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Inland Revenue
Te Tari Taake

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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

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Binding rulings

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Judge not disqualified from hearing application to set aside his earlier judgment 57

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Questions we've been asked

QB 10/01: Reimbursing shareholder-employees for motor vehicle expenses and the use of the Commissioner's mileage rate 59

This question we've been asked considers whether an employer who reimburses an employee for the business use of their private motor vehicle is able to use the Commissioner's mileage rate and clarifies the "employee criteria" when it comes to reimbursing shareholder-employees. The item also considers whether the 5,000 km limitation on using that mileage rate also applies when reimbursing employees.

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 our information booklet *Adjudication & Rulings: A guide to binding rulings (IR 715)* or the article on page 1 of *Tax Information Bulletin*, Vol 6, No 12 (May 1995) or Vol 7, No 2 (August 1995).

You can download these publications free from our website at **www.ird.govt.nz**

PUBLIC RULING BR PUB 09/08: "COST PRICE OF THE VEHICLE" – MEANING OF THE TERM FOR FRINGE BENEFIT TAX PURPOSES

Note (not part of ruling): The key issue considered by this Ruling is what is included in the "cost price" of a motor vehicle for fringe benefit tax purposes. The conclusion is that the cost price includes the vehicle's purchase price, initial registration and licence plate fees, the cost of accessories (other than "business accessories"), and the cost of transporting the vehicle to the place where it is first to be used (each of these costs being on a GST-inclusive basis).

This Ruling replaces public ruling BR Pub 03/06, which was published in *Tax Information Bulletin* Vol 15, No 9 (September 2003). BR Pub 03/06 applied until 31 October 2008 and was a reissue of BR Pub 00/10, which was published in *Tax Information Bulletin* Vol 12, No 10 (October 2000). This Ruling is essentially the same as BR Pub 03/06, but now indicates that the Commissioner is prepared to accept that signwriting the vehicle in the employer's colours (in physical terms, the addition of paint or other graphics) is not part of the cost price of the vehicle for FBT purposes. A reference is also made to road user charges. The Ruling has been updated to apply the Income Tax Act 2007, which came into force on 1 April 2008. The changes between the provisions in the Income Tax Act 1994 and the Income Tax Act 2007 do not affect the conclusions previously reached.

BR Pub 09/08 applies for an indefinite period beginning on 1 November 2008.

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

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of section CX 6(a) and Schedule 5 (and the meaning of "cost price" for the purposes of determining the value of a benefit to an employee).

The Arrangement to which this Ruling applies

The Arrangement is the provision of a motor vehicle by an employer, who owns, leases, or rents a motor vehicle, to an employee for the employee's private use and enjoyment.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows.

The "cost price of the vehicle" for the purposes of the calculation of fringe benefit tax under section CX 6(a) and Schedule 5 will be determined as follows:

- The "cost price of the vehicle" will include the:
  - purchase price of the vehicle (inclusive of goods and services tax (GST));
  - cost of initial registration and licence plate fees (inclusive of GST);
  - cost of accessories, components and equipment (other than "business accessories") fitted to the vehicle at the time of purchase or at any time thereafter (all costs inclusive of GST);
  - cost (if any), including freight insurance costs and any customs duty, of transporting the motor vehicle to the place where the motor vehicle is to be first used (all charges inclusive of GST).
- The "cost price of the vehicle" will not include the cost of:
  - annual vehicle re-licensing fees;
  - road user charges;
  - signwriting the vehicle in the employer's colours or style (in physical terms, the addition of paint or other graphics such as magnetic signs, decals or transfers);
  - "business accessories" fitted to the motor vehicle at the time of purchase or at any time thereafter; and
  - financing the purchase of the vehicle.

For the purposes of this Ruling the terms "business accessories" and "fitted to the vehicle" have the following meanings:

- The term "business accessories" means accessories, components and equipment fitted to the vehicle, required for and relating solely to the business operations for which the vehicle is used, and that are in themselves "depreciable property" for the purposes of the Act. Where powered, they will usually require the vehicle's power source to operate them (for example, a two-way radio, roof-mounted flashing warning lights, and electronic testing/monitoring equipment).
- The term "fitted to the vehicle" means permanently affixed to the vehicle. Permanency would not be negated if the accessory were removed from the vehicle on a temporary basis, for repair or maintenance, or on the removal of the accessory at the time of sale or disposal of the vehicle or the accessory itself.

The period or income year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 1 November 2008.

This Ruling is signed by me on the 30th day of November 2009.

Susan Price
Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 09/08

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusion reached in public ruling BR Pub 09/08 "the Ruling").

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

Background

If an employee has the private use or enjoyment, or the availability for private use or enjoyment, of a motor vehicle that is made available by the employer of the employee, the employer must pay fringe benefit tax (FBT) on the value of the benefit. An employer has the option (since 1 April 2006) of valuing owned, leased, or rented motor vehicles at either the vehicle's cost price or tax value. When choosing the cost price option the benefit is calculated by reference to the cost price of the vehicle to the employer, not the value of the benefit to the employee. If an employer purchases, leases, or rents a motor vehicle to be used by, or to be made available for use by, an employee, costs are incurred in addition to the purchase price of the vehicle for the vehicle to be in a state where it can be used by the employee. Additional costs include:

- on-road costs—under section 5 of the Transport (Vehicle and Driver Registration and Licensing) Act 1986, no motor vehicle can be driven on the road unless the:
  - motor vehicle is registered; and
  - registration plates and a current licence issued for the vehicle are affixed and displayed on the vehicle; and
  - full amount of the accident compensation levy has been paid;
- road user charges—under section 5 of the Road User Charges Act 1977 subject to section 7 of the Road User Charges Act 1977, no person shall operate certain motor vehicles on a road unless there is carried on the motor vehicle in accordance with the Road User Charges Act 1977 a distance licence;
- the cost, including freight insurance costs and any customs duty, of transporting the vehicle to the initial place where it is to be used;
- the cost of fitted accessories, components or equipment required for and relating solely to the business operations for which the vehicle is used; and
- the cost of accessories, components and equipment, such as tow bars, roof racks, and stereos, fitted to the car at the time of purchase or at some later time.

This Ruling identifies the costs that form part of the "cost price of the vehicle" for the purposes of calculating FBT.

The Commissioner considers the cost of a motor vehicle includes any accessories that are permanently affixed to the vehicle. Everything that is permanently affixed to the vehicle, including accessories such as CD players, tow bars and radio-telephone sets, is part of the cost to the employer of making the vehicle available to the employee. Accessories that are not permanently affixed are not part of the cost price of the vehicle in the first place and their FBT (or other income tax) status is to be determined separately. However, the Commissioner considers that certain accessories, permanently fitted to the vehicle and relating solely to the business operations for which the vehicle is used, should not be treated as part of the cost of the vehicle for FBT purposes. For example, a radio-telephone set fitted to the vehicle and able to be used only for business purposes would be excluded from the vehicle's cost price because it is a "business accessory". On the other hand, a mobile phone is an example of an item considered not to be part of the cost price of the vehicle because it does not meet the test of being permanently affixed to the vehicle.

Legislation

The legislative provisions relevant to the subsequent analysis in this commentary are set out below.

Section CX 6 provides that a fringe benefit arises, when a motor vehicle is made available to an employee for their private use, and section RD 29(2) and (4) sets out the formulae for calculating the value of such a benefit:

RD 29 Private use of motor vehicle: formulas

Quarterly payment

(2) If FBT is paid quarterly, the value of the benefit is calculated using the formula—

$$\frac{\text{day} \times \text{schedule 5 amount}}{90}$$

Payment by income year

(4) If FBT is paid on an income year basis, the value of the benefit is calculated using the formula—

$$\frac{\text{day} \times \text{schedule 5 amount}}{365}$$

Clause 1 paragraphs (a)(i) and (b)(i) of Schedule 5 state:

Fringe benefit values for motor vehicles

1 The following paragraphs apply to determine the value of the benefit that an employee has for a quarter, tax year, or income year when section RD 60 applies, if in the quarter, tax year, or income year, a motor vehicle is provided by a person for the private use of an employee, or is made available for their private use:

(a) if the vehicle is owned by the person, jointly or otherwise,—

(i) on the basis of the **cost price of the vehicle to the person**: for a quarter, 5% of the **cost price**, and for a tax year or income year, 20% of the **cost price**:

(ii) …

(b) if the vehicle is leased or rented by the person from another person, whether they are associated or not,—

(i) on the basis of the **cost price of the vehicle** to its owner at the time the benefit is provided to the employee: for a quarter, 5% of the **cost price**, and for a tax year or income year, 20% of the **cost price**:

[Emphasis added]

Clause 8 of Schedule 5 provides:

To determine the value of a benefit under clause 1—

(a) any GST paid on the acquisition of a vehicle by the owner or lessor of the vehicle is—

(i) included in the cost price of the motor vehicle or in the calculation of the motor vehicle's tax value:

(ii) not reduced by an amount of input tax on the supply of the vehicle to the owner or lessor:

The definition of "adjusted tax value" in section YA 1(a) provides:

adjusted tax value—

(a) is defined in sections EE 55 to EE 60 …

Sections EE 55(1)(a), EE 56(1) and (2), and EE 57(1) and (2), which are particularly relevant to this matter, provide:

EE 55 Meaning of adjusted tax value

(1) **Adjusted tax value** means,—

(a) for an item of depreciable property, the amount calculated using the formula in section EE 56: …

EE 56 Formula

Formula

(1) The formula referred to in section EE 55 is—

base value − total deductions.

Definition of items in formula

(2) In the formula,—

(a) base value has the applicable meaning in sections EE 57, EE 58, EE 59, and EZ 22(1) (Base value and total deductions in section EE 56: before 1 April 1995): …

EE 57 Base value in section EE 56 when none of sections EE 58, EE 59, and EZ 22(1) applies

When this section applies

(1) This section applies when none of sections EE 58, EE 59, and EZ 22(1) (Base value and total deductions in section EE 56: before 1 April 1995) applies.

Base value

(2) Base value is the cost of the item to the person.

Application of the legislation

The determinative factor in the calculation of FBT on motor vehicles is the "cost price of the vehicle to the person" (that is, the employer, as provided in *CIR v Atlas Copco (NZ) Ltd* (1990) 12 NZTC 7,327) where the employer is the owner or, if the vehicle is leased or rented, the cost price of the vehicle to its owner at the time the benefit is provided to the employee: Schedule 5.

The High Court decision of *CIR v Atlas Copco (NZ) Ltd* was a test case regarding the meaning of "cost price" for the purposes of FBT. More specifically the issue in this case was whether "cost price" included or excluded GST. Sinclair J held that "cost price" is the GST exclusive cost to the employer of providing the benefit to the employee.

Following this decision Parliament amended the law to expressly provide that "cost price" included GST and to reflect that the intention of the FBT rules is to equate the "cost price" of motor vehicles with the cost that the employee would have had to pay had the employee purchased the vehicle (see: Tax Amendment Act (No. 3) 1991). This amendment only dealt with GST. There were no other changes made to the existing legislative wording for valuing the benefit to an employee. The reference to the cost price remained "the cost price of the motor vehicle to **that person**" (being the person providing the benefit). A set rate (now 5% for a quarter and 20% for a tax or income year under clause 8 of Schedule 5) is then applied to the GST inclusive cost price to arrive at the value of the benefit to an employee.

Meaning of "cost price"

"Cost price" is not defined in the Act for the purposes of the FBT rules. It is therefore not clear whether it is limited to the purchase price of the vehicle, as some suggest, or whether it includes costs incidental to the purchase, such as on road costs and the costs of transporting the vehicle to the place where it is to be used. However, as shown below, the use of the term throughout the Act—in the trading stock rules, the depreciation rules and in other contexts—and as reflected in accounting practice and relevant case law, indicates that "cost" and "cost price" are interchangeable. Consequently, "cost price" includes costs incidental to the purchase, such as on road costs and the costs of transporting the vehicle to the place where it will be used.

"Cost" and "cost price" in the Act

The words "cost" and "cost price" are used extensively throughout the Act. The definitions of "cost" and "cost price" in section YA 1, which defines the words for a limited number of sections, indicate that the two words are effectively synonymous and that they include more than simply the purchase price. Examples include the following:

- For the purposes of Part EB (Valuation of trading stock) "cost" is defined as:

  > In subpart EB (…) for trading stock, means costs incurred in the ordinary course of business to **bring trading stock to its present location and condition** including purchase costs and costs of production calculated under sections EB 6 to EB 8.
  >
  > [Emphasis added]

- "Cost price" in relation to "specified leases" means:

  > the amount of expenditure of a capital nature that is incurred, in acquiring and **installing** the asset,—
  >
  > (i) by the lessor;
  >
  > [Emphasis added]

The significance of these two definitions (even though they have limited application in the Act) is that they both include a reference to costs ("bringing to its present location" and "installing") that are more than simply the **purchase price** of the item in question. In the definition of "cost" (for the purposes of the trading stock rules), it could be argued that getting the stock "to its present location" is synonymous with "installing" as used in the definition of "cost price". "Install" is defined in the *Concise Oxford English Dictionary* (11th ed, revised, 2006) as "place or fix (equipment) in position ready for use". While the two definitions relate to the two different sides of the revenue–capital distinction, they both relate to the assets used in a business.

Where the words are used in other parts of the Act and there is no specific definition, it is considered that "cost price" should be given a similar interpretation. This means that "cost price" as used for FBT purposes also means "cost".

Trading stock context

The definition of "cost" applying to the valuation of trading stock requires the "cost" to include (section YA 1):

> Costs incurred in the ordinary course of business to bring trading stock to its present location and condition, including purchase costs and costs of production, calculated under sections EB 6 to EB 8.

The requirements for valuing trading stock under section EB 6, which essentially says that the trading stock valuation must comply with the New Zealand International Accounting standard NZIAS2 or an equivalent standard issued in its place, endorse the view that "cost" and "cost price" are effectively interchangeable.

Under NZIAS2, Inventories it is stated that:

> 10 The cost of inventories shall comprise all **costs of purchase**, costs of conversion and **other costs incurred in bringing the inventories to their present location and condition**.
>
> [Emphasis added]

Similarly the predecessor of NZIAS2, FRS4, which applied from 1994, indicated "cost" and "cost price" were interchangeable by taxpayers in valuing trading stock under the former valuation option, "cost price", and that the Commissioner accepted similar calculations to FRS 4. That is illustrated by the contents of an item on the valuation of trading stock published in *Public Information Bulletin* No 82 (December 1974). This item set out the three options available to taxpayers: cost price, market selling value, or replacement price. The item then went on to define "cost" (note, not "cost price"). In respect of purchases of finished goods, the item said (at page 2):

> Here the cost should include **freight inwards**, customs duty, **insurance**, and sales tax in addition to the actual purchase price of the goods.
>
> [Emphasis added]

This view that "cost" and "cost price" have the same meaning finds support in the decisions referred to below. Both the Australian decisions of *Phillip Morris Ltd v FCT* [1979] ATC 4, 352, and *Australasian Jam Company Proprietary Limited v Federal Commissioner of Taxation* 88 CLR, 23, considered section 31(1) of the Australian Income Tax Assessment Act 1936, which gave taxpayers an option of valuing trading stock at its "cost price". The wording of the section was very similar to the former New Zealand equivalent—section EE 1(3) of the Income Tax Act 1994 before amendments that applied from the 1998/99 income year (that is, the same "cost price" option applied to New Zealand taxpayers). It follows that in considering the use of the words "cost price" in New Zealand, New Zealand courts would arguably adopt the same position the Australian courts adopted in those decisions.

- In *Phillip Morris Ltd v FCT* [1979] ATC 4, 352, the Supreme Court of Victoria had to decide what constituted "cost price" for the valuation of cigarettes (trading stock) on hand at the end of an income year under section 31(1) of the Income Tax Assessment Act 1936 (Australia). Jenkinson J said:

  > the words "cost price" in section 31(1) of the Income Tax Assessment Act 1936 should be understood as meaning "cost". [page 355]
  >
  > The statutory conception of "cost price" or, **in the case of manufacturer's stock, "cost"** is merely a value at a particular time … [page 360]
  >
  > [Emphasis added]

- In *Australasian Jam Company Proprietary Limited v Federal Commissioner of Taxation* 88 CLR, 23, Fullagar J said (at page 529):

  > The words "cost price" in the section [relating to the valuation of trading stock] are **perhaps not literally appropriate to goods manufactured, as distinct from goods purchased**, by the taxpayer, but I feel no difficulty in reading them as meaning simply "cost".
  >
  > [Emphasis added]

  [See also "Some Aspects of Valuation of Trading Stock for Income Tax Purposes" (1964) 1 NZULR 256, ILM Richardson (now Sir Ivor) which endorsed Fullagar J's view in *Australasian Jam* at page 261:

  > "If "price" adds anything to "cost" it is only in emphasis, in stressing that what is involved is the actual expenditure of money by the taxpayer with relation to the trading stock".]

- In *TRA Case S12* (1995) 17 NZTC 7,102, Barber DJ considered what is meant by "its cost price" in relation to the valuation of foals born to broodmares owned by a horse breeder. He determined that the foal's cost price should include the write-down (depreciation) of the broodmare. Barber DJ said (at page 7,107):

  > The Legislature has provided that the breeder or farmer must take progeny into account at "its cost price". Those words do not seem to me to be a particularly happy choice because **"cost price" is normally that at which a merchant buys something** (refer Sixth Edition of the *Concise Oxford Dictionary*). The cost is the price to be paid for a thing and the price is the money or other consideration for which a thing is bought or sold. The taxpayer has not purchased the foal but has had the foal created through the mare after servicing from the stallion. However, in their context, the words "its cost price" must be given a sensible interpretation. In the *Shorter Oxford English Dictionary* (3rd Edition) a meaning for "cost" is "That which must be given in order to acquire, produce or effect something".
  >
  > [Emphasis added]

Accounting practice more generally

The *Atlas Copco* decision also provides support for the view that "cost" and "cost price" effectively have the same meaning. In *Atlas Copco*, for example:

- Sinclair J (at page 7,332) referred to expert accounting evidence on the meaning of "cost" and stated:

  > This accords with the expert evidence given by two accountants, Mr John Hagen and Professor David Emanuel. Professor Emanuel cited a number of definitions of "cost" from leading textbooks on accounting:
  >
  > "(a) 'Costs represent the financial sacrifices which are involved in acquiring or producing assets.' [Ma, Matthews and MacMullen, *The Accounting Framework*, 2nd ed, Longman Cheshire, 1986, at p 43.]

BINDING RULINGS

(b) 'Accountants have placed a great deal of emphasis upon the principle of objective evidence, and nowhere is it more apparent than in accounting for the acquisition of plant and equipment. Cost is used as the valuation method in this instance because it is more easily identified than any other valuation and because it is said to be the sacrifice given up now to accomplish future objectives.' [McCullers and Schroeder, *Accounting Theory: Text and Readings*, Wiley, 1978, at p 233.]

(c) 'We define cost here as the sum of the quantitative representations of the sacrifices necessarily incurred **to bring the fixed asset to its place and state of use**.' [Most, *Accounting Theory*, Grid, 1977, at p 235.]

[Emphasis added]

(d) 'Cost is thus the economic sacrifice expressed in monetary terms required to obtain a specific asset or group of assets.' [Hendriksen, *Accounting Theory*, 3rd ed, Irwin, by ES Hendriksen, 1977, at p 270.]

(e) 'Cost is an economic sacrifice, an outflow of wealth, by giving up asset value or incurring liability value.'" [Staubus, *Activity Costing for Decisions*, Garland Publishers, New York, 1988, at p 192.]

Professor Emanuel then summarised the position by saying that:

"Cost is the economic sacrifice associated **with getting the purchased item to its current location and condition**."

[Emphasis added]

[It is interesting to note that here the accountants used the term "cost" rather than "cost price"—the term (as used in Schedule 5) that the court was considering.]

- When the Commissioner objected to the evidence of the accountants Sinclair J said (at page 7,333):

Counsel for the Commissioner objected to the evidence of the two accountants on the basis that the interpretation of "cost price" is a question of law for the Court, and to rely upon the interpretation of accountants would infringe the "ultimate issue" rule. Moreover, counsel felt that the accountants had mistakenly placed economic substance over legal form in analysing the nature of the payment paid by the purchaser.

It is true that defining "cost price" is a question of statutory interpretation and, as such, must be resolved by the Court. **Where the meaning of words in a statutory context is unclear or ambiguous, however, the Court may derive some assistance from common business parlance and practice**, as well as international standards. Moreover, as I have already discussed, the approach of the accountants accords with both the economic substance and the legal form of the transaction: the GST component of the purchase price which may be recovered by a registered purchaser cannot be considered part of the effective "cost price".

[Emphasis added]

Here, the Court accepts that where there is uncertainty in the legislation, common business practice can be taken into account in defining terms or words. As sufficient doubt surrounds the use of the words in question, accounting or business usage may be of assistance.

Generally, the accounting treatment is that the initial cost of a fixed asset includes the costs of putting it into the working condition necessary for its intended use, installation costs, freight and so on (see, for example, NZIAS2 and the expert evidence given in *Atlas Copco*).

Depreciation context

The only provisions that deal with valuation of capital assets in the Act are the depreciation rules set out in Subpart EE.

Generally, business assets are "depreciable property" as defined in section EE 6. Section EE 6 provides that depreciable property is property that:

> ... might reasonably be expected to decline in value while it is used or available for use ... in carrying on a business for the purposes of deriving assessable income.

This is provided the assets are not trading stock, land, financial arrangements, or intangible property. Motor vehicles are "depreciable property" and qualify for depreciation deductions under Part EE.

Under section EE 17(4) the value or cost to calculate depreciation is, where the:

- diminishing value method is being used, on the "adjusted tax value" of the item; or
- straight-line method is being used, on the "cost of the item" to the taxpayer.

"Cost" is not defined in the Act for the purposes of section EE 17. Section YA 1 provides that "adjusted tax value" is defined in sections EE 55 to EE 60. The main component of the formula to calculate the adjusted tax value is the "base value" of the property (section 56). "Base value" in most cases, especially in respect of property acquired after the beginning of the 1993/94 income year, will be its "cost" (sections EE 57(2), EE 58, and EE 59).

As stated above, as far as trading stock is concerned there appears to be no difference between the use of the words "cost" and "cost price". The words are interchangeable. If the same applies in respect of the word "cost" used in Subpart EE, it could mean that "cost" and "cost price" are interchangeable elsewhere in the Act (for example, in Schedule 5, in determining the "cost price" of a motor vehicle for FBT purposes).

Conclusion

On the above analysis, it is concluded that "cost" and "cost price" as used in the Act are interchangeable. The calculations of both terms, using accepted accounting principles, include costs in addition to what can be termed the "purchase price". This means that for the purposes of the phrase "cost price of the motor vehicle" in the FBT rules, the "cost price" of a motor vehicle will be more than just its purchase price.

What is the "cost price" of a motor vehicle for fringe benefit tax purposes?

When a new motor vehicle is purchased, government charges have to be paid before the purchaser can use the vehicle on the road. The purchaser may also have accessories fitted to the vehicle at the time of purchase or later. Some of these accessories may be of a non-business nature, such as a tow bar, a CD player, conversion to compressed natural gas (CNG) or liquefied petroleum gas (LPG), air conditioning, or alloy wheels. Generally, unless these accessories are part of a special deal, they will be additional costs to the purchaser. In some instances, the purchaser may have a business accessory, such as a radio-telephone, fitted to the vehicle at the time of purchase or later.

The question to be considered is whether all or any of the cost of these items forms part of the "cost price" of the vehicle.

Government charges

Fees payable at the time of the purchase of a new car so that it can be driven on the road include:

- once-only payments: the registration fee and number plate fee; and
- ongoing (recurring) fees: the annual re-licensing fee, the accident compensation levy, the label fee and road user charges.

It is arguable that without payment of the initial registration and plate fees (as distinct from the recurring annual re-licensing fees) by the owner the vehicle cannot be used immediately. The owner has to pay these costs before the vehicle can be "put on the road" or in a position to be used. This suggests these costs are properly to be treated as part of the "cost price" of the car.

Support for the view that "cost" includes such items as getting the vehicle "on the road" so that it can be used, is found in the High Court of Australia case *BP Refinery (Kwinana) Ltd v FCT* (1960) 8 AITR 113. Kitto J, in considering the issue of what was included in the term "cost", said (at page 117):

> … in my opinion, the word "cost" in section 56(1)(b) [of the Income Tax Assessment Act 1936] bears the meaning which it has in the business life of the community. It seems to me impossible to suppose that the depreciation provisions of the Act are intended to apply only to those simple cases in which the ascertainment of cost is a purely arithmetical process. I interpret it as embracing the whole sum which, according to accepted accountancy practice as applied to the circumstances of the case, ought to be considered as having been laid out by the taxpayer in order to acquire the subject-matter as plant, **that is to say installed and ready for use** as plant for the purpose of producing assessable income.
>
> [Emphasis added]

Therefore, the cost of the vehicle must include expenditure making it "ready for use" by the taxpayer. Without payment of the registration and plate fees, the vehicle is not ready for the purpose intended.

Whether the costs of the initial registration fee and the plate fee form part of the cost of the vehicle is not entirely clear. The Commissioner considers the better view of the law, and the likely intent of Parliament, is that such expenses form part of the cost price of the vehicle, particularly given that they are one-off costs that fall into the "once and for all payments" category (see *BP Australia Ltd v FCT* [1965] 3 All ER 209). Therefore, they are capital in nature. These fees are intended to make the vehicle able to be used.

The remaining fees are annual or ongoing charges and normal accounting practice would treat them as revenue expenditure, even if they were incurred upon the purchase of the vehicle.

In summary, the better view is that registration and plate fees are "once and for all" payments, are of a capital nature, make the vehicle able to be used, and are part of the "cost price" of the vehicle. Ongoing charges (such as licensing, the accident compensation levy and road user charges) are revenue expenditure, so are not part of the "cost price".

Business accessories

Generally, accessories permanently fitted to the motor vehicle are properly to be included as part of the vehicle's cost. As discussed earlier, accessories, such as stereos, tow bars and roof racks, fitted to a vehicle will form part of its cost price.

However, some components or equipment fitted to vehicles may be of a purely business nature. The issue arises as to whether such components or equipment should also be included in the "cost price of the vehicle" for FBT purposes.

There is no legislative direction on this issue. This may indicate that all accessories, components or equipment attached to the vehicle form part of its "cost price". It is arguable, however, that business accessories, components and equipment fitted to the vehicle should not be treated as forming part of the cost price where they are required and relate solely to the special business operations for

which the vehicle is used, and are in themselves depreciable property for the purposes of the Act (for example, a two-way radio-telephone in a salesperson's vehicle). Such components or equipment are fitted to the vehicle to facilitate the business use of the vehicle and may be considered as separate business assets located in the vehicle.

Another factor (relevant to this last-mentioned aspect) possibly pointing to the components or equipment as not being part of the cost price, is the nature of the assets and how they are treated by businesses for accounting purposes. For example, it is most likely that components such as two-way radios are accounted for and depreciated separately. The radios can be removed from vehicles or moved from one vehicle to another, so it seems logical that they be treated as separate assets for depreciation purposes. [Note that motor vehicles and radio-telephone equipment are listed separately in the Commissioner's Table of Depreciation Rates.] Two-way radios have their own depreciation rate because they are regarded as assets in their own right and not accessories to a motor vehicle. They form part of a larger asset, for example, the entire radio-telephone network, consisting of radios in vehicles and the central control unit in the employer's premises. In such circumstances, even though they are a form of accessory or addition to the motor vehicle, they are an asset in their own right, and therefore require a separate asset classification. Usually, radio networks are purchased as a package consisting of radios (one for each vehicle) plus the central control station. To treat the network as part of the cost price of each car would require an apportionment of the overall expense, including installation costs to each vehicle. The Commissioner does not consider this to be a sensible approach.

The same could be said of accessories such as roof-mounted flashing lights and electronic monitoring equipment. If these types of assets are added to the vehicle because they are required for and relate solely to the business operations for which the vehicle is used, they will be treated similarly to the two-way radio system.

Therefore, where business components, such as two-way radios, roof-mounted flashing lights, and electronic testing or monitoring equipment, are fitted to the vehicle and are paid for by the employer, they do not form part of the vehicle's "cost price" for FBT purposes. As mentioned earlier, such accessories are business assets of the employer, coming within the definition of "depreciable property" for the purposes of the Act.

As previously discussed under the heading "Application of the legislation", it was the intent of Parliament to equate the "cost price" of motor vehicles with the cost that the employee would have had to pay had the employee purchased the vehicle rather than having it provided by the employer. It follows that if the employee had to pay for the vehicle, the cost to the employee must also include accessories fitted to the vehicle as already discussed. Exceptions are the cost of separately depreciable components or equipment fitted to the vehicle solely to meet the special needs of any business operations for which the vehicle is used.

Therefore, the Commissioner considers that business components fitted to the vehicle that are required for and relate solely to the business operations for which the vehicle is used and are in themselves depreciable property should be excluded from the "cost price" of motor vehicles for FBT purposes. This covers assets requiring the vehicle's power source in order to operate: they are not part of the cost price of the car itself.

There may be isolated instances where the type of business asset mentioned above will unavoidably be used for non-business purposes. The Commissioner considers that any extraordinary and unenvisaged use of the accessory for non-business use over the life of the asset will not in itself negate the purpose of fitting the accessory to be "solely for business purposes" in this context.

Cost of non-business accessories

Commonly, when a vehicle is purchased the owner asks for certain "extras" or accessories (other than business accessories) to be fitted to the vehicle. If these accessories are not "optioned" (and included in the purchase price), the dealer will charge for their cost and fitting to the vehicle. Such accessories can include: a stereo, a tow bar, a sunroof, a roof rack, CNG/LPG conversion, alloy wheels, air-conditioning, electric windows and locking systems, and higher specification tyres.

Where the vendor charges for any of these accessories, the question arises as to whether they should be added to the "cost price" of the vehicle for FBT purposes. The same issue arises if the accessories are acquired from another person or supplier, or acquired later.

Such accessories are of a capital nature and should be added to the vehicle's purchase price to arrive at its "cost price". They are part of the vehicle as a whole and are not generally removed at the time the vehicle is sold or otherwise disposed of. They are either singularly or collectively "once and for all" payment(s), culminating in the "cost price" of the vehicle that is provided to the employee by the employer for the employee's "private use and enjoyment".

Under this interpretation, the cost price may vary from period to period, depending on when accessories are added

(or in the unlikely or rarer event of an accessory being removed).

Therefore, in summary, accessories fitted to a vehicle form part of its "cost price" for FBT purposes (as contemplated in Schedule 5), irrespective of the time they are purchased and fitted to the vehicle.

Cost of signwriting or painting the vehicle in the employer's colours or design

There are different types of signwriting that fall into some broad categories including magnetic decals or door magnets that can be removed, decals or transfers that cannot be easily removed and colour or paint that is applied permanently to a motor vehicle.

So far as magnetic decals or door magnets that are designed to be easily removed are concerned, they do not become part of a vehicle and it seems reasonably clear that they should not form part of a vehicle's cost price for FBT purposes.

Other non-removable signwriting is, however, potentially part of the cost price of a vehicle in the same way that accessories such as stereos, tow bars and roof racks, fitted to a vehicle will form part of its cost price. However, it is accepted that signwriting costs are purely of a business nature. Given this, although they are not in every case able to be separately depreciated, the Commissioner accepts that such costs do not form part of the cost price of the vehicle for FBT purposes.

Transporting or freighting the vehicle to its place of use

In the above discussion on "cost price", it is clear that the courts have accepted that the cost of transporting or freighting goods (whether those goods are trading stock or capital assets of the business) to the place where they are to be used is part of the cost of the goods. Generally, the initial cost of fixed assets will include expenditure incurred to put the asset into the working condition necessary for its intended use. In *Atlas Copco* (at page 333) there was reference to, "cost is … associated with getting the purchased item to its current location and condition", which includes installation costs and freight.

The cost of transporting a purchased motor vehicle to the place where it can be used by the taxpayer is clearly part of its "cost price", both for FBT and depreciation purposes; for example, the purchase of vehicles direct from a manufacturer or from another source overseas, where the purchaser pays for the cost of transporting the vehicle to New Zealand. Transport costs incurred may include the physical transportation costs as well as freight insurance costs and any customs duty. It is the Commissioner's view that these transport costs form part of the "cost price" of the vehicle for FBT purposes.

However, these costs relate only to the initial cost of getting the vehicle to the place it will first be used by the owner after acquisition. Subsequent transport costs of moving the vehicle within New Zealand (say from one branch of the employer's firm to another), including any costs of insuring the vehicle for such transport, are considered part of the employer's normal business operations and on revenue account.

Cost of repairs and maintenance and capital expenditure

Another issue relates to the costs of repairs and maintenance to the vehicle and/or accessories, and whether they should be added to the cost price as capital expenditure.

Generally, repairs and maintenance expenditure on the vehicle or accessories will not increase the vehicle's "cost price" for FBT purposes. However, if work on the car is more than normal repairs and maintenance, such as replacing the existing motor with one of larger capacity, the question arises whether that alteration increases the cost price of the vehicle for FBT purposes. If the repair or replacement is considered to be of a revenue nature and deductible for income tax purposes, the cost price of the vehicle will not increase in value for the calculation of FBT. On the other hand, if the repair or replacement is of a capital nature, the cost price for FBT purposes must be increased by the amount of that capitalisation.

Each case needs to be considered on the basis of its own facts, applying the established capital/revenue tests. If the FBT cost price is increased, the recalculation of FBT (on the increased cost price) will apply from the quarter in which that capital expenditure was incurred.

Examples

Example 1

Employer A purchases a second-hand motor vehicle as a company car for the use of a salesperson employee. The employee will be travelling long distances, so the employer purchases a CD player and has it fitted to the vehicle. The employee has full use of the vehicle for private use and is likely to tow his own trailer from time to time, so he asks the employer to purchase and fit a tow bar to the vehicle. The employer agrees.

The "cost price" of the vehicle for FBT purposes will be the total of the purchase price plus the cost of acquiring and fitting the CD player and the tow bar (all costs GST inclusive).

Example 2

Employer B is looking for a vehicle to replace an existing vehicle written-off by the firm's Wellington-based accountant. The accountant will be entitled to use the vehicle for private purposes when it is not being used for business purposes. While on a trip to Auckland, the employer locates a suitable second-hand car, purchases it, and has it transported to Wellington where the accountant will use it.

The "cost price" of the car for FBT purposes will be the purchase price plus the cost, including freight insurance costs, of transporting it to Wellington (all costs GST inclusive).

Example 3

Employer C decides to replace the company's fleet of cars used by its sales representatives, because of the high cost of maintaining the existing fleet. The sales representatives are permitted to use the vehicles for private use when they are not required for business purposes. Through a contact with a motor vehicle dealer, the company decides to purchase 10 second-hand diesel-powered cars direct from Japan. The employer agrees on a purchase price with a Japanese car dealer and arranges for the vehicles to be shipped to New Zealand. In New Zealand employer C arranges for the company logo to be painted on to the vehicles and purchases a 1000 km road user charge distance licence for each vehicle.

The "cost price" of the vehicles for FBT purposes will be the total of:

- the purchase price of the cars, including any costs or commissions paid in Japan or New Zealand;
- the cost of transporting the cars to New Zealand, including freight insurance costs and any customs duty;
- GST and any import or inspection levies payable at the time of importation;
- the cost of initial registration and licence plate fees; and
- the cost of any accessories fitted to the cars at the time of purchase or any time after purchase, either in Japan or New Zealand.

The "cost price" of the vehicles for FBT purposes will not include:

- the cost of road user charges; and
- the cost of signwriting the vehicles with employer C's logo.

Example 4

Employer D is a forestry contracting firm that has recently purchased a four-wheel drive motor vehicle for its forestry foreman. The foreman has the full use and enjoyment of the vehicle for private purposes while not working. As with the employer's other work vehicles, the car is fitted with a radio-telephone used only for communication between the company's headquarters and its own vehicles.

The radio-telephone is fitted solely for business purposes and may be considered a separately depreciable business asset located in the vehicle, so it does not form part of the cost price of the vehicle for FBT purposes.

Example 5

An employee of employer E is a travelling salesperson. When the employer purchased a new vehicle for the employee's use, a mobile phone kit (mobile phone and car kit) was installed in the car at the employer's expense.

The cost of the mobile phone is excluded from the cost price of the motor vehicle because it is not "permanently affixed to the vehicle". Whether use of the mobile phone gives rise to a fringe benefit in its own right will need to be considered under the FBT rules generally, including section CX 21, which applies to the use of "business tools".

PUBLIC RULINGS BR PUB 09/09: DEDUCTIBILITY OF BREAK FEE PAID BY A LANDLORD TO EXIT EARLY FROM A FIXED INTEREST RATE LOAN; AND, BR PUB 09/10: DEDUCTIBILITY OF BREAK FEE PAID BY LANDLORD TO VARY THE INTEREST RATE OF AN EXISTING FIXED INTEREST RATE LOAN

Note (not part of ruling): These rulings deal with the payment of a break fee by a landlord to exit early from, or vary the interest rate of, a fixed interest rate loan. It was considered appropriate to issue two separate rulings to deal with the two scenarios. However, a single commentary applies to both rulings.

PUBLIC RULING BR PUB 09/09: DEDUCTIBILITY OF BREAK FEE PAID BY A LANDLORD TO EXIT EARLY FROM A FIXED INTEREST RATE LOAN

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

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This ruling applies in respect of sections DA 1, DB 6, DB 7, and EW 31 and the definition of "interest" in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is where a person has entered into a fixed interest rate loan and the money has been used to acquire a property from which rental income is derived or to refinance another loan used for that purpose. The person subsequently pays a break fee to the lender to repay in full and terminate that loan earlier than its agreed repayment date. It does not matter whether the loan is replaced by further borrowing from either the same or a different lender.

This Ruling will not apply where the loan is not used solely for the deriving of rental income, or where the loan is part of or connected with one or more other financial arrangements between the lender and the borrower.

This Ruling will also not apply if the taxpayer has adopted the IFRS financial reporting method in section EW 15D.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the arrangement as follows:

- A base price adjustment will be required.
- The amount of any break fee will be included in the "consideration" element of the base price adjustment formula for a borrower and will increase the overall negative figure that the base price adjustment provides.
- The negative amount under the base price adjustment will be expenditure incurred under the financial arrangements rules and will be interest.
- An automatic deduction will be available for companies (other than qualifying companies) for the negative base price adjustment amount as interest under section DB 7.
- A deduction will be available for other taxpayers under section DB 6, provided the general permission in section DA 1 is satisfied.
- Where the money was borrowed to purchase a property from which rental income is derived, the general permission will be satisfied.

The period or income year for which this Ruling applies

This ruling will apply from the first day of the 2008/09 income year to the last day of the 2011/12 income year.

This ruling is signed by me on the 16th day of December 2009.

Martin Smith
Chief Tax Counsel

PUBLIC RULING BR PUB 09/10: DEDUCTIBILITY OF BREAK FEE PAID BY LANDLORD TO VARY THE INTEREST RATE OF AN EXISTING FIXED INTEREST RATE LOAN

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

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This ruling applies in respect of sections DA 1, DB 6, DB 7, and EW 31 and the definition of "interest" in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is where a person has entered into a fixed interest rate loan and the money has been used to acquire a property from which rental income is derived or to refinance another loan used for that purpose. The person then subsequently pays a break fee to the lender for a variation of that loan to adjust the interest rate.

This Ruling will not apply where the loan is not used solely for the deriving of rental income, or where the loan is part of or connected with one or more other financial arrangements between the lender and the borrower.

This Ruling will also not apply if the taxpayer has adopted the IFRS financial reporting method in section EW 15D.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the arrangement as follows:

- No base price adjustment will be required.
- Taxpayers who are not cash basis persons, and cash basis persons who have chosen to adopt a spreading method, will be required to apply Determination G25 in relation to the variation to the terms of the loan. The amount of the break fee will be included in the calculation under the determination. This means an adjustment will be made in the year of variation and the deduction of the break fee will effectively be spread over the term of the loan.
- Cash basis persons will be able to deduct the amount of the break fee when it is incurred under the general permission, provided the money was borrowed to purchase a property from which rental income is derived.

The period or income year for which this Ruling applies

This ruling will apply from the first day of the 2008/09 income year to the last day of the 2011/12 income year.

This ruling is signed by me on the 16th day of December 2009.

Martin Smith
Chief Tax Counsel

COMMENTARY ON PUBLIC RULINGS – BR PUB 09/09 AND BR PUB 09/10

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 09/09 and Public Ruling BR Pub 09/10 ("the Rulings").

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

Background

The Rulings deal with the deductibility of fees charged by banks to permit landlords to repay a fixed interest rate loan early or to vary the existing terms of such a loan. These fees are variously referred to by terms such as "early repayment fees", "early repayment adjustment charge", "early exit fees" or "mortgage break fees". In these Rulings, the term "break fee" is used to refer to all such charges.

The amount of the fee and the circumstances that trigger the charging of the fee vary from lender to lender. The fee is generally seen as compensation for the loss the lender may have suffered if their current interest rate for a similar loan for a fixed interest rate period closest to the borrower's unexpired fixed interest period is lower than the fixed interest rate applying to the borrower's loan. A break fee is charged in two primary scenarios:

- the loan is repaid early (whether replaced by further borrowing from the same or another financial institution or not); and
- the interest rate of the loan is simply renegotiated during the term of the loan and the existing loan continues.

Legislation

Note that the Income Tax Act 2007 was amended by the Taxation (Business Tax Measures) Act 2009 with effect from the 2009/10 income year. The amendments allow non-individuals to return income tax for financial arrangements on a cash accounting basis. Where necessary, the following legislation includes the relevant provisions for the 2008/09 income year and the 2009/10 and later income years.

Section DA 1(1) and (2) reads as follows:

DA 1 General permission

Nexus with income

(1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—

(a) incurred by them in deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income; or

(b) incurred by them in the course of carrying on a business for the purpose of deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income.

General permission

(2) Subsection (1) is called the **general permission.**

Section DA 2(1) and (2) reads as follows:

DA 2 General limitations

Capital limitation

(1) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature. This rule is called the **capital limitation**.

Private limitation

(2) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. This rule is called the **private limitation**.

Section DB 6(1) and (4) reads as follows:

DB 6 Interest: Not capital expenditure

Deduction

(1) A person is allowed a deduction for interest incurred.

Link with subpart DA

(4) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

Section DB 7(1), (2) and (8) reads as follows:

DB 7 Interest: Most companies need no nexus with income

Deduction

(1) A company is allowed a deduction for interest incurred.

Exclusion: Qualifying company

(2) Subsection (1) does not apply to a qualifying company.

Link with subpart DA

(8) This section supplements the general permission and overrides the capital limitation, the exempt income limitation, and the withholding tax limitation. The other general limitations still apply.

Section DB 11 reads as follows:

DB 11 Negative base price adjustment

Deduction

(1) A person who has a negative base price adjustment under section EW 31(4) (Base price adjustment formula) is allowed a deduction for the expenditure to the extent to which it arises from assessable income, under section CC 3 (Financial arrangements), derived by the person under the financial arrangement in earlier income years.

Link with subpart DA

(2) This section supplements the general permission and overrides all the general limitations.

Section EW 3(2) and (3) reads as follows:

EW 3 What is a financial arrangement?

Money received for money provided

(2) A financial arrangement is an arrangement under which a person receives money in consideration for that person, or another person, providing money to any person—

(a) at a future time; or

(b) on the occurrence or non-occurrence of a future event, whether or not the event occurs because notice is given or not given.

Examples of money received for money provided

(3) Without limiting subsection (2), each of the following is a financial arrangement—

(a) a debt, including a debt that arises by law:

(b) a debt instrument:

(c) the deferral of the payment of some or all of the consideration for an absolute assignment of some or all of a person's rights under another financial arrangement or under an excepted financial arrangement:

(d) the deferral of the payment of some or all of the consideration for a legal defeasance releasing a person from some or all of their obligations under another financial arrangement or under an excepted financial arrangement.

Section EW 29(3) reads as follows:

EW 29 When calculation of base price adjustment required

Maturity

(3) A party to a financial arrangement must calculate a base price adjustment as at the date on which the arrangement matures.

Section EW 31 reads as follows:

EW 31 Base price adjustment formula

Calculation of base price adjustment

(1) A person calculates a base price adjustment using the formula in subsection (5).

When formula applies

(2) The person calculates the base price adjustment for the income year in which section EW 29 applies to them.

Positive base price adjustment

(3) A base price adjustment, if positive, is income, under section CC 3 (Financial arrangements), derived by the person in the income year for which the calculation is made. However, it is not income to the extent to which it arises from expenditure incurred by the person under the financial arrangement in earlier income years and for which a deduction was denied in those income years.

Negative base price adjustment

(4) A base price adjustment, if negative, is expenditure incurred by the person in the income year for which the calculation is made. The person is allowed a deduction for the expenditure under section DB 11 (Negative base price adjustment).

Formula

(5) The formula is—

consideration − income + expenditure + amount remitted

Definition of items in formula

(6) The items in the formula are defined in subsections (7) to (11).

Consideration

(7) **Consideration** is all consideration that has been paid, and all consideration that is or will be payable, to the person for or under the financial arrangement, ignoring non-contingent fees, minus all consideration that has been paid, and all consideration that is or will be payable, by the person for or under the financial arrangement. For the purposes of this subsection, the following are ignored:

(a) non-contingent fees, if the relevant method is not the IFRS financial reporting method in section EW 15D:

(b) non-integral fees, if the relevant method is the IFRS financial reporting method in section EW 15D.

Consideration in particular cases

(8) If any of sections EW 32 to EW 48 applies, the consideration referred to in subsection (7) is adjusted under the relevant section.

Income

(9) **Income** is—

(a) income derived by the person under the financial arrangement in earlier income years; and

(b) dividends derived by the person from the release of the obligation to repay the amount lent; and

(c) income derived under section CF 2(2) and (3) (Remission of specified suspensory loans).

Expenditure

(10) **Expenditure** is expenditure incurred by the person under the financial arrangement in earlier income years.

Amount remitted

(11) **Amount remitted** is an amount that is not included in the consideration paid or payable to the person because it has been remitted—

(a) by the person; or

(b) by law.

For the 2008/09 income year, section EW 54 reads as follows:

EW 54 Meaning of cash basis person

Who is cash basis person

(1) A ***cash basis person*** is—

(a) a natural person who meets the criteria in section EW 56:

(b) a trustee of a deceased's estate, whether or not a natural person, in the circumstances described in section EW 60.

Natural persons excluded by Commissioner

(2) A natural person may be excluded under section EW 59 from being a cash basis person for a class of financial arrangements.

For the 2009/10 and later income years, section EW 54 reads as follows:

EW 54 Meaning of cash basis person

Who is cash basis person

(1) A person is a ***cash basis person*** for an income year if—

(a) 1 of the following applies in the person's case for the income year:

(i) section EW 57(1); or

(ii) section EW 57(2); and

(b) section EW 57(3) applies in the person's case for the income year.

Persons excluded by Commissioner

(2) A person may be excluded under section EW 59 from being a cash basis person for a class of financial arrangements.

Section EW 55 reads as follows:

EW 55 Effect of being cash basis person

Use of spreading method

(1) A cash basis person is not required to apply any of the spreading methods to any of their financial arrangements, but may choose to do so under section EW 61.

Calculation of base price adjustment

(2) The fact that a cash basis person does not use any of the spreading methods for the financial arrangement does not excuse them from the requirement to calculate a base price adjustment when any of section EW 29(1) to (12) applies to them.

For the 2008/09 income year, section EW 56 reads as follows:

EW 56 Natural person

Criteria for natural person as cash basis person

(1) A natural person is a cash basis person for an income year if—

(a) 1 of the following applies in the person's case for the income year:

(i) section EW 57(1); or

(ii) section EW 57(2); and

(b) section EW 57(3) applies in the person's case for the income year; and

(c) the person is not a trustee.

Financial arrangements, income, and expenditure relevant to application of criteria

(2) The calculations required by section EW 57(1) to (3) are done for the financial arrangements, or the income and expenditure, described in section EW 58.

Increase in specified sums

(3) The Governor-General may make an Order in Council increasing a sum specified in any of sections EW 57(1) to (3).

Section EW 56 was repealed with effect from the 2009/10 income year.

For the 2009/10 and later income years, section EW 57(1)–(9) reads as follows:

EW 57 Thresholds

Income and expenditure threshold

(1) For the purposes of section EW 54(1)(a)(i), this subsection applies if the absolute value of the person's income and expenditure in the income year under all financial arrangements to which the person is a party is $100,000 or less.

Absolute value threshold

(2) For the purposes of section EW 54(1)(a)(ii), this subsection applies if, on every day in the income year, the absolute value of all financial arrangements to which the person is a party added together is $1,000,000 or less. The value of each arrangement is,—

(a) for a fixed principal financial arrangement, its face value:

(b) for a variable principal debt instrument, the amount owing by or to the person under the financial arrangement:

(c) for a financial arrangement to which the old financial arrangements rules apply, the value determined under those rules.

Deferral threshold

(3) For the purposes of section EW 54(1)(b), this subsection applies if the result of applying the formula in subsection (4) to each financial arrangement to which the person is a party at the end of the income year and adding the outcomes together is $40,000 or less.

Formula

(4) The formula is—

(accrual income − cash basis income) + (cash basis expenditure − accrual expenditure)

Definition of items in formula

(5) The items in the formula are defined in subsections (6) to (9).

Accrual income

(6) **Accrual income** is the amount that would have been income derived by the person under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made. It is calculated using 1 of the following methods, as chosen by the person:

(a) the yield to maturity method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(b) the straight-line method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(c) an alternative method approved by the Commissioner.

Cash basis income

(7) **Cash basis income** is the amount that would have been income derived by the person under the financial arrangement if the person had been a cash basis person in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made.

Cash basis expenditure

(8) **Cash basis expenditure** is the amount that would have been expenditure incurred by the person under the financial arrangement if the person had been a cash basis person in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made.

Accrual expenditure

(9) **Accrual expenditure** is the amount that would have been expenditure incurred under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made. It is calculated using 1 of the following methods, as chosen by the person:

(a) the yield to maturity method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(b) the straight-line method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(c) an alternative method approved by the Commissioner.

Increase in specified sums

(10) The Governor-General may make an Order in Council increasing a sum specified in any of subsections (1) to (3).

For the 2008/09 income year, sections EW 57(1), (2) and (3) referred to sections EW 56(1)(a)(i), EW 56(1)(a)(ii) and EW 56(1)(b) respectively.

In section YA 1, the definitions of "interest", "maturity", "non-contingent fee", and "non-integral fee" read as follows:

YA 1 Definitions

interest,—

…

(c) in sections DB 6 (Interest: not capital expenditure), DB 7 (Interest: most companies need no nexus with income), and DB 8 (Interest: money borrowed to acquire shares in group companies),—

(i) includes expenditure incurred under the financial arrangements rules or the old financial arrangements rules

…

maturity,—

(a) in the financial arrangements rules, means,—

(i) for an agreement for the sale and purchase of property or services or an option, the date on which the agreement or option ends:

(ii) for any other financial arrangement, the date on which the last payment contingent on the financial arrangement is made:

…

non-contingent fee means a fee that—

(a) is for services provided for a person becoming a party to a financial arrangement; and

(b) is payable whether or not the financial arrangement proceeds non-integral fee means a fee or transaction cost that, for the purposes of financial reporting under IFRSs, is not an integral part of the effective interest rate of a financial arrangement

non-integral fee means a fee or transaction cost that, for the purposes of financial reporting under IFRSs, is not an integral part of the effective interest rate of a financial arrangement

In Determination G25: Variations in the Terms of a Financial Arrangement, the definition of "Variable Rate Financial Arrangement" reads as follows:

Variable Rate Financial Arrangement means a financial arrangement under which:

(a) the interest rate is determined by a fixed relationship to economic, commodity, industrial or financial indices or prices, or banking or general commercial rates; or

(b) the interest rate is set periodically by reference to market interest rates.

Application of the legislation

The application of the legislation depends on whether the loan is repaid in full and terminated or the loan remains in existence and there is simply a variation of the interest rate.

Loan repaid in full

A fixed interest rate loan is a financial arrangement pursuant to section EW 3. The financial arrangements rules ("FA rules") will therefore apply. When a loan is repaid in full, a base price adjustment ("BPA") is required under section EW 29.

Although many landlords are likely to be cash basis persons under the FA rules and not required to use a spreading method, they are still subject to the FA rules and will be required to do a BPA if the loan is repaid in full.

The formula for calculating a BPA is in section EW 31(5). The formula for a borrower is:

consideration − income + expenditure + amount remitted

A break fee charged by a bank in respect of the early repayment of the loan will fall within the definition of "consideration" in section EW 31(7) as "consideration that has been paid … by the person for or under the financial arrangement". The break fee will not be ignored as a "non-contingent fee" because the fee is not "for services provided for the taxpayer **becoming a party** to the financial arrangement and payable whether or not the financial arrangement proceeds". The fee is payable to allow the taxpayer to cease being a party to the financial arrangement. As the scope of these rulings excludes landlords who have adopted the International Financial Reporting Standard ("IFRS") financial reporting method under section EW 15D, it is unnecessary to consider whether the break fee constitutes a non-integral fee.

As part of the consideration paid by a borrower, the amount of the break fee will increase the overall negative figure that the BPA provides in this scenario (see Example 1 below).

A negative BPA is expenditure incurred under the FA rules pursuant to section EW 31(4). In the case of taxpayers who have previously returned income under a financial arrangement (such as lenders), an automatic deduction is allowed for the negative BPA expenditure under section DB 11 to the extent of that previously returned income. However, as landlords are generally borrowers who will not have derived income from their loans, section DB 11 will have no application in those circumstances.

Negative BPA expenditure is also "interest" for the purposes of sections DB 6 and DB 7 (see the definition of "interest" in section YA 1). An individual taxpayer or qualifying company will be able to deduct the amount of the negative BPA as interest under section DB 6, provided the general permission in section DA 1 is satisfied and none of the general limitations (excluding the capital limitation) apply. Section DB 6 specifically provides that the capital limitation will not apply, so it is unnecessary to consider whether the amount is of a capital or revenue nature.

Where the borrowed money was used to purchase property from which rental income is derived, the Commissioner's view is that the general permission will be satisfied and the amount of the negative BPA will be deductible under section DB 6. Note that if the borrowing was used for a private or domestic purpose, a deduction would be denied under the private limitation in section DA 2(2).

In the case of a company (other than a qualifying company), the amount of the negative BPA will be automatically deductible under section DB 7 without any requirement to consider the general permission.

The Commissioner notes that some commentators have suggested section DB 5 may have application when the loan amount is refinanced. Section DB 5 provides a deduction for expenditure incurred in borrowing money used as capital in deriving income. The Commissioner's view is that section DB 5 has no application where the FA rules apply. The amount of the break fee is dealt with under the BPA on repayment of the original loan, as set out above. This will be the case whether or not the amount of the loan is refinanced.

Interest rate varied

Instead of repaying a loan in full and then refinancing with a new loan, a borrower may negotiate with their lender to vary the rate of interest on an existing loan. This is sometimes referred to as an "interest rate switch". A break fee will often be charged in these circumstances.

Where the renegotiation of the interest rate is simply a variation of the loan and that same loan continues in existence, a BPA is not required. In these circumstances, the deductibility of the break fee depends on whether or not the taxpayer is a cash basis person. Note that if the change in the interest rate is effected by way of the existing loan being discharged and a new loan agreement being entered into, a BPA will be required as discussed above.

A taxpayer who is not a cash basis person will have been required to adopt a spreading method in relation to the loan under the FA rules. As the loan is a fixed interest rate loan at the time of the variation, it will not be a variable rate financial arrangement (as defined in Determination G25: Variations in the terms of a financial arrangement). Therefore, the taxpayer will need to apply Determination G25 when the loan is varied, rather than Determination G26: Variable rate financial arrangements. The break fee will be brought into the Determination G25 calculation. This means an adjustment is made in the year of variation and the deduction of the break fee is effectively spread over the term of the loan (see Example 2 over).

A cash basis person is not required to adopt a spreading method, although they may choose to do so. A person will be a cash basis person if:

- the income and expenditure under all the person's financial arrangements for the income year does not exceed $100,000, or
- the value of all the person's financial arrangements on every day of the income year does not exceed $1 million.

In addition, the difference between the accrual treatment and the cash treatment of all the person's financial arrangements cannot exceed $40,000 for the income year.

Where a significant break fee is paid, it is possible that these thresholds may be breached and a person may cease to be a cash basis person. In those circumstances the treatment of the break fee set out above for a non-cash basis person will apply.

Note that as a result of the changes made by the Taxation (Business Tax Measures) Act 2009 (referred to in Legislation above) with effect from the 2009/10 income year a non-natural person may be a cash basis person.

Where a cash basis person does not adopt a spreading method, the deductibility of the break fee is determined outside the FA rules.

The break fee will be incurred whether it is actually paid or simply added to the balance of the loan: *King v CIR* (1973) 1 NZTC 61,107.

The break fee will be deductible if it satisfies the general permission and none of the general limitations apply. Where the borrowed money was used to purchase property from which rental income is derived, the Commissioner's view is that the general permission will be satisfied. Note that if the borrowing was used for a private or domestic purpose, a deduction would be denied under the private limitation in section DA 2(2).

Note that section DB 5 will also have no application in these circumstances. Where all that occurs is a variation of the interest rate applicable to a loan, the break fee cannot be said to have been incurred in borrowing money.

Examples

Example 1 – Loan repaid in full

At the beginning of year 1, B borrows $200,000 at a flat 10% per annum fixed interest rate to purchase a rental property from which rental income is derived. The loan is interest only. At the end of year 2, B breaks the loan in order to refinance at a lower interest rate with another bank. B repays the loan and pays an additional $10,000 break fee.

B will have to calculate a BPA in relation to the loan as follows:

consideration – income + expenditure
+ amount remitted

The consideration received by B is the original loan amount of $200,000. The consideration paid by B is the return of the principal, two instalments of interest at $20,000 each, and the break fee of $10,000, or $250,000:

($200,000 + $20,000 + $20,000 + $10,000)

There is no income amount or amount remitted. The expenditure amount is the $20,000 interest incurred under the loan in year 1.

The BPA is thus:

($200,000 – $250,000) – $0 + $20,000 + $0

= –$50,000 + $20,000

= –$30,000

The negative BPA amount of $30,000 represents the $20,000 interest expense for year 2 and the amount of the break fee.

The negative BPA amount is expenditure incurred under the FA rules and is deemed to be interest. It will be deductible to B in the year in which it is incurred under section DB 7 (if B is a company) or section DB 6 and the general permission (if B is a non-corporate or qualifying company).

Example 2 – Interest rate varied

A and B are the shareholders in S Ltd. S Ltd owns two residential rental properties. S Ltd borrows $100,000 for three years. Interest is fixed at 10% payable annually in arrears. S Ltd is not a cash basis person. Assuming a straight-line spreading method, the total annual expenditure incurred under the FA rules would be:

($100,000 + $30,000 – $100,000)/3 = $30,000/3
= $10,000 per annum

In year 2 the loan is renegotiated to an 8% interest rate. A break fee of $2,500 is charged. The revised annual finance charges are:

($100,000 + $26,000 + $2,500 – $100,000)/3
= $28,500/3 = $9,500 pa

Determination G25 will apply. The formula is:

a – b – c + d

where:

a is the sum of all amounts that would have been income derived by the person in respect of the financial arrangement from the date it was acquired or issued to the end of the income year, if the changes had been known as at the date the financial arrangement was acquired or issued;

b is the sum of all amounts that would have been expenditure incurred by the person in respect of the financial arrangement from the date it was acquired or issued to the end of the income year, if the changes had been known as at the date the financial arrangement was acquired or issued;

c is the sum of all amounts treated as income derived of the person in respect of the financial arrangement since it was acquired or issued to the end of the previous income year; and

d is the sum of all amounts treated as expenditure incurred of the person in respect of the financial arrangement since it was acquired or issued to the end of the previous income year.

Applying the Determination G25 formula, the adjustment in year 2 is:

$0 – $19,000 – $0 + $10,000 = –$9,000

This gives total expenditure for years 1 and 2 of $19,000 ($10,000 + $9,000), the equivalent position by the end of year 2 had the revised annual expenditure of $9,500 been claimed from the outset of the financial arrangement. This means the deduction for the break fee is effectively spread over the term of the loan.

NEW LEGISLATION

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.

TAXATION (CONSEQUENTIAL RATE ALIGNMENT AND REMEDIAL MATTERS) ACT 2009

The Taxation (Consequential Rate Alignment and Remedial Matters) Bill was introduced into Parliament on 21 July 2009. It received its first reading on 28 July 2009, its second reading on 19 November 2009 and the third reading on 24 November 2009.

Several changes were made by Supplementary Order Paper (SOP No 93) after the Bill's introduction. They included measures to clarify the GST treatment of facilitation services for tour packages for overseas visitors, and changes to the supplementary dividend rules in the Income Tax Act to allow newly signed tax treaties with Australia, Singapore and the United States to come into force. The SOP also introduced measures to update income tax law to reflect recent changes to portability arrangements for New Zealand superannuation and the veteran's pension.

The resulting Act received Royal assent on 7 December 2009. It amends the Income Tax Act 2007, Income Tax Act 2004, Tax Administration Act 1994, Goods and Services Tax Act 1985 and makes minor changes to other legislation, including the Student Loans Scheme Act 1992.

RESIDENT WITHHOLDING TAX RATES ON INTEREST INCOME

Section RE 12(5) and schedule 1, part D, tables 2 and 3 of the Income Tax Act 2007; sections 25A and 33A of the Tax Administration Act 1994

Resident withholding tax (RWT) rates on interest income have been aligned with recent changes to the company and individual income tax rates.

Background

RWT is a withholding tax based on the marginal tax rate of the recipient of interest income. Its purpose is to ensure that tax is paid at source on that income at a rate that closely approximates the recipient's marginal tax rate. Compliance and administrative costs are therefore minimised as recipients are less likely to request a personal tax summary or file a tax return if tax is withheld at the correct rate.

Previously the RWT rates were: 19.5%, 33% and 38% or 39%, which aligned with the former income tax rates. The default RWT rate where a person had provided a tax file number but had not elected a rate was 19.5%.

The legislation introduces new RWT rates to reflect recent changes to the company and individual tax rates.

Key features

Schedule 1, part D, tables 2 and 3 of the Income Tax Act 2007 introduces the following new RWT rates:

Marginal income tax rates	Income band	Former RWT rates	New RWT rates	Application date
12.5%	0–$14,000	19.5%	12.5%	1 April 2010
21%	$14,001–$48,000		21%	1 April 2010
30%	N/A – Company tax rate	33%	30%	1 April 2011 or from 1 April 2010 at payer's discretion
33%	$48,001–$70,000		33%	No change
38%	$70,001	38% or 39%	38%	1 April 2010

The amendments also allow Inland Revenue to instruct interest payers to change a person's RWT rate if the person's rate is inconsistent with their marginal tax rate.

Application dates

The changes generally apply from 1 April 2010.

The 30% RWT rate for companies applies from 1 April 2011 but is optional for interest payers from 1 April 2010.

Detailed analysis

Default rate

A new 21% RWT rate applies for those who were previously on the 19.5% default rate. Previously, the default rate of RWT that applied if the recipient of interest (not a company) did not elect a rate was 19.5%.

Consequently, row 5 of schedule 1, part D, table 2 provides that anyone who was on the 19.5% RWT rate before 1 April 2010 (either by default or by election) will have their rate changed to 21% from that date.

For people who open a new account with an interest payer after 31 March 2010 but do not elect a rate, row 2 of schedule 1, part D, table 2 introduces a new 38% default rate. This is to encourage people to elect the rate that aligns with their marginal tax rate.

Non-declaration rate

A new 38% rate applies from 1 April 2010 to persons who do not supply their tax file number to their interest payer. This non-declaration rate aligns with the new highest marginal tax rate.

The 38% rate in row 1 of schedule 1, part D, table 2 therefore replaces the previous 39% RWT rate that applied before 1 April 2010 to those taxpayers who did not supply their tax file number to their interest payer.

New 12.5% rate

Row 7 of schedule 1, part D, table 2 introduces a new 12.5% RWT rate. A person may elect the 12.5% rate only if they have a reasonable expectation at the time of election that their income for the income year will be $14,000 or less and they provide their tax file number to their interest payer.

The 12.5% rate is not available to trustees other than those who receive interest as the trustee of a testamentary trust to which section HC 37 applies. Trustees of a testamentary trust do not need to satisfy a "reasonable expectation" test regarding their income but do need to provide their tax file number to their interest payer.

38% RWT rate

If a person has previously elected the 39% rate, it is intended that their interest payer will shift the person to the new 38% RWT rate from 1 April 2010.

Consequently, the 39% rate has been removed from table 2 and replaced with the 38% rate, in line with the reduction in the highest marginal tax rate.

RWT rates for companies (section RE 12(5) and schedule 1, part D, table 3)

Section RE 12(5) introduces an optional 30% RWT rate for interest paid to a company which may be applied for the 2010–11 income year.

Specifically, an interest payer may choose to apply an RWT rate of 30% if interest is paid to a company or a portfolio investment entity (PIE) in the income year when the RWT rate would have otherwise been 33%. The provision does not apply to companies that are trustees or Māori authorities, the rates for which are set out in schedule 1, part D, table 2.

The 33% RWT rate has been replaced in schedule 1, part D, table 3 by a 30% RWT rate from 1 April 2011. The 30% rate applies to companies that are not trustees or Māori authorities and which previously elected the 33% rate before 1 April 2011. The 30% rate also applies to companies that have supplied their tax file number but which did not elect a rate.

For PIEs that are trusts, the 30% rate may be applied under section RE 12(5) for the 1 April 2010–11 income year and will apply from 1 April 2011 under schedule 1, part D, table 3.

Additionally, in schedule 1, part D, table 3, the 39% RWT rate has been replaced by a 38% rate, which also applies from 1 April 2010 for companies that elected a 39% rate before that date.

Inland Revenue may instruct interest payers to change an inconsistent RWT rate (section 25A of the Tax Administration Act 1994)

New section 25A adopts a similar approach to that used by Inland Revenue in relation to secondary tax codes, where it may instruct employers to use a particular PAYE tax code for an individual taxpayer.

Accordingly, if Inland Revenue considers that a person receiving interest income is on an RWT rate (whether by election or by default) that is inconsistent with their marginal tax rate, it may instruct the interest payer to change the person's RWT rate and provide the appropriate rate. The rate provided by Inland Revenue must be used by the interest payer as soon as reasonably practicable after the date that they are notified.

The interest recipient may subsequently elect a different rate, in which case the interest payer must use that rate. However, Inland Revenue may instruct the interest payer to change the person's rate the next year.

PORTFOLIO INVESTMENT ENTITY TAX RATES

Sections CX 56, HM 56 to HM 58, YA 1 and schedule 6, table 1 of the Income Tax Act 2007

Changes have been made to the tax rates on portfolio investment entities (PIEs) and the income thresholds so they align with the new personal tax rate structure enacted in 2008. This is to ensure that investors are not disadvantaged if they invest in a PIE rather than investing directly. This is particularly important as the tax on PIEs is a final tax.

Background

Previously, the PIE tax rates were as follows:

Taxable income	Taxable + PIE income	PIE tax rate
$0–$38,000	$0–$60,000	19.5%
$38,001+	Any	30%
Any	$60,001 and over	30%

Key features

The new rates contained in new schedule 6, table 1 are as follows:

Taxable income	Taxable + PIE income	PIE tax rate
$0–$14,000	$0–$48,000	12.5%
$0–$14,000	$48,001–$70,000	21%
$14,001–$48,000	$0–$70,000	21%
$48,001 and over	Any	30%
Any	$70,001 and over	30%

Taxpayers who were previously on the 19.5% PIE tax rate will be shifted to 21% from 1 April 2010. Those taxpayers who have earned no more than $14,000 of taxable income and no more than $48,000 of combined taxable and PIE income in the past two years may elect the 12.5% rate from this date.

Consequential amendments reflecting the rate changes have been made to sections CX 56, HM 56 to HM 58 and the definition of "prescribed investor rate" under section YA 1.

Application date

The amendments apply from 1 April 2010.

RETIREMENT SCHEME CONTRIBUTION TAX RATES

Schedule 1, part D and new schedule 6 of the Income Tax Act 2007; section 28C of the Tax Administration Act 1994

Amendments have been made to the Income Tax Act 2007 to align the retirement scheme contribution tax (RSCT) rates with the new personal tax rate structure from 1 April 2010.

Background

The retirement scheme contribution tax rules are an elective regime that allows a retirement scheme contribution, such as a taxable Māori authority distribution or a dividend made by a retirement scheme contributor to a retirement savings scheme, to be subject to a withholding tax called RSCT. The rules allow retirement scheme contributions that would be taxable in the hands of the person who benefits from the contribution to be subject to a final withholding tax instead.

Key features

The definition of "retirement scheme prescribed rate" has been replaced. The rates are now set out in new schedule 6, table 2 of the Income Tax Act 2007 as follows:

- 0% if the person is a non-resident at the time and the contribution is non-resident passive income; or
- 12.5% if the person:
  - has, in either of the two income years immediately before the year in which the contribution is made, taxable income of between $14,000 or less;
  - is a non-resident and the retirement scheme contributor is a Māori authority, and the distribution is $200 or less;
  - is a non-resident and the retirement scheme contributor is a Māori authority and the person supplies the Māori authority with a notice under section 28C of the Tax Administration Act 1994; or
- 21% if the person has, in either of the two income years immediately before the year in which the contribution is made, taxable income of $14,001 or more and less than or equal to $48,000; or
- 33% if the person has, in either of the two income years immediately before the year in which the contribution is made, taxable income of $48,001 or more and less than or equal to $70,000; or
- 38% in any other case.

The basic rates for RSCT in schedule 1, part D, table 5 have also been aligned with the new personal tax rate structure.

Section 28C of the Tax Administration Act 1994 requires a person who gives notice of a retirement scheme prescribed rate of less than the top personal rate to include their Inland Revenue number in that notice. The reference to 39% has been replaced with 38%.

Application date

The amendments apply from 1 April 2010.

TAX TREATMENT OF EXTRA PAYS

Sections RD 10(2), RD 17(2), (3) and (4) and schedule 2, part B, table 1 of the Income Tax Act 2007; section 33A of the Tax Administration Act 1994

A consequential amendment to the Income Tax Act 2007 introduces a new 12.5% withholding tax rate for extra pays.

The amendment aligns the tax rate for extra pays with the new personal tax rate of 12.5% introduced in 2008 for individuals whose income is under $14,001 a year.

Background

"Extra pays" are lump sum payments made to employees that are not related to overtime worked and are not regularly included in a pay period. They include bonuses, gratuities, back-pay, profit shares and retiring allowances.

A remedial amendment has also been made to the extra pay rules to more accurately withhold tax on extra pays earned in a job where a secondary tax code is used.

Key features

12.5% withholding tax rate

Section RD 17(2) and schedule 2, part B, table 1 introduces a new bottom rate of 12.5% for extra pays to align with the new personal tax rate structure. It ensures that tax on a lump sum payment received by a person who earns under $14,001 a year will be withheld correctly.

Extra pay in secondary jobs

New section RD 17(3) and (4) more accurately withholds tax on extra pays earned in a job where a secondary tax code is used. It ensures that people who receive an extra pay relating to secondary income have tax withheld on that income at a rate which reflects their extra pay income, their secondary income and a proxy for their primary income.

Employee's option to choose rate

Section RD 10(2) has been amended to allow an employee to choose a 21% rate for extra pays if they expect their taxable income to be under $48,001.

Application date

The amendments apply from 1 April 2010.

NEW SECONDARY TAX CODE

Schedule 2, part A, clause 9 of the Income Tax Act 2007; sections 24B(3)(bb), 24C and 33A of the Tax Administration Act 1994

A new 12.5% secondary tax code has been introduced to align withholding rates on secondary income with the new personal income tax rates introduced in 2008.

Background

Employees who receive secondary employment income (or those receiving income-tested benefits or student allowances who are also in employment) must choose a secondary tax code for their secondary source of employment income, based on the marginal tax rate they expect to be on for that year.

In 2008 the government introduced a new set of personal income tax rates. This new tax scale included a 12.5% rate for income of $14,000 and below. Previously, the lowest rate for withholding tax on secondary employment income was 21%. This means there was the potential for lower-income individuals to have excess tax withheld on their secondary income.

Key features

To accurately withhold tax on secondary income, a new 12.5% code has been introduced. New schedule 2, part A clause 9 of the Income Tax Act 2007 and section 24B(3)(bb) of the Tax Administration Act 1994 allow employees to elect an "SB" code for secondary employment earnings if their annual income is not more than $14,000.

Section 24C of the Tax Administration Act 1994 has been amended to ensure that people who receive income-tested benefits can choose the 12.5% tax code for any employment income if that is their correct code, and to clarify that employees who receive an income-tested benefit can choose their correct secondary tax code for their employment income.

Application date

The changes apply from 1 April 2010.

INCOME TAX TREATMENT OF PFSI FORESTRY

Sections EH 34 and YA 1 of the Income Tax Act 2007 and section OB 1 of the Income Tax Act 2004

Amendments have been made to ensure that foresters under the Permanent Forest Sink Initiative (PFSI) are eligible:

- for the same tax treatment for expenditure as those who carry out conventional forestry; and
- to use income equalisation accounts.

The amendments are intended to achieve consistency in the taxation of different types of forestry activity.

Background

The PFSI is a government climate change initiative. Under the scheme, a person who owns land which has been reforested since 31 December 1989, or who owns land which they intend to reforest, can enter into a binding covenant with the government. This covenant limits the landowner's rights to fell the trees, but in exchange they receive emissions units reflecting carbon capture in the trees. See **www.maf.govt.nz/forestry/pfsi** for further information.

Specific income tax rules exist for forestry, primarily in subpart DP. These rules apply to people who carry on a "forestry business". Under the previous legislation, there was uncertainty over whether some PFSI foresters were carrying on a "forestry business". If they were not, the deduction rules applicable to them would be different from the rules applying to other foresters.

Income equalisation accounts are addressed in subpart EH. A person is entitled to use an income equalisation account for their "income from forestry". Under the previous legislation, income derived by a PFSI forester from selling the emissions units received did not fall within the definition of "income from forestry", and so PFSI foresters were not eligible to use income equalisation accounts.

Both of these issues conflicted with the policy objective of generally applying the same rules to PFSI foresters and those carrying out conventional forestry involving the harvest of trees.

Key features

A new definition of "forestry business" has been inserted in section YA 1 of the Income Tax Act 2007 and section OB 1 of the Income Tax Act 2004. It includes PFSI forestry, so that the provisions in subpart DP apply to PFSI foresters.

The definition of "income from forestry" in section EH 34(1) of the Income Tax Act 2007 has been amended to refer to PFSI forestry income, so that PFSI foresters are entitled to use income equalisation accounts.

Application dates

The amendments to the Income Tax Act 2007 to extend the application of subpart DP and to extend the availability of income equalisation accounts to PFSI foresters apply from the 2008–09 income year.

The amendment to the Income Tax Act 2004 to extend the application of subpart DP to PFSI foresters apply from 1 April 2005.

TIMING OF ALLOCATION OF BENEFICIARY INCOME

Section HC 6 of the Income Tax Act 2007

Section HC 6 has been amended to remove a timing problem for tax agents who administer trusts, in particular, to allow them more time to allocate beneficiary income. Under the previous rules, beneficiary income had to be allocated within an arbitrary six months of a trust's balance date, creating undue pressure for tax agents at a time when their clients' business tax requirements also had to be met.

Background

Under the previous law, trustees had to allocate beneficiary income within six months of the trust's balance date. This did not fit well with tax agents' work schedules as frequently they had to give priority to trust accounts to ensure the six months rule was met. This conflicted with the more commercial requirements of tax agents' clients.

Key features

Section HC 6(1) has been amended to allow the income allocation to be made in the longer of the following periods:

- six months after the end of the income year; or
- the earlier of:
  - the date on which the trustee files the tax return of income for the income year; or
  - the date by which the trustee must file a tax return for the income year under section 37 of the Tax Administration Act 1994.

Also, sections HC 6(3) and (4) concerning which year the beneficiary returns the income have been combined and their application has been clarified.

Application date

The amendments apply to income derived in the 2009–10 and subsequent income years.

PORTFOLIO LISTED COMPANIES – EXTENSION OF TIME FOR LISTING ON A RECOGNISED EXCHANGE

Sections HL 12 and HM 18 of the Income Tax Act 2007; section HL 11B of the Income Tax Act 2004

Currently PIEs that are not listed on a recognised exchange but intend to list, and demonstrate this intention by complying with a number of criteria, can elect to be a portfolio listed company. This provides these companies with portfolio listed company tax treatment. The criterion that requires that the company actually lists on a recognised exchange within a certain timeframe has been amended to extend the time period from two to four years (from the date of election). This recognises that certain companies require an extended period as a result of the recent financial crisis.

Background

Section HL 12 of the Income Tax Act 2007 sets out the rules that allow an unlisted company to elect to become a portfolio listed company. The general rules in section HL 12 are that an unlisted company may choose to become a portfolio listed company provided it meets certain criteria, and it is listed on a recognised exchange two years after electing to become a portfolio listed company.

Key features

The section has been amended to allow an extension of time for companies that elect to become a portfolio listed company to list on a recognised exchange. The period of time has been extended from two years to four years provided that, before 2 July 2009, the company has resolved to become a company listed on a recognised exchange in New Zealand if it were to obtain the required consents, and it has applied to the Securities Commission for an exemption to disclose in a prospectus its intention to become a listed company.

Corresponding amendments have been made to section HM 18 of the rewritten PIE rules and to section HL 11B of the Income Tax Act 2004.

Application dates

The amendment to section HL 12 of the Income Tax Act 2007 applies for the 2008–09 and later income years.

The amendment to the Income Tax Act 2004 is effective from 1 October 2007, which is the date that the PIE rules started.

The change to subpart HM of the Income Tax Act 2007 applies for the 2010–11 and later income years to align with the start date of the rewritten PIE rules.

TAXATION OF OUTBOUND DIVIDENDS

Subpart IV and sections LP 1, LP 2, LP 7 to LP 10, RF 9, RF 11B and YA 1 of the Income Tax Act 2007

New rules have been introduced for dividends paid by New Zealand companies to non-resident shareholders.

Background

Various changes have been made to the rules concerning the taxation of dividends paid to non-residents. These changes affect the supplementary dividend regime and the non-resident withholding tax (NRWT) rules.

Tax treaties signed with Australia, Singapore and the United States in 2008 and 2009 provided the catalyst for these domestic law changes. The new treaties reduce the rate of New Zealand tax that can be imposed on non-portfolio dividends paid to non-residents from 15% to either 5% or zero, depending on the size of the shareholder's stake in the company paying the dividend, and certain other criteria. There is no zero rate under the Singapore treaty.

Key features

The supplementary dividend rules in subpart LP have been amended. From 1 February 2010, credits will no longer be available for supplementary dividends paid to non-residents in respect of non-portfolio interests in New Zealand companies, nor if the rate of tax applicable to the dividend is less than 15%.

Effective from the same date, a zero rate of NRWT has been introduced for non-portfolio dividends paid to non-residents, and for other outbound dividends for which the applicable rate of tax would otherwise be less than 15%. This zero rate applies to the extent the dividends are imputed.

From 1 April 2011, credits under subpart LP will cease to be available for distributions to supplementary dividend holding companies. Provisions supporting the supplementary dividend holding company regime are fully repealed for the 2013–14 and later income years.

Application dates

Various application dates are relevant to these changes. These are outlined above and discussed in more detail below.

Detailed analysis

Changes to the supplementary dividend rules

The rules concerning credits for supplementary dividends are set out in subpart LP. Section LP 2 provides that, when a resident company pays a dividend and a related supplementary dividend to either a non-resident or a supplementary dividend holding company, it qualifies for a tax credit calculated under the formula in subsection (2).

Distributions to non-residents

Section LP 2(1)(a) deals with distributions to non-residents. It has been amended so that a credit is only available for a dividend and related supplementary dividend paid by a company to a non-resident if the non-resident has less than a 10% direct voting interest in the company and the rate of tax applicable to the dividend is 15% or more. This change applies from 1 February 2010.

The requirement in section LP 2(1)(a)(ii) that the rate of tax payable on the dividend must be at least 15% will ensure that credits under this subpart are also unavailable for dividends and related supplementary dividends paid to non-resident portfolio investors if a lower rate of tax

applies. For example, under Article 10(4) of the new double tax agreement with Australia, dividends paid on portfolio interests held by a Contracting State, political subdivision or local authority will be exempt from source taxation.

Distributions to supplementary dividend holding companies

Section LP 2(1)(b) deals with distributions to supplementary dividend holding companies. It has been repealed, along with subpart IV, sections LP 1(2), LP 2(4) to (6) and sections LP 7 to LP 10, which make further provision for such holding companies. Consequential amendments have been made to sections LP 2(2) and YA 1.

The repeal of section LP 2(1)(b) applies from 1 April 2011, as do the related repeals of sections LP 1(2), LP 2(5) and (6), and the amendments to sections LP 2(2) and YA 1. It will therefore be possible to continue to claim credits for dividends and supplementary dividends paid to holding companies for a limited period after these credits cease to be available for distributions to non-residents.

This delayed application allows time for distributions to be paid up through a chain of holding companies and on to non-resident investors. It is intended to deal with the possibility that a lower-tier holding company has already received a dividend and a supplementary dividend before 1 February 2010 without having made a corresponding distribution by that date. Delaying the repeal of section LP 2(1)(b) and related provisions ensures that a higher-tier holding company can continue to receive supplementary dividends and correspondingly adjusted imputation credits, and therefore have a tax liability against which to claim a credit under subpart LP when making a distribution to a portfolio investor.

Note that, under section YA 1, a supplementary dividend holding company must have an ongoing purpose of enabling the payment of a supplementary dividend to a non-resident. Supplementary dividends will not be payable to non-residents for non-portfolio holdings after 1 February 2010. Accordingly, we would not expect supplementary dividend holding companies to be maintained beyond 1 February 2010, except when it is necessary to enable payment of supplementary dividends to non-resident portfolio investors. Holding company structures typically involve non-portfolio interests.

Other provisions relating to supplementary dividend holding companies will be left in place until they are no longer required. Accordingly, the repeal of subpart IV, section LP 2(4), and sections LP 7 to LP 10, and the related amendment to section YA 1, do not apply until the 2013–14 income year.

Remedial amendment to section LP 8(2)

The formula in section LP 8(2) has been amended, with effect for the 2008–09 and later income years (up to repeal). This corrects an unintended change made when the Income Tax Act 2007 replaced its predecessor.

The formula in section LP 8(2) specifies how the taxable income of a holding company is to be determined. Before its amendment, the section specified a lower amount of taxable income—and therefore liability to tax—than was needed to allow the holding company to use in full the credit it became entitled to when it paid a supplementary dividend. Under the Income Tax Act 2004, the missing income was brought into account by section LE 3(8), which provided that a supplementary dividend received by the holding company was not exempt income under section CW 10.

Section LE 3(6) of the Income Tax Act 2004 specified the amount of a dividend that was to be treated as exempt income (if any), while section LE 3(8) provided that the supplementary dividend was not exempt income. The Income Tax Act 2007 takes a different approach, with section LP 8(2) simply prescribing the amount of taxable income a holding company derives. It is therefore appropriate to correct the formula in section LP 8(2), rather than resurrect section LE 3(8) of the Income Tax Act 2004.

Changes to the NRWT rules

NRWT is imposed under subpart RF. New section RF 11B has been introduced, with a consequential amendment to section RF 9. These changes apply from 1 February 2010.

The effect of these amendments is to apply a zero rate of NRWT to dividends paid by a company to a non-resident that either has a direct voting interest in the company of 10% or more or (section RF 11B aside) would be subject to tax on the dividend at a rate below 15%. The zero rate applies to the extent the dividend is imputed, with this to be determined under section RF 9.

New section RF 11B is the corollary to the amendments to section LP 2 discussed above. If a dividend paid to a non-resident is outside the scope of section LP 2(1)(a) (as amended), either because it relates to a direct voting interest of 10% or more, or because it is taxed at a rate below 15%, then, to the extent the dividend is imputed, it becomes eligible for a zero rate of NRWT under subpart RF.

TAX TREATMENT OF NEW ZEALAND SUPERANNUATION AND THE VETERAN'S PENSION PAYABLE OVERSEAS

Sections RD 5 and YA 1 of the Income Tax Act 2007

Changes have been made to the income tax treatment of New Zealand superannuation and the veteran's pension, which are payable overseas. The entitlement to these pensions has been expanded. These pensions will not be subject to New Zealand income tax if the recipient is residing overseas, but will remain taxable if the recipient is travelling overseas and not residing in a country outside New Zealand.

Background

Full New Zealand superannuation and the veteran's pension previously generally ceased to be paid to persons who were out of New Zealand for more than 26 weeks. A payment of New Zealand superannuation or the veteran's pension to a person outside New Zealand is called a portable New Zealand superannuation or a portable veteran's pension. Normal New Zealand superannuation and the veteran's pension are taxable. However, section CW 28 of the Income Tax Act 2007 exempts payments of portable New Zealand superannuation and the portable veteran's pension from income tax. The policy basis for the exemption is that the recipient's country of residence should have sole taxation rights on this pension income because it is responsible for providing public services and support infrastructure for the recipient.

The New Zealand Superannuation and Retirement Income Amendment Act 2009 and the War Pensions Amendment Act 2009, which came into force on 5 January 2010, expand the entitlement to New Zealand superannuation and the veteran's pension payable to people who are outside New Zealand for more than 26 weeks in certain circumstances. This makes it easier for superannuitants and veteran pensioners to travel or retire overseas while retaining their entitlement to New Zealand superannuation or a veteran's pension.

Key features

The definitions of "portable New Zealand superannuation" and "portable veteran's pension" in section YA 1 of the Income Tax Act have been amended to exclude pensions paid to persons who travel overseas for more than 26 weeks but do not reside in a country outside New Zealand. This amendment ensures that these pensions remain subject to New Zealand income tax.

This is because these travellers will still generally be resident in New Zealand and should, in accordance with existing policy, be taxed in New Zealand on their New Zealand pension income. A tax exemption should apply only to people who have permanently emigrated, not to those who are residing in New Zealand but are travelling overseas. Also, a person travelling overseas would not generally be subject to any income tax liability in the countries in which they are travelling.

Once a person ceases travelling and resides in a country with which New Zealand does not have a social security agreement, payments of New Zealand superannuation and the veteran's pension will be treated as exempt income (that is, they will become "portable New Zealand superannuation" and "portable veteran's pension" as defined in section YA 1 of the Income Tax Act).

Payments of New Zealand superannuation and the veteran's pension to persons travelling outside New Zealand for more than 26 weeks will not have PAYE deducted, as provided in section RD 5. Instead, these individuals will need to include this income in their tax return each year. Inland Revenue will have access to information about these payments.

Application date

The amendment applies from 5 January 2010.

TAX RECOVERY ARRANGEMENTS

Sections 3(1), 173B and 173G of the Tax Administration Act 1994

Section 173G of the Tax Administration Act 1994 has been amended (and the definitions of "contested tax" in sections 3 and 173B of that Act have been consequentially repealed). The purpose of the changes is to ensure that New Zealand can fully meet its treaty obligations to provide tax recovery assistance (also known as collection assistance) to another country under a tax recovery arrangement with that country.

Background

New Zealand has in recent years begun entering into bilateral tax recovery arrangements with a selected number of its tax treaty partners—to date, with Australia, the Netherlands, Poland and the United Kingdom. In the case of Australia, Poland and the United Kingdom the arrangements form part of New Zealand's double tax agreements (DTAs) with those countries by including specific Articles on "Assistance in the Collection of Taxes". In the case of the Netherlands the arrangements have been established in a stand-alone Tax Recovery Convention.

Part 10A of the Tax Administration Act 1994 authorises the entering into of collection assistance arrangements. It also sets limits on the collection assistance that New Zealand can provide. Before the amendment, part 10A prohibited the Commissioner of Inland Revenue from providing collection assistance relating to unpaid tax that was "contested". (The term "contested", as defined, had a broad meaning. For example, it included tax not actually subject to objection but for which the time limits for objecting had not yet expired.)

However, the treaty obligation, as expressed in the Assistance in the Collection of Taxes Articles in the DTAs with Australia, Poland and the United Kingdom, is for the requested State to provide collection assistance unless the person owing the tax is **unable to prevent its collection** under the laws of the requesting State. A similar outcome arises under the Netherlands Tax Recovery Convention, albeit by means of different wording.

The laws of some States may require the payment of taxes even when an objection has been made or the period for objecting has not yet expired. For example, in New Zealand, the Commissioner may require payment of all tax in dispute if there is a significant risk that the tax in dispute will not be paid if the objection did not succeed. This conflict could have resulted in the Commissioner being required by treaty to provide collection assistance in cases where domestic law prohibits the provision of such assistance.

The amendment to section 173G, and the consequential amendments to the definitions of "contested tax" in sections 3 and 173B will ensure that the Commissioner is not constrained by the Tax Administration Act 1994 provisions from providing collection assistance in compliance with New Zealand's treaty obligations.

Key features

Section 173G of the Tax Administration Act 1994 has been amended, and the definitions of "contested tax" in sections 3 and 173B of that Act have been consequentially repealed, to ensure that the Commissioner is no longer constrained by domestic law from providing collection assistance in compliance with New Zealand's treaty obligations.

Application date

The amendment applies from the date of enactment, 7 December 2009.

ELECTRONIC COMMUNICATIONS

Section 14(7) of the Tax Administration Act 1994

An amendment has been made to the Tax Administration Act 1994 which allows Inland Revenue to issue notices and other information electronically in a broader range of circumstances than previously.

Background

Inland Revenue issues many of its notices and other information to taxpayers by post. This is costly, and in some cases ineffective. As part of a long-term project, the department intends to provide more information electronically rather than by post.

The previous rules required a taxpayer's consent for Inland Revenue to provide a communication electronically (the consent could be express or inferred). However, in certain circumstances gaining consent is impractical and is inconsistent with the tax administration rules that apply to sending notices via post.

Key features

An amendment to section 14(7) allows Inland Revenue to provide information electronically if there are no reasonable grounds to believe that the communication will not be received by the person.

Application date

The amendment applies from 7 December 2009.

PERSONAL TAX SUMMARIES

Sections 33A(5), 80C, 80D and 80KV of the Tax Administration Act 1994; section 15 of the Student Loan Scheme Act 1992

A personal tax summary (PTS) is issued to some salary and wage earners at the end of the income year. It shows a taxpayer's income details for the year and whether the taxpayer needs to pay further tax or if they are entitled to a refund.

Background

Under the previous rules Inland Revenue was required to issue PTSs to several categories of individual taxpayers, including those with over $200 of employment income withheld under certain tax codes. However, issuing PTSs was not always necessary for all these groups, particularly when the correct amount of tax was likely to have been withheld during the year. The lack of flexibility in the legislation therefore imposed unnecessary compliance and administrative costs for these taxpayers and Inland Revenue.

Key features

Sections 33A(5), 80C, 80D and 80KV of the Tax Administration Act 1994 have been amended to remove the previous requirement for Inland Revenue to automatically issue PTSs.

Inland Revenue will identify certain categories of taxpayers to whom PTSs will still be issued or who will need to request a PTS, and publish these categories in the Tax Information Bulletin later this year.

Taxpayers can still request a PTS from Inland Revenue if they wish.

Spouses of Working for Families recipients

A consequential change has been made to section 80KV to ensure that a PTS will not be automatically issued to spouses of Working for Families recipients.

Student loan borrowers

The Student Loan Scheme Act 1992 has also been consequentially amended to ensure that a PTS will not be automatically issued to student loan borrowers.

Application date

The changes apply for the 2009–10 and later income years.

CORRECTION OF MINOR ERRORS IN SUBSEQUENT RETURNS

Section 113A of the Tax Administration Act 1994

A rule has been introduced to allow taxpayers who have made minor errors in a return (involving $500 or less in tax) to correct them in a subsequent return.

This will help to increase certainty for taxpayers, while reducing their compliance costs and exposure to use-of-money interest and penalties.

Background

The new rule is largely aimed at helping to reduce compliance costs for small and medium-sized enterprises (SMEs) and individuals, although it will apply to taxpayers generally. It was first outlined in the government discussion document, *Reducing tax compliance costs for small and medium-sized enterprises*, released in December 2007. The rule's introduction was subsequently part of a wider package of tax measures aimed at SMEs in 2009.

As SMEs account for over 95% of New Zealand's businesses it is important that the people who operate them can concentrate on the things that will help their businesses. Reducing the number of tax returns, payments and calculations SMEs have to deal with will help to ease the tax burden they currently face, and free-up some of their time and money to focus on strengthening their businesses.

Taxpayers are required to correctly determine the amount of tax payable under tax laws. If an amount is not correctly calculated, or not paid on time, penalties can apply. Use-of-money interest also generally applies if the correct amount of tax is not paid when due.

Errors are generally required to be corrected in the returns in which they arose. This involves, in addition to the penalty and interest implications noted above, further compliance costs for the taxpayer.

By allowing taxpayers to rectify minor errors they have identified in previous returns by including them in current returns, taxpayers and their agents will be provided with a greater level of comfort in making such changes. This will also reduce the number of interactions taxpayers have with Inland Revenue.

Key features

New section 113A of the Tax Administration Act 1994 allows taxpayers to correct minor errors made in income tax, fringe benefit tax, or goods and services tax returns, in the next subsequent return after discovering the error(s).

A minor error is defined as an error (or errors) that was caused by a clear mistake, simple oversight, or mistaken understanding on the taxpayer's part and that, for a single return, causes a total reduction in the resulting assessment of tax of $500 or less.

For the purpose of calculating the $500 reduction, errors the taxpayer may have for each income tax, fringe benefit tax, or goods and services tax returns are treated separately.

Application date

The new rule applies from 7 December 2009.

Detailed analysis

Under the new rule, when a taxpayer identifies and realises they have made an error or errors caused by a clear mistake, simple oversight or mistaken understanding that results in an underpayment of tax of $500 or less, they no longer need to correct the return in which the mistake arose. Instead, the mistake can be rectified in the next return that is due after the discovery of the error, and the associated tax shortfall caused by the mistake paid along with any tax due from that subsequent return.

In these circumstances the new rule allows the taxpayer to correct the error in this manner. The taxpayer will not be required to specifically notify the Commissioner of the change made.

> **Example**
>
> As a result of a computer inputting error, a taxpayer inadvertently omits a taxable fringe benefit provided to an employee in their FBT return for the quarter ended 31 June 2010. This results in an underpayment of FBT of $245 for this return. The taxpayer, upon discovering the error in August 2010, can now include the taxable fringe benefit in the FBT return for the quarter ended 30 September 2010 and pay the associated shortfall along with any tax due from that return.

Excepted situations

It should be noted that Inland Revenue may review error adjustments when examining taxpayers' records, and may consider limited cases under the compliance and penalties provisions for lack of reasonable care (or more serious penalties if appropriate). An example is if a taxpayer makes a number of habitual adjustments to a number of return periods, or several similar adjustments in varying periods. Such a situation may fall outside the new rule.

GST TREATMENT OF WASTE DISPOSAL LEVY PAYMENT

Section 5 of the Goods and Services Tax Act 1985

Changes have been made to the Goods and Services Tax Act 1985 to clarify the tax treatment of the waste disposal levy, introduced on 1 July 2009, under the Waste Minimisation Act 2008. The amendment treats payments of this levy as consideration for a supply of services in the course or furtherance of a taxable activity and therefore as subject to GST.

Background

Most activities of public and local authorities are included within the GST base in line with the broad-base principle that GST applies to practically all supplies of goods and services. Some public or local authority levies are, for clarity, specifically made subject to GST, for example, road user charges and the fire service levy.

Key features

Section 5(6AC) of the Goods and Services Tax Act 1985 clarifies that the three central payments made in relation to the waste disposal levy are consideration for a supply of services made in the course or furtherance of a taxable activity. Those supplies are therefore subject to GST. These payments give rise to input tax credits when they are made in the course or furtherance of a taxable activity. The three payments are:

- payment of the levy from the user of a waste disposal facility to the operator of that waste disposal facility;
- payment of the levy from the waste disposal facility operator to the Secretary for the Ministry of the Environment, represented by the levy collector; and
- payment made from the Secretary for the Ministry of the Environment to funding recipients and for other payments described in section 30 of the Waste Minimisation Act 2008.

Application date

The amendment applies retrospectively from 1 July 2009 to align with the date on which the levy first applied.

GST ON FACILITATION SERVICES

Section 8(2) of the Goods and Services Tax Act 1985

Changes have been made to the Goods and Services Tax Act 1985 to clarify the GST treatment of facilitation services provided by inbound tour operators (ITOs).

Background

ITOs are in the business of packaging and selling New Zealand tourist services for overseas visitors. The supply of these packages incorporates, but does not generally separate out, a "facilitation fee" component for an ITO's services in arranging the package.

There has been some uncertainty about the correct GST treatment of the facilitation service component of tour packages. The purpose of the amendment is to clarify this uncertainty.

Key features

New section 8(2B) provides that, to the extent to which a supply of services consists of the facilitation of inbound tour operations (facilitation services), the supply is taxed at the standard rate of GST. This section has a retrospective effect from 1 July 2007.

To ease the transition to the rules for some ITOs, new section 8(2C) introduces a transitional period from 1 July 2007 to 30 June 2008. During this period, the supply of facilitation services should be taxed at the rate of 0%. The consideration for the supply must be quantified on the basis of the person's gross margin attributable to the facilitation of inbound tour operations, or by other means that the Commissioner is able to verify.

New section 8(2D) provides that the amount of consideration charged by a person for facilitation services during the transitional period must be calculated for each of the person's taxable periods that fall within the transitional period. For any days in the person's taxable period that fall outside the transitional period, the consideration must be apportioned on a pro rata basis.

New section 8(2D) states that if a registered person has paid GST in respect of a supply of facilitation services at the standard rate during the transitional period, the person is entitled to a refund of the amount of tax paid. The application for the refund must be made in writing by 7 June 2010.

New section 8(2F) clarifies the meaning of "facilitation services". Facilitation services are the services that a registered person provides in packaging one or more domestic tourism products and services in New Zealand and selling them outside New Zealand to a non-resident person. The tourism products and services may include accommodation, meals, transport, and other activities.

Application date

The amendments apply from 1 July 2007.

REMEDIAL MATTERS

RESEARCH AND DEVELOPMENT DEDUCTIONS AND GAAP

Sections DB 34, DB 35 and YA 1 of the Income Tax Act 2007; sections DB 26, DB 27 and OB 1 of the Income Tax Act 2004

Amendments have been made to allow for the fact that currently there are two version of generally accepted accounting principles (GAAP) in use, colloquially known as IFRS (International Financial Reporting Standards) GAAP and "old" GAAP.

Background

When the IFRS GAAP tax amendments were made it was not known that "old" GAAP would be retained for some time and the references to "old" GAAP were replaced with references to IFRS GAAP. Thus it has become necessary to ensure that the Income Tax Acts address deductibility for research and development in terms of both "old" GAAP and IFRS GAAP.

Key features

The core changes are in section DB 34 of the Income Tax Act 2007 (and section DB 26 of the Income Tax Act 2004). The other changes are consequential definition changes. In particular, both the old and the new GAAP reporting standards are now referred to.

Application date

The amendments apply from the date the original legislation could have applied from, generally the 2007–08 income year.

COST OF TIMBER

Sections DP 11 and YA 1 of the Income Tax Act 2007; sections DP 10 and OB 1 of the Income Tax Act 2004

Amendments have been made to align the rules relating to deductions for certain forestry expenditure with new generally accepted accounting principles (International Financial Reporting Standards GAAP) requirements.

Background

The main purpose of section DP 11 of the Income Tax Act 2007 (section DP 10 of the Income Tax Act 2004) is to allow a deduction for certain forestry expenditure that might not otherwise be deductible. It also quantifies and times this deduction.

However, the deduction is linked to the accounting treatment of expenditure that should be capitalised as part of the "cost of bush" under generally accepted accounting principles (GAAP). It was identified that the effect of the GAAP requirements in the provision potentially resulted in section DP 11 not applying to either:

- a person who owns forestry assets but does not account for those assets in financial reports; or
- a person who owns forestry assets, and who is required to comply with GAAP, in particular NZIAS 41, under which forestry assets must be reported at value, and not as a "cost of timber".

Because the term "cost of timber" was defined by reference to the amount that was allowed as a deduction in section DP 11, it was unclear whether an expenditure incurred after timber was harvested could be included in the amount that is a "cost of timber". This circularity created uncertainty as to which provisions should apply to costs such as environmental restoration expenditure.

Key features

The section has been amended to remove a reference to GAAP. This amendment ensures that section DP 11 can apply to:

- a taxpayer owing forestry assets but does not report those assets in financial statements; and
- a taxpayer complying with GAAP and who cannot report "cost of timber" in their financial statements.

In addition, the definition of "cost of timber" in the 2004 Act has been amended to clarify that an amount cannot be a cost of timber if:

- the amount is an expenditure to which sections DB 46 or DQ 4 of the 2007 Act (sections DB 37 or DQ 4 of the 2004 Act) apply;
- the expenditure is incurred after the timber is harvested (for harvested timber); or
- the expenditure is incurred after the disposal of standing timber or any right to take timber or any other right referred to in section DP 11(4) (DP 10(4) of the 2004 Act).

Application date

As the adoption of IFRS in relation to forestry assets can affect taxpayers back to the 2005–06 income year, the amendments for "cost of timber" apply from:

- the 2008–09 income year for the 2007 Act; and
- the 2005–06 income year for the 2004 Act.

AMENDMENTS TO THE LIFE INSURANCE TAXATION RULES

Sections EY 15, EY 17, EY 18, EY 19, EY 21, EY 22, EY 30 and YA 1 of the Income Tax Act 2007

Several changes have been made to the new rules for taxing life insurance business. The changes made by the Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 affect the scope of the grandparenting provisions applicable to life insurance policies sold before 1 July 2010. Remedial amendments have also been made to ensure that the new rules achieve their intended policy effect.

Background

The Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 significantly changed the taxation rules applicable to life insurance business. The new rules are designed to tax the income from term life business so that life insurance companies pay tax on their profits like any other New Zealand business.

The new rules also contained a comprehensive set of transitional provisions that preserve the previous income treatment of life insurance policies sold before the application date.

In response to submissions received on the Taxation (Consequential Rate Alignment and Remedial Matters) Bill, the Finance and Expenditure Committee recommended a number of technical amendments be made the new rules.

Key features

The main amendments to the new taxation rules for life insurance affect the scope of the transitional rules. Other technical changes have been made to correct technical problems identified with the new rules. The amendments are consistent with the policy intent of the new taxation rules for life insurance business.

Application date

The changes apply from 1 July 2010. Life insurers have the option to apply the rules from the beginning of their income year, if that year includes 1 July 2010.

Detailed analysis

Grandparenting of term life products (section EY 30(2), (4), (5), (11), (14) and (15))

Section EY 30 allows life insurance policies sold under the previous rules to be grandparented and subject to transitional rules for a period of up to five years. The application of the previous life rules is therefore preserved, for a limited period, for term policies sold before the start of the new taxation rules for life insurance business. Several changes have been made to clarify the scope of the grandparenting rules:

Group life policies – workplace group policies: Changes have been made that allow employee lives insured after 1 July 2010 to be grandparented if the life cover arises from a compulsory group life policy provided by an employer. Previously, the new rules for workplace group policies (referred to as "employer-sponsored group policies") required life insurers to "look through" the group life policy to the individual lives covered and limited the benefits associated with grandparenting to lives insured before the application date. Because group life policies insure a portfolio of lives, the requirement to "look through" was not considered practical or feasible because of information constraints and related systems costs.

Changes have therefore been made which remove the need to distinguish between employee members of a compulsory workplace group scheme that joined before the application date and those that joined afterwards.

The maximum grandparenting period for these policies has, however, been reduced from five years to three years.

The new definition of "workplace group policy" in section EY 30(15) also ensures that policies sold to trade unions to cover their members are similarly treated.

Credit card repayment insurance: Life policies that provide for the repayment of a credit card balance which are sold directly to cardholders may now be grandparented as a result of amendments to the definition "credit card repayment insurance". Previously, credit card repayment insurance could only be grandparented if the cover was provided under a master policy and the general public was excluded.

Table 1 summarises the operation of the grandparenting rules, including the changes made by the Taxation (Consequential Rate Alignment and Remedial Matters) Act. This table replaces the earlier table printed on page 55 of *Tax Information Bulletin* Vol 21, No 8, Part II.

Table 1: Operation of grandparenting rules

Life insurer's grandparenting product criteria: Section EY 30

	Individual policies	Group life master policies (including life reinsurance policies)	Credit card repayment insurance	Workplace group policies
Subsections of section EY 30	**(2)**	**(3) & (14)**	**(4) & (11)**	**(4) & (12)**
Main criteria				
(5)(a) Single premium	Contract expiry (2)(b)	Contract expiry for each life (3)(b)	Not applicable	Not applicable
(5)(b) Fixed premium	Later: 5 years or end of continuous rate period (2)(b), unless contract expiry is earlier	Not applicable	Not applicable	Not applicable
(5)(c) Variable premium	Earlier: contract expiry or 5 years (2)(b)	Earlier: contract expiry or 5 years (3)(b)	Earlier: contract expiry or 5 years (4)(b)	Not applicable
(5)(d) Variable premium	Not applicable	Not applicable	Not applicable	Earlier: contract expiry or 3 years (4)(b)
Other criteria				
New members excluded	Not applicable	Yes (3)(c)	No	No
No policyholder base income or deduction for the policy (excludes savings products; eg whole of life, endowment & unit linked)	Risk only (2)(a)	Risk only (3)(a)	Risk only (4)(a)	Risk only (4)(a)
Disqualification criteria				
Life cover % increase over "cover review period": > 10% opening cover > % movement in consumer price index	Applicable (2)(c)	Applicable for each life (3)(e)	Not applicable	Not applicable
Substantial & material terms & conditions have changed on or after grandparenting start-day	Not applicable	Applicable (3)(d)	Applicable (4)(d)	Applicable (4)(d)

Premium payback policies

Changes have been made to the new rules for premium payback policies. Premium payback policies are life policies which pay a portion of premiums back to policyholders who hold their policies for a set minimum period. The definition of "savings product policy" in section YA 1 has been amended to exclude life policies if the surrender value arises wholly from a "premium payback amount" (as defined in section YA 1). Under the new rules, if the policy is not treated as a savings product it cannot have policyholder base income and the transitional rules therefore have effect.

These amendments ensure that these policies can be grandparented, if sold before the application date, and that any premium return feature does not give rise to the life insurer having policyholder base income.

Drafting matters

A number of amendments have been made clarify certain aspects of the new life insurance rules:

- Section EY 17(3) has been changed to provide context to the application of the term "policyholder unvested liabilities" by referring to the value of any assets used to support such liabilities. The term "policyholder unvested liabilities" is defined in section YA 1.
- Sections EY 18 and EY 22 have been changed to ensure that "net transfers" are ignored when calculating allowable deductions allocated to the policyholder base. The change prevents double-counting as amounts relating to net transfers can be positive or negative and are allocated when determining policyholder base income under section EY 17 or shareholder base income under section EY 21.
- Sections EY 17(2) and EY 21(2) have been changed by giving context to the term "shareholders" as it is used in these sections. The sections now refer to "shareholder's retained earnings".
- Sections EY 15(5), EY 17(2), EY 19(2) and EY 21(2) have been changed to ensure drafting consistency with the rest of the Income Tax Act 2007.

ATTRIBUTION RULE

Section GB 27 of the Income Tax Act 2007

Previous amendments allowed for certain non-qualifying companies to distribute their income using the qualifying company regime fully imputed or exempt rules. Section GB 27 has been amended to allow for the removal of the deemed credits that arise when a company attributes income to allow the qualifying company mechanism to work as intended.

The amendment applies from the 2008–09 income year.

AMENDMENTS TO THE REWRITTEN PORTFOLIO INVESTMENT ENTITY RULES

Sections HM 14(3), HM 15(2), HM 57, HM 59 (repealed), HM 60, HM 61, HM 72 and YA 1 of the Income Tax Act 2007

A number of remedial amendments have been made to the rewritten tax rules for portfolio investment entities. These amendments ensure that the rules achieve their intended policy effect.

Application dates

The changes to sections HM 14(3), HM 15(2), HM 57, HM 59, HM 60, HM 61 and YA 1 apply for the 2010–11 and later income years.

The change to section HM 72 applies for income years beginning on or after 1 April 2010.

PAYROLL GIVING REMEDIALS

Sections LD 4(7), LD 6 and LD 7 of the Income Tax Act 2007

Amendments have been made to ensure that the new payroll-giving scheme, which took effect from 7 January 2010, meets its original policy intent.

Key features

Section LD 4(7), which contains the definition of "pay" for the purposes of the payroll-giving scheme, has been amended to clarify that income-tested benefits are not specifically included in the definition of "pay".

Sections LD 6 and LD 7 have been amended to ensure that a tax credit for payroll donations can be extinguished under these provisions, as intended.

Application date

The amendments apply from 7 January 2010.

RESIDENT WITHHOLDING TAX AND INTERMEDIARIES OR AGENTS

Sections RE 10B, RM 8(3) to (6) of the Income Tax Act 2007; section NF 2E of the Income Tax Act 2004

The amendments clarify the operation of the tax credit and resident withholding tax (RWT) rules in relation to amounts received by intermediaries or agents acting on behalf of a New Zealand resident with foreign investment fund (FIF) interests.

The amendments apply to a natural person who begins an income year with more than $50,000 of attributing interests in a FIF, and who consequently is required to include FIF income from those interests as taxable income.

Background

If a New Zealand resident has more than $50,000 of FIF interests during an income year:

- section EX 59(2) requires the resident to calculate FIF income using a FIF calculation method (section EX 59(2)); and
- all distributions derived from the attributing FIF interests in that income year are no longer treated as dividends (section CD 36).

Section NF 7(5) of the 2004 Act permitted either the intermediary or agent, or the New Zealand beneficial recipient of the distribution to apply for a refund of any amounts withheld by the intermediary or agent. However, that provision applied only if the amount withheld was in relation to resident withholding income. As the effect of section CD 36 was that distributions from the FIF were no longer dividends, technically, no refund could be made.

It is considered there are likely to be a number of cases where the intermediary or agent may not necessarily be aware of the change in circumstances of the New Zealand resident at the time the distribution is on-paid to the New Zealand resident. In these circumstances, it is appropriate that amounts withheld from a distribution from a FIF by an intermediary or agent in the belief the distribution is resident passive income should be treated as a RWT credit.

Key features

A technical amendment is necessary for both the 2004 or 2007 Income Tax Acts to ensure that a tax credit is available for a New Zealand resident when an intermediary or agent for the resident:

- received a distribution from attributing interests in foreign investment funds owned by the New Zealand resident; and
- subsequently on-paid the distribution to the New Zealand resident; and
- withheld an amount on account of resident withholding tax in the belief the resident was within the $50,000 threshold rule in section CQ 5(1)(d) or (e) and that the on-payment was resident passive income of the New Zealand resident.

The amendments provide that:

- the intermediary, agent or the recipient can apply for a refund of the amount withheld if section EX 59(2) applies to the recipient; or
- if no application for a refund is made by 31 March following the withholding, the amount withheld is treated as a RWT tax credit for the recipient.

Detailed analysis

Section RM 8 of the Income Tax Act 2007 Act has been amended to provide that the intermediary, agent or recipient of the distribution may apply for a refund of the amount withheld. However, the application must be made to the Commissioner on or before the 31 March following the date of the withholding.

If no application is made by the 31 March following the date the amount is withheld from the distribution from the FIF interests by the intermediary or agent, section RE 10B treats the amount withheld by the intermediary or agent as a RWT tax credit of the recipient. The amount withheld by an intermediary or agent is treated as RWT for the purposes of subpart LA, section LB 3, and the refund rules in sections RM 1 to RM 10.

Section RE 10B(2) also provides that the amount withheld is treated as tax paid in excess for the purposes of Part 10B of the Tax Administration Act 1994 (Transfers of excess tax). These amendments ensure both the recipient and the Commissioner can use the amount withheld to satisfy other tax obligations of the recipient.

Similar amendments have been made in section NF 2E in the Income Tax Act 2004 to permit the amount withheld to be treated as a RWT tax credit. This amendment also ensures that section NF 7(5) of the 2004 Act can operate as intended to validate past applications by the intermediary, agent, or recipient for a refund of the amounts withheld.

Application date

The amendments in section RE 10B and RM 8 apply from the beginning of the 2008–09 income year.

The amendment made in section NF 2E of the Income tax Act 2004 applies from the beginning of the 2005–06 income year.

BINDING RULINGS ON THE INCOME TAX ACT 1994 AND 2004

Sections 91C(1)(e) and (eb) of the Tax Administration Act 1994

Previously Inland Revenue could not make a binding ruling for the period before the Income Tax Act 2007 came into effect if the application for the ruling was received by Inland Revenue after the beginning of the 2008–09 income year.

An amendment has been made to the Tax Administration Act 1994 to allow Inland Revenue to make binding rulings for this period, provided that other constraints on the ability to rule for back periods do not apply.

Application date

The amendment applies from the date of enactment, 7 December 2009.

MAKING THE REQUIREMENT TO PAY TAX IN DISPUTE A NON-DISPUTABLE DECISION

Section 138E of the Tax Administration Act 1994

The exercise of the Commissioner's discretion to require payment of all tax in dispute has been made a non-disputable decision.

Background

Section 138I of the Tax Administration Act 1994 concerns payment of tax in dispute. Since 2003 the Commissioner has been able to require that a disputant pay all of the tax in dispute if the Commissioner considers there is a significant risk that the tax in dispute will not be paid should the disputant's challenge be unsuccessful (section 138I(2B)). This discretion is exercised in exceptional circumstances only—for example, where the Commissioner considers there is a flight risk or a substantial risk of assets being alienated.

It was not intended that a decision of the Commissioner to require full payment should be a disputable decision.

Key features

Previously, a decision of the Commissioner to require full payment was a disputable decision. This was not intended. Therefore, a reference to section 138I(2B) has been added to section 138E, which sets out the provisions where there is no right of challenge, making the exercise of the discretion a non-disputable decision.

Application date

The amendment applies from the date of enactment, 7 December 2009.

DEFINITION OF "ASSOCIATED PERSONS" IN THE GST ACT, AND CHARITABLE BODIES

Section 2A(1) of the Goods and Services Tax Act 1985

Changes have been made to the definition of "associated persons" in the Goods and Services Tax Act 1985 to ensure that supplies to and by charitable and non-profit bodies do not give rise to a GST obligation when the donor or donee is associated with the body.

Background

GST charged in relation to a supply of goods and services is calculated by reference to the value of that supply, which is normally the consideration paid for the goods and services in question. It is possible, therefore, that two associated persons may agree to enter into a transaction with each other where the consideration charged for goods or services is either reduced or is nil. The GST Act provides a special valuation rule in these circumstances whereby the consideration for a supply is treated as being the open market value of the supply where the supply is made between associated persons. However, the special valuation rule applies to any supply made for nil value, including the supply of goods and services by or to a charitable or non-profit body.

Section 2A of the GST Act contains the definition of "associated persons". The combined effect of the wording of the "associated persons" definition before the amendments and the special valuation rule was that certain activities of charitable and non-profit bodies could be subject to GST on the full open market value because they were made by or to an associated person.

Key features

Section 2A(1)(f) associates a trustee and a beneficiary of a trust. The section has been amended so it does not apply in relation to a supply of goods and services when:

- the trustee is a charitable or non-profit body with wholly or principally charitable, benevolent, philanthropic, or cultural purposes and the supply is made by the trustee in carrying out these purposes; and
- the beneficiary is a charitable or non-profit body with wholly or principally charitable, benevolent, philanthropic, or cultural purposes and the supply enables them to carry out these purposes.

Section 2A(1)(h) associates a trustee of a trust and a trustee of another trust if the same person is a settlor of both trusts. The section has been amended to ensure that two trustees with a common settlor are not associated when one of those trusts is a charitable or non-profit body with wholly or principally charitable, benevolent, philanthropic, or cultural purposes, and the supply is made in carrying out, or enables the carrying out, of these purposes.

Application date

The amendments apply from 7 December 2009.

GIFTS OF MONEY BY COMPANY

Section DB 32(3) of the Income Tax Act 2004

An amendment has been made to ensure that the policy to remove the 5% limit on deductions for charitable donations made by companies applies from the intended date of 1 April 2008.

Key features

Section DB 32(3) of the Income Tax Act 2004 has been amended to restore the position in relation to deductions for gifts of money made by companies that should have applied from 19 December 2007.

Section 757 of the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 has been repealed.

Application date

The amendment applies from 19 December 2007.

MISCELLANEOUS TECHNICAL AMENDMENTS

INTERPRETATION OF TAX TREATIES

Section BH 1 of the Income Tax Act 2007

A minor technical change has been made to clarify the relationship between domestic and treaty law.

Background

Section BH 1(7) clarifies that a reference in a double tax agreement to two persons being unrelated is to be read, if possible, as a reference to two persons being not associated. The clarification concerns the rules for interest paid to banks and similar financial institutions in new tax treaties with the United States (signed in December 2008) and Australia (signed in June 2009).

Under domestic law, a person may be exempt from non-resident withholding tax on interest paid to a non-resident provided they pay the approved issuer levy and are "not associated" with the lender (section RF 12 of the Income Tax Act 2007, section 32M of the Tax Administration Act 1994 and part VIB of the Stamp and Cheque Duties Act 1971).

For interest paid to banks and similar financial institutions, this exemption has now been written into New Zealand's tax treaties with Australia and the United States. The relevant treaty provisions require the lender to be "unrelated to" the borrower; section BH 1(7) clarifies that this is the same as the requirement under domestic law for the borrower and lender to be "not associated".

Key features

New subsection (7) has been added to section BH 1, clarifying that a reference in a double tax agreement to two persons being unrelated is to be read, if possible, as a reference to two persons being not associated.

Application date

Section BH 1(7) comes into force on 7 December 2009.

EXCLUSION FROM ATTRIBUTION FOR TELECOMMUNICATIONS INCOME OF A CFC

Section EX 20B of the Income Tax Act 2007

Subsection EX 20B(11) has been amended to broaden the exclusion of certain telecommunications income from an "attributable CFC amount".

The amendment, in broad terms, allows the exclusion to be used when a group of people has a common controlling interest—whether direct or indirect through a chain of companies—in both a network operator and a CFC.

As originally enacted, the exclusion applied only if the controlling interest in the CFC was held directly by persons with a controlling interest in the network operator, or held directly by the network operator itself.

The criterion used to determine that there is a controlling interest in a company is a voting interest of more than 50%. A person's voting interest in a company that is owned indirectly (through a chain of companies, for example) is able to be determined using the existing rules in subpart YC of the Income Tax 2007. As in section IC 3 of the Income Tax Act, on which the amendment is modelled, if a "market value circumstance" exists there must also be a market value interest of more than 50%.

Application date

The amendment applies for all income years beginning on or after 1 July 2009.

DEFINITION OF "RELATIVE"

Section YA 1 of the Income Tax Act 2007

The Securities Act 1978 uses the definition of "relative" in the Income Tax Act 2007. The Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 amended the definition of "relative" in section YA 1 of the Income Tax Act 2007 so that, from 1 April 2010, it extends only to the second degree of blood relationship. Currently the definition also extends, for the purposes of certain provisions (including the Securities Act 1978) to the fourth degree of blood relationship.

An amendment has been made to the definition of "relative" in section YA 1 so that it will continue to extend to four degrees of blood relationship for the purposes of the Securities Act 1978. The amendment therefore maintains the status quo in relation to the definition used in the Securities Act 1978.

Application date

The amendment applies from 1 April 2010.

RWT ON TAXABLE MĀORI AUTHORITY DISTRIBUTIONS

Schedule 1, part D, table 4 of the Income Tax Act 2007

The RWT rate that applies to a taxable Māori authority distribution where a Māori authority does not have the tax file number of the recipient and the distributions are more than $200 has been reduced from 39% to 38%. This reduction reflects the recent change to the highest marginal tax rate.

Application date

The amendment applies from 1 April 2010.

REWRITE AMENDMENTS

The Act includes a number of remedial changes to the Income Tax Act 2007 and the Income Tax Act 2004, at the recommendation of the Rewrite Advisory Panel. The Panel sets out submissions for the Income Tax Act 1994 and the Tax Administration Act 1994 unintended changes on its website (**www.rewriteadvisory.govt.nz**), along with its conclusions and recommendations for each submission.

Rewrite remedial items also include:

- minor drafting matters that have been brought to the attention of the Rewrite Advisory Panel. In general, amendments consist of corrections of ambiguities, compilation errors, cross-references, spelling, punctuation, terminology, formulas and consistency of drafting. The Rewrite Advisory Panel publishes lists of these maintenance items on its website;
- consequential amendments arising from the amendment as recommended by the Rewrite Advisory Panel and the minor drafting items referred to above.

Background

At the time of reporting back the Income Tax Bill 2002, the Finance and Expenditure Committee expressed concern that the new, rewritten, legislation could contain unintended policy changes.

To alleviate that concern, the committee recommended that a panel of taxation specialists review any submission that rewritten income legislation contains an unintended policy change. An unintended policy change is regarded as a change in the drafting of a provision that results in a different legislative outcome from its corresponding provision in earlier income tax legislation. For example, to determine the corresponding provision for a provision in the Income Tax Act 2007, it is necessary at times to trace the legislation back to the Income Tax Act 1976, by examining the history of the provision through the Income Tax Act 2004, the Income Tax Act 1994, and the Taxation (Core Provisions) Act 1995.

The Rewrite Advisory Panel performs this review function. The process for making a submission to the Panel is set out in its statement, RAP 001 which is published on the Panel's website.

In general, the Panel considers whether a change in outcome has occurred, and then recommends that a provision:

- be amended to counter the effect of an unintended change;
- be identified in schedule 51 of the 2007 Act as an intended change; or
- remains unamended, as it contains no change in outcome when compared with its corresponding provision in the earlier Act.

The Finance and Expenditure Committee also noted in its commentary on the Income Tax Bill 2002 that there might be a situation in which:

> … the Government of the day decides to retain the rewritten law without retrospective amendment.

The Committee went on to say:

> Such a decision would be a change in policy, and the Inland Revenue Department would be obliged to require taxpayers to meet any increased tax. The department has advised us that it intends to inform taxpayers through an appropriate publication that, in such cases, where taxpayers rely on the transitional provisions, they will be required to meet the tax obligation but will not be subject to penalties, and any use-of-money interest incurred will be remitted. The taxpayer must have taken reasonable care and adopted a reasonable tax position under the old law. We agree with this approach.

Inland Revenue has published two standard practice statements setting out how it will apply the penalty and interest rules within the context of the comments of the Finance and Expenditure committee referred to above. Those two statements are SPS 08/03, issued in relation to the 2007 Act (published in the *Tax Information Bulletin* Vol 20, No 10, December 2008) and SPS 05/02, issued in relation to the 2004 Act (published in the *Tax Information Bulletin* Vol 17, No 5, July 2005).

Application dates

Unless otherwise stated, the following amendments apply from the beginning of the 2008–09 income year.

Detailed analysis

Sections 2(4), 2(10), 4, 6, 7, 9, 10, 13, 14, 16, 17, 21, 22, 26, 29, 31, 42, 44, 53 to 72, 80(1), 84, 85, 86 to 101, 104(1), 104(3), 105 to107, 110 to 113, 117, 118(4), 118(5), 118(9), 118(10 to (14), 118(18), 118(27), 118(29), 118(31), 118(32), 118(37), 119 to 121, 122(1), 122(7), 123(1), 123(4), 125, 126, 135, 149, 157, 158, 160, 161 and 164 of the Income Tax Act 2007

The Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 amends the following provisions of the Income Tax Act 2007, the Income Tax Act 2004, the Income Tax Act 1994 and the Tax Administration Act 1994.

Recommendations of the Rewrite Advisory Panel

Capital gain amount

Section CD 44(11) of the Income Tax Act 2007; section CD 33(11) of the Income Tax Act 2004

The Panel considered that section CD 44(11) could prevent a capital gain amount from passing through a corporate chain and subsequently being distributed, on liquidation of the company, to the ultimate shareholders (not being associated persons of the company).

The Panel noted that this outcome was not possible under the corresponding provisions of the 1994 Act, and that the change had occurred in drafting section CD 33(11) of the 2004 Act. Section CD 33(11) was later re-enacted as section CD 44(11) of the 2007 Act.

Section CD 44(11) (and correspondingly, section CD 33(11) of the 2004 Act) has been amended by adding a cross-reference to subsection (7). This cross-reference clarifies that section CD 44(11) does not limit the application of section CD 44(7). Section CD 44(7) permits capital gain amounts to retain their nature in passing through a corporate chain, if distributed to non-associated shareholders in the course of liquidating the company making the distribution.

The amendment to section CD 33(11) in the 2004 Act applies from the beginning of the 2005–06 income year.

Controlled foreign company carrying on business of life insurance

Section EX 21(26) of the Income Tax Act 2007 and the Income Tax Act 2004

Section EX 21(26) provides that the branch equivalent income (or loss) of a New Zealand resident relating to a controlled foreign company (CFC) carrying on the business of life insurance is the portion of the CFC's net income or net loss actuarially determined to be attributable to the New Zealand resident shareholders of the CFC.

This outcome is different from that given by the corresponding provision in the 1994 Act, section CG 11(19). Section CG 11(19) provided that the branch equivalent income (or loss) of a New Zealand resident relating to a CFC carrying on the business of life insurance would be the portion of the CFC's profit or loss actuarially determined to be attributable to the New Zealand resident shareholders of the CFC.

The amendment restores the effect of section CG 11(19) of the 1994 Act, by ensuring the branch equivalent income (or loss) is actuarially determined by reference to the accounting profit or loss of the CFC.

The amendment to section EX 21(26) in the 2004 Act applies from the beginning of the 2005–06 income year.

Qualifying companies and pre-entry loss balances

Section HA 21 of the Income Tax Act 2007

The Rewrite Advisory Panel considered that section HA 21 was ambiguous, as it could be read as requiring a company that becomes a qualifying company to extinguish its carried forward foreign tax losses only.

The policy is that on entry to the qualifying company rules, all carried forward losses of the company are extinguished.

The amendment to section HA 21 clarifies that on entry to the qualifying company regime, a company cannot carry forward any pre-existing loss balance or any carried forward losses (CFC or FIF losses).

Meaning of "settlor" and "settlement"

Sections HC 27(3) and HZ 7, schedule 51 of the Income Tax Act 2007

The rewrite of the 2004 Income Tax Act's definition of "settlor" (section OB 1) resolved an ambiguity inherent in the wording in paragraph (a)(i) of that definition. The wording of that paragraph stated that the meaning of the term "settlor" included "… a person who makes, or has made at any time, a disposition of property to or for the benefit of the trust or on the terms of the trust for less than market value".

The rewritten definition of "settlor" in section HA 27 clarifies that if a transaction increases the market value of the trustee's net assets without the trustee giving full consideration, the amount of transaction is a settlement for income tax purposes. This policy outcome is a key element of the settlor trust rules to ensure that one person cannot use a trust structure to transfer income from one person to another without an appropriate amount of taxation being paid. The 2007 Act provides a clearer expression of that policy, and the amendment to schedule 51 confirms that the 2007 Act drafting is an intended change in the legislation.

However, the Rewrite Advisory Panel considered that wording of paragraph (a)(i) of the 2004 Act's definition could be interpreted as permitting a person to take into account the market value of a third-party consideration in determining whether a settlement existed. The Panel considered that this interpretation gave rise to an unintended change in outcome in the context of salary

sacrifice arrangements in relation to employee share purchase agreements. The Panel was concerned that economic double taxation would arise under the 2007 Act definition of "settlor".

For example, if a deductible employer's contribution to a trust under the terms of an employee share purchase agreement is income of the trustee, economic double taxation occurs as follows:

- to the extent the employer's contribution forms part of a taxable benefit of the employee under section CE 1(d) of the 2007 Act, the employer's contribution is subject to tax; and
- under section HC 7(3), an employer's deductible settlement on the terms of a trust is income of the trustee (under section HC 7(3)).

New section HC 27(3B) provides that an employer is not treated as a settlor in relation to contributions to an employee share purchase agreement to the extent that:

- employer contributions are used to acquire shares under that agreement; and
- an amount that is less than or equal to the employer contribution would be income of the employee under section CE 1(d).

However, the relief under new section HC 27(3B) does not apply to employer contributions made under the terms of the employee share purchase agreement, if those contributions are used by the trustee for any other purpose, such as administration costs of the trustee. Nor does this exclusion apply to employer payments made to employee share purchase schemes, for which no taxable benefit for the employee arises (ie no economic double taxation occurs).

In addition, new section HZ 7 preserves the effect of any binding rulings made in relation to the meaning of "settlement" under the 2004 Act, despite the intended change in legislation to the meaning of "settlor" in the 2007 Act.

The savings provision for these binding rulings applies only up to the date of Royal assent of the Taxation (Consequential Rate Alignment and Remedial Matters) Act. After that date, any existing binding rulings cease to apply, as provided by section 91G of the Tax Administration Act 1994.

Carrying forward attributed CFC net losses and FIF net losses

Section IQ 1B of the Income Tax Act 2007

The Rewrite Advisory Panel considered that the wording of section IQ 1(1) of the 2007 Income Tax Act is inconsistent with the statement in section IA 2(5), and IA 7(1) that sections IA 2, IA 3, and IA 4 do not apply to ring-fenced losses, including an attributed CFC net loss. The Panel concluded that this provision could be read as having the effect of preventing a taxpayer from carrying forward an attributed CFC net loss from one tax year to the next.

Sections IE 3 and IE 4 of the 2004 Act provided that attributed CFC net losses and FIF net losses would be carried forward under the general rules, but the amount able to be offset and the manner of offset was provided for in special ring-fencing rules for attributed CFC net losses and FIF net losses.

In the 2007 Act, the general loss carry-forward rules have been distinguished from the special rules relating to the carry-forward of ring-fenced tax losses, such as attributed CFC net losses. The Panel noted that subpart IQ provides for the amount and manner for the use of carried-forward attributed CFC net losses or FIF net losses, implying that both attributed CFC net losses and FIF net losses would be carried forward.

However, the Panel considered that the absence of a specific carry-forward rule was not consistent with the objective of the Rewrite project of reducing compliance costs through drafting clear legislation.

Therefore, section IQ 1 has been amended to insert section IQ 1B to provide a specific carry-forward rule for attributed CFC net losses or FIF net loss The new section also makes it clear that a company may carry forward an attributed CFC net loss of FIF net loss provided the company satisfies the shareholding continuity requirements.

Family scheme income – adjustment for depreciation recovered

Section MB 1(5C) of the Income Tax Act 2007

A person's family scheme income includes depreciation recovered from the sale of buildings to the extent the recovery relates to depreciation deductions in the 2003–04 income year or a later income year.

However, in the 2004 Act, in calculating a person's family scheme income for the purpose of the Family Scheme rules, section KD 1(1)(e)(v) of the 2004 Act made an adjustment for an amount of depreciation recovered to the extent that recovery related to depreciation deductions for buildings during the 2002–03 and earlier income years.

However, in the 2007 Act, the effect of section KD 1(1)(e)(v) was inadvertently omitted, resulting in an unintended change in legislation. New section MB 1(5C) reinstates the effect of section KD 1(1)(e)(v) of the 2004 Act to ensure that family scheme income is adjusted for depreciation recoveries relating to deduction for depreciation on buildings in the 2002–03 or earlier income years.

Memorandum accounts and breach of shareholder continuity

Section OB 41(1), (3); table O2, row 14, column 3; section OC 24(1), (3); table O4, row 13, column 3; section OE 10(1), (3); table O7, row 5, column 3; section OK 15(1), (3); table O18, row 7, column 3; section OP 42(1), (3); table O20, row 16, column 3; section OP 73(1), (3); table O22, row 11, column 3; section OP 104(1), (3); table O25, row 5, column 3 of the Income Tax Act 2007

The Rewrite Advisory Panel considered that section OB 41 of the 2007 Act had altered the time at which a breach in shareholding continuity gave rise to a debit to a company's imputation credit account (ICA). Under section ME 5(i) of the 2004 Act, the debit to the ICA for loss of continuity was at the "specified time", that is, at the time the loss of continuity occurred.

However, if a company attached imputation credits to a dividend paid on the day (but before) a breach of continuity, section ME 5(i) of the 2004 Act provided that a debit for imputation credits attached to dividends paid was to be made "on the day the dividend is paid". This concept does not provide a specific time, and it is unclear at what time during the day the debit should occur.

However, in *CIR v Albany Food Warehouse Ltd* (2009) 24 NZTC 23,532, the High Court found that a debit for imputation credits attached to a dividend is to be treated as being attached to the dividend at the time the dividend is paid. This decision resolved this uncertainty.

Consequently, the approach in the rewritten section OB 41 is no longer necessary. The amendment to section OB 41 and other related memorandum account rules restores the effect of the 2004 Act. As a result, all memorandum account rules now provide that the debit to a memorandum account for a breach of shareholding continuity occurs at the time of the breach.

Resident withholding tax – reasonable enquiries test

Section RE 22 of the Income Tax Act 2007

The Rewrite Advisory Panel considered that section RE 22 prevented a payer of resident passive income from relying on a "reasonable enquiries" argument that the payer was not required to withhold resident withholding tax (RWT).

The Panel agreed that section RE 22, as drafted, required the recipient to be a non-resident of New Zealand (section RE 22(1)(a)). The Panel concluded that the "non-resident requirement" is inconsistent with the corresponding provision, section NF 5 of the 2004 Act.

Section NF 5 of the 2007 Act provided that if a payer of resident passive income who has made "reasonable enquiries" about the residency status of the recipient, and concluded that the payer is non-resident, the payer is not required to withhold RWT. If it is subsequently determined that, despite the reasonable enquires, the recipient is resident in New Zealand, the payer can rely on the "reasonable enquires" defence against any imposition of RWT, penalties and interest.

The amendments to section RE 22 restore the effect given by section NF 5 of the 2004 Act.

Withholding taxes and dividend arising under section GB 1

Sections RE 2(5)(i), RF 6(1B), YA 1 and schedule 51 of the Income Tax Act 2007

The Panel considered that it was unclear in the 2004 Act whether the resident withholding tax (RWT) rules or the non-resident withholding tax (NRWT) rules applied to a dividend arising under section GB 1. The Panel noted that the rewritten section GB 1 in the 2007 Act had clarified that the dividend arising was to be treated as part of the consideration paid for the shares.

The amendment to schedule 51 confirms that the rewritten section GB 1, which provides that the dividend arising is treated as part of the consideration paid for the shares, is an intended legislative change.

In addition, the Finance and Expenditure Committee noted that there are practical difficulties in applying the RWT and NRWT rules to the company distributing the dividend, for the following reasons:

- The company treated as paying the dividend may not have knowledge of the circumstances of the person treated as deriving the section GB 1(3) dividend.
- Other dividends arising under other part G rules that are treated as dividends paid, for which a payer can be identified are explicitly excluded from the resident withholding tax rules.

Therefore, the committee recommended that the RWT and NRWT rules should be amended to ensure that the RWT and NRWT rules not apply to a dividend arising under section GB 1. These amendments are reflected in sections RE 2(5)(j) and RF 6(1B).

The definition of "dividend" has also been amended to ensure that:

- the amount of the dividend does not affect the determination of the ratios for the benchmark dividend rules;
- the paying company is not required to issue retrospectively, a shareholder dividend statement; and
- the paying company is not able to attach imputation credits (or other memorandum account credits) to the section GB 1(3) dividend.

The amendment to the definition of "dividend" in section YA 1 is consistent with the policy of the imputation rules that imputation credits cannot be streamed to any particular shareholder, and ensures that the taxation obligation for a section GB 1(3) dividend is imposed entirely on the recipient of the dividend.

However, the person treating as deriving the dividend remains liable for the tax on a dividend arising under section GB 1, under normal assessment processes.

Non-resident withholding tax and the definition of "natural resource"

Section RF 1(2) of the Income Tax Act 2007

The 2007 Act contains a new definition of "natural resource". This term is used extensively in New Zealand's network of double taxation agreements and was undefined in the 2004 Act. The new definition was made in line with the rewrite objective of reducing compliance costs by providing clear legislation. Consequently, the defined term "natural resource" is listed, in schedule 51 of the 2007 Act, as an intended change in legislation.

The new definition of "natural resource" includes land. The Panel considered that, by implication, the exploitation of land would fall within the meaning of "royalty" as an exploitation of a natural resource, and that the new definition may have broadened the application of the non-resident withholding tax rules. An example given was a payment for the right to use an easement, which if paid to a non-resident, would now be subject to non-resident withholding tax.

The new definition of "natural resource" was not intended to be so broad that it would cause amounts derived from rights over land that are no more than a rental stream being subject to non-resident withholding tax.

The amendment to section RF 1(2) clarifies that amounts paid in relation to the exploitation of land (including rights over land) is subject to non-resident withholding tax only if the amounts paid are for either or both of:

- the exploitation of, or right to exploit, plant material or a naturally occurring material or mineral arising in or on the land; or
- the removal of, or right to remove, plant material or a naturally occurring material or mineral arising in or on the land.

The amendments to section RF 1(2) ensure that payments for the use or exploitation of land not of a type listed in section RF 1(2) are not subject to non-resident withholding tax.

Nominal settlements

Section YB 21(2) of the Income Tax Act 2007

The Rewrite Advisory Panel considered that the meaning of "nominee" in section YB 21 is not sufficiently clear that the term "nominee" includes (for income tax purposes) a person who, although not a nominee at general law, makes a nominal settlement on behalf of another person. The Panel considered that as the definition of "nominee" was not sufficiently clear, the person making a nominal settlement could be treated as a settlor in relation to the nominal settlement, rather than as a nominee.

New section YB 21(3) clarifies that a person making a nominal settlement on behalf of another person is a nominee in relation to the settlement. The amendment ensures when applying section YB 21(1), the principal is treated as the person making the settlement, and not the person making the nominal settlement.

Maintenance items

Simplified method for measuring FIF income interests

Section EX 49(6) of the Income Tax Act 2007; section EX 42(5) of the Income Tax Act 2004

Section CG 20(2) of the 1994 Act permitted a person holding FIF interests and using the accounting profits method to calculate the FIF income for their FIF interests to elect to use a simplified method of calculating their income interest in the FIF.

To make the election, the taxpayer was required to meet two requirements. First, the election under section CG 20(2) was only permitted if the FIF interest had been held for at least 12 months. Secondly, the election was to be made for the tax year in which the interest was acquired. As the two requirements were in conflict, in rewriting section CG 20(2) as section 42(5) of the 2004 Act, the requirements were reduced to requiring only that the election be made in relation to a tax year.

The amendment to section EX 42(5) of the 2004 Act and section EX 49(6) of the 2007 Act restores the original policy intention. The original policy intention is that a person using the accounting profits method of calculating FIF income can elect to use a simplified method for measuring the person's income interests in a FIF only if the person has held that income interest for at least 12 months. The election continues to be made by using the simplified method in the person's return of income.

The amendment to the 2004 Act applies from the 2005–06 income year.

Rate of tax for extra pay

Section RD 17(1), (1B) of the Income Tax Act 2007

An amendment to section RD 17(1) and (1B) removes an ambiguity from the provision. Previously, it was possible to read the section as requiring the amount of the extra pay to be counted twice in determining the correct rate of tax to apply to the extra pay.

In section NC 2(5) of the 2004 Act, it was clear that the rate of tax was determined by adding the amount of the extra pay to the annualised amount of all other PAYE income payments received by the person in the four-week period before payment of the extra pay amount.

The amendment to section RD 17(1) and (1B) makes it clear that the employer must determine the rate of tax to apply to the extra pay using the following steps:

- determine the actual amount of the extra pay;
- annualise the aggregate amount of all other types of PAYE income payments (other than the extra pay) during the four-week period before the date the extra pay is paid; and
- add the amount of the extra pay to the annualised amount, and then determine the rate of tax from the application of subsections (2) or (3) of section RD 17.

Other maintenance items

The following maintenance items, most of which come into force on 1 April 2008, have been amended to correct:

- ambiguities
- compilation errors
- cross-references
- drafting consistency, including readers' aids, for example, the defined terms lists
- grammar
- punctuation
- some defined terms
- spelling
- subsequent amendments arising from substantive rewrite amendments
- terminology and definitions.

These items relate to the following provisions:

2007 Act

Flow chart B2; section CF 1(2)(a), (b); section CZ 9B; section DB 2(2); section DC 14(4); section DP 10(5); section DS 1(2); section DU 2(2)(a); section EW 43(1); section EW 49(1); section EX 32(1)(f); section IA 2(2), (4)(b) to (g), (6), (7); section IA 3(5); section IA 4(1)(b), (2); section IA 5(1), (4), (6); section IA 6(1); section IA 7(1B), (2), (6); section IQ 1(1); section IQ 2(1)(a), (b), (2)(b); section IQ 3((1)(a), (b); section IQ 4(1)(a), (b), (2), (3); section IQ 6(1); section IQ 7(1)(a), (b), (2)(a), (b); section IQ 8(1), (2)(a); section IS 1 (heading), (2), (3); section IS 2(1)(a), (b), (2), (4), (5); section IS 3(1)(a); section IS 5(2); section IT 1(1), (1B), (1C), (2B); section LP 8(2); section OA 18(3); section OB 4(3)(c); section RA 2 compare note; section RE 1(1)(c); section RF 3; section YA 1, definition of employer monthly schedule, paragraph (k); section YA 1, definition of lease, paragraph (f)(ii); section YA 1, definition of lessee, paragraphs (a), (b); section YA 1, definition of lessor, paragraphs (a), (b); section YA 1, definition of loss balance; section YA 1, definition of net mining loss; section YA 1, definition of PIE rules; section YA 1, definition of RWT proxy; section YA 1, definition of share purchase agreement; section YA 1, definition of tax loss; section YA 1, definition of taxable distribution; section YA 1, definition of timber; section YB 1(8); section YB 14(1); schedule 1, part D, clauses 3 to 6; schedule 2, part A, clause 2; defined terms lists, as amended by schedule 1 of the Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009

2004 Act

Section ME 4(1)(a)(ii)

1994 Act

Section ME 4(1)(a)(ii)

Tax Administration Act 1994

Section 44C(3)

ORDERS IN COUNCIL

FBT RATE FOR LOW-INTEREST LOANS LOWERED

The prescribed rate used to calculate fringe benefit tax on low-interest employment-related loans has been reduced from 6.41% to 6%.

The rate applies retrospectively from 1 October 2009. This is because when the FBT rate is lowered, the new rate applies from the start of the current quarter.

The rate is reviewed regularly to align it with the results of the Reserve Bank's survey of first home mortgage interest rates.

The new rate was set by Order in Council on 23 November 2009.

Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations (No 3) 2009

MINIMUM FAMILY TAX CREDIT INCOME AMOUNT INCREASED

The Income Tax (Minimum Family Tax Credit) Order 2009, made on 23 November 2009, increases the net income level guaranteed by the minimum family tax credit. The net income level will rise from $20.540 to $20,800 a year from 1 April 2010.

The order increases to $20,800 the prescribed amount in the definition, in section ME 1(3)(a), Income Tax Act 2007, of the items in the formula for calculating the minimum family tax credit.

The increase applies for the 2010–11 and later tax years. The prescribed amount is used when calculating the amount that a person may be allowed as a credit of tax under section ME 1(2).

The order also amends the Income Tax (Family Tax Credit) Order 2008 to limit its application to the 2009–10 tax year.

Income Tax (Minimum Family Tax Credit) Order 2009 (SR 2009/367)

STUDENT LOAN SCHEME REPAYMENT THRESHOLD FOR THE 2010–11 TAX YEAR

The income threshold at which New Zealand-based borrowers must begin repaying their student loans will remain at the current level of $19,084 for the 2010–11 tax year.

The threshold will be reviewed next year.

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.

CORRECTION

FOREIGN CURRENCY AMOUNTS – CONVERSION TO NEW ZEALAND DOLLARS

The exchange rates for the six months ending 30 September published in the October/November 2009 issue of the *Tax Information Bulletin* Vol 21, No 8, pp14–17, were incorrect. The correct tables and updated article are reproduced here.

Note: On 1 April 2009, Inland Revenue changed the method of sourcing such information and now uses wholesale rates from Bloomberg for rolling 12-month average, end of month and mid-month actual. These rates are now given in three tables. Previously the actual and average mid-month rates had been shown in one table.

This article provides the exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand dollars under the controlled foreign company (CFC) and foreign investment fund (FIF) rules for the six months ending 30 September 2009. These exchange rates are found in the following tables.

You can choose either the:

- actual rate for the day for each transaction (including closing market value), or
- average mid-month rate for the 12 months or the relevant period (see the table **Currency rates 2009 – rolling 12-month average**).

The **Currency rates 2009 – end of month** table, which provides the exchange rates on the last day of the month, is no longer necessary for the CFC or FIF rules but is provided to assist taxpayers who may need exchange rates on those days.

You must apply the chosen conversion method to all interests for which you use the FIF or CFC calculation method in that and each later income year.

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown. Round the exchange rate calculations to four decimal places wherever possible.

If you need an exchange rate for a country or a day not listed in the tables, please contact one of New Zealand's major trading banks.

Currency rates 2009 – rolling 12-month average table

This table is the average of the mid-month exchange rate for that month and the previous 11 months, ie, the 12-month average.

Use this table to convert foreign currency amounts to New Zealand dollars for:

- FIF income or loss calculated under the accounting profits, comparative value, fair dividend rate, deemed rate of return, or cost methods under sections EX 49(8), EX 51, EX 57 and EX 56 of the Income Tax Act 2007
- branch equivalent income or loss calculated under the CFC and FIF rules pursuant to section EX 21(4) of the Income Tax Act 2007 for accounting periods of 12 months
- foreign tax credits calculated under the branch equivalent method for a CFC or FIF under section LJ 2 of the Income Tax Act 2007 for accounting periods of 12 months.

Currency rates 2009 – mid-month actual table

This table is the exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the preceding working day on which they were quoted.

You can use the rate as the actual rate for any transactions arising on the 15th of the month.

Where the accounting period is less than or greater than 12 months, and branch-equivalent income or loss is calculated under the CFC or FIF rules pursuant to section EX21(4) of the Income Tax Act 2007, you can use the mid-month rate as the basis of the rolling average for the shorter or longer period (see Example 4).

Example 1

A taxpayer with a 30 September balance date purchases shares in a Philippines company (which is a FIF but does produce a guaranteed yield) on 7 September 2009. Its opening market value on 1 October 2009 or its closing market value on 30 September 2009 is PHP 350,000. Using the comparative value method the opening market value is converted as follows:

PHP 350,000 ÷ 34.3916 = $10,176.90

(In this example, the rate selected is the end-of-month rate for September 2009 for PHP.)

Example 2

A CFC resident in Hong Kong has an accounting period ending on 30 September 2009. Branch equivalent income for the period 1 October 2008 to 30 September 2009 is 200,000 Hong Kong dollars (HKD), which converts to:

HKD 200,000 ÷ 4.5993 = $43,484.88

(In this example, the rate selected is the rolling 12-month average rate for September 2009 for HKD.)

Example 3

A resident individual with a 30 September 2009 accounting period acquires a FIF interest in a Japanese company in July 2009 for 10,500,000 yen. The interest is sold in September 2009 for 10,000,000 yen. Using the comparative value method, these amounts are converted as:

JPY 10,500,000 ÷ 56.3883 = $186,208.84

JPY 10,000,000 ÷ 56.3883 = $177,341.75

(In this example, the rolling 12-month average rate for September 2009 has been applied to both calculations.)

Example 4

A CFC resident in Singapore was formed on 21 April 2009 and has a balance date of 30 September 2009. During the period 1 May 2009 to 30 September 2009, branch equivalent income of 500,000 Singaporean dollars was derived.

1. Calculating the average monthly exchange rate for the complete months May–September 2009:

   0.8614 + 0.9212 + 0.9416 + 0.9790 + 1.005 = 4.7037

   4.7037 ÷ 5 = 0.9407

2. Conversion to New Zealand currency:

   SGD 500,000 ÷ 0.9407 = $531,496.48

(In this example, the rates are from the mid-month table from May to September 2009 inclusive for SGD.)

Currency rates 2009 – rolling 12-month average

Country currency	Code	15-Apr-09	15-May-09	15-Jun-09	15-Jul-09	15-Aug-09	15-Sep-09
Australia Dollar	AUD	0.8184	0.8158	0.8154	0.8170	0.8169	0.8168
Bahrain Dinar	BHD	0.2363	0.2307	0.2270	0.2231	0.2222	0.2236
Britain Pound	GBH	0.3739	0.3733	0.3735	0.3743	0.3769	0.3820
Canada Dollar	CAD	0.7108	0.7047	0.7000	0.6958	0.6956	0.6998
China Yuan	CNY	4.3008	4.1875	4.1158	4.0458	4.0283	4.0533
Denmark Kroner	DKK	3.3291	3.2905	3.2714	3.2549	3.2523	3.2630
Euporean Community Euro	EUR	0.4469	0.4418	0.4392	0.4371	0.4368	0.4384
Fiji Dollar	FJD	1.0725	1.0808	1.0929	1.1089	1.1283	1.1527
French Polynesia Franc	XPF	53.2046	52.6074	52.2986	52.0610	52.0346	52.1894
Hong Kong Dollar	HKD	4.8758	4.7571	4.6766	4.5937	4.5720	4.5993
India Rupee	INR	29.1190	28.8159	28.6465	28.5009	28.6769	29.0032
Indonesia Rupiah	IDR	6,434.6092	6,352.3575	6,303.1400	6,261.5617	6,281.2175	6,342.3875
Japan Yen	JPY	63.2158	61.1883	59.5758	57.9292	56.7892	56.3883
Korea Won	KOR	761.7235	756.9584	758.5067	762.3782	771.2208	781.5241
Kuwait Dinar	KWD	0.1723	0.1694	0.1680	0.1665	0.1669	0.1690
Malaysia Ringit	MYR	2.1669	2.1321	2.1130	2.0987	2.1006	2.1164
Norway Krone	NOK	3.8091	3.8031	3.8160	3.8361	3.8606	3.8891
Pakistan Rupee	PKR	47.6634	47.2037	47.3106	47.2142	47.3652	48.0014
Phillipines Peso	PHP	29.1099	28.7132	28.4649	28.1354	28.1888	28.4456
PNG Kina	PGK	1.6661	1.6293	1.6041	1.5757	1.5774	1.5959
Singapore Dollar	SGD	0.9072	0.8913	0.8819	0.8735	0.8717	0.8767
Solomon Islands Dollar*	SBD	4.8557	4.7509	4.6858	4.6192	4.6119	4.6576
South Africa Rand	ZAR	5.6119	5.5561	5.4755	5.4215	5.4155	5.4044
Sri Lanka Rupee	LKR	69.0893	68.0058	67.3240	66.5985	66.7476	67.5578
Sweden Krona	SEK	4.5166	4.5185	4.5510	4.5870	4.6188	4.6557
Swiss Franc	CHF	0.6973	0.6847	0.6767	0.6698	0.6658	0.6653
Taiwan Dollar	TAI	20.2293	19.8697	19.6948	19.5229	19.5362	19.6913
Thailand Baht	THB	21.4845	21.1057	20.8271	20.5151	20.4524	20.5470
Tonga Pa'anga*	TOP	1.2589	1.2450	1.2393	1.2314	1.2337	1.2397
United States Dollar	USD	0.6272	0.6122	0.6024	0.5921	0.5897	0.5935
Vanuatu Vatu	VUV	67.5637	66.8126	66.3668	65.9471	65.8644	65.8644
West Samoan Tala*	WST	1.7167	1.6931	1.6759	1.6696	1.6687	1.6703

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 2009 – mid-month actual

Country currency	Code	15-Apr-09	15-May-09	15-May-09	15-Jul-09	15-Aug-09	15-Sep-09
Australia Dollar	AUD	0.7976	0.7812	0.7938	0.8078	0.8148	0.8165
Bahrain Dinar	BHD	0.2190	0.2202	0.2379	0.2445	0.2556	0.2658
Britain Pound	GBH	0.3875	0.3857	0.3867	0.3950	0.4100	0.4276
Canada Dollar	CAD	0.6993	0.6901	0.7151	0.7240	0.7449	0.7559
China Yuan	CNY	3.9700	3.9900	4.3100	4.4300	4.6400	4.8100
Denmark Kroner	DKK	3.2733	3.2280	3.4045	3.4239	3.5547	3.5800
Euporean Community Euro	EUR	0.4394	0.4335	0.4572	0.4599	0.4776	0.4810
Fiji Dollar	FJD	1.2742	1.2497	1.2804	1.3321	1.3550	1.3805
French Polynesia Franc	XPF	52.4188	51.7111	54.5550	54.8206	57.0050	57.2868
Hong Kong Dollar	HKD	4.5044	4.5358	4.8914	5.0280	5.2572	5.4638
India Rupee	INR	28.8711	28.8861	30.1098	31.5450	32.7246	34.2912
Indonesia Rupiah	IDR	6306.0400	6115.9200	6388.3100	6565.2100	6735.5200	6974.2100
Japan Yen	JPY	57.7300	55.7000	61.7400	61.1400	64.3800	64.1900
Korea Won	KOR	771.6016	740.2273	800.8030	825.6780	840.7025	854.8829
Kuwait Dinar	KWD	0.1693	0.1694	0.1822	0.1863	0.1947	0.2019
Malaysia Ringit	MYR	2.0944	2.0772	2.2268	2.3130	2.3863	2.4679
Norway Krone	NOK	3.8843	3.8202	4.0737	4.1430	4.1252	4.1491
Pakistan Rupee	PKR	46.7290	47.3934	51.2821	53.1915	55.8659	58.1395
Phillipines Peso	PHP	27.6939	27.7939	30.3162	31.0446	32.5788	34.1220
PNG Kina	PGK	1.7059	1.6039	1.6886	1.6911	1.8278	1.8925
Singapore Dollar	SGD	0.8720	0.8614	0.9212	0.9416	0.9790	1.0005
Solomon Islands Dollar*	SBD	4.6738	4.6465	4.9780	5.1515	5.3535	5.6278
South Africa Rand	ZAR	5.2947	5.0977	5.1088	5.2656	5.4858	5.1923
Sri Lanka Rupee	LKR	67.1141	68.9655	72.4638	74.6269	78.1250	80.6452
Sweden Krona	SEK	4.7962	4.6331	4.9532	5.0366	4.8795	4.9004
Swiss Franc	CHF	0.6642	0.6565	0.6887	0.6970	0.7270	0.7296
Taiwan Dollar	TAI	19.6353	19.2588	20.7843	21.3833	22.3103	23.0006
Thailand Baht	THB	20.5803	20.2352	21.5326	22.1015	23.0860	23.9030
Tonga Pa'anga*	TOP	1.2317	1.2156	1.2845	1.3083	1.3329	1.3568
United States Dollar	USD	0.5812	0.5852	0.6311	0.6488	0.6783	0.7050
Vanuatu Vatu	VUV	66.2252	64.5161	67.1141	68.4932	69.9301	69.4444
West Samoan Tala*	WST	1.6317	1.6050	1.6564	1.8189	1.8088	1.7660

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

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The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

Currency rates 2009 – end of month

Country currency	Code	30-Apr-09	31-May-09	30-Jun-09	31-Jul-09	31-Aug-09	30-Sep-09
Australia Dollar	AUD	0.7790	0.7991	0.8008	0.7918	0.8120	0.8194
Bahrain Dinar	BHD	0.2131	0.2413	0.2434	0.2495	0.2583	0.2725
Britain Pound	GBH	0.3821	0.3954	0.3924	0.3960	0.4206	0.4525
Canada Dollar	CAD	0.6739	0.6981	0.7505	0.7132	0.7492	0.7733
China Yuan	CNY	3.8600	4.3700	4.4100	4.5200	4.6800	4.9300
Denmark Kroner	DKK	3.1823	3.3687	3.4271	3.4568	3.5574	3.6787
Euporean Community Euro	EUR	0.4272	0.4524	0.4602	0.4642	0.4780	0.4941
Fiji Dollar	FJD	1.2447	1.3528	1.3165	1.3450	1.3654	1.3966
French Polynesia Franc	XPF	50.9411	53.9869	54.8923	55.3706	56.9923	58.9099
Hong Kong Dollar	HKD	4.3805	4.9650	5.0050	5.1286	5.3099	5.6060
India Rupee	INR	28.2798	30.1541	30.9347	31.8128	33.5107	34.7751
Indonesia Rupiah	IDR	6017.9900	6620.9100	6623.5300	6568.3700	6906.3100	6986.8300
Japan Yen	JPY	55.7400	61.0300	62.2200	62.6500	63.8000	64.8700
Korea Won	KOR	726.0428	803.4685	822.8638	808.6538	855.2901	849.8595
Kuwait Dinar	KWD	0.1645	0.1841	0.1857	0.1902	0.1968	0.2072
Malaysia Ringit	MYR	2.0117	2.2382	2.2726	2.3314	2.4126	2.5039
Norway Krone	NOK	3.7069	4.0285	4.1532	4.0481	4.1211	4.1764
Pakistan Rupee	PKR	45.4545	51.8135	52.6316	54.9451	56.8182	60.2410
Phillipines Peso	PHP	27.1299	30.1362	31.0467	31.7237	33.4179	34.3916
PNG Kina	PGK	1.5979	1.7176	1.6939	1.7020	1.8280	1.9343
Singapore Dollar	SGD	0.8372	0.9249	0.9348	0.9524	0.9873	1.0197
Solomon Islands Dollar*	SBD	4.5471	5.0566	5.1178	5.3221	5.4980	5.7580
South Africa Rand	ZAR	4.7763	5.0855	4.9817	5.1358	5.3280	5.4322
Sri Lanka Rupee	LKR	68.0272	73.5294	74.0741	75.7576	78.7402	83.3333
Sweden Krona	SEK	4.5492	4.8275	4.9742	4.7597	4.8777	5.0363
Swiss Franc	CHF	0.6447	0.6830	0.7013	0.7068	0.7255	0.7494
Taiwan Dollar	TAI	18.7336	20.8867	21.1871	21.7123	22.5527	23.2514
Thailand Baht	THB	19.9435	21.9810	21.9943	22.5228	23.3035	24.1888
Tonga Pa'anga*	TOP	1.2079	1.3252	1.3328	1.3108	1.3242	1.3867
United States Dollar	USD	0.5652	0.6405	0.6457	0.6618	0.6851	0.7232
Vanuatu Vatu	VUV	64.1026	69.9301	68.0272	68.4932	70.9220	70.9220
West Samoan Tala*	WST	1.5975	1.7162	1.6903	1.7217	1.7423	1.7919

Notes to table:

All currencies are expressed in NZD terms, ie, 1NZD per unit(s) of foreign currency.

The currencies marked with an asterisk * are not published on Bloomberg in NZD terms. However these currencies are expressed in USD terms and therefore the equivalent NZD terms have been generated as a function of the foreign currency USD cross-rate converted to NZD terms at the NZDUSD rate provided.

The rates provided represent the Bloomberg generic rate (BGN) based on the last price (mid rate) at which the currency was traded at the close of the New York trading day. Where the date specified was not a trading day, then the rate reflects the last price on the preceding business day.

Source: Bloomberg CMPN BGN

LEGAL DECISIONS – CASE NOTES

This section of the TIB sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, Privy Council and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

CORRECTION

SUMMARY OF SUPREME COURT RULING ON "TRINITY"

The summary case notes for the "Supreme Court Ruling on 'Trinity'" published in the *Tax Information Bulletin* Vol 21, No 1 (March 2009), page 44, contained an error in the Impact of decision.

The Impact of decision stated that the Court clearly directed that the Commissioner ought to advance a matter on the basis that there is sham, or avoidance, but not both. This was incorrect.

The Supreme Court decision on the sham issue is to be found at paragraphs [32] to [39] of the majority judgment.

The Supreme Court found it is important to keep firmly in mind the difference between sham and avoidance:

> [34] It is important to keep firmly in mind the difference between sham and avoidance. A sham exists when documents do not reflect the true nature of what the parties have agreed. Avoidance occurs, even though the documents may accurately reflect the transaction which the parties intend to implement, when, for reasons to be discussed more fully below, the arrangement entered into gives a tax advantage which Parliament regards as unacceptable.

The Commissioner, keeping in mind the difference between sham and avoidance, can advance both sham and avoidance.

TAX ON MSD BENEFIT DISALLOWED

Case	Irene Yeh Leng Goh v the Commissioner of Inland Revenue
Decision date	11 November 2009 oral decision
Acts	Income Tax Act 2004, Tax Administration Act 1994, Injury Prevention, Rehabilitation, and Compensation Act 2001
Keywords	Income tested benefit, PAYE, ACC, backdated compensation

Summary

An application for judicial review of a decision of the Commissioner was struck out. The decision related to tax payments made by the Accident Compensation Corporation ("ACC"), reimbursing certain previously paid benefits.

Impact of decision

The Court reinforced the fact that the procedures in the Tax Administration Act ("TAA") are the only way to challenge an assessment in the majority of cases.

Facts

Between March 1998 and September 2005, the plaintiff received a domestic purposes benefit (the "benefit") from the Ministry of Social Development ("MSD"). During that time, MSD had on behalf of the plaintiff paid PAYE to Inland Revenue on the benefit.

The plaintiff was later found to be entitled to compensation from ACC for the period in which she was paid the benefit. The plaintiff was entitled to a lump sum payment of backdated ACC weekly compensation in relation to the 1998 to 2005 income tax years as well as ongoing weekly compensation from November 2005.

Because the plaintiff was no longer entitled to the benefit she had previously received from MSD; ACC calculated the

lump-sum backdated entitlement by deducting an amount equivalent to the gross amount of the benefit paid by MSD for that period.

ACC paid to MSD the net amount of the benefit previously paid and paid Inland Revenue an amount equivalent to the PAYE tax deductions that MSD had paid Inland Revenue on behalf of the plaintiff.

The plaintiff brought judicial review proceedings against the Commissioner, challenging his decision to disallow her claim to a tax credit of around $10,000. The plaintiff claimed that ACC had no statutory right to deduct an amount equivalent to the PAYE tax paid on her behalf by MSD, and that ACC had no power to pay that amount to Inland Revenue.

The Commissioner applied to strike out the plaintiff's claim on the basis that the judicial review proceedings amounted to an abuse of process and nevertheless the claim was untenable.

Decision

Abuse of process

The Court was satisfied that the plaintiff's claim amounted to an abuse of process.

The Court referred to the Court of Appeal decision of *Westpac Banking Corporation v Commissioner or Inland Revenue* [2009] 2 NZLR 99 (CA), for the proposition that the TAA makes it clear that in almost all cases the only means of challenging a decision of the Commissioner is pursuant to the procedures contained in Parts IVA and VIIIA of the TAA.

The Court held that as the plaintiff was not satisfied with the Commissioner's adjudication decision, she should have issued challenge proceedings pursuant to the TAA.

Claim untenable

The Court cited *Buis v Accident Compensation Corporation* (unreported, HC Auckland, 6 March 2009) and agreed with Rodney Hansen J that the excess benefit payment is the "grossed up" sum. Both the net amount, after tax, and the tax portion are required by section 252 of the Injury Prevention, Rehabilitation and Compensation Act 2001 to be withheld from the person entitled to compensation and dealt with in accordance with other statutory provisions or interdepartmental arrangements. The requirement is that the total sum is to be refunded to MSD.

The plaintiff is in the same position she would have been if she had never received the domestic purposes benefit in the first place. The ACC payment has replaced the benefit, and with a legitimate surplus to the plaintiff. If the plaintiff's contentions were correct, and by some means or another she was to get a credit for the $10,000, then she would receive a windfall of that amount.

GST PAYABLE ON AIRPORT DEVELOPMENT LEVY

Case	Rotorua Regional Airport Limited v Commissioner of Inland Revenue
Decision date	12 November 2009
Acts	Goods and Services Tax Act 1985; Airport Authorities Act 1966
Keywords	GST, levy, consideration

Summary

The Court held that the development levy that the airport charged to departing passengers was consideration for the use of airport facilities, and therefore the airport was required to account for goods and services tax ("GST") on the levy.

Impact of decision

Any consideration (including a charge or levy) made for a supply of services is subject to GST. The use made of that consideration is irrelevant.

Facts

Rotorua Regional Airport Limited ("RRAL") operates the Rotorua Airport. Since 1 October 2002 it has charged a $5 levy on passengers over the age of 5 years departing from the airport. The levy (development levy) is used to pay for the development of facilities at the airport.

RRAL sought a declaration under the Declaratory Judgments Act 1908, that the development levy is not subject to section 8(1) of the Goods and Services Tax Act 1985 ("GST Act"). RRAL contended that the development levy is a charge authorised by legislation rather than consideration for services. The Commissioner contended that the development levy is consideration for the use of airport facilities and the use to which the funds gathered from the levy are put is not relevant.

Decision

The Court agreed with the Commissioner's submission that the use to which the levy was put was irrelevant. Instead, the Judge focused on the legal relationship between RRAL and the departing passengers, and found that the levy was consideration for a service supplied by RRAL. Passengers were required to pay the development levy before they were allowed to board the aircraft. If passengers did not pay the levy, RRAL could deny them access to the aircraft. The Court held that there was a nexus between the payment and the services, the payment being "in respect of" or "in response to" the supply of services.

His Honour considered that the present case held some similarities to *Turakina Māori Girls College Board of Trustees & Ors v CIR* (1993) 15 NZTC 10,032 (CA) where the issue was whether attendance dues charged to parents of children at integrated schools were consideration for a taxable supply. He also considered that this interpretation was not inconsistent with the empowering section (4A) of the Airport Authorities Act.

The Judge concluded that the development levy is consideration for a taxable supply in terms of section 8 of the GST Act, and declined RRAL's application for declaratory relief.

COMMISSIONER NOT RESTRAINED FROM ADVERTISING LIQUIDATION PROCEEDINGS

Case	The Commissioner of Inland Revenue v Property Ventures Investments Limited & Ors
Decision date	Oral Judgment 1 December 2009
Acts	High Court Rules, Companies Act 1993
Keywords	Liquidation, restraint, advertising

Summary

The companies unsuccessfully applied to restrain the Commissioner from advertising his liquidation proceedings.

Impact of decision

The decision is an application of corporate insolvency jurisprudence to the 1993 Companies Act. Of interest is the reaffirmation of the principle that creditors' statutory rights and the "wider public interest" are paramount in liquidation proceedings.

Facts

Three Christchurch companies ("the companies") controlled by Mr David Henderson, a property developer, collected and self-assessed, but had not paid goods and services tax ("GST") on the sale of certain properties to the Christchurch City Council. The Commissioner sought to liquidate the companies as the debt was unpaid and it seemed the GST collected had been otherwise applied within Mr Henderson's group of companies.

Liquidation orders were applied for in August and shortly thereafter the companies applied for a stay of advertising and liquidation on the grounds that a compromise proposal could well satisfy creditors. The Commissioner agreed not to pursue the liquidation until an interlocutory application to consider the compromise had been heard. However, by early November the creditors' meeting had not taken place. Instead, the companies were granted leave to seek orders for a compromise under section 236 of the Companies Act 1993, rather than by vote of creditors. This application was to be heard in February 2010.

Decision

His Honour, Pankhurst J referred to a brief affidavit filed by Mr Henderson which set out the structure and business of his various companies. Mr Henderson deposed as to the adverse effect advertising would have on the business of the group as a whole. In dismissing the companies' application, Pankhurst J referred to the Court of Appeal Authority of *Anglian Sales v South Pacific Manufacturing Co Ltd* [1984] 2 NZLR 249 (CA) where the court's inherent jurisdiction to grant a stay was contrasted with a creditor's statutory right to petition for winding-up. The Court of Appeal had held that a "balance of convenience" test was inappropriate and that a stay could only be granted upon a serious challenge being raised, such as that of the petitioners' very status. This jurisdiction was to be exercised with "great circumspection".

His Honour did not find the affidavit evidence persuasive to the extent that it raised the requisite serious challenge. He considered the "wider public interest" test stated by Randerson J in *CIR v Sigatoka Investments No 3* (1988) 12 PRNZ 678. He found the facts of that matter similar to the present one and, notwithstanding "collateral damage" likely within the debtor company's group, the creditors' statutory rights prevailed.

The application by the companies to stay advertising was refused with an award of costs to the Commissioner.

GST REFUNDS AND SECTION 46 OF THE GOODS AND SERVICES TAX ACT 1985

Case	The Commissioner of Inland Revenue v Contract Pacific Limited
Decision date	4 December 2009
Act	Goods and Services Tax Act 1985
Keywords	GST refund, section 46, notice requirements

Summary

The Commissioner had satisfied his obligations under section 46 of the Goods and Services Tax Act 1985 when he issued an investigation notice within the prescribed time limits in section 46(5).

Impact of decision

Where the Commissioner has issued a notice to investigate within the time limits set out under section 46(5) of the Goods and Services Tax Act 1985 ("GST Act"), he will not need to issue any requests for information (which form part of that investigation) within the time limits set out in section 46(4) to ensure the Commissioner maintains his authority to withhold the refund while he completes that investigation.

Facts

At all relevant times, Contract Pacific Ltd ("Contract Pacific") carried on the business of an inbound tour operator, selling New Zealand-based holiday packages to overseas wholesalers who then sold to overseas retailers. Those retailers in turn sold to overseas-based holidaymakers who were to visit New Zealand.

Between July 1993 and April 1999, Contract Pacific included goods and services tax ("GST") in the sale prices for the services it sold to overseas wholesalers while other inbound tour operators did not.

In May 1999, the law was changed to remove any ambiguity over liability to include GST in the sale prices for New Zealand-based services sold to overseas persons for the purpose of on-sale to New Zealand-bound visitors.

On 26 June 2000, Contract Pacific filed a GST return in which it sought a readjustment and refund of the GST it had paid between 1 July 1993 and 30 April 1999.

On 10 July 2000, the Commissioner advised that the GST refund had been withheld pending investigation of the readjustment claim.

Through an administrative error, a notice of assessment and refund cheque were issued on 5 February 2001. On 9 February 2001, the Commissioner became aware of the error and took steps to stop payment on the refund cheque.

On 2 April 2001, the Government introduced the Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provisions) Bill ("the Bill"). On 2 July 2001 a notice of assessment was sent to Contract Pacific which disallowed the credit adjustment and consequential refund it sought.

On 24 October 2001, the Bill came into force as the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001 ("2001 Act"), with retrospective effect. The general effect of the new legislation (section 241) was to make clear there was and always had been liability to pay GST on the services to overseas persons. A savings provision was enacted that exempted a small category of persons from this effect. Contract Pacific would come within this savings provision if the circumstances of receiving the refund cheque meant it had been "paid a refund".

In April 2005, Contract Pacific wrote to the Commissioner requesting payment of $6,281,767 plus interest, being the balance of the stopped refund cheque after a facilitation fee credit adjustment was deducted. The Commissioner rejected the claim.

High Court judgment

The High Court ((2009) 24 NZTC 23,092) confirmed that the Commissioner had issued a notice under section 46(2)(a) of the GST Act, notifying his intention to investigate the matter, and had done so within the 15-day time limit prescribed in section 46(5). However, the High Court held that as the Commissioner had also made requests for information pursuant to that investigation, and these were made outside the prescribed time limits in section 46(4), he had "lost his authority to withhold the disputed refund".

The High Court also held that, given it was concluded that the cheque issued by the Commissioner was valuable consideration, the position was "unaffected by section 241(6) of the 2001 Act". The High Court did conclude, however, that in any event, under the common law, the cheque was a "payment" for the purposes of section 241(6)(a).

The Commissioner appealed the decision. Both parties agreed to limit the appeal to two issues.

Decision

The Court of Appeal allowed the appeal.

Issue one – section 46 of the GST Act

The Court of Appeal concluded that the Commissioner, when investigating Contract Pacific's GST return, had satisfied the time limits contained in section 46(5) of the GST Act and therefore there was no obligation to make a refund.

In particular, the Court concluded that when the Commissioner issues a notice of investigation within the 15-day period:

> [37] … that investigation is not subject to any limitation, curtailment or restriction. If, in the course of the investigation, instead of or as well as seeking submissions, the Commissioner requires additional information, he can ask for it and such request will not engage section 46(2)(b).
>
> [38] It is artificial to consider that, if the investigation route under section 46(2)(a) is embarked upon, the registered person is immune from information requests except in the 15 day period or subsequent 15 day periods following the provision of information. That is not what the words say and such an interpretation would be most impractical.

The Court of Appeal confirmed that some investigations are complex and therefore require a number of information requests, whereas others will only require additional information that has been overlooked.

The Court held that "it is not sensible for these two different kinds of inquiries to be governed by the same approach. The more expansive must necessarily include the narrower process".

Issue two – section 241(6)of the 2001 Act – the "paid" point

The Court did not consider this issue on the basis that the parties had agreed that the second issue was unnecessary for the Court to consider should it find in favour of the Commissioner on issue one.

JUDGE NOT DISQUALIFIED FROM HEARING APPLICATION TO SET ASIDE HIS EARLIER JUDGMENT

Case	Redcliffe Forestry Venture Limited & Ors v Commissioner of Inland Revenue (Trinity)
Decision date	2 December 2009
Act	
Keywords	Administrative decision, assignment of Judge, disqualification, prior involvement principle

Summary

The plaintiffs' application to revisit an administrative decision of the List Judge to assign Venning J to this case was unsuccessful. The plaintiffs argued that Venning J should be disqualified from hearing their application to set aside his earlier judgment on the basis of his prior involvement.

Impact of decision

This judgment confirms that there are limits on the circumstances in which the Courts will order matters (which are remitted for rehearing) to be before a new Judge or panel of Judges.

Facts

On 19 December 2008, the Supreme Court upheld the High Court and Court of Appeal decisions that the Trinity investment scheme was tax avoidance; *Ben Nevis Forestry Ventures Ltd and Others v CIR* (2009) 24 NZTC 23,188.

In these proceedings the plaintiffs (some of which were appellants in the Supreme Court) sought to set aside the judgment of the High Court delivered on 20 December 2004 on the basis that the Commissioner presented a false case. The Commissioner entered a protest as to jurisdiction and sought to dismiss the proceedings.

When these proceedings first came before Associate Judge Faire, he determined that a Judge should deal with this matter and consequently referred it to the Civil List Judge for the allocation of a Judge. Venning J, who decided the High Court decision in 2004, was assigned.

The plaintiffs filed memoranda submitting that the file should not have been assigned to Venning J and sought to revisit or review that administrative decision. It was, effectively, an interlocutory application for Venning J to disqualify himself and for another Judge to be assigned.

Decision

The plaintiffs argued that there is a "prior involvement" principle which supports the disqualification of Venning J and that such situations include a decision-maker:

a) hearing an appeal or review from his/her own decision;
b) rehearing a case that has been remitted to him/her by review in Court;
c) hearing a fresh proceeding asserting the earlier decision should be set aside based on a false case: *Kuwait Airways Corporation v Iraqi Airways Corporation* [2003] 1 Lloyd's Rep 448.

Venning J held that neither of the situations in a) or b) applies in this case and that the decision referred to in c) is not authority for the proposition advanced by the plaintiffs.

The plaintiffs also argued that while there was not a legal test or even a legal requirement on the facts of this case requiring Venning J to stand aside, "pragmatism" ought not to be ignored. The plaintiffs finally argued that if the case is heard by Venning J, the plaintiffs may have a feeling of pre-determination by the Court.

Venning J held that the authorities and texts that the plaintiffs referred to to support the applicability of the "prior involvement" principle were primarily directed at the situation where a decision has been reviewed or overturned and the issue has been remitted back to the decision-maker, effectively for a second hearing. That is not the case in these proceedings since the decision has been substantially upheld through the appeal process.

Venning J accepted the submission of the Commissioner that:

> … the rationale that underlies the desirability of a fresh decision-maker being involved, if the mater is remitted, is that it avoids the decision-maker having to effectively determine facts that the decision-maker had previously determined. (paragraph [20])

The prior involvement principle may also extend to other cases such as where the decision-maker is hearing a review from his/her own decision. That, however, is not the case here.

Venning J accepted that important principles underlie the decisions in *Re Pinochet* [1999] 1 All ER 577 (no person should be a judge in their own cause) and *Saxmere Company Ltd v Wool Board* [2009] NZSC 122 (a reasonable, fair minded and informed observer might be concerned at the financial relationship between the Judge and counsel) but the principles must be applied to the facts and these principles are not triggered by the facts in this case.

Regarding the submission that parties may have a feeling of pre-determination because of the previous findings of the Court adverse to their case, Venning J found that the position for refusing disqualification here was even stronger than in *JG Russell v Taxation Review Authority & Commissioner of Inland Revenue* CIV 2005-404-5203 19 December 2008 where the applicant sought unsuccessfully to have Barber DCJ recused on the grounds that, effectively, there was a perception that the Judge had already made up his mind as he had ruled on a number of occasions against entities using the "Russell" template. Venning J agreed with the High Court in *JG Russell* that there cannot be presumptive bias where the rulings of the Judge, although consistently adverse to a party's interests, have nevertheless been consistently in accordance with the law. Venning J noted that:

> The findings in this Court have been substantively upheld by the Court of Appeal and Supreme Court. They have been held to be in accordance with the law. (paragraph [32])

Venning J concluded that the plaintiffs are entitled to expect a fair and impartial hearing of their case on its merits and they will have that. They are not entitled to select (by way of disqualification without proper basis) the Court that will hear their case. The allocation of Judges to cases is an administrative matter for the Court.

QUESTIONS WE'VE BEEN ASKED

QB 10/01: REIMBURSING SHAREHOLDER-EMPLOYEES FOR MOTOR VEHICLE EXPENSES AND THE USE OF THE COMMISSIONER'S MILEAGE RATE

All legislative references are to the Income Tax Act 2007, unless otherwise stated.

We have been asked whether an employer who reimburses an employee for the business use of their private motor vehicle is able to use the Commissioner's mileage rate as set out in Operational Statement 09/01: *Commissioner's statement of a mileage rate for expenditure incurred for the business use of a motor vehicle* ("OS 09/01"), published in *Tax Information Bulletin* Vol 21, No 3 (May 2009), and to also clarify the "employee criteria" when it comes to reimbursing shareholder-employees.

We have also been asked whether the 5,000 km limitation on using that mileage rate also applies in these circumstances.

Summary

An employee may receive reimbursements that are exempt from tax for the use of their private motor vehicle under section CW 17. For the purposes of section CW 17, the meaning of "employee" includes a shareholder-employee of a close company who does not receive PAYE income payments.

The options that an employer has to reimburse an employee, including a shareholder-employee, for the business use of their private vehicle are:

- actual expenditure incurred by the employee for the distance travelled by the vehicle for work purposes;
- an employer's own reasonable estimate of expenditure likely to be incurred by the employee. This estimate may be based on a rate published by a reputable independent New Zealand source, eg, the New Zealand Automobile Association Inc.; and
- the mileage rate set by the Commissioner pursuant to section DE 12. Although the 5,000 km limitation does not apply in these circumstances, an employee whose annual business travel exceeds 5,000 km may need to be reimbursed using an alternative method.

Discussion

Section CW 17 provides that an employee may be reimbursed an amount that is exempt from tax for the use of their own vehicle for work-related purposes.

Employers can reimburse an employee based on actual expenditure incurred by the employee for the distance travelled by the employee's own vehicle for work purposes, or by making a reasonable estimate of the amount of expenditure likely to be incurred under section CW 17(3).

As a reasonable estimate employers may reimburse their employees using the rates published by a reputable independent New Zealand source, such as the New Zealand Automobile Association Inc., provided that the rate represents a reasonable estimate of the expenditure likely to be incurred by the employee. Employers may also use the Commissioner's mileage rate as set out in OS 09/01 as a reasonable estimate to reimburse employees.

The employee criteria

In regards to reimbursing shareholder-employees, OS 09/01 states that "where shareholder-employees meet the employee criteria, they may be reimbursed using the mileage rate as a reasonable estimate".

In fact, where a shareholder-employee meets the employee criteria as defined in section YA 1, they are entitled to tax-free reimbursements in the same way as an ordinary employee.

Section YA 1 defines the term "employee" as a person who receives a PAYE income payment and includes a person to whom sections RD 3(2) to (4) apply for the purposes of section CW 17.

A person comes within section RD 3(2) if they are a shareholder-employee of a close company and they do not receive salary or wages of a regular amount for regular pay periods of one month or less, or where the payments received by the person as an employee total to less than 66% of that person's annual gross income.

"Close company" is defined in section YA 1 and for the purposes of sections RD 3(2) to (4), it includes a company with 25 or fewer shareholders.

Sections RD 3(3) and (4) provide that the shareholder-employee referred to in section RD 3(2) may choose that the amount paid to them in the current tax year is not PAYE income payment, and that the amounts paid to them in later tax years are deemed not to be PAYE income payments.

Consequently, shareholder-employees, whether or not they receive a PAYE income payment, may come within the meaning of employee for the purposes of receiving tax-free reimbursements.

The 5,000 km limitation

The Commissioner's mileage rate in OS 09/01 was set taking into account the purchase price of a motor vehicle and other expenses such as insurance and registration, as well as running costs (including the cost of fuel, and repairs and maintenance etc). This rate is based on average travel for a motor vehicle of 14,000 km a year, and is primarily intended to be used by self-employed taxpayers whose business travel is 5,000 km or less each year.

While the 5,000 km limitation does not apply to reimbursing employees, it is up to the individual employer who chooses to use the Commissioner's mileage rate to ensure that the rate is suitable and that it represents a reasonable estimate of the employee's expenditure. If an employee's annual business travel exceeds 5,000 km, the Commissioner's mileage rate may no longer represent a reasonable estimate of that employee's expenditure as those costs which are not running costs will have been recovered. In these circumstances the employer may need to use an alternative method to reimburse the employee for the excess kilometres.

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Legal and Technical Services

Legal and Technical Services contribute the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters.

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