, the vendor cannot make such a supply to them. Furthermore, if the purchaser receives a benefit (of not having to pay rates), that benefit is gained only because the vendor complied with their statutory obligation and not because the purchaser paid a rates apportionment. The purchaser would have received the benefit even if the purchaser did not pay the rates apportionment.

22. As the payment from the purchaser to the vendor reflecting the apportionment of prepaid rates is a payment in respect of, in response to, or for the inducement of the single supply of land, the payment increases the "consideration" and value of the supply for GST purposes. Accordingly, GST should be charged on the amount of that apportionment received by a GST-registered vendor.

23. The purchaser can claim an input tax deduction (to the extent to which the property is used for, or is available for use in, making taxable supplies) if they are entitled to an input tax deduction for the other consideration paid.

Where the rates are in arrears

The Local Government (Rating) Act 2002

24. A purchaser's liability for rates that are in arrears is a contingent liability. That is, the vendor has primary responsibility for rates invoiced during the time the vendor owns the property. Only in the event of the vendor's default would the purchaser be pursued for those rates. This is important because the existence or non-existence of a statutory obligation on the purchaser to pay an amount can affect whether payment of that amount gives rise to consideration for a supply. The continued existence of a primary liability on a vendor means the purchaser can give value to the vendor by agreeing to discharge the vendor's liability. If the liability is solely on the purchaser to meet an obligation, then no such consideration can be given to the vendor when the purchaser discharges that liability.

25. The Local Government (Rating) Act 2002 ("LGRA") states that a local authority can charge rates (ss 13–20 of the LGRA) and, where rates are charged, those rates are to be paid by the ratepayer (s 12 of the LGRA). The ratepayer is the person listed in the rating information database and the district valuation roll (s 10 of the LGRA). This is usually the owner or the lessee (s 11 of the LGRA).
26. When the rates are assessed, the ratepayer is given notice of their rates liability by a rates assessment: s 44 of the LGRA. If rates are due for a particular period, then the ratepayer is sent a rates invoice: s 46 of the LGRA. The rates invoice also includes a due date (s 46 of the LGRA). Both the rates assessment and the rates invoice name the ratepayer who is liable for the rates (ss 45 and 46 of the LGRA).
27. Therefore, if the vendor is the ratepayer, the vendor will be sent the rates assessment and rates invoice and be liable for the rates. Because the vendor is named as the ratepayer and receives the rates assessment and rates invoice, the vendor remains liable for those rates until they are paid. If the vendor sells their property, they must notify the local authority of the sale within one month (s 31 of the LGRA) and the vendor will remain liable for the rates that are due while the vendor is listed as the ratepayer. Section 34 of the LGRA states:

    > Notice given under sections 31 to 33 does not release any person from liability for any rates that are due before the notice is given.

28. However, while the vendor may be liable for rates that were charged before the sale of the property that remained unpaid when the property was sold, the new purchaser can also become responsible for the unpaid rates. A purchaser can become liable for the rates because the rates are a charge on the land (s 59 of the LGRA) and the charge survives a sale of the property concerned.

Analysis

29. There is only one supply by the vendor where rates are in arrears – the supply of the property. The question is whether the discharge of the rates by the purchaser can be consideration for the supply of the property by the vendor.
30. Case law establishes that a taxpayer's fulfilment of their statutory obligation cannot amount to consideration for a supply from a supplier. However, in the context of the rating legislation the primary responsibility for discharging unpaid rates remains with the vendor, regardless of the sale of the property to the purchaser. The purchaser has only a contingent liability to pay the rates. It is contingent because, as the rates are a charge on the land, the local authority may, if unable to collect the rates from the vendor, seek payment by enforcing that charge on the land. In this sense, the purchaser is able to give consideration for the supply of the property by the vendor by offering to discharge the unpaid rates as part of the bargain for the property. In such a case, the purchaser is not simply fulfilling its statutory obligation, as that obligation is only contingent. Such a discharge of rates, by virtue of a contract between vendor and purchaser, can be consideration for the supply of the property.
31. Where the vendor allows a deduction from the settlement amount in return for a promise by the purchaser to discharge the unpaid local authority rates, the overall consideration received by the vendor from the purchaser is made up of three elements:
    - the purchase price;
    - the credit of the vendor's share of the unpaid rates against the purchase price; and
    - the total amount of the vendor's liability to the local authority that the purchaser has agreed to discharge.
32. That is, the consideration for the vendor's supply is made up of the actual monetary consideration received by the vendor from the purchaser and the discharge of the vendor's liability to the local authority.
33. The amount of the vendor's liability to the local authority that the purchaser has agreed to discharge, less the credit of the vendor's share of the unpaid rates against the purchase price, will generally equal the purchaser's share of the unpaid rates. This means that the consideration remains the same as in a "prepaid rates" situation, being equal to the purchase price plus the purchaser's share of the rates. The difference between the "prepaid rates" and "rates in arrears" situations is that where rates are prepaid, the consideration is the total amount paid by the purchaser to the vendor; whereas, where rates are in arrears, the consideration is the total amount paid by the purchaser to the vendor and to the local authority.
34. This is consistent with the definition of "consideration" in s 2(1). That definition includes any payment made "in respect of, in response to, or for the inducement of" the supply of any goods and services, but does not require the payment to be made to the supplier.

Sections 11(1)(mb) and 11(1)(m) of the GST Act

35. Section 11(1)(mb) zero-rates a sale of land where the supply is between registered persons and wholly or partly consists of land that the purchaser intends to use for making taxable supplies (s 11(1)(mb)).

36. If for some reason the supply of land is not covered by s 11(1)(mb), s 11(1)(m) might apply to zero-rate the supply of the land if it is a taxable activity, or part of a taxable activity, that is a going concern.
37. The effect of the zero-rating provisions of ss (11)(1)(mb) and 11(1)(m) is that the rates apportionment, since it forms part of the consideration for the supply of a zero-rated property, will also be zero-rated.

Section 5(15) of the GST Act

38. If the property being transferred is to be used by the purchaser in a taxable activity and the property also includes a house (for example, farm land that includes a house), s 5(15) deems the house (not being a commercial dwelling) to be a separate supply from the supply of the land in certain circumstances.
39. The effect of s 5(15) is that GST is charged (at either the standard rate or, if ss 11(1)(mb) or 11(1)(m) apply, at zero percent) only on the commercial supply (that is, the farm land) and not on the residential supply (that is, the house). The rates apportionment, since it forms part of the consideration for the property, will be divided between the dwelling and the land. One possible method for dividing the rates apportionment between the dwelling and the land is given in Example 7 in [89] to [98].

Examples

40. This part of the commentary discusses seven different land sale examples and sets out the GST consequences of each scenario. Examples 1–3 are situations where the rates are prepaid, so they explain the application of BR Pub 16/01 and BR Pub 16/02. Examples 4-6 are situations where the rates are in arrears, so they explain the application of BR Pub 16/03 and BR Pub 16/04. Example 7 is a situation where s 5(15) applies.
41. Each example discusses the GST consequences of the transaction, shows a sample settlement statement and, if applicable, shows a sample tax invoice. The sample settlement statements and tax invoices are not prescriptive; they are examples of how these documents might be drafted.

Situations where rates are prepaid

Assumptions underpinning Examples 1–3

42. The GST position for rates paid in advance is illustrated in the property sale examples that follow. In Examples 1–3 assume the following:
    - The vendor is selling property to the purchaser.
    - The purchase price the parties have agreed is $400,000 (plus GST, if any). The purchaser has paid a deposit of $40,000.
    - The settlement date is 26 April 2015.
    - The vendor has paid the local authority rates in advance to 30 June 2015.
    - The annual rating liability to the local authority is $2,518.50 (inclusive of $328.50 of GST).
    - The amount of rates relating to the period of the purchaser's occupation of the land is $448.50 (inclusive of $58.50 of GST). This amount is payable by the purchaser to the vendor under the agreement for sale and purchase of the land.

***Example 1:** Sale by an unregistered vendor*

43. An unregistered vendor is not entitled to an input tax deduction for the rates they have paid in advance to the local authority. The supply of the property will not be a taxable supply for GST purposes.
44. In the absence of a provision in the Property Law Act 2007 or elsewhere, the amount of the apportionment is a matter for negotiation between the vendor and purchaser. Usually, however, the vendor would wish to recover the full GST-inclusive amount of $448.50.
45. The total consideration paid by the purchaser and received by the vendor would be $400,448.50.
46. If the purchaser is unregistered, the Act does not allow an input tax deduction.
47. If the purchaser is registered and entitled to a secondhand goods deduction on the overall property purchase, then the purchaser is able to claim an input tax deduction for the rates apportionment under s 20(3). However, the purchaser is only able to claim a secondhand goods deduction on the property purchase and the rates apportionment to the extent to which the property is used for, or is available for use in, making taxable supplies under s 20(3C).
48. The vendor's settlement statement would be:

Purchaser:
Vendor:
Settlement Date: 26 April 2015

ADDRESS OF PROPERTY

TO:	Purchase price in accordance with contract	400,000.00	
BY:	Deposit paid		40,000.00
TO:	Purchaser's proportion of rates from 27/4/15 to 30/6/15 (65 days at $2,518.50 p/a)	448.50	
BY:	Balance required to settle		360,448.50
		$400,448.50	$400,448.50
Amount required to settle on 26 April 2015		$360,448.50	

49. The vendor is unregistered, so a GST tax invoice is not required.

Example 2: *Sale by a registered vendor – standard rate*

50. In this example assume the following (in addition to the assumptions set out at [42]):
    - The vendor is selling the property to a purchaser who is:
      - unregistered; or
      - registered, but does not intend using the property for making taxable supplies; or
      - registered, but intends using the property as a principal place of residence for themselves or any of their relatives.

51. If the vendor can satisfy the requirements of s 20(3), the vendor will be able to claim an input tax deduction for the GST on the amount of annual rates they have prepaid to the local authority.

52. In this example, the supply of the land is in the course or furtherance of the vendor's taxable activity, so it is a taxable supply on which the vendor must charge and return GST output tax. The consideration for the land itself will therefore be $400,000 plus $60,000 of output tax. The apportionment of the rates paid will also be part of the consideration for that supply. This part of the consideration will be $390 plus $58.50 of output tax, which the vendor must return to Inland Revenue. The total consideration for the supply will be $460,448.50.

53. If the purchaser is unregistered, the Act does not allow an input tax deduction.

54. If the purchaser is registered they will not be able to claim an input tax deduction, because the property will not be used for, or be available for use in, making taxable supplies.

55. The vendor would return GST output tax on the value of the supply of land (including the apportionments) and would issue a tax invoice to the purchaser inclusive of the apportionments.

56. The vendor's settlement statement would be:

Purchaser:
Vendor:
Settlement Date: 26 April 2015

ADDRESS OF PROPERTY

TO:	Purchase price in accordance with contract	400,000.00	
TO:	GST as per tax invoice	60,058.50	
BY:	Deposit paid		40,000.00
TO:	Purchaser's proportion of rates from 27/4/15 to 30/6/15 (65 days at $2,190 p/a GST exclusive)	390.00	
BY:	Balance required to settle		420,448.50
		$460,448.50	$460,448.50
Amount required to settle on 26 April 2015		$420,448.50	

57. The vendor's tax invoice would be:

TAX INVOICE

23 April 2015

From: Vendor's name — GST number: XXX-XXX-XXX
Vendor's address

To: Purchaser's name
Purchaser's address

ADDRESS OF PROPERTY

TO:	Purchase price as per agreement	400,000.00
TO:	Purchaser's share of rates apportioned as at settlement date	390.00
TO:	GST on total value of supply	60,058.50
		$460,448.50

Total GST: **$60,058.50**

Settlement date – 26 April 2015

Example 3: *Sale by a registered vendor – zero-rated*

58. As discussed at [35]–[37] above, a zero-rated sale of land arises under ss 11(1)(mb) or 11(1)(m).

59. If the vendor can satisfy the requirements of s 20(3), the vendor will be able to claim an input tax deduction for the GST on the amount of annual rates they have prepaid to the local authority.

60. In this situation, the apportionments on sale should be GST exclusive ($390) rather than inclusive ($448.50), which is consistent with zero-rating the supply of land.

61. The total consideration paid by the purchaser and received by the vendor would be $400,390.

62. As the sale is zero-rated, the purchaser cannot claim an input tax deduction for any element of the consideration for the property, including the rates apportionment.

63. The vendor's settlement statement would be:

Purchaser:
Vendor:
Settlement Date: 26 April 2015

ADDRESS OF PROPERTY

TO:	Purchase price in accordance with contract	400,000.00	
TO:	GST as per tax invoice	nil	
BY:	Deposit paid		40,000.00
TO:	Purchaser's proportion of rates from 27/4/15 to 30/6/15 (65 days at $2,190 p/a GST exclusive)	390.00	
BY:	Balance required to settle		360,390.00
		$400,390.00	$400,390.00
Amount required to settle on 26 April 2015		$360,390.00	

64. The vendor's tax invoice would be:

TAX INVOICE

23 April 2015

From: Vendor's name, Vendor's address — GST number: XXX-XXX-XXX

To: Purchaser's name, Purchaser's address

ADDRESS OF PROPERTY

TO:	Purchase price as per agreement	400,000.00
TO:	Purchaser's share of rates apportioned as at settlement date	390.00
TO:	GST on total value of supply	nil
		$400,390.00

Settlement date – 26 April 2015

Situations where the rates are in arrears

Assumptions underpinning Examples 4–6

65. The GST position for rates in arrears is illustrated in the land sale examples that follow. In Examples 4–6 assume the following:
    - The vendor is selling property to the purchaser.
    - The purchase price the parties agreed is $400,000 (plus GST, if any). The purchaser has paid a deposit of $40,000.
    - The settlement date is 26 April 2015.
    - The vendor has not paid the local authority rates from 1 April 2015 (that is, the rates are in arrears for the current rating quarter).
    - The annual rating liability to the local authority is $2,518.50 (inclusive of $328.50 of GST).
    - The amount outstanding for the current quarter is $627.90 (inclusive of $81.90 of GST). Of this figure, the amount of rates relating to the period of the vendor's occupation of the land is $179.40 (inclusive of $23.40 of GST).
    - The parties have agreed that the purchaser will discharge the unpaid rates in exchange for a deduction from the settlement amount for the amount of rates relating to the period of the vendor's occupation of the land.

***Example 4:** Sale by an unregistered vendor*

66. In a sale by an unregistered vendor, the supply of the property will not be a taxable supply for GST purposes.

67. The amount of the credit against the purchase price is a matter for negotiation between the vendor and purchaser. In this example, the parties have agreed to a credit of the GST-inclusive amount of the vendor's share of the rates: $179.40. This is a figure that is likely to be agreed to by two parties to an arm's length transaction because using this figure puts both parties in the same position they would have been in if the vendor had paid the rates up until settlement and the purchaser had paid the rates from settlement onwards.

68. As discussed at [31] above, the consideration is made up of three elements. These elements are:
    - the purchase price: $400,000;
    - the credit of the vendor's share of the unpaid rates against the purchase price: $179.40; and
    - the total amount of vendor's liability to the local authority that the purchaser has agreed to discharge: $627.90.

69. Therefore, the total consideration for the supply will be $400,448.50.

70. If the purchaser is unregistered, the Act does not allow an input tax deduction for any element of the transaction.

71. If the purchaser is registered and can satisfy the requirements of s 20(3), the purchaser is able to claim a secondhand goods deduction for the property purchase. The consideration will be $400,448.50, so this is the figure the purchaser should use for calculating the amount of input tax. However, the purchaser is only able to claim a secondhand goods deduction on the property purchase and the rates apportionment to the extent to which the property is used for, or is available for use in, making taxable supplies under s 20(3C).

72. The vendor is unregistered, so a GST tax invoice is not required. The vendor's settlement statement would be:

Purchaser: Vendor: Settlement Date: 26 April 2015			
ADDRESS OF PROPERTY			
TO:	Purchase price in accordance with contract	400,000.00	
TO:	Rates to be paid by purchaser as agreed by parties	627.90	
BY:	Deposit paid		40,000.00
BY:	Credit for vendor's proportion of unpaid rates from 1/4/15 to 26/4/15 (26 days at $2,518.50 p/a)		179.40
BY:	Amount to be paid by purchaser to local authority to discharge vendor's liability for outstanding rates		627.90
BY:	Balance required to settle		359,820.60
		$400,627.90	$400,627.90
Amount required to settle on 26 April 2015		$359,820.60	

Example 5: *Sale by a registered vendor – standard rate*

73. In this example assume the following (in addition to the assumptions set out at [65]):
    - The vendor is selling the property to a purchaser who is:
      - unregistered; or
      - registered, but does not intend using the property for making taxable supplies; or
      - registered, but intends using the property as a principal place of residence for themselves or any of their relatives.

74. In this example, the supply of the land is in the course or furtherance of the vendor's taxable activity and is therefore a taxable supply on which the vendor must charge and return GST output tax.

75. The amount of the credit against the purchase price is a matter for negotiation between the vendor and purchaser. In this example, the parties have agreed to credit the GST-exclusive amount of the vendor's share of the rates ($156) against the property's GST-exclusive purchase price. (This gives the same result as a credit of the GST-inclusive amount of the vendor's share of the rates ($179.40) against the property's GST-inclusive purchase price.) This is a figure that is likely to be agreed to by two parties to an arm's length transaction because using this figure puts both parties in the same position they would have been in if the vendor had paid the rates up until settlement and the purchaser had paid the rates from settlement onwards.

76. As discussed at [31] above, the consideration is made up of three elements. These elements are:
    - the purchase price: $400,000 plus GST, so $460,000;
    - the credit of the vendor's share of the unpaid rates against the purchase price: $179.40; and
    - the total amount of vendor's liability to the local authority that the purchaser has agreed to discharge: $627.90.

77. Therefore, the total consideration for the supply will be $460,448.50. As consideration is a GST-inclusive amount, the correct amount of GST on the supply is the tax fraction of the consideration - $60,058.50. The vendor must charge and return this amount.

78. If the purchaser is unregistered, the Act does not allow an input tax deduction.

79. If the purchaser is registered, they will not be able to claim an input tax deduction because the property will not be used for, or be available for use in, making taxable supplies.

80. The vendor's settlement statement would be:

Purchaser: Vendor: Settlement Date: 26 April 2015			
ADDRESS OF PROPERTY			
TO:	Purchase price in accordance with contract	400,000.00	
TO:	Rates to be paid by purchaser as agreed by parties (GST exclusive)	546.00	
TO:	GST as per tax invoice	60,058.50	
BY:	Deposit paid		40,000.00
BY:	Credit for vendor's proportion of unpaid rates from 1/4/15 to 26/4/15 (26 days at $2,190 p/a GST exclusive)		156.00
BY:	Amount to be paid by purchaser to local authority to discharge vendor's liability for outstanding rates		627.90
BY:	Balance required to settle		419,820.60
		$460,604.50	$460,604.50
Amount required to settle on 26 April 2015		$419,820.60	

81. The vendor's tax invoice would be:

TAX INVOICE

23 April 2015

From:	Vendor's name Vendor's address	GST number: XXX-XXX-XXX
To:	Purchaser's name Purchaser's address	
ADDRESS OF PROPERTY		
TO:	Purchase price as per agreement, less discount for unpaid rates	$399,844.00
TO:	Rates to be paid by purchaser to local authority	$546.00
TO:	GST on total value of supply	$60,058.50
		$460,448.50

Total GST: **$60,058.50**

Settlement date – 26 April 2015

***Example 6:** Sale by a registered vendor – zero-rated*

82. As discussed at [35]–[37] above, a zero-rated sale by a registered vendor arises under ss 11(1)(mb) or 11(1)(m).

83. The amount of the credit against the purchase price is a matter for negotiation between the vendor and purchaser. In this example, the parties have agreed to a credit of the GST-inclusive amount of the vendor's share of the rates ($179.40) **plus** the amount of GST input tax credit that the vendor has claimed on the purchaser's share of the rates ($58.50): $237.90. This is a figure that is likely to be agreed to by two parties to an arm's length transaction because using this figure puts both parties in the same position as they would have been in if the vendor had paid the rates up until settlement and the purchaser had paid the rates from settlement onwards.

84. As discussed at [31] above, the consideration is made up of three elements. These elements are:

- the purchase price: $400,000;
- the credit of the vendor's share of the unpaid rates **and** the GST on the purchaser's share of the rates against the purchase price: $237.90; and
- the total amount of vendor's liability to the local authority that the purchaser has agreed to discharge: $627.90.

85. Therefore, the total consideration for the supply will be $400,390.

86. As the sale is zero-rated, the purchaser cannot claim an input tax deduction for any element of the consideration for the property, including the rates apportionment.

87. The vendor's settlement statement would be:

Purchaser:			
Vendor:			
Settlement Date:	26 April 2015		
ADDRESS OF PROPERTY			
TO:	Purchase price in accordance with contract	400,000.00	
TO:	Rates to be paid by purchaser as agreed by parties	627.00	
TO:	GST as per tax invoice	nil	
BY:	Deposit paid		40,000.00
BY:	Credit for vendor's proportion of unpaid rates from 1/4/15 to 26/4/15 (26 days at $2,518.50 p/a GST inclusive)		179.40
BY:	Credit for GST claimed by vendor on purchaser's share of rates		58.50
BY:	Amount to be paid by purchaser to local authority to discharge vendor's liability for outstanding rates		627.90
BY:	Balance required to settle		359,762.10
		$400,627.90	$400,627.90
Amount required to settle on 26 April 2015		$359,762.10	

88. The vendor's tax invoice would be:

TAX INVOICE		
25 April 2015		
From:	Vendor's name Vendor's address	GST number: XXX-XXX-XXX
To:	Purchaser's name Purchaser's address	
ADDRESS OF PROPERTY		
TO:	Purchase price as per agreement, less discount for unpaid rates	$399,762.10
TO:	Rates to be paid by purchaser to local authority	$627.90
TO:	GST on total value of supply	nil
		$400,390.00
Settlement date – 26 April 2015		

Situations where s 5(15) applies

***Example 7:** Sale by a registered vendor to a registered purchaser – sale of commercial land with a principal place of residence*

89. In this example assume the following:

- The vendor is selling property to the purchaser.
- The land in question is farm land that includes a farm house.
- The purchaser is registered and intends using the farm land for making taxable supplies.
- The purchase price agreed on by the parties is $2,500,000 (plus GST). The purchaser has paid a deposit of $250,000.
- The value of the farm house and curtilage is $500,000.
- The settlement date is 26 April 2015.
- The vendor has paid the local authority rates in advance to 30 June 2015.
- The annual rating liability to the local authority is $7,300 (exclusive of $1,095 of GST). The amount of rates relating to the period of the purchaser's occupation of the land is $1,300 (exclusive of $195 of GST). This amount is payable by the purchaser to the vendor under the agreement for sale and purchase of the land.

90. If the vendor can satisfy the requirements of s 20(3), the vendor can claim an input tax deduction for the GST component of the rates they have prepaid to

the local authority. This input tax deduction will be subject to an adjustment for private use.

91. In this example, the supply of the land is in the course or furtherance of the vendor's taxable activity. It is therefore a taxable supply but it is zero-rated under s 11(1)(mb). The farm house and curtilage is a non-taxable supply.

92. The rates apportionment will be part of the consideration for the supply. The amount of the apportionment is a matter for negotiation between the vendor and purchaser. In this example, the parties have agreed that the rates apportionment will be $1,300 plus the portion of the GST of $195 on the $1,300 that the vendor is unable to claim an input tax deduction for because it relates to the farm house and curtilage. This amount will depend on the amount of the rates apportionment that is allocated to the land and the amount that is allocated to the farm house and curtilage. It may be able to be calculated by reference to the local authority rates demand.

93. In this example the local authority rates demand shows that:

- 24% of the rates amount is directly attributable to the taxable supply (that is, relates to services provided in relation to the farm land) – 24% of $1,300 is $312. GST is charged at 0% on $312.
- 16% is directly attributable to the non-taxable supply (that is, relates to services provided in relation to the farm house and curtilage) – 16% of $1,300 is $208. GST, at the standard rate, of $31.20 is added to $208. This is part of the portion of the GST of $195 on the $1,300 that the vendor is unable to claim an input tax deduction for because it relates to the farm house and curtilage.
- The remaining 60% is attributable to both the taxable and the non-taxable supply – 60% of $1,300 is $780. GST is charged at 0% on 80% of $780 (ie, on $624). This is because the taxable supply (the farm land) makes up 80% of the total supply. GST, at the standard rate, of $23.40 is added to the remaining 20% of $780 (ie, to $156). This is the other part of the portion of the GST of $195 on the $1,300 that the vendor is unable to claim an input tax deduction for. It is added to the $31.20, giving a total of $54.60.

94. The rates apportionment on sale will therefore be $1,354.60 (ie, $1,300 plus $54.60).

95. The total consideration for the supply will be $2,501,354.60.

96. As the supply of the land is zero-rated and the supply of the farm house and curtilage is non-taxable, the purchaser cannot claim an input tax deduction for any element of the consideration for the property, including the rates apportionment.

97. The vendor's settlement statement would be:

Purchaser:
Vendor:
Settlement Date: 26 April 2015

ADDRESS OF PROPERTY

TO:	Purchase price in accordance with contract	2,500,000.00	
TO:	GST as per tax invoice	nil	
BY:	Deposit paid		2,500,000.00
TO:	Purchaser's proportion of rates from 27/4/15 to 30/6/15 (65 days at $7,300 p/a GST exclusive PLUS Purchaser's proportion of GST on rates on house and curtilage)	1,354.60	
BY:	Balance required to settle		2,251,354.60
		$2,501,354.60	$2,501,354.60
Amount required to settle on 26 April 2015		$2,251,354.60	

98. The vendor's tax invoice shows how the rates apportionment may be divided based on these figures:

TAX INVOICE

23 April 2015

From:	Vendor's name Vendor's address	GST number: XXX-XXX-XXX	
To:	Purchaser's name Purchaser's address		

ADDRESS OF PROPERTY

TO:	Purchase price as per agreement		$2,500,000.00
	Supply subject to GST Purchase price as per agreement	$2,500,000.00	
	LESS non-taxable supplies	$500,000.00	
	Taxable supply	$2,000,000.00	
TO:	GST on taxable supply – zero-rated		nil
TO:	Purchaser's share of rates apportioned as at settlement date		$1,354.60
	Rates attributable to the taxable supply: Rates attributable to both the taxable and non-taxable supplies	$780.00	
	Taxable supply as a percentage of the total supply (see "supply subject to GST" above)	80%	
	80% of $780.00	$624.00	
	PLUS Rates directly attributable to the taxable supply – zero-rated	$312.00	
		$936.00	

TO: GST on rates apportionment attributable to the taxable supply – zero-rated	nil
	$2,501,354.60

Total GST: **nil**

Settlement date – 26 April 2015

References

Expired Ruling(s)
BR Pub 99/8 "Local authority rates apportionments on property transactions – goods and services tax treatment" *Tax Information Bulletin* Vol 11, No 11 (December 1999): 4
BR Pub 10/10 "Local authority rates apportionments on property transactions where the rates have been paid beyond settlement – goods and services tax implications for vendor"; BR Pub 10/11 "Local authority rates apportionments on property transactions where the rates have been paid beyond settlement – goods and services tax implications for purchaser"; BR Pub 10/12 "Local authority rates apportionments on property transactions where the rates are in arrears – goods and services tax implications for vendor"; BR Pub 10/13 "Local authority rates apportionments on property transactions where the rates are in arrears – goods and services tax implications for purchaser" *Tax Information Bulletin* Vol 22, No 10 (November 2010): 3
Subject references
GST, local authority rates, rates apportionments
Legislative references
Goods and Services Tax Act 1985 – ss 2(1), 3A(1), 5(7)(a), 5(15), 8(1), 10(2), 11(1)(m), 11(1)(mb), 20(3) and 20(3C)
Local Government (Rating) Act 2002 – ss 10, 11, 13–20, 31, 34, 44–46 and 59
Case references
Iona Farm Ltd v CIR (1999) 19 NZTC 15,261 (HC)
The Trustee, Executors and Agency Co NZ Ltd v CIR (1997) 18 NZTC 13,076 (HC)

APPENDIX: LEGISLATION

Goods and Services Tax Act 1985

1. "Consideration" is defined in s 2(1) to mean:

   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; but does not include any payment made by any person as an unconditional gift to any non-profit body.

2. "Dwelling" is defined in s 2(1) to mean:

   (a) ... premises, as defined in section 2 of the Residential Tenancies Act 1986,—

   (i) that the person occupies, or that it can reasonably be foreseen that the person will occupy, as their principal place of residence; and

   (ii) in relation to which the person has quiet enjoyment, as that term is used in section 38 of the Residential Tenancies Act 1986; and

   (b) includes—

   (i) accommodation provided to a person who is occupying the same premises, or part of the same premises, as the supplier of the accommodation and who meets the requirements of paragraph (a)(i):

   (ii) any appurtenances belonging to or used with the premises:

   (iii) despite paragraph (a)(ii), a residential unit in a retirement village or rest home when the consideration paid or payable for the supply of accommodation in the unit is for the right to occupy the unit; and

   (iv) excludes a commercial dwelling:

3. "Input tax" is relevantly defined in s 3A(1) to mean:

   (a) tax charged under section 8(1) on a supply of goods or services acquired by the person:

   ...

4. Section 5(7)(a) relevantly states:

   For the purposes of this Act—

   (a) every local authority is deemed to supply goods and services to any person where any amount of rates is payable by that person to that local authority:

5. Section 5(15) states:

   When either of the following supplies are included in a supply, they are deemed to be a separate supply from the supply of any other real property that is included in the supply:

   (a) a supply of a principal place of residence:

   (b) a supply referred to in section 14(1)(d).

6. Section 8(1) states:

   Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

7. Section 10(2) defines "value of supply" relevantly as

follows:

> Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of,—
>
> (a) to the extent that the consideration for the supply is consideration in money, the amount of the money:
>
> (b) to the extent that the consideration for the supply is not consideration in money,—
>
> (i) the open market value of that consideration,
>
> ...

8. Section 11(1) relevantly states:

> A supply of goods that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:
>
> ...
>
> (m) the supply to a registered person of a taxable activity, or part of a taxable activity, that is a going concern at the time of the supply, if—
>
> (i) the supply is agreed by the supplier and the recipient, in writing, to be the supply of a going concern; and
>
> (ii) the supplier and the recipient intend that the supply is of a taxable activity, or part of a taxable activity, that is capable of being carried on as a going concern by the recipient; or
>
> (mb) the supply wholly or partly consists of land, being a supply—
>
> (i) made by a registered person to another registered person who acquires the goods with the intention of using them for making taxable supplies; and
>
> (ii) that is not a supply of land intended to be used as a principal place of residence of the recipient of the supply or a person associated with them under section 2A(1)(c); or
>
> ...

9. Section 20(3C) relevantly states:

> For the purposes of subsection (3), ...
>
> (a) input tax as defined in section 3A(1)(a) or (c) may be deducted to the extent to which the goods or services are used for, or are available for use in, making taxable supplies:
>
> ...

NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

NEW LEGISLATION – TAXATION (ANNUAL RATES FOR 2015–16, RESEARCH AND DEVELOPMENT, AND REMEDIAL MATTERS) ACT 2016

The Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill was introduced into Parliament on 26 February 2015. It received its first reading on 11 March 2015, second reading on 20 October 2015 and the third reading on 16 February 2016 followed by Royal assent on 24 February 2016.

The new legislation addresses tax impediments to research and development innovation, and clarifies the GST rules for bodies corporate. It also proposes a suite of measures to ensure the tax system is well maintained and that the tax and social policy rules operate as intended.

The new Act amends the Income Tax Act 2007, Income Tax Act 2004, Income Tax Act 1994, Income Tax Act 1976, Tax Administration Act 1994, Child Support Act 1991, Child Support Amendment Act 2013, Social Security Act 1964, Goods and Services Tax Act 1985, Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014, Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters Act 2013, Finance Act (No. 2) 1990 and the Goods and Services Tax (Grants and Subsidies) Order 1992.

"CASH OUT" OF RESEARCH AND DEVELOPMENT TAX LOSSES

Sections DF 1, DV 26, LA 7, LB 4B, MA 1, MF 6, MX 1 to MX 7, OB 47B, Table O2, sections RM 10, YA 1 and schedule 22 of the Income Tax Act 2007; sections 70C, 81 and 97C of the Tax Administration Act 1994; Goods and Services Tax (Grants and Subsidies) Order 1992

Changes have been made to the Income Tax Act 2007, Tax Administration Act 1994 and Goods and Services Tax (Grants and Subsidies) Order 1992 to allow tax loss-making research and development start-up companies to "cash out" their tax losses arising from research and development expenditure.

Key features

Research and development start-up companies will be able to receive a payment for up to 28 percent (the current company tax rate) of their tax losses from research and development expenditure in any given year.

To be eligible, the company must be a loss-making company resident in New Zealand, with a sufficient proportion of labour expenditure on research and development.

The amount of losses that can be cashed out will be capped at $500,000 for the 2015–16 year, increasing by $300,000 over the next five years, to $2 million. The amount that can be cashed out for any year is the smallest of that cap, the company's net loss for the year, the company's total research and development expenditure for the year, and 1.5 times the company's labour costs for research and development for the year. Because the cash-out is administered through the tax system, it is delivered in the form of a tax credit.

Research and development expenditure eligible for the measure is more restricted than the research and development expenditure that is deductible under sections DB 34 and DB 35 of the Act. Expenditure on certain activities and some types of expenditure are excluded from the measure.

A cashed-out loss can be thought of as an interest-free loan from the Government to be repaid from the taxpayer's future income; it is intended to provide a cashflow timing benefit only. In economic terms, repayment of cashed out losses will occur when a taxpayer pays tax on net income that would otherwise have been sheltered by the cashed out losses. An earlier repayment will also be triggered in certain circumstances. Triggers for the early repayment of amounts cashed out include the sale of research and development assets, liquidation or migration of the company, and the sale of the company. The early repayment will be effected via a new R&D repayment tax. Where a cashed out loss is required to be repaid early, a new deduction will reinstate the loss, which will be available to offset future income.

Background

The Government's Business Growth Agenda emphasises the importance of innovation to help grow New Zealand's economy. Innovation creates new sources of economic growth by delivering new products and generating improvements in the quality and cost of existing products. Encouraging business innovation is one of the seven key initiatives of the Government's Building Innovation workstream, which recognises that research and development is a key element in the innovation process.

The new rules focus on start-up companies engaging in intensive research and development, and are intended to reduce their exposure to market failures and tax distortions arising from the current tax treatment of losses.

High up-front costs associated with undertaking research and development mean that relative to other investment projects, the profit cycle for research and development projects tends to be much more heavily skewed towards early losses. This can pose a particularly significant barrier to undertaking research and development for innovative start-up companies. Larger firms generally have the ability to use those losses earlier, setting them off against existing streams of income.

The general tax rules delay the ability of loss-making businesses to use their deductions, as they are required to carry the losses forward. This provides an important integrity measure in the tax system to mitigate the creation of artificial losses. However, these current tax settings create a cashflow problem for certain companies in an on-going tax loss position.

This cashflow bias is particularly significant for companies undertaking research and development, and this can increase the cost of investing in research and development rather than in other assets.

Problems can be compounded for start-up companies undertaking research and development who are already likely to suffer from broader capital constraints.

The general tax rules can also penalise businesses that engage in research and development that ultimately turns out to be unsuccessful. This is because losses, in this case from unsuccessful research and development, can only be used going forward if there is a subsequent profitable business. The general rules therefore make the use of previous tax losses contingent upon successful innovation or future income earning by the same group of investors. The risk of incurring this potential additional sunk cost is likely to discourage investment in marginal research and development projects further.

The timing that those companies can access their tax losses is being brought forward, provided they meet certain criteria. This will help to reduce the bias against investment in these firms from current tax settings.

Consultation on the high level policy changes took place in July 2013, with the release of the officials' issues paper, *R&D tax losses*.

The new legislation received Royal assent on 24 February 2016.

Application date

The new rules apply to income years beginning on or after 1 April 2015.

Detailed analysis

Research and development expenditure

Section YA 1 and new schedule 22 of the Income Tax Act 2007

The new measure applies in respect of "R&D expenditure", as defined in section YA 1. "R&D expenditure" is basically expenditure incurred on research and development. The terms "research" and "development" have the same meanings as they do for accounting purposes. These are also the same definitions that govern deductibility of research and development expenditure under sections DB 34 and DB 35. Using the existing definition is simpler for taxpayers already familiar with it for accounting purposes. However, to ensure that the measure stays targeted, the definition of "R&D expenditure" is subject to certain limits.

Expenditure on an activity listed in a new schedule 22 of the Income Tax Act 2007 is excluded from the definition of "R&D expenditure" (and thus the measure). Activities are generally listed in the schedule because they take place in a post-development phase, are related to routine work or there is an indeterminate relationship between the activity and economic growth. Also, many of the excluded activities are expected to take place when the company is less likely to be capital and cashflow-constrained.

The following activities are listed in schedule 22:

- an activity performed outside of New Zealand;
- acquiring or disposing of land and related activities, except if the land is used exclusively for housing research or development facilities;
- acquiring, disposing of or transferring intangible property, core technology, intellectual property or know-how, and related activities (for example, drafting sale and purchase agreements for patents);
- prospecting for, exploring for or drilling for, minerals, petroleum, natural gas or geothermal energy;
- research in social sciences, arts or humanities;
- market research, market testing, market development or sales promotion, including consumer surveys;
- quality control or routine testing of materials, products, devices, processes or services;
- making cosmetic or stylistic changes to materials, products, devices, processes or services;
- routine collection of information;

- commercial, legal and administrative aspects of patenting, licensing or other activities;
- activities involved in complying with statutory requirements or standards;
- management studies or efficiency surveys;
- reproduction of a commercial product or process by a physical examination of an existing system or from plans, blueprints, detailed specifications or publicly available information; and
- pre-production activities, such as a demonstration of commercial viability, tooling-up, and trial runs.

Similarly, some items of expenditure are specifically excluded from the definition of R&D expenditure on the basis that their inclusion could create an economic distortion, inequity between taxpayers in a similar position, or risk compromising the integrity of the initiative. Items excluded on this basis are:

- expenditure on goods and services used to provide a service of research or development to someone who is in the business of providing research and development services, or used to further another person's research or development activities;
- expenditure for which no deduction is available for the income year;
- expenditure for or under a financial arrangement; and
- expenditure for the acquisition or transfer of intangible property, core technology, intellectual property or know-how.

An important component of the definition of "R&D expenditure" is that any intellectual property and know-how that results from the research or development is vested in the company, solely or jointly. These requirements are intended to ensure that the value of the amounts cashed out goes to the company that is incurring the risk of investing in the research and development.

More detailed guidelines to help applicants interpret the definition will be made available.

Eligibility

Sections MX 1, MX 2, MX 3 and YA 1 of the Income Tax Act 2007

The eligibility requirements are set out in new sections MX 1, MX 2, MX 3 and YA 1 of the Income Tax Act 2007 and target the measure to start-up firms engaging in intensive research and development. The measure is not expected to apply to highly structured or complex firms which have an R&D aspect. The eligibility requirements must be met for each income year that the taxpayer applies to cash out a loss.

Optional

The decision to cash out a tax loss is optional for each income year. That is, a company may choose to cash out a loss in one year, and may choose not to for a subsequent year. The rules governing the repayment of cashed-out amounts are not optional.

Corporate eligibility

The applicant must be a company that is resident in New Zealand for the whole year and not treated, under a double tax agreement, as a resident of a foreign country or territory. A company incorporated part-way through the year will be eligible as long as it meets all the requirements for the part of the year that it is in existence.

Example: Residence of shareholders

Moby is a touring surfer who has an idea to use a new type of lightweight material to construct surfboards. Moby's Hawaiian-resident friend Peleg agrees to fund investigating the idea. Modern Boards Limited (MBL) is incorporated in New Zealand (Peleg owns 85 percent of the shares and Moby the remaining 15 percent) and starts work on the idea. MBL has tax losses from that work. The residence of the shareholders does not affect the eligibility of the company to cash out losses, and therefore MBL may be eligible to cash out research and development tax losses.

The initiative is not intended to apply to companies owned by the Crown. A company that is established by or subject to the Education Act 1989, the New Zealand Public Health and Disability Act 2000 or the Crown Entities Act 2004, is not eligible.

Companies that are partially owned by the Crown may be eligible if less than 50 percent of the shares are together held by public authorities, local authorities, Crown research institutes or State enterprises.

Example: Ineligible from government-sector ownership

A Crown research institute and a State enterprise each have a 25 percent share of a joint venture company set up to do research and development on tidal impacts on new cable materials. The other 50 percent is owned by a private investor. The joint venture company is not able to cash out its losses because it is 50 percent owned by the Crown.

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Example: Ineligible as a Crown entity

As a result of the rebuilding work carried out in Christchurch, researchers in University A and University B have invented a new process for quickly testing the setting rate of newly poured concrete. Magnitron Ltd is set up to develop the invention and the two universities together, through two different subsidiaries, own 51 percent of Magnitron Ltd. The remaining 49 percent share is owned by the two university-employed researchers who invented the idea and other private investors. Magnitron Ltd is not eligible to cash out its tax losses because it is subject to the Crown Entities Act 2004.

The company must not be a listed company or otherwise listed on a recognised exchange.

Losses from R&D that is owned by the company

The company must have a net loss for the relevant tax year. Also, the company must have incurred "R&D expenditure" in the relevant income year.

A tax loss arising from a deduction for research and development expenditure that is allocated to a future income year under section DB 34(7) of the Income Tax Act cannot be cashed out either in the year the expenditure was incurred or in the year the deduction is allocated to. This is because the definition of "R&D expenditure" does not include research and development expenditure for which no deduction is available for the income year.

Example: Expenditure allocated to later income years not eligible for the tax credit

Mattlab Ltd is a biotechnology firm designing a new medicine to repair liver damage. In the 2016–17 income year the company makes a loss of $1.1m carrying out a pre-clinical trial on mice. Although the whole of the loss relates to research and development expenditure, Mattlab Ltd can only cash out losses of $800,000 (the maximum allowed under the cap for the 2016–17 year). Developing the medicine further requires new venture capital. New equity investors are found in the 2017–18 year and the remaining losses from the 2016–17 income year are allocated to the 2018–19 year. All of the losses generated by Mattlab Ltd in the 2017–18 year are cashed out. In the 2018–19 year Mattlab Ltd incurs $0.9m of research and development expenditure, which generates a tax loss of the same amount. The reallocation of deductions from the 2016–17 year mean that Mattlab Ltd has losses of $1.2m, however it can only cash out losses of $0.9m, and must carry forward the remaining losses of $0.3m.

Group companies

If a company is part of a group for tax purposes, then that group must also meet some of the eligibility requirements in aggregate. The group must have a net loss for the corresponding tax year and meet the wage intensity criteria. These features are important for the integrity of the initiative.

The "R&D group" is defined and can include a company, look-through company or limited partnership.

Wage intensity criteria

To target the initiative to innovative start-ups, proportional labour expenditure on research and development is used as a proxy to gauge the intensity of research and development. Evidence indicates that loss-making research and development-intensive businesses, particularly smaller and younger businesses, tend to spend a greater proportion of their wage and salary costs on research and development than other businesses.

The wage intensity criteria are set out in section MX 3 of the Income Tax Act and to be eligible, the company must have a wage intensity calculation of 0.2 or more. Similarly, if the company is part of a group, the amount calculated for the "R&D group" in aggregate should be 0.2 or more.

The intensity calculation is:

> *total research and development labour expenditure ÷ total labour expenditure.*

There are two options for calculating wage intensity under the new rules. Option 1 is the simpler of the two. Option 2 is more accurate for employers who remunerate their staff with fringe benefits and superannuation contributions in addition to other types of compensation for labour.

Under Option 1, total research and development labour expenditure is defined as the total of amounts incurred in the income year on:

- the taxpayer's "contractor R&D consideration" multiplied by 0.66. The "contractor R&D consideration" is the amount paid to an external provider (excluding GST) for research and development work. This is to reflect the fact that taxpayers may outsource a part of their research and development work to an external provider. For taxpayers who are part of a research and development group, the contractor must not be part of that group.
- salary or wages paid to employees for carrying out research and development; and
- amounts paid to shareholder-employees for carrying out research and development that are not subject to PAYE.

Total research and development labour expenditure does not include expenditure on labour or contractors engaged in research and development activities that are listed in schedule 22. Similarly, the expenditure cannot be for goods and services used by the taxpayer to provide a service of research and development to another person, or to further another person's research or development activities. In addition, the intellectual property and know-how resulting from the research and development must vest in the taxpayer, solely or jointly.

Total labour expenditure is the total of amounts incurred in the income year on:

- the "contractor R&D consideration" multiplied by 0.66 (as in the numerator);
- salary or wages paid to employees; and
- amounts paid to shareholder-employees that are not subject to PAYE.

Under Option 2, the calculation is the same as for Option 1, except:

- the following amounts must be added to total labour expenditure:
  - the employer's superannuation contributions for the employee that are not salary or wages;
  - tax on the employer's superannuation cash contributions for the employee;
  - fringe benefits attributed to the employee; and
  - the employer's FBT liability in relation to the employee and the fringe benefits attributed to the employee.
- A proportion of the above amounts must also be added to total research and development labour expenditure. The proportion is the same, for each employee, as the proportion of the employee's total salary or wages that is paid for carrying out research and development, and included in the "total research and development labour expenditure" component of the formula.

Example: Wage intensity

Mattlab Ltd decides from the beginning of the 2017–18 income year to change its remuneration package for its full-time researchers to encourage them to stay in the company's employment. Its two research scientists, doing research and development full-time, are each paid $100,000/year and will receive superannuation contributions of 5 percent of their income for each year of service with the company (up to a maximum of 15 percent). Both have been with the company for two years. Thirteen other staff are paid $1,040,000 in total, and the CEO who spends one day a week doing research and development, is paid $120,000. Mattlab Ltd has outsourced some research and development work for that year for a price of $75,000 (excluding GST).

The wage intensity calculations for the 2017–18 year are:

Option 1

Total research and development labour expenditure is $273,500 [($75,000 * 0.66) + $200,000 + ($120,000 * 0.2)]

Total labour expenditure is $1,409,500 [($75,000 * 0.66) + ($200,000 + 1,040,000) + $120,000]

The wage intensity calculation is $273,500 ÷ $1,409,500 = 0.194

Option 2

Total research and development labour expenditure is $300,100 [($75,000 * 0.66) + ($200,000) + $20,000 + $6,600 + ($120,000 * 0.2)]

Total labour expenditure is $1,436,100 [($75,000 * 0.66) + $200,000 + $20,000 + $6,600 + $1,040,000 + $120,000)]

The wage intensity calculation is $300,100 ÷ $1,436,100 = 0.209

The superannuation package adds $20,000 of superannuation contributions and $6,600 of tax on superannuation contributions to both the numerator and denominator of the calculation.

Mattlab Ltd meets the wage intensity criteria using Option 2, but not if it uses Option 1.

Amount of the cash-out

Sections MX 4 and YA 1 of the Income Tax Act 2007

Because the cash-out is administered through the tax system, it is delivered in the form of a refundable tax credit. This tax credit is referred to as the "R&D loss tax credit" Similarly to other tax credits, only the net loss for the relevant year can be cashed out. That means that it will not be possible to cash out a tax loss in a year subsequent to when the loss arose (that is, carried forward tax losses cannot be cashed out). Any net losses for a year which cannot be cashed out will be carried forward under the usual rules.

New section MX 4 of the Income Tax Act 2007 sets out the amount of the R&D loss tax credit for a year. It is the smallest of:

- $500,000 (for the 2015–16 tax year, and increasing by $300,000 for each of the following five years) multiplied by the corporate tax rate;

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- the company's net loss for the year multiplied by the corporate tax rate;
- the company's total R&D expenditure for the tax year multiplied by the corporate tax rate; and
- the company's total research and development labour expenditure for the year (as calculated under section MX 3), multiplied by 1.5 and also multiplied by the corporate tax rate.

The $500,000 cap on eligible losses will be increased to $2 million over five years. The gradual increase of the cap is an integrity measure and should also help industry sectors to plan for the future supply of researchers.

Example: Amount of the tax credit

Amblack Ltd is a company carrying out research and development on a new variety of avocado that also tastes of lemon. They have two senior plant researchers and a technician working full-time on the project. In the 2016–17 tax year Amblack Ltd had a net loss of $600,000, spent $425,000 on research and development, and the researchers and technician were paid $245,000 in salary and wages for research and development.

The amounts under the four tests are: $800,000 (cap) > $600,000 > $425,000 > $245,000 * 1.5 ($367,500), each multiplied by the company tax rate of 0.28% for that year.

Amblack Ltd is eligible to receive a R&D loss tax credit of $102,900 for that year ($367,500 * 0.28).

Treatment of tax losses

Sections MX 5, MX 6 and YA 1 of the Income Tax Act 2007

New section MX 5 of the Income Tax Act 2007 will extinguish tax losses that are cashed out.

New section MX 6 creates a new deduction if the company tax rate increases after a tax loss has been cashed out. This is to ensure that a company is not disadvantaged by electing to cash out a tax loss instead of carrying it forward if the corporate tax rate is subsequently increased (as an increase in the corporate tax rate will increase the amount of tax saved by any tax losses). The amount of the new deduction is essentially the difference between:

- the amount of the cashed out tax losses that would still have been available when the tax rate increased; and
- the amount of tax losses that would need to be cashed out at the new rate to produce the same tax credit as the above tax losses produced when cashed out at the old rate.

The amount of the deduction is calculated for each year in which an R&D loss tax credit was received using the formula:

*tax credits * (new rate – old rate) ÷ (new rate * old rate)*

The items in the formula are defined as follows:

"tax credits" is the total amount of the company's R&D loss tax credits for years before the rate increases minus the total amount of:

- the company's terminal tax, plus tax credits giving rise to imputation credits, minus refundable tax credits giving rise to imputation debits, for the period beginning with the first year a R&D loss tax credit was claimed and ending with the tax year before the current year; and
- payments of R&D repayment tax relating to the R&D loss tax credits before the current year (R&D repayment tax is discussed in the next section).

"new rate" is the basic tax rate for a company after the rate increase:

"old rate" is the greatest of:

- the basic tax rate for a company before the rate increase;
- the basic tax rate for a company for the latest year, before the current year, for which the person received a previous deduction under section MX 6; and
- the basic tax rate for a company for the year in which the latest R&D loss tax credit arose (before the current year).

Example: Increase in the company tax rate

Hemantware Ltd researches new materials for sport shoes. The company cashes out $800,000 of tax losses in the 2016–17 income year when the company tax rate is 0.28, to receive tax credits of $224,000. The company tax rate changes to 0.30 for the 2017–18 tax year. Hemantware Ltd has a resulting deduction of $53,333 [$224,000 * (0.3 – 0.28) ÷ (0.30 * 0.28)] for that year.

There is no complementary provision to create income (or remove deductions) if the company tax rate is reduced.

Repayment of cashed out losses

Sections DV 26, MX 7 and YA 1 of the Income Tax Act 2007; section 70C of the Tax Administration Act 1994

A cashed out loss can be thought of as an interest-free loan from the Government to be repaid from the taxpayer's future taxable income; it is intended to provide a temporary cashflow timing benefit when the company is in a tax loss position.

Repayment of cashed out losses will occur when a taxpayer pays tax on taxable income that would have been sheltered by the cashed out losses if they had been carried forward. However if the company or the shareholders make an untaxed return on their investment before they have repaid the value of the cashed-out loss, this would lead to an outcome that is concessionary for the taxpayer unless it triggered the repayment of some cashed-out losses. This is because, in addition to the untaxed receipt, the taxpayer would also retain the benefit of the remaining cashed-out losses that have not yet been repaid. This also creates a fiscal risk.

If the company sells intellectual property, migrates or if the company is sold, it is highly likely the company will no longer be constrained to the same degree by the market conditions and cashflow constraints affecting small research and development intensive start-up companies. In this situation, the original policy rationale will no longer apply, as the company will have funds available to pay back the value of the cashed-out loss. Section MX 7 sets out the rules required to recover the value of any remaining cashed-out loss to ensure the correct policy outcome.

The remaining amount of any cashed-out tax losses must be repaid when one or more of the following four repayment events occur during the year:

- The company makes a return on its investment by disposing of or transferring research and development assets (that is, intellectual property, intangible property, core technology and know-how). The exceptions are if the disposal is part of an amalgamation or if the disposal is for at least market value consideration that is assessable income to the company.
- The company ceases to be a company resident in New Zealand for tax purposes or becomes resident in a foreign country under a double tax agreement. This is most likely to apply if the company migrates.
- The company has a liquidator appointed.
- Or more than 90 percent of the company is sold or transferred after the tax loss was cashed out.

A cashed-out tax loss is repaid by payment of the new R&D repayment tax. The R&D repayment tax is due by the terminal tax date for the tax year in which the repayment event occurs. The amount of R&D repayment tax payable depends on the type of repayment event which occurs.

Transfer of intellectual property (and when migration or liquidation-induced repayment obligations do not apply)

In the case of the sale of research and development assets, the repayment amount (R&D repayment tax) will be capped, for that event, at the market value of the consideration for the disposal or transfer, multiplied by the tax rate.

That is, the R&D repayment tax is the lesser of any unrepaid R&D loss tax credits and the market value of the transferred assets (intangibles' market value), multiplied by the tax rate.

The unrepaid R&D loss tax credits are the total amount of R&D loss tax credits paid to the company over time:

- minus the company's terminal tax;
- minus tax credits giving rise to imputation credits (for example, provisional tax);
- plus refundable tax credits giving rise to imputation debits; and
- minus earlier payments of R&D repayment tax,

where those amounts are for tax years from the first time losses were cashed out until the repayment year.

"Intangible market value" is the market value of the research and development assets that are disposed of in the year, excluding assets sold for at least market value consideration that is assessable income for the taxpayer.

Example: Disposal or transfer of intangible property

Taylortronics Ltd is incorporated in May 2015 to develop new guidance systems for munitions. It cashes out losses of $150,000 and $300,000 for the 2015–16 and 2016–17 income years respectively. It receives tax credits of $42,000 and $84,000. It carries forward other losses of $50,000. In the 2017–18 year the company enters a manufacturing phase selling trading stock to earn net income of $150,000. It has taxable income of $100,000 and pays income tax of $28,000. In the 2018–19 income year it sells know-how for $250,000 (which is a capital receipt) and also has taxable income of $80,000. The sale triggers a repayment event, as the receipt from the sale of the know-how was not assessable income for Taylortronics. Therefore Taylortronics has to pay R&D repayment tax as well as income tax of $22,400. The R&D repayment tax is the lesser of:

1. the market value of the research and development assets sold that year multiplied by the tax rate. This amount is $70,000 [$250,000 * 0.28]; and
2. the unrepaid R&D loss tax credits. This amount is $75,600 [$42,000 + $84,000 – $28,000 – $22,400].

Therefore, Taylortronics pays R&D repayment tax of $70,000.

In the 2019–20 income year the company has taxable income of $150,000 and pays income tax of $42,000.

Unless Taylortronics Ltd cashes out further losses, no further repayments will be required from that time. R&D Repayment tax and income tax payments made since the 2017–18 income year of $162,400 [$28,000 + $70,000 + $22,400 + $42,000] exceed the $126,000 [$42,000 + $84,000] of tax credits received for the 2015–16 and 2016–17 income years.

Example: Patent disposal or transfer at market value

Cameron Waterboards Ltd is incorporated in June 2015 to produce a hoverboard that can cross open bodies of water. It cashes out losses of $200,000 and $400,000 for the 2015–16 and 2016–17 income years respectively for R&D loss tax credits of $56,000 and $112,000. It obtains a patent for the technology in the 2016–17 year but realises that it is not in a position to develop the technology itself. In the 2017–18 year the company sells the patent at its market value of $1,000,000 and returns that amount as assessable income. As the patent sale has given rise to assessable income and was sold at market value, no defined repayment event occurs.

Example: Disposal or transfer of intangible property below market price

Viditech Ltd is incorporated as a subsidiary of BR Semiconductors Ltd to investigate new methods of layering semiconducting materials. Viditech cashes out losses of $200,000 and $400,000 in the 2015–16 and 2016–17 income years, for R&D loss tax credits of $56,000 and $112,000 respectively. It obtains a patent for the technology in the 2016–17 year and then, in the 2017–18 year, sells the patent to its parent for $500,000, well below the market value of $1,000,000. It has taxable income of $350,000 in the 2017–18 year and pays income tax of $98,000. The sale triggers a repayment event as the consideration received was below market value. Viditech Ltd is required to pay R&D repayment tax equal to the lesser of:

1. the remaining balance of the tax credit of $70,000 [$56,000 + $112,000 – $98,000]; and
2. the patent's market value multiplied by the company tax rate, which equals $280,000 [$1,000,000 * 0.28].

Therefore Viditech Ltd will pay R&D repayment tax of $70,000. The R&D loss tax credit balance is repaid in full.

Example: Multiple sales of intangible property

Replicosteo Ltd is incorporated in July 2015 to develop new synthetic materials for hip replacements that are similar to bone. Replicosteo cashes out losses of $500,000 and $800,000 for the 2015–16 and 2016–17 income years for R&D loss tax credits of $140,000 and $224,000 respectively. In the 2017–18 year, Replicosteo sells know-how for $600,000 (which is its market value and a capital receipt) and also has taxable income of $200,000 on which $56,000 of income tax is paid. That year Replicosteo has to pay R&D repayment tax of $168,000 [$600,000 * 0.28 < (140,000 + 224,000 – $56,000)], and has a tax credit balance of $140,000 remaining [$140,000 + $224,000 – $56,000 – $168,000].

Replicosteo sells further know-how in the 2018–19 year for $900,000 (which is its market value and a capital receipt) and has taxable income of $300,000 and income tax of $84,000 that year. Replicosteo has R&D repayment tax of the lower of the remaining balance of the tax credit – $56,000 [$140,000 + $224,000 – $56,000 – $168,000 – $84,000] and the value of the know-how sold that year multiplied by the company tax rate of $252,000 [$900,000 * 0.28]. Replicosteo therefore pays R&D repayment tax of $56,000, and so the R&D loss tax credit balance is fully repaid.

Sale of the company (and when migration or liquidation-induced repayment obligations do not apply)

If the company is sold, the repayment amount (R&D repayment tax) will be capped at the market value of the company shares that have been sold since the first tax loss was cashed out, multiplied by the tax rate.

That is, the R&D repayment tax is the lesser of:

- any unrepaid R&D loss tax credits; and
- the market value of the shares that have been sold (*shares' market value*) multiplied by the tax rate.

The unrepaid R&D loss tax credits are the total amount of R&D loss tax credits:

- minus the company's terminal tax;
- minus tax credits giving rise to imputation credits (for example, provisional tax);
- plus refundable tax credits giving rise to imputation debits; and
- minus earlier payments of R&D repayment tax,

where those amounts are for tax years from the first time losses were cashed out until the repayment year. This amount is the same as the unrepaid R&D loss tax credits for the other repayment events.

"Shares' market value" is defined to be the market value of all the company's shares disposed of or issued, that combined to cause the repayment event to be triggered, regardless of the year in which the disposals or issues occurred. This is because the repayment event can be triggered even if the disposal or issue events were to occur over a number of income years. The market value of the shares at each disposal or issue should be accumulated to calculate the shares' market value.

Example: Multiple transfers of shares

Hine and Akira incorporate a company, HydroPasifika Ltd, in October 2015 to develop large-scale hydroponic farms as alternatives to farming in increasingly saline soils on Pacific islands. As they expand, they dilute their shareholding in exchange for finance before selling the company entirely. The table below shows how this takes place:

Shareholding	Voting interest at 31/3/16	Voting interest at 31/3/17	Voting interest at 31/3/18	Voting interest at 31/3/19
Hine and Akira	100%	50%	25%	0%
Angel investor	0%	50%	0%	0%
Development Co	0%	0%	75%	100%

The table below shows how the shares were valued and sold (assume each sale takes place on the last day of the income year):

	31/3/16	31/3/17	31/3/18	31/3/19
Number of shares	500,000	1,000,000	1,000,000	1,000,000
New shares issued	0	500,000	0	0
Shares sold	0	0	750,000	250,000
Value per share	$0.25	$1.00	$2.00	$2.50
Value of issue/sale	N/A	$500,000	$1,500,000	$625,000
Value of company	$125,000	$1,000,000	$2,000,000	$2,500,000

The continuity breach occurs in the 2018–19 income year as Hine and Akira's shareholding falls from 100% ownership to 0%. R&D repayment tax is required to be paid for the 2018–19 income year because no group of persons have at least 10% of voting rights over the period from first receiving a credit (2015–16 income year) to a later income year (2018–19 income year).

HydroPasifika has received $750,000 of R&D loss tax credits over the four-year period, and has not paid any income tax in this period.

The R&D repayment tax will be lesser of:

1. the R&D loss tax credit balance of $750,000; and
2. the disposed or issued shares' market value multiplied by the company tax rate, which equals $735,000 [($500,000 + $1,500,000 + $625,000) * 0.28].

Therefore HydroPasifika will have R&D repayment tax of $735,000.

Change of residence or liquidation of company

The company will be required to repay any unrepaid cashed-out losses in full if the company ceases to be resident in New Zealand for tax purposes, becomes resident in a foreign country under a double tax agreement, or has a liquidator appointed.

In this case, the amount of R&D repayment tax payable is the total amount of R&D loss tax credits:

- minus the company's terminal tax;
- minus tax credits giving rise to imputation credits (for example, provisional tax);
- plus refundable tax credits giving rise to imputation debits ; and
- minus earlier payments of R&D repayment tax,

where those amounts are for tax years from the first time R&D tax losses were cashed out until the repayment year. This amount is the same as the unrepaid R&D loss tax credits for the other repayment events.

Example: Multiple loss reinstatement events

Nest Guarder Ltd is incorporated in August 2015 and is attempting to develop robots that protect the nests of native birds from predators. Nest Guarder cashes out losses of $400,000 and $700,000 for the 2015–16 and 2016–17 income years for R&D loss tax credits of $112,000 and $196,000 respectively. It also sells know-how for $100,000 in the 2016–17 income year (which equals the market value and is a capital receipt), and pays R&D repayment tax of $28,000 [$100,000 * 0.28].

In the 2016–17 tax year, the R&D repayment tax payment of $28,000 reduces the tax credit balance from $308,000 to $280,000.

In the 2017–18 tax year, Nest Guarder receives a $140,000 tax credit from cashing out a $500,000 loss and the company is sold for $1,000,000 (which equals the market value and is a capital receipt), triggering R&D repayment tax of $280,000 ($1,000,000 * 0.28 is less than the credit balance of $420,000). The tax credit balance is reduced to $140,000 [$420,000 - $280,000].

In the 2018–19 tax year, Nest Guarder migrates offshore, which triggers R&D repayment tax of the remaining tax credit balance of $140,000.

The table below shows when Nest Guarder cashes out losses and has loss repayment events where R&D repayment tax must be paid.

Year	Description	Change in value of tax credit balance	R&D loss tax credit balance
2015–16	R&D loss tax credit	+ $112,000 ($400,000 loss)	$112,000
2016–17	R&D loss tax credit Know-how sold; R&D repayment tax	+ $196,000 ($700,000 loss) – $28,000 (28% of $100,000)	$308,000 $280,000
2017–18	R&D loss tax credit Company sold; R&D repayment tax	+ $140,000 ($500,000 loss) – $280,000 ($1,000,000 sale)	$420,000 $140,000
2018–19	Company leaves NZ and can no longer satisfy residency requirement; R&D repayment tax	– $140,000 (migration)	$0

Multiple reinstatement events

If more than one repayment trigger event occurs in a given year, the amount to be repaid will depend on what events have occurred. For example, the loss of residence or liquidation of a company will trigger the repayment of all unrepaid amounts, regardless of whether a share or asset sale event has also occurred in the year. If the company is sold in the same year that R&D assets are sold, repayments in relation to both those events need to be paid, up to the total value of unrepaid R&D loss tax credits.

Reinstatement of repaid losses

Any cashed out tax loss that is repaid with R&D repayment tax will be reinstated via a deduction under section DV 26. However, for simplicity, those deductions cannot be allocated to a future income year.

Imputation

Sections OB 47B, table O2: imputation debits row 20B and section YA 1 of the Income Tax Act 2007

No credit balance will arise in an imputation credit account of a company that has cashed out a loss until that company has repaid all the cashed-out amounts (whether through normal payment of income tax or via R&D repayment tax). This is to maintain neutrality with taxpayers who are not able to cash out losses. However cashing out a tax loss will not put a taxpayer's imputation credit account into a debit balance. The rules are set out in section OB 47B of the Income Tax Act 2007.

Example: No imputation credits arise until tax credit balance repaid

R&D Biotics' imputation credit account has a zero balance at the beginning of the 2015–16 year. R&D Biotics cashes out losses of $100,000 in the 2015–16 year and $125,000 in 2016–17, receiving tax credits of $28,000 and $35,000 respectively. R&D Biotics pays no tax for these years. R&D Biotics pays income tax of $22,400 in 2017–18 and $35,000 in 2018–19. R&D Biotics will not have a credit balance (or a debit balance) in its imputation credit account for any of income years from 2015–16 to 2018–19 inclusive. This is because the amount cashed out has not been fully repaid by the end of the 2018–19 income year, with a balance of $5,600 remaining. R&D Biotics earns $150,000 in the 2019–20 income year and pays tax of $42,000. It will therefore have a credit balance of $36,400 for income tax paid for the 2019–20 income year (income tax of $42,000 – loss cash-out balance of $5,600).

Administration

Sections LA 7, LB 4B, MA 1, MF 6 and RM 10 of the Income Tax Act 2007; sections 70C, 81(4)(v) and (w), and 97C of the Tax Administration Act 1994

Companies will need to apply to cash out their tax losses. Applications will need to be made by the time the company files the corresponding income tax return. While the application will need to be in electronic form, the income tax return does not have to be filed electronically. A company with R&D repayment tax to pay must include the amount in any application to cash out their tax losses they file for the year, or file a separate statement if there is no such application.

Like other tax credits, R&D loss tax credits may be used to satisfy an existing tax liability of the company.

Exceptions have been added to the secrecy rules to allow Callaghan Innovation and the Ministry of Business, Innovation and Employment to support Inland Revenue in the administration of the R&D loss tax credits. This will permit information-sharing between Inland Revenue and Callaghan Innovation to help Callaghan Innovation assist Inland Revenue in making decisions on the R&D eligibility for difficult applications. The Ministry of Business, Innovation and Employment will also provide ICT and policy support to Inland Revenue.

Consequential amendments

Section DF 1(1BA) of the Income Tax Act 2007 and the Goods and Services Tax (Grants and Subsidies) Order 1992

Consequential amendments have been made in section DF 1(1BA) of the Income Tax Act 2007 and to the Goods and Services Tax (Grants and Subsidies) Order 1992. This is to ensure that:

- the bar on deductions in relation to Government grants does not apply for cashed out losses; and
- the cashed out loss is not subject to GST.

BLACK HOLE EXPENDITURE

Sections CG 7B, CG 7C, DB 34, DB 37, DB 40B, EE 18B, EE 19, EE 33, EE 34, EE 34B, EE 44, EE 57, EE 60, EE 61, EE 67, YA 1 and schedule 14 of the Income Tax Act 2007

Several amendments have been made to the Income Tax Act 2007 relating to business expenditure that taxpayers were previously unable to deduct for income tax purposes, either immediately or over time. This expenditure is commonly referred to as "black hole" expenditure.

The amendments give effect to changes announced in Budget 2014 and are primarily targeted at black hole research and development (R&D) expenditure. These changes, which are part of the Government's "encouraging business innovation" initiative under its Business Growth Agenda "Building Innovation" work-stream, aim to reduce tax distortions that may discourage investment in R&D.

Background

Section DB 34 allows taxpayers a tax deduction for expenditure they incur on research or development, in certain circumstances. An immediate tax deduction is allowed, under section DB 34, for R&D expenditure incurred up until the point that an intangible asset is recognised under the accounting rules. Any further development expenditure incurred must be capitalised. Previously, any development expenditure incurred after recognition of an intangible asset for accounting purposes was generally non-deductible for income tax purposes, either:

- because the intangible asset created was not listed in schedule 14 as an item of "depreciable intangible property"; or
- if it was, the depreciable costs of the asset had been, or would likely have been, interpreted to exclude development expenditure.

This may have discouraged businesses from undertaking R&D investments that they would have undertaken in the absence of taxation. To address concerns about this, the Government released a discussion document, *Black hole R&D expenditure*, in November 2013, which outlined initial proposals to allow tax deductions for black hole R&D expenditure.

Submissions on the proposals were generally supportive of their intent. However, many submitters wanted the scope of the proposals widened to provide tax deductibility for both successful and unsuccessful capitalised development expenditure towards intangible assets that are not depreciable for tax purposes. In response, the scope of the proposals was widened to provide tax deductibility for these expenditures. Additionally, a number of submitters identified other categories of expenditure that fit within the policy framework in the discussion document (namely, expenditure relating to registered designs and the copyright in an artistic work that has been applied industrially) and the proposals were extended to cover them. Enabling capital expenditure on these assets to be deducted over their lives would reduce tax distortions against investment in these assets.

At the select committee stage of the bill, the Finance and Expenditure Committee recommended amendments to the proposed claw-black provision and an existing provision that allows a deduction for expenditure incurred in unsuccessful software development, to ensure that the policy intent would be achieved. The Committee also recommended an amendment to make it clear that only expenditure a business incurs in carrying out R&D would be deductible, and that a business that purchased "work in progress" would not be able to deduct the purchase cost for tax purposes if it subsequently derecognised the intangible asset.

The main changes aim to reduce tax distortions that may discourage investment in R&D, by allowing capitalised development expenditure to be either deducted over time as depreciation (when the R&D results in a depreciable intangible asset) or deducted upon the intangible asset being derecognised for accounting purposes (when the R&D does not result in a depreciable intangible asset). Restricting deductions for expenditure on non-depreciable intangible assets to assets that have been derecognised for accounting purposes restricts deductions to cases when it is clear that the expenditure is of no on-going value.

Key features

- An amendment to section DB 34 allows a taxpayer, who has developed an intangible asset (recognised for accounting purposes) that is not depreciable for income tax purposes, a one-off income tax deduction for capitalised development expenditure they have incurred on the asset, upon derecognition of the asset for accounting purposes.
- New section CG 7C claws back, as income, a deduction a taxpayer has taken for capitalised development expenditure they incurred on a non-depreciable intangible asset that has been derecognised for accounting purposes, if the taxpayer subsequently sells the previously derecognised intangible asset or rerecognises the intangible asset for accounting purposes.
- New section EE 18B enables a taxpayer who has created an intangible asset that is depreciable for income tax purposes to include, as part of the asset's depreciable costs, capitalised expenditure that they have incurred on an underlying non-depreciable intangible asset.
- Registered designs, applications for the registration of a design, and copyright in an artistic work that has been applied industrially, have been made depreciable for income tax purposes.

Application dates

Most of the amendments apply from the beginning of the 2015–16 income year.

The exceptions are the following amendments, which apply from the beginning of the 2011–12 income year:

- the amendment allowing capitalised expenditure relating to an item of depreciable intangible property that was listed in schedule 14 before the beginning of the 2015–16 income year (other than a patent, patent application or plant variety rights) to be included as part of the item's depreciable costs;
- the amendments to section EE 33(3)(a) and (b), which make consequential changes to the definition of an item in a formula for calculating the annual rate of depreciation for items of fixed-life intangible property; and
- the remedial amendment to section DB 40B, which ensures that taxpayers can obtain a deduction for expenditure they incur in unsuccessful software development.

Detailed analysis

Research and development expenditure on derecognised non-depreciable assets

New subsection (3) of section DB 34 allows a taxpayer a tax deduction for expenditure they incurred on the development of an intangible asset (which has been recognised for financial reporting purposes) that is not depreciable for income tax purposes, if the taxpayer subsequently:

- derecognises the intangible asset for financial reporting purposes under paragraph 112(b) of NZ IAS 38 *Intangible Assets*; or
- writes off the intangible asset for financial reporting purposes under paragraph 5.14 of Financial Reporting Standard No. 13: *Accounting for Research and Development Activities (1995)*.

An intangible asset is derecognised under paragraph 112(b) of NZ IAS 38 when no future economic benefits are expected from its use or disposal. A tax deduction, in relation to a non-depreciable intangible asset that has been derecognised under paragraph 112(b) of NZ IAS 38, is allowed irrespective of whether the asset was useful for a period or the R&D was unsuccessful. A tax deduction, upon derecognition of an intangible asset for financial reporting purposes, is not allowed in relation to an intangible asset that has been derecognised on disposal under paragraph 112(a) of NZ IAS 38.

Only expenditure incurred on or after 7 November 2013 qualifies for the deduction. Subject to this qualification about when the expenditure must have been incurred, upon derecognising a non-depreciable intangible asset (other than on disposal), a taxpayer may deduct the full amount of capitalised expenditure they incurred on the development of the asset. In other words, the amount of the deduction is not limited to the carrying amount of the asset net of impairment losses.

The deduction is allocated to the income year in which the relevant intangible asset is derecognised or written off by the taxpayer for financial reporting purposes.

Only expenditure a taxpayer incurs in carrying out development of an intangible asset can be deducted under new section DB 34(3). Expenditure incurred by a taxpayer on purchasing a non-depreciable intangible asset is not deductible to the purchasing taxpayer upon derecognition of the asset for financial reporting purposes. A taxpayer who purchases a non-depreciable intangible asset is, however, able to claim a deduction, upon derecognition of the asset, for any development expenditure they incurred on further developing the asset after purchasing it.

Example 1

Business A begins an R&D project during March 2016. After 24 months of R&D, Business A recognises an intangible asset for financial reporting purposes, which has been created from the R&D. In the six months after recognising the intangible asset for financial reporting purposes, Business A incurs $200,000 in capitalised development expenditure further developing the asset. The intangible asset is not listed in schedule 14 and, therefore, it is not depreciable for tax purposes. Business A then sells the incomplete intangible asset to Business B (which intends to continue the R&D and complete the asset) for $10 million. Business A makes an untaxed capital gain of $9.8 million from the sale. Business B incurs $300,000 in capitalised development expenditure further developing the asset before abandoning the project and derecognising the asset for financial reporting purposes. Business B is allowed a deduction under new section DB 34(3) for the $300,000 it incurred in capitalised development expenditure. Business B is not allowed a deduction for the $10 million cost of purchasing the asset from Business A.

Claw-back for derecognised non-depreciable assets

New section CG 7C is a claw-back provision, which applies if:

- a taxpayer has been allowed a deduction under section DB 34 because new section DB 34(3) applies (that is, a deduction for capitalised development expenditure on a non-depreciable intangible asset that has been derecognised for financial reporting purposes); and
- the previously derecognised non-depreciable intangible asset is subsequently:
  - disposed of for consideration that is not income under another provision of the Income Tax Act 2007; or
  - rerecognised for financial reporting purposes.

Paragraph 118(e)(viii) of NZ IAS 38 requires an entity to disclose, for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets, a reconciliation of the carrying amount at the beginning and end of a period showing other changes in the carrying amount during the period. Although the information required to be disclosed is for a grouping of assets, to calculate the change in the carrying amount for the grouping of assets during a period, the entity would have to sum up the changes in the carrying amounts of each individual asset in the group during the period. If a previously derecognised intangible asset has a positive carrying amount at the end of a period that it had a carrying amount of zero at the beginning of, this implies that it must have been rerecognised for financial reporting purposes during the period.

When a taxpayer derives consideration for a disposal, the amount that will be clawed back, as income, will be the lesser of the consideration derived for the disposal and the amount of the deduction previously taken.

When a taxpayer rerecognises an intangible asset, the entire amount of the deduction previously taken will be clawed back, as income. For the purposes of the depreciation rules, the taxpayer is treated as never having had the deduction. Therefore, if the taxpayer eventually acquires an item of depreciable intangible property to which the expenditure relates (for example, if the intangible asset rerecognised by a taxpayer is an invention that they subsequently patent), they will be able to deduct the expenditure over time as depreciation.

An amount clawed back under new section CG 7C is treated as income of the taxpayer in the income year of the disposal or rerecognition, as the case may be.

Depreciable costs of certain depreciable intangible assets

Intangible assets are only depreciable if they are listed in schedule 14 of the Income Tax Act 2007 as an item of "depreciable intangible property". New section EE 18B specifies that the "cost" to a taxpayer of an item of depreciable intangible property for depreciation purposes includes expenditure they have incurred on an underlying item of intangible property, if that item gives rise to, supports, or is an item in which the person holds, the item of depreciable intangible property. An amount of expenditure cannot be included in the depreciable cost of the item of depreciable intangible property if a deduction for the expenditure has already been allowed.

In the case of patents, patent applications, plant variety rights, and the new additions to schedule 14 (registered designs, applications for the registration of a design, and copyright in an artistic work that has been applied industrially), the person must have incurred the expenditure on or after 7 November 2013, for the expenditure to be included in the depreciable cost of the item of depreciable intangible property.

Consequential amendments have been made to sections EE 33 and EE 34, which set out how to calculate the annual rate of depreciation for fixed-life intangible property and patents, respectively.

A remedial amendment has also been made to section DB 40B to ensure that taxpayers can obtain a deduction for expenditure they incur in unsuccessful software development.

Example 2

Business C begins an R&D project during May 2016. After 18 months of R&D, Business C recognises an invention resulting from the R&D as an intangible asset for financial reporting purposes. Subsequently, Business C incurs some capitalised development expenditure further refining the invention. An invention is an intangible asset that is not an item of depreciable intangible property. Business C then applies for a patent for the invention. Assume that the patent application filed by Business C has a complete specification of the invention. A patent application with a complete specification lodged on or after 1 April 2005 is an item of depreciable intangible property. The depreciable cost of the patent application comprises the administrative and legal fees Business C incurred in applying for the patent and the capitalised development expenditure Business C incurred on refining the invention. The capitalised development expenditure is included in the depreciable cost of the patent application because the invention is an underlying item of intangible property in which Business C holds the patent application. If the patent is subsequently granted, the depreciable cost of the patent will also include the capitalised development expenditure Business C incurred on refining the invention, to the extent that it has not already been deducted as depreciation of the patent application.

Example 3

During September 2015, Business D began an in-house project to develop some software for use in its own business. The expenditure Business D incurs during the development must be capitalised. After seven months, the development is completed. The software is an item of intangible property owned by Business D. However, "software" is not an item of depreciable intangible property. "The copyright in software" is an item of depreciable intangible property, however. Business D, having developed its own software, will own the copyright in that software. Because the software is an underlying item of intangible property in which Business D holds the copyright in the software, the depreciable cost of the copyright in software is the amount of the capitalised expenditure Business D incurred in developing the software.

New depreciable intangible assets

For an intangible asset to be depreciable for income tax purposes, it must be listed in schedule 14 as an item of "depreciable intangible property". The following three new items have been added to schedule 14:

- a design registration;
- a design registration application; and
- industrial artistic copyright.

Definitions of each of these terms have been inserted into section YA 1.

The definitions of "design registration" and "design registration application" make it clear that a registration of a design in New Zealand under the Designs Act 1953 and a registration of a design in other jurisdictions, under similar laws, and associated applications, are eligible for depreciation.

The definition of "industrial artistic copyright" makes it clear that, for the copyright in an artistic work to be depreciable, the artistic work needs to have been "applied industrially" as provided by section 75 of the Copyright Act 1994. Therefore, the industrial application:

- can have taken place in New Zealand or in any other country;
- must have been by or with the licence of the copyright owner; and
- at least one of the criteria listed in paragraphs (a) to (c) of section 75(4) of the Copyright Act 1994 must be satisfied.

Additionally, for the copyright in an artistic work to be depreciable, the artistic work must be one of the types of artistic work for which section 75 of the Copyright Act 1994 provides a special exception from copyright protection. Depreciation is therefore not available for the copyright in:

- a sculpture, unless it is a cast or pattern for an object that has a primarily utilitarian function; or
- a work of architecture, being a building or a model for a building.

Furthermore, the copyright in an artistic work is only depreciable from when the artistic work is applied industrially until such time as protection against infringement of the copyright in the artistic work is no longer available due to the operation of section 75 of the Copyright Act 1994.

Section EE 16 defines the cost of the three new depreciable intangible assets for the purpose of calculating the annual amount of depreciation allowed. An amendment to this section excludes expenditure incurred before 7 November 2013 from eligibility for depreciation. An amendment to section EE 19 reiterates this, making it clear that costs incurred before 7 November 2013 for these new depreciable intangible assets cannot be added to the asset's adjusted tax value and depreciated.

New section EE 34B sets out how to calculate the annual rate of depreciation for a design registration.

An amendment to section EE 67 provides that the legal life of a design registration or application for depreciation purposes starts from when the application was first lodged.

The amendment to section EE 67 also provides that the legal life of industrial artistic copyright is the length of time, from when the artistic work was applied industrially, until protection against infringement of that copyright is no longer available under the Copyright Act 1994. This time period, commencing from when the artistic work is applied industrially, will be:

- 25 years for a work of artistic craftsmanship;
- 16 years for a sculpture that is a cast or pattern for an object that has a primarily utilitarian function; or
- 16 years for any other artistic work (that is not one of the excluded types of artistic work).

An amendment to section DB 37 allows a taxpayer a deduction for capital expenditure they incurred for the purpose of applying for the grant of a design registration if they did not obtain the design registration because the application was not lodged or was withdrawn, or because the grant was refused. The deduction is allocated to the income year in which the taxpayer decides not to lodge the application, withdraws the application or is refused the grant of design registration.

An amendment to section CG 7B ensures that this existing claw-back provision claws back, as income, deductions that have been taken for aborted or unsuccessful applications for the grant of design registration, if the taxpayer subsequently sells or uses the abandoned application property.

To ensure that the depreciation rules operate appropriately in relation to the new depreciable intangible assets, the following consequential amendments to the rules have been made:

- New section EE 44(2)(bb) ensures that no depreciation recovery calculation has to be performed when an application for the registration of a design concludes because the design registration is granted.
- An amendment to section EE 57(3)(cb) ensures that the "base value" used to calculate a design registration's or a design registration application's "adjusted tax value" includes any expenditure clawed back as income under section CG 7B.
- Amendments to section EE 60 ensure that:
  - "total deductions", which are deducted from "base value" in calculating a design registration's "adjusted tax value", include depreciation deductions for the related application; and
  - for a design registration, the period in which the depreciation deductions must have occurred starts on the date on which the taxpayer acquired the design registration application or, if no depreciation deductions have been taken, the beginning of the month in which the taxpayer acquired the design registration application.
- Amendments to section EE 61 ensure that the annual rate of depreciation for a design registration is the rate set by new section EE 34B.

OTHER POLICY MATTERS

GST AND BODIES CORPORATE

Sections 2, 5(8A), 5(8AB), 10(7A), 20(3)(hc), 21HB, 21HC, 51(1B), 51(5B) 52(8) and 52(9) of the Goods and Services Tax Act 1985

Amendments have been made to the Goods and Services Tax Act 1985 to clarify that services provided by GST-registered bodies corporate to their members are subject to GST. The changes also provide bodies corporate with the option to register for GST, with new rules to protect the tax base from potential adverse consequences of optional registration. A new "savings" provision is included for GST-registered bodies corporate members that have historically claimed costs incurred by the body corporate.

Background

A body corporate is a legal entity created under the Unit Titles Act 2010 when multiple owners have unit title properties in an apartment building or similar complex. The body corporate comprises all of the property owners and provides a way for individual owners to act together in relation to common and shared interests. Bodies corporate are responsible for managing, maintaining, repairing and organising insurance for the building and common property areas, and for making and enforcing the body corporate operational rules.

Bodies corporate are a product of unit owners undertaking joint actions for their mutual benefit, with the funds of the body corporate being held in expectation that they will all be spent for common purposes. Consequently, the GST treatment of bodies corporate should be largely GST-neutral.

Inland Revenue's historic position was not to allow bodies corporate to register for GST. A High Court decision in Taupo Ika Nui Body Corporate v CIR (1997) 18 NZTC 13,147, appeared to support this position by suggesting that many bodies corporate would not be required to register for GST because they did not make supplies to unit owners for consideration.

More recently, Inland Revenue was asked to revisit the question of whether bodies corporate should be able to register for GST. Inland Revenue undertook a legal analysis and came to a different view, which was that a body corporate could be considered to make supplies to its owners and therefore to carry on a taxable activity. A consequence of this view was that if a body corporate makes supplies that exceed the $60,000 threshold, it would be required to register for GST.

The new rules ensure that this interpretation does not adversely affect bodies corporate by requiring them to register for GST on the basis of the supplies made to their members. The amendments clarify that services provided by bodies corporate to their members are supplies for consideration, and provide bodies corporate with the option to register for GST.

Key features

The new rules apply to bodies corporate that are subject to the Unit Titles Act 2010, except those that are retirement villages registered under the Retirement Villages Act 2003 (see the new definition of "unit title body corporate" under section 2).

New section 5(8A) confirms that levies and other amounts paid to the body corporate by its members are treated as being consideration received for services supplied by the body corporate to its members. Despite this, section 51(1B) excludes the value of the body corporate's supplies to its members from the total value of its supplies for the purposes of determining whether the body corporate is required to register for GST under section 51(1). Consequently, if a body corporate only makes supplies to its members, it may voluntarily register for GST but it is not required to do so.

Several measures have been included to protect the tax base from potential adverse consequences of allowing bodies corporate the option to register for GST:

- From 26 February 2015, when a body corporate decides to register for GST, or is required to do so because its third-party supplies exceed $60,000, section 5(8AB) treats the total value of money and assets received as "exempt supplies" as consideration for a taxable supply. This means the body corporate must return GST equal to the tax fraction (3/23rds) of the value of the money (including financial investments) and assets (excluding common property) on the day of registration.
- An amendment to section 21B prevents bodies corporate from claiming input tax deductions after their registration for goods and services acquired before registration.
- Section 51(5B) prevents bodies corporate from backdating their GST registration before the date they applied to register.
- Section 52(8) prevents bodies corporate from backdating the cancellation of their registration before the date they applied to cancel their registration.
- A four-year "lock-in" rule in section 52(9) prevents bodies corporate registered after 26 February 2015 from cancelling their registration until four years from their registration date.

A "savings" provision in sections 20(3)(hc) and 21HC preserves the position of GST-registered persons who held interests in unregistered bodies corporate, and who claimed input tax deductions for the GST charged on goods and services purchased by the body corporate. The savings provision applies when the GST-registered member has claimed a deduction for an amount of GST incurred by the body corporate, to the extent that the GST relates to either specific costs incurred and passed on to that GST-registered member, or a share of the body corporate's expenses which the member pays through their body corporate levies.

Application dates

The rules that confirm that amounts paid to a body corporate by its members are consideration for the supply of a service but give bodies corporate the option to register apply from the date the GST Act came into force on 1 October 1986.

The base protection rules, including new sections 5(8AB), 51(5B), 52(8) and 52(9), apply from 26 February 2015, the date the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill was introduced.

The "savings" provision applies to supplies acquired by the body corporate between 1 November 2010 and 26 February 2015, and for which a member has claimed a deduction for their share of the body corporate supplies before 3 November 2015.

Detailed analysis

Definition of "body corporate"

The new rules apply to bodies corporate under the Unit Titles Act 2010, except when the body corporate is a retirement village registered under the Retirement Villages Act 2003. This includes bodies corporate established under either the Unit Titles Act 1972 or the Unit Titles Act 2010.

From 1 October 1986 until the commencement of the Unit Titles Act 2010 (20 June 2011), the definition refers to a body corporate as defined in the Unit Titles Act 1972.

Optional registration

Section 5(8A) confirms that levies and other amounts that a body corporate receives from its members are treated as consideration for the supply of a service for GST purposes. However, section 51(1B) provides that these supplies are not included when determining whether a body corporate exceeds the $60,000 threshold and is therefore required to register for GST. This means that a body corporate that only makes supplies to its members, or that makes taxable supplies to third parties below the $60,000 registration threshold, is not required to register.

A body corporate is still able to voluntarily register under section 51(3), however, once a body corporate is registered, it must return GST on the value of all the taxable supplies that it makes, including on the levies and other amounts paid by its members.

Example 1

Body Corporate Number 100,000 is a body corporate consisting of 25 units with 25 corresponding unit owners. Each member pays $3,000 per year in body corporate levies. Despite receiving $75,000 in levies over a 12-month period, the body corporate is not required to register for GST.

The body corporate is still able to voluntarily register for GST, in which case it will be required to charge and return GST on its body corporate levies and on any other taxable supplies that it makes.

These rules apply retrospectively (from 1 October 1986). Retrospective application of these rules ensures that past tax positions taken by bodies corporate are preserved. Specifically, a body corporate's decision to register before the enactment of these rules is retrospectively confirmed. In contrast, bodies corporate that did not register before the enactment of these rules will be treated as not having been required to do so solely because of their supplies to members, as these supplies are excluded from the registration threshold.

Applying to voluntarily register for GST

Under section 51(5B), a body corporate that applies to voluntarily register for GST after 26 February 2015 must be registered with effect from a date after the application date (the date the body corporate applied to be registered). This prevents bodies corporate from backdating their registration to a more advantageous date, or to a date before the introduction of these amendments in order to avoid paying GST on any money and assets received as exempt supplies held at the time of registration under new section 5(8AB).

Output tax liability on registration

When a body corporate chooses to register for GST, or is required to do so after 26 February 2015, section 5(8AB) imposes output tax on the money and investments that the body corporate holds on the day it becomes registered. Section 5(8AB) treats a body corporate as receiving consideration for a service supplied on the day that it becomes registered, of an amount equal to the total value of the money and exempt assets (excluding common property) that it holds on the day of registration.

This means that the body corporate is liable for output tax equal to the tax fraction (3/23rds) of the total value of any:

- Money held by the body corporate on registration day (including money held in the funds prescribed by the Unit Titles Act 2010, which are the operating account, long-term maintenance fund, optional contingency fund and optional capital improvement fund).
- Assets held by the body corporate on registration day that are received as exempt supplies, except for the common property of the body corporate. This includes the market value of assets that the body corporate has received by way of an exempt supply of financial services, such as bonds, shares or other financial investments.

This rule is designed to prevent a body corporate from gaining an advantage by accumulating untaxed funds before registration (or investing in exempt assets that can be sold after registration without being subject to GST), and then claiming input tax deductions when it spends the funds after registration.

Example 2

Body Corporate Number 100,000 voluntarily applies to register from 1 October 2015, which is a date on or after it has made the application to register.

On 1 October 2015, the body corporate has $2,000 in its operating account and $7,000 in its long-term maintenance fund. It also holds an investment in shares listed on the NZX that have a market value of $2,500.

The effect of section 5(8AB) is that the body corporate is deemed to make a supply for consideration equal to $11,500 on the date of registration, and is required to return output tax of $1,500. This is 3/23rds of the total value of the money and exempt assets (excluding common property) it held on registration day.

The rule applies from 26 February 2015, which was the date the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill was introduced. This application date ensures bodies corporate that decided to register before the introduction of the rules are not required to return GST on the money and assets they held at the time of registration.

Assets acquired before registration

A body corporate cannot obtain an input tax deduction for goods or services acquired before registration under section

21B. This ensures that a body corporate cannot obtain an advantage by acquiring an asset before registration (which would have been paid for with untaxed funds) and then claiming input tax deductions once it is registered.

However, if an asset acquired before registration is supplied in the course or furtherance of a body corporate's taxable activity once they are registered, the subsequent disposal of the asset will be subject to GST and the body corporate will be entitled to a wash-up input tax deduction under section 21F.

Applying to cancel GST registration

If a body corporate has registered for GST before 26 February 2015, section 52(8) provides that if it applies to cancel its registration, the cancellation must take effect from a date on or after the date of its application.

A body corporate that registers for GST on or after 26 February 2015 is subject to a four-year "lock-in" rule. The lock-in rule applies to prevent a body corporate from gaining an advantage by changing its registration status. If a body corporate registers for GST after this date, section 52(9) provides that the cancellation of its registration can take effect only from the later of:

- four years after its date of registration; and
- the date on which it applies to cancel its registration.

A registered body corporate that ceases to carry on a taxable activity (which includes its activity as a body corporate) is required to inform Inland Revenue under section 52(3). The new four-year lock-in rule does not prevent Inland Revenue from deregistering a body corporate in these circumstances.

Output tax liability on deregistration

Consistent with the treatment of other registered taxpayers leaving the GST system, a body corporate is required to return output tax on the assets of its taxable activity on the day of its deregistration. However, section 10(7A) provides that the common property of the body corporate is treated as having zero value for the purposes of section 5(3), which imposes output tax on deregistration.

Definition of "common property"

The common property of a body corporate is excluded from the assets on which output tax must be paid, on both registration (new section 5(8AB)) and deregistration (existing section 5(3)).

Section 5 of the Unit Titles Act 2010 defines common property as:

- all the land and associated fixtures that are part of the unit title development but that are not contained in a principal unit, accessory unit or future development unit; and
- for a subsidiary unit title development, that part of the principal unit subdivided to create the subsidiary unit title development that is not contained in a principal unit, accessory unit or future development unit.

"Savings" provision

A savings provision in sections 20(3)(hc) and 21HC preserves the positions of GST-registered persons who held interests in unregistered bodies corporate, and who claimed input tax deductions for the GST charged on goods and services purchased by the body corporate. The savings provision preserves the input tax deductions claimed by unit owners in recognition of a period of uncertainty with the GST treatment of bodies corporate that existed before the introduction of the new rules.

The savings provision applies to body corporate members that have claimed input tax deductions on a share of the goods and services acquired by the body corporate in a return filed before 3 November 2015 (the date the Supplementary Order Paper containing the saving provision became publicly available).

New section 21HC contains certain conditions that are required to be met before deductions claimed by body corporate members are preserved under this savings provision:

- The goods and services acquired by the body corporate must have been acquired between 1 November 2010 and 26 February 2015 and the body corporate must have been unregistered at the time the goods and services were acquired.
- The body corporate must have acquired the goods and services for the purpose of making supplies to unit owners under section 84 of the Unit Titles Act 2010 (relating to the powers and duties of a body corporate, such as repairing and maintaining the unit title development).
- The body corporate member must have filed a return before 3 November 2015 in which it claimed an input tax deduction for the GST incurred on goods and services acquired by the body corporate.
- The body corporate member maintained sufficient records to enable the Commissioner to ascertain:
  - the nature of the supply of goods and services acquired by the body corporate and the supply by the body corporate to the body corporate member;
  - the amount that the member paid to the body corporate for the supply;
  - that the goods and services acquired by the body corporate were by way of a taxable supply; and

- that the supply to the member is used by the member to make taxable supplies.

The savings provision applies to two types of input tax deduction claimed by body corporate members:

- GST costs incurred by the body corporate and charged directly to certain members. For example, the costs associated with repairing damage to a specific unit, which are charged to the unit owner directly because the costs directly relate to that particular unit and no other unit.
- Those more general GST costs that are recovered by the body corporate through levies. These levies are generally charged on the basis of members' ownership and/or utility interests as defined in section 5 of the Unit Titles Act 2010 – for example, the body corporate repairing the roof on the apartment building, when the costs are recovered from the members on the basis of their ownership interest in the unit title development.

As long as the amounts claimed by the member are fair and reasonable, based on the member's ownership interest and utility interest in the body corporate, the amount claimed will be preserved if the other requirements above are also met.

ANNUAL INCOME TAX RATES FOR 2015–16 TAX YEAR

The annual income tax rates for the 2015–16 tax year are the rates set out in schedule 1 of the Income Tax Act 2007, and are the same that applied for the 2014–15 tax year.

Application date

The provision will apply for the 2015–16 tax year.

CHILD SUPPORT

Sections 2, 3A, 4A, 8, 13, 13A, 25, 27, 32, 34, 35, 35A, 39A, 40AA, 40, 41, 42, 44, 44A, 45, 51, 88, 88A, 89L, 90, 91, 96C, 96D, 96X, 96Y, 96Z, 96ZA, 98, 99, 102, 103, 105, 106A, 106B, 107, 129, 130, 135G, 135GA, 135JA, 135L, 152B, 154, 158, 180, 240, 276 and schedule 1 of the Child Support Act 1991

Sections 2, 37, 38, 43, 44, 45 and 57 to 63 of the Child Support Amendment Act 2013

Section 70A of the Social Security Act 1964

The Child Support Act 1991 sets out the requirements for individuals to apply for, be assessed on, and to make or receive child support payments through Inland Revenue.

The Government undertook a reform of the child support scheme and significant changes were made in the Child Support Amendment Act 2013. The key features of that Act were summarised in the *Tax Information Bulletin* (Vol. 25 No. 5, June 2013). The reform is being implemented in two phases. The first phase of amendments, which mainly relate to a new child support formula, came into force on 1 April 2015. The second phase of amendments is due to come into force on 1 April 2016, and mainly relates to administrative provisions, penalties and debt.

The Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 amends the Social Security Act 1964 and both the 1991 and 2013 child support legislation to:

- repeal or amend some of the significant changes in the second phase of the 2013 reforms;
- legislate for child support changes announced in Budget 2014 (concerning sole parent students) and Budget 2015 (concerning legacy child support debt); and
- make remedial changes to the child support scheme to ensure the policy intent is achieved, or to improve understanding of the legislation.

Amendments to the 2013 reforms

The Child Support Amendment Act 2013 implemented a major reform to the child support scheme to bring in a new, more detailed formula assessment, taking into consideration the costs of raising children, and also the income and care provided by both parents. It also:

- changed the way a liable parent and a receiving carer are determined (and changed the associated terminology and defined terms);
- recognised a greater range of people directly involved in the care of a child, including non-parent receiving carers;
- provided greater options for the payment of child support;
- introduced a two-stage late payment penalty, and reduced the monthly incremental late payment penalties payable after a year; and
- provided greater flexibility for the Commissioner of Inland Revenue to manage child support debt.

The first phase of changes to the child support scheme was originally due to come into force on 1 April 2014, with the second phase to come into force on 1 April 2015. However, those dates were delayed by one year by the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014.

Some of the key features of the 2013 reforms enacted by the 2013 child support legislation, which have been amended by the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 include:

- Compulsory deductions of child support payments from employment income, subject to exemptions on privacy or cultural grounds, which were added to existing compulsory deductions rules for liable parents receiving a benefit payment or who had child support arrears.

- A wider definition of "income", referred to as "adjusted taxable income", that included most of the adjustments to taxable income that apply to family scheme income in the Income Tax Act 2007 for the purpose of Working for Families tax credits. These adjustments include income earned through a close company or trust, some fringe benefits, and the ignoring of business and investment losses.
- Provisions for making an estimate of income for a child support year, which were extended from liable parents to receiving carers who are parents. The penalty for underestimating the income was also extended so it applies to all parents who underestimate income for a year.
- Allowing the Commissioner further discretion to offset current child support payments against arrears where the liable parent and the receiving carer swapped roles. This can also apply to payments and debts with an overseas parent if allowed under the laws of a foreign jurisdiction.
- Allowing the Commissioner the discretion to accept that a child support liability has been met through an agreed non-cash payment. A list of criteria had to be met for a payment to qualify as meeting the child support liability, including agreement from all parents of the child and that the payment would directly benefit the child.

Further background information on these items can be found in the *Tax Information Bulletin* (Vol. 25 No. 5, June 2013).

Key features

Amendments made by the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 repeal some of the second phase of reforms made by the 2013 legislation that were yet to come into force. It also repeals the "underestimation of income" penalty that is in force but not yet applied for the 2015–16 child support year. Specifically, the following provisions have been repealed:

- compulsory deductions of child support from employment income of liable parents (who are not receiving a benefit or have child support arrears), and the associated exemptions from compulsory deduction on privacy and cultural grounds;
- the wider definition of "adjusted taxable income" that would include most of the family scheme income adjustments in the Income Tax Act 2007;
- the penalty for the underestimation of income;
- allowing the Commissioner discretion for the further offsetting of ongoing child support payments against child support arrears; and
- a Commissioner discretion to allow various prescribed payments to be recognised for child support purposes, such as payment of the child's school fees (known as qualifying payments).

The 2016 changes add new options to the operation of the child support scheme, to replace some of the items that have been repealed. These are:

- the ability to request that child support payments be deducted from employment income, and for those deductions to cease as long as the person is not receiving a social security benefit or has no child support arrears; and
- a new administrative review ground to take account of child support arrears owing to the liable parent, to enable the ongoing liability to be offset against the arrears.

The new legislation also changes the commencement date for some of the discretionary debt write-off provisions so they can apply from the day after Royal assent rather than from 1 April 2016.

Application dates

With some exceptions, the new amendments came into force on the day after the date of Royal assent (25 February 2016).

The following sections came into force on 1 April 2015:

- sections 45 and 90(1)(d) of the Child Support Act 1991 (Underestimation penalties).

The following sections came into force on 1 April 2016:

- sections 96D(1)(ba), 105(2)(d) and 106B of the Child Support Act 1991 (Offsetting payments).

Detailed analysis

Compulsory deductions of child support from employment income

New sections that provided for compulsory deductions of child support payments from a liable parent who has employment income have been repealed. Consequently, the exemptions from the new compulsory deductions have also been repealed.

Section 129 of the Child Support Act 1991 has been replaced and sections 154 and 158 have been amended to allow a liable parent who has employment income to request that child support payments be deducted from employment income using the same mechanism as for liable parents who have child support arrears. A liable parent who chooses to have child support deductions from employment income can also make a request to the

Commissioner that such deductions stop from a future date. This request will be accepted as long as the liable parent does not have child support arrears and is not receiving a main benefit payment.

Adjusted taxable income

The sections that defined "adjusted taxable income" to be taxable income adjusted by most of the adjustments set out in the definition of "family scheme income" under subpart MB of the Income Tax Act 2007 have been repealed.

The 2016 legislation replaces section 35 of the Child Support Act 1991 with a new definition of "adjusted taxable income". It will be defined as:

- the person's income from employment for the calendar year immediately preceding the start of the child support year if, in the most recent tax year, the person's taxable income was derived solely from withholding income; or
- (if the above does not apply) the person's taxable income in the tax year immediately preceding the most recent tax year inflated by the inflation percentage for the child support year.

The 2016 legislation also makes it clear that "adjusted taxable income" is subject to the provisions that allow a person to elect for "adjusted taxable income" to be assessed using an estimate of taxable income for the current child support year, and provisions for determining overseas income. Consequential changes have been made to sections 40AA to 44A of the Child Support Act 1991.

No change has been made to the existing administrative ground that allows for a departure from a formula assessment to recognise other income or resources that a parent may have.

Underestimation penalty

Section 45 of the Child Support Act 1991 has been repealed. This section imposed a penalty for underestimating income for a child support year and was to apply to receiving carers as well as liable parents.

A transitional provision is in place to allow underestimation penalties to continue to be imposed in relation to child support years before 1 April 2015.

There is no change to the existing provisions relating to the estimation of income that allows the Commissioner to refuse an estimate on a variety of grounds.

Offsetting payments

The Child Support Act 1991 provides in section 152B for the offsetting of current liabilities where there is split care of children (each parent has care of a child from the previous relationship). This section was replaced by the 2013 child support legislation with a new provision that gave the Commissioner discretion to also offset current monthly liabilities against child support arrears, whether arising from New Zealand or foreign child support schemes or both. That provision has been repealed by the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 but the existing section 152B for split care remains in place.

The Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 creates a new administrative review ground in section 105 of the Child Support Act 1991. The new ground will allow a departure from a formula assessment to recognise that a person with a current liability can also be owed child support from the person they are required to make payments to. The new ground will allow for one liability to be offset against another liability if two people are each liable to pay the other an amount of child support under a formula assessment (whether or not those amounts have become due and payable). The new ground can be considered when it would be just and equitable, and otherwise proper, and is subject to the usual considerations for an administrative review ground in subsection 105(4) of the Child Support Act 1991.

New section 106B of the Child Support Act 1991 provides further detail on what an order for offsetting of liabilities under section 105 may provide. For example, the offsetting of liabilities could be applied to the following circumstances:

- when two people are caring at different times for the same child;
- when two people are caring at the same time for two or more different children;
- in relation to different child support years;
- for child support years ending before 1 April 2016 (before the new administrative ground came into force); or
- under different formula assessments (for example, under the formula in place before the 2013 child support reform).

An order to offset a liability is not available when the receiving carer is a social security beneficiary, as the Crown retains the child support collected in these cases. Nor can an order be used to offset any penalty debt, as this is also payable to the Crown. There are also restrictions on multiple offsetting applying for the same month, whether under sections 106 or 152B.

Qualifying payments

The ability to meet a child support liability through a qualifying non-cash payment has been repealed. Qualifying payments were those to be made by or on behalf of the liable parent to a person for goods and services that directly

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benefited the child; for example, the payment of the child's school fees. Among other criteria, it required there to be no outstanding child support arrears and for both the liable parent and the receiving carer to agree on the qualifying payment.

Other sections of the Child Support Act 1991 such as section 180 on the uplift of a financial support debt, may apply to achieve a similar outcome to the qualifying payments provisions.

Debt write-off

The Child Support Amendment Act 2013 contained a discretion for the Commissioner of Inland Revenue to write off child support penalties or assessment debt in specific circumstances. These provisions were to apply on and after 1 April 2016 but have subsequently been changed to come into force the day after Royal assent of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016, being 25 February 2016. The relevant sections are:

- new section 135AA of the Child Support Act 1991, which allows the Commissioner to decline a new instalment arrangement when there has been earlier non-compliance without reasonable cause;
- new section 135GA Child Support Act 1991, which allows the Commissioner to provide relief for residual penalty-only debt; and
- section 135G of the Child Support Act 1991, to allow the Commissioner to write off incremental penalties when some but not all of the financial support debt and initial late payment penalties have been paid.

BUDGET 2014 CHANGES TO SOLE PARENT STUDENTS

Section 2 and schedule 1 of the Child Support Act 1991; section 70A of the Social Security Act 1964

Budget 2014 announced a series of measures to support sole parents to enter into and remain in study. One measure concerned the application of the Child Support Act 1991 to sole parent students who had been granted a Jobseeker Support payment between academic years on the grounds of hardship (known as Jobseeker Support Student Hardship or JSSH).

Previously, under section 9 of the Child Support Act 1991 a sole parent granted a JSSH benefit and who expected to be a receiving carer was required to apply for a formula assessment of child support, with any child support payment collected being withheld by the Crown to recover the cost of the benefit. The JSSH recipient was unable to end the formula assessment or use the uplift provisions, and may have been subject to other restrictions and obligations under the child support scheme. The compulsory requirements that previously applied in the short period the sole parent receives a JSSH could be disruptive to the sole parent and to any care or private support arrangements they had in place to support their studies. This is especially so given that a sole parent receiving a student allowance is not subject to these requirements, as a student allowance is not defined as a social security benefit under the Child Support Act 1991. The JSSH is only granted to students between academic years.

Key features

The definition of a "social security benefit" has been amended to exclude a sole parent granted a Jobseeker Support payment under section 88C(2) or (3) of the Social Security Act 1964. These sections provide exceptional hardship grounds for granting a Jobseeker Support payment to a full-time student (including certain students who are aged 16 years or 17 years) during the period between the end of one academic year and the start of the next.

The exclusion of JSSH payments from the definition of "social security benefit" means JSSH beneficiaries are no longer subject to the requirements of the Child Support Act 1991 that apply to social security beneficiaries. For example, they are not required to apply for child support under section 9, to be compellable witnesses under section 122, or to have payments withheld under section 142. For the period a receiving carer is receiving a JSSH they will be treated in the same way for child support as if they were receiving a Student Allowance. They may end an assessment of child support under section 27 or uplift a liability under section 180 of the Child Support Act 1991.

A transitional provision (schedule 1, part 1A, section 8AA) applies so the Child Support Act 1991 continues to apply in relation to periods before the date the law changed. This will allow payments relating to earlier periods to continue to be collected, penalties to be applied and review, objections and appeal provisions to apply.

A consequential change to the Social Security Act 1964 confirms that JSSH beneficiaries are no longer subject to the sanction in section 70A for failure to comply with sections 9 or 122 of the Child Support Act 1991.

Application dates

The amendments came into force on the first day of the month following Royal assent (that is 1 March 2016) and apply in relation to JSSH benefits whether granted before, on or after that day.

Example

A sole parent is granted a JSSH on 1 September 2015. They are required to apply for a formula assessment of child support. The liable parent is required to pay child support according to the formula assessment. Payments relating to the months of September through to February are withheld by the Crown to cover the cost of the JSSH. Payments that relate to the month of March and later months are passed on to the receiving carer. The receiving carer can end the formula assessment any time on or after 1 March but not before. If the liable parent did not make payments, penalties are applied and continue to apply after 1 March, and Inland Revenue will continue to pursue collection of the debt. The receiving carer cannot uplift any liability relating to periods before 1 March but can uplift liability for periods on or after 1 March.

A sole parent is granted a JSSH on 1 September 2016. They are not required to apply for child support. Any private arrangement they had with the other parent of the child can continue.

BUDGET 2015 CHILD SUPPORT DEBT MEASURES

Sections 135FA, 135G, 135GA and 135JA of the Child Support Act 1991

Measures announced as part of Budget 2015 included changes to penalty relief in the Child Support Act 1991. The changes have been designed to relax the circumstances in which the Commissioner of Inland Revenue can provide relief from penalties and broaden the circumstances when incremental penalties can be relieved for payment arrangements that are subject to 26-week review.

Background

When the Child Support scheme was introduced in 1992, the number of penalties and the rate at which they would increase was not anticipated. In some cases, these penalties have reached a level where they have become a barrier to compliance.

In many cases, the amount of penalties charged far outweighs the actual child support due. Some liable parents feel the debt cannot be repaid, and therefore disengage from the scheme. The result is increased debt, increased collection costs for Inland Revenue, and child support not being passed on to financially support children.

Improving the rate of child support collected better focuses the child support scheme on meeting the needs of children, and helping the financial wellbeing of both liable parent and receiving carer families.

Accordingly, measures announced as part of Budget 2015 to incentivise parents to re-engage with their child support obligations, and strengthen Inland Revenue's ability to work with parents to help control and manage their child support debts and improve equity across the debt book will come into force on 1 April 2016. The measures are:

- extending the mandatory write-off of incremental penalties for a payment arrangement subject to a 26-week review, to include payment arrangements where a liable person has not explicitly agreed to this arrangement; and
- amending the penalty write-off tests to allow a more pragmatic test based on "fair and reasonable".

Extension of mandatory write-off of monthly incremental penalties subject to a 26-week review

Before the changes announced in Budget 2015, a payment arrangement for child support debt agreed between the Commissioner of Inland Revenue and a liable parent would qualify for an automatic write-off of monthly incremental late payment penalties after a review of each 26-week period or at the completion of an arrangement and subject to compliance with the agreement. Under section 135J, incremental penalties relating to the arrangement would be written off on a proportional basis, depending on the amount of debt repaid.

Repayment arrangements where explicit agreement with the liable parent had not been received would not qualify for the write-off of monthly incremental late payment penalties as above. This type of arrangement can occur when the Commissioner has statutory authority to collect payment by automatic deduction from a liable parent's source deduction income (such as salary and wages, contract payments or student allowances) and income from benefits (such as Social Security, and NZ Superannuation and Retirement benefits) or when a liable parent cannot be reached to agree to the arrangement.

The manner in which the repayment is being made, and the rate of repayment, can be the same as an arrangement explicitly agreed with a liable parent, the only difference being no explicit agreement. Extending the mandatory write-off of monthly incremental penalties that are subject to 26-week review periods to include payment arrangements with no explicit agreement (deduction plans) will also enable monthly incremental penalties to be written off in these circumstances.

A pragmatic test based on "fair and reasonable" for penalty relief

Before the changes announced in Budget 2015, qualifying for relief from certain penalties required a liable parent to be

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in serious hardship or for continued collection to represent an inefficient use of the Commissioner's resources.

In both circumstances, write-off was subject to further tests requiring the Commissioner to have regard to maintaining the integrity of the tax system, promoting compliance, the rights and responsibilities of taxpayers and Inland Revenue, and her duty to maximise revenue within practical boundaries. While these further tests were legislated, to ensure appropriate consideration was given to debt write-off and that checks and balances are in place, they provided little discretion for the relief of liable parents in debt.

Key features

Extension of the mandatory write-off of monthly incremental penalties

- A payment arrangement for child support debt that has not been explicitly agreed to by a liable parent and is subject to 26-week review periods (a "deduction plan") will have penalty relief granted for monthly incremental penalties to the extent that the arrangement has been complied with.
- A "deduction plan" is defined in the legislation and applies to a plan made on or after 1 April 2016 by the Commissioner in relation to a liable person.
- The penalty relief will be based on a proportional calculation that takes into account payments made and debt amounts subject to the deduction plan.

Amendment to penalty write-off tests to adopt a more pragmatic test based on "fair and reasonable"

- The Commissioner may grant penalty relief to a liable person when it is "fair and reasonable" to do so for:
  - incremental penalties of the liable person that were unpaid at the time a payment arrangement was entered into;
  - incremental penalties of the liable person if the liable person has paid some or all of the financial support debt and initial late payment penalties to which the incremental penalties relate; and
  - incremental and initial late payment penalties of the liable person if the liable person has paid, or had written off, the entire liable person's financial support debt.
- The "fair and reasonable" ground for relief replaces the ground that the recovery of the penalties would involve an inefficient use of the Commissioner's resources (having regard to matters referred to in sections 6 and 6A of the Tax Administration Act 1994).

Detailed analysis

Extension of mandatory write-off of monthly incremental penalties subject to 26 week review

New section 135JA extends mandatory relief from monthly incremental penalties to payment arrangements without explicit agreement (deduction plans) that are subject to 26-week review and compliance.

If a "deduction plan" has been made and the plan has been complied with up to a particular review date, the Commissioner must, on that review date, —

- review the incremental penalties in relation to the initial debt (financial support and related initial late payment penalties at the time the plan is made); and
- write off the incremental penalties, subject to a proportional calculation.

"Deduction plan" is defined in the legislation and covers a plan made on or after 1 April 2016 by the Commissioner in relation to a liable person. It is intended to cover circumstances when the Commissioner has statutory authority to collect payment by automatic deduction from a liable parent's source deduction income (such as salary and wages, contract payments or student allowances) and income from benefits (such as Social Security, and NZ Superannuation and Retirement benefits), and is a plan that is not made with the agreement of a liable person.

"Review date" is also defined to mean:

- the day that is 26 weeks after the date on which the deduction plan is made; and
- each of the days on which there expire periods of 26 weeks that consecutively succeed the first period of 26 weeks described above; and
- the day on which the deduction plan expires.

Compliance with a deduction plan is determined at a particular review date if all the required deductions and payments have been made.

The incremental penalties written off are calculated using the formula included in section 135JA(4):

$$r = \frac{(a \times c)}{b} - d$$

Where:

r is the amount of incremental penalty that is to be written off;

a is the total amount of the initial debt that has been paid since the deduction plan was made;

b is the initial debt;

c is the total amount of incremental penalties related to the initial debt of the liable person that were unpaid at the time the deduction plan was made;

d is the total amount of incremental penalties related to the initial debt of the liable person that have already been written off according to the above formula since the deduction plan was made.

A pragmatic test based on "fair and reasonable" for penalty relief

The Commissioner will grant penalty relief to a liable person when it is "fair and reasonable" to do so for the following:

- incremental penalties of the liable person that were unpaid at the time a payment arrangement was entered into (section 135FA);
- incremental penalties of the liable person if the liable person has paid some or all of the financial support debt and initial late payment penalties to which the incremental penalties relate (section 135G);
- incremental or initial late payment penalties, or both, of the liable person if the liable person has paid, or had written off, the entire liable person's financial support debt (section 135GA).

The "fair and reasonable" ground for relief replaces the ground that the recovery of the penalties would involve an inefficient use of the Commissioner's resources (having regard to the matters referred to in sections 6 and 6A of the Tax Administration Act 1994).

What is considered "fair and reasonable" will be determined by the Commissioner but is intended to cover circumstances where it makes sense to do so, such as when liable parents have low income and no likelihood of significant income increases.

Example 1

A liable parent receiving NZ Superannuation from the Ministry of Social Development owes $136,958 in penalties for child support. He has paid all his core assessment debt, all his late payment penalties and $943 towards his incremental late payment penalty debt. He is repaying his penalty debt at $25 per week. He will be 89 years old at the conclusion of the arrangement in 2037. As his debt is currently under arrangement, he does not qualify for any penalty write-off. The new legislation now allows for the write-off of some or all of the incremental late payment penalty debt.

The extension of the mandatory write-off of incremental penalties for a deduction plan subject to 26-week review and compliance will apply to deduction plans made by the Commissioner on or after 1 April 2016.

The changes to penalty relief provisions to introduce a test based on "fair and reasonable" come into force on 1 April 2016.

CHILD SUPPORT REMEDIAL ITEMS

Sections 105(2)(d), 105(3A), (3B), (3C), (3D), 106A, 27, 88, 88A, 89L, 91 and 35A of the Child Support Act 1991

A number of remedial changes have been made to the Child Support Act 1991 and the Child Support Amendment Act 2013 to ensure the policy objectives of the child support reforms are achieved. The remedial items correct minor errors, clarify wording, correct terminology and make additional consequential amendments to ensure the Child Support Scheme operates as intended.

Key features

Correcting the rules for the re-establishment costs departure to the formula assessment ground

Amendments have been made to sections 105(2)(d), 105(3A), (3B), (3C), (3D) and section 106A of the Child Support Act 1991. The amendments replace changes made by section 37 of the Child Support Amendment Act 2013 and clarify how the departure to a child support formula assessment will operate when a re-establishment cost ground exists.

First, the amount of income from additional work that can be taken into account is limited to the amount that has been, is, or will be used to re-establish a person following separation, up to a maximum of 30 percent of their adjusted taxable income. Secondly, the new sections make it clear that it can apply to receiving carers as well as liable parents.

Removing the unilateral opt-out rule where there is shared care

Section 27 of the Child Support Act 1991 has been replaced and makes changes to the process required for ending a child support formula assessment. Previously, this could be unilaterally requested by the receiving carer with few requirements, unless they were a social security beneficiary.

The new formula assessment that came into force on 1 April 2015 recognises situations when care of the child is shared and the fact that the roles of receiving carer and liable parent can change during the year. This could be due to changes in estimates of income or changes in shared-care arrangements. This raises the possibility of elections to end an assessment being later overturned, with retrospective liabilities being imposed and additional cost and debt for all parties, if it later turns out the receiving carer was actually a liable parent at the time the election was made.

The new process now requires the agreement of all recognised carers of the child to elect to end an assessment.

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A recognised carer is a receiving carer of the child or a parent of the child who provides the child with at least 28 percent of ongoing daily care. It does not matter who makes the application to end the assessment; it will be accepted if all the conditions are met. An election to end will not be accepted if any of the recognised carers is a social security beneficiary.

The new section also confirms that the decision to end an assessment is final (with few exceptions) and will not be "undone" based on a later determination of who is a receiving carer.

Requirements for Notices

Sections 88 and 88A of the Child Support Act 1991 set out the minimum amount of information that the Commissioner must provide in a notice of assessment relating to a formula assessment of child support. The amendments are aimed at giving the Commissioner greater flexibility to leave out information that is not relevant to the child support assessment concerned, and make the notice easier to understand.

Commissioner determinations that differ from what was asked for

Section 89L of the Child Support Act 1991 requires an application for a departure to the child support formula assessment to set out the grounds on which the application is made. The amendment to section 89L now allows the Commissioner to make determinations that differ from what is applied for under the original departure request. This allows the Commissioner to make determinations that are correct and fair in the circumstances, and removes the need for a cross-application or re-application to be made to achieve that outcome.

Objections

Section 91 of the Child Support Act 1991 now permits a parent to object to an amended assessment for child support even when their final liability or entitlement has not changed, but a component within it has changed. However, the matters covered by the objection must be on specified grounds and only if attributable to the amendment of the assessment.

The wording of section 91(2) has been tightened to confirm that only those for whom the Commissioner is required to give a notice of the assessment can object. The restriction means the ability to object is not available to anyone who considers they may have been affected by an assessment.

Unsupported Child's Benefit recipients – ending of assessments

Section 27 of the Child Support Act 1991 has been amended to confirm that a carer who is receiving an Unsupported Child's Benefit can elect to end a child support assessment in relation to children that are not the child for whom the Unsupported Child's Benefit is paid for. That is, the restriction on the election to end an assessment that applies to people who receive an Unsupported Child Benefit only applies to child support assessments where the qualifying child is the child for whom Unsupported Child Benefit was granted.

Living allowance – updating reference to welfare benefits

Section 35A of the Child Support Act 1991 sets out how to calculate a parent's living allowance under the child support formula, which is used to determine a parent's liability to pay, or entitlement to receive, child support.

The amendment updates references to certain social security benefits to take account of the changes to social security benefits made by the Social Security (Benefit Categories and Work Focus) Amendment Act 2013.

Application dates

With one exception, the remedial amendments came into force on the day after the date of Royal assent – being 25 February 2016.

Section 35A (Living allowance – updated references) came into force on 1 April 2015.

Detailed analysis

Correcting the rules for re-establishment costs of a departure ground to the child support formula assessment

Under sections 104 to 106, the Family Court may, in relation to the payment of child support, make an order departing from the provisions of the Child Support Act 1991 relating to a formula assessment. One or more of the grounds set out in section 105(2) must exist, and it must be just and equitable and otherwise proper to make the order. The Commissioner has a corresponding power under part 6A, which also operates by reference to section 105(2).

Section 37 of the Child Support Amendment Act 2013 inserted a new ground into section 105(2) of the Child Support Act 1991 relating to "re-establishment costs situations", namely, situations when the adjusted taxable income of a parent for a child support year includes income that:

- is from additional work that the parent performs within a specified period after the child's parents separate; and
- has been used, or will be used, by the parent to re-establish himself or herself following the separation; and
- is no more than 30 percent of the parent's adjusted taxable income for the relevant child support year.

The new ground was due to come into force on 1 April 2016. Instead, section 37 of the Child Support Amendment Act 2013 has been repealed and amendments made to sections 105(2)(d), 105(3A), (3B), (3C), (3D) and section 106A of the Child Support Act 1991 to clarify the two restrictions placed on the new ground.

First, the additional work must be performed within three years after the parental separation (subject to a potential extension of up to three months when there is an attempt at reconciliation).

The relevant three-year period means the three year period starting on the date on which the qualifying child's parents ceased to live together in a marriage, civil union or de facto relationship. The fixed period reflects the expectation that a parent's costs to re-establish themselves will diminish over time.

Therefore, if a parent earned income from relevant additional work within three years of separation, to be used to re-establish themselves, application(s) for relief can be sought for the child support year(s) in which the additional income will be/has been included in their adjusted taxable income, (rather than the assessments within three years of separation).

Secondly, an order made on the above mentioned new ground may exclude from the parent's adjusted taxable income an amount that is not to exceed the lesser of the following:

- the income from the additional work that is used, or will be used, by the parent for re-establishment costs; or
- 30 percent of the parent's adjusted taxable income for the relevant child support year.

New section 107(4) means if for some reason the Commissioner does not want to amend the "adjusted taxable income" amount to put into effect a departure order, another part of the formula can be used to achieve the reduction in the parent's income as outlined above, if the parent meets the specified criteria.

The new departure ground will apply for the child support year starting on 1 April 2016 and later child support years.

Example 2

In a child support relationship, the liable parent's usual income is $40,000 but following separation there is additional income from over-time worked and secondary employment of $20,000. Therefore, adjusted taxable income for the child support year is $60,000. If this is multiplied by 30 percent this produces $18,000.

If at least $18,000 has been/will be spent on re-establishment costs in relation to the liable parent and any child or another person they have a duty to maintain, (and it is just and equitable and otherwise proper to make a departure from the formula assessment), then the liable parent's adjusted taxable income may be reduced by up to $18,000 for the purpose of the formula assessment.

However, if only $12,000 has been/will be used for re-establishment costs, the adjusted taxable income can only be reduced by $12,000 under the departure process.

Example 3

In a child support relationship, the liable parent's income is $80,000 before separation and the additional income from increased working hours is $10,000. The adjusted taxable income is therefore $90,000. If this is multiplied by 30 percent this produces $27,000. The liable parent spends $12,000 on re-establishment costs.

Any departure under the new departure ground is limited to the income from the relevant additional work, which in this example is $10,000.

Removing the unilateral opt-out rule where there is estimated income

Originally, the ability for a parent under the Child Support Scheme to end an assessment was put in place to allow parents to opt out of the scheme and to set up a voluntary arrangement (as long as they were not receiving a social security benefit). At the time, it was assumed that the liable parent in the child support relationship concerned would always agree in such circumstances, so the decision to end an assessment rested with the receiving carer. Further, under the old formula such roles were mostly fixed once the assessment came into force.

The nature of the new formula, and the work and care arrangements of parents today, makes it more complex to determine who the receiving carer is – particularly when more than one party has a level of care of at least 28%. Other changes in circumstances can also cause a change in who the receiving carer or liable parent is – for example, when the liable parent has made or changes an estimation of income. When this is a backdated adjustment, it could retrospectively change who the receiving carer is. If the receiving carer had made an election to end the assessment in the meantime, that election would be invalid (that is, they were not the receiving carer in retrospect and therefore had no authority to end the child support assessment). This situation would have created uncertainty, stress and would have given rise to a child support debt. It was also questionable how the section worked if there was more

NEW LEGISLATION

than one receiving carer, and they did not both agree to ending the child support assessment.

To avoid this outcome, new section 27 states that when more than one party has a level of care of at least 28 percent, the parties must agree to elect to end the formula assessment. It does not matter who makes the application to end the assessment – it will be accepted if all the conditions are met. When an agreement is reached, the formula assessment concerned is accordingly at an end and this outcome cannot be reversed. The only exceptions are when an objection under the Child Support Act 1991 is made or the Commissioner becomes aware that a recognised carer was a social security beneficiary at the relevant time of the election to end the assessment.

If no agreement is reached, the assessment should continue and the election to end a formula assessment would not be properly made. As with the previous rule, an election to end a formula assessment cannot occur if any party with ongoing care of the child of at least 28 percent is a social security beneficiary.

Notice rules

Changes to section 88A of the Child Support Act 1991 apply when a parent is part of a multi-group child support relationship and they are subject to a departure order to the formula assessment, which affects the calculation of the dependent child allowance as contained in the formula assessment. The Commissioner is no longer required to disclose every variation of allowance for the same dependent child, for the same parent on a notice of assessment.

The Commissioner now has the discretion to be able to record enough details on a notice of assessment to allow a parent to exercise their objection rights without infringing the privacy rights of the dependent child in the child support relationship concerned. This should also allow the notice to be easier to understand.

Commissioner determinations that differ from what is requested

The Child Support Act 1991 and the Child Support Amendment Act 2013 were previously silent on the Commissioner's ability to make a contrary departure determination against what was actually applied for by a parent.

Australia has a specific provision for such a scenario under its child support scheme, so determinations made by the Registrar are not limited by the terms of the application and may depart from the formula assessment.

Section 89L of the Child Support Act 1991 now allows the Commissioner to make determinations that differ from what is applied for under the original departure application if the result of the determination is correct and fair, without the need for a cross-application or re-application to be made.

Objections

A person will be able to object to their assessment if their liability or entitlement has increased, decreased or has not changed but a component within the child support formula assessment has. For example, a new income amount has been used that does not affect the liability or entitlement amount but is otherwise objected to. However, the matters covered by the objection must be on specified grounds and only if attributable to the amendment of the assessment.

The wording of section 91(2) has been tightened to confirm that only those for whom the Commissioner is required to give a notice of the assessment can object. It also confirms that receiving carers as well as liable parents can object to an assessment.

Under the Child Support Act 1991, an objection must occur within 28 days after the date the notice of the decision or assessment objected to was given by the Commissioner. The child support year beginning 1 April 2015 is the first year under the new formula assessment and a number of receiving carers have already made objections. To meet fairness requirements, and in recognition of the time restrictions for making objections, receiving carers are able to object to child support assessments for the child support year starting 1 April 2015. Schedule 1, part 1A, section 8D(2) and (3) have been amended accordingly.

Unsupported Child's Benefit – ending of assessments

Previously, a receiving carer who was in receipt of an Unsupported Child's Benefit could not elect to end their entitlement for other children who were not subject to an Unsupported Child's Benefit. This meant that the receiving carer was locked into receiving an entitlement for children they no longer wished to receive an entitlement for. The amendment corrects this anomaly.

When a receiving carer receiving an Unsupported Child's Benefit has other children that are in the child support scheme, the receiving carer will now be able to elect to end their entitlement to non-Unsupported Child's Benefit children. Accordingly, section 27 now treats the carer as a social security beneficiary only in relation to the child for whom an Unsupported Child's Benefit is granted.

Living allowance – updating the reference to welfare benefits

Section 35A of the Child Support Act 1991 has been updated to reflect the new names and section references for certain social security benefits to reflect the changes to social security benefits made by the Social Security (Benefit Categories and Work Focus) Amendment Act 2013.

RECIPIENTS OF CHARITABLE OR OTHER PUBLIC BENEFIT GIFTS

Schedule 32 of the Income Tax Act 2007

The following charities have been granted donee status from the 2015–16 income year:

- Adullam Humanitarian Aid Trust
- Bicycles for Humanity, Auckland
- Face Nepal Charitable Trust Board New Zealand
- Hagar Humanitarian Aid Trust
- Himalayan Trust
- International Needs Humanitarian Aid Trust
- Mercy Ships New Zealand
- Orphans Aid International Charitable Trust
- ShelterBox New Zealand Charitable Trust
- So They Can

The Act also makes changes to two existing charities listed on schedule 32:

- "ADC Incorporated" replaces "Aotearoa Development Cooperative" following the charity's restructure to an incorporated society. "ADC Incorporated" is inserted in schedule 32 with effect from 20 June 2014 and "Aotearoa Development Cooperative" is removed from the schedule with effect from 1 April 2015.
- "SpinningTop Trust" replaces "Children on the Edge NZ Trust" from 28 March 2011.

Background

New Zealand-based charities who apply some or all of their funds for overseas purposes and who want donors to receive tax benefits in connection with any donations received, are required to be named as a donee organisation on the list of recipients of charitable or other public benefit gifts in the Income Tax Act 2007.

Donee status entitles individual donors to a tax credit of 331/3 percent of the amount donated to these organisations, up to the level of their taxable income. Companies and Māori Authorities are eligible for a deduction for monetary donations up to the level of their net income.

Application dates

The new insertions apply from the 2015–16 and later income years. The other changes apply from the dates specified above.

CALCULATION OF FRINGE BENEFITS FROM EMPLOYMENT-RELATED LOANS

Section RD 35 of the Income Tax Act 2007

The fringe benefit tax (FBT) rules provide two methods for an employer to value the fringe benefit arising from an employment-related loan – the prescribed interest rate method, and the market interest rate method.

As most employers would likely incur high compliance costs if they had to apply the market interest rate method, its use is limited to persons in the business of lending money to the public, as lenders should be able to easily determine and track the prevailing market rates of interest.

The amendment extends eligibility to use the market interest rate method to employers who are part of the same group of companies as a person in the business of lending money to the public. These employers should be able to obtain the information needed to apply the method from the lender within the group, without incurring high compliance costs.

Background

When a person receives a loan from their employer at less than market interest, a fringe benefit arises, as the employee benefits from the reduced interest expense. This fringe benefit is subject to FBT.

To limit compliance costs, most employers must calculate the fringe benefit arising from the loan by comparing the interest accruing under the loan with the interest that would accrue if the loan was at the prescribed interest rate, which is set by regulation. The prescribed rate is set with reference to the Reserve Bank's survey of published floating first mortgage interest rates.

Since 2006, an employer in the business of lending money to the public has had the option of valuing the fringe benefit by comparing the rate of interest under the loan with the market rate of interest charged on a comparable loan made to an unrelated borrower.

This option was provided because persons who lend money to the public were expected to have systems in place to easily monitor movements in market rates of interest, and could therefore apply the market interest rate method without difficulty. The option was not extended to other employers, as the compliance costs associated with the option would not make it worthwhile.

Before the latest amendment, an employer who was not lending to the public could not use the market value method even when its employees received discounted loans under an arrangement with a lender within the same group of companies that was itself lending to the public. The employer was required instead to value the benefit using the prescribed interest rate, which may have led to a slightly higher FBT liability for the employer because the calculation did not factor in any available market discounts on the official carded lending rates.

Key features

The amendment allows an employer who is a member of the same group of companies as a person who is in the business of lending money to the public, to use the market interest rate method of determining the fringe benefit arising from a low-interest employment-related loan.

As it is anticipated that the employer will be able to obtain information on market interest rates from the lender, these employers too should be able to apply the market interest rate method without difficulty.

The amendment includes transitional rules that apply to an employer who is paying FBT on a quarterly basis, and enable the employer to make an election before 1 April 2016 to use the market interest rate method, and apply the method from the following quarter.

Application date

The amendment came into force on the date of enactment, being 24 February 2016.

Detailed analysis

Eligibility to use the method

The amendment expands eligibility to apply the market interest rate method to an employer who is a member of a group of companies that includes a person who is in the business of lending money to the public.

Membership of a group of companies is determined by the existing test. A person will be a member of a group of companies when a group of persons holds a 66 percent common voting interest and, when applicable, a 66 percent market-value interest.

Valuing the benefit arising under an employment-related loan using the market interest rate method requires the employer to determine the amount of interest that would arise on the loan, taking into account the rate that would be charged on a loan of a similar kind, provided to a group of persons similar to the employee. To ensure the accuracy of this test, the group must have a comparable credit risk, membership of the group must be unrelated to a connection with the employer, and the group must have sufficiently large membership to ensure transactions are on an arm's-length basis.

It is expected that the lender within the group of companies would provide necessary information to another employer applying the method, to enable it to comply with the above requirements.

Transitional rules

Under the existing provision, an employer must give notice to the Commissioner of Inland Revenue at least a year before the start of the income year in which the change in method to value an employment-related loan is to occur. The purpose of this rule is to prevent flip-flopping – changing between methods in order to obtain advantage from a difference between the two rates. The employer must then apply the method for at least two income years.

First applying the market interest rate method

It is anticipated that some of the employers will already have provided their employees with employment-related loans and, as they could not previously have used the market interest rate method, they will therefore have been valuing the benefit arising from the loan using the prescribed interest rate method.

Allowing these persons to elect to apply the method to an existing loan may benefit these employers, and does not pose a risk of flip-flopping.

Therefore, as a transitional measure, the rules allow an employer to whom the amendment applies to elect to use the market interest rate method, and for the change to take effect from the start of the following quarter, provided the employer notifies the Commissioner of Inland Revenue of the intended change before 1 April 2016.

As this option could have led to an employer applying the rule partway through an income year, it is limited to employers who pay FBT on a quarterly basis. (See the following example.)

Example

ACo is a member of a group of companies that includes BCo. BCo lends money to the public, while ACo does not. Under an arrangement between ACo and BCo, BCo offers and provides loans to employees of ACo. For FBT purposes, the benefit is treated as provided to ACo's employees by ACo.

Before the amendment, ACo was required to value the benefit from these loans using the prescribed interest rate method.

After the amendment comes into force, ACo decides that it prefers to apply the market interest rate method to value the benefit arising under these loans, using information provided by BCo. On 1 March 2016 it elects to apply the market interest rate method by notifying the Commissioner.

As ACo was previously unable to apply the method, the transitional rule applies and enables it to apply the market interest rate method from the quarter beginning 1 April 2016. In the absence of this rule, it would only be able to first apply the method to the loan from 1 April 2017.

From 1 April 2016, ACo values the loan using the market interest rate method, using information obtained from BCo to determine an appropriate market rate.

Ceasing to apply the market interest rate method

Allowing an employer to opt to apply the market interest rate method partway through an income year would be inconsistent with the requirement that a person apply the method for two full income years. To avoid this inconsistency, the transitional rules treat any part-income year arising as a result of using the transitional provision as a full income year when determining whether the minimum application period has been met.

CFC REMEDIALS

ATTRIBUTION OF INCOME FOR PERSONAL SERVICES

Sections EX 20B and GB 27 to 29 of the Income Tax Act 2007

Amendments have been made that allow taxpayers to choose between the standard attribution of income for personal services rules or the controlled foreign company (CFC) rules, if they provide personal services through a foreign company.

Background

The attribution rule for income from personal services applies when a taxpayer has interposed an entity (commonly a company) between themselves and the person to whom they are providing services. The attribution rule looks through the interposed entity and, in certain circumstances, attributes the income earned by the company for services provided by the taxpayer, back to the taxpayer. These rules are duplicated and have the same effect under the CFC rules in section EX 20B(9). Income earned by a taxpayer providing services through a foreign company would generally be considered passive income and would be attributed back to the taxpayer.

While the tax effect of the two sets of rules is the same, taxpayers who fall under the CFC personal services attribution rules face a more complex undertaking, as the CFC rules require attribution of personal services income as well as other forms of passive income. This was not an issue for taxpayers who derive both personal services income and other forms of passive income from their CFC interests, but taxpayers who only derived personal services income from their CFC interests faced additional costs compared with taxpayers who fell under the standard rules.

Key features

Section GB 27(3) provides certain exemptions from attribution for personal services income. Section GB 27(3)(d), which provides an exemption for low-value amounts of less than $5,000, has been amended to exclude from this exemption personal services income derived through a CFC, if the person has filed after the date of Royal assent of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 a tax return attributing income to the person under section GB 27.

Section GB 27(3)(e) has also been amended so that the exemption from attribution under section GB 27 only applies in relation to income derived from a CFC, if the person has filed after the date of Royal assent of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 an income tax return attributing income to the person under the CFC rules.

A corresponding amendment has been made to section EX 20B(9), which provides that personal services income derived through a CFC is only attributed under the CFC rules, if the person files after the date of Royal assent of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016, a return of income in which the personal services income is attributed to the person under the CFC rules.

The practical effect of the amendments is that a taxpayer who derives income from personal services through a CFC has to attribute that income irrespective of the amount, but is able to elect whether to attribute this income either under section GB 27 or under the CFC rules. This election is made by filing an income tax return including personal services income attributed to the person either under sections EX 20B or GB 27 after the date of Royal assent of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016.

Example

Dr Paul provides medical services to his patients, but incorporates a company to be the contractual provider of those services. The company then employs Dr Paul, who sees the patients and carries out the services. Dr Paul may be required to attribute income derived by the company in relation to his services under the attribution rule in sections GB 27 to 29. If the company were a CFC and the services were performed in New Zealand, the CFC rules would also attribute the services back to Dr Paul.

Dr Paul is able to make a one-off election to determine whether he attributes the income earned by the company for his services under the CFC rules or the rule in section GB 27. If Dr Paul would like to attribute under the rule in section GB 27, his one-off election would be in the form of filing an income tax return that includes the amount attributed to him under the rule in that section after the date of Royal assent of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016.

Application date

The amendments came into force on the date of enactment, 24 February 2016.

PREPAID EXPENDITURE

Section EX 20C of the Income Tax Act 2007

An amendment has been made to the CFC rules so that they mirror the effect of the prepayment rules in section EA 3 of the Income Tax Act 2007, to prevent taxpayers from claiming an immediate deduction for an amount that should be spread over several years.

Background

The tax rules allow taxpayers to claim deductions for expenses incurred in generating taxable income. If a taxpayer incurs an expense in one year for something that will last more than one year, adjustments are made so that the deductions are spread over the relevant years. These rules, known as the prepayment rules, are separate from the depreciation rules but serve similar purposes.

Previously, the CFC rules did not include such adjustments and taxpayers could make a full claim in the year payment was made for expenses that may have related to goods or services that would be used over many years.

Key features

An amendment has been made to section EX 20C(13)(a)(iii) to correct an anomaly in the rules which previously allowed immediate deductions for amounts that should have been be spread over several years. This is achieved through direct reference to the adjustments provided in sections CH 2 and DB 50.

Application date

The amendment applies to the 2016–17 and later income years.

FAIR DIVIDEND RATE METHODS

Sections EM 1, EM 6, EX 52A, EX 52, EX 53 and YA 1of the Income Tax Act 2007

The amendments provide that a taxpayer can change between fair dividend rate (FDR) methods in calculating income from offshore investments no more than once every four years for each foreign investment fund (FIF) interest.

Background

Under the FDR method of calculating taxable income from their offshore investments, taxpayers are considered to have income from their FIF interests equal to 5 percent of the opening value of each investment. Before enactment of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016, this was referred to as the "usual method" of calculation. This has been renamed the "fair dividend rate annual method". Most taxpayers use this method, but they also have the option to use a more complex FDR method previously known as the "unit-valuing funds" method. This has been renamed the "fair dividend rate periodic method".

Consequential amendments have been made to sections EM 1(1)(b)(ii), EM 6(3)(b)(ii), and EX 44 as a result of these name changes. In addition, definitions of "fair dividend rate annual method" and "fair dividend rate periodic method" have been inserted into section YA 1, which refer to sections EX 52 and EX 53, respectively. Together, these two methods now form the "fair dividend rate method", as defined in section YA 1.

Taxpayers must use the same FDR method for all of their FIF interests.

The FDR periodic method was introduced for certain investment funds, for which the calculation method is mandatory. It was also extended to all taxpayers who were willing to incur the additional compliance costs of basing the FDR calculation on the value of the investment on each day of the year – that is, they must make 365 calculations rather than just one. The FDR periodic method provides a more accurate result as it takes into account changes in value throughout the year.

If a FIF loses value over the course of a year, the periodic method calculates a lower amount of income than the usual method because the latter method will base the entire year's income on the (higher) opening value. Conversely, if the FIF gains value over the year, the periodic method will result in more taxable income than the usual method.

As the choice of method is made retrospectively – that is, after the taxpayer has observed if the FIF has gained or lost value – taxpayers are able to pick the method which produces the least income. This was not an intended feature of the rules, as it was expected that taxpayers would choose one method and use it consistently.

Key features

The FDR "usual method" has been renamed the "fair dividend rate annual method", and the "unit-valuing method" has been renamed the "fair dividend rate periodic method".

New section EX 52A limits when a taxpayer may switch between the FDR annual method and periodic method for an attributing interest in a FIF. The new section sets out when a person must the FDR annual method or periodic method in relation to an attributing interest in a FIF. Sections EX 52 and EX 53 have been amended to reflect this addition.

When a person must use the FDR periodic method

Section EX 52A(2) determines when a person must use the FDR periodic method for an attributing interest in a FIF in a particular income year.

Section EX 52A(2)(a) provides that a person must use the periodic method for an attributing interest for the current year if the person is a unit trust or other entity that makes investments for the benefit of other persons (the investors), assigns each investor an interest in a proportion of the net returns from the investment, and determines the value of each investor's interests for each of a number of periods making up the income year. Section EX 52A(2)(a) reflects the wording in previous section EX 53(1)(b).

A new rule has been introduced in section EX 52A(2)(b) to limit when a person may switch between the FDR annual method and periodic method for an attributing interest.

Section EX 52A(2)(b) provides that a person must use the periodic method for an attributing interest in a FIF in the current year, if two conditions are met:

- they used the periodic method for the attributing interest in the previous year; and
- they have also used the annual method for the attributing interest in any of the four income years preceding the current year, in any of the income years in the period from the beginning of the 2015–16 income year until the current year, or in any of the income years ending before the current year since the person acquired the attributing interest, whichever is shortest.

When a person must use the FDR annual method

New section EX 52A(3) provides the circumstances in which a person must use the FDR annual method for an attributing interest in a FIF. In particular, it restricts when a person may switch between the FDR annual method and periodic method for an attributing interest.

Similar to section EX 52A(2)(b), section EX 52A(3) provides that a person must use the FDR annual method for an attributing interest in a FIF in the current year, if two conditions are met:

- they used the annual method for the attributing interest in the previous year; and
- they have also used the periodic method for the attributing interest in any of the four income years preceding the current year, in any of the income years in the period from the beginning of the 2015–16 income year until the current year, or in any of the income years ending before the current year since the person acquired the attributing interest, whichever is shortest.

Application date

The amendment applies to the 2016–17 and later income years.

PART-YEAR EXEMPTIONS FOR AUSTRALIAN FIFS

Section EX 35 of the Income Tax Act 2007

An amendment has been made to limit the test for the Australian FIF exemption so that it only applies to the period of the year that the taxpayer holds an interest in the FIF.

Background

Section EX 35 provides that taxpayers with a 10 percent or more interest in a FIF that is resident in Australia generally qualify for the Australian FIF exemption and do not have to declare income from that investment. One of the criteria for the exemption was that the taxpayer must have a 10 percent or more income interest in the FIF at all times in the income year.

Generally, income interests are calculated by averaging out the taxpayer's interests in the FIF across the income year. This averaging out is done across the whole income year irrespective of whether the taxpayer had an interest in the FIF at all times or not. Therefore, if a taxpayer acquired a 15 percent holding halfway through a year, their income interest would be calculated as a 7.5 percent income interest for the year.

Key features

Section EX 35(a) has been amended so that the ownership calculation test for the purposes of the Australian FIF exemption in section EX 35 only looks at the total period that the person has rights in the FIF in question during the relevant year.

This means that a taxpayer who acquires a 15 percent holding halfway through a year would qualify for the section EX 35 exemption.

Application date

The amendment applies to income years beginning on or after 1 July 2011.

ANTI-AVOIDANCE RULE FOR THE TEST GROUPING CONCESSION

Section GB 15BA of the Income Tax Act 2007

A new anti-avoidance rule has been introduced in section GB 15BA to prevent taxpayers from using the CFC test grouping rules, which were introduced as a compliance concession, to gain an unintended tax advantage.

Background

The CFC rules allow taxpayers to consolidate same-jurisdiction CFCs into a test group when applying the active income exemption test. This means that operational CFCs, which earn active income, can shelter the passive income of holding CFCs. While some criteria must be met (for example, each CFC must have a taxed CFC connection with the same jurisdiction) the taxpayer otherwise has complete discretion over whether they include a CFC in a test group.

The rules were introduced to allow taxpayers to take full advantage of the active income exemption, irrespective of their business structures. Because taxpayers have discretion in applying the test group rules, it is possible for them to arrange matters so that they pay no tax when they have income, but still accumulate losses when they do not.

This means when there is an operating (active) CFC and a holding (passive) CFC, the taxpayer can choose to group the CFCs when the holding CFC has passive income but not when it makes a loss. When grouped, the active income of the operating CFC will grant the group the active income exemption. When not grouped, the loss of the passive CFC will be carried forward to be used against any future attributable income within that jurisdiction. In this way taxpayers may be able to accumulate losses without having to pay tax on their income.

Key features

A specific anti-avoidance rule has been introduced in section GB 15BA to ensure that taxpayers do not gain a tax advantage from choosing to group certain CFCs together in one year and not in another year.

Section GB 15BA provides that the Commissioner may treat an election to include or not to include a particular CFC in a test group as reversed, if the effect of the arrangement is that the person has less net attributable CFC income when the CFC is in the test group and greater net attributable CFC losses when the CFC is not in the test group.

In some circumstances, there may be legitimate reasons for changing test groups. The anti-avoidance rule in section GB 15BA recognises this.

Application date

The amendment applies to the 2016–17 and later income years.

TEST GROUPS FOR GROUPS OF COMPANIES ACQUIRED OR DISPOSED OF DURING THE YEAR

Sections EX 21D and EX 21E of the Income Tax Act 2007

Amendments have been made to sections EX 21D and EX 21E to allow taxpayers using either the default or accounting standard tests to form test groups of newly acquired or disposed CFCs in the year of acquisition or disposal.

Background

Taxpayers have the option of grouping multiple CFCs together into a test group and working out the ratio of active to passive income based on the consolidated accounts when applying the active business test. The CFCs must be resident in the same country and the taxpayer must hold an income interest of more than 50 percent in each CFC. The latter rule prevents a single CFC from being used by more than one taxpayer.

This rule produces counter-intuitive results when a taxpayer acquires or disposes of a group of foreign companies part-way through a year. To address this, sections EX 21D and EX 21E have been amended so that taxpayers using either the default or accounting standard tests can form test groups comprising newly acquired or disposed CFCs in the year of acquisition or disposal for the periods they hold the interests.

Key features

New sections EX 21D(1B)(a) and EX 21E(2B)(a) provide that the CFCs in the test group must either be all acquired in the same accounting period or all disposed of during the same accounting period by the interest holder or a member of a wholly owned group that includes the interest holder. Under sections EX 21D(1B)(c) and EX 21E(2B)(c), each CFC needs to be owned by the interest holder (or a member of the interest holder's wholly owned group) either at the beginning of the accounting period or the end of the accounting period. That is, a CFC acquired during an accounting period and disposed of during the same accounting period cannot be part of a test group.

For the period during the accounting period in which the interest holder (or a member of a wholly owned group that includes the interest holder) holds the interests in the CFCs, the interest holder or wholly owned member must own an income interest of more than 50 percent in each CFC, as calculated under section EX 17. This means that the 50 percent ownership requirement must still be met, but the test is limited to the part of the accounting period when the interest holder or wholly owned member has an income interest in the CFC. These provisions are contained in sections EX 21D(1B)(b) and EX 21E(2B)(b).

In addition, sections EX 21D(1B)(d) and EX 21E(2B)(d) require that acquired or disposed CFCs forming a test group must still meet the standard requirements that apply to test grouping as set out in sections EX 21D(1) and EX 21E(2), excluding sections EX 21D(1)(b) and EX 21E(2)(c) respectively.

Application date

The amendments apply to the 1 July 2009 and later income years.

ATTRIBUTABLE FIF INCOME METHOD FOR INDIRECTLY HELD INVESTMENTS

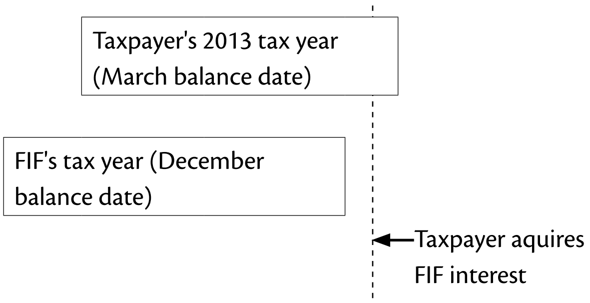
Section EX 58 of the Income Tax Act 2007

Amendments have been made to ensure that when a taxpayer has an income interest in a CFC and a resulting indirect interest in a FIF, income does not arise from the FIF interest if the taxpayer does not hold an interest in the FIF during that FIF's relevant accounting period, when using the attributable FIF income method.

Taxpayers who hold a 10 percent or more interest in a FIF have the option of using the attributable FIF income method to calculate their FIF income. This method provides a more accurate result but at a higher compliance cost and largely mirrors the CFC rules.

The amendments ensure that under the attributable FIF income method, a taxpayer who acquires an interest in a FIF after the end of that FIF's income year will not have attributable income. For example, a taxpayer with a 31 March balance date acquires an interest in FIF Co on 1 March 2013. FIF Co's balance date is 31 December.

The taxpayer will not have to include any income from FIF Co's 2013 tax year (1 January 2012 to 31 December 2012) as they did not acquire the FIF interest until after the end of that year.



Previously, the taxpayer would have been attributed income from the FIF for the 2013 tax year even though they did not hold an interest in the FIF during the FIF's 2013 income year.

Amendments have been made to sections EX 58(1)(ab) and (4)(b) to ensure that when a taxpayer has an indirect income interest in a FIF, this treatment is mirrored and the taxpayer is only attributed income from the FIF if they hold the FIF during the relevant period.

Application date

The amendment applies to income years starting on or after 1 July 2011.

MINOR TECHNICAL REMEDIALS

The following changes have been to correct or update terminology used in the CFC and FIF rules to make them easier for readers to understand.

Section	Change
Section CD 18(3)(a)	Previously referred to income tax paid "in the country". Expanded to "in the country or territory" in line with changes made to section LJ 3 in the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014.
Section CD 39(13) and (14)	Repeals sections relating to attributed repatriation rules.
Section CQ 2(2)	Section title renamed "Special rule: Taxable distributions under the attributable FIF income method". Previous title used out-of-date terminology.
Section CQ 5(1)(c)(xiv)	The word "non-resident's" has been deleted to match section DN 6(1)(c)(xiv).
Section CQ 5(3)	Clarifies that income from a FIF held by a non-attributing active CFC can be attributed by inserting "or a non-attributing acting CFC under section EX 21B (Non-attributing active CFCs)" at the end of the subsection. Previously the subsection referred only to section EX 22 (Non-attributing Australian CFCs).
Section DN 6(1)(c)(iv)	Replaces the word "regime" with "rules" to match section CQ 5(1)(c)(iv).
Section DN 6(3)	Clarifies that losses from a FIF held by a non-attributing active CFC can be attributed by inserting "or a non-attributing acting CFC under section EX 21B (Non-attributing active CFCs)" at the end of the subsection. Previously the subsection referred only to section EX 22 (Non-attributing Australian CFCs).
Section EX 24(3) and (4)	Replaces references to "branch equivalent income or loss" with "CFC attributable income or loss" to reflect current terminology.
Section EX 25	Removes references to "attributed repatriation".
Section EX 31(2)(c)(ii)	Clarifies how the rules apply when a taxpayer acquires separate share packages on different days by amending the subsection to read "at the earliest date in the income year when the person acquires shares in the company, if the person does not own shares in the company at the beginning of the income year".
Section EX 44(1)	Clarifies that this provision applies on an interest-by-interest basis rather than to all interests by adding the words "from an attributing interest".
Section EX 50(6)	Removes an in-text definition of "indirect attributing interest" and refers to "indirect attributing interest" as defined in section YA 1, but is restricted to an indirect attributing interest in a foreign company.
Section EX 58(1)(ab)	Updates the terminology to use the term "indirect attributing interest" as defined in section YA 1.
Section EX 58(1)(b)	Removes the phrase "because section EX 21(33) applies" to clarify that additional FIF income or loss can be attributed if the CFC is a non-attributing active CFC under EX 21E.
Section EX 58(4)(b)	Updates the terminology to use the term "indirect attributing interest" as defined in section YA 1.
Section EX 58(6)	Clarifies that the section, which applies to CFCs that hold interests in FIFs, applies to both non-attributing active CFCs and non-attributing Australian CFCs by inserting "or a non-attributing active CFC under section EX 21B (Non-attributing active CFCs)" at the end of the subsection.
Section EX 62(2)(a)	Repeals section containing transitional rules relating to the 2011 FIF rule changes. These rules are no longer needed.

Section EX 62(6)	Removes references to "branch equivalent method" as this method is no longer available.
Section EX 63	Removes references to "branch equivalent method" as this method is no longer available.
Section EX 72	Removes reference to "attributed repatriation".
Section YA 1	Introduces a definition of an "indirect attributing interest" to clarify the changes made to section EX 58 in the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014. The definition of "indirect attributing interest" is also used for the purposes of section EX 50. The definition refers to a person's income interest in one FIF, which has an income interest in another FIF. An income interest in a CFC is an income interest in a FIF, even though it may not be an attributing interest in that FIF. Thus, the definition can also include an interest in a CFC.

WORKING FOR FAMILIES

WORKING FOR FAMILIES

Sections MB 1(5D), MB4, MB7, MB 9, and MB 13(2) of the Income Tax Act 2007; sections 41(4) and 80KV of the Tax Administration Act 1994

The new Act introduces four Working for Families tax credits (WFFTC) remedial amendments. Two amendments correct drafting oversights or ambiguities that occurred when the definition of "family scheme income", used to calculate WFFTC recipients' entitlements was broadened on 1 April 2011, while the remaining two amendments reduce compliance costs for recipients of the scheme.

MAIN INCOME EQUALISATION SCHEME

Sections MB 1(5D), MB4, MB7 and MB 9 of the Income Tax Act 2007

Amendments have been made to clarify that when a Working for Families tax credits (WFFTC) recipient's associated entities draw on funds deposited into their main income equalisation accounts it does not reduce the recipient's WFFTC entitlement, but that withdrawal of interest earned on the accounts should continue to reduce the WFFTC entitlement.

Amendments have also been made to clarify that when a WFFTC recipient's associated entities (companies and trusts) make a deposit into or receive a refund from their main income equalisation accounts, the WFFTC recipient's WFFTC entitlement is only changed by the proportion of the interest the WFFTC recipient has in the associated entities.

Background

The definition of "family scheme income" was broadened on 1 April 2011 to improve the fairness and integrity of Working for Families. As a result, new section MB 9 intended to ensure that deposits made by WFFTC recipients and their associated companies and trusts into the main income equalisation scheme are included in family scheme income. The inclusion prevents people from making deposits to the scheme to artificially reduce their income and therefore increase their WFFTC entitlements.

However, section MB 1(5D), which prevented these main income equalisation scheme deposits from being included in a WFFTC recipient's family scheme income again when they draw on their funds, only referred to "a person". It did not list the person's associated entities. Therefore, arguably when a WFFTC recipient's associated entities drew on funds deposited into their main income equalisation accounts, the funds could be included in the WFFTC recipient's family scheme income a second time. This was not the policy intention as it overstates the income available to a person over a set period.

In addition, it is intended that when a WFFTC recipient's associated company makes a deposit into their main income equalisation account, the WFFTC recipient's family scheme income should only increase by the percentage share the WFFTC recipient has in the associated company, using the formula in section MB 4. Similarly, a deposit made by a WFFTC recipient's associated trust should reflect the number of settlors and the formulas in section MB 7. Likewise, when the WFFTC recipient's associated entities draw on these deposits, the WFFTC recipient's family scheme income should only decrease by the proportion attributable to the recipient by the associated company and trusts. However, the previous wording in sections MB 9 and MB 1(5D) was unclear and could have been read as including the whole amount of the deposit made by the recipient's entities, not just the proportion attributable to the WFFTC recipient.

Key features

The structure of sections MB 9, MB 1(5D), MB 4 and MB 7 and the way they interrelate has been amended to clearly set out and separate the treatment of deposits a WFFTC recipient makes into, and refunds they receive from, their main income equalisation account from the treatment of deposits made into and refunds received by the WFFTC recipient's associated entities from their main income equalisation accounts.

WFFTC recipient deposits and refunds

Section MB 9, which outlined the treatment of deposits made by a WFFTC recipient or their associated entities into their main income equalisation accounts has been repealed. Section MB 1(5D) has been replaced with section MD 1(5D) and (5E), and has been extended to include the treatment of deposits made by WFFTC recipients into their main income equalisation accounts. The wording in former section MB 1(5D) regarding WFFTC recipient deposits into and refunds from main income equalisation accounts has been shortened and simplified. This has been in part achieved by defining "main income equalisation deposit" and "main income equalisation refund".

These changes make it clear that WFFTC recipients who make deposits into their main income equalisation account are required to include the amount of the deposit in their family scheme income. Likewise, they make it clear that WFFTC recipients who draw funds from their main income equalisation account are not required to include the deposit in their family scheme income, unless the amount relates to interest payable (under section EH 6). These amendments also mean WFFTC recipients who do not have associated entities do not have to consider the WFFTC associated entities main income equalisation rules.

WFFTC recipient's associated entities deposits and refunds

The formulas in sections MB 4 and MB 7 have been extended. The formulas in MB 4 outline what income of major shareholders in close companies is included in WFFTC recipients' family scheme income. The formulas in section MB 7 outline what income of settlors of trusts is included in the associated WFFTC recipients' family scheme income. The formulas now require a main income equalisation deposit to be included in the item "income" and a main income equalisation refund to be subtracted from the item "income".

These amendments, and amendments to section MB 1(5D) and (5E), make it clear that when a WFFTC recipient's associated entities draw on main income equalisation funds from their accounts, the funds are not included in the WFFTC recipient's family scheme income a second time.

Including main income equalisation deposits and refunds in the company and trust formulas in sections MB 4 and MB 7 also makes it clear that when a WFFTC recipient's associated entities make a deposit or draw funds from their main income equalisation accounts, the WFFTC recipient's family scheme income should only be changed by an amount of the deposit that is proportional to the interest the WFFTC recipient has in the entities.

Application date

The amendments are treated as coming into force on 1 April 2011, the date that the definition of "family scheme income" was broadened to include deposits into the main income equalisation scheme.

SCHOLARSHIPS AND BURSARIES

Section MB 13(2) of the Income Tax Act 2007

An amendment has been made to section MB 13(2), which clarifies that educational bursaries are not included as income for WFFTC purposes.

Background

A number of payments that are treated as exempt from income tax are also not intended to affect Inland Revenue social policy entitlements. Two of these payments are scholarships and bursaries for attendance at educational institutions. Although these payments are similar, the wording of the exemption of scholarships and bursaries from income tax in section CW 36 suggested they were different.

On 1 April 2011, "scholarship" but not "bursary" was added to the list of payments in section MB 13 that are excluded from "family scheme income", which is used to calculate WFFTC recipient entitlements. It was intended that scholarships and bursaries would be treated as being excluded from family scheme income.

Key features

The replacement of section MB 13(2)(f) in the Income Tax Act 2007 extends the list of payments excluded from the definition of "family scheme income" from "an educational scholarship" to " an educational scholarship or educational bursary". This ensures that bursaries are treated the same as scholarships for WFFTC purposes so receiving a bursary will not reduce WFFTC recipient entitlements.

Application date

The amendment is treated as coming into force on 1 April 2011, the date that the definition of "family scheme income" was broadened to include scholarships. The amendment applies for the 2011–12 and later income years, ensuring that neither scholarships nor bursaries received in these income years will reduce WFFTC recipient entitlements.

FAMILY ASSISTANCE CREDIT DETAILS NOT NEEDED

Section 41(4)(a) of the Tax Administration Act 1994

An amendment has been made to section 41(4)(a) of the Tax Administration Act 1994 to remove the requirement for taxpayers to provide Inland Revenue with details of every family assistance credit (WFFTC) paid to them, as this is unnecessary.

Background

Previously, section 41(4)(a) of the Tax Administration Act 1994 required WFFTC recipients to furnish details to Inland Revenue of each family assistance credit paid to them in

NEW LEGISLATION

the tax year. However, Inland Revenue does not request or require this information from recipients.

Key features

The amendment repeals section 41(4)(a) of the Tax Administration Act 1994.

Application date

The amendment came into force on the date of enactment, being 24 February 2016

FAMILY SCHEME INCOME STATEMENTS

Section 80KV of the Tax Administration Act 1994

The replacement of section 80KV of the Tax Administration Act 1994 enables a WFFTC recipient and their spouse, civil union partner or de facto partner to submit separate family scheme income declaration forms.

Background

Inland Revenue sends out a notice of entitlement in order to confirm a person's social policy entitlements and obligations. Section 80KV(2) of the Tax Administration Act 1994 then required the person to give the Commissioner a statement that confirmed or added to the information in the notice of entitlement, including the family scheme income of their spouse, civil union partner, or de facto partner. This requirement generally worked for most households. However, for some (especially those with child support arrangements), it could be difficult to identify each spouse's portion of family scheme income. In these situations, it would be better for each person to submit their income separately.

Key features

The amendment changes subsections (1) and (2) and adds subsections (3) and (4) of section 80KV of the Tax Administration Act 1994 to ensure people who have been given a notice of entitlement from the Commissioner are not always required to provide in their statement of family scheme income for the tax year, the income of their spouse, civil union partner, or de facto partner.

Instead, the new legislation enables the person's spouse, civil union partner, or de facto partner to submit a separate family scheme income form to confirm or correct the information contained in the notice of entitlement.

Application date

The amendment came into force on the date of enactment, being 24 February 2016.

OTHER REMEDIAL MATTERS

REPEAL OF THE SIMPLIFIED FILING REQUIREMENTS FOR INDIVIDUALS

Section 33AA of the Tax Administration Act 1994

Amendments have been made to the Tax Administration Act 1994 to repeal recent legislation, which sought to simplify filing requirements for individuals. The provisions have been repealed as the problems the legislation was intended to address are better dealt with as part of Inland Revenue's Business transformation programme reforms.

Background

In 2012, legislation was enacted with the aim of simplifying filing requirements for individuals. This legislation was due to take effect in the 2016–17 income year, and contained the following two initiatives:

- *The 4 + 1 square-up:* Individuals who would not be required to file a tax return, but chose to do so anyway, would be required to file tax returns for the previous four years in addition to the year in which they chose to file.
- *Working for Families (WFF) delinking:* The link between the receipt of WFF tax credits and the requirement to file an annual income tax return was removed.

Before the 2012 legislation change, individuals who were not required to file a tax return were able to pick and choose the years that they would file a return in order to maximise the benefit to them. For example, an individual would file a tax return in a year they were due a refund, but not in a year in which they were in a tax debt. This practice is referred to as "cherry picking".

The simplified filing legislation addressed concerns of fairness by removing the ability for people to "cherry pick" and removed the requirement for others to file tax returns. These initiatives were seen as a "back-end" solution (that is, stopping people from cherry picking the years in which they file a tax return) to a "front-end" problem of inaccurate PAYE deductions during the year, leading to the need to square-up and file a tax return at the end of the year.

At the time this legislation was enacted in 2012, Inland Revenue's Business Transformation (BT) programme was in its very early stages. Inland Revenue's current BT thinking is for more streamlined processes, with salary and wage earners' information being provided by third parties such as employers and banks to Inland Revenue, and Inland Revenue undertaking the necessary calculations. This should lead to a more accurate PAYE structure, which means fewer people in a refund or tax-debt position at the end of the year. The problem of "cherry picking" is expected to become redundant. As a result, the Government agreed to repeal the simplified filing legislation.

Key features

Section 33AA (which is due to take effect on 1 April 2016) has been amended to ensure that:

- Individuals who are not required to file a tax return but choose to do so anyway can continue to file tax returns for each of the four tax years immediately preceding the tax year in which the individual decides to file a tax return. The result will be that individuals will continue to have the ability to choose the years in which they file a tax return.
- Recipients of Working for Families (WFF) tax credits (and their partners) must continue to file a tax return or receive a personal tax summary but only if they receive their WFF entitlements from Inland Revenue.

Consequential amendments have also been made to section 120B, which relates to use-of-money interest, and to section 139B, which relates to a late payment penalty.

Application date

The amendments apply from the beginning of the 2016–17 tax year.

EXTENDING THE GRACE-PERIOD OF THE TAX ON NET ASSETS FOR DEREGISTERED CHARITIES

Section HR 12 of the Income Tax Act 2007

Amendments have been made so that section HR 12 will not apply to a community housing entity that is deregistered by Charities Services before 1 April 2017, as opposed to the 1 April 2015 date set by the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014.

Background

The Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 introduced a new set of tax rules for entities removed from the Charities Register.

These rules, contained in section HR 12 of the Income Tax Act 2007, require a deregistered charity, in the year of deregistration, to either apply its income and assets to charitable purposes or become liable to tax on the balance.

Section HR 12 applied from 14 April 2014 to any entity which requested to be removed from the Charities Register, and from 1 April 2015 to any entity removed from the register.

The rationale behind the split application dates was to deal with the possibility that some community housing providers might be deregistered. This was because Charities Services undertook to review all registered charities that had the provision of housing as their main or primary purpose, following a High Court decision relating to the Queenstown Lakes Community Housing Trust.

The grace-period for the net assets tax was set at 1 April 2015 to allow time for entities to be deregistered without being affected by the new obligations in relation to accumulated income and assets. Further, it was expected that by 1 April 2015, a specific tax exemption for community housing providers would be finalised.

Delays in finalising this tax exemption have meant that it has not been possible for Charities Services to advance its review. Consequently, the Government agreed to extend the grace-period for the tax on net assets for deregistered charities whose activities involve the provision of housing from 1 April 2015 to 1 April 2017. This means that a community housing entity deregistered by Charities Services before 1 April 2017 will not be subject to section HR 12.

Application date

The amendment came into force on 14 April 2014.

MEANING OF "CHARITABLE OR OTHER PUBLIC BENEFIT GIFT"

Section LD 3 of the Income Tax Act 2007

Section LD 3 of the Income Tax Act 2007 has been amended to clarify that for a subscription to be treated as a "charitable or other public benefit gift", it must, in addition to not conferring any rights arising from its membership:

- be an amount of $5 or more; and
- be paid to an entity that is not carried on for the private pecuniary profit of an individual, and whose funds are wholly or mainly applied to charitable, benevolent, philanthropic or cultural purpose within New Zealand; or
- be an organisation listed in schedule 32.

Background

Currently, income tax relief is provided to individuals, companies and Māori authorities for gifts of money to a charitable or other public benefit entity ("a charitable or other public benefit gift").

Previously, under section LD 3 of the Income Tax Act 2007, there were two categories of "charitable or other public benefit gift":

- a gift of $5 or more paid to a society, institution, association, organisation, trust or fund (an entity) that is not carried on for the private pecuniary profit of an individual, and whose funds are wholly or mainly applied to charitable, benevolent, philanthropic or cultural purpose within New Zealand, or an organisation listed in schedule 32 of the Income Tax Act 2007 (generally an overseas donee organisation); and

- a subscription paid to an entity, only if the subscription does not confer any rights arising from its membership.

Based on the previous wording, the legislation did not require a subscription paid to an entity to be:

- an amount of $5 or more; and
- the entity to be one that is not carried on for the private pecuniary profit of an individual wholly or mainly to charitable, benevolent, philanthropic or cultural purposes within New Zealand, or listed in schedule 32.

This was contrary to the original policy intent. The corresponding provision in the Income Tax Act 2004 clearly set out these requirements for a subscription paid to be treated as a "charitable or other public benefit gift".

This was a drafting oversight which arose as part of the rewrite of the Income Tax Act 2004.

Application date

The amendment applies on and from 1 April 2008, when the Income Tax Act 2007 came into force.

TERTIARY EDUCATION INSTITUTIONS AND THEIR SUBSIDIARIES

Section CW 55BA of the Income Tax Act 2007

Section CW 55BA has been amended to widen the income tax exemption for a Tertiary Education Institute (TEI) to include income earned by a business, such as a subsidiary, for the benefit of the TEI.

The amendment corrects an earlier oversight and restores the tax exempt position for TEI subsidiaries that existed before 1 July 2008, when section CW 55BA was enacted.

Background

Before the enactment of section CB 55BA, both TEIs and their subsidiaries were exempt from income tax under a charities-related income tax exemption.

Following new requirements for charities to be registered with the (then) Charities Commission, in July 2008 TEIs were given their own income tax exemption. This meant TEIs did not have to register as a charitable entity under the Charities Act 2005. TEIs were already considered to be subject to sufficient reporting and monitoring requirements under the Education Act 1989 and the additional charities registration requirements would have added another layer of complexity and cost.

When first enacted, section CW 55BA only provided an exemption for TEIs, but not their subsidiaries. This was an oversight.

Key features

- Section CW 55BA ensures that the income of a subsidiary of a TEI is exempt from income tax.
- A new definition of "tertiary education subsidiary" is contained in section CW 55BA.
- Specific control tests will apply to the tertiary education subsidiary, similar to those that apply to a business of a charity in section CW 42.

Application date

The amendment applies for the 2008–09 and later income years.

EMPLOYER-PROVIDED OVERSEAS ACCOMMODATION

Section CE 1C of the Income Tax Act 2007

The rule in section CE 1C for valuing overseas accommodation provided by employers to their staff has been amended to also cover accommodation payments and accommodation allowances.

Background

The market rental value of accommodation provided by an employer to an employee is generally taxable income of the employee. Section CE 1C enables overseas accommodation provided by an employer to be valued at the lesser of the rental value of the overseas accommodation or the market rental value of accommodation that the employee would likely occupy if they were working in New Zealand.

Section CE 1C was intended to cover both actual accommodation and accommodation payments, including allowances. The special report that was issued soon after the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 was enacted indicated this intention. However, the enacted rule was inadvertently limited to actual accommodation provided, which meant that there was a different tax outcome depending on how the overseas accommodation benefit was provided.

Key features

The remedial amendment specifies that the provision of accommodation at or near an overseas work location includes an accommodation allowance or an amount paid for or towards the provision of the accommodation. The allowance or payment must be either the actual cost to the employee for the accommodation or a reasonable estimate of the expenditure likely to be incurred by the employee or a group of employees for which reimbursement is payable.

Application date

The amendment applies on and after 1 April 2015, to coincide with the application date of the original provision.

PROJECT OF LIMITED DURATION

Section CW 16B of the Income Tax Act 2007

The definition of "project of limited duration" in section CW 16B has been amended to clarify that it is intended to apply to employees when their employer is the contractor or a subcontractor who undertakes the work rather than the person who has hired the contractor.

Background

When an employee is required, because of their job, to work away from their normal place of residence, they can be eligible for an income tax exemption of up to two years on any accommodation or accommodation payment that their employer provides. However, when an employee is involved in "a project of limited duration", such as the building of a dam, the employee can be eligible for an income tax exemption on accommodation of up to three years. This longer exemption reflects the likelihood that the employee's stay at the distant workplace will be longer given the nature of such projects.

Given that it is a relative generous exemption, the definition of "project of limited duration" is intended to be tightly defined. It focuses on work projects whose principal purpose is to create, build, develop, restore, replace or demolish a capital asset, and which are carried out under a contract of service between an employer and one or more persons who are not associated with the employer. It is the latter aspect that required clarification, to emphasise that the employer being referred to is the contractor or a subcontractor and not, for example, the construction company that builds the dam, the specialists who install the turbines, or the business "owner" that contracted the construction company to undertake the work.

Key features

Paragraphs (b) and (c) of the definition have been clarified so that a "project of limited duration" is now defined as:

(a) a work project whose principal purpose is to create, build, develop, restore, replace or demolish a capital asset; and

(b) which is carried out under a contract between an employer (the contractor) and one or more persons who are not associated with the contractor; and

(c) in relation to which the engagement of an employee of the contractor at the distant work place –

  i. has, at the outset, clear start and end dates; and

  ii. involves work that, apart from incidental activities, is undertaken solely for the purposes of the project; and

  iii. in the contractor's expectation at the start of the project, will last for a period of no more than three years.

Application date

The amendment comes into force on 1 April 2015, to coincide with the application date for section CE 1E.

DEFINITION OF "REMUNERATION" IN RULE USED TO VALUE ACCOMMODATION PROVIDED TO MINISTERS OF RELIGION

Section CE 1E of the Income Tax Act 2007

An amendment has been made to the valuation rule used to measure the taxable income arising from accommodation provided by religious organisations to ministers of religion. It confirms that the value of accommodation is not considered as remuneration for the purposes of the formula in section CE 1E.

Background

Section CE 1E of the Income Tax Act 2007 (inserted by section 15 of the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014) contains a specific valuation rule for accommodation provided to ministers of religion. The rule in effect provides that the taxable value of the accommodation is 10 percent of the minister's "remuneration". This rule is a codification of a longstanding administrative practice and overrides the general rule that the taxable value is the market rental value.

Specifically, the formula is:

remuneration x (1 – adjustment) + excess rental

where:

remuneration is the amount that equals 10 percent of the remuneration that the person receives for the income year for the performance of their duties as a minister from the religious society or organisation of which they are a minister;

adjustment is the portion of the accommodation apportioned to work-related use; and

excess rental is the amount that is not less than zero that is the difference between (i) the market rental value for the year of the accommodation provided and (ii) the market rental value for the income year of accommodation that is reasonably commensurate with the duties of the person as a minister and for the location in which they perform their duties.

Historically, the administrative practice involved valuing the

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accommodation for taxation purposes at 10 percent of the stipend provided to the minister. In codifying this rule it was agreed that the legislation should cover not only stipends but also equivalent remuneration to reflect changes to the way religious bodies have remunerated their ministers over the years. Some churches, for example, now pay their ministers market-related salaries.

A technical question arose over whether "remuneration" could be interpreted to include the value of the accommodation being provided to the minister. This outcome was not within the policy intent as it is inconsistent with the previous administrative practice.

To avoid doubt, the amendment makes it clear that the value of accommodation is not included in a minister's "remuneration" for the purpose of calculating the taxable value of the accommodation in accordance with section CE 1E.

Application date

The amendment applies on and after 1 April 2015, to coincide with the application date for section CE 1E.

COMMENCEMENT DATE FOR ACCOMMODATION PROVISIONS APPLYING TO MINISTERS OF RELIGION

Section CZ 33 of the Income Tax Act 2007

An amendment ensures that the new provisions relating to accommodation provided by religious organisations to their ministers of religion apply from 1 July 2013, as originally intended.

Background

The accommodation provisions relating to ministers of religion were reorganised in response to submissions made to the Finance and Expenditure Committee. During that reorganisation, the commencement date of the relevant provisions was inadvertently changed from 1 July 2013 to 1 April 2015. To correct the error, a transitional provision has been enacted to cover the intervening period.

Key features

The transitional provision essentially replicates the requirements of section CE 1E that apply on and from 1 April 2015. Section CE 1E sets out the "10 percent of remuneration" formula for determining the taxable value of accommodation provided to ministers of religion. The only difference with the transitional provision is that its formula does not include the "excess rental" as that adjustment was only intended to come into force on 1 April 2015. The "excess rental" is the difference between the market value of the accommodation provided and the market value of accommodation that is reasonably commensurate with the duties of the minister and the location in which he or she performs those duties.

Application date

The amendment applies on and from 1 July 2013 to 31 March 2015.

FOREIGN SUPERANNUATION

Sections CF 3, CQ 5, EX 33, EZ 32G and YA 1 of the Income Tax Act 2007; section CF 4 of the Income Tax Act 2004 and section CC 5 of Income Tax Act 1994

A number of remedial changes have been made to the Income Tax Act 2007, Income Tax Act 2004, and Income Tax Act 1994 (relating to the tax treatment of foreign superannuation interests held by New Zealand residents). They clarify various aspects of the rules applying to foreign superannuation interests and ensure that the new rules introduced in the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 operate as intended.

Application date

All but one of the remedial amendments came into force on 1 April 2014, which aligns with the start date of the new rules.

The remaining change, which relates to the $50,000 foreign investment fund (FIF) minimum threshold when a person has a FIF superannuation interest, came into force on 1 April 2015.

Key features

The changes:

- ensure that the foreign superannuation rules (rather than the foreign investment fund (FIF) rules) apply to interests acquired while a person was a New Zealand tax resident under domestic law, but not resident in New Zealand under a double tax agreement (DTA);
- ensure that the foreign superannuation rules apply (rather than the FIF rules) to interests first acquired while a person is non-resident, and additional contributions are made while the person is a New Zealand tax resident;
- reintroduce the exclusion from the FIF rules for interests in registered Australian superannuation schemes acquired while a person was a New Zealand resident;
- ensure that the schedule method in the foreign superannuation rules applies to lump-sum withdrawals and transfers from a foreign superannuation interest if a taxpayer has less than $50,000 of FIF interests;
- ensure that a person who transfers their interest from one foreign superannuation scheme to another foreign superannuation scheme continues to be subject to the

foreign superannuation rules rather than the FIF rules;

- resolve historic non-compliance with the FIF rules for persons who return pension income in their income tax return.

Background

The tax rules applying to foreign superannuation interests held by New Zealand residents were substantially reformed in the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014.

The previous rules for interests in foreign superannuation schemes were complex and it was not always clear that they produced an appropriate result. In some cases, the interest was subject to the FIF rules and tax was required to be paid on accrual. When the FIF rules did not apply, tax generally needed to be paid under other tax rules when a distribution was received (such as the rules for pensions or the rules for distributions from trusts or companies).

From 1 April 2014, under the new rules, interests in most foreign superannuation schemes are taxed only on receipt. Pensions received from a foreign superannuation scheme continue to be taxed in full. For lump-sum withdrawals (and transfers to New Zealand and Australian superannuation schemes), generally a proportion of the amount is taxed depending on how long the person has been resident in New Zealand.

The FIF rules no longer apply to interests in foreign superannuation schemes unless the interest is grandparented or the interest is acquired while the person is a New Zealand tax resident.

A concessionary rule to help people meet their historic tax obligations was also introduced as part of the reforms. If a person made a lump-sum withdrawal or transfer between 1 January 2000 and 31 March 2014, and did not comply with their tax obligations at the time, they have the option to pay tax on 15 percent of the withdrawn or transferred amount. Otherwise, they remain liable under the rules that applied to their scheme at the time of withdrawal or transfer (either the FIF rules or other tax rules that may apply to their interest).

The changes in the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 ensure that the new rules for taxing foreign superannuation interests work as intended. The changes therefore largely confirm or clarify existing policy settings.

Detailed analysis

Interests in foreign superannuation schemes acquired while not resident in New Zealand under a double tax agreement

Under the rules for taxing interests in foreign superannuation schemes, the FIF rules continue to apply if a person acquires their interest while they are New Zealand-resident. This is to ensure the FIF rules that apply to foreign portfolio investments held by New Zealand residents are not undermined.

In certain circumstances, a New Zealander who goes overseas to work for several years could still remain a New Zealand tax resident when they acquire rights in a foreign superannuation scheme. They could also be tax-resident in another country and "tiebreak" to that other country under a DTA (generally, if the person's affairs are more closely linked to the other country) at the time that they first acquired the foreign superannuation interest. It would not be appropriate in this situation for the person to be required to account for tax under the FIF rules.

Amendments have been made to section CF 3 and the definition of "FIF superannuation interest" in section YA 1 of the Income Tax Act 2007 to exclude from the FIF rules interests in foreign superannuation schemes acquired while the person is resident in New Zealand under section YD 1 of the Income Tax Act 2007, but "tiebreaks" to another country or territory under a DTA (as a "treaty non-resident"). When a foreign superannuation interest is acquired in these circumstances, the interest is taxable on receipt – in particular, using the rules in section CF 3 for foreign superannuation withdrawals and the ordinary rules for pensions.

Under this change, an interest in a foreign superannuation scheme acquired while the scheme holder is treaty non-resident does not have an exemption period set out in section CF 3(5) and (6). Instead, the assessable period as set out in section CF 3(8) begins when the person is treated as New Zealand-resident under all DTAs for the first time while owning the interest in the scheme. This is achieved by the introduction of new section CF 3(8)(ab).

Consequential amendments have also been made to the rules that provide rollover relief in the case of a transfer following death or a relationship split. When an interest in a foreign superannuation scheme passes to a person's spouse under a relationship agreement following a death or relationship split, both the transferor and transferee need to be resident under all DTAs for rollover relief to be provided. This is a consequential amendment to maintain revenue integrity and is provided for in changes to sections CF 3(1), CF 3(3) and CF 3(21)(d).

The changes came into force on 1 April 2014.

Example 1

Mary is a New Zealand tax resident but has been working in Germany for the past few years. For the purposes of the Germany-New Zealand DTA, Mary is considered to be a resident of Germany. While working in Germany, she contributes to a German pension scheme. Mary moves back to New Zealand and from 14 October 2014 is considered to be resident in New Zealand for the purposes of the Germany-New Zealand DTA.

Mary does not have a FIF superannuation interest as she was non-resident under the Germany-New Zealand DTA when she acquired the rights in her pension scheme. Under section CF 3, Mary's assessable period for her interest in the German pension scheme begins on 14 October 2014.

Interests in foreign superannuation schemes acquired while not resident in New Zealand, and subsequent contributions are made while resident in New Zealand

An interest in a foreign superannuation scheme is taxed under the foreign superannuation tax rules in section CF 3 of the Income Tax Act 2007 if the rights in the scheme are acquired while the person is non-resident (either under domestic law or under a DTA). If they are a New Zealand tax resident at the time of acquisition, they must account for tax under the FIF rules.

There may be situations when a person first acquires rights in a foreign superannuation scheme while they are non-resident, but continues to make contributions to the scheme while they are resident in New Zealand.

In some cases each additional contribution to a superannuation scheme could be considered a separate interest in the scheme and would require the person to apportion their scheme between the foreign superannuation rules and the FIF rules. This would most likely occur when the scheme is constituted as a trust, as each contribution could constitute a new settlement on the trust.

In this situation it is intended that the person is taxed under the section CF 3 foreign superannuation rules in relation to the whole interest in the scheme. It is not intended that the person be required to apportion their interest in the scheme between the foreign superannuation rules and the FIF rules, as this would be highly complex and compliance-heavy.

Amendments have been made to sections CF 3(20) and CF 3(21) to clarify that when an individual first acquires rights in a foreign superannuation scheme while non-resident under section YD 1 or a DTA (and is therefore subject to the foreign superannuation tax rules in section CF 3 of the Income Tax Act 2007), any subsequent contributions made to the scheme while they are New Zealand-resident are considered to be part of the interest in the superannuation scheme acquired while non-resident, and are taxed under the foreign superannuation rules, rather than under the FIF rules.

The amendments came into force on 1 April 2014.

Application of the $50,000 FIF threshold to FIF superannuation interests

Under the new rules for taxing interests in foreign superannuation schemes, the FIF rules continue to apply if a person acquires their interest while they are New Zealand-resident. This is to ensure the FIF rules that apply to foreign portfolio investments held by New Zealand residents are not undermined.

However, there is a minimum threshold under the FIF rules for certain taxpayers who have only relatively small foreign portfolio investments. The minimum threshold is intended to reduce compliance costs for these taxpayers.

Existing sections CQ 5(1)(d)(i) and DN 6(1)(d)(i) treat a person as having no FIF income or loss if the total cost of their interests in all FIFs is less than $50,000. When a person falls within the scope of this FIF threshold and they have not opted to pay tax under the FIF rules, tax is paid on receipt of any distributions from their FIFs under other tax rules that may apply to their interest (such as the rules for distributions from trusts or companies).

The concept of a "low-value FIF superannuation interest" has been included in section CF 3(1)(b) to ensure that an individual with a FIF superannuation interest who has no FIF income or loss due to the operation of sections CQ 5(1)(d) and DN 6(1)(d), is taxed under the schedule method in section CF 3(10), (11) and (19) on lump-sum withdrawals and transfers received from their foreign superannuation interest, rather than other tax rules that may apply to distributions (for example, the rules for distributions from companies or trusts). This is consistent with the intent of the new rules for taxing foreign superannuation interests, which was to provide a relatively simple set of rules for taxpayers to follow.

The concept of "low-value FIF superannuation interest" in new section CF 3(1)(b) refers to sections CQ 5(1)(d) and DN 6(1)(d) in their entirety, which means that the change only applies if the person has not opted out of the FIF minimum threshold and into the FIF rules through sections CQ 5(1)(d)(ii), (iii), and DN 6(1)(d)(ii) and (iii).

A person with a low-value FIF superannuation interest is not permitted to use the formula method set out in sections CF

3(12) to (19) to calculate their taxable income arising from a foreign superannuation withdrawal. New section CF 3(9)(b)(ib) reflects this.

A person with a low-value FIF superannuation interest is not eligible for an exemption period set out in section CF 3(5) and (6). An amendment to section CF 3(5) provides clarity on this point

The assessable period for a low-value FIF superannuation interest begins when the person first acquired the rights in the scheme. This is achieved by changes to amendments in section CF 3(8), including the introduction of new section CF 3(8)(ac).

These amendments apply beginning on 1 April 2015.

Example 2

George is a New Zealand tax resident. He travels to the United Kingdom for one year for his OE. While working in the United Kingdom he contributes to a pension scheme. During that time he remains a New Zealand tax resident and does not "tiebreak" to the United Kingdom under the New Zealand-United Kingdom DTA. At face value, George has a FIF superannuation interest. However, George has no other foreign investments and the interest in his pension scheme is worth $5,000. Under sections CQ 5(1)(d) and DN 6(1)(d), George has no FIF income or loss and so is not required to account for tax on his foreign superannuation interest under the FIF rules.

George transfers his pension scheme to a New Zealand superannuation scheme and calculates his tax liability on the transfer using the schedule method set out in section CF 3.

Previous FIF exemption for Australian-regulated superannuation savings: section EX 33

Previously, section EX 33 provided an exemption from the FIF rules for Australian-regulated superannuation savings. This was repealed in the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014. Consequential references to section EX 33 in sections CQ 5(1)(c)(iii) and DN 6(1)(c)(iii) were also repealed by that Act.

This was not intended; sections EX 33, CQ 5(1)(c)(iii) and DN 6(1)(c)(iii) have therefore been reinstated, effective from the date the of the repeal, 1 April 2014.

An amendment has also been made to the definition of "FIF superannuation interest" in section YA 1 to ensure that a FIF superannuation interest does not include an Australian superannuation interest referred to in section EX 33.

Example 3

Natalie is a New Zealand tax resident but works in Australia. She contributes to a regulated superannuation fund while working in Australia. Under section EX 33, Natalie's interest in an Australian regulated superannuation fund is not an attributing interest in a FIF.

Transfers between foreign superannuation schemes

Under the rules in section CF 3, a transfer from one foreign superannuation scheme to another (non-Australian) foreign superannuation scheme is not taxable income. This is achieved through omission in section CF 3(2) which lists the types of foreign superannuation withdrawals that are considered to be "income".

Rollover relief is provided until a person receives a foreign superannuation withdrawal that is income, but the assessable period takes into account the number of years the person held the original interest while they were New Zealand-resident.

When a transfer from one foreign superannuation scheme to another occurs, a problem arises because the interest in the new scheme is not adequately carved out of the FIF rules. This is due to a missing reference to section CF 3(21)(b) in the definition of "FIF superannuation interest".

The definition of "FIF superannuation interest" has been amended to include a reference to section CF 3(21)(b) to ensure that this rollover relief is provided. The amendment came into force on 1 April 2014.

Periodic pensions and historic FIF non-compliance

When the FIF rules ceased to apply on 1 April 2014, any historic non-compliance under the FIF rules is overridden if the person uses the formula or schedule method for lump-sum withdrawals and transfers made on or after 1 April 2014, if the person's assessable period began before 1 April 2014. The rule is provided in section CF 3(22), to ensure that the person is not double taxed.

However, section CF 3(22) only applies when a person receives foreign superannuation withdrawals. If there is historic FIF non-compliance, but the person does not receive any foreign superannuation withdrawals and only receives a pension, there was no corresponding provision to override the FIF non-compliance.

To resolve this problem, new section EZ 32G has been introduced to override non-compliance under the FIF rules in two situations. The first is when the person derived no payments from their foreign superannuation interest before 1 April 2014 and receives only pension payments from 1 April 2014. The second situation is when the person received only pension payments from the foreign superannuation scheme before 1 April 2014 and included all of these pension payments in their income tax returns for the appropriate income years by the due date for each of those returns.

Corresponding sections have also been introduced in the Income Tax Act 1994 (new section CC 5) and Income Tax Act 2004 (new section CF 4).

These amendments came into force on 1 April 2014 and apply to pension payments made from 1 January 2000. This is in line with the override in section CZ 21B, which is available for certain lump-sum withdrawals and transfers.

Example 4

Eva has an interest in a foreign superannuation scheme, which before 1 April 2014, was an attributing interest in a FIF. Eva did not realise that she had to return her FIF income or loss in her income tax return every year.

In 2009, Eva started to receive pension payments from her foreign superannuation interest and assumed she should be paying New Zealand tax on her foreign pension, so she included all of these pension payments in her income tax return each year.

From 1 April 2014, Eva's interest in her foreign superannuation scheme does not meet the definition of "a FIF superannuation interest", so her interest is no longer an attributing interest in a FIF. This means that from 1 April 2014, Eva should be including her pension payments in her income tax return.

New sections EZ 32G and CF 4 in the Income Tax Act 2004, and section CC 5 in the Income Tax Act 1994 provide that because Eva included all of pre-1 April 2014 pension payments in her income tax returns (albeit mistakenly), the FIF income and losses that she should have actually returned before 1 April 2014 have been overridden.

Example 5

Leo has an interest in a foreign superannuation scheme, which before 1 April 2014, was an attributing interest in a FIF. Leo did not realise that he had to return his FIF income or loss in his income tax return every year.

Leo received no distributions from his scheme before 1 April 2014.

From 1 April 2014, Leo's interest is not a FIF superannuation interest and so it is no longer an attributing interest in a FIF.

In January 2015, Leo starts to receive a periodic pension from his foreign superannuation scheme. He is required to include these as income in his income tax returns.

New sections EZ 32G and CF 4 in the Income Tax Act 2004, and section CC 5 in the Income Tax Act 1994 provide that Leo has no FIF income or loss arising from his foreign superannuation interest before 1 April 2014.

TAX POOLING RULES

Sections RP 17, RP 17B, RP 19, RP 19B, RZ 10 and RZ 12 of the Income Tax Act 2007; section 3 of the Tax Administration Act 1994

Amendments have been made to the Income Tax Act 2007 and to the Tax Administration Act 1994 to deal with two unintended policy outcomes relating to the use of tax pooling funds in cases of tax disputes or challenge proceedings.

The first amendment allows purchased tax pooling funds to be used to meet outstanding interest liabilities in relation to increased amounts of tax resulting from an amended assessment, or the resolution of a tax dispute that is subject to challenge proceedings.

The second amendment allows tax pooling funds to be accessed when a taxpayer's dispute is similar to that of another taxpayer's dispute that is before the courts. The taxpayer and the Commissioner can agree to stay proceedings and be bound by the outcome of the dispute before the courts. In this situation the taxpayer can access tax pooling funds even though the dispute has not proceeded to challenge.

Background

The tax pooling regime was introduced in 2003 to deal with concerns about the difference between the interest rate charged on underpayments of tax and the rate paid on overpayments of tax. In essence, the tax pooling regime allows tax pooling intermediaries to provide a market for businesses to pool their tax with that of other businesses, so that underpayments can be offset by overpayments within the pool, and participating taxpayers receive a more attractive interest rate than would be available through Inland Revenue.

Interest on increased amounts of tax

The policy intent was that taxpayers could transfer funds from a tax pool to pay increased amounts of tax that resulted from either an amended assessment of their tax liability or the resolution of a tax dispute still subject to challenge proceedings.

The policy was to stop further interest from accruing on these payments once funds were accessed from a tax pool. However, the interaction of two legislative provisions in the Revenue Acts resulted in interest continuing to be charged, namely:

- in the case of purchased funds accessed from a tax pooling intermediary, these funds were limited to the increased amount of tax, which did not include any interest outstanding; and
- payments of tax were first applied to interest and then any remainder applied to the tax outstanding.

This resulted in a shortfall in tax that then attracted interest until further payments were made.

The following example illustrates the outcome under the previous rules.

Example 1

A provisional taxpayer's tax liability for the 2010–11 tax year is reassessed, resulting in an increased amount of tax of $9,000. For use-of-money interest purposes this amount was due in three equal instalments of $3,000 on 28 August 2010, 15 January 2011 and 7 May 2011. The taxpayer applied to a tax pooling intermediary to purchase backdated funds, but funds were only available on 7 April 2013. The taxpayer was therefore subject to use-of-money interest (of say $1,000) for the period 29 August 2010 to 7 April 2013.

The previous rules restricted the amount of purchased funds that could be accessed by a taxpayer from a tax pooling intermediary to the increased amount of tax of $9,000. However, once this amount was transferred to Inland Revenue to pay the taxpayer's outstanding tax as at 7 April 2013, the rules required the amount to be first applied to the payment of interest ($1,000), and the remaining $8,000 applied to tax. This left a shortfall of $1,000 in tax, which continued to attract interest from 8 April 2013 until the balance of $1,000 tax and all further accrued interest was paid in full by means other than tax pooling.

Under the amended rules the taxpayer in the example above is able to purchase both the increased amount of tax of $9,000 and use-of-money interest of $1,000 on 7 April 2013 and thereby fully pay the tax and interest owing as at that date.

Reassessments

If, as a result of a reassessment for a tax year, any amount previously refunded in respect of that income year and any credit interest paid on that refunded amount may need to be repaid as a result of the reassessment. This is illustrated in the example below.

Example 2

A taxpayer has tax deducted of $2,000 during the 2013 tax year. At year-end the taxpayer's tax assessment is for $1,500 and the taxpayer receives a refund of $500 plus credit use-of-money interest. In 2015 the taxpayer is reassessed and the tax liability for the 2013 year is increased to $2,500. The taxpayer is liable to pay an additional $1,000. The taxpayer can use backdated tax pooling funds to pay both the increased amount of tax of $1,000 and the use-of-money interest which has accrued on this.

In addition the taxpayer will also have to repay the credit use-of-money interest that was paid out on the $500 originally refunded. However, the taxpayer will not be able to use backdated tax pooling funds to repay the credit use-of-money interest as this is neither an increased amount of tax nor a debit amount of use-of-money interest payable in respect of an increased amount of tax.

While the above example is a simple one, provisional taxpayers who have to repay credit use-of-money interest may require more complex interest calculations if they have both debit and credit interest accruing during a provisional tax year.

The legislative timeframes for using tax pooling to meet use-of-money interest obligations are the same as those for the underlying increased amount of tax under section RP 17B(5) or (6) as applicable.

The maximum amount of use-of-money interest that can be sourced from a tax pooling account is limited to the interest amount payable on the increased amount of tax under section RP 17B(7).

When proceedings are stayed following the outcome of similar case before the courts

Tax pooling can be used by taxpayers following the resolution of a dispute to meet any resulting increased amount of tax within 60 days of the date of issue of the notice of assessment (section RP 17B(5)), unless the taxpayer files a challenge. If a taxpayer files a challenge with the Taxation Review Authority (TRA) or a court, the amount of tax in relation to which taxpayer has filed the challenge becomes deferrable tax. Tax pooling funds can be used to pay the deferrable tax once the challenge is finally determined (section RP 17B(6)).

Under the previous rules, an issue arose when the Commissioner and the taxpayer agreed to stay their disputes and not proceed to the challenge stage and instead chose to be bound by the outcome of a similar case before the courts. In this case an assessment resulting in an increased amount of tax was issued in the interim (for example, when a time-bar was imminent). The taxpayer then missed the opportunity to access tax pooling funds for the disputed amount if they did not pay within the 60-day period set out in section RP 17B(5). However, if the taxpayer chose to proceed to challenge proceedings, the tax pooling rules enabled the taxpayer to access pooling funds for the disputed amount under section RP 17B(6). This tax pooling availability arose out of the "deferrable tax" status attached to the amount of tax in dispute when a dispute enters challenge proceedings.

The result was an undesirable policy outcome because it impeded settlement of a dispute at a time when it would have been beneficial to both the taxpayer and the Commissioner to avoid challenge proceedings. The availability of tax pooling is often crucial in settling a dispute because of the opportunity for a taxpayer to minimise use-of-money interest. Use-of-money interest is likely to be particularly significant if the taxpayer is a large entity or if the dispute has been drawn out over a long period.

To deal with this problem, amendments have been made to the tax pooling rules to enable tax pooling funds to be used to pay the disputed amounts of tax when the Commissioner and the taxpayer agree that a dispute be stayed pending the outcome of another challenge before the TRA or courts.

Note, a taxpayer who files their tax return, and then disputes the position taken in the return, will still need to pay the assessed amount by the terminal tax date for the year. If they fail to pay the amount due on their terminal tax date and lose the dispute, they will not be able to access tax pooling funds for the disputed amount as there are no increased amounts of tax owed, just the original assessed amounts that were due on the terminal tax date and not paid.

If taxpayers want to wait until they know the outcome of their dispute before using tax pooling to pay the disputed amount, they should make a sufficient deposit of their own funds into a tax pooling account on or before the relevant due date(s). These personally deposited funds can then be transferred to Inland Revenue if the taxpayer loses the dispute, or they can be refunded from the pool to the taxpayer if they win the dispute.

If a taxpayer (taxpayer A) agrees to be bound by the outcome of another challenge (by taxpayer B), which is before the TRA or the courts, taxpayer A should consider their position if taxpayer B's case is withdrawn and not settled by the TRA or the courts. This could occur when the Commissioner and taxpayer B enter into an agreement to settle the case and withdraw from court proceedings. In this situation taxpayer A's agreement to stay proceedings will lapse and taxpayer A's dispute will be determined in the Commissioner's favour.

To mitigate this risk, taxpayer A may wish to file a challenge in the TRA and, following entering into the agreement with the Commissioner, stay the proceedings in the TRA, pending the outcome of taxpayer B's challenge proceedings. If taxpayer B's challenge is withdrawn, taxpayer A's proceedings can be determined by the TRA (or transferred to the High Court for determination).

Timing of interest transfers – clarifying information provided in the bill Commentary

There was an inconsistency between the officials' commentary on the bill and the legislation itself as to when interest transfers must be made following the enactment of the legislation. The Commentary stated that the transfer must be made within 60 days of the date of enactment. This was incorrect. The enacted legislation correctly states that the interest transfers must be made within 60 days of the date on which the Commissioner notifies the amount of interest payable. This only affected the interest transfer requests received by Inland Revenue which needed to be held between the date of the Minister's announcement (3 July 2014) and the date of enactment of the legislative changes.

Key features

Interest on increased amounts of tax

Section RP 17(1) previously allowed tax pooling funds to be used to meet an obligation to pay provisional tax, terminal tax or an increased amount of tax. A change has been made to enable purchased tax pooling funds to be used to pay interest outstanding in relation to increased amounts of tax resulting from an amended assessment, or the resolution of a dispute which is subject to challenge proceedings.

Changes have also been made to sections RP 17B(2), (5), (6) and (7), RP 17B(10) and RP 19B(5) to insert a reference to "interest payable under part 7 of the Tax Administration Act 1994 on the increased amount of tax". Amendments have also been made in these sections to insert after the term "deferrable tax" a reference to "interest payable under part 7 of the Tax Administration Act on the deferrable tax".

The amendments do not stipulate how the interest amount that is able to be sourced from a tax pooling account is determined when there is already debit and/or credit interest that has arisen. An example would be when there is already an amount of tax owing that is not an increased amount of tax and on which debit interest has already accrued.

The Commissioner will calculate the interest on the increased amount of tax as if it were a standalone amount for the purposes of quantifying the interest under the tax pooling rules. This ensures consistency with situations when there is only an increased amount of tax and debit interest on that amount.

Section RP 19(1B) has been amended to clarify that this section only applies to the payment of provisional tax or terminal tax. This section determines the order in which the provisional tax payment is applied and ensures it is consistent with the specific provisions relating to provisional tax set out (as applicable) in sections 120J to 120V of the Tax Administration Act 1994. For non-income tax revenues, the normal ordering rule in section 120F of the Tax Administration Act 1994 applies.

A transitional provision has been inserted – section RZ 12, to allow minor errors in the calculation of the amount of interest required to be accessed from a tax pooling intermediary during the period from the date of the Ministerial announcement (on 3 July 2014) until the legislation is enacted, to be corrected. After the date of enactment the Commissioner will check the interest transfers that have been held and, if corrections are required, she will issue notifications to taxpayers and advise their intermediaries that an adjustment to the interest can be made. Taxpayers will have 60 days from the date of the notification to have their tax pooling intermediary request the Commissioner to amend the previously requested interest amount.

Interest on increased amounts of tax

In section 3(1) of the Tax Administration Act, the definition of "deferrable tax" has been amended to include an amount of tax assessed as described in section RP 17B(3)(bb) of the Income Tax Act 2007.

Section RP 17B(3) has been amended by inserting a new paragraph (bb). This paragraph includes a new amount of tax, known as "agreed delay tax", in the list of increased amounts of tax for the purposes of the tax pooling rules. "Agreed delay tax" is an amount of tax which is the subject of a dispute between the taxpayer and the Commissioner, when the following conditions are met:

- the parties have agreed that the taxpayer's dispute will be determined by the outcome of another dispute currently before the High Court or the TRA; and
- the facts and questions of law in the taxpayer's dispute closely resemble the facts and questions of law of the proceedings before the courts.

Other amendments have been made to sections RP 17B(6) and (7) and RP 19B(5) to include a reference to "agreed delay tax" after the term "deferrable tax".

Application dates

The ability to use tax pooling to meet use-of-money interest obligations in respect of an increased amount of tax applies beginning on 3 July 2014, being the date of the Government's announcement of its intent to change the legislation.

Taxpayers who had an amended assessment issued or challenge proceedings were resolved before 3 July 2014 will be able to access tax pooling funds to pay the interest outstanding when the 60-day period to access tax pooling funds was current on 3 July 2014, and their tax pooling intermediary filed a transfer schedule for the interest amount within the same 60-day timeframe as applied to their increased amount of tax or deferrable tax.

The amendments allowing tax pooling to be used for disputes that are stayed pending the outcome of another case before the courts came into force on the date of enactment, being 24 February 2016.

MIXED-USE ASSETS

Sections DG 4, DG 9, DG 11, DG 12, DG 13, DG 14 and DG 16 of the Income Tax Act 2007

Several remedial changes have been made to the mixed-use asset rules in subpart DG of the Income Tax Act 2007.

Background

The mixed-use asset rules were introduced as new subpart DG and related provisions by the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013.

The rules generally apply from the 2013–14 income year to prevent excessive deductions for assets that have a significant element of private use, as well as income-earning use, and periods of non-use. An example of such mixed use is a bach that is used privately and rented out to third parties, but remains empty for most of the year.

The latest set of amendments clarifies and further modifies the rules for interest expenditure for close companies, as well as making some minor drafting changes. The amendments also clarify the rules in relation to the use of a mixed-use asset by an associated-person employee during their employment.

Key features

The amendments:

- clarify the basis for interest apportionment for close companies that have excessive debt;
- ensure that the share of interest expenditure of a close company related to the capital use of an asset is allowed as a deduction; and

- clarify that the use of a mixed-use asset by an associated-person employee in the course of their employment is not private use.

Application dates

The amendments apply for the 2013–14 and later income years for land and improvements, and the 2014–15 and later income years for aircraft and boats.

Detailed analysis

Interest expenditure of a close company

New section DG 11(3B) and (6B) – (6D) quantifies the amount of deduction that a close company is allowed for an income year, when the company's debt is greater than the value of its mixed-use asset.

Under the previous section DG 11(3) provisions, if the company's debt was equal to or less than the value of its mixed-use assets, it was assumed that the debt related solely to the mixed-use asset and all interest was apportioned under the formula in section DG 9(2). Conversely, under section DG 11(4), if the company's debt is more than the value of the mixed-use asset, the debt is first allocated to the mixed-use asset and then the balance is assumed to relate to other assets held by the company. Only interest expenditure arising from the debt allocated to the mixed-use asset was subject to the apportionment formula in section DG 9(2), according to previous section DG 11(6).

The policy behind the interest expenditure related to the balance of the debt is that it should be deductible under normal principles, which for a company usually means it is fully deductible under section DB 7.

This policy intention was not clearly achieved by the previous rules as there was some ambiguity regarding the treatment of the balance of the debt and associated interest expense.

The remedial amendment (section DG 11(6B) – (6D)) clarifies that this balance is dealt with under the general interest deductibility rules for companies. The amendment also introduces a stand-alone apportionment formula for section DG 11 (section DG 11 (3B)) rather than cross-referring to section DG 9. This is further explained below.

Interest expenditure of a close company related to capital use of an asset

The amendment relates to section DG 11, which quantifies the amount of an interest deduction that a close company with a mixed-use asset is allowed in an income year.

The primary expenditure apportionment formula is contained in section DG 9(2). This formula was amended by the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014, to deal with situations when there is capital use of an asset (such as use of an airplane to travel to assess potential capital acquisitions), as well as income-earning use and private use. The amendment ensured that an appropriate proportion of mixed-use expenditure was denied when it related to capital and private use of an asset, but allowed when it related to income-earning use.

A related amendment has been made to the apportionment rule for interest expenditure incurred by a close company – contained in section DG 11(3).

The rules relating to deductibility of interest have been amended to ensure that a proportionate share of interest expenditure of a close company related to capital use of an asset is allowed as a deduction. This was necessary to ensure that, except in relation to private use of the asset, the mixed-use asset interest deduction rule for companies aligns with the general interest deductibility rule for companies. This means all interest for a company is automatically deductible and, unlike other expenditure, there is no denial of deductions when the expenditure relates to a matter of capital.

This ensures that a company owning a mixed-use asset is no worse-off than a company that does not own a mixed-use asset in relation to deductions for interest that relate to capital matters. The mixed-use asset-owning company will still be denied interest deductions for private use of that asset, which was the purpose of the mixed-use asset reforms.

Example

Assume an airplane owned by a close company is:

- used 30 days for inome-earning purposes;
- used 30 days for private purposes;
- used 30 days for capital purposes; and
- not in use for 275 days.

There is $1,000 of insurance, $1,000 of hangar fees and $1,000 interest expense that should be apportioned under the mixed-use asset rules.

The hangar fees and insurance should be apportioned allowing deductions for income-earning days only.

The formula in section DG 9(2) achieves this as follows:

$2,000 expenditure × 30 income-earning days ÷ (30 income-earning days + 60 counted days) = $667

In contrast, for a close company, the interest expense should be apportioned allowing deductions for income earning days and capital days.

The formula in section DG 9(2) did not achieve this outcome – under that formula, the outcome would be as follows:

$1,000 expenditure × 30 income-earning days ÷ (30 income-earning days + 60 counted days) = $333

The new formula in section DG 11(3B) apportions the interest expense of a close company as follows:

$1,000 expenditure × 30 income-earning days + 30 capital-use days) ÷ (30 income-earning days + 60 counted days) = $667

Note that if the airplane is held by an individual or trust (or any entity other than a company), the standard apportionment formula in section DG 9(2) applies and there is no deduction for capital-use days.

Use of an asset by an associated-person employee

This amendment relates to section DG 4(3), which defines when the use of an asset is not private use.

Previously, if an associate of the asset owner (for example, a 25 percent shareholder in the asset-owning company) used the asset in the course of their employment, this was deemed to be private use even though it related to an income-earning use of the asset. Treating this use as private use resulted in more deductions being denied than was intended. It could also mean that certain assets were subject to the mixed-use asset rules when they should not have been (for example, because there was minimal or no true private use).

The previous exclusion from the definition of "private use" for assets used solely in the ordinary course of a taxpayer's business (section DG 4(3)) did not extend to employees.

The amendment extended the exclusion to cover all situations when the asset is being used to derive assessable income of the natural person using the asset, including fees earned as a contractor, and employment income.

As a result, the use of a mixed-use asset by an employee is no longer treated as private use, but as ordinary business use, and deductions are able to be claimed.

Other minor amendments

A minor clarifying amendment has been made to the description of the "person" who has private use of an asset in section DG 4(2)(b). The amendment clarifies that the use of an asset by a natural person associated with the non-natural person owner (for example, a company or trust) is considered to be private use.

Another small amendment has been made to section DG 9(1), inserting the words "where it is referred to", after the words "for use". This was done to ensure that there is no element of double limitation, and that the formula in section DG 9 does not also apply where the formula in section DG 11(3) applies.

PROPERTY TRANSFER RULES

Sections FB 1, FB 1B, FB 1C, FC 1, FC 4 and FC 6 of the Income Tax Act 2007

Subparts FB and FC of the Income Tax Act 2007 specify the tax treatment of property transfers in certain circumstances, including: transfers under a settlement of relationship property, transfers upon death, transfers by a trustee of a trust to a beneficiary, and the making of a gift.

A number of areas were identified where the rules in subparts FB and FC did not clearly achieve the intended policy and may have had unintended consequences. The amendments address the relevant areas.

Background

The Income Tax Act 2007 accords concessionary treatment to certain types of property transfers, such as a transfer under a settlement of relationship property or a transfer upon death to a close relative or spouse, in certain circumstances (see subpart FB and section FC 3). Broadly speaking, this concessionary treatment involves deferring any tax consequences of transfer until the transferee ultimately disposes of the property. This is often referred to as "rollover relief". It generally involves two steps:

- deeming the transferor to have no tax consequences on disposal; and
- deeming the transferee to acquire not only the property, but all the characteristics of the transferor in relation to that property – for example, the date of acquisition, cost at acquisition and intention of acquisition.

This treatment contrasts with the general treatment under subpart FC which crystallises tax consequences on transfer between parties not accorded the concessionary treatment. Section FC 2 achieves this by treating the transfer as a disposal by the transferor and acquisition by the transferee at market value. Subpart FC was introduced as a generic set of rules to clarify the income tax treatment of "in kind" or "in specie" distributions and gifts – in particular, but not limited to, upon death.

Key features

- The definition of a "settlement of relationship property", that determines the scope of the rollover relief, has been broadened to include transactions between the parties to the relationship property agreement and associated persons.
- Subpart FB has been amended to include a default rule for the treatment of property transfers under a settlement of relationship property when none of

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the specific provisions in sections FB 2 to FB 21 apply. Previously, there was no clear provision in subpart FB that applied to certain types of property – for example, attributing foreign investment fund (FIF) interests – and accordingly, there was scope for uncertainty about the outcome of certain transfers.

- In the case of distributions of property from a trustee of a trust to a beneficiary of the trust, section FC 2(1) generally deems the transfer to occur at market value. An exception has been enacted to the market value deeming rule if the beneficiary has paid an arm's-length amount for the property.
- Other clarifying amendments to remove uncertainty. For example, the headings of sections FB 1 and FC 1 have been changed to reflect their operative nature (the headings are currently those of purpose provisions), an incomplete section cross-reference in section FC 4(1)(b) has been corrected and cross-references to relevant sections in subpart FB have been included in applicable sections in subpart FC to assist readers.

Application dates

The amendments generally apply for the 2008–09 and later income years. However, further amendments to section FB 1B apply on and from 1 April 2011, and from the date of enactment, being 24 February 2016.

Detailed analysis

Expanding the types of transaction eligible for rollover relief

The definition of "settlement of relationship property" in section FB 1B defines the transactions that are eligible for the concessionary rollover relief under subpart FB. The amendment to the definition broadens the range of transactions that are eligible for the rollover relief to include not just transactions between the parties to the relationship property agreement but also transactions between the parties and associated persons. However, the amendment does not provide rollover relief for transactions between a party to the relationship property agreement and a third party.

Example 1

When Jack and Jill were married, they were trustees and beneficiaries of mirror family trusts. When the relationship broke down, Jill's family trust transferred an investment property to Jack's family trust under a relationship property agreement. As the transfer of the property is between associates of parties to the relationship property agreement, it is eligible for the rollover relief in subpart FB.

Clarifying the treatment of transfers of property not currently specifically covered

There was previously uncertainty over the tax treatment of transfers of certain types of property (for example, attributing FIF interests) under a relationship property agreement or on a person's death. Specifically, it was unclear whether the rollover relief in subpart FB applied to the relevant transfers. This was because subpart FB dealt with specific types of property in each section, without a clear catch-all provision.

While subpart FB only deals with relationship property agreements, the issue feeds through to transfers following a person's death because the relevant provisions in subpart FC (for example, section FC 3(2)) refer to subpart FB to determine the treatment of the transfer – that is, subpart FC feeds into the existing provisions in subpart FB in certain cases.

While the policy intent of the legislation for the relevant rollover relief to apply to the relevant transactions was clear, the provisions did not achieve that intent because there was no catch-all provision.

Accordingly, the amendments re-write section FB 1(2) as an operative default rollover relief provision (now contained in section FB 1C) to deal with property that does not have a corresponding specific provision in sections FB 2 to FB 21. The default provision ensures:

- the transferor remains responsible for all tax obligations relating to the period ending immediately before the transfer; and
- the transferee acquires not only the property, but all the characteristics of the transferor in relation to that property – for example, date of acquisition, cost at acquisition, and intention of acquisition.

Example 2

Mary and Alice entered into a relationship property agreement after they separated. Mary had an attributing interest in a foreign investment fund (FIF) that was transferred to Alice under the relationship property agreement. Mary remains responsible for all the tax obligations that relate to the interest for the period up to immediately before the transfer. Alice is responsible for all the tax obligations following the transfer of the interest. Alice is treated as having acquired the interest at the cost, and on the date, that Mary acquired it. Alice is also treated as holding the interest with same status, intention and purpose that Mary held the interest.

Transfer by a trustee of a trust when an arm's-length amount is paid for the property

Under sections FC 1(1)(c) and FC 2(1), a distribution of property from a trustee to a beneficiary of the trust is generally deemed to be a disposal and acquisition at market value. This is an inappropriate outcome in some circumstances. Accordingly, the amendment to section FC 1(1)(c) provides that the deemed market value does not apply if the beneficiary pays an arm's-length amount for the property.

Example 3

Bill pays $2,000 to his family trust (of which Bill is a beneficiary) to acquire some shares. At the time of distribution, the shares are worth $3,000. Bill acquired the shares with the intention of selling them and disposes of them to a third party for $3,000.

The cost base in the circumstances should be the amount Bill paid for the shares, not the market value of the shares on the date of distribution, as this more correctly reflects the economic cost of acquiring the shares. As a result, under the amendment, Bill is held to have acquired the shares for $2,000 and sold them for $3,000. Bill has income of $1,000 in the relevant year.

Other clarifying changes

The headings of sections FB 1 and FC 1 have been changed to reflect the operative nature of those provisions.

The definition of "settlement of relationship property" has been amended to remove a potentially circular reference to a relationship agreement that created a disposal and acquisition of property "under this subpart".

The policy underlying section FC 4 is to accord rollover relief to property transferred on a person's death to a beneficiary who is a close relative or a charity. However, the wording previously referred to "a person exempt under section CW 43". The problem is that charities are not generally exempt under section CW 43. Instead, the section exempts the income of a deceased person's executor or administrator when it relates to a charitable bequest. It is sections CW 41 and CW 42 that exempt income derived by tax charities. Accordingly, section FC 4(1) has been extended to persons exempt under sections CW 41, CW 42 or CW 43. An incomplete section cross-reference in section FC 4(1) has also been corrected.

To help readers find the correct corresponding provision in subpart FB, cross-references to sections FB 6 and FB 7 have been included in section FC 6 "Forestry assets transferred to close relatives".

FOREIGN INVESTMENT PIES: ACCESS TO LOWER TREATY RATE

Schedule 6 of the Income Tax Act 2007

The tax treatment of unimputed dividends derived from New Zealand-resident companies that are attributed to non-resident investors in a foreign investment variable-rate portfolio investment entity (PIE) has been amended. The change ensures they are subject to the same rate of tax as if the shares were held directly by the non-resident.

Background

A non-resident investor in a foreign investment variable-rate PIE is subject to a 30% tax rate on all unimputed New Zealand dividends unless they reside in a country that has a double tax agreement (DTA) with New Zealand, in which case the rate is reduced to 15%.

These rates were chosen so that a non-resident investor owning New Zealand shares through a foreign investment variable-rate PIE would be subject to the same amount of tax as if they owned the shares directly and were subject to non-resident withholding tax (NRWT) on the dividends. The non-DTA rate of NRWT on unimputed dividends is 30%; this rate is normally reduced to 15% under a double tax agreement for portfolio dividends.

New Zealand has DTAs with certain countries that only facilitate the exchange of information and do not reduce the rate of tax on dividends. When an investor from one of these countries holds New Zealand-resident company shares directly, any unimputed dividends received will be subject to a NRWT rate of 30%.

Key features

The amendment restricts access to the lower 15% rate to investors in foreign investment PIEs who reside in a country that has a DTA with New Zealand that reduces the dividend NRWT rate. This is achieved by amending the relevant rows in table 1B in schedule 6 of the Income Tax Act 2007. The amendment is consistent with the policy intent of the foreign investment PIE rules.

Application date

The amendment applies for the 2012–13 and later income years to align with the application date of the foreign investment PIE rules.

A "savings" provision applies for dividends attributed by a PIE to an investor based on the previous wording of table 1B in schedule 6 before 26 February 2015, being the date of introduction of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill.

INCOME STATEMENTS AND INCOME TAX FILING EXEMPTIONS

Sections 33AA, 33A and 80D of the Tax Administration Act 1994

A number of amendments have been made to the Tax Administration Act 1994 relating to when the Commissioner is required to issue an income statement and when an individual is required to file an income tax return.

Key features

Income statements for IR 56 taxpayers

The Taxation (Annual Rates, GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003 removed the requirement for most IR 56 taxpayers[1] to file end-of-year income tax returns. Instead the Commissioner was required to issue an income statement to IR56 taxpayers. The drafting of this provision did not, however, make it clear that it was only intended to apply to IR 56 taxpayers, leaving open the possibility that income statements could be required to be issued to many other taxpayers, including those who would not otherwise have to file an income tax return. An amendment to section 80D of the Tax Administration Act 1994 clarifies the application of this provision.

Schedular payment filing exemption

The legislation has been aligned with the current practice that an individual, who is not otherwise required to file an income tax return, will only have to do so when they derive more than $200 of schedular payments, irrespective of their total income. This replaces the current requirement that an individual, who is not otherwise required to file an income tax return, will have to do so if their total income is more than $200 and they derive any amount of schedular payments.

Employees' obligations

Section 33A of the Tax Administration Act 1994, which sets out when an individual is not required to file an income tax return, will be replaced by section 33AA and will come into force on 1 April 2016. One provision within section 33A requires an individual to file a return if the employee's obligations are not met. The equivalent provision in section 33AA requires an individual to file a return if the employer's or PAYE intermediary's obligations are not met. An employer has additional obligations to those of an employee, such as having to pay to Inland Revenue tax that has been withheld. To maintain current policy settings this has been amended so that section 33AA will refer to the employee's (rather than employer's) obligations not being met.

Exceptions to requirement for return of income

Section 33AA(1) to (3) of the Tax Administration Act 1994, which is scheduled to come into force on 1 April 2016, sets out the criteria for allowing an individual not to file an income tax return. These three subsections have been amended to simplify their interpretation without changing their application.

Application dates

The amendment to income statements for IR 56 taxpayers and the amendment to the schedular payment filing exemption applies on 1 April 2014.

The amendments for an employee's obligations and other section 33AA amendments have the same application date as the current section 33AA, and come into force on 1 April 2016.

REPORTING REQUIREMENTS OF EMPLOYERS IN THE AGRICULTURE, HORTICULTURE AND VITICULTURE INDUSTRIES

Section 24O of the Tax Administration Act 1994

Section 24O of the Tax Administration Act 1994 that required employers in the agricultural, horticultural or viticultural industries to provide Inland Revenue with information about employees covered by an exemption certificate or special tax rate certificate has been repealed.

These requirements would have imposed unreasonable costs on employers and Inland Revenue while not being effective at identifying non-compliant employees. Accordingly, the provision has not been enforced and instead employers can check the validity of an employee's certificate directly with Inland Revenue.

Application dates

This section has been repealed with effect from the 2008–09 income year to align with the original introduction of this provision.

REPEAL OF REDUNDANT COST OF TIMBER PROVISION

Section 92AAA of the Tax Administration Act 1994

Section 92AAA of the Tax Administration Act 1994, which required the Commissioner to issue a determination on the cost of timber incurred, has been repealed. This provision was introduced when the cost of timber was recorded in a separate account and carried forward to be offset against future forestry income.

The cost of timber is now deductible in the year incurred without the need for the Commissioner to issue a determination, rendering section 92AAA redundant.

[1] These taxpayers include private domestic workers, staff of foreign consulates and embassies, New Zealand-based representatives of foreign companies and Operation Deep Freeze personnel.

Application dates

This section has been repealed with effect from the 2015–16 income year.

NON-MONETARY CONSIDERATION IN THE CONTEXT OF SALES

Various sections in the Income Tax Act 2007

A number of references to "sale" and similar terms in the Income Tax Act 2007 have been amended to ensure that transfers or supplies in exchange for non-monetary consideration are covered by the relevant provisions. These amendments address concerns that references to "sale" and similar terms may require an exchange of money and may therefore exclude transactions involving an exchange for non-monetary consideration such as a disposal of shares in exchange for a financial arrangement.

The terms that have been amended include "sale", "buy", "purchase" and variations of these terms.

Application dates

The amendments apply for the 2015–16 and later income years.

GST RATIO METHOD FOR CALCULATING PROVISIONAL TAX

Sections RC 17 and RC 18 Income Tax Act 2007

Amendments have been made to clarify when a person must stop using the GST ration method to determine the amount of provisional tax payable for a tax year.

Background

A taxpayer may choose to use the GST ratio method to calculate provisional tax payable for a tax year if all of the following requirements in section RC 16 are satisfied:

- the residual income tax (RIT) for the preceding year from which the GST ratio is calculated must be within the range of $2,501 to $150,000 for the year;
- the taxpayer must be GST-registered for the entire prior year; and
- their ratio of RIT to total taxable supplies for the prior year (GST ratio) must not exceed 100 percent or be less than zero percent. The GST ratio is applied to taxable supplies (turnover) in each GST period to determine the provisional tax payable.

Once a tax year has started, if a taxpayer does not satisfy all of these requirements, the GST ratio method for calculating provisional tax is not available to the taxpayer. The previous legislation was unclear on the point that if RIT was calculated in a return of income for an earlier tax year and filed during the current tax year, the above requirements were not satisfied.

Key features

The amendments make it clear that a person must stop using the GST ratio method to determine the amount of provisional tax payable for a tax year, if:

- the person files a return of income during that tax year; and
- the RIT calculated in that return of income means the taxpayer no longer meets the requirements of section RC 16(2) and (5) of the Income Tax Act 2007.

The person must stop using the GST ratio method from the date on which the return of income is filed. The taxpayer must then apply either the estimation method or a standard method for calculating their provisional tax. The method used depends on whether the return of income was filed before or after the due date for Instalment A of provisional tax.

Application date

The amendments apply from the beginning of the 2016–17 income year.

Detailed analysis

The residual income tax calculated in an income tax return filed for an earlier tax year may result in either the RIT or GST ratio falling outside the required threshold ($2,501 to $150,000) to use the GST ratio method for calculating provisional tax.

If these eligibility requirements are not satisfied once the prior year's return of income is filed, the person must cease using the GST ratio method from the date on which the return of income is filed.

The taxpayer must then apply either the estimation method or a standard method for calculating their provisional tax. The method used depends on whether the return of income was filed before or after the due date for Instalment A of provisional tax.

These outcomes are illustrated in the following example.

Example

For provisional tax payments for the 2014–15 tax year, a taxpayer having an extension-of-time arrangement for filing the income tax return for the 2013–14 year, might not file the return until 31 March 2015.

For due dates for payment of provisional tax falling before this return is filed, the taxpayer would not know the RIT and annual turnover figures from the 2013–14 tax year. The taxpayer is then permitted to use the RIT and annual turnover data from the 2012–13 year to calculate provisional tax due for the 2014–15 tax year.

After filing the 2013–14 annual return of income, if the RIT for the 2013–14 tax year exceeds the $150,000 threshold, the taxpayer becomes ineligible to use the GST ratio method for the 2014–15 year.

In this case, the amendment clarifies that the taxpayer must cease to use the GST ratio method for calculating provisional tax. Instead, they must use either:

- the standard or estimation method of determining provisional tax, if the return is filed before the due date for Instalment A of provisional tax for the tax year. (In this case, the taxpayer is also treated as never having elected to apply the GST ratio method for the tax year.); or
- the estimation method, if the return is filed after Instalment A of provisional tax for the tax year.

Some minor consequential amendments have been made to clarify that:

- the date the taxpayer is treated as ceasing to use the GST ratio method is the date on which the relevant return of income is filed; and
- if the taxpayer is a borrower under the Student Loan Scheme Act 2011, the requirement to cease using the GST ratio method for calculating provisional tax does not change the due dates for student loan repayments.

FINANCIAL MARKETS (REPEALS AND AMENDMENTS) ACT 2013 – RELATED CHANGES

Section YA 1 of the Income Tax Act 2007; section 3(1) of the Finance Act (No. 2) 1990

Following amendments made by the Financial Markets (Repeals and Amendments) Act 2013, Officials identified that changes to the definitions of "approved unit trust" and "public unit trust" in the Act would have introduced unintended and undesirable consequences.

To prevent these consequences arising, transitional regulations, which apply from 1 December 2014 to 30 November 2016 (the transitional period), were included in the Financial Markets Conduct Regulations 2014. The transitional regulations relevant to these definitions have now been superseded by changes in the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016.

Background

Approved unit trusts

The Financial Markets (Repeals and Amendments) Act 2013 amended the definition of an "approved unit trust" in the Finance Act (No. 2) 1990 to refer to the definition of a unit trust in the Income Tax Act 2007 rather than the Unit Trusts Act 1960, which has been repealed. However, an approved unit trust is specifically excluded from being a unit trust under the Income Tax Act 2007.

Clause 30(8)(g) of schedule 1 of the Financial Markets Conduct Regulations 2014 states that, during the transitional period, a unit trust that was, immediately before 1 December 2014, an approved unit trust must be treated as continuing to be an approved unit trust.

Public unit trusts

The Financial Markets (Repeals and Amendments) Act 2013 amended the definition of a "public unit trust" in the Income Tax Act 2007 to refer to regulated offers made under the Financial Markets Conduct Act 2013 rather than securities offered to the public under the Securities Act 1978, which has been repealed. A regulated offer under the Financial Markets Conduct Act 2013 is not a direct equivalent to an offer of securities to the public under the Securities Act 1978; as a result, this amendment altered the scope of what could qualify as a public unit trust.

Clause 30(5)(f) of schedule 1 of the Financial Markets Conduct Regulations 2014 states that, during the transitional period, the reference to regulated offers made under the Financial Markets Conduct Act 2013 in paragraphs (a) and (b)(vi) and (vii) of the definition of "public unit trust" in section YA 1 of the Income Tax Act 2007 must be treated as including a reference to an offer that would have been an offer of securities to the public under the Securities Act 1978 Act if the 1978 Act had not been repealed.

Key features

Approved unit trusts

The definition of an "approved unit trust" in the Finance Act (No. 2) 1990 has been further amended to exclude paragraph b(x) of the "unit trust" definition in the Income Tax Act 2007. Paragraph b(x) excludes an approved unit trust from being a unit trust so this amendment allows an approved unit trust to meet the Finance Act (No. 2) 1990 definition.

Public unit trusts

The definition of a "public unit trust" in the Income Tax Act 2007 has been further amended, to remove the requirement that regulated offers are made under the Financial Markets Conduct Act 2013 (there being no equivalent concept of offers to the public in the Financial Markets Conduct Act 2013). Paragraph (a) of the public unit trust definition now requires 100 or more unit holders, treating all associated persons as one person, who meet the current requirements in subparagraphs (i) to (iii). Paragraph (b)(vi) and (vii) have had their thresholds reduced from 25 percent to 5 percent to ensure public unit trusts qualifying under these provisions are sufficiently widely held.

Application date

The amendments came into force on 24 February 2016, being the date of enactment of the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill.

THIN CAPITALISATION REMEDIALS

Sections FE 1, 2 and 31D of the Income Tax Act 2007

Three amendments have been made to the thin capitalisation rules to ensure that they operate as intended. The changes are to sections:

- FE 1, to ensure the description of how the rules operate is accurate;
- FE 2(1)(cb)(i), to ensure that shareholder interests are not counted more than once; and
- FE 31D, to ensure the section, designed to deem a company's worldwide group to be the same as its New Zealand group, works appropriately in all situations.

Key features

Introductory provision

Section FE 1 sets out how the thin capitalisation rules are intended to operate. Subsection (1)(a)(iii) previously referred to an entity that is "controlled by a group of entities, including non-residents and entities controlled by non-residents, that act together". However this was not correct. The phrase "acting together" is not used in the operative provisions of the thin capitalisation rules.

Accordingly, section FE 1(1)(a)(iii) has been amended to clarify that the rules apply when a taxpayer is a trustee and when the majority of settlements have come from people subject to the rules who are acting in concert.

Double counting rule

Section FE 2(1)(cb)(i) provides that the thin capitalisation rules apply when the members of a non-resident owning body have, on aggregate, a 50 percent or larger ownership interest in a New Zealand company. However, as a person's ownership interest in a company includes any direct ownership interests that an associated person has in that company this can potentially result in a person's ownership interest being counted more than once.

To prevent this double counting, the section previously required that the aggregate ownership interest of a non-resident owning body should be determined as if the members are associated. However, this did not achieve the intended effect of eliminating double counting.

Accordingly, an amendment has been made to require adjustment to the extent necessary to eliminate any double counting.

Worldwide group rule

The changes to the thin capitalisation rules in the Taxation (Employee Allowances, Annual Rates, and Remedial Matters) Act 2014 included a provision to deem the worldwide group of a New Zealand company to be the same as its New Zealand group in certain situations. These are when the company is subject to the thin capitalisation rules only because it:

- is controlled by a non-resident owning body; or
- is controlled by a trustee that is subject to the thin capitalisation rules.

This section previously did not operate as intended in every situation. Accordingly, the section has been amended to ensure it operates appropriately.

Application date

The changes apply from the beginning of the 2015–16 income year.

DISPUTES PROCEDURES

Response period when taxpayer late issuing disputes document

Sections 89AB and 89AC of the Tax Administration Act 1994

Amendments have been made to clarify that the period for the Commissioner to respond to a late disputes document issued by a taxpayer starts from the time when:

- the Commissioner accepts the late disputes document; or
- the challenge to the Commissioner's rejection of the late disputes document is settled by the Taxation Review Authority or the High Court.

Background

Certain documents that form part of the tax disputes process are subject to mandatory response periods. A breach of a response period can see a taxpayer forfeit their right to begin, or continue with, a dispute. However, if exceptional circumstances are found to exist or the taxpayer has a demonstrable intention to continue the disputes process, the Commissioner can treat a late disputes document as if it had been given within the required response period.

The decision about whether to accept the late document is at the discretion of the Commissioner. A taxpayer may challenge a refusal to accept a late document by filing proceedings with the Taxation Review Authority within two months of the rejection notice being issued.

Key features

An amendment to section 89AB makes the response period for the Commissioner for a notice of proposed adjustment or disclosure notice subject to new section 89AC.

New section 89AC specifies that the Commissioner's response period for a taxpayer's late notice of proposed adjustment or disclosure notice starts from the time when:

- the Commissioner accepts the late disputes document; or
- the challenge to the Commissioner's rejection of the late disputes document is settled by the Taxation Review Authority or the High Court.

Application date

The amendments came into force on the date of enactment, being 24 February 2016.

The disputes process under a taxpayer-initiated dispute

Sections 89M(6BA) and 138G of the Tax Administration Act 1994

Amendments have been made so the Commissioner is not required to issue a statement of position for a truncated dispute when the dispute is taxpayer-initiated and the taxpayer has issued a statement of position. The changes are intended to reduce potential delays and unnecessary administrative costs.

Background

In a taxpayer-initiated dispute, the disputes process is completed either when the Commissioner agrees to make an amended assessment or issues a challenge notice (at which point the disputant is able to file challenge proceedings in the High Court or with the Taxation Review Authority).

Section 89P(3) of the Tax Administration Act 1994 provides that the Commissioner cannot issue a challenge notice without statements of position being exchanged, unless one of the exceptions in section 89N(1)(c) applies. The circumstances in section 89N(1)(c) set out when the requirement to complete the full disputes process does not apply. However, under the previous rules, section 89M(6BA) required the Commissioner to issue a statement of position whenever the taxpayer issued a statement of position.

The combination of the provisions meant the Commissioner had to issue a statement of position in response to a taxpayer's statement of position, even if one of the exceptions to completing the full dispute process applied. This had the potential to delay a dispute unnecessarily and impose unnecessary administration costs.

Key features

The amendment to section 89M(6BA) ensures that after the taxpayer has issued a statement of position, and one of the circumstances in section 89N(1)(c) applies, the dispute can be submitted to the High Court or Taxation Review Authority without requiring the Commissioner to issue a statement of position. The change is only relevant for taxpayer-initiated disputes.

An amendment to section 138G clarifies if a taxpayer-initiated dispute proceeds in this way, the Commissioner and the taxpayer will be bound by the exclusion rule. The amendment clarifies when a taxpayer or the Commissioner can raise new issues in the challenge and ensures the Commissioner can rely on information that would otherwise have been included in her statement of position.

Application date

The amendments came into force on the date of enactment, being 24 February 2016.

PETROLEUM RULES: DEFINITIONS

Sections DT 3, DT 8, DZ 4, DZ 5, YA 1: Permit area; Petroleum exploration expenditure; Petroleum permit

Amendments have been made to the definitions of "permit area", "petroleum permit" and "petroleum exploration expenditure" in section YA of the Income Tax Act 2007.

The amendments correct an unintended legislative change in the definitions of "petroleum permit" and "petroleum exploration expenditure". These two definitions inadvertently do not refer to petroleum mining privileges issued under the Petroleum Act 1937 (1937 Act). The policy intention is that the tax treatment for costs relating to mining privileges issued under the 1937 Act is intended to be determined under the petroleum mining rules.

The changes to the definitions of "petroleum permit" and "petroleum exploration expenditure" clarify that they include petroleum mining privileges issued under the 1937 Act, and ensure that they apply, as intended, to petroleum exploration expenditure. The amendment to the definition of "permit area" updates a cross-reference, consequential to an amendment to the Crown Minerals Act 1991."Savings" provisions apply in relation to sections DT 8 and section YA 1: Petroleum permit. These provisions protect a taxpayer's tax position taken on the basis of the legislation as it was before the amendments, in relation to an arrangement for the acquisition of a petroleum mining asset that was entered into before the introduction of the amending legislation.

Key features

Amendments to the definitions of "permit area", "petroleum permit" and "petroleum exploration expenditure" have been made to:

- correct unintended legislative changes made in rewriting those definitions into the Income Tax Act 2007; and
- implement a "savings" provision for taxpayers to protect tax positions taken in relation to the definition of petroleum exploration expenditure on arrangements entered into before introduction of the amending legislation.

Application date

The amendments apply from the beginning of the 2008–09 income year.

TREATMENT OF EXPENDITURE FOR COMMERCIAL FITOUT

Sections DA 5 and DB 22B of the Income Tax Act 2007

A specific rule relating to expenditure on items of commercial fit-out (section DA 5) has been removed from a subpart intended for general provisions relating to deductions and re-enacted in a more appropriate place (section DB 22B).

There is no change to the effect of the provision.

Section DA 5 is concerned with how the capital limitation rule applies to certain expenditure incurred on commercial fit-out. In particular, it is intended to ensure that:

- capital expenditure incurred for commercial fit-out is not immediately deductible as repairs and maintenance on the building; and
- the replacement or improvement of a previously separately depreciated item of commercial fit-out is capitalised and depreciated over its estimated useful life.

The Rewrite Advisory Panel noted that section DA 5 is inconsistent with the scheme and purpose of subpart DA, which:

- contains the general permission; and
- sets out principles and rules for understanding the relationship of the general permission with specific deduction provisions in part D.

The Panel considered that section DA 5 should be relocated to reduce the potential for:

- misunderstanding and misinterpretation of the scheme and purpose for subpart DA; and
- section DA 5 being cited as an example or precedent in support of placing other targeted provisions in subpart DA.

Application date

The amendment applies from the beginning of the 2011–12 income year.

ELECTION TO BE A COMPLYING TRUST

Sections HC 10 and HC 33 (Income Tax Act 2007); sections HH 4(7B), (7C) and OB 1: Qualifying trust (Income Tax Act 2004); sections HH 4(7B), (7C) and OB 1: Qualifying trust (Income Tax Act 1994); and section 226(1): Qualifying trust and section 228(8), (9) (Income Tax Act 1976)

Amendments have been made to sections HC 10 and HC 33 of the Income Tax Act 2007 (election to be a complying trust) and corresponding provisions in earlier income tax legislation for the following reasons:

- to correct an unintended legislative change made in relation to an election to be a complying trust; and
- to allow a trust to continue to be treated as a complying trust after the settlor migrates from New Zealand if, since that time, the trustee has continued to comply fully with New Zealand income tax obligations.

The amendments address:

- an unintended legislative change relating to an election for a trust to be a complying trust (sections HC 10 and HC 33 of the Income Tax Act 2007); and
- an inconsistency in the complying trust rules relating to the classification of a trust when a settlor of the trust migrates from New Zealand.

Key features

Unintended legislative change

A complying trust is a trust for which the trustees:

- have always been liable for tax at the trustee rate on their world-wide trustee income; and
- have always met their income tax compliance obligations.

Provided these requirements are satisfied, a foreign trust may also be a complying trust in relation to its distributions. The main benefit for a foreign trust also being a complying trust is that distributions to beneficiaries that are not beneficiary income are exempt from New Zealand income tax. This exempt treatment of a distribution is because the underlying income of the trust fund has already been taxed at the trustee rate in New Zealand.

A foreign trust is a trust which does not have a settlor resident in New Zealand at all times since the trust was formed. Income derived by the trustees of a foreign trust is only liable for New Zealand tax on income derived from sources in New Zealand. However, a trust for which the settlor migrates from New Zealand may also meet the requirements to be a complying trust if:

- a settlor, trustee or beneficiary of the trust elects for the trust to pay tax at the trustee rate on its world-wide trustee income; and
- the trustees continue to meet all income tax compliance obligations for the trust.

In the absence of this election, a foreign trust cannot be a complying trust if the trustee:

- is not liable for New Zealand tax on foreign-sourced income; and
- derives non-resident passive income from sources in New Zealand that is not subject to full rates of tax in New Zealand.

The amendment ensures that an election for a foreign trust to be a complying trust relates to satisfying tax obligations on world-wide trustee income of the trust.

Remedial matter

The amendments also address a minor remedial matter, mainly relating to situations that have arisen for trustee companies, such as the Public Trust. These trustees act for many trusts and are not always made aware when a settlor's residence changes. In some situations, this can lead to the trustee continuing to pay tax as if the trust was a complying trust, despite not having elected for the trust to be a complying trust.

The amendment clarifies that if the trustee is not aware when a settlor migrates from New Zealand, the trust will be treated as a complying trust, provided that the trustee:

- •calculates and pays tax at the trustee rate on the world-wide trustee income of the trustee; and
- indicates in the annual return of income that the trust is a complying trust.

Application dates

The amendments correcting the unintended change apply from the beginning of the 1995–96 income year.

The amendments addressing the inconsistency in the complying trust rules when a settlor migrates from New Zealand apply from the beginning of the 1988–1989 income year.

BAD DEBT DEDUCTION AND CAPITAL LIMITATION

Sections DB 31(6)(b)(iii) of the Income Tax Act 2007 and section DB 23 (6)(b)(iii) of the Income Tax Act 2004

The amendment to section DB 31(6)(b)(iii) of the Income Tax Act 2007 (and section DB 23 (6)(b)(iii) of the Income Tax Act 2004) clarifies that the capital limitation does not prevent a deduction for a bad debt of the principal amount of a financial arrangement held as part of a business of holding or dealing in financial arrangements.

This amendment does not alter the current treatment of debts owed by associated persons.

Background

The amendment results from the Rewrite Advisory Panel agreeing with a submission that the bad debt deduction rule contained an unintended change in legislation from the corresponding bad debt provisions in the Income Tax Act 1994. The unintended legislative change identified was that the bad debt deduction rule may deny a deduction for the principal amount of a financial arrangement to a person carrying on a business of holding or dealing in financial arrangements.

An example of a possible adverse consequence arising from the unintended legislative change would be for a holder of securitised financial arrangements, if those securitised assets are held as part of a business of holding or dealing in financial arrangements.

Key features

The amendment clarifies that the capital limitation does not apply to a business holder or dealer in determining whether a bad debt deduction is allowed for a financial arrangement that is held as part of a business of holding or dealing in financial arrangements. This ensures that a business holder or dealer is allowed a bad debt deduction for accrued interest and principal (including capitalised interest) if:

- the procedural requirements of section DB 31 are satisfied;
- the financial arrangement is held as part of the person's holding or dealing business; and
- the financial arrangement is not entered into with an associated person.

Whether a holder of a financial arrangement is carrying on a business of holding or dealing in financial arrangements will continue to be determined under ordinary principles.

Application dates

The amendments apply from the beginning of the 2008–09 income year (Income Tax Act 2007) and the 2005–06 income year (Income Tax Act 2004).

Detailed analysis

This policy for bad debt deductions for a person carrying on the business of holding or dealing in financial arrangements (a business holder or dealer) stems from the 1987 recommendations of the Consultative Committee on Accrual Tax Treatment of Income and Expenditure (the Brash Committee). Those recommendations were to maintain the common law position in relation to bad debt deductions, except for bad debts entered into between associated persons.

Under common law, a bad debt suffered by a business holder or dealer which related to a financial arrangement entered into in the ordinary course of business was considered to be on revenue account, including the principal amount of the loan and subsequent capitalisations of accrued interest. Also under common law, a debt entered into outside the normal or ordinary course of business would be usually treated as a non-deductible capital loss as a result of applying the capital/revenue tests.

The Brash Committee also considered that the common law treatment for bad debts should not apply to debts between associated persons because associated persons may seek to convert capital losses into revenue deductions simply by substituting what would ordinarily be equity capital for a debt instrument. The amendment does not affect this outcome.

The amendments ensure that:

- a bad debt deduction is allowed for both the principal and accrued interest of a financial arrangement that is held as part of a business of holding or dealing in financial arrangements; and
- does not allow a bad debt deduction for the principal amount of a financial arrangement that is not held as part of a business of holding or dealing in financial arrangements.

The following examples illustrate circumstances in which a bad debt deduction would not be allowed for the principal amount of a financial arrangement.

Example 1

A financial institution enters into a joint venture with other financial institutions through a joint venture company to develop an activity that relates to the business structure of each of the financial institutions (such as a data clearing house operation that serves all partners). The joint venture company is not an associated person of any of the financial institutions (25% interest for each of the financial institutions).

Each institution individually carries on a business of either holding or dealing in financial arrangements (for example, banking). The joint venture partners contribute their capital by way of debt.

If the joint venture operation is not successful, its value is dissipated and the joint venture company becomes unable to pay its debts. The debt becomes uncollectible, and is bad. From a policy perspective, a debt of this nature relates to the capital structure of the financial institution's business. If the debt becomes bad it is a loss of capital and no deduction should be allowed.

Example 2

Company X's business includes the supply of certain goods and the making of loans to customers. Company X entered into an arrangement with a major customer, Company Y, which indicated it could buy goods from another supplier.

Under the arrangement, Company X made a loan to Company Y, and Company Y agreed to buy certain goods exclusively from Company X. The loans are the same as or similar to loans made to other customers (having similar interest rates and other terms).

However, the bad debt under the loan to Company Y is a capital loss because the main purpose of the loans was to obtain a capital advantage (an exclusive supply agreement). This type of loan is generally not made or held in the ordinary course of a business of holding or dealing in financial arrangements because a moneylending business is usually concerned with interest returns rather than securing a long-term capital advantage.

Example 3

A company in financial difficulty is lent money by a minority shareholder to protect the shareholder's investment in that company at a small margin on the rate of interest borne by the minority shareholder. That type of loan is generally not made in the ordinary course of a business of holding or dealing in financial arrangements because a moneylending business does not usually provide funds to an entity having significant credit risk unless the interest rate is high enough to compensate for credit risk.

BAD DEBT DEDUCTIONS FOR HOLDERS OF DEBT – BASE MAINTENANCE CHANGE

Section DB 31 of the Income Tax Act 2007

Changes introduced by the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 were intended to align the tax rules with the policy settings for taking bad debt deductions, by limiting bad debt deductions that can be taken by dealers and holders of debt to the economic cost of the debt. These changes were discussed in the *Tax Information Bulletin*, (Vol. 26 No. 4, May 2014). Officials subsequently became aware that these changes did not, in all cases, produce the correct result.

Accordingly, the tax rules have been further amended so that when a creditor's business includes dealing in or holding the same or similar financial arrangements, they can only take bad debt deductions for their economic loss. That is, they can only take bad debt deductions for amounts owing up to the consideration they have provided and any income they have returned for tax purposes.

Background

Under the rules preceding the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014, taxpayers who dealt in or held the same or similar financial arrangements could, theoretically, take bad debt deductions for amounts owing even when they did not suffer an economic loss. This was inconsistent with the policy intent.

For example, if a taxpayer purchased a debt at a discount, under the old rules they may have been able to take a bad debt deduction for the full face value of the debt even though they only suffered an economic loss equal to the discounted purchase price. While the base price adjustment[2] (BPA) would square up any excess deductions taken, the purchaser would still benefit from a timing advantage (and potentially a permanent advantage if a BPA was never performed). This timing advantage arose because the bad debt deduction for an amount greater than the purchase price could be taken well before the corresponding income from the BPA is recognised, presenting a risk to the revenue base.

Subsequent to enactment of the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014, officials realised that the changes made might not produce the desired policy result in certain cases. The matter was raised in the *Tax Information Bulletin* (Vol. 26 No. 4, footnoted on page 53) and it was signalled that further amending legislation would probably be required.

Accordingly, subsections DB 31(4B) – (4E) as inserted by the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 have been replaced by subsections DB 31(3B) and (4B) – (4D). This is simply a reordering and tidy-up of the provisions inserted by the earlier legislation.

For completeness, this TIB coverage of the new rules repeats all the relevant detail from the earlier item in Vol. 26 No. 4 for bad debt deductions-base maintenance. Examples 3 and 4 from that TIB have been replaced to reflect the latest amendments. New examples 5 and 6 have been included to further explain the changes made by both Acts.

Key features

The tax rules have been amended so that when a creditor's business includes dealing in or holding the same or similar financial arrangements, they can only take bad debt deductions for their economic loss. This means they can only take bad debt deductions for amounts owing up to the consideration they have provided, and any income they have returned for tax purposes. This change is achieved by subsection DB 31(4B)(a).

Two further amendments support this underlying change:

- Limited recourse arrangements – When a taxpayer is party to a debt that a limited recourse arrangement relates to, they will only be able to take a bad debt deduction for the money at risk. This is an anti-avoidance measure to ensure that section DB 31(4B)(a) cannot be circumvented by funding the acquisition of a financial arrangement by using a limited recourse arrangement.
- Claw-back for prior bad debt deductions – Section CZ 27 is a claw-back rule that requires taxpayers who have taken bad debt deductions greater than their economic loss to return the excess deductions as income in their return for the 2014–15 year. This rule ensures taxpayers are in the correct tax position, consistent with the policy intent. There is no concern for financial arrangements that have ended before or during the 2014–15 year, as the BPA would have been performed and squared-up any excess deductions taken.

Detailed analysis

New subsection DB 31(4B)(a) ensures bad debt deductions are limited to their economic cost.

Some submissions made at the select committee stage of the 2014 legislation questioned whether the correct economic result would be achieved under the proposed new rules when the consideration paid for a debt is less than the face value. The policy intent is that a bad debt deduction should not exceed the economic cost of the debt to the taxpayer. However, it is recognised that the operation of the BPA for the debt may result in assessable income for taxpayers, for which a deduction is required. Under the new rules, bad debt deductions for these income amounts are taken under subsection DB 31(2), and bad debt deductions for other amounts not received are taken under subsection DB 31(3) (limited by subsection DB 31(4B)(a), to the consideration paid for acquiring the debt). This is illustrated by the example below:

[2] A wash-up calculation performed when the financial arrangement comes to an end; shortened to "BPA".

Example 1: Application of section DB 31(3) and (4B)(a)

A debt with a face value of $5 million is acquired for $1million by Company G who is a dealer in the same or similar financial arrangements. Company G does not receive any income from the debtor and the entire $5 million debt is eventually remitted by law. Company G has suffered an economic loss of $1 million.

On remission, Company G performs a BPA as follows:

BPA: consideration – income + expenditure + amount remitted

= ($0 – $1 million) – $0 + $0 + $5 million

= $4 million income

Under the new rules, bad debt deductions are intended to be taken as follows:

- $1 million (for the economic loss) under subsection DB 31(3) (limited by section DB 31(4B)(a)) – being a deduction for the amount not received by a dealer in financial arrangements, but limited to the consideration paid for acquiring the debt; and
- $4 million under subsection DB 31(2) – being a deduction for an income amount (the BPA income) not received.

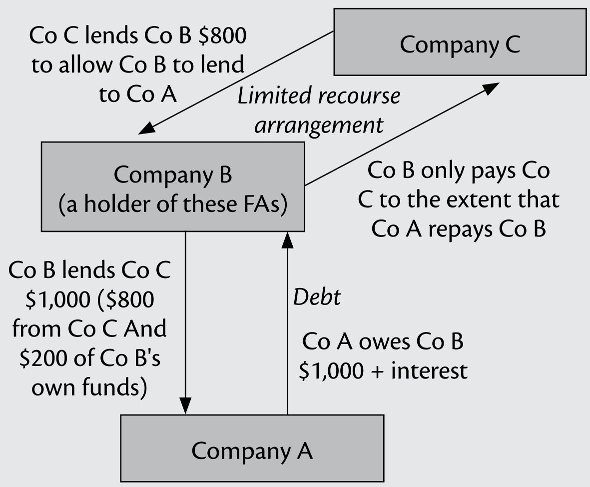
Limited recourse arrangements – an anti-avoidance measure

New subsections DB 31(4B) – (4D) are intended to ensure that dealers and holders can only take bad debt deductions for the money at risk.

The definition of "limited recourse arrangement" is contained in subsection DB 31(5B) and is intended to capture arrangements that are used to fund the underlying financial arrangement (for which a bad debt deduction is being sought). To illustrate, an example of a limited recourse arrangement is set out below:

Example 2: Limited recourse arrangement

Co B (a holder of the same or similar financial arrangements) lends money to Co A. Under this debt arrangement, Co B lends Co A $1,000 repayable in five years with $100 interest payable per year. Co B only funds $200 of the amount lent and borrows the remaining $800 from Co C. Under the arrangement with Co C, Co B is only required to repay the $800 and interest to Co C to the extent that Co A pays these amount to Co B. Amounts received from Co A will be split on a proportional 80:20 basis (Co C: Co B). Assume Co B is an accruals-basis taxpayer.



In the absence of rules for limited recourse arrangements, if Co A failed to repay the $1,000 to Co B, even with new subsection DB 31(4B)(a), it would be possible to Co B to take a bad debt deduction for the full $1,000 even though it has only suffered an economic loss of $200. The new rules are intended to ensure that prior to the BPA for the limited recourse arrangement Co B can only take a bad debt deduction up to $200 under section DB 3(4B)(c). If Co B was able to take a deduction for more than $200, it would receive an unintended advantage.

Limited recourse arrangements may take a variety of forms and the drafting is intentionally broad to capture a wide range of possible arrangements.

Subsection DB 31(4B)(c) is intended to ensure that, prior to the BPA of the limited recourse arrangement, dealers and holders of the same or similar financial arrangements can only take bad debt deductions under section DB 31(3) for the money at risk. Subsection DB 31(4D) is intended to ensure that when a BPA for the limited recourse arrangement is performed, dealers and holders of the same or similar financial arrangements are allowed a deduction for amounts owing under the debt for which deductions have not been taken under subsections DB 31(2) or (3).

Example 3: All interest received when due each year, $80 received during the liquidation of Co A, Co B is an accruals-basis taxpayer. No bad debt deductions are taken on the debt prior to the year in which the BPA is performed for the limited recourse arrangement.

Assume that Co A paid Co B all interest amounts when they fell due. Co A was put into liquidation during year 5 and after the last interest payment was received but the principal was not repaid. Only $80 of the remaining $1,000 repayable was received during the liquidation of Co A. On a proportional 80:20 basis (Co C: Co B) Co B uses the amounts received from Co A to pay Co C under the limited recourse arrangement. This means Co C receives a total of $400 from interest payments, and Co B retains the remaining $100. Co C also receives $64 of the $80 received on liquidation of Co A, and Co B retains the remaining $16. In this case Co B has suffered a cash loss of $84 from both arrangements overall, being the cash flow from the limited recourse arrangement ($800 – $464) and the cash flow from the debt ($580 – $1,000). It is assumed for simplicity that the BPAs for both arrangements take place in the same year.

Debt

For Co B, the cash flow under the debt is a loss of $420 ($580 received – $1,000 lent). Co B's overall tax position should reflect this.

For Co B the BPA for the debt (between Co A and Co B) is:

> Consideration – income + expenditure + amount remitted
>
> = ($580 – $1,000) – $400 + 0 + $920
>
> = $100

Tax position:

- The BPA performed under the debt arrangement will result in $100 of income for Co B. This amount represents interest received in the last year.
- Co B was required to return $400 interest income received from A in years 1 to 4.
- To align the tax position with the cash flow position (the loss of $420); a deduction of $920 is required.
- In this example it is assumed that bad debt deductions under sections DB 31(2) & (3) were not sought prior to the BPA being performed.
- Co B is allowed a deduction under section DB 31(4D) for $920 when the BPA for the limited recourse arrangement is performed. This is calculated as the amount owing under the financial arrangement (debt) ($920) less the total deductions under subsections (2) & (3) prior to the BPA for the limited recourse arrangement being performed (that is, Nil).

This is the correct tax result overall for the debt, as it aligns with the cash loss of $420.

Interest income returned	$400
BPA income returned	$100
DB 31(2) & (3) deductions	$0
DB 31(4D) deduction	($920)
Total	($420)

Limited recourse arrangement

For Co B, the cash flow under the limited recourse arrangement is a gain of $336 ($800 received – $464 paid). Co B's overall tax position should reflect this.

For Co B the BPA for the limited recourse arrangement (between Co B and Co C) is:

> Consideration – income + expenditure + amount remitted
>
> = ($800 – $464) – $0 + $320 + $0
>
> = $656

Tax position:

- The BPA performed under the limited recourse arrangement will result in $656 of income for Co B.
- Deductions of $320 for interest paid to Co C in prior years under the limited recourse arrangement would be allowed under section DB 7 ($80 each year for years 1 to 4).
- This gives the correct tax result for Co B under the limited recourse arrangement as the tax position ($656 income – $320 deductions) aligns with the cash flow ($336 gain).

Summary of tax in all years for both arrangements

	Years 1–4	*Year 5 (BPA year)*
Interest income on debt	$400	$0
Interest expenditure LRA	($320)	$0
BPA income on debt	$0	$100
BPA income on LRA	$0	$656
DB 31(4D) deduction for debt	$0	($920)
Total	$80	($164)

Note that section BD 4(5) allocates deductions to income years so their total does not exceed the amount of the expenditure or loss.

Example 4: No interest received when due each year, $80 received during the liquidation of Co A, Co B is an accruals-basis taxpayer. No bad debt deductions are taken on the debt prior to the year in which the BPA is performed for the limited recourse arrangement.

This example further illustrates the intended application of the rules including amended section DB 31(4D).

Assume that Co A did not pay Co B any of the interest amounts when they fell due, and that Co A was put into liquidation during year 5 after the interest for that year and principal repayment were due. Co B received $80 during the liquidation of Co A. On a proportional

80:20 basis (Co C: Co B) Co B uses the amount received from Co A to pay Co C $64 under the limited recourse arrangement. In this case Co B has suffered a cash loss of $184 from both arrangements overall being the cash flow from the debt ($80 – $1,000) and the cash flow from the limited recourse arrangement ($800 – $64). It is assumed that the BPAs for both arrangements take place in the same year.

Debt

For Co B, the cash flow under the debt is a loss of $920 ($80 received – $1,000 lent). Co B's overall tax position should reflect this.

The BPA for the debt (between Co A and Co B) is:

BPA: Consideration – income + expenditure + amount remitted

= ($80 – $1,000) – $400 + 0 + $1,420

= $100

Tax position:

- The BPA performed under the debt arrangement will result in $100 of income for Co B. This amount represents interest income not received in year 5, for which a bad debt deduction can be taken under subsection DB 31(2) as an amount owing.
- Co B was required to return $400 interest income for interest payable by Co A in previous years. The $80 that was received during the liquidation of Co A is attributed to the earliest amount of unpaid interest (in year 1). A deduction for the interest amounts that were returned but not received in years 1 to 4 (that is, $320) can be taken under subsection DB 31(2).
- To align the tax position with the cash flow position (the loss of $920), a further deduction of $1,000 is required.
- In this example it is assumed that bad debt deductions under sections DB 31(2) and (3) were not sought prior to the BPA being performed (although section DB 31(2) bad debt deductions of $100 and $320 are being taken in the final income year as outlined in the first two bullet points).
- Co B is allowed a deduction under section DB 31(4D) for $1,000 when the BPA for the limited recourse arrangement is performed. This is calculated as the amount owing under the financial arrangement (debt) ($1,420) less the total deductions under subsections (2) and (3) (that is, $420).

This is the correct tax result overall, as it aligns with the cash loss of $920.

BPA income returned	$100
Interest income returned	$400
DB 31(2) deductions	($100) + ($320)
DB 31(3) deductions	$0
DB 31(4D) deduction	($1,000)
Total	($920)

Limited recourse arrangement

For Co B, the cash flow under the limited recourse arrangement is a gain of $736 ($800 received – $64 paid). Co B's overall tax position should reflect this.

The BPA for the limited recourse arrangement (between Co B and Co C) is:

BPA: Consideration – income + expenditure + amount remitted

= ($800 – $64) – $0 + $320 + $0

= $1,056

Tax position:

- The BPA performed under the limited recourse arrangement will result in $1,056 of income for Co B.
- Deductions of $320 for interest accrued but not paid to Co C in prior years would be allowed under section DB 7 ($80 each year for years 1 to 4).
- This gives the correct tax result for Co B under the limited recourse arrangement as the tax position ($1,056 income – $320 deductions) aligns with the cash flow ($736 gain).

Summary of tax in all years for both arrangements

	Years 1–4	*Year 5 (BPA year)*
Interest income on debt	$400	$0
Interest expenditure LRA	($320)	$0
BPA income on debt	$0	$100
BPA income on LRA	$0	$1,056
DB 31(2) deductions for debt	$0	($420)
DB 31(4D) deduction for debt	$0	($1,000)
Total	$80	($264)

Note that section BD 4(5) allocates deductions to income years so their total does not exceed the amount of the expenditure or loss.

Example 5: Same as Example 3, all interest received when due each year, $80 received during the liquidation of Co A, Co B is an accruals-basis taxpayer. However, bad debt deductions are taken in a year prior to the year in which the BPA is performed for the limited recourse arrangement.

NEW LEGISLATION

Assume that Co A paid Co B all interest amounts when they fell due. Co A was put into liquidation and after the last interest payment was received but the principal was not repaid. Only $80 of the remaining $1,000 repayable was received during the liquidation of Co A. On a proportional 80:20 basis (Co C: Co B) Co B uses the amounts received from Co A to pay Co C under the limited recourse arrangement. This means Co C receives a total of $400 from interest payments, and Co B retains the remaining $100. Co C also receives $64 of the $80 received on liquidation of Co A, and Co B retains the remaining $16. In this case Co B has suffered a cash loss of $84 from both arrangements overall, being the cash flow from the limited recourse arrangement ($800 – $464) + cash flow from the debt ($580 – $1,000). It is assumed for simplicity that the BPAs for both arrangements take place in the same year.

Debt

For Co B, the cash flow under the debt is a loss of $420 ($580 received – $1,000 lent). Co B's overall tax position should reflect this.

However, unlike Example 3, Co B decided in year 4 that it is not going to recover $200 of the debt owing by Co A and writes off $200. It wants to claim a bad debt deduction in year 4 to the extent possible for the bad debt written-off.

Co A has been paying all its interest, which has been returned as accrual income by Co B. It is assumed that the bad debt deduction is not being claimed under section DB 31(2) because the amount written off is not an amount owing related to that income. So the deduction will need to be claimed for an amount owing under section DB 31(3).

Section DB 31(3B) limits the deduction to the lesser of the amount provided by subsection (4B) and the amount provided by subsection (5). Subsection (5) is assumed to be not relevant here so the amount of the deduction will be determined by subsection (4B).

Subsection (4B) provides that the amount of the deduction is the least of –

Para (a), is the amount that Co B pays for acquiring the financial arrangement (debt), being $1,000 in this case. Co B acquired the debt by lending $1,000 to Co A:

Para (b), is the amount owing under the financial arrangement, being $1,000 in this case:

Para (c), is the amount calculated using the formula:

Amount owing ($1,000) – limited recourse consideration ($800) = $200

The amount of the deduction for the bad debt written off in year 4 is therefore limited to $200 by subsection (4B)(c). This happens to be the amount actually written off so Co B can claim a deduction for that amount in year 4.

In year 5 the BPAs for the debt and the limited recourse arrangement are performed.

The BPA for the debt (between Co A and Co B) is:

BPA: Consideration – income + expenditure + amount remitted

= ($580 – $1,000) – $400 + $0 + $920

= $100

Tax position:

- The BPA performed under the debt arrangement will result in $100 of income for Co B. This amount represents interest received in the last year.
- Co B was required to return $400 interest income received from A in years 1 to 4.
- To align the tax position with the cash flow position (the loss of $420); a deduction of $920 is required.
- In this example a bad debt deduction was taken under section DB 31 (3) for $200 in year 4.
- Co B is allowed an additional bad debt deduction under section DB 31(4D) for $720 when the BPA for the limited recourse arrangement is performed. This is calculated as the amount owing under the debt ($920) less the total deductions under subsections (2) & (3) prior to the BPA for the limited recourse arrangement being performed (that is, $200 under subsection (3) in year 4).

This is the correct tax result overall for the debt, as it aligns with the cash loss of $420.

Interest income returned	$400
BPA income returned	$100
DB 31(2) and (3) deductions	($200)
DB 31(4D) deduction	($720)
Total	($420)

Limited recourse arrangement

For Co B the cash flow under the limited recourse arrangement is a gain of $336 ($800 received – $464 paid). Co B's overall tax position should reflect this.

The BPA for the limited recourse arrangement (between Co B and Co C) is:

BPA: Consideration – income + expenditure + amount remitted

= ($800 – $464) – $0 + $320 + $0

= $656

Tax position

- The BPA performed under the limited recourse arrangement will result in $656 of income for Co B.
- Deductions of $320 for interest paid to Co C in prior years under the limited recourse arrangement would be allowed under section DB 7 ($80 each year for years 1 to 4).
- This gives the correct tax result for Co B under the limited recourse arrangement as the tax position ($656 income – $320 deductions) aligns with the cash flow ($336 gain).

Summary of tax in all years for both arrangements

	Years 1–4	*Year 5 (BPA year)*
Interest income on debt	$400	$0
Interest expenditure LRA	($320)	$0
BPA income on debt	$0	$100
BPA income on LRA	$0	$656
DB 31(3) deduction	($200)	$0
DB 31(4D) deduction	$0	($720)
Total	($120)	$36

Note that section BD 4(5) allocates deductions to income years so their total does not exceed the amount of the expenditure or loss.

Example 6: Same as Example 4, no interest received when due each year, $80 received during the liquidation of Co A, Co B is an accruals-basis taxpayer. However, bad debt deductions are taken in years prior to the year in which the BPA is performed for the limited recourse arrangement.

This example further illustrates the intended application of the new rules, including amended section DB 31(4D).

Assume that Co A did not pay Co B any of the interest amounts when they fell due, and that Co A was put into liquidation during year 5 after the interest for that year and principal repayment were due. Co B received $80 during the liquidation of Co A. On a proportional 80:20 basis (Co C: Co B) Co B uses the amount received from Co A to pay Co C $64 under the limited recourse arrangement. In this case Co B has suffered a cash loss of $184 from both arrangements overall, being the cash flow from the debt ($80 – $1,000) and the cash flow from the limited recourse arrangement ($800 – $64). It is assumed that the BPAs for both instruments take place in the same year.

Debt

For Co B, the cash flow under the debt is a loss of $920 ($80 received – $1,000 lent). Co B's overall tax position should reflect this.

However, unlike Example 4, Co B has decided in year 4 that it is not going to recover $500 of the $1,400 debt owing at that point ($1,000 lent and $400 unpaid interest) by Co A and writes off $500. It wants to claim a bad debt deduction in year 4 to the extent possible for the bad debt written-off.

Co A has not paid its interest due of $400 in the first four years. As an accruals taxpayer $400 has been returned as accrual income by Co B in these four years. Co B can take a bad debt deduction for $400 under section DB 31(2) because the amount written off is an amount owing related to that income. So the remaining $100 of the $500 written off will need to be claimed under subsections DB 31(3), (3B) and (4B). Subsection (4D) does not apply as the BPA on the limited recourse arrangement has not been performed in year 4.

Section DB 31(3B) limits the deduction to the lesser of the amount provided by subsection (4B) and the amount provided by subsection (5). Subsection (5) is assumed to be irrelevant here so the amount of the deduction will be determined by subsection (4B).

Subsection (4B) provides that the amount of the deduction is the least of –

Para (a), is the amount that Co B pays for acquiring the financial arrangement (debt), being $1,000 in this case. Co B acquired the debt by lending $1,000 to Co A:

Para (b), is the amount owing under the financial arrangement, being $1,400 in this case (assumed to be immediately after interest for year 4 is due and still in year 4):

Para (c), is the amount calculated using the formula:

> Amount owing ($1,000)* – limited recourse consideration ($800) = $200

* The amount owing is defined in subsection (4C) as the lesser of:

(i) The amount of consideration paid for acquiring the financial arrangement ($1,000), (so this para applies); or

(ii) The amount owing ($1,400) under the financial arrangement.

The amount of the deduction for the bad debt written off in year 4 is therefore limited to $200 by subsection

NEW LEGISLATION

(4B)(c). This is more than the $100 Co B wants to claim a deduction for, so it can claim a deduction for $100 in year 4.

In year 5 the BPAs for the debt and the limited recourse arrangement are performed.

Co B's BPA for the debt (between Co A and Co B) is:

Consideration – income + expenditure + amount remitted

= ($80 – $1,000) – $400 + $0 + $1,420

= $100

Tax position:

- The BPA performed under the debt arrangement will result in $100 of income for Co B. This amount represents interest income not received in year 5. A bad debt deduction can be taken under subsection DB 31(2) for this amount owing.
- Co B was required to return $400 interest income for interest payable by Co A in previous years.
- Co B took a bad debt deduction of $400 in year 4 under subsection DB 31(2) for the interest income not received. The $80 received during the liquidation relates to the bad debt deduction in year 4 but $80 has been included in the BPA calculation and correctly dealt with for tax.
- In this example bad debt deductions were taken under sections DB 31(2) ($400) and (3) ($100) in year 4; and a bad debt deduction of $100 under section DB 31(2) is being taken in the BPA year.
- To align the tax position with the cash flow position (the loss of $920), a further deduction of $820 is required.
- Co B is allowed a deduction under section DB 31(4D) for $820 when the BPA for the limited recourse arrangement is performed. This is calculated as the amount owing under the debt ($1,420) less the total deductions under subsections (2) and (3) (that is, $600).

This is the correct tax result overall, as it aligns with the cash loss of $920.

BPA income returned	$100
Interest income returned	$400
DB 31(2) deductions	($100) + ($400)
DB 31(3) deductions	($100)
DB 31(4D) deduction	($820)
Total	($920)

Limited recourse arrangement

For Co B the cash flow under the limited recourse arrangement is a gain of $736 ($800 received – $64 paid). Co B's overall tax position should reflect this.

Co B's BPA for the limited recourse arrangement (between Co B and Co C) is:

Consideration – income + expenditure + amount remitted

= ($800 – $64) – $0 + $320 + $0

= $1,056

Tax position:

- The BPA performed under the limited recourse arrangement will result in $1,056 of income for Co B.
- Deductions of $320 for interest accrued but not paid to Co C in prior years would be allowed under section DB 7 ($80 each year for years 1 to 4).
- This gives the correct tax result for Co B under the limited recourse arrangement as the tax position ($1,056 income – $320 deductions) aligns with the cash flow ($736 gain).

Summary of tax in all years for both arrangements

	Years 1-4	*Year 5 (BPA year)*
Interest income on debt	$400	$0
Interest expenditure LRA	($320)	$0
BPA income on debt	$0	$100
BPA income on LRA	$0	$1,056
DB 31(2) deductions for debt	($400)	($100)
DB 31(3) deduction for debt	($100)	$0
DB 31(4D) deduction for debt	$0	($820)
Total	($420)	$236

Note that section BD 4(5) allocates deductions to income years so their total does not exceed the amount of the expenditure or loss.

Claw-back for prior bad debt deductions

The new rules have aligned the law with the policy intent. It was never intended that bad debt deductions be taken for more than the economic loss. Section CZ 27 was introduced to rectify this by clawing back any excess bad debt deductions taken in prior years.

The rules apply to a taxpayer who has taken an excess bad debt deduction before 20 May 2013. An excess bad debt deduction is one that would not have been allowed under the rules introduced by the 2014 legislation. Subsection

CZ 27(2) has been amended by the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 to recognise the renumbering and reordering of the subsections in section DB 31. If a taxpayer took an excess bad debt deduction under a financial arrangement before 20 May 2013, and if that financial arrangement is still in existence in the 2014–15 income year, the taxpayer is treated as receiving an amount of income equal to the amount of the excess bad debt deduction taken.

The claw-back rule in section CZ 27 only applies if a BPA has not already been calculated in the 2014–15 or earlier income year. This is because the BPA will have captured excess deductions, and result in an income amount for the taxpayer.

There is a "savings" provision for taxpayers who, on 20 May 2013, were already involved in the disputes process in relation to the prior bad debt deduction. For these taxpayers, section CZ 27 will not apply.

Application dates

The changes apply from 20 May 2013, the date the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill 2014 was introduced.

The claw-back rule applies to taxpayers who have taken excess bad debt deductions for financial arrangements in income years prior to the 2014–15 income year and are not performing base price adjustments on those financial arrangements in the 2014–15 income year. It requires them to return those amounts as income in the 2014–15 income year. The effect of this rule is that it is retrospective for financial arrangements that are in existence in the 2014–15 income year, subject to a "savings" provision for taxpayers who are involved in assessments that are subject to the tax disputes process.

TRANSFER OF FINANCIAL ARRANGEMENTS ON AMALGAMATION

Section FO 13(2) of the Income Tax Act 2007

An amendment has been made, to ensure that when two companies amalgamate, the income or expenditure arising in the year of amalgamation under a financial arrangement held by the amalgamating company (the company that ceases to exist) is allocated on a fair and reasonable basis with the amalgamated company (the company that will continue to exist).

Background

When two companies amalgamate, and as a result, a financial arrangement is transferred by the amalgamating company to the amalgamated company, in most cases the amalgamating company must perform a base price adjustment (BPA). The policy intention is that this BPA should result in a fair and reasonable allocation of income and expenditure, as follows:

- the amalgamating company should be allowed a deduction for expenses incurred (or be assessable on any income derived) up until the date of the amalgamation; and
- any amounts incurred or derived after this point should be incurred/derived by the amalgamated company.

Before the amendment, the wording of section FO 13(2) of the Income Tax Act 2007 (and corresponding earlier provisions since a legislative change made in 1999) required a fair and reasonable allocation of income or expenditure to be included in the variable "consideration" in the BPA formula. That produced a result that was inconsistent with the policy intention.

Key features

The amendment to section FO 13(2) restores the law to ensure that the result of the BPA calculation gives a fair and reasonable allocation of income and expenditure between the amalgamating and amalgamated companies.

Application date

The amendment applies to amalgamations occurring in the 2008–09 and later income years. A "savings" provision applies for tax positions taken in these income years based on the wording of the legislation before the current amendment.

Detailed analysis

When two companies amalgamate, and as a result, a financial arrangement is transferred by the amalgamating company to the amalgamated company, in most cases the amalgamating company must perform a base price adjustment (BPA).

In calculating the BPA, the amalgamation rules intend to ensure that the amalgamating company is allowed a deduction for expenses incurred (or returns any income derived) up until the date of the amalgamation. Any amounts incurred or derived after this point should be incurred/derived by the amalgamated company. This ensures that the rules give the correct amount of expenditure or income over the remaining life of the financial arrangement.

Before the current amendment, section FO 13(2) of the Income Tax Act 2007 did not achieve this result because section FO 13(2) provided the incorrect amount of "consideration" to be included in the BPA formula. Also, section FO 13(2) and the pre-1999 corresponding provisions had different effects:

- The pre-1999 legislation deemed the result of the BPA to be a fair and reasonable allocation of income and expenditure between the amalgamating and amalgamated companies.
- The post-1999 provision deemed the consideration component in the BPA formula to be a fair and reasonable allocation of income and expenditure between the amalgamating and amalgamated companies.

As shown in the example below, the latter approach gave the incorrect result and could result in too much income being derived and sometimes result in excessive deductions.

The amendment to section FO 13(2) provides the correct policy outcome.

Example

An amalgamating company borrows $100 and pays interest in year 1 of $3, in year 2 of $3 and in year 3 an amalgamation takes place and the amalgamating company only pays $1.50 interest. The amalgamated company pays the remaining $1.50 for year 3.

Under the pre-1999 legislation, the BPA would have resulted in a deduction to the amalgamating company of $1.50.

However under section FO 13 of the Income Tax Act 2007 before to the amendment, the amount of consideration in the BPA calculation would have been $1.50. Consequently, for the amalgamating company, the BPA would have given the following result:

BPA = consideration – income + expenditure + amount remitted

= –$1.50 – $0 + $6 + $0

= $4.50

Under the BPA calculation the amalgamating company would have had $4.50 income in the year of amalgamation, whereas it should have received a $1.50 deduction.

As a result of the amendment, section FO 13 will result in the BPA having the following outcome for the amalgamating company:

BPA = ($100 –$107.50) – $0 + $6 + $0 = $1.50

Therefore, the amalgamating company will be entitled to a $1.50 deduction in the year of amalgamation. The amalgamated company will also be entitled to a $1.50 deduction in the year of amalgamation.

TRANSITIONAL RESIDENT DEFINITION

Section HR 8 of the Income Tax Act 2007

Amendments to section HR 8 clarify that a person who has elected to not be a transitional resident will cease being treated by the Act as a transitional resident. This was clear in the Income Tax Act 2004 and the proposed amendments will make this clear for the Income Tax Act 2007.

Other wording changes to section HR 8(2) to (4) have been made to improve clarity in the section as a whole.

A related amendment has been made in section MC 5 to ensure consistency with these amendments in section HR 8.

Application date

The amendments will apply from the beginning of the 2008–09 income year.

CAPITAL PROFITS OR LOSSES AND HERD SCHEME LIVESTOCK SALES AND PURCHASES

Section CD 44(7)(d) and (9)

An amendment has been made to section CD 44 to deem gains and losses resulting from the transfer of herd scheme livestock to associated persons when section EC 4B applies.

Background

Section EC 4B applies to certain sales of herd scheme livestock to associated persons. When it applies, both the disposer and the acquirer will likely derive a gain or a loss when comparing transfer values with actual herd scheme values.

Key features

In keeping with the conceptual nature of the herd scheme, this gain or loss is in the nature of a capital gain or capital loss and the amendment treats it as such.

Application date

The amendment applies beginning on 28 March 2012, which was the date the underlying amendments applied from.

IMPLEMENTING THE CURRENT TAX PROVISIONS FOR COMMUNITY HOUSING ENTITIES

Section CW 42B and schedule 34 of the Income Tax Act 2007; section 225D of the Tax Administration Act 1994

Section CW 42B has been amended to provide criteria (which are listed in new schedule 34), relating to beneficiaries or clients of a community housing entity, that determine whether the entity is a community housing entity (CHE) for the purposes of section CW 42B.

Section 225D has been amended to allow the criteria listed in schedule 34 to be amended by Order in Council.

Other amendments have been made to ensure that section CW 42B operates as intended.

Background

A specific income tax exemption for certain community housing providers (referred to as CHEs) was enacted in June 2014. The purpose of the income tax exemption was to preserve the tax-exempt status of certain community housing providers who were at risk of being deregistered as a charity and therefore would lose their income tax exemption status.

This CHE tax exemption has not been in force as regulations were required to finalise criteria to be used to determine who could qualify as an eligible recipient of a CHE for the purposes of the income tax exemption.

In the course of finalising the criteria, it was decided to include the criteria in section CW 42B and to make any future adjustments to the criteria by way of an Order in Council.

Key features

Section CW 42B provides that an entity will not qualify as a community housing entity if more than 15 percent of its beneficiaries do not meet criteria set out in new schedule 34.

The criteria are as follows:

- Income caps: A single applicant must have income of $80,000 or less. A group of applicants must have a combined income of $120,000 or less.
- Previous estate in land: An applicant that has previously owned an estate in land is subject to the asset caps listed in the schedule. An applicant that has no previous land ownership is not subject to asset caps.
- Asset caps: The applicant must have assets equal to or less than either: $110,000, $90,000 or $70,000. These asset caps depend on the area in which the client is purchasing a house.

Some minor amendments have also been made:

- Section CW 42B(3)(a) has been amended to refer to the criteria listed in new schedule 34 and to specify that the 15 percent threshold contained in the section only applies to individuals who become a beneficiary or client after 14 April 2014. This provision has also been reworded to enhance clarity.
- References to "provision of housing" in section CW 42B have been replaced with "provision of housing or housing assistance".
- Section CW 42B has been amended so that an entity will qualify as a community housing entity if its activities involve the provision of housing or housing assistance. Previously, the entity's activities had to be predominantly the provision of housing in order to qualify.
- Section 225D of the Tax Administration Act has been amended to allow the criteria in schedule 34 to be amended by Order in Council.

Detailed analysis

Section CW 42B(3)(a)

The existing beneficiaries or clients of a CHE as at 14 April 2014 are not counted in order to determine whether 15 percent of the CHE's beneficiaries or clients exceed the criteria in schedule 34. Only beneficiaries or clients joining after 14 April 2014 should be assessed against the criteria, at the time they become a beneficiary or client of the CHE. This means that technically, after 14 April 2014, a CHE's first six beneficiaries or clients must meet the criteria, otherwise it will exceed the 15 percent threshold.

It was a deliberate decision to only count new beneficiaries or clients after 14 April 2014, and not existing beneficiaries or clients. This is because:

- Before 14 April 2014, certain charitable requirements would have applied so these CHEs would not have assisted beneficiaries or clients above a certain threshold. This means a CHE would not have met the "relief of poverty" or "other purposes beneficial to the community" heads of charitable purpose if they had assisted people that did not face some degree of hardship.
- As some people might be beneficiaries or clients of a CHE for up to 10 years because of the types of homeownership products offered (such as shared equity schemes), it would have been a compliance burden if CHEs had to go back 10 years to assess whether their beneficiaries or clients met the thresholds.
- Furthermore, it would have been unfair to assess those beneficiaries or clients, at the time they joined, against thresholds that are relevant today. The current thresholds would have had to be adjusted for inflation, which would have further increased compliance costs.

Provision of housing

Section CW 42B has been amended to replace "provision of housing" with "provision of housing or housing assistance" as it was considered that assisted home ownership does not fall within the definition of "provision of housing".

This reference has also been amended in section CW 42B(3)(b) to clarify that an entity would not qualify as a CHE if it provided housing assistance to qualifying recipients (those who meet the criteria) that was substantially different to assistance it provided to non-qualifying recipients (those who do not meet the criteria). Previously, section

CW 42B(3)(b) only referred to the provision of housing. This only prevented a CHE from providing a substantially more expensive house to non-qualifying recipients than to qualifying recipients (if the CHE wanted to qualify for the tax exemption) but placed no limits on the amount of assistance a CHE could give to a non-qualifying recipient.

Activities involve the provision of housing or housing assistance

Under the previous rules, there was a concern that some community housing entities could have faced deregistration because of the extent of their housing programmes but would have been unable to meet the "predominantly" test for the CHE tax exemption as they provided other charitable services that would not have involved housing.

To ensure these entities remain tax-exempt, section CW 42B has been amended to provide that an entity's activities only had to involve the provision of housing or housing assistance in order to qualify for the CHE income tax exemption.

Order in Council

The ability to amend the criteria in schedule 34 by Order in Council is necessary to ensure that the thresholds can be amended quickly.

New schedule 34

Schedule 34 contains the applicable criteria for assessing the eligibility of a beneficiary or client of a CHE.

The term "applicant" is defined as a person, or one of a group of persons, who successfully applies for housing or housing assistance from a CHE. This means that if a group is purchasing a house together and is applying for assistance, each person in that group is counted as one applicant. This is for two reasons. First, the assets thresholds can apply to just one applicant in a group – that is, if one of the group had previously owned a home, the asset criteria will apply to that person, but not to the rest of the people in the group. Secondly, in terms of the 15 percent threshold in section CW 42B(3)(a), each applicant in a group is counted individually. This is deliberate as it is possible that one person in a group meets the thresholds but another does not (for example, a person who has previously owned a home may fail the asset test).

Application date

The amendments apply on and from 14 April 2014, the date on which the community housing entity income tax exemption came into force.

COMMUNITY HOUSING ENTITIES AND THEIR SUBSIDIARIES

Section CW 42B of the Income Tax Act 2007

Amendments have been made to section CW 42B to provide that:

- a community housing entity owned by another community housing entity is eligible for the community housing tax exemption; and
- community housing companies and trusts are eligible for the community housing tax exemption.

Background

Previously, section CW 42B(2)(c) provided that the income of a business carried on for the benefit of a community housing entity would not be exempt from income tax if a person with control over the business was able to direct an amount from the business to their own benefit. Under section CW 42B(4) a person was deemed to be able to do this by virtue of their position as a settlor or trustee of a trust, or shareholder or director of a company by which the business was carried on.

This gave rise to unintended outcomes. For example:

- If a community housing entity (CHE 1) owned another community housing entity (CHE 2), CHE 2 was excluded from the community housing tax exemption in section CW 42. This was because CHE 1 was regarded as having control over CHE 2 and as being able to divert amounts to its own benefit – that is, CHE 1 was able to influence dividends paid to it by CHE 2.
- Companies and trusts were automatically in breach of section CW 42(1)(c) because of the deeming provision in section CW 42(5).

Key features

Section CW 42B(2)(c) has been amended to provide that a community housing entity is able to divert amounts from another community housing entity that it controls without contravening the section. The effect is that a community housing entity owned by another community housing entity or charity can divert amounts to that community housing entity or charity and still qualify for the exemption. Further, the amendment also clarifies that a community housing entity itself is able to divert amounts to its own benefit (that is, towards purposes as outlined in its constitution or trust deed) without breaching the section.

The words "to their own benefit or advantage" have been removed from section CW 42B(4) so that community housing companies and trusts no longer automatically breach section CW 42B(2)(c).

Application date

The amendments apply on and from 14 April 2014, the date on which the community housing entity exemption came into force.

CHARITABLE BUSINESSES

Section CW 42 of the Income Tax Act 2007

Amendments have been made to section CW 42 to clarify that:

- Businesses carried on by a subsidiary of a charity are eligible for the business income tax exemption for charities.
- Charitable companies and trusts are eligible for the charities business income tax exemption.

Background

Previously, section CW 42(1)(c) provided that the income of a business carried on for the benefit of a charity would not be exempt from income tax if a person with control over the business was able to direct an amount from the business to their own benefit. Under section CW 42(5) a person was deemed to have control by virtue of their position as a settlor or trustee of a trust, or shareholder or director of a company by which the business was carried on.

This gave rise to unintended outcomes:

- Subsidiaries of charities were excluded from the business income tax exemption in section CW 42. This is because a charitable entity owning shares in a company operating a charitable business was regarded as having control over that charitable business and as being able to divert amounts to its own benefit, due to its ability to influence dividends paid to it by the charitable business.
- Companies and trusts were automatically in breach of section CW 42(1)(c) because of section CW 42(5).

Key features

- Section CW 42(1)(c) has been amended to provide that a charity is able to divert amounts from its subsidiary business to its own benefit without contravening the section. The amendment also clarifies that the entity itself is able to divert amounts to its own benefit without breaching the section.
- The words "to their own benefit or advantage" have been removed from section CW 42(5) so that companies and trusts no longer automatically breach section CW 42(1)(c). The effect of this amendment is that a trustee, settlor, shareholder or director is deemed to be able to divert amounts from the business by virtue of their position, but not to their own advantage. As a result, section CW 42(1)(c) is not automatically breached.

Application date

The amendments came into force on the date of Royal assent, being 24 February 2016.

TRANSITIONAL RULES RELATING TO THE TREATMENT OF DWELLINGS

Section 21HB(4) of the Goods and Services Tax Act 1985

The Taxation (GST and Remedial Matters) Act 2010 amended the definitions of "dwelling" and "commercial dwelling". Section 21HB was subsequently inserted as a transitional rule to allow a person affected by the change in the definition of "dwelling" to have the option of not including a commercial dwelling as part of their broader taxable activity.

A remedial amendment to section 21HB(4) has been made to ensure that the transitional rule applies in situations when a property that was previously treated as a dwelling no longer fits into either the definition of either "dwelling" or "commercial dwelling" as a result of the changes. This ensures the rule captures situations when a property such as a holiday home is no longer treated as a dwelling due to the change in the definitions.

Application date

This amendment came into force on 1 April 2011, being the date that section 21HB(4) took effect.

FINANCIAL ARRANGEMENTS – IFRS FINANCIAL REPORTING METHOD AND MODIFIED FAIR VALUE METHOD

Sections EW 15D, EW 15G and EZ 69B of the Income Tax Act 2007

The tax rules for spreading income and expenditure for financial arrangements have been amended to correct a drafting omission in the rules for taxpayers who use International Financial Reporting Standards (IFRS) introduced in 2007. A change has been made to the IFRS financial reporting spreading method in section EW 15D to ensure all amounts included in equity and reserves for financial arrangements are spread appropriately for tax. Amendments have also been made to section EW 15G (the modified fair value method), as the two sections are linked.

Background

Most types of debt are taxed under the financial arrangement rules. These rules require taxpayers to spread the income or expenditure that is expected to arise over the term of the debt. The rules also impose a wash-up (the base price adjustment) when a debt expires, to ensure any income or expenditure that has not been spread is accounted for.

Officials became aware of an issue with how one of the spreading methods (the IFRS financial reporting method) operates because of a particular transaction between two companies. Under the specific wording of that spreading method, one of the companies has been able to exclude a portion of their income from the ambit of the spreading method (technically, because the company has been able to treat the income as a contribution to capital rather than "equity reserves"). Under the previous legislation, the wording of section EW 15D(2)(b) only required amounts allocated to "equity reserves" to be included in the spreading method. This meant the amount allocated to equity may never have been allocated through the company's profit or loss account. It meant the company would not have been required to pay tax on the income allocated to capital until the debt expired, which would have provided them a significant timing advantage. This was inappropriate.

An example of that type of transaction would be if, say, Company B takes over $49 million of Company A's debt. Company B has a lower credit rating than Company A, so the interest rate on the debt is increased from around 5.6% pa to 6.7% pa. In exchange for taking over the debt, Company A paid Company B the $49 million face value of the loans, plus a $6 million premium. This premium is to compensate Company B for the higher interest payments that it would have to make.

In economic substance, Company B continues to have only 5.6% pa interest to pay on the debt; the premium received from Company A compensates Company B for the fact it actually has to pay interest at 6.7% pa for the term of the debt. Company B should therefore only be able to claim a deduction each year for its in-substance interest payment of 5.6% pa.

However, under the IFRS financial reporting spreading method, Company B can claim a deduction each year for the full interest payment of 6.7% pa. This is because Company B is technically not required to spread the $6 million premium received from Company A under the IFRS financial reporting spreading method, as it has been able treat the premium as a contribution to capital. Company B will not be required to pay tax on the premium until the debt expires and it performs a base price adjustment.

To address this matter, the IFRS financial reporting spreading method has been amended to ensure that all allocations to equity, equity reserves, or other comprehensive income arising from a financial arrangement are spread appropriately over the arrangement's term.

Application date

The amendment applies for the 2015–16 and later income years.

Key features

Section EZ 69B provides that any taxpayer who has a financial arrangement still current in the 2015–16 income year, is using the IFRS financial reporting method for that financial arrangement, and has allocated an amount for the financial arrangement to equity or other comprehensive income (such as Company B in the example above), is required to perform a catch-up of their income and expenditure in the 2015–16 income year.

This catch-up requires the taxpayer to account for tax for the portion of the amount they have treated as a capital contribution that relates to previous periods. If this catch-up were not required, the amount would not have to be recognised by the taxpayer until the debt expires, which may be some time away.

Detailed analysis

The substantive change to ensure all amounts are spread under the method is contained in section EW 15D(2)(b). The words "arising from the use of the fair value method may be allocated to equity reserves" are replaced with the words "may be allocated to equity, equity reserves, or other comprehensive income". "Other comprehensive income" has been included for completeness and to avoid any doubt about amounts allocated through "other comprehensive income". Amounts allocated through "other comprehensive income" during an accounting period usually go to equity reserves in that period. However, the words have been included to ensure that all amounts not allocated through the profit or loss account in the period are included in the amounts to be spread under this amendment.

The policy objective is to ensure that any amounts not allocated to the profit or loss account under IFRS are included in the on-going tax spreading for the financial arrangement under the IFRS financial reporting method. This means amounts that have been allocated to equity, equity reserves or other comprehensive income are required to be spread under the method from the point they are recognised/allocated outside the profit or loss account. This is the same spreading approach that section EW 15D(2)(b) applied to amounts allocated to equity reserves prior to this amendment.

IFRS accounting includes two different approaches for recognising income and expenditure for financial instruments; fair value through profit or loss and amortised cost/effective interest. Section EW 15D does not distinguish between these two accounting approaches. In other words, both are included in the section EW 15D IFRS financial reporting spreading method as appropriate.

The change to section EW15D(2)(b) means that any amounts allocated to equity, equity reserves or other comprehensive income are now spread under the IFRS financial reporting method. It no longer applies solely to amounts allocated under the accounting "fair value method" as defined in section YA 1. Amounts allocated to equity, equity reserves or other comprehensive income under the amortised cost/effective interest accounting approach will need to be included in the on-going tax spreading under the IFRS financial reporting method as a result of this change.

It is possible that amounts recognised in equity, equity reserves or other comprehensive income may relate to either of the two accounting approaches. Under the fair value accounting approach, the amount would have been otherwise recognised in the profit or loss account in the period it was allocated to equity, equity reserves or other comprehensive income. Under the IFRS financial reporting method, the amount allocated would be taxable in that period when the accounting approach for the financial arrangement is fair value through the profit or loss account. In the example above, the $6 million premium received by Company B is taxable in the income year it is received and allocated to equity. On-going changes to the initial amount allocated will be taxable in the periods they occur under that spreading method.

When the accounting approach is amortised cost/effective interest the amount allocated to equity, equity reserves or other comprehensive income would otherwise be spread for accounting over the life/remaining life of the financial instrument. The accounting approach requires all integral fees and points, and all transaction costs, premiums and discounts to be included in the effective interest spreading included in the profit or loss account. When the accounting approach for the financial arrangement is amortised cost/effective interest, the tax spreading of any amounts allocated to equity, equity reserves or other comprehensive income should be based on spreading the amounts on the same basis that would have been applied under the amortised cost/effective interest accounting approach. That is, it will form part of the amount that would have been included in effective interest in the profit or loss account in each period over the term/remaining term of the financial arrangement. In the example above, the $6 million premium received would be spread for tax over the term of the debt by Company B to give the equivalent result of an effective interest rate of 5.6% on the debt – that is, reducing the interest on the debt from 6.7% to the economic cost of 5.6% by spreading the premium.

Changes have also been made to subsections EW 15D(2)(ac) and (ad) which reflect the same policy objective as the substantive change to subsection EW 15D(2)(b) discussed above. The changes to these two subsections mean they now apply to any amounts allocated to equity, equity reserves other comprehensive income, or profit or loss.

There are also changes to section EW 15G (Modified fair value method). Subsection EW 15G(2)(a) now applies to amounts allocated to equity, equity reserves or other comprehensive income, and simply reflects the substantive change to section EW 15D(2)(b) above. It means that amounts allocated to equity, equity reserves or other comprehensive income do not have to be spread under the modified fair value method when the accounting approach is the fair value method. Previously, it only applied to amounts allocated to equity reserves. Similar changes have been made to subsections EW 15G(2)(b), (b)(v), and (3)(a) so that amounts allocated to equity, equity reserves, or other comprehensive income are treated correctly under the policy objective.

Section EZ 69B has been introduced to effect the catch-up required by taxpayers who may have financial arrangements on hand in the 2015–16 income year that are subject to the changes made to section EW 15D(2)(b). It applies to any amounts for financial arrangements remaining allocated to equity, equity reserves[3] or other comprehensive income in the 2014–15 income year, and which section EW 15D(2)(b) now requires to be included in the tax spreading method in the 2015–16 income year. Amounts remaining allocated to equity, equity reserves or other comprehensive income may have been allocated to those locations in any income year up to and including the 2014–15 income year. Those amounts will not have been included in the tax spreading method for the relevant financial arrangements before the 2015–16 income year and will not have been included in a base price adjustment in any year, including the 2015–16 income year.

The catch-up required by section EZ 69B is achieved in the 2015–16 income year by the change of spreading method adjustment provisions in section EW 26(2), (3), and (4), and section EW 27. Using the example above, if Company B is using the fair value accounting method for the financial arrangement for tax under section EW 15D, and had allocated the $6 million premium to equity in any year prior to the 2015–16 year, it will include the $6 million as income in the 2015–16 income year as part of the change of spreading method adjustment, along with

[3] As currently drafted the words "equity reserves" have been omitted from section EZ 69B(1)(a) and (b). This is an error and it is intended that it is corrected in the next available tax bill.

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any other amounts for the financial arrangement in the profit or loss account that year. If Company B was using the amortised cost/effective interest accounting approach for the financial arrangement for tax under section EW 15D, and assuming the $6 million premium was allocated to equity in the 2013–14 income year, the change of spreading method adjustment would include two years (2013–14 and 2014–15) effective interest income and the effective interest income for the 2015–16 income year. The aggregate interest expenditure for tax on the debt for the three years to 2015–16 equals the economic cost of 5.6% pa. The aggregate expenditure for the three years in the example would be approximately $8.23 million ($49 million at 5.6% pa for three years) under the new rules. Effective interest expenditure of approximately $6.57 million ($49 million at 6.7% pa for two years) will have been claimed in the first two years under the old rules, so the change of spreading method adjustment in 2015–16 to achieve the aggregate of $8.23 million will be expenditure of approximately $1.66 million.

MINOR TECHNICAL AMENDMENTS

Sections CD 39, CQ 2, CX 56C, CZ 10, CZ29(3), DB 35, EC 41, EE 32, EW 9, EX 25, EZ 5, FE 28, FO 12, GB 8, GB 9, GB 11, GB 13, LP 6, LU 1, MC 5, OB 1, OP 27, OP 50, Table 019, RC 7, RD 27 and YA 1: "Employee", Employer", "Mineral miner", "Non-filing taxpayer", "Tax position", "Tax situation" of the Income Tax Act 2007

The amendments in the following Table reflect minor technical maintenance items arising from both the rewrite of Income Tax legislation and subsequent changes.

Until its disestablishment on 2 December 2014, the Rewrite Advisory Panel monitored the working of the Income Tax Act 2007 and reviewed submissions on what may have been unintended changes in the law as a result of its having been rewritten. The Panel recommended legislative action, when necessary, to correct any problems. Since the Panel's disestablishment, this process is being managed by Inland Revenue within its normal remedial tax policy work programme.

The following amendments relate to minor maintenance items to correct any of the following:

- ambiguities;
- compilation errors;
- cross-references;
- drafting consistency, including readers' aids – for example, the defined terms lists;
- grammar;
- punctuation;
- spelling;
- consequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions.

Section	Act	Amendment	Commencement date
CD 39	2007 Act	Repeal redundant provisions	Assent
CQ 2	2007 Act	Repeal redundant provisions	Assent
CX 56C	2007 Act	Terminology corrected	1 April 2010
CZ 10	2007 Act	Repeal redundant provision	Assent
CZ 29(3)	2007 Act	Insert subsection heading	4 September 2010
DB 35	2007 Act	Terminology corrected	1 April 2015
EC 41	2007 Act	Terminology corrected	
EE 32	2007 Act	Terminology corrected	
EW 9	2007 Act	Cross-references corrected	
EX 25	2007 Act	Repeal redundant provisions	Assent
EZ 5	2007 Act	Terminology corrected	
FE 28	2007 Act	Grammar corrected	
FO 12	2007 Act	Ambiguity and cross-reference corrected	
GB 8, GB 9, GB 11, GB 13	2007 Act	Repeal redundant provisions	Assent
LP 6	2007 Act	Repeal redundant heading	Assent
LU 1	2007 Act	Terminology corrected	1 April 2014
MC 5	2007 Act	Terminology corrected	

OB 1	2007 Act	Drafting consistency	
OP 27, OP 50, Table O19	2007 Act	Terminology corrected	
RC 7	2007 Act	Terminology corrected	
RD 27	2007 Act	Terminology corrected	
YA 1 "employee", "employer	2007 Act	Cross-reference corrected	5 Jan 2010
YA 1 "mineral miner"	2007 Act	Insert index entry for definition	1 April 2014
YA 1 "non-filing taxpayer"	2007 Act	Cross-reference corrected	
YA 1 "tax position", "tax situation"	2007 Act	Cross-reference and terminology corrected	Assent

Application dates

Unless otherwise stated, all the amendments to the Income Tax Act 2007 apply with effect from the beginning of the 2008–09 income year.

ORDER IN COUNCIL

FBT RATE FOR LOW-INTEREST LOANS DECREASES

The prescribed rate of interest used to calculate fringe benefit tax on low-interest, employment-related loans is 5.77%, down from the previous rate of 5.99% which applied from the quarter beginning 1 October 2015.

The new rate applies for the quarter beginning 1 January 2016.

The rate is reviewed regularly to align it with the results of the Reserve Bank's survey of variable first mortgage housing rates.

The new rate was set by Order in Council on 22 February 2016.

Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2016 (LI 2016/31)

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IG 16/01: DETERMINING EMPLOYMENT STATUS FOR TAX PURPOSES (EMPLOYEE OR INDEPENDENT CONTRACTOR?)

Relevant legislative provisions are reproduced in the Appendix to this Interpretation Guideline.

Summary

1. This Interpretation Guideline will help taxpayers determine their employment status for tax purposes.
2. This Interpretation Guideline updates and replaces Interpretation Guideline IG 11/01, "Income tax; Goods and Services Tax - Determining employment status for tax purposes (employee or independent contractor?)", *Tax Information Bulletin* Vol 24, No 5 (June 2012): 3. IG 11/01 outlined the tests for determining whether a person is an employee or independent contractor. This Interpretation Guideline corrects an error regarding the control test in [5] of IG 11/01 (the test is stated correctly in the body of the item). This Interpretation Guideline also updates legislative references and case law and has been revised in places for clarity. The Commissioner's approach to determining employment status for tax purposes remains unchanged.
3. A taxpayer's tax obligations for amounts earned from work done depends on their employment status (ie, whether the taxpayer is an employee or an independent contractor).
4. The Income Tax Act 2007 (ITA) defines "employee" to include a person who receives or is entitled to receive a "PAYE income payment". A "PAYE income payment" is defined to include a payment of "salary or wages" or "extra pay". Both of these terms are defined as being "… made to a person in connection with their employment". Case law has determined that the use of the word "employment" in these definitions relates to "a contract of service". Under the Goods and Services Tax Act 1985 (GSTA), supplies of goods and services under a "contract of service" are not taxable. These provisions do not explain how to determine whether there is a contract of service in any particular case. Therefore, we must rely on the common law to determine whether there is a contract of service.
5. The common law distinguishes between contracts **of** service and contracts **for** services. A contract of service means there is an employer–employee relationship; a contract for services means there is a principal–independent contractor relationship. At common law, the courts have developed various tests to determine whether there is a contract of service or a contract for services. The case law shows that the main tests are the intention, control, independence, fundamental and integration tests. These tests can be summarised as follows:
   - Intention of the parties test – looks at the intentions of each party to the agreement as to the nature of the relationship.
   - Control test – examines the degree of control the employer or principal exerts over the manner in which the work is done. A high level of control supports the conclusion that the person engaged to perform the services is an employee.
   - Independence test – examines the level of independence the person engaged to perform the services exerts over their work. A high level of independence supports the conclusion that the person engaged to perform the services is an independent contractor.
   - Fundamental test – considers whether the person engaged to perform the services is doing so as a person in business on their own account. If the answer is "yes", this supports the conclusion that the person is an independent contractor; if the answer is "no", this supports the conclusion that the person is an employee.
   - Integration test – looks at whether the person engaged to perform the services is integrated into the business. If the person is integrated into the business, this supports the conclusion that they are an employee. By contrast, if the person is not integrated into the business, but rather is an

accessory to it, this supports the conclusion that they are an independent contractor.

6. The leading case on employment status is the Supreme Court decision in *Bryson v Three Foot Six Ltd* [2005] NZSC 34, [2005] 3 NZLR 721. In *Bryson*, the Supreme Court considered whether a person was an "employee" under the Employment Relations Act 2000. *Bryson* is consistent with the Court of Appeal's decision in *TNT Worldwide Express Ltd v Cunningham* [1993] 3 NZLR 681 (CA).

Analysis

7. The analysis in this Interpretation Guideline is divided into the following sections:
   - **Types of employment relationship:** discusses the difference between "contracts of service" (which employees have) and "contracts for services" (which independent contractors have).
   - **Employment status and tax law:** outlines the significance to taxpayers of their employment status. It also explains how the common law on determining employment status can be relevant when determining a taxpayer's employment status under the GSTA and the ITA.
   - **Relevance of Employment Relations Act 2000 case law:** considers s 6 of the Employment Relations Act 2000. Section 6 defines "employee" for that Act. This part concludes that, when determining employment status for tax purposes, s 6 decisions are relevant to the extent that those decisions concern the common law on the employee/independent contractor distinction.
   - **Determining employment status – leading New Zealand authorities:** discusses the leading New Zealand authorities on determining employment status – *Bryson* and *TNT*.
   - **Common law tests of employment status:** summarises the main tests for deciding employment status – the intention of the parties, control, independence, fundamental and integration tests.
   - **Relevant decisions:** summarises three cases that illustrate how the courts have applied the common law tests, and lists other decisions since *Bryson* on how to determine employment status.

Types of employment relationship

8. The law distinguishes between two types of employment relationship: the employer–employee relationship and the principal–independent contractor relationship. Each relationship has different legal rights and obligations. The type of employment relationship in any particular case depends on whether there is a "contract **of** service" or a "contract **for** services" between the persons concerned. In *New Zealand Educational Institute v Director-General of Education* [1981] 1 NZLR 538 (CA), the Court of Appeal stated at 539:

> On many occasions over the years the Courts have had to decide whether the relationship between two persons was that of employer and employee or, as it used to be called, master and servant. The inquiry normally involved the distinction between a contract of service in which the relation was that of employer and employee and a contract for services in which the relation was that between employer and independent contractor. A decision in any particular case required an examination of the contract between the two - it might be expressed in words or it might be implicit from the circumstances.

9. Employees have a "contract **of** service" with their employer. Contracts of service evolved from the earlier concept of a master–servant relationship. This type of relationship required an employee to be continuously available for service and to accept a high degree of control by the employer. A "contract **for** services" applies to the relationship between an independent contractor and a principal. It emphasises the nature of the services to be provided by a person rather than their availability to work as directed.

10. At common law, the courts have developed several tests to determine whether there is a contract of service or a contract for services. The case law shows that the main tests are the intention, control, independence, fundamental and integration tests. These tests are discussed below at [51] – [80].

Employment status and tax law

Consequences of employment status for tax purposes

11. A taxpayer's tax obligations for amounts earned from work done depends on their employment status (ie, whether the taxpayer is an employee or an independent contractor). Employment status has the following consequences for tax purposes:
   - Payments to employees from their employer must have PAYE deducted at source.
   - Employees cannot register for GST or charge GST for services they supply as employees.
   - Independent contractors may deduct certain expenses incurred in deriving assessable income.
   - Independent contractors must account to Inland Revenue for tax and accident compensation earner and employee premiums for themselves and any employees.

- Independent contractors must meet all the requirements of the GSTA if the services they supply are in the course of a taxable activity and they are registered (or liable to register) for GST.

12. Taxpayers cannot change their employment status (or the resulting tax implications of that status) merely by calling themselves independent contractors when they are essentially still employees.

Relevance of common law tests under tax law

13. Neither the ITA nor the GSTA explains how to determine whether there is a contract of service or a contract for services in any particular case. We must therefore rely on the common law tests for determining employment status.

Income Tax Act 2007

14. The ITA defines "employee" in s YA 1 as follows:

> **employee**—
>
> (a) means a person who receives or is entitled to receive a PAYE income payment:
>
> (ab) for the purposes of the FBT rules, includes a shareholder-employee who has chosen under section RD 3(3) to treat amounts paid to them in the income year in their capacity as employee as income other than from a PAYE income payment:
>
> (ac) despite paragraph (a), in sections CE 1, CE 1B, and CW 16B to CW 16F (which relate to accommodation provided in connection with employment), includes an employee provided with accommodation or an accommodation payment as described in section CE 1(3)(a) (Amounts derived in connection with employment):
>
> (b) in sections CW 17, and CW 17B to CW 18B (which relate to expenditure, reimbursement, and allowances of employees) includes a person to whom section RD 3(2) to (4) (PAYE income payments) applies:
>
> (c) in the FBT rules, and in the definition of **shareholder-employee** (paragraph (b)), does not include a person if the only PAYE income payment received or receivable is—
>
> (i) a payment referred to in section RD 5(1)(b)(iii), (3), (3B), (6)(b) and (c) and (7) (Salary or wages):
>
> (ii) a schedular payment referred to in schedule 4, parts A and I (Rates of tax for schedular payments) for which the person is liable for income tax under section BB 1 (Imposition of income tax):
>
> (d) is defined in section DC 15 (Some definitions) for the purposes of sections DC 12 to DC 14 (which relate to share purchase schemes):
>
> (db) does not include an owner of a look-through company or a person who has a look-through interest for a look-through company, unless the owner or person is a working owner:
>
> (e) for an employer, means an employee of the employer

15. Paragraph (a) defines "employee" as a person who receives or is entitled to receive a "PAYE income payment". The latter term is defined in s RD 3(1) as follows:

> (1) The PAYE rules apply to a **PAYE income payment** which—
>
> (a) means—
>
> (i) a payment of salary or wages, see section RD 5; or
>
> (ii) extra pay, see section RD 7; or
>
> (iii) a schedular payment, see section RD 8:

16. Other relevant definitions include:

- "salary or wages" (s RD 5(1)(a)):

> (1) **Salary or wages—**
>
> (a) means a payment of salary, wages, or allowances made to a person in connection with their employment; … .

- "an extra pay" (s RD 7(1)(a)(i)):

> (1) **An extra pay—**
>
> (a) means a payment that—
>
> (i) is made to a person in connection with their employment; … .

- "employment" (s YA 1):

> **employment** has a meaning corresponding to the meaning of **employee**, and—
>
> (a) includes the activities performed by the Governor-General, a member of Parliament, or a judicial officer that give rise to an entitlement to receive a PAYE income payment for the activities: …

17. The use of the word "employment" suggests that the above provisions apply where there is a contract of service. This interpretation is supported by *Challenge Realty Ltd v CIR* (1990) 12 NZTC 7,212 (CA). In this decision, the Court of Appeal considered the definition of "salary or wages" in s 2 of the Income Tax Act 1976. This definition provided:

> 'Salary or wages', in relation to any person, means salary, wages, or allowances (whether in cash or otherwise), including all sums received or receivable by way of overtime pay, bonus, gratuity, extra salary, commission, or remuneration of any kind, in respect of or in relation to the employment of that person; … .

18. Delivering the judgment of the court, Bisson J stated at 7,224:

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> In the context of "salary and wages" in sec 2, the word "employment", in our view, relates to a contract of service … . It is that word which governs the definition: the definition being intended to include all forms of remuneration received under a contract of employment … .

19. Consequently, the definition of "salary or wages" did not include amounts received as remuneration under a contract for services.

20. The ITA does not explain how to determine whether a taxpayer is employed under a contract of service. Therefore we must rely on the common law to determine employment status. As a general principle of statutory interpretation, where legislation makes use of terms with established meanings at common law, it is presumed that Parliament intended those terms to be given their common law meanings (subject to any contrary legislative intention): *Bank of England v Vagliano Bros* [1891] AC 107 (HL); *R v Kerr* [1988] 1 NZLR 270 (CA). As mentioned earlier, the common law distinguishes between contracts of service and contracts for services, and the courts have developed tests to establish whether there is a contract of service or a contract for services.

21. However, it is important to highlight that some parts of the relevant definitions in the ITA (see [15] and [16] above) **do not** rely on the common law. The ITA identifies particular classes of persons and payments that are specifically included or excluded from the definitions. For example:

    - Section RD 3(1)(b) provides that "PAYE income payment" does not include:

      > (i) an amount attributed under section GB 29 (Attribution rule: calculation):
      >
      > (ii) an amount paid to a shareholder-employee in the circumstances set out in subsection (2):
      >
      > (iii) an amount paid or benefit provided, by a person (the **claimant**) who receives a personal service rehabilitation payment from which an amount of tax has been withheld at the rate specified in schedule 4, part I (Rates of tax for schedular payments) or under section RD 18 (Schedular payments without notification), to another person for providing a key aspect of social rehabilitation referred to in paragraph (c) of the definition of **personal service rehabilitation** payment in section YA 1 (Definitions).

    - Section YA 1 defines "employment" to include:

      > … the activities performed by the Governor-General, a member of Parliament, or a judicial officer that give rise to an entitlement to receive a PAYE income payment for the activities; ...

    - Similarly, s RD 5(5) provides that "salary or wages" includes salary and allowances made to the Governor-General, members of Parliament and judicial officers.

22. A "PAYE income payment" includes "a schedular payment". A "schedular payment" is defined in s RD 8 to mean a payment of a class set out in sch 4 of the ITA. Schedule 4 lists payments made to a wide variety of workers, including, for example, insurance agents and shearers. A worker who receives "a schedular payment" will typically be an independent contractor at common law. If an independent contractor receives "a schedular payment", then tax must be deducted at source. However, the other consequences of being an independent contractor (set out at [11] above) remain.

Goods and Services Tax Act 1985

23. Under the GSTA, employees are not liable for GST on supplies of goods and services they make to their employers. This is because s 6(3)(b) excludes from the definition of "taxable activity", "any engagement, occupation, or employment under any **contract of service** or as a director of a company, subject to subsection (4)" [emphasis added]. The GSTA does not explain how to determine whether there is a "contract of service". For the reason explained in [20] above, the common law tests must be used to determine whether there is a contract of service or contract for services.

Relevance of Employment Relations Act 2000 case law

24. The common law tests for determining whether there is a contract of service or a contract for services have been developed by the courts over the course of many decisions. In some of these decisions the courts were determining employment status for tax purposes. However, in most decisions the courts were determining employment status under employment legislation. The employment legislation currently in force is the Employment Relations Act 2000 (ER Act). Sections 6(1), (1A), (2) and (3) of the ER Act define "employee" as follows:

    > (1) In this Act, unless the context otherwise requires, **employee**—
    >
    > (a) means any person of any age employed by an employer to do any work for hire or reward under a contract of service; and
    >
    > (b) includes—
    >
    > (i) a homeworker; or
    >
    > (ii) a person intending to work; but
    >
    > (c) excludes a volunteer who—

(i) does not expect to be rewarded for work to be performed as a volunteer; and

(ii) receives no reward for work performed as a volunteer; and

(d) excludes, in relation to a film production, any of the following persons:

(i) a person engaged in film production work as an actor, voice-over actor, stand-in, body double, stunt performer, extra, singer, musician, dancer, or entertainer:

(ii) a person engaged in film production work in any other capacity.

(1A) However, subsection (1)(d) does not apply if the person is a party to, or covered by, a written employment agreement that provides that the person is an employee.

(2) In deciding for the purposes of subsection (1)(a) whether a person is employed by another person under a contract of service, the court or the Authority (as the case may be) must determine the real nature of the relationship between them.

(3) For the purposes of subsection (2), the court or the Authority—

(a) must consider all relevant matters, including any matters that indicate the intention of the persons; and

(b) is not to treat as a determining matter any statement by the persons that describes the nature of their relationship.

25. The definition of "employee" in s 6 is only for the purposes of the ER Act. The definition does not affect the interpretation of "employee" in the ITA or "contract of service" in the GSTA. However, the case law on s 6 can be relevant when determining employment status for tax purposes. In *Bryson*, the Supreme Court held at [32] – ¬[33] that the definition of "employee" in s 6(1)(a) – "any person of any age employed by an employer to do any work for hire or reward under a contract of service" – reflected the common law. It also held that the common law tests for determining employment status were relevant when determining the "real nature of the relationship" between the parties under ss 6(2) and (3). Therefore, when determining employment status for tax purposes, s 6 case law can be relevant to the extent that those decisions concern the common law tests.

Determining employment status – leading New Zealand authorities

26. This part of the guideline discusses the leading New Zealand authorities on determining employment status. These authorities are the Supreme Court decision in *Bryson* and the Court of Appeal decision in *TNT*.

Bryson v Three Foot Six Ltd

Facts and decision

27. In *Bryson*, the Supreme Court considered whether a person was an "employee" under s 6 of the ER Act.

28. In this decision, the appellant, Mr Bryson, was a model maker for Weta Workshop. Weta Workshop had a close working relationship with Three Foot Six Ltd, which was the company that administered the production of The Lord of the Rings. Mr Bryson was seconded from Weta Workshop to Three Foot Six Ltd and soon took a permanent position there. Mr Bryson was not given a written employment contract when he started, but some months later Three Foot Six Ltd supplied a written contract to all staff (the "crew deal memo"). The crew deal memo set out the conditions of employment and, in particular, it referred throughout to "contractor" and "independent contractor". Mr Bryson was required to sign the crew deal memo every week to secure payment for work done. A year later Mr Bryson was made redundant and he alleged unjustifiable dismissal. He could bring an unjustified dismissal claim only if he were found to have been an employee.

29. The Employment Relations Authority held that Mr Bryson was not an "employee" under the ER Act. On appeal, Judge Shaw in the Employment Court reversed this decision: *Bryson v Three Foot Six Ltd* [2003] 1 ERNZ 581. Her Honour held that Mr Bryson was an "employee" despite references to "independent contractor" in the crew deal memo. A majority of the Court of Appeal overturned the Employment Court's decision: *Three Foot Six Ltd v Bryson* [2004] 2 ERNZ 526. However, the Supreme Court reversed the Court of Appeal's decision and upheld the Employment Court's decision: *Bryson v Three Foot Six Ltd* [2005] NZSC 34, [2005] 3 NZLR 721.

30. The Supreme Court quoted Judge Shaw from the Employment Court as follows at [5]:

> Judge Shaw said that s 6 changed the tests for determining what constituted a contract of service. She summarised the principles she considered to have been established by Employment Court cases on that section as follows:
>
> - "The Court must determine the real nature of the relationship.
> - The intention of the parties is still relevant but no longer decisive.
> - Statements by the parties, including contractual statements, are not decisive of the nature of the relationship.

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- The real nature of the relationship can be ascertained by analysing the tests that have been historically applied such as control, integration, and the 'fundamental' test.
- The fundamental test examines whether a person performing the services is doing so on their own account.
- Another matter which may assist in the determination of the issue is industry practice although this is far from determinative of the primary question."

[Footnotes omitted]

31. The Supreme Court said at [32] that Judge Shaw had accurately stated what s 6 requires the courts to do, and had listed the relevant matters to be considered under that section. The Supreme Court said that "all relevant matters" certainly include the written and oral terms of the contract between the parties and that the terms will usually contain indications of the parties' common intention concerning the status of their relationship. The Supreme Court said it was clear from Judge Shaw's judgment that "she was very much alive to the need to begin by looking at the written terms and conditions which had been agreed to by Mr Bryson and Three Foot Six Ltd".

32. The Supreme Court made it clear that the common law tests for determining employment status were relevant under s 6 when the court stated at [32] that "'[a]ll relevant matters' equally clearly requires the Court or the authority to have regard to features of control and integration and to … the fundamental test". The court also said at [33] that Judge Shaw was correct in saying that the real nature of the relationship could be ascertained by analysing the tests that historically have been applied, such as the control, integration and fundamental tests:

> ...The Judge [Judge Shaw] obviously was not suggesting that these three customary indicia were to be applied exclusively. She correctly used them, in conjunction with the other relevant matters to which she referred, in an endeavour to determine the real nature of the relationship, as directed by s 6(2). …

33. In the Employment Court, Judge Shaw had concluded that the fact Mr Bryson required six weeks training for the position with Three Foot Six Ltd indicated that he could not be said to have been contracting his skills because he did not have the relevant experience. The company closely controlled the work Mr Bryson did, including requirements about attendance at meetings and specific work hours, which included time when his services were not required. If he had been an independent contractor, he would not have been paid for the down time and would have been free to get on with his own private business. Judge Shaw emphasised that her decision was based solely on the individual circumstances of Mr Bryson's employment and was not to be regarded as affecting the status of any other employee in the film industry.

Industry practice

34. The concept of industry practice was given prominence in *Bryson* because the outcome was thought to be critical to the New Zealand film industry. In *Bryson*, Judge Shaw stated that Three Foot Six Ltd did not contemplate that Mr Bryson was anything other than an independent contractor "because that was the invariable practice at Three Foot Six [and] across the film industry" (at [36] of the Employment Court decision). Judge Shaw in the Employment Court recognised that industry practice was relevant under s 6, but not determinative, as noted by the Supreme Court at [30] above.

35. At [21], Judge Shaw held that industry practice was also relevant under the common law. In support of this, at [22] her Honour cited *Muollo v Rotaru* [1995] 2 ERNZ 414 (EC) as a case where the Chief Judge held that:

> the Court may consider industry practice when assessing the nature of an employment contract especially where a custom or practice is sufficiently well established. In such a case, the Chief Judge held that such practice could go to establishing the intention of the parties.

36. However, Judge Shaw held at [36] that, on the facts of the case, the industry practice was of little use in establishing the intention of both parties. At [57] – [76], her Honour reviewed the evidence given by expert witnesses as to industry practice and stated at [68]:

> It is clear from the evidence that the defendant and the film and television industry in general has a real and genuine concern that any changes to the present employment arrangements which have been in place for many years will cause significant disruptions in the film industry with potentially adverse outcomes both in economic terms and in terms of attracting overseas film companies to bring the productions to New Zealand. Mr Binnie submitted that a decision in Mr Bryson's favour [ie, that he was an employee] would "automatically 'unwind'" every existing crew deal memo and any future crew contracts for movie productions.

37. Judge Shaw held that this evidence did not support finding that Mr Bryson was an employee. Her Honour stated at [68] that "[w]hilst these concerns are acknowledged … in the context of this case, they are overstated." Her Honour therefore gave little weight to industry practice on the facts.

38. The majority of the Court of Appeal held that the Employment Court had not given sufficient weight to the evidence of industry practice. It held that industry practice compelled the conclusion that Mr Bryson was not an employee (at [111], [113] and [117]). The Supreme Court disagreed. It held that the Employment Court had not erred in its treatment of industry practice. At [35]:

> The question for this Court is whether the Court of Appeal majority was correct in holding that what the Judge said in relation to industry practice amounted to legal error. We do not believe that it was. She did not overlook or ignore the evidence of industry practice. In rejecting a submission from counsel for Mr Bryson, she in fact said that it could not be completely disregarded, referring with evident approval to a case under the Employment Contracts Act where the Chief Judge had held that industry practice could go to establish the intention of the parties. In the case before her, however, the Judge found that industry practice was not helpful in relation to establishing the common intention of Mr Bryson and Three Foot Six for the reasons given by her and mentioned at para [9] above. Later in her judgment she summarised the evidence on industry practice. It was, as she said, given in general terms. She found that it did not apply to Mr Bryson's situation. He had not been working on projects for several producers. He had not operated like a sole trader.

Summary

39. In summary, the following points can be taken from the Supreme Court's decision in *Bryson*.

40. When determining whether a person is an "employee" as defined in s 6 of the ER Act, the common law tests for determining employment status are still relevant. Consequently, when determining employment status for tax purposes, s 6 case law is relevant to the extent that it considers and applies the common law tests.

41. Consistent with the common law, s 6 requires the court not to treat as determinative any statement by the parties that describes the nature of their relationship.

42. Also consistent with the common law, s 6 requires the court to consider:
    - matters indicating the intention of the parties, in particular the terms of the contract agreed to (whether in writing or orally) by the parties, and industry practice;
    - any divergences from, or supplementations of, those terms and conditions that are apparent in the way in which the relationship has operated in practice;
    - features of control and integration and whether the contracted person has been effectively working on his or her own account (the fundamental test).

43. Following the Supreme Court's decision, Parliament amended s 6 of the ER Act to insert provisions concerning film workers. Section 6(1)(d) excludes from the definition of "employee" persons engaged in "film production work". "Film production work" is defined in s 6(7). However, s 6(1A) provides that this exclusion "does not apply if the person is a party to, or covered by, a written employment agreement that provides that the person is an employee." As already discussed, s 6 of ER Act defines "employee" only for that Act.

TNT Worldwide Express Ltd v Cunningham

44. The other leading New Zealand authority on employment status is the Court of Appeal decision in *TNT*. In this decision, the Court of Appeal discussed in detail the intention, control and fundamental tests developed at common law. The Supreme Court in *Bryson* cited *TNT* with approval.

45. In *TNT*, the appellant company, TNT, engaged the respondent as an owner–driver to conduct a courier service for the company. The owner–driver:
    - provided his own vehicle and was responsible for the vehicle's maintenance and upkeep;
    - was responsible for his own tax and accident compensation payments;
    - claimed deductions as if he were self-employed; and
    - had a contract with TNT that said he was an independent contractor.

46. The company terminated the respondent's contract, and the respondent sought to invoke the personal grievance procedure under the Employment Contracts Act 1991 (now repealed).

47. The Employment Court ([1992] 3 ERNZ 1,030) held that an owner–driver courier for TNT was an employee and not self-employed. In reaching that conclusion, the court placed considerable emphasis on the rigorous control the company exercised over its owner–drivers. The Employment Court considered that the company's actions showed that it treated the owner–driver as its employee.

48. On appeal, the Court of Appeal held that the written contract entered into by the parties created a genuine independent contractor relationship. It accepted that an owner–driver courier was an independent contractor where the owner–driver's contract with TNT:
    - required the owner–driver to provide his own vehicle, uniform, approved radio telephone, goods service licence under the Transport Act 1962 and insurance;

- paid the owner–driver mainly on a per trip basis;
- made the owner–driver responsible for employing any relief driver;
- referred to the owner–driver as an independent contractor; and
- gave TNT very extensive control over the owner–driver's operations.

49. The Court of Appeal acknowledged the extensive control TNT exercised over the owner–driver, but concluded that the owner–driver accepted only that degree of control and supervision necessary for the efficient and profitable conduct of the business he was running on his own account as an independent contractor. At 667, Casey J cited the following statement of MacKenna J in *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 1 All ER 433 (QBD) at 447:

> A man does not cease to run a business on his own account because he agrees to run it efficiently or to accept another's superintendence.

50. The Court of Appeal said that when the contract is wholly in writing and it is not a sham, then the nature of the relationship intended by the parties is determined from the terms of that contract in the light of all the surrounding circumstances at the time the contract was made. Cooke P noted at 683 that "it is necessary to consider all the terms of the agreement". He also made the following observations at 686 and 687:

> When the terms of a contract are fully set out in writing which is not a sham (and there is no suggestion of a sham in this case) the answer to the question of the nature of the contract must depend on an analysis of the rights and obligations so defined.
>
> ...
>
> In the end, when the contract is wholly in writing, it is the true interpretation and effect of the written terms on which the case must turn.

Common law tests of employment status

51. In considering how the distinction between contracts for services and contracts of service is to be made, the Court of Appeal in *TNT* noted at 697 the following observation of the Privy Council in *Lee Ting Sang v Chung Chi-Keung* [1990] 2 AC 374, 382:

> What then is the standard to apply? This has proved to be a most elusive question and despite a plethora of authorities the courts have not been able to devise a single test that will conclusively point to the distinction in all cases.

52. The Privy Council in *Lee Ting Sang* quoted with approval from the judgment of Cooke J in *Market Investigations Ltd v Minister of Social Security* [1969] 2 QB 173, 184–185, where it was said:

> No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of the considerations which are relevant in determining that question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases.

53. Although there is no exhaustive list of considerations, the tests discussed below (established by the case law) provide useful guidance on the factors to be considered in determining whether someone is engaged as an employee or contractor. The relevance of the tests will depend on the particular facts in each case.

54. It is important when determining employment status to balance all the circumstances of the relationship between the parties. Often there will be competing factors that support differing conclusions on whether someone is an employee or an independent contractor. Applying the tests to the facts of a case requires an objective weighing of the various relevant factors to determine the true nature of the relationship.

55. Often the terms of the relationship between two persons will be recorded in a written agreement; though this is not always the case. If there is a written agreement, the first step is to analyse its terms and conditions. However, it is important to note that the nature of the relationship may change over time (eg, a person takes on more duties), and this may not be reflected in the written agreement. Changes in regulations and work practices may also cause the employment status of some workers to change. Alternatively, it could simply be that the written agreement does not accurately reflect how the relationship works in practice. How the parties actually work together must be considered when determining the type of employment relationship between them. As the Supreme Court in *Bryson* stated at [32]:

> It is not until the Court or authority has examined the terms and conditions of the contract, and the way in which it actually operated in practice, that it will usually be possible to examine the relationship in light of the control, integration and fundamental tests. Hence the importance, stressed in *TNT*, of analysing the contractual rights and obligations.

56. *Bryson* and *TNT* both discussed the main common law tests for determining employment status – the intention, control, fundamental and integration tests. In the following paragraphs, these tests (along with the independence test) are examined in greater detail.

57. It is important to remember that the application of the common law tests is a weighing-up process. Sometimes the facts of a particular case may suggest different characterisations of the relationship, and there may be either overlap or tensions between the tests.

58. Also, as the characterisation of the relationship is dependent on the particular facts at hand, it is crucial that the facts are well understood, including any changes to the relationship that have occurred over time.

Intention of the parties test

59. The intention of the parties test looks at the intentions of each party to the agreement regarding the nature of the relationship. The description given to a relationship by the parties to the contract is a strong, but not conclusive, indication of the type of relationship that exists. The fact a written contract states a person is an employee or an independent contractor may indicate the intention of the parties, but it is not determinative: *Bryson* at [32] (SCNZ). Holland J in the High Court in *Challenge Realty Ltd v CIR* [1990] 12 NZTC 7,022 said at 7,032:

> Obviously the Court's function in interpreting a contract is to determine the intentions of the parties. When, however, the question for determination is the legal relationship between the parties created by the contract, the expressed intention of the parties will not be determinative of the question. It is nevertheless an important factor, and if after considering all factors the exact state of the relationship is a matter of some ambiguity, may be decisive. In the present cases before me Harcourts is the only one with a written agreement. Nevertheless I would conclude that in all cases it was the intention of the parties to create an agency relationship rather than an employer/employee relationship. The question remains as to whether that result has been achieved.

60. If the actual circumstances point to an employment relationship, then simply labelling it an independent contract relationship will not alter the true position.

61. In *TNT*, a clause in the written contract that purported to override all other aspects of the agreement stated that the courier was an independent contractor. The Employment Court found that the actual conduct of the relationship showed that TNT imposed a high level of control and supervision of its staff that was inconsistent with any independence or initiative on the part of its staff. However, in reversing this decision, the Court of Appeal concluded, after weighing all the circumstances, that the TNT standard form contract created a genuine independent contractor relationship.

62. The taxation arrangements between the parties may be relevant when establishing their intentions. In *Bryson*, the Employment Court acknowledged at [55] that tax status can be an indicator of what a person intends his contractual relationship to be. For example, if the person engaged to perform the services is paid at a set rate at regular intervals and PAYE is deducted, this may support the view that the parties intended a contract of service. However, in some cases taxation arrangements between the parties may not be given much weight. In *Bryson*, Mr Bryson completed IR3 forms, which referred to the taxpayer as being self-employed in business or trade, and had claimed deductions for work-related expenses. The Employment Court stated at [55] that this was not conclusive evidence that Mr Bryson was an independent contractor. This was because he had not registered for GST and payslips received from Three Foot Six Ltd referred to PAYE deductions having being made. In these circumstances, it could not be said that Mr Bryson had acquiesced to independent contractor status.

63. In some circumstances industry practice may be relevant when determining the intention of the parties. As already discussed, in *Bryson* the Supreme Court agreed with the Employment Court's statement that industry practice could be relevant when considering the parties' intention, but that it was not determinative.

64. In *Bryson*, Three Foot Six Ltd considered Mr Bryson should be regarded as an independent contractor because the invariable industry practice was that production workers were hired as independent contractors. Expert witnesses explained that the reason for this practice was the project-based, intermittent nature of screen productions and the fact that production workers normally worked with several different producers during the course of the year. The Employment Court held at [59] – [60] that the evidence of industry practice was of little use on the facts of that case, because it was "necessarily general" and not consistent with the particular circumstances of Mr Bryson's case. Mr Bryson worked continuously for Three Foot Six Ltd alone and, unlike other workers in the industry, did not own any plant or equipment and did not operate as a sole trader. Mr Bryson's working conditions were therefore not typical of the industry.

65. By contrast, in *Muollo v Rotaru*, industry practice was given considerable weight. In *Bryson*, the Employment Court cited *Muollo* as authority for the proposition that industry practice was relevant at common law

when considering the parties' intention as to their employment relationship. In *Muollo*, the Employment Court considered whether Mr Rotaru, who worked as a crew member aboard a fishing vessel, was an employee for the purposes of the Employment Contracts Act 1991 (now repealed). There was no written employment agreement. The Employment Court concluded that Mr Rotaru was an independent contractor and considered this conclusion was supported by the "custom and usage in the commercial fishing industry". It stated at 425-426 that the evidence of industry practice:

> … presents a picture of an industry in which the co-operative venture is not only prevalent and a typical mode of conducting business but a commercial norm. All parties under such arrangements share in the proceeds. The commercial reasons for it suggested by Mr Gartrell were five in number, as follows:
>
> 1. It conduces to business viability;
> 2. ensures proper work attitudes;
> 3. takes cognisance of the fact that work is intermittent, and its duration uncertain;
> 4. acknowledges the seasonal nature of the work; and
> 5. means that there is not a pool of people waiting round in off-times with no work but still having to be paid.
>
> Mr Gartrell urged upon me the good sense of the industry's considerations moving it to adopt this custom, mentioning the sporadic nature of the enterprise and the use of a percentage basis of determining the rewards and sharing productivity and risk. Along much the same lines Mr Gartrell stressed a total of six factors that were particularly important to both appellants:
>
> 1. work was intermittent;
> 2. duration of work was uncertain;
> 3. no liability for sick and holiday pay;
> 4. the business did not want the liability of an employee when work was not available;
> 5. proper work attitudes;
> 6. business/work cohesion.

66. An expert witness also stated that he was not aware of any fishing vessels where a crew member was on a wage or salary. In the expert's opinion, the normal arrangement was for crew members to be paid according to their share of the catch, for withholding tax to be deducted at source, and for crew members to pay their own ACC levies. The Employment Court stated that this evidence was consistent with the circumstances in which Mr Rotaru provided his services. It concluded that the evidence of industry practice showed that the parties' intention was to enter into a contract for services.

67. In summary, industry practice may be relevant when establishing the parties' intention, especially where the custom or practice is sufficiently well established. Industry practice is not determinative, and it may be given less weight where it is inconsistent with the facts of the particular relationship considered.

Control test

68. The control test looks at the degree of control the employer or principal exerts over the work an employee or contractor is to do and the manner in which it is to be done. The greater the extent to which the principal or employer specifies work content, hours and methods and can supervise and regulate a person, the more likely it is the person is an employee.

69. The control test used to be considered the deciding test, but this is no longer the case. The Court of Appeal in *TNT* emphasised that control is only one of several relevant factors. The court endorsed the statement of Cooke J in *Market Investigations Ltd* (at 185) that while control will always have to be considered, it can no longer be regarded as the sole factor in determining the relationship between the parties. The Court of Appeal in *TNT* considered the Employment Court had given this factor too much weight.

Independence test

70. The independence test was not mentioned in *Bryson* or *TNT*, but has been discussed in several Taxation Review Authority cases that determined employment status: *Case U9* (1999) 19 NZTC 9,077; *Case X17* (2006) 22 NZTC 12,224; and *Case Z10* (2009) 24 NZTC 14,113. The independence test is simply the inverse of the control test. A high level of independence on the part of an employee or a contractor is inconsistent with a high level of control by an employer or a principal.

71. A person generally has a high level of independence if they:
    - work for multiple people or clients (but the fact the person works for only one person or client does not necessarily mean the person is an employee);
    - work from their own premises;
    - supply their own (specialised) tools or equipment;
    - have direct responsibility for the profits and risks of the business;
    - hire or fire whomever they wish to help them do the job;
    - advertise and invoice for the work;
    - supply the equipment, premises and materials used;

- pay or account for taxes and government and professional levies.

72. On the other hand, when some independent contractors perform work for a principal, they may agree not to work for a competitor or give away trade secrets. This alone will not make the worker an employee (it actually emphasises that the worker is usually entitled to work for others).

Fundamental test

73. The Employment Court decision in *Bryson* applied *Market Investigations Ltd*. In that decision, Cooke J said that the fundamental test for distinguishing an employee and an independent contractor was as follows, at 184–185:

> "Is the person who has engaged himself to perform these services performing them as a person in business on his own account?" If the answer to that question is "yes", then the contract is a contract for services. If the answer is "no", then the contract is a contract of service. ... factors which may be of importance are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task.

74. The Privy Council approved the fundamental test in *Lee Ting Sang*. This Privy Council decision was subsequently cited by four of the five judges in the Court of Appeal in *TNT*.

75. The fundamental test is also sometimes described as the "business test" or the "economic reality test". In *Challenge Realty*, the Court of Appeal stated at 7,219:

> If it is helpful to look for a test for application in this case, apart from that of control, which is a key feature of the Act, we favour that suggested by Adrian Merritt, Lecturer in Industrial Law, University of New South Wales in his article "'Control' v 'Economic Reality': Defining the Contract of Employment" (1982) Australian Business Law Review 105 at p 118,
>
> > "The issue that must be settled in today's cases is whether the worker is genuinely in business on his own account or whether he is 'part-and-parcel of' - or 'integrated into' - the enterprise of the person or organisation for whom work is performed. The test is, therefore, one of 'economic reality'."

76. The fundamental test looks at factors such as:
    - whether the type of business or the nature of the job justifies or requires using an independent contractor;
    - the behaviour of the parties before and after entering into the contract;
    - whether there is a time limit for completing a specific project;
    - whether the worker can be dismissed;
    - who is responsible for correcting sub-standard work;
    - who is legally liable if the job goes wrong.

77. Usually, an independent contractor agrees to be responsible for their work. An independent contractor cannot usually be dismissed, although the contract can be terminated if it is broken.

Integration test

78. In *Enterprise Cars Ltd v CIR* (1988) 10 NZTC 5,126 (HC), Sinclair J said that the integration test is whether the person is part and parcel of the organisation and not whether the work is necessary for the running of the business.

79. Under the integration test, a job is likely to be done by an employee if it is:
    - integral to the business organisation;
    - the type of work commonly done by "employees";
    - continuous (not a "one-off" or accessory operation);
    - for the benefit of the business rather than for the benefit of the worker.

80. In the Employment Court decision in *Bryson*, at [50] Judge Shaw quoted Lord Denning's "classic description of this test" from his judgment in *Stevenson Jordan & Harrison Ltd v MacDonalds* [1952] 1 TLR 101, 111 (CA):

> ... under a contract of service, a man is employed as part of the business, and his work is done as an integral part of the business; whereas, under a contract for services, his work, although done for the business, is not integrated into it but is only accessory to it.

Relevant decisions

81. This part of the Interpretation Guideline discusses three cases heard in the Employment Court since the Supreme Court's decision in *Bryson*:
    - *Tse v Cieffe (NZ) Ltd* [2009] ERNZ 20;
    - *Kiwikiwi v Maori Television Service* (2007) 5 NZELR 6;
    - *Tsoupakis v Fendalton Construction Ltd* (EC Wellington WC 16/09, 18 June 2009).

82. These decisions concern employment status under s 6 of the ER Act. As already discussed, s 6 decisions can be relevant when determining employment status for tax purposes to the extent that the decisions concern the common law tests.

83. The intention of this discussion is to illustrate how the courts approach the question of employment status following *Bryson*. When considering such decisions, it is important to remember that each case turns on

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its own facts. As Judge Shaw noted in *Tse v Cieffe (NZ) Ltd*, "previous case law is only useful in reiterating the relevant principles".

Tse v Cieffe (NZ) Ltd

Facts

84. The issue in *Tse v Cieffe (NZ) Ltd* was the plaintiff's employment status. Ms Tse worked for Cieffe from 2005 to 2008.

85. At the beginning of the relationship between the parties there was no written contract between the parties. An oral agreement was reached about the terms of the relationship between the parties. The terms included that Ms Tse would:

- work for 20 hours a week and would be paid at an agreed hourly rate;
- work on the company's internal system but also have some reception duties and general office administration duties;
- invoice Cieffe as a contractor rather than be paid as an employee.

86. In 2007, Cieffe provided Ms Tse with a written consultancy agreement. The agreement provided that Ms Tse's work would be performed under the general supervision and direction of a Cieffe representative, but that Ms Tse was not an employee of Cieffe. Ms Tse signed the agreement.

87. Ms Tse performed the duties that were agreed between the parties at the outset of the relationship, as well as sharing a variety of other office tasks, such as tidying and cleaning, with other employees. When the work Ms Tse had originally been engaged for was nearing completion she was asked to provide further ongoing services that were related to the original work. Ms Tse's work was closely supervised.

88. By her own choice, Ms Tse worked regular hours. She was not instructed to attend the office at any specific time. Over time, her hours increased to 40 hours a week with some overtime. When Ms Tse would not be at work she would advise Cieffe that she would not be present; she would not request leave.

89. Ms Tse invoiced Cieffe for the hours that she worked. Initially, Ms Tse invoiced Cieffe through a company that Ms Tse had set up with her partner. After several months, Ms Tse began invoicing Cieffe in her own name. For the first year of the relationship Ms Tse added GST to the invoices, but she stopped doing this when she discovered that she was not required to be registered for GST.

90. Cieffe provided Ms Tse with branded clothing at work, a credit card (which was used on a business trip) and a business card. The business card had Cieffe's logo and described Ms Tse as "Office Manager" and later as "Client Relationship Assistant Manager".

91. Several times throughout the period that Ms Tse worked for Cieffe, she referred to herself as a contractor.

Application of law

92. **Intention of the parties:** Judge Shaw found that "at the commencement of the relationship both parties deliberately entered into an independent contracting arrangement" (at [40]). The arrangement was evidenced by the method of invoicing and Ms Tse's references to herself as a contractor. Judge Shaw found that the consultancy agreement "confirms the nature of the relationship which had existed from the outset: a contract for services" (at [42]).

93. **Control:** Ms Tse's counsel argued that several factors pointed towards Ms Tse being under the control of Cieffe. One factor was that some of the tasks Ms Tse performed were not sufficiently specialised. Another factor was that Ms Tse's work was supervised by a Cieffe representative. Judge Shaw noted that the non-specific tasks (such as tidying and cleaning) would not generally be performed by a contractor. However, other factors pointed towards a lower level of control by Cieffe than would be expected in an employment relationship. In particular, it was up to Ms Tse when she would undertake the work and she worked a variety of hours each month.

94. **Integration:** The integration test indicated that Ms Tse was an employee of Cieffe. Judge Shaw stated at [47]:

> In some respects the evidence points to a degree of integration of Ms Tse into the business. These are the business cards and the Cieffe-branded clothing. She used Cieffe equipment and had access to the building. Calling her an office manager or client relationship assistant manager certainly presents an image of her to the outside observer as somebody who was part of the management team rather than running a separate business on their own. Such integration would not normally be expected of a consultant.

95. **Fundamental test:** Judge Shaw found that Ms Tse's supply of invoices to Cieffe evidenced a business relationship. Ms Tse's references to herself as a contractor also supported the view that she was in business on her own account.

Conclusion

96. Judge Shaw concluded at [50]:

> While there were some elements in the conduct of her employment which, viewed in isolation, would not support a finding that she was self-employed, taken in the round I find that the real nature of the relationship

between Ms Tse and Cieffe was, as intended, a contract for services.

Kiwikiwi v Maori Television Service

Facts

97. In *Kiwikiwi v Maori Television Service*, the issue was whether Mr Kiwikiwi was an employee or an independent contractor of Maori Television Service (MTS). Mr Kiwikiwi worked as a teleprompter for MTS.

98. When Mr Kiwikiwi started working for MTS, he was filling an urgent vacancy and had no experience as a teleprompter. There was no written agreement at the beginning of the relationship between the parties. Mr Kiwikiwi understood that he was on a one-month trial period with the prospect of a full-time job at the end of the trial period if he was suitable. He was told he would have at least 30 hours of work a week, with more at times. (As the volume of work for teleprompters fluctuates seasonally, hours were flexible.)

99. It was agreed between the parties that Mr Kiwikiwi would be operating on a roster that was prepared a month in advance. He would be paid an hourly rate and would present invoices to be paid.

100. Mr Kiwikiwi undertook teleprompting work but also did various ancillary duties, such as photocopying and banking. After he expressed concern at the additional tasks he was asked to perform, he was given a role profile description. Mr Kiwikiwi worked between 30 and 40 hours a week.

101. After seven and a half months of work, Mr Kiwikiwi was concerned that he still did not have an employment contract. He contacted MTS's operation manager to request an employment contract. Following this, his rostered hours were reduced. The operation manager began to have issues with Mr Kiwikiwi's performance and it was decided that Mr Kiwikiwi had to do some retraining before he could be re-rostered.

102. MTS argued that it was typical working practice in the television industry for teleprompters to be freelancers. Only one teleprompter had been an employee of MTS, with all other teleprompters being freelancers. However, the court heard evidence that TVNZ uses a combination of employees and freelancers as teleprompters.

Application of law

103. **Intention of the parties:** Judge Shaw found that there was no evidence of any common intention by the parties. The parties discussed some "incidents of employment", such as the hourly rate and rostered hours, but did not discuss Mr Kiwikiwi's employment status.

104. **Control:** MTS argued that Mr Kiwikiwi was free to do his work as he saw fit and was not subject to the control of MTS. Judge Shaw found that Mr Kiwikiwi was controlled by MTS's systems. Mr Kiwikiwi was required to comply with the set rosters, had no flexibility within the role and had to perform tasks in addition to teleprompting. The role profile description he was given was prescriptive. When standards slipped, Mr Kiwikiwi had to undergo retraining.

105. **Fundamental test:** Judge Shaw found that Mr Kiwikiwi was not in business on his own account as an independent contractor. The factors that led to this conclusion included:

- Mr Kiwikiwi was not registered for GST;
- Mr Kiwikiwi did not work for any other employer (apart from some shearing work over summer when little work was available from MTS);
- Mr Kiwikiwi had no separate accounts and did not operate under a business entity (such as a company);
- Mr Kiwikiwi did not bring any experience or skill to the position;
- Mr Kiwikiwi took no financial risk with his own capital and could not alter his profits by changing his work habits.

106. Judge Shaw stated that the invoices that Mr Kiwikiwi rendered each fortnight were inconclusive as he only rendered them to get paid.

107. **Integration:** Judge Shaw found that Mr Kiwikiwi's position was an integral part of the production process; it was "not an adjunct which the television station could do without" (at [42]).

108. **Industry practice:** Judge Shaw stated that industry practice can be relevant to both the intention of the parties and the nature of the continuing relationship. However, the industry practice was not black and white. MTS had employed a teleprompter as an employee in the past, and TVNZ used a combination of employees and independent contractors. Therefore, industry practice did not assist in determining Mr Kiwikiwi's employment status.

Conclusion

109. Judge Shaw concluded that the real nature of the relationship between Mr Kiwikiwi and MTS was one of employer/employee.

Tsoupakis v Fendalton Construction Ltd

Facts

110. The issue in *Tsoupakis v Fendalton Construction Ltd* was whether Mr Tsoupakis was an employee or an independent contractor. Mr Tsoupakis worked as a painter for Fendalton Construction for six months in 2005 and 2006 and then again for a year from 2007 to 2008. It was agreed by the parties that Mr Tsoupakis was an independent contractor during the 2005/2006 period. The issue before the Employment Court was whether Mr Tsoupakis was an employee or an independent contractor for the 2007/2008 period.

111. Fendalton Construction hired both employees and independent contractors to undertake painting work. Contractors were generally paid a higher hourly rate. Fendalton Construction provided both types of staff with mobile phones to keep in touch during jobs.

112. Mr Tsoupakis was not given an employment agreement, despite repeatedly asking for a copy of his contract.

113. Mr Tsoupakis filled out a daily work record, including the hours worked and the address of the jobs worked on. He could reclaim costs of travel to jobs in some circumstances. Mr Tsoupakis submitted weekly invoices to Fendalton Construction for payment.

114. Mr Tsoupakis had his own business card that described him as a director of his own trading entity. There was no evidence that he used the card to solicit business for himself while working for Fendalton Construction. Mr Tsoupakis also had signwriting on his motor vehicle advertising his trading name and personal mobile number. Neither the car signwriting, nor the business card, referred to Mr Tsoupakis's association with Fendalton Construction.

115. While on jobs, Mr Tsoupakis was not supervised constantly by Fendalton Construction, but on most jobs Mr Tsoupakis's work was inspected by Fendalton Construction.

116. Fendalton Construction provided some of the tools required to do the jobs (although usually not paint brushes) and all of the consumables required (such as paint and rags). Mr Tsoupakis purchased materials as required for jobs using Fendalton Construction's trade accounts.

117. Mr Tsoupakis was given work on a daily basis with detailed work directions. He could be redirected to jobs when Fendalton Construction required. Mr Tsoupakis was expected to meet set criteria, such as the time to be taken and the volume of paint to be used. He was required to check in with Fendalton Construction when he finished a job. Mr Tsoupakis could not delegate his work to others to complete, and he was expected not to undertake other work.

Application of law

118. **Intention of the parties:** Chief Judge Colgan found that there was no discernible mutual intention of the parties as there had been no express discussion about the nature of their relationship.

119. **Control:** Chief Judge Colgan found that Fendalton Construction exercised a high degree of control over Mr Tsoupakis's work – both what was done and also how and when it was to be done. Mr Tsoupakis had to account in detail for his hours of work and had no ability to delegate or organise as he chose. In reality, he was constrained from working for anyone else or for himself.

120. **Integration:** The facts pointed towards Mr Tsoupakis having some elements of independence from Fendalton Construction – in particular, his business cards, the signwriting on his vehicle and that he was invited to the contractors' Christmas party (as opposed to the employees' party). Chief Judge Colgan found that, despite these elements, Tsoupakis was an integral part of Fendalton's business in the same way as would be expected of an employee. Factors pointing towards Mr Tsoupakis's integration were that he was held out as a member of Fendalton Construction's staff and that he was paid for the time that he worked rather than a set fee for each job.

121. **Fundamental test:** Chief Judge Colgan found that Mr Tsoupakis was not in business on his own account. Mr Tsoupakis provided his own paint brushes but other equipment was provided by Fendalton Construction. The fact Mr Tsoupakis was not trained by Fendalton Construction was a neutral factor, as Mr Tsoupakis was engaged as an experienced tradesperson.

122. **Industry practice:** Only limited evidence was presented to the court on industry practice in the painting industry. Chief Judge Colgan found that the evidence of industry practice was neutral, as it established that companies (including Fendalton Construction) engaged both independent contractors and employees as painters.

Conclusion

123. Chief Judge Colgan concluded that Mr Tsoupakis was an employee of Fendalton Construction for the 2007/2008 period.

List of other relevant decisions

124. Below is a list of relevant decisions of the Employment Court (EC), Employment Relations Authority (ERA) and Taxation Review Authority (TRA) since *Bryson*. This list may assist readers to locate decisions

concerning occupations similar to the particular case before them. Decisions may also be found online via the following free searchable judgment indexes (links as at 2 March 2016):

- **http://employment.govt.nz/workplace/determinations/**
- **https://forms.justice.govt.nz/jdo/Search.jsp**
- **http://www.justice.govt.nz/tribunals/taxation-review-authority/search-nzlii-nztra**

125. It is important to note that each case turns on its specific facts. Consequently, the outcome reached in a particular case cannot be presumed to indicate the likely outcome in a case in the same industry but with a different factual background.

- *Case X17* (2006) 22 NZTC 12,224 (TRA) – relief driver hired by a courier driver.
- *Davis v Canwest Radioworks Ltd* (2007) 4 NZELR 355 (EC) – radio commentator.
- *Hollis v JV Hiab Transport Ltd* (ERA Auckland AA 394/07, 14 December 2007) – truck driver.
- *Bambury v Elation Ltd t/a Komodo Premium Bar* (ERA Auckland AA 12/08, 17 January 2008) – club manager.
- *Sage v NZ Underwater Assn Inc* (ERA Auckland AA 68/08, 29 February 2008) – business advisor.
- *Reading v Civil Engineering Solutions Ltd* (ERA Auckland AA 128/08, 3 April 2008) – business partner in a civil engineering company.
- *Evans v Gibbston Valley Wines Ltd* (ERA Christchurch CA 54/08, 2 May 2008) – cellar hand.
- *Hughes v Upper Hutt Cosmopolitan Club Inc* (ERA Wellington WA 120/08, 17 September 2008) – caterers.
- *Cameron v PBT Couriers Ltd* (ERA Christchurch CA 143/08, 25 September 2008) – courier driver.
- *King v Creative Energy Wholesale Ltd* (ERA Wellington WA 150/08, 11 November 2008) – sales manager.
- *Westwell v Wheeler* (ERA Auckland AA 10/09, 19 January 2009) –painter/foreperson.
- *Case Z10* (2009) 24 NZTC 14,113 (TRA) – relocation driver hired by rental vehicle company.
- *Hughes v Primary Care Development Solutions Ltd* (ERA Wellington WA 25/09, 9 March 2009) – medical researcher.
- *Philpott v London Ltd t/a Ladybirds for Gifts* (ERA Wellington WA 34/09, 23 March 2009) – shop attendant.
- *Pillay v Radius Security Ltd* (ERA Auckland AA 153/09, 14 May 2009) –accountant.
- *Dittmer v Progressive Investment Enterprise Ltd* (ERA Auckland AA 179/09, 11 June 2009) – manager.
- *Smith v Wairarapa Medical Ltd* (ERA Wellington WA 84/09, 15 June 2009) – medical practitioner.
- *Hunapo v Garin Family Trust* (ERA Auckland AA 209/09, 26 June 2009) – security officer.
- *Kelly v Lodge at 199 Ltd* (ERA Auckland AA 224/09, 8 July 2009) – lodge managers.
- *Newcombe v Summit Systems New Zealand Ltd* (ERA Christchurch CA 108/09, 21 July 2009) – marketers.
- *Shearer v Jardin Nous Ltd* (ERA Christchurch CA 124/09, 5 August 2009) – gardener.
- *Yang v New Zealand College of Chinese Medicine* Ltd (ERA Auckland AA 376/09, 29 October 2009) – teacher.
- *Te Amo v Becon Ltd* (EC Christchurch CC 17/09, 4 November 2009) – manager responsible for establishing a waste-sorting plant.
- *Wickbom v DRH (Northland) Ltd* (ERA Auckland AA 10/10, 15 January 2010) – sales and marketing manager.
- *Singh v Eric James & Associates Ltd* [2010] NZEmpC 1 – insurance salesperson.
- *Broad v Financial Gain (Auckland) Ltd* (ERA Auckland AA 103/10, 5 March 2010) – salesperson.
- *Chief of Defence Force v Ross-Taylor* [2010] NZEmpC 22 – medical practitioner.
- *Poulter v Antipodean Growers Ltd* [2010] NZEmpC 77 – horticulturalist.
- *Keach v Brown & Son Construction Ltd* (ERA Christchurch CA 136/10, 29 June 2010) – builder's labourer.
- *Baldwin v Bossi's Hair & Beauty Ltd* (ERA Auckland AA 486/10, 18 November 2010) – hairdresser.
- *Webb v Professional Relief Services Ltd* (ERA Auckland AA 457/10, 22 October 2010) – courier van driver.
- *Ratcliffe v Weber* (ERA Auckland AA 510/10, 14 December 2010) – circus trainer.
- *Oliver v Brown t/a Autoweb Solutions* (ERA Wellington WA 203/10, 20 December 2010) – website developer.
- *Wu v JDC New Zealand Co Ltd* (ERA Auckland AA 527/10, 23 December 2010) – restaurant chef.
- *Brunton v Garden City Helicopters Ltd* [2011] NZEmpC 29 – airplane pilot.

- *Casares v AAV New Zealand Ltd* [2011] NZERA Auckland 34 – accounts manager.
- *Jaques v Annandale Logistics Ltd* [2011] NZERA Auckland 117 – truck driver.
- *Sanders v Pulp Media Ltd (in liq)* [2011] NZERA Auckland 133 – magazine editor.
- *May v Armourguard Security Ltd* [2011] NZERA Auckland 208 – security guard.
- *Gibbs v Grasshopper Lawnmowing Services Ltd* [2011] NZERA Christchurch 182 – lawn mower.
- *Lundbom v Avisit Solutions Ltd* [2011] NZERA Auckland 436 – marketing and graphic design work for the IT industry.
- *Olivier v Cloudberry Business Solutions Ltd* [2012] NZERA Christchurch 73 – personal assistant.
- *Champion v White, Fox & Jones* [2013] NZERA Christchurch 103 – law firm consultant.
- *Kearns v Southern Institute of Technology* [2013] NZERA Christchurch 122 – assignment marker.
- *Stringer v Sanford Ltd* [2013] NZERA Auckland 345 – engineer for a fishing company.
- *Franix Construction Ltd v Tozer* [2014] NZEmpC 159 – managerial role.
- *Kluge v Jim Crosbie t/a Operative Brick & Block* [2014] NZERA Christchurch 189 – bricklayer.
- *Bucknell v Woolston Store Ltd* [2015] NZERA Christchurch 40 – market manager.
- *Atkinson v Phoenix Commercial Cleaners Ltd* [2015] NZEmpC 19 – commercial cleaner.
- *O'Sullivan v Stargate Operations Ltd* [2015] NZERA Auckland 276 – general manager.

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Employment status for tax purposes
Goods and services tax
Income tax
Meaning of "contract for services", "contract of service", "employee", "employment", "PAYE income payment" and "taxable activity"
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Enterprise Cars Ltd v CIR (1988) 10 NZTC 5,126 (HC)
Kiwikiwi v Maori Television Service (2007) 5 NZELR 6 (EC)
Lee Ting Sang v Chung Chi-Keung [1990] 2 AC 374 (PC)
Market Investigations Ltd v Minister of Social Security [1969] 2 QB 173
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R v Kerr [1988] 1 NZLR 270 (CA)
Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance [1968] 1 All ER 433 (QBD)
Stevenson Jordan & Harrison Ltd v MacDonalds [1952] 1 TLR 101 (CA)
Three Foot Six Ltd v Bryson [2004] 2 ERNZ 526 (CA)
TNT Worldwide Express Ltd v Cunningham [1992] 3 ERNZ 1,030 (EC)
TNT Worldwide Express Ltd v Cunningham [1993] 3 NZLR 681 (CA)
Tse v Cieffe (NZ) Ltd [2009] ERNZ 20 (EC)
Tsoupakis v Fendalton Construction Ltd (EC Wellington WC 16/09, 18 June 2009)

APPENDIX – LEGISLATION

Goods and Services Tax Act 1985

1. Section 6 reads:

> **6 Meaning of term taxable activity**
>
> (1) For the purposes of this Act, the term ***taxable activity*** means—
>
> (a) any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other

person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:

(b) without limiting the generality of paragraph (a), the activities of any public authority or any local authority.

(2) Anything done in connection with the beginning or ending, including a premature ending, of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity.

(3) Notwithstanding anything in subsections (1) and (2), for the purposes of this Act the term ***taxable activity*** shall not include, in relation to any person,—

(a) being a natural person, any activity carried on essentially as a private recreational pursuit or hobby; or

(aa) not being a natural person, any activity which, if it were carried on by a natural person, would be carried on essentially as a private recreational pursuit or hobby; or

(b) any engagement, occupation, or employment under any contract of service or as a director of a company, subject to subsection (4); or

(c) any engagement, occupation, or employment—

(i) pursuant to the Members of Parliament (Remuneration and Services) Act 2013 or the Governor-General Act 2010:

(ii) as a Judge, Solicitor-General, Controller and Auditor-General, or Ombudsman:

(iia) pursuant to an appointment made by the Governor-General or the Governor-General in Council and evidenced by a warrant or by an Order in Council or by a notice published in the Gazette in accordance with section 2(2) of the Official Appointments and Documents Act 1919:

(iii) as a Chairman or member of any local authority or any statutory board, council, committee, or other body, subject to subsection (4); or

(d) any activity to the extent to which the activity involves the making of exempt supplies.

Income Tax Act 2007

2. Section RD 3 reads:

RD 3 PAYE income payments

Meaning generally

(1) The PAYE rules apply to a ***PAYE income payment which—***

(a) means—

(i) a payment of salary or wages, see section RD 5; or

(ii) extra pay, see section RD 7; or

(iii) a schedular payment, see section RD 8:

(b) does not include—

(i) an amount attributed under section GB 29 (Attribution rule: calculation):

(ii) an amount paid to a shareholder-employee in the circumstances set out in subsection (2):

(iii) an amount paid or benefit provided, by a person (the claimant) who receives a personal service rehabilitation payment from which an amount of tax has been withheld at the rate specified in schedule 4, part I (Rates of tax for schedular payments) or under section RD 18 (Schedular payments without notification), to another person for providing a key aspect of social rehabilitation referred to in paragraph (c) of the definition of ***personal service rehabilitation payment*** in section YA 1 (Definitions).

When subsections (3) and (4) apply: close companies

(2) Subsections (3) and (4) apply for an income year when a person is a shareholder-employee of a close company, and—

(a) they do not derive as an employee salary or wages of a regular amount for regular pay periods—

(i) of 1 month or less throughout the income year; or

(ii) that total 66% or more of the annual gross income of the person in the corresponding tax year as an employee; or

(b) an amount is paid as income that may later be allocated to them as an employee for the income year.

Income in current tax year

(3) The person may choose to treat all amounts paid to them in the income year in their capacity as employee of the close company as income other than from a PAYE income payment.

Income in later tax years

(4) All amounts paid to the person in later income years in their capacity as employee of the close company are treated as income other than from a PAYE income payment.

If questions arise

(5) If a question arises whether the PAYE rules apply to all or part of a PAYE income payment, other than an amount referred to in subsections (2) to (4), the Commissioner must determine the matter.

3. Section RD 5 reads:

RD 5 Salary or wages

Meaning

(1) ***Salary or wages—***

(a) means a payment of salary, wages, or allowances made to a person in connection with their employment; and

(b) includes—

(i) a bonus, commission, gratuity, overtime pay, or other pay of any kind; and

(ii) a payment described in subsections (2) to (8); and

(iii) an accident compensation earnings-related payment; and

(c) does not include—

(i) an amount of exempt income:

(ii) an extra pay:

(iii) a schedular payment:

(iv) an amount of income described in section RD 3(3) and (4):

(v) an employer's superannuation contribution other than a contribution referred to in subsection (9):

(vi) a payment excluded by regulations made under this Act.

Employees' expenditure on account

(2) A payment of expenditure on account of an employee is included in their salary or wages.

Payments to working partners

(3) A payment to a working partner under section DC 4 (Payments to working partners) is included in their salary or wages.

Payments to working owners

(3B) A payment to a working owner under section DC 3B (Payments to working owners) is included in their salary or wages.

Payments to past employees

(4) A periodic payment of a pension, allowance, or annuity made to a person or their spouse, civil union partner, de facto partner, child, or dependant in connection with the past employment of the person is included in their salary or wages.

Payments to Governor-General, members of Parliament, and judicial officers

(5) The following payments made under a determination of the Remuneration Authority are included in salary or wages

(aa) salary made to the Governor-General:

(a) salary or allowances made to a member of Parliament:

(b) salary and principal allowances made to a judicial officer.

Sum payable after office of Governor-General becomes vacant

(5B) A payment to a person made under section 7 of the Governor-General Act 2010 is included in the salary and wages of that person.

Certain benefits and grants

(6) A payment of the following benefits or grants is included in salary or wages

(a) a gratuitous payment as described in paragraph (a) of the definition of ***pension*** in section CF 1(2) (Benefits, pensions, compensation, and government grants):

(b) an income-tested benefit:

(bb) a veteran's pension, other than a veteran's pension paid under section 182 of the Veterans' Support Act 2014:

(bc) New Zealand superannuation, other than New Zealand superannuation paid under section 26(2)(b) of the New Zealand Superannuation and Retirement Income Act 2001:

(bd) a retirement lump sum paid under Part 5, subpart 7 of the Veterans' Support Act 2014:

(be) weekly income compensation paid under Part 3, subpart 4 of the Veterans' Support Act 2014:

(bf) weekly compensation paid under Part 4, subpart 5 of the Veterans' Support Act 2014:

(bg) weekly compensation or aggregated payments, as applicable, paid under schedule 2, part 4, clause 54, 55, 58, or 59 of the Veterans' Support Act 2014:

(c) a basic grant and independent circumstances grant made under regulations made under section 193 of the Education Act 1964, section 303 of the Education Act 1989 or an enactment substituted for those sections.

Parental leave payments

(7) A parental leave payment made under Part 7A of the Parental Leave and Employment Protection Act 1987 is included in salary or wages.

Accommodation benefits

(8) A benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment) is included in salary or wages.

Cash contributions

(9) An amount of an employer's superannuation cash contribution that an employee chooses to have treated as salary or wages under section RD 68 is included in salary or wages.

4. Section RD 7 reads:

RD 7 Extra pay

Meaning

(1) An extra pay—

(a) means a payment that—

(i) is made to a person in connection with their employment; and

(ii) is not a payment regularly included in salary or wages payable to the person for a pay period; and

(iii) is not overtime pay; and

(iv) is made in 1 lump sum or in 2 or more instalments; and

(b) includes a payment of the kind described in paragraph (a) made—

(i) as a bonus, gratuity, or share of profits; or

(ii) as a redundancy payment; or

(iii) when the person retires from employment; or

(iv) as a result of a retrospective increase in salary or wages, but only to the extent described in subsection (2); and

(c) includes an amount of income that a person derives under section CE 9 (Restrictive covenants) or CE 10 (Exit inducements) if the income is derived in connection with an employment relationship between the person and the person who paid the amount; and

(d) does not include a payment of exempt income.

Limit on retrospective increase in salary or wages

(2) A payment described in subsection (1)(b)(iv) is included in extra pay only to the extent to which,—

(a) it accrues from the start of the increase until the start of the first pay period in which the increase is included in salary or wages; and

(b) when a week ends with a Saturday, the total of the increase for the week, and of the salary or wages for the week excluding the increase, and of any other salary or wages that the person earns for the week, is more than $4.

5. Section RD 8 reads:

RD 8 Schedular payments

Meaning

(1) A schedular payment—

(a) means—

(i) a payment of a class set out in schedule 4 (Rates of tax for schedular payments); and

(ii) in relation to a sale, the net amount paid after subtracting from the purchase price all commission, insurance, freight, classing charges and other expenses incurred by the seller in connection with the sale; and

(b) does not include—

(i) salary or wages; or

(ii) an extra pay; or

(iii) a payment for services provided by a public authority, a local authority, a Maori authority, or a company, other than a non-resident contractor, a non-resident entertainer, or an agricultural, horticultural, or viticultural company; or

(iv) a payment covered by an exemption certificate provided under section 24M of the Tax Administration Act 1994; or

(v) a payment for services provided by a non-resident contractor who has full relief from tax under a double tax agreement, and is present in New Zealand for 92 or fewer days in a 12-month period; or

(vi) a contract payment for a contract activity or service of a non-resident contractor when the total amount paid for those activities to the contractor or another person on their behalf is $15,000 or less in a 12-month period.

Protected payments

(2) The fact that a schedular payment may be protected against assignment or charge does not override a person's obligation to withhold the amount of tax for the payment.

Determination of expenditure incurred

(3) The Commissioner may determine from time to time the amount or proportion of expenditure that a person incurs in deriving a particular schedular payment or class of schedular payments.

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

PROVISIONAL DEPRECIATION DETERMINATION PROV27: GEOTHERMAL AND THERMAL POWERHOUSES

Note to Determination PROV27

The Commissioner of Inland Revenue has set a provisional depreciation rate for geothermal and thermal powerhouses by adding new asset classes to the "Power generation and electrical reticulation" industry category and the "Buildings and structures" asset category.

Geothermal and thermal powerhouses are made up of a number of items of depreciable property, including:

- The powerhouse building – the building itself, including the building's structural elements (including foundations, pillars and beams), walls, internal floors and roof;
- Turbines and generators, including any additional or extraordinary foundations that are directly attached to these items of plant and whose sole purpose is to provide the necessary support and stability that the turbines and generators require to function;
- Gantry cranes, including any crane beams and rails on which the crane travels;
- Other components of plant that are situated within a geothermal or thermal powerhouse building.

Geothermal and thermal powerhouse building

Geothermal and thermal powerhouse buildings meet the criteria of the building test set out in Interpretation Statement IS 10/02 Meaning of "building" in the depreciation provisions. The component parts of a building (the structural elements (including the foundations, pillars and beams), walls, floor and roof) will always form part of the building even when they are strengthened to allow items of plant to be attached to the building. This is because the purpose of the component parts of a building is to allow the building to function as a building. For instance, where an air conditioning unit is attached to the roof of a building, the roof remains part of the building and does not form part of the air conditioning unit. Even if the roof were to be strengthened to take the weight of the air conditioning unit, because any building requires a roof, this strengthening would be undertaken to allow the building to remain functioning as a building in the particular setting for which it was designed. Similarly, attaching the gantry crane rails to the building pillars does not mean that these pillars (and their strengthened foundations) will form part of the crane. These remain part of the building and are depreciated accordingly.

Geothermal and thermal powerhouses should be depreciated at a rate of 0%, as set out in the determination below.

Turbines and generators

Turbines and generators are plant and are depreciated in line with the general economic rate provided in the "Power generation and electrical reticulation systems" industry category. This provides for an estimated useful life of 20 years for "Turbines (steam)" and "Generators (steam)" at a rate of 10% DV, based on an estimated useful life of 20 years. In the context of a geothermal or thermal powerhouse, a turbine or generator includes any purpose built plant foundations that are additional to the building's floor and foundations and that are directly attached to these items of plant in order to provide the necessary support and stability that the turbines and generators require to function.

Gantry cranes

Gantry cranes are plant and are depreciated in line with the general economic rate provided in the "Lifting" asset category. This provides for an estimated useful life of 25 years for "Cranes (overhead travelling)". In the context of a geothermal or thermal powerhouse, a gantry crane includes all of the components (including the rails that are attached to the powerhouse building) that allow the crane to function, but not those pillars or foundations which are also part of the structure of the building.

Other components

To the extent that other components situated within a geothermal or thermal powerhouse building are separate depreciable property, they are to be depreciated in line with the general economic rate provided in the "Power Generation and electrical Reticulation Systems" industry category.

The provisional depreciation rates for geothermal and thermal powerhouse buildings do not apply to powerhouses used as part of other forms of electricity generation.

DETERMINATION: TAX DEPRECIATION RATES PROVISIONAL DETERMINATION NUMBER 27

1. Application

This determination applies to taxpayers who own depreciable property of the kinds listed in the table below.

This determination applies from the 2012 and subsequent income years.

2. Determination

Pursuant to section 91AAG of the Tax Administration Act 1994, the provisional determination will apply to the kind of items of depreciable property listed in the table below by adding into the "Power generation and electrical reticulation" industry category and the "Buildings and structures" asset category, new asset classes, estimated useful lives (EUL), and diminishing value (DV) and straight line (SL) depreciation (Depn) rates, as listed below:

Asset	EUL (years)	DV depn rate (%)	DV+ 20% loading	SL depn rate (%)	SL+ 20% loading
Geothermal powerhouse building	50	0	n/a	0	n/a
Thermal powerhouse building	50	0	n/a	0	n/a

3. Interpretation

In this determination, unless the context otherwise requires, words and terms have the same meaning as in the Income Tax Act 2007 and the Tax Administration Act 1994.

This determination is signed by me on the 23rd day of February 2016.

Vanessa Montgomery

LTS Manager, Technical Standards

INCOME TAX (NATIONAL STANDARD COSTS FOR LIVESTOCK) DETERMINATION 2016

Note to Determination

Section EC 24 of the Income Tax Act 2007 allows the Commissioner ("the CIR") to issue a determination stating the methods that may be used to calculate the value of specified livestock under the national standard cost scheme. The matters that may be included in such a determination are set out in section 91AAD of the Tax Administration Act 1994 ("the TAA"). To date these sections have been used to issue two determinations; the *Income Tax (National Standard Costs for Livestock) Determination 1993 and the Income Tax (National Standard Costs for Livestock) Determination 1994*[1]. These determinations set out the methods used to calculate the cost of specified livestock, details of the provisions that apply to these valuations, the inventory system requirements under the national standard cost scheme, and the requirements for movement between national standard cost and other livestock valuation schemes.

Section 91AAD(9) of the TAA allows the CIR to vary the contents of determinations made under these sections. This subsection is here being utilised to vary the above determinations by issuing the *Income Tax (National Standard Costs for Livestock) Determination 2016 ("the 2016 determination").*

The variations contained in the 2016 determination replace the words "purchase" (to "acquisition"), "purchased" (to "acquired") and "sales" (to "disposals) and are made to confirm, for the avoidance of any doubt, that these transactions include those that involve the receipt or payment of non-monetary (as well as monetary) consideration. These changes are made as part of wider wording changes listed in Schedule 3 of the Taxation *(Annual Rates for 2015-2016, Research and Development, and Remedial Matters) Act 2016.*

Although the Commissioner acknowledges that the replacement words are capable of having a wide meaning, solely for the purposes of this determination it is emphasised that to come within the words used the transaction must be made for "consideration", whether that consideration be in money or some other form.

For the avoidance of doubt, it is therefore confirmed that the words used DO NOT include the acquisition of homebred livestock or livestock that has been gifted inter-generationally or donated. In addition, the words used DO NOT include the disposal of livestock that dies or is culled and is disposed of on-farm or to still-born livestock ("slinks"). Although slinks are generally sold for monetary consideration, it is the Commissioner's view that being still-born, slinks are not livestock and therefore not subject to any of the national standard costs for livestock determinations. Note however that amounts received for slinks should continue to be treated as part of the ordinary business income of a farmer.

INCOME TAX (NATIONAL STANDARD COSTS FOR LIVESTOCK) DETERMINATION 2016

This determination may be cited as the Income Tax (National Standard Costs for Livestock) Determination 2016.

This determination applies in respect of the valuation of specified livestock under the national standard cost scheme for the 2015-2016 income years and subsequent income years.

This determination varies the Income Tax (National Standard Costs for Livestock) Determination 1993 and the Income Tax (National Standard Costs for Livestock) Determination 1994 by replacing, wherever they appear in these determinations, the following words:

"purchased"	to	"acquired"
"purchase"	to	"acquisition"
"sales"	to	"disposals"

This determination is signed by me on the 14th day of March 2016.

Rob Wells

LTS Manager, Technical Standards

Legal and Technical Services

[1] These may be viewed at **http://www.ird.govt.nz/technical-tax/determinations/livestock/national-standard/** or in *Tax Information Bulletin* Vol 5, Nos. 2 and 11 (August 1993 and April 1994)

2016 INTERNATIONAL TAX DISCLOSURE EXEMPTION ITR27

Introduction

Section 61 of the Tax Administration Act 1994 ("TAA") requires taxpayers to disclose interests in foreign entities.

Section 61(1) of the TAA states that a person who has a control or income interest in a foreign company or an attributing interest in a foreign investment fund ("FIF") at any time during the income year must disclose the interest held. Please note that a person opting out of the de minimis threshold needs to include FIF income or loss in any of the four subsequent income years even if the total cost of all attributing interests is $50,000 or less.

Even after four years, a person must continue to apply the FIF rules if they still hold any of the shares at the time of the opting out. Section 61(2) of the TAA allows the Commissioner of Inland Revenue to exempt any person or class of persons from this requirement if disclosure is not necessary for the administration of the international tax rules (as defined in section YA 1) contained in the Income Tax Act 2007 ("the ITA").

To balance the revenue forecasting and risk assessment needs of the Commissioner with the compliance costs of taxpayers providing the information, the Commissioner has issued an international tax disclosure exemption under section 61(2) of the TAA that applies for the income year corresponding to the tax year ended 31 March 2016. This exemption may be cited as "International Tax Disclosure Exemption ITR27"("the 2016 disclosure exemption") and the full text appears at the end of this item.

Scope of exemption

The scope of the 2016 disclosure exemption is the same as the 2015 disclosure exemption.

Application date

This exemption applies for the income year corresponding to the tax year ended 31 March 2016.

Summary

In summary, the 2016 disclosure exemption removes the requirement of a resident to disclose:

- an interest of less than 10% in a foreign company if it is not an attributing interest in a FIF or if it falls within the $50,000 de minimis exemption (see section CQ 5(1)(d) and section DN 6(1)(d) of the ITA). The de minimis exemption does not apply to a person that has opted out of the de minimis threshold by including in the income tax return for the income year a FIF income or loss[1].
- If the resident is not a widely-held entity, an attributing interest in a FIF that is an income interest of less than 10%, if the foreign entity is incorporated (in the case of a company) or otherwise tax resident in a treaty country or territory, and the fair dividend rate or comparative value method of calculation is used.
- if the resident is a widely-held entity, an attributing interest in a FIF that is an income interest of less than 10% if the fair dividend rate or comparative value method is used for the interest. The resident is instead required to disclose the end-of-year New Zealand dollar market value of all such investments split by the jurisdiction in which the attributing interest in a FIF is held or listed.

The 2016 disclosure exemption also removes the requirement for a non-resident or transitional resident to disclose interests held in foreign companies and FIFs.

Commentary

Generally, residents who hold an income interest or a control interest in a foreign company, or an attributing interest in a FIF are required to disclose these interests to the Commissioner. These interests are considered in further detail below.

Attributing interest in a FIF

A resident is required to disclose an attributing interest in a FIF if FIF income or a FIF loss arises through the use of one of the following calculation methods:

- attributable FIF income, deemed rate of return or cost methods; or
- fair dividend rate or comparative value methods, if the resident is a "widely-held entity" or
- fair dividend rate or comparative value methods, if the resident is not a widely-held entity and the country in which the attributing interest is incorporated or otherwise tax resident in a country or territory with which New Zealand **does not** have a double tax agreement[2] in force as at 31 March 2016.

The 40 countries or territories that New Zealand does have a double tax agreement in force as at 31 March 2016 are listed next page.

[1] In the case of partnerships, disclosure needs to be made by the individual partners in the partnership. The partnership itself is not required to disclose.

[2] For the avoidance of doubt, the term "double tax agreement" does not include tax information exchange agreements or collection agreements and is limited to the double tax agreements negotiated with the 40 countries or territories listed in this 2015 disclosure exemption.

Australia	India	Russian Federation
Austria	Indonesia	Singapore
Belgium	Ireland	South Africa
Canada	Italy	Spain
Chile	Japan	Sweden
China	Korea	Switzerland
Czech Republic	Malaysia	Taiwan
Denmark	Mexico	Thailand
Fiji	Netherlands	Turkey
Finland	Norway	United Arab Emirates
France	Papua New	United Kingdom
Germany	Guinea	United States of America
Hong Kong	Philippines	Samoa*
Viet Nam	Poland	

* The Samoa double tax agreement applies for withholding taxes from 1 February 2016 and for all other provisions from 1 April 2016.

No disclosure is required by non-widely-held taxpayers for attributing interests in FIFs that are income interests of less than 10% and are incorporated or otherwise tax resident in a tax treaty country or territory, if the fair dividend rate or comparative value methods of calculation are used.

A "widely-held entity" for the purposes of this disclosure is an entity which is a:

- portfolio investment entity (this includes a portfolio investment-linked life fund); or
- widely-held company; or
- widely-held superannuation fund; or
- widely-held group investment fund ("GIF").

Portfolio investment entity, widely-held company, widely-held superannuation fund and widely-held GIF are all defined in section YA 1 of the ITA.

The disclosure required, by widely-held entities, of attributing interests in FIFs which use the fair dividend rate or the comparative value method of calculation is that, for each calculation method, they disclose the end-of-year New Zealand dollar market value of investments split by the jurisdiction in which the attributing interest in a FIF is held, listed, organised or managed. In the event that tax residence is not easily determined. A further option of a split by currency in which the investment is held will also be accepted as long as it is a reasonable proxy - that is at least 90-95% accurate - for the underlying jurisdiction in which the FIF is held, listed, organised or managed. For example, investments denominated in euros will not be able to meet this test and so euro-based investments will need to be split into the underlying jurisdictions.

FIF interests

The types of interests that fall within the scope of section 61(1) of the TAA are:

- rights in a foreign company or anything deemed to be a company for the purposes of the ITA (eg, a unit trust)
- an entitlement to benefit from a foreign superannuation scheme, if a person acquired the interest before 1 April 2014, treated the interest as a FIF interest in a return of income filed before 20 May 2013 and for all subsequent income years
- an entitlement to benefit from a foreign superannuation scheme, if a person's interest in a scheme was first acquired whilst the person was tax resident of New Zealand
- an entitlement to benefit from a foreign life insurance policy
- an interest in an entity specified in schedule 25, part A of the ITA (no entities were listed when the Tax Information Bulletin Vol 28, No 3 went to press).

However, the following interests are exempt (under sections EX 31 to EX 43 of the ITA) from being an attributing interest in a FIF and do not have to be disclosed:

- an income interest of 10% or more in a CFC (although separate disclosure is required of this as an interest in a foreign company)
- certain interests in Australian resident companies listed on an approved index of the Australian Stock Exchange and required to maintain a franking account (refer to the IR871 form that can be found on Inland Revenue's website **www.ird.govt.nz** (keywords: other exemptions or IR871))
- an interest in an Australian unit trust that has an New Zealand RWT proxy with either a high turnover or high distributions
- an interest of 10% or more in a foreign company that is treated as resident, and subject to tax, in Australia (although separate disclosure is required of this as an interest in a foreign company)
- a beneficial interest in a foreign superannuation scheme which was first acquired whilst the person was not a tax resident of New Zealand and which has not been treated as an attributing interest in a FIF by a person
- certain foreign pensions or annuities (see Inland Revenue's guide *Overseas pensions and annuity schemes* (IR257) for more information)
- an interest in certain venture capital investments in New Zealand resident start-up companies that migrate to a grey-list country

- an interest in certain grey-list companies owning New Zealand venture capital companies
- an interest in certain grey-list companies resulting from shares acquired under a venture investment agreement
- an interest in certain grey-list companies resulting from the acquisition of shares under an employee share scheme
- an interest held by a natural person in a foreign entity located in a country where exchange controls prevent the person deriving any profit or gain or disposing of the interest for New Zealand currency or consideration readily convertible to New Zealand currency.

De minimis

Interests in foreign entities held by a natural person not acting as a trustee also do not have to be disclosed if the total cost of the interests remains under $50,000 at all times during the income year. This disclosure exemption is made because no FIF income under section CQ 5 of the ITA or FIF loss under section DN 6 arises in respect of these interests.

This de minimis exemption does not apply to a person who has opted out of the de minimis threshold by including in the income tax return for the year a FIF income or loss. Please note that a person opting out of the de minimis threshold needs to include FIF income or loss in any of the four subsequent income years even if the total cost of all attributing interests is $50,000 or less. Even after four years a person must continue to apply the FIF rules if they hold any of the shares they held at the time of opting out.

Format of disclosure

The forms for the disclosure of FIF interests are as follows:

- IR443 form for the deemed rate of return method
- IR445 form for the fair dividend rate method (for widely-held entities)
- IR446 form for the comparative value method (for widely-held entities)
- IR447 form for the fair dividend rate method (for individuals or non-widely-held entities)
- IR448 form for the comparative value method (for individuals or non-widely-held entities)
- IR449 form for the cost method
- IR458 electronic form for the attributable FIF income method (this form can also be used to make electronic disclosures for all other methods).

It is now possible to download a spreadsheet as a working paper or complete the disclosures online. If you're downloading the spreadsheet you will be able to save it as a working paper on your computer and when completed submit the form by using Inland Revenue's online services.

You will still be able to complete the disclosure online without downloading a spreadsheet by directly entering the disclosure online.

The IR445 and IR446 forms, which reflect the disclosure for fair dividend rate and comparative value for *widely-held entities*, must be filed online. As discussed above this disclosure is by country rather than by individual investment as is the general requirement of section 61. In order to be exempt from the general requirements, the alternative disclosure must be made electronically.

The IR447, IR448 and IR449 forms, applying to the fair dividend rate and comparative value methods for *individuals or non widely-held entities* as well as the cost method for all taxpayers, may be completed online.

As noted above, all of the above disclosures can now be filed using the IR458 electronic disclosure.

The online forms can be found at www.ird.govt.nz "Get it done online", "Foreign investment fund disclosure".

Income interest of 10% or more in a foreign company

A resident is required to disclose an income interest of 10% or more in a foreign company. This obligation to disclose applies to all foreign companies regardless of the country of residence. For this purpose, the following interests need to be considered:

a) an income interest held directly in a foreign company

b) an income interest held indirectly through any interposed foreign company

c) an income interest held by an associated person (not being a controlled foreign company) as defined by subpart YB of the ITA.

To determine whether a resident has an income interest of 10% or more for CFCs, sections EX 14 to EX 17 of the ITA should be applied. To determine whether a resident has an income interest of 10% or more in any entity that is not a CFC, for the purposes of this exemption, sections EX 14 to EX 17 should be applied to the foreign company as if it were a CFC.

Format of disclosure

Disclosure of all interests in a controlled foreign company is required using a Controlled foreign companies disclosure (IR458) form. This form, which involves uploading a prescribed spreadsheet, can cater for up to 500 individual disclosures.

The IR458 form must be completed online at **www.ird.govt.nz** (keyword: ir458). Please note that electronic filing is a mandatory requirement for CFC disclosure.

Overlap of interests

It is possible that a resident may be required to disclose an interest in a foreign company which also constitutes an attributing interest in a FIF. For example, a person with an income interest of 10% or greater in a foreign company that is not a CFC is strictly required to disclose both an interest held in a foreign company and an attributing interest in a FIF.

To meet disclosure requirements, only one form of disclosure is required for each interest. If the interest is an attributing interest in a FIF, then the appropriate disclosure for the calculation method, as discussed previously, must be made.

In all other cases, where the interest in a foreign company is not an attributing interest in a FIF, the IR458 for controlled foreign companies must be filed.

Interests held by non-residents and transitional residents

Interests held by non-residents and transitional residents in foreign companies and FIFs do not need to be disclosed.

This would apply for example to an overseas company operating in New Zealand (through a branch) in respect of its interests in foreign companies and FIFs; or to a transitional resident with interests in a foreign company or an attributing interest in a FIF.

Under the international tax rules, non-residents and transitional residents are not required to calculate or attribute income under either the CFC or FIF rules. Therefore disclosure of non-residents' or transitional residents' holdings in foreign companies or FIFs is not necessary for the administration of the international tax rules and so an exemption is made for this group.

Persons not required to comply with section 61 of the Tax Administration Act 1994

This exemption may be cited as "International Tax Disclosure Exemption ITR27".

1. Reference

This exemption is made under section 61(2) of the Tax Administration Act 1994. It details interests in foreign companies and attributing interests in FIFs in relation to which any person is not required to comply with the requirements in section 61 of the Tax Administration Act 1994 to make disclosure of their interests, for the income year ended 31 March 2016.

2. Interpretation

For the purpose of this disclosure exemption:

- to determine an income interest of 10% or more, sections EX 14 to EX 17 of the Income Tax Act 2007 apply for interests in controlled foreign companies. In the case of attributing interests in FIFs, those sections are to be applied as if the FIF were a CFC, and
- double tax agreement means a double tax agreement in force as at 31 March 2016 in one of the 39 countries or territories as set out in the commentary.

The relevant definition of "associated persons" is contained in subpart YB of the Income Tax Act 2007.

Otherwise, unless the context requires, expressions used have the same meaning as in section YA 1 of the Income Tax Act 2007.

3. Exemption

i. Any person who holds an income interest of less than 10% in a foreign company, including interests held by associated persons, that is not an attributing interest in a FIF, or that is an attributing interest in a FIF in respect of which no FIF income or loss arises under either section CQ 5(1)(d) or section DN 6(1)(d) of the Income Tax Act 2007, is not required to comply with section 61(1) of the Tax Administration Act 1994 for that interest and that income year.

ii. Any person who is a portfolio investment entity, widely-held company, widely-held superannuation fund or widely-held GIF, who has an attributing interest in a FIF, other than a direct interest of 10% or more in a foreign company that is not a foreign PIE equivalent, and uses the fair dividend rate or comparative value calculation method for that interest, is not required to comply with section 61(1) of the Tax Administration Act 1994 in respect of that interest and that income year, if the person discloses the end-of-year New Zealand dollar market value of investments, in an electronic format prescribed by the Commissioner, split by the jurisdiction in which the attributing interest in a FIF is held or listed.

iii. Any person who is not a portfolio investment entity, widely-held company, widely-held superannuation fund or widely-held GIF, who has an attributing interest in a FIF, other than a direct income interest of 10% or more, and uses the fair dividend rate or comparative value calculation method is not required to comply with section 61(1) of the Tax Administration Act 1994 in respect of that interest and that income year, to the extent that the FIF is incorporated or tax resident in a country or territory with which New Zealand has a double tax agreement in force at 31 March 2016.

iv. Any non-resident person or transitional resident who has an income interest or a control interest in a foreign company or an attributing interest in a FIF in the income year corresponding to the tax year ending 31 March 2016, is not required to comply with section 61(1) of the Tax Administration Act 1994 in respect of that interest and that income year if either or both of the following apply:
    - no attributed CFC income or loss arises in respect of that interest in that foreign company under sections CQ 2(1)(d) or DN 2(1)(d) of the Income Tax Act 2007; and/or
    - no FIF income or loss arises in respect of that interest in that FIF under sections CQ 5(1)(f) or DN 6(1)(f) of the Income Tax Act 2007.

This exemption is made by me acting under delegated authority from the Commissioner of Inland Revenue pursuant to section 7 of the Tax Administration Act 1994.

This exemption is signed on 7 March 2016.

Dr Peter Loerscher

Principal Advisor (International Tax)

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 16/01: INCOME TAX, WORKING FOR FAMILIES TAX CREDITS – PRINCIPAL CAREGIVER – DEPENDENT CHILD – PRIMARY RESPONSIBILITY FOR DAY-TO-DAY CARE – MEANING OF "TEMPORARY BASIS"

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

Question

1. Can a person looking after a child on a temporary basis become eligible to receive Working for Families tax credits (WfFTC)?

Answer

2. To be eligible for WfFTC, a person needs to meet a number of requirements, including that they are the **principal caregiver** of a **dependent child**. Generally a person who is caring for a child on a temporary basis would not be eligible for WfFTC because they would probably not meet the principal caregiver requirement, and also the child would likely not be their dependent child.

3. A person will be a principal caregiver for a dependent child when the following criteria are met:
   - the child meets certain age and status requirements;
   - the person is primarily responsible for the child's care;
   - the child is maintained as a member of the person's family;
   - the child is financially dependent on the person; **and**
   - the person either:
     - (a) has the primary responsibility for the day-to-day care of the child on a more than temporary basis;

   or

     - (b) they live apart from whoever meets the requirement in (a), and they have the child in their exclusive care for certain minimum periods (so there is shared care of the child).

4. This QWBA provides some guidance on each of these criteria.

Please note: *The focus of this QWBA is on situations where someone has taken over the primary responsibility for the day-to-day care of a child for a time, and the question is whether that is on a more than temporary basis. If it is, that would mean that they are the child's "principal caregiver" and may become eligible for WfFTC.*

In situations where the care of a child is divided between people in different households, there may be what is known as shared care. In a shared care situation, there will be more than one "principal caregiver" for a child. Under the shared care rules, both parents (or other caregivers) may therefore potentially be eligible for WfFTC. Those situations do not involve considering whether the person has primary responsibility for the day-to-day care of the child on a more than temporary basis.

There will be shared care if there is a person who lives apart from someone else who qualifies for WfFTC, and they have the child in their exclusive care for at least a third of a 4-month period, tax year, or (in the case of the parental tax credit) entitlement period.

Explanation

Background

5. The Working for Families (WfF) regime is aimed at helping families with dependent children, through the provision of financial support to ensure an adequate family income and to help make it easier to work and raise a family. The WfF regime includes four different tax credits: the family tax credit, the in-work tax credit, the minimum family tax credit, and the parental tax credit.

6. There are a number of requirements that must be met for someone to qualify for WfFTC. The main requirements are that the person must be at least 16 years old, satisfy certain residence requirements, and be the principal caregiver for one or more dependent children. In the case of the in-work tax credit and the minimum family tax credit there are also work-based criteria.

7. This QWBA provides guidance on when someone will be a **principal caregiver** for a **dependent child**. The criteria for a child being a person's dependent child, and for the person being a principal caregiver of the

child, are set out above at [3]. Each of those criteria is discussed below, and summarised in the flowchart in the Appendix to this QWBA.

8. This QWBA **does not consider any of the other WfFTC requirements** (such as those mentioned at [6]).

When will a child be a person's dependent child?

9. A child will be a person's **dependent child** when:

Dependent child

- *the child meets certain age and status requirements;*
- *the person is primarily responsible for the child's care;*
- *the child is maintained as a member of the person's family; and*
- *the child is financially dependent on the person.*

What are the age and status requirements the child has to meet?

10. To potentially be a "dependent child" for WfFTC, a child must be:
    - aged:
        - 15 or younger; or
        - 16-18, and not financially independent[1] (and in the case of an 18 year old, attending either school or a tertiary educational institution); and
    - unmarried, and not in a civil union or de facto relationship.

11. It is noted that in some circumstances a child will be excluded from being a "dependent child". This may be the case where a payment is made because the child is placed in someone's charge under s 362 of the Children, Young Persons, and Their Families Act 1989, or if an orphan's or unsupported child's benefit is paid in relation to the child. Only in-work tax credits may be available in those situations.

When will a person be primarily responsible for a child's care?

12. The person seeking to claim WfFTC must be primarily responsible for the child's care. This means that the person has the main obligation or responsibility for ensuring that the health, welfare, maintenance and protection of the child are being provided for. Often this will be one of the child's parents.

13. Where there is a question about whether the primary responsibility for the child's care has shifted to the other parent, or to another person, it is a matter of judgement whether the person who had the primary responsibility for care has given that responsibility to someone else. This will involve considering who makes decisions about the child's care (eg, housing, health, education etc) and takes the main responsibility for ensuring that the child is cared for physically and emotionally.

14. This question often arises when an overseas exchange student is staying with a family in New Zealand. In this situation, the Commissioner considers that the New Zealand host family is typically not primarily responsible for the child's care, and so is typically not eligible for WfFTC for the child. Although the child is staying with and being cared for by the New Zealand host family, the child's parent(s) or (other guardians / caregivers) will usually still have the primary responsibility for ensuring that the child's care needs are met. There may be some circumstances where this is not the case, and the host parents have taken over the primary responsibility for care.

15. Another common situation is when multiple generations live together as a family in one household, and a person other than the child's parent(s) provides much of the day-to-day care for the child. In this situation, if the parent(s) are part of the family and involved in the child's life, and are not themselves dependent children, the Commissioner considers that they will not typically have given up their primary responsibility for ensuring that the child's care needs are met. There may be some circumstances where they have given up responsibility, but this will not be the case simply because someone else in the family cares for the child while the parent(s) are working, for instance. This means that if anyone can claim WfFTC, it will be the parents, not the extended family member.

When will a child be maintained as a member of a person's family?

16. The child needs to be maintained as a member of the person's family. This means that the child is treated as part of the person's family group and, as with other members of the family, they receive what they need to live, such as food, shelter, and clothing. Being maintained as a member of the person's family implies that the arrangement is an on-going one, though not necessarily indefinite.

When will a child be financially dependent on a person?

17. The child needs to be financially dependent on the person seeking to claim WfFTC. This means that the child is not financially independent,[2] and is reliant on the person for financial support to meet their needs.

[1] A child will be considered financially independent if they work an average of 30 hours or more per week, or if they receive a benefit, student allowance, or other similar government assistance.

[2] See footnote 1 above as to when a child is considered financially independent.

18. A child may be financially dependent on more than one person. For example, in a two-parent family, a child will be financially dependent on both parents. It does not matter that one of the parents may not have an income source; the child is still dependent on both parents for the provision of their financial needs.
19. On the other hand, a child will not necessarily be financially dependent on a person just because they provide some money to help support the child. There needs to be dependence on the financial support, such that without it the child's needs would not be met.

When will a person be a child's principal caregiver?

20. If all of the "dependent child" criteria discussed above are met, the person must also be the child's **principal caregiver** to be potentially eligible for WfFTC. This will be the case when:

Principal caregiver

- *the person either:*
  - *(a) has the primary responsibility for the day-to-day care of the child on a more than temporary basis;*

  or

  - *(b) they live apart from whoever meets the requirement in (a), and they have the child in their exclusive care for certain minimum periods (so* there is shared care of the child).

21. The "principal caregiver" **cannot be**:
    - a body of persons (whether incorporated or not);
    - the spouse or partner of a "transitional resident" (see s HR 8); or
    - a proprietor or employee of certain residences[3] or institutions[4] in which the child is cared for.
22. In addition to not being the spouse or partner of a transitional resident, the person cannot get WfFTC if they are themselves a transitional resident. If an application for WfFTC is made by a transitional resident, it is treated as being an election to no longer be a transitional resident (see s HR 8(5)).

Shared care

23. As noted above, if the care of a child is divided between parents (or other caregivers/guardians), there may be what is known as "shared care". In a shared care situation, there will be more than one "principal caregiver" for a child. Under the shared care rules, both parents (or other caregivers) may therefore potentially be eligible for WfFTC.
24. A person will be another "principal caregiver" under the shared care rules if they live apart from someone else who qualifies for WfFTC, and they have the child in their exclusive care for at least a third of a 4-month period, tax year, or (in the case of the parental tax credit) entitlement period.[5]
25. Those situations do not involve considering whether the person has primary responsibility for the day-to-day care of the child on a more than temporary basis.

When will a person have primary responsibility for the day-to-day care of a child on a more than temporary basis?

26. In situations where someone has **taken over the primary responsibility for the day-to-day care of a child** for a time, they may potentially become eligible for WfFTC. This requires considering whether their primary responsibility for the day-to-day care is on a more than temporary basis.

Primary responsibility for day-to-day care of the child

27. To meet this requirement, the person must be the one who is primarily responsible for providing or ensuring the provision of what the child needs on a daily basis for their health, welfare, maintenance and protection.
28. To decide if a person has the primary responsibility for the day-to-day care of a child, you must consider the extent to which the person performs the day-to-day responsibilities for the child, or ensures that these responsibilities are met. These day-to-day responsibilities include things such as taking the child to and from school or childcare, preparing their meals, supervising their leisure activities, taking care of their daily routines (such as bathing, hygiene and sleep), and caring for them when sick.
29. This does not mean that the person has to perform all of these responsibilities themselves (though invariably they will perform at least some). For example, the fact that another family member or a paid caregiver performs some, or even most, of these day-to-day tasks does not mean that the person does not have the primary responsibility for the provision of that care. The fact that they have arranged for someone else to perform these tasks while they are at work, or because they require assistance, does not mean they do not have primary responsibility for the child's day-to-day care.

[3] Residences established under the Children, Young Persons, and Their Families Act 1989.

[4] Any institution in which a child is cared for, including residential disability care institutions as defined in s 58(4) of the Health and Disability Services (Safety) Act 2001.

[5] This is the first 70 days after the child's birth date (s MD 11(1)(b)(i)).

30. In a sole-parenting situation, it will often be easy to determine who has the primary responsibility for the day-to-day care of the child and so is the child's principal caregiver. In a joint-parenting situation, where the parents live in the same household, the child's principal caregiver must still be determined, as this is the person who will receive the WfFTC. The above factors will be relevant to deciding who this is.

31. Where parents (or other caregivers) who do not live together share the care of a child, only one of them can have the primary responsibility for the day-to-day care of the child. However, in a shared care situation both parents (or other caregivers) may be principal caregivers of the child, and so potentially eligible for WfFTC. The requirements for the other parent/caregiver in a shared care arrangement to also be a "principal caregiver" are noted above from [23].

Temporary basis

32. A person will **not** be a "principal caregiver" for a dependent child[6] if they have primary responsibility for the day-to-day care of the child only on a temporary basis.

33. The Act does not define what a "temporary basis" is, and the Commissioner has been asked to provide some guidance around this.

34. The *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) defines "temporary" as "lasting only for a limited period". The ordinary meaning of "temporary" indicates that day-to-day care will be on a "temporary basis" if it lasts for a limited (and usually short) period of time.

35. The courts have not considered the meaning of the term "temporary" in s MC 10(1)(a). However, the Australian courts have considered the meaning of "temporary" in the context of social security legislation. In *Hafza v Director General of Social Security* (1985) 60 ALR 674 (FCA), Wilcox J considered whether a person's absence from Australia was temporary only, which would mean that the person would remain entitled to a child endowment under the (then) Social Services Act 1947 (Cth). Wilcox J stated (relevantly) at 682:

> The *Shorter Oxford Dictionary* defines 'temporary' as 'lasting for a limited time; existing or valid for a time (only); transient; made to supply a passing need'. The Macquarie Dictionary definition is to similar effect, with the addition of 'not permanent'. In one sense any absence from Australia, which in fact comes to an end, is temporary; it turns out to have lasted for a limited — as distinct from an unlimited — time and to have been not permanent. In this sense everything in human affairs, including life itself, is 'temporary'. But it is doubtful whether the word 'temporary' was used in this wide sense in s. 103(1)(d). As I have pointed out, had it been intended to protect the endowment rights of persons absent abroad for lengthy periods, who ultimately return to Australia and who, in the meantime, maintain some association with Australia, it would have been enough to refer to residence in Australia. Plainly it was intended to be more restrictive than that. **I think that the adjective 'temporary' was used to denote an absence that was, both in intention and in fact, limited to the fulfilment of a passing purpose. The purpose might be of a business or professional nature; it might be for a holiday or for compassionate or family reasons. But, whatever the purpose, it seems to me to be implied in the concept of 'temporary' absence that the absence will be relatively short and that its duration will be either defined in advance or be related to the fulfilment of a specific, passing purpose.** [Emphasis added]

36. The Commissioner considers that "temporary" in the context of s MC 10(1) should be given a similar meaning. That is, primary responsibility for the day-to-day care of a dependent child would be on a **temporary basis** if:

- it was for a relatively short period; <u>and</u>
- the duration for which the person has the responsibility for day-to-day care is either defined in advance or related to the fulfilment of a specific, passing purpose.

37. Based on the statutory context of the WfFTC provisions, the Commissioner considers that if someone has primary responsibility for the day-to-day care of a child for a period (or expected period) of at least three to four months, that will be more than "relatively short". In those circumstances, the person might therefore have primary responsibility for the child's day-to-day care on a more than "temporary basis". However, it is also necessary to consider the circumstances of any given situation including whether the period for which the person has the primary responsibility for day-to-day care is defined in advance or is related to the fulfilment of a specific, passing purpose.

38. The Commissioner considers that if someone has primary responsibility for the day-to-day care of a child for a period expected to be less than three to four months, that is not enough to be more than temporary. It is unlikely that a person will meet the level of responsibility for a child to be their "dependent child" (which is required by the legislation) if the

[6] Shared care situations aside – see further from [23] in that regard.

intended timeframe for them having the primary responsibility for the child's day-to-day care is less than that. In the Commissioner's view, the other WfFTC eligibility requirements, including that the child is the person's dependent child, give some context to the sort of indicative time period that might be regarded as more than temporary.

39. Conversely, this means that a person who has the primary responsibility for the day-to-day care of a dependent child for a period that is, or is expected to be, more than three to four months is likely to be the child's principal caregiver. However, if the responsibility for care is for a defined period, or for a specific, passing purpose, that will need to be taken into consideration in determining whether the responsibility for the care is nonetheless only on a temporary basis.

Change of arrangements

40. If the arrangements for the care of a child change and this means that a person will no longer be a principal caregiver for the child, that person must notify the Commissioner of the change in care arrangements immediately (see s MC 10(6)).

Other requirements for WfFTC eligibility

41. As noted above, this QWBA is only looking at the requirements for being a principal caregiver for a dependent child. It **does not consider any of the other WfFTC requirements** (such as those mentioned at [6]).

Examples

42. The following examples are included to assist in explaining when a person will be a principal caregiver for a dependent child by virtue of having primary responsibility for the day-to-day care of the child, other than on a temporary basis. These examples do not consider whether there is shared care of the child, or whether the other WfFTC eligibility requirements (such as age and residency) are met.

Example 1: The primary responsibility for the day-to-day care does not change to another person

43. Tane is five years old. He lives with his parents, Anahera and Justin. Anahera is Tane's principal caregiver. She works as a bus driver and receives WfFTC. Anahera and Justin are undertaking major renovations to their home, and they decide that Tane should stay at his grandmother's house for approximately five months while the renovations are carried out.

44. For the following five months, Tane sleeps at his grandmother's house and spends most of his free time there. Anahera drops Tane off to school in the mornings, and his grandmother picks him up after school. After work, Anahera and Justin spend the evenings at Anahera's mother's house with Tane. They eat dinner with him, help him with his homework, and put him to bed. Tane's grandmother prepares Tane's meals, and Anahera and Justin contribute towards the cost of groceries and other bills. Anahera takes Tane to soccer, birthday parties, and to friends' houses to play. When Tane is sick during this time, Anahera takes him to doctor's appointments and looks after him at her mother's house. She spends the weekends with Tane at her mother's house, while Justin works on the house renovations.

45. There is no question that Tane is Anahera's "dependent child" – Anahera is primarily responsible for ensuring that he is cared for, she maintains him as a member of her family, and he is financially dependent on her.

46. Anahera wants to know if she is still considered Tane's "principal caregiver" during the five-month period of the renovations, and so remains eligible for WfFTC during that time.

47. Anahera continues to have the primary responsibility for Tane's day-to-day care during the period of the house renovations, while he is staying at his grandmother's house. This is because she is the person with the main responsibility for ensuring that Tane is physically cared for on a daily basis. It is predominantly Anahera who performs the day-to-day responsibilities involved in caring for Tane, or ensures that these responsibilities are met. While Tane's grandmother helps provide day-to-day care for Tane, Anahera continues to have primary responsibility for the provision of that care.

48. Because Anahera continues to have the primary responsibility for Tane's day-to-day care, it is irrelevant that he is living at his grandmother's house for a length of time that would potentially be regarded as more than temporary in terms of s MC 10(1). Tane's grandmother does not have the primary responsibility for Tane's day-to-day care. Anahera remains eligible for WfFTC during the renovation period.

Example 2: Having primary responsibility, but only on a temporary basis

49. Michelle is a single mum with a seven-year-old daughter, Isabella. Michelle works in a call centre and, as Isabella's principal caregiver, receives WfFTC. Michelle has to undergo major surgery, and will not be able to look after Isabella for approximately one month after the surgery. During Michelle's recovery period, Isabella is going to live with her aunt, Olivia. For that month, Olivia will take on all of the responsibilities

involved in Isabella's day-to-day care. She will be responsible for Isabella's meals, will take Isabella to school and pick her up from after school care, will help her with her homework, supervise her leisure activities, and care for her in the evenings and on the weekends. Michelle will be unable to ensure that Isabella's day-to-day care needs are met, and Olivia will be taking on responsibility for ensuring that they are.

50. Michelle wants to know if Olivia will be Isabella's principal caregiver for WfFTC purposes for this period of time.

51. Olivia will have the primary responsibility for Isabella's day-to-day care during the time she will be living with her. However, Olivia's primary responsibility for Isabella's day-to-day care is only on a temporary basis. This is because it is for a relatively short period (approximately one month), and is for a specific, temporary purpose, as Michelle recovers from her surgery. Olivia will therefore not be Isabella's principal caregiver during this period, and Michelle will remain Isabella's principal caregiver.

52. In any event, it is noted that Isabella would be unlikely to be Olivia's "dependent child" during Michelle's recovery period. Olivia is unlikely to assume primary responsibility for high level care decisions for Isabella (such as housing, health, education etc) during this period, and Isabella is unlikely to be financially dependent on her aunt just because her aunt is caring for her temporarily.

53. This means that Michelle will continue to receive WfFTC for Isabella during this period.

Example 3: Parental caregiver changes

54. James, a single dad, is receiving WfFTC. He is unable to look after his ten-year-old son, Hayden, as his new job requires him to travel extensively. James' sister, Margaret, who works as a retail assistant, agrees to have Hayden come and live with her until James' circumstances change. James will only look after Hayden during his annual leave, and every few weekends when he is in town. At this stage, James does not know when he will be able to look after Hayden on a full-time basis again. Margaret looks after Hayden as if he were her own son, and James sends some money to Margaret to help with the costs of looking after Hayden. To work out who is entitled to WfFTC, James and Margaret want to know who is Hayden's principal caregiver while this arrangement remains in place.

55. While this care arrangement exists, James will not be Hayden's principal caregiver. He does not have the primary responsibility for Hayden's day-to-day care during this time; Margaret does. Margaret has the main responsibility for ensuring that Hayden is physically cared for on a daily basis. She performs (or ensures the performance of) the day-to-day responsibilities involved in caring for Hayden. Margaret is taking on the responsibility of caring for Hayden for an undefined period of time, because James does not know when his work will enable him to look after Hayden on a full-time basis again. This means that Margaret is taking on the primary responsibility for Hayden's day-to-day care on a more than temporary basis. As such, James will no longer be Hayden's principal caregiver and will no longer be eligible for WfFTC. James is required to notify the Commissioner of the change in care arrangements immediately (see s MC 10(6)).

56. For Margaret to be eligible for WfFTC, Hayden must be her dependent child (see [9] to [19]), and the other WfFTC requirements must be met (see for example [6]).

57. To determine if Hayden is Margaret's "dependent child", it will be necessary to consider whether she has taken on primary responsibility for his care. It will be a matter of judgement whether James has given up this responsibility. This will involve considering who makes decisions about Hayden's care (eg, housing, health, education etc), and takes the main responsibility for ensuring that Hayden is cared for physically and emotionally. In this case, it may be that Margaret has assumed such responsibility. Hayden must also be maintained as a member of Margaret's family. This criteria would be met in this case. Finally, Hayden must be financially dependent on Margaret. While James provides some money to help with the costs of looking after Hayden, it may well be that Hayden is financially dependent on Margaret as well as James – more information about the financial arrangements would be required to determine this.

References

Subject references
Income Tax, Working for Families, principal caregiver, primary responsibility for day-to-day care, temporary basis
Legislative references
Income Tax Act 2007 – ss MC 2, MC 4, MC 10, and the definition of "dependent child" in s YA 1.
Case references
Hafza v Director General of Social Security (1985) 60 ALR 674 (FCA)
Other references
The Concise Oxford English Dictionary (12th ed, Oxford University Press, New York, 2011)

Appendix

A person will be a "principal caregiver" for a "dependent child" when:

The child is the person's dependent child

The **child** meets certain requirements[1]

The child must be:

- aged 15 or younger; or
- aged 16-18 and not financially independent (ie, not working an average of 30 hours or more per week, and not receiving a benefit, student allowance, or other similar government assistance)

[If aged 18, they must be at school or a tertiary educational institution]; and

- unmarried, and not in a civil union or de facto relationship.

The person is **primarily responsible for the child's care**

They are the one with the main obligation or responsibility for ensuring that the health, welfare, maintenance and protection of the child are being provided for (eg, they are responsible for making decisions about the child's housing, health, education etc, and they take the main responsibility for ensuring that the child is cared for physically and emotionally).

The child is **maintained as a member of the person's family**

The child is treated as part of the person's family group in an on-going way, and as such they receive what they need to live, such as food, shelter, and clothing.

The child is **financially dependent** on the person

The child is not financially independent, and is reliant on the person for financial support to meet their needs.

The person[2] is a principal caregiver for the child

The person has the primary responsibility for the day-to-day care of the child on a more than temporary basis

The person has the main responsibility for ensuring the child's **day-to-day** care needs are met. This includes things such as: taking the child to/from school or childcare, preparing their meals, supervising their leisure activities, taking care of their daily routines, and caring for them when sick.

But primary responsibility for the day-to-day care of a dependent child would be on a **temporary basis** if:

- it is for a **relatively short** period (typically a period that is, or is expected to be, less than three to four months); <u>and</u>
- the duration for which the person has the responsibility is either **defined in advance** or **related to the fulfilment of a specific, passing purpose**.

The person has shared care of the child

The person lives apart from someone else who qualifies for WfFTC, and they have the child in their exclusive care for at least a third of a 4-month period, tax year, or (for the parental tax credit) the entitlement period.

[1] **Note:** The child might be **excluded** where certain benefits are paid – see [11].

[2] **Note:** The person cannot be: a body of persons, a tax "transitional resident" or the spouse/partner of one, or the proprietor or employee of an institution that cares for the child.

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