

TAX INFORMATION

Bulletin

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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

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

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

| Ref | Draft type/title | Description/background information |
|---------|---|--|
| XPB0043 | "Cost price of the motor vehicle" – meaning of the term for fringe benefit tax purposes | The ruling considers what is included in the "cost price" of a motor vehicle for fringe benefit tax purposes. It replaces Public Ruling BR Pub 03/06, which was a reissue of BR Pub 00/10. It is essentially the same as BR Pub 03/06, but now includes reference to road user charges and has been updated to apply the Income Tax Act 2007, which came into force on 1 April 2008. |
| ED 0116 | Draft Standard Practice Statement: <i>Extension of time applications from taxpayers without tax agents</i> | This draft Standard Practice Statement sets out Inland Revenue's practice for considering applications from taxpayers without tax agents for an extension of time to file their annual income tax returns, and it updates the current Standard Practice Statement RDC-1 under the same title. |

IN SUMMARY

Binding rulings

Product ruling BR Prd 09/07

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This product ruling applies to the raising of capital by Rabo Capital and Rabobank Nederland, by offering to the public New Zealand dollar denominated, perpetual, non-cumulative, non-voting preference shares of up to \$200 million.

Public ruling BR Pub 09/07: Provision of benefits by third parties – fringe benefit tax consequences – section CX 2(2)

7

This public ruling considers the application of section CX 2(2) of the Income Tax Act 2007 to the receipt of a benefit by an employee from a third party where there is an arrangement between the employer and the third party, and where the benefit would be subject to FBT if it had been provided by the employer.

Legal decisions – case notes

Director to represent companies in appeal

22

The Court of Appeal has allowed the director of two companies to represent them in Court, finding the case was an exception to the established rule in the *Mannix* case.

“Structured finance” transactions are tax avoidance arrangements

23

Six structured finance transactions entered into by BNZ are tax avoidance arrangements and are therefore void as against the Commissioner for income tax purposes.

No exceptional circumstances to allow a challenge outside the response period

24

The Taxation Review Authority could not allow the taxpayer to commence challenge proceedings after the statutory response period because the exceptional circumstances required by section 138D of the Tax Administration Act 1994 did not exist in this case.

Decision to impose section HK 11 disputable

25

The Commissioner assessed the director of the company under the provisions of section HK 11 ITA 1994 without first issuing a Notice of Proposed Adjustment (“NOPA”). When debt recovery action was taken, the District Court found that it could not impose judgment on the director because the Commissioner’s decision to impose the provision of section HK 11 was subject to dispute in the Taxation Review Authority.

Legal expenditure allowed if meets “principal purpose” test

25

The High Court found that the trustees of the Mangaheia and Te Mata Property Trusts were entitled to deduct GST input tax credits in relation to legal services acquired for litigation proceedings. The High Court also found that the “principal purpose” test has to be met before GST on services and supplies can be claimed as an input tax under section 3A(1)(a) of the Goods and Services Tax Act 1985 (“GST Act”).

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

PRODUCT RULING BR PRD 09/07

This is a product ruling made under section 91E of the Tax Administration Act 1994.

Persons to whom the Ruling applies (“the Applicants”)

This Ruling has been applied for by:

- Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. (“Rabobank Nederland”); and
- Rabo Capital Securities Limited (“Rabo Capital”).

Taxation Laws

All legislative references are to the Income Tax Act 2007 (“the Act”) unless otherwise stated.

This Ruling applies in respect of sections CX 56, GB 35 and BG 1.

The Arrangement to which this Ruling applies

The Arrangement is the raising of capital by Rabo Capital and Rabobank Nederland. Rabo Capital has offered to the public (in New Zealand and to investors in other jurisdictions where they may be lawfully offered) New Zealand dollar denominated, perpetual, non-cumulative, non-voting preference shares (“PIE Capital Securities”) of up to \$200 million (with the option to accept unlimited oversubscriptions at its discretion). Rabo Capital has accepted applications of \$280 million. The PIE Capital Securities will be listed on the New Zealand Debt Market (“NZDX”).

Rabo Capital will use the funds raised from the issue of the PIE Capital Securities to invest in capital securities issued by Rabobank Nederland (“Underlying Securities”) on or about the issue date of the PIE Capital Securities. Rabobank Nederland will use these funds for its banking business. Some of the funds may be used in its New Zealand business.

The Board of Directors of Rabo Capital and/or the Supervisory Board of Rabobank Nederland have no

intention that Rabo Capital and/or Rabobank Nederland promote the acquisition of PIE Capital Securities by providing holders of PIE Capital Securities or prospective holders with a loan or other financing from any of the companies in the Rabo Capital or Rabobank Nederland Group.

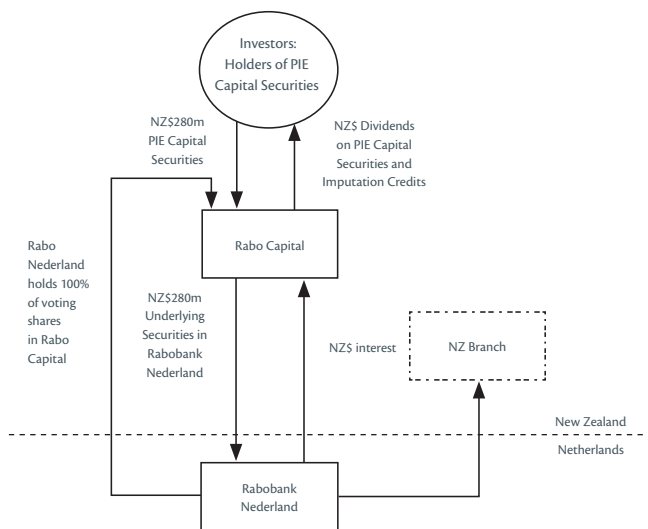
This Ruling does not apply to any holder of PIE Capital Securities who or which has funded the acquisition of PIE Capital Securities by means of borrowing or other financing from any of the companies in the Rabobank group of companies, where such borrowing or other financing was part of an express agreement or arrangement (whether in writing or otherwise) with such company that the proceeds of some or all of such borrowing or other financing would be used for the purposes of acquiring PIE Capital Securities.

Further details of the Arrangement are set out in the paragraphs below.

1. Parties to the Arrangement are:
 - Rabobank Nederland, a cooperative entity incorporated under Dutch law and tax resident in the Netherlands;
 - Rabo Capital, a limited liability company incorporated under New Zealand law which is a wholly-owned subsidiary of Rabobank Nederland; and
 - holders of PIE Capital Securities.
2. The transactions comprising the Arrangement are governed by documents that were provided to Inland Revenue on 2 April, 22 April or 24 April 2009. The documents are:
 - Agency Agreement between Rabo Capital, Rabobank Nederland and Computershare Investor Services Limited (“Registrar”) dated 16 April 2009 (“Agency Agreement”);
 - Terms and Conditions of the Underlying Securities set out in Exhibit A of the Agency Agreement;

- Constitution of Rabo Capital registered with the New Zealand Companies Office on 27 April 2009 (“the Constitution”);
- Terms and Conditions of the PIE Capital Securities attached as the Appendix to the Constitution (“PIE Conditions”);
- Investment Statement for the purposes of the Securities Act 1987 for the offer of PIE Capital Securities, dated 17 April 2009 (“the Investment Statement”);
- NZX Regulation Decision dated 17 April 2009; and
- Listing Agreement NZDX Market between Rabo Capital and NZX Limited (“NZX”).

3. The Arrangement is summarised in the diagram below:



4. The PIE Capital Securities and the Underlying Securities will constitute Tier 1 Capital of the Rabobank Group (comprising Rabobank Nederland together with its branches, consolidated subsidiaries and local member banks, including Rabo Capital) for the purposes of the Dutch Central Bank, which is the home prudential authority for Rabobank Nederland.

Rabo Capital

Incorporation of Rabo Capital

5. Rabo Capital is a special purpose company incorporated on 15 April 2009 under the Companies Act 1993 with 1000 \$1 ordinary shares, all of which are held by Rabobank Nederland. Rabobank Nederland is a cooperative entity incorporated under Dutch law and tax resident in the Netherlands.
6. The ordinary shares carry all the voting rights in Rabo Capital but the holder of the ordinary shares is not, by virtue of that holding, entitled to participate in any dividend or distribution (including by way of a return of capital) made by Rabo Capital.

Rabo Capital Constitution

7. Rabo Capital has no power to carry on any business or activity other than that described in the Constitution.
8. Clause 5.1 of the Constitution states:
 - 5.1 **Limitation on Business:** The only business or activity which the Company may carry on is to:
 - (a) issue and maintain in existence PIE Capital Securities, including listing (and maintaining a listing of) those shares on any stock or securities exchange in New Zealand or elsewhere;
 - (b) use the proceeds of PIE Capital Securities to subscribe for perpetual Tier 1 bonds issued by Rabobank Nederland, or a related company of Rabobank Nederland;
 - (c) enter into the Agency Agreement and the Security Trust Deed (and any other administration agreements, security trust deeds, registration agreements and/or deed polls in connection with the issue of PIE Capital Securities); and
 - (d) do all other things reasonably incidental to the activities referred to in sub-paragraphs (a), (b), (c) above and this Constitution.

The Company has no power to:

- (e) carry on any other business or activity; or
 - (f) apply amounts received by way of interest on, or repayment of, the bonds referred to in sub-paragraph (b) above for any purpose other than in payments to Holders, meeting costs and expenses incurred in connection with the issuance and maintenance in existence of PIE Capital Securities and making income and other tax payments to the New Zealand Inland Revenue Department.
9. Rabo Capital elected to be a “portfolio listed company” (“PLC”) under the “portfolio investment entity” (“PIE”) regime on 22 April 2009, with a commencement date of 27 May 2009.
 10. Under the Constitution, Rabo Capital may take all steps it considers necessary or desirable to ensure it continues to be eligible as a PIE and a PLC or otherwise to comply with the requirements of the Act relating to PIEs. These requirements include (but are not limited to):

- refusing to register the transfer of any PIE Capital Securities;
- treating the transfer of any PIE Capital Securities as void (ab initio or from such other date as Rabo Capital may decide in its complete discretion) (clause 3(i)(ii) of the PIE Conditions);
- deeming any PIE Capital Securities held that would result in any holder (or where the holder is a nominee their beneficial owner) exceeding the

maximum holding that an investor may hold in Rabo Capital in order for it to meet the PIE eligibility requirements in the Act, to be held by the holder of the PIE Capital Securities on trust for any member of the Rabobank Group appointed by Rabo Capital and allowing such member full powers of direction in relation to those PIE Capital Securities, including when, how and to whom they may be transferred (clause 3(i)(ii) of the PIE Conditions);

- allowing Rabo Capital or the Registrar to request any holder (or any person associated with that holder) of PIE Capital Securities to provide such information or evidence as it may require to determine whether Rabo Capital is eligible or continues to be eligible as a PIE and qualify as a PLC and, where holders do not provide such information within specified time periods, deeming that such holder's (or where the holder is a nominee, such beneficial owner's) PIE Capital Securities are held on trust for a member of the Rabobank Group appointed by Rabo Capital and such member of the Rabobank Group shall have full powers of direction in relation to those PIE Capital Securities including when, how and to whom they may be transferred (clauses 3(i)(iii) and (iv) of the PIE Conditions);
- allowing Rabo Capital or the Registrar to take any of the steps in clause 3(i)(v) of the PIE Conditions to ensure that any breach of the PIE regime "investor interest size" requirement is remedied within the period required by the Act.

PIE Capital Securities

11. Rabo Capital offered PIE Capital Securities with a face value of \$1 each to the public in New Zealand for \$1 per security. The minimum holding amount is \$5,000. The offer which opened on 27 April 2009 and closed on 22 May 2009, was available to retail and institutional investors. Rabobank Nederland subscribed \$5,000 for 5,000 PIE Capital Securities.
12. On 25 May 2009 Rabo Capital accepted a total of \$280 million in applications.
13. Rabo Capital has entered into a Listing Agreement with NZX for the PIE Capital Securities to be quoted on the NZDX (the debt security market operated by NZX). Although the PIE Capital Securities are not debt securities for the purposes of the Securities Act 1978, NZX Regulation has given certain rulings and waivers from the NZDX Listing Rules in relation to the listing of the PIE Capital Securities on the NZDX.
14. The PIE Capital Securities are perpetual non-cumulative, non-voting preference shares of Rabo Capital and shall

at all time rank *pari passu* and without any preference among themselves (clause 4(a) of the PIE Conditions). They are direct, unsecured and subordinated obligations of Rabo Capital and are not guaranteed by Rabobank Nederland or any other person.

15. Dividends will be paid on the PIE Capital Securities quarterly in arrears on the "Initial Rate Dividend Payment Date", with the first dividend payment date scheduled to occur on 18 June 2009 (clause 5(c) of the PIE Conditions).
16. The dividend amount is the amount of cash payable to holders of PIE Capital Securities on the relevant dividend payment date. The dividend amount for each dividend period from 18 June 2009 to 18 June 2019 is calculated as follows:

$$\frac{\text{face value} \times \text{dividend rate} \times (1 - t)}{4}$$

Where "t" is the weighted basic rate of New Zealand corporate income tax expressed as a percentage applicable to Rabo Capital (currently 30%) during the period ending on the relevant dividend payment date. The "dividend rate" used to calculate the dividend amount will be as follows:

- (a) for the first 10 years, the initial rate, which is equal to the sum of the margin and the benchmark rate (the five-year swap rate), which will be reset after five years; and
- (b) thereafter, the floating rate, which is equal to the sum of the margin and the three-month bank bill rate, which is reset quarterly.

17. The Investment Statement contains the following statement, relating to dividends payable on the PIE Capital Securities (at page 6):

Dividend:

The PIE Capital Securities will pay a non-cumulative dividend. Dividend Amounts are scheduled to be paid quarterly on each 18 March, 18 June, 18 September and 18 December. The Dividend Amount is the cash component of the dividend and is a proportion of the amount calculated using the Dividend Rate. Dividend Amounts payable on the PIE Capital Securities will be paid to the person registered as the Holder on the relevant Record Date (including in relation to the first Dividend Amount payable).

Initial Dividend Rate:

The initial Dividend Rate will be set for an initial period of approximately 5 years from the Issue Date to 18 June 2014 at the greater of:

- the Minimum Initial Rate, which is 8% per annum; and
- the Benchmark Rate on 25 May 2009 plus the Margin.

Dividend Rate reset:

The Dividend Rate will be reset for a further 5 years on 18 June 2014 at the prevailing Benchmark Rate plus the Margin. From 18 June 2019 the Dividend Rate will reset quarterly, at the 90 day bank bill rate plus the Margin.

18. On 25 May 2009 the dividend rate for the period until 18 June 2014, incorporating the margin (which has been set at 3.75 percent per annum) and the swap rate, was set at 8.7864 percent per annum.
19. Rabo Capital will attach imputation credits to distributions made to holders of PIE Capital Securities to the maximum extent permitted by the imputation credits available. The Investment Statement contains the following statement (at page 11):

Imputation Credits

The Issuer will attach imputation credits to Dividend Amounts to the extent permitted by the imputation credits that the directors of the Issuer determine are available. It is expected that dividends will have imputation credits fully attached to a Dividend Amount (30/70th of the Dividend Amount assuming a corporate tax rate of 30%). If the Issuer does not fully impute a Dividend Amount, this may trigger an Exchange Event and the PIE Capital Securities may, at the Issuer's option, exchange into the Underlying Securities issued by Rabobank Nederland or be redeemed. Alternatively, the Issuer may, at its discretion, put in place an arrangement to reimburse Holders who are adversely affected by the dividends not being fully imputed.

Underlying Securities

20. Rabo Capital will use the funds raised from the issue of PIE Capital Securities to invest in Underlying Securities issued by Rabobank Nederland on or about the issue date of the PIE Capital Securities. The Underlying Securities are interest-bearing, unsecured, perpetual, non-cumulative subordinated bonds. The principal amount of the Underlying Securities will be equal to the subscription amount of the PIE Capital Securities. The Underlying Securities will have terms conforming substantially to the terms of the PIE Capital Securities. However, the Underlying Securities will be bonds paying interest rather than shares paying imputed dividends. The Underlying Securities will be the only material asset of Rabo Capital and at least 90 percent of the income Rabo Capital will derive will be interest from its investment in the Underlying Securities.
21. Rabobank Nederland will use the funds raised from the issue of Underlying Securities for its banking business. The funds are not being raised specifically for the purposes of Rabobank Nederland's New Zealand branch ("NZ Branch"), although Rabobank Nederland may "on-lend" some of the funds raised to NZ Branch.

22. Interest received by Rabo Capital on the Underlying Securities will constitute assessable income for Rabo Capital.

Termination of Arrangement

23. The PIE Capital Securities are perpetual securities that have no scheduled repayment date, but the PIE Capital Securities will be redeemed in the following circumstances (among others). The circumstances are set out in clause 8 of the PIE Conditions and are:
- if Rabo Capital exercises the option contained in clause 8(c) of the PIE Conditions and elects to redeem the PIE Capital Securities on the "First Call Date" which is specified as being 18 June 2019 or on any dividend payment date thereafter;
 - if, as a result of a Netherlands tax law change, there is more than an insubstantial risk that additional amounts are payable under the Underlying Securities or interest payable on the Underlying Securities would not be deductible to Rabobank Nederland for Netherlands tax purposes and Rabo Capital elects to redeem the PIE Capital Securities;
 - if the Dutch Central Bank notifies Rabo Capital that the PIE Capital Securities may not be included in consolidated Tier 1 Capital of the Rabobank Group and Rabo Capital elects to redeem the PIE Capital Securities;
 - where the Underlying Securities are redeemed; or
 - on the occurrence of certain "Exchange Events" the PIE Capital Securities may be, at the option of Rabo Capital either cancelled and exchanged for Underlying Securities with a face value equal to the face value of the PIE Capital Securities or redeemed. The types of circumstances that would constitute an "Exchange Event" are described in the "Definitions" section of the PIE Conditions and summarised in the Investment Statement as follows (at page 12):

Exchange Events

On the occurrence of certain events (each an "Exchange Event") the PIE Capital Securities may, at the option of the Issuer, exchange into the Underlying Securities issued by Rabobank Nederland or be redeemed. The Exchange Events are:

- if the Dutch Central Bank requires that all PIE Capital Securities must be issued directly by Rabobank Nederland; or
- an Insolvency Event in relation to the Issuer or Rabobank Nederland; or
- a default by the Issuer for more than 30 days in the payment of Dividend Amounts or Redemption Amounts (other than relating to an

- administrative error) in respect of any of the PIE Capital Securities; or
- (d) any of the following events that the Issuer determines in its absolute discretion is an Exchange Event;
- (i) an Increased Costs Event; or
 - (ii) any Tax Law Change which has or is expected to have the effect that the anticipated tax outcomes for the Issuer or for Holders as at the Issue Date are adversely affected (as determined by the Issuer); or
 - (iii) the Issuer does not impute a Dividend Amount at the maximum imputation ratio under the Tax Act and an arrangement is not in place, or in the Issuer's opinion is not expected to be in place, within 90 Business Days of the relevant Dividend Payment Date to fully reimburse Holders who are adversely affected; or
 - (iv) the New Zealand Inland Revenue Department has indicated that it will not provide or renew a satisfactory binding ruling or rulings (as determined by the Issuer) confirming the anticipated tax implications of the transaction for the Issuer and the Holders.

Upon the occurrence of an Exchange Event, Holders of the PIE Capital Securities may, at the option of the Issuer, receive Underlying Securities in a principal amount equal to the Redemption Amount of each Holder's PIE Capital Securities at the relevant time or have their PIE Capital Securities redeemed. Prior to the distribution to Holders of the Underlying Securities or redemption, any Outstanding Amounts and any surplus amounts (after accounting for the Outstanding Amounts and the distribution of the Underlying Securities) held by the Issuer will be paid out pro rata to Holders.

Administration costs

24. It is expected that Rabo Capital will pay for ongoing costs and expenses related to the issue of PIE Capital Securities. If Rabo Capital has insufficient funds with which to pay these costs and expenses, Rabobank Nederland will reimburse Rabo Capital for the costs and expenses. Because of this arrangement, it is unlikely Rabo Capital will pay an administration fee to Rabobank Nederland, but in the event that any administration fee is paid in the future, such administration fee will not exceed an arm's length amount.
25. The New Zealand branch of Rabobank Nederland ("NZ Branch") will provide a liquidity facility to Rabo Capital pursuant to which Rabo Capital may request advances of up to NZ\$10 million from NZ Branch. Any interest paid by Rabo Capital to NZ Branch pursuant to the liquidity facility will be on arm's length terms

or, if not on arm's length terms, on terms that are in favour of Rabo Capital. It is expected that money from this funding facility will only be used to pay tax or other expenses of Rabo Capital if it has insufficient available funds before receiving income under the Underlying Securities. There is no intention on the part of the Board of Directors of Rabo Capital and/or the Supervisory Board of Rabobank Nederland that Rabo Capital, Rabobank Nederland and/or NZ Branch would be paid any of the income that should otherwise be paid to the holders of PIE Capital Securities.

Condition stipulated by the Commissioner

This Ruling is made subject to the following condition:

- This Product Ruling will cease to apply if the Binding Private Ruling (BR Prv 09/40) issued in respect of the Rabo Capital PIE regime Arrangement no longer applies or Rabo Capital ceases to be eligible to be a PIE and a PLC.

How the Taxation Laws apply to the Applicants and the Arrangement

Subject in all respects to any condition stated above, the Taxation Laws apply to the Applicants and the Arrangement as follows:

- Distributions or dividends made by Rabo Capital to holders of PIE Capital Securities will constitute excluded income of a New Zealand tax resident holder who is a natural person or a trustee and who does not include the amount as income in their return of income for the income year, pursuant to section CX 56(3)(a).
- Where section CX 56(3)(a) does not apply, distributions or dividends made by Rabo Capital to holders of the PIE Capital Securities will be excluded income of a holder to the extent to which the amount of the distribution is more than the amount of the distribution that is fully imputed (as described in section RF 9(2)) pursuant to section CX 56(3)(b)(i).
- Section GB 35 does not apply to the Arrangement.
- Section BG 1 does not apply to vary or negate the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 27 May 2009 and ending on 30 June 2014.

This Ruling is signed by me on 16th day of June 2009.

Howard Davis
Director (Taxpayer Rulings)

PUBLIC RULING BR PUB 09/07: PROVISION OF BENEFITS BY THIRD PARTIES – FRINGE BENEFIT TAX CONSEQUENCES – SECTION CX 2(2)

Note (not part of the ruling): This Public Ruling is a reissue of Public Ruling BR Pub 04/05: “The provision of benefits by third parties: Fringe benefit tax (FBT) consequences – Section CI 2(1)”, *Tax Information Bulletin* Vol 16, No 5 (June 2004). BR Pub 04/05 applied from 20 May 2004 until 19 May 2007. The Commissioner’s view, as expressed in this Ruling, is not intended to differ from that in BR Pub 04/05. Differences between this Ruling and BR Pub 04/05 reflect the subsequent enactment of the Income Tax Act 2007 or editorial amendments made only to assist readers’ understanding, and updates case law.

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 2(2) and the definition of “arrangement” in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the receipt of a benefit by an employee from a third party where there is an arrangement between the employer and the third party and where the benefit would amount to a “fringe benefit” if it had been provided by the employer.

The Arrangement does not include situations where the remuneration given by an employer to an employee is reduced because a benefit has been received from the third party, or otherwise takes the receipt of a benefit provided by a third party into account (including salary sacrifice situations). There cannot be any trade-off between the benefits provided and the remuneration that would otherwise have been received by the employee, or any difference between the remuneration levels of employees who receive benefits and those who do not.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- (a) For the purposes of section CX 2(2), there will be an arrangement for the provision of a benefit to employees where:
- (i) consideration passes from the employer to the third party in respect of the benefit being provided; or

- (ii) the employer requests (other than merely initiating contact), instructs, or directs, the third party to provide a benefit; or
 - (iii) there is negotiation or discussion between the employer and the third party that (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employees; or
 - (iv) the third party and the employer are associated parties, and there is a group policy (whether formal or informal), or any other agreement between the associated parties, that employees of the group will be entitled to receive benefits from the other companies in the group.
- (b) Where it has been determined that the benefit has not been provided in circumstances within any of the categories identified above, section CX 2(2) will not apply where the benefit is provided in any of the following circumstances:
- (i) there is negotiation or discussion between the employer and the third party that results in no more than:
 - (A) the employer granting the third party access to the premises or work environment to discuss the benefit with employees; and/or
 - (B) agreement between the parties as to the level of benefit that is to be offered by the third party to employees; and/or
 - (C) the employer agreeing to advertise or make known the availability of the benefit; or
 - (ii) the employer has done no more than initiate contact or discussions with the third party; or
 - (iii) there is no significant contact between the employer and the third party.

The period for which this Ruling applies

This Ruling will apply for a period beginning on the first day of the 2008/09 income year and ending on the last day of the 2013/14 income year.

This Ruling is signed by me on the 31st day of July 2009.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR Pub 09/07

Introduction

1. 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 09/07 (“the Ruling”).
2. The Ruling is a reissue of Public Ruling BR Pub 04/05: “The provision of benefits by third parties: Fringe benefit tax (FBT) consequences – section CI 2(1)”, *Tax Information Bulletin* Vol 16, No 5 (June 2004), which applied from 20 May 2004 to 19 May 2007.
3. BR Pub 04/05 concerned the application of section CI 2(1) of the Income Tax Act 1994 to the Arrangement. The Income Tax Act 1994 has since been repealed. The relevant provision is now section CX 2(2) of the Income Tax Act 2007.
4. All legislative references are to the Income Tax Act 2007, unless otherwise stated.

Background

5. This Ruling arises from several private ruling applications that the Rulings Unit has considered. It considers the scope of section CX 2(2) and what will be an “arrangement” that falls within the scope of this provision.

Legislation

6. Section CX 2(2) provides:

A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

7. “Arrangement” is defined in section YA 1 to mean, unless the context otherwise requires:

an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect.

Application of the legislation

8. Under the Act, an employer may be liable to pay fringe benefit tax (FBT) on fringe benefits that it provides to an employee. As a rule, an employer will not be liable to pay FBT on a benefit provided to an employee by a third party. However, under section CX 2(2) an employer may be liable to pay FBT on a benefit provided to an employee by a third party if that benefit is provided through an “arrangement” made between the employer and the third party. If section CX 2(2) applies, the benefit provided by the third party is treated as if it were

provided by the employer to the employee directly. This enables the other provisions of subpart CX to be applied to determine whether FBT is payable on the benefit.

9. Understood in this way, section CX 2(2) is an anti-avoidance provision. Its purpose is to prevent employers avoiding liability for FBT by arranging for a third party to provide a benefit to an employee in circumstances where FBT would have been payable had that benefit been provided by the employer directly.
10. It is important to note that liability for FBT does not necessarily arise if section CX 2(2) applies. For liability for FBT to arise, the benefit provided through the arrangement must amount to a “fringe benefit” within the meaning of section CX 2(1). It is possible that an arrangement may satisfy the requirements of section CX 2(2), but no FBT will be payable, as a result of the other provisions of subpart CX or because of the operation of the valuation rules in subpart RD. For instance, the benefit provided to the employee will not be a “fringe benefit” if section CX 23 or section CX 33 applies. Section CX 23 exempts from FBT certain benefits provided on the premises of the employer or of a company that is part of the same group of companies as the employer. Section CX 33 provides that in certain circumstances a discount on goods provided by a third party will not amount to a “fringe benefit”.
11. This Ruling considers only what will be an “arrangement” that comes within the scope of section CX 2(2). It does not consider whether FBT will be payable on a benefit that is provided through an arrangement to which section CX 2(2) applies.
12. It is clear that section CX 2(2) applies where any form of consideration passes from the employer to the third party to compensate for, or is otherwise in relation to, the benefit provided by the third party to the employee. The wording of section CX 2(2) is broad and seems to apply in a variety of cases wider than this obvious one. The issue is: where there is no direct or indirect consideration (in any form) provided by the employer to the third party, in what circumstances will the provision apply?

Conclusion on the scope of section CX 2(2)

13. The conclusions reached in this commentary on the requirements of section CX 2(2) are summarised in the following paragraphs.
14. For section CX 2(2) to apply, a “benefit” must be “provided” to an employee through an “arrangement” made between the employee’s employer and another person “for” the benefit to be “provided” to the employee.

15. The term “arrangement” is defined in section YA 1. Under this definition, the term “arrangement” encompasses various degrees of formality and enforceability. An “arrangement” may be a legally enforceable contract, a less formal agreement or plan that may or may not be legally enforceable, or an informal, unenforceable understanding. An implication of this is that an “arrangement” may exist even if no consideration is given by the employer to the third party so as to create a legally binding contract.
16. In the context of section CX 2(2), the term “arrangement” will include situations where the employer arranges with the third party to provide a benefit, where the employer agrees to allow the third party to approach the employees, or where the employer agrees to allow an employee to join a scheme promoted by the third party.
17. Section CX 2(2) provides that the arrangement made between the employer and another party be “for the benefit to be provided”. These words mean that the arrangement must be “made for the purpose” of providing a benefit to an employee or “with the object” of providing such a benefit. This requires consideration of the purpose or object of the employer and third party in making the arrangement.
18. Where the employer and the third party have a different purpose or object in making the arrangement, section CX 2(2) will apply only if the employer’s purpose or object for making the arrangement was to provide a benefit to an employee.
19. In determining the employer’s purpose or object, the relevant consideration is the subjective purpose of the employer in making the “arrangement”. In order for section CX 2(2) to apply, the employer must have, at least, the more than incidental purpose or object of providing a benefit to an employee in making the arrangement.
20. That it can be argued that the benefit has been provided to the employee through an employee–third-party arrangement does not mean that the same benefit cannot be regarded as having also been provided through an employer–third-party arrangement that satisfies the requirements of section CX 2(2).
21. For there to be a “benefit” for the purposes of section CX 2(2), the thing provided to an employee must be a “fringe benefit” (as defined in section CX 2(1)) and the employee must take advantage of or use that thing.
22. For section CX 2(2) to apply, the benefit must have been “provided” to an employee by a third party. The word “provided” requires that the benefit must have been supplied, furnished or made available to the employee.
23. The Commissioner does not consider that all situations involving associated persons will necessarily fall within section CX 2(2). It is only in those situations where there is a group policy, or any other agreement between the associated parties, regarding the provision of benefits that the Commissioner considers that the section will apply.
24. It is concluded that these requirements will be fulfilled and section CX 2(2) will apply where:
- consideration passes from the employer to the third party in respect of the benefit being provided;
 - the employer requests (other than merely initiating contact), instructs or directs the third party to provide a benefit;
 - there is negotiation or discussion between the employer and the third party that (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employees; or
 - the third party and the employer are associated parties, and there is a group policy (whether formal or informal), or any other agreement between the associated parties, that employees of the group will be entitled to receive benefits from the other companies in the group.
25. Where it has been determined that the benefit has not been provided in circumstances within any of the categories identified above, section CX 2(2) will not apply where the benefit is provided in any of the following circumstances:
- there is negotiation or discussion between the employer and the third party that results in no more than:
 - (i) the employer granting the third party access to the premises or work environment to discuss the benefit with employees; and/or
 - (ii) agreement between the parties as to the level of benefit that is to be offered by the third party to employees; and/or
 - (iii) the employer agreeing to advertise or make known the availability of the benefit; or
 - the employer has done no more than initiate contact or discussions with the third party; or
 - there is no significant contact or arrangement between the employer and the third party.

26. Under the heading “How the Taxation Laws apply to the Arrangement”, the Ruling identifies, in paragraph (a), categories where the requirements of section CX 2(2) will be satisfied. In addition, the Ruling identifies, in paragraph (b), categories where the requirements of section CX 2(2) will not be satisfied. Some categories in paragraphs (a) and (b) may overlap. Accordingly, it is possible that a benefit may be provided in circumstances that come within a category in both paragraphs (a) and (b). In such cases, the requirements of section CX 2(2) are considered to have been satisfied. For this reason, the Ruling qualifies the categories in paragraph (b) with the words “[w]here it has been determined that the benefit has not been provided in circumstances within any of the categories identified above”. For example, if a benefit is provided in circumstances that come within the “requests ... instructs or directs” category in paragraph (a), section CX 2(2) applies even if it can be argued that those circumstances also come within the “agreement ... as to the level of benefit that is to be offered” subcategory in paragraph (b).

27. A consequence of this Ruling may be that the employer is required to put into place systems to enable them to obtain the relevant information required to fulfil their FBT obligations. In the Commissioner’s opinion, where the employer is involved in the types of arrangement contemplated by the first four of the bullet points set out in paragraph 24, the employer will generally be in a sufficient relationship with the third party to obtain the information they require to fulfil their obligations. The onus is on employers who are involved in arrangements for the provision of benefits in any of these ways to ensure that they can do so (for example, by requiring this of the third party).

What is meant by the term “arrangement”?

28. The definition of “arrangement” in section YA 1 makes it clear that the term “arrangement” is very wide in its application, and that it encompasses not only legally binding contracts, but also unenforceable understandings. It is clear that what is required for an arrangement to exist is less than that required for a binding contract.

29. The *Concise Oxford English Dictionary* (11th ed, revised, 2006) defines the individual words contained in the section YA 1 definition as follows:

- “Agreement” – a negotiated and typically legally binding arrangement
- “Contract” – a written or spoken agreement intended to be enforceable by law

- “Plan” – a detailed proposal for doing or achieving something
- “Understanding” – an informal or unspoken agreement or arrangement.

30. The above definitions show that the words used to describe an “arrangement” in section YA 1 all appear to be slightly different concepts. They indicate that the term “arrangement” is defined to encompass varying degrees of formality and enforceability. The term “arrangement” may be a legally enforceable contract, a less formal agreement or plan that may or may not be legally enforceable, or an informal, unenforceable understanding.

31. That an “arrangement” does not need to be legally enforceable is confirmed by the section YA 1 definition providing that “arrangement” means “an agreement, contract, plan or understanding, **whether enforceable or unenforceable**” (emphasis added). An implication of this is that an “arrangement” may exist even if there is no consideration given by the employer to the third party so as to create a legally binding contract.

32. The courts have not considered the definition of “arrangement” in the context of section CX 2(2), but have considered the same definition in the context of the general anti-avoidance rule in section BG 1.

33. The predecessor to the definition of “arrangement” in section YA 1 is section 99(1) of the Income Tax Act 1976. This defined the term “arrangement” for the purposes of the general anti-avoidance provision (as then enacted) as:

any contract, agreement, plan, or understanding (whether enforceable or unenforceable) including all steps and transactions by which it is carried into effect.

34. This definition was discussed by Richardson P in *CIR v BNZ Investments Ltd* (2001) 20 NZTC 17,103 (CA). His Honour stated (at page 17,116):

The words contract, agreement, plan and understanding appear to be in descending order of formality. A contract is more formal than an agreement, and in ordinary usage is usually written while an agreement is generally more formal than a plan, and a plan more formal or more structured than an understanding. And it is accepted in the definition of arrangement that the contract, agreement, plan or understanding need not be enforceable. Section 99 thus contemplates arrangements which are binding only in honour.

35. The courts have considered the meaning of “arrangement” in several other cases. They have generally held that the term “arrangement” applies in a wide variety of situations.

36. The High Court of Australia in *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548 considered the meaning of “arrangement” and stated (at page 573):

it may be said that the word “arrangement” is the third in a series which as regards comprehensiveness is an ascending series, and that the word extends beyond contracts and agreements so as to embrace all kinds of concerted action by which persons may arrange their affairs for a particular purpose or so as to produce a particular effect.

37. The Privy Council in *Newton v Commissioner of Taxation of the Commonwealth of Australia* [1958] 2 All ER 759 held (at page 763):

Their Lordships are of opinion that the word “arrangement” is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons – a plan arranged between them which may not be enforceable at law. But it must in this section comprehend, not only the initial plan but also all the transactions by which it is carried into effect – all the transactions, that is, which have the effect of avoiding taxation, be they conveyances, transfers or anything else.

38. In the context of section BG 1, the courts have considered whether the term “arrangement” requires consensus or meeting of minds. This issue was considered by the Court of Appeal in *BNZ Investments*. In that decision, the majority of the court held that consensus or meeting of minds was required. Thomas J dissented in holding that there was no such requirement. His Honour held that the term “arrangement” does not require that one party knew of, or agreed to, all the steps and transactions undertaken by the other party in order to discharge its obligations under the “agreement, contract, plan or understanding”. Thomas J’s approach was endorsed by the majority of the Privy Council in *Peterson v CIR* (2005) 22 NZTC 19,098 (at paragraph 34).

39. However, it is noted that other elements of section CX 2(2) require that the employer must be aware that a benefit would be provided to an employee by the third party. In section CX 2(2), the term “arrangement” is qualified by the words “made between their employer and another person for the benefit to be provided”. As will be discussed, these words mean that section CX 2(2) applies only if the employer’s purpose or object in making the arrangement is for a benefit to be provided to an employee: see paragraphs 73–79. For this requisite purpose or object to exist, the employer must have authorised the third party to provide a benefit to an employee.

40. The section BG 1 case law is consistent with the case law on the meaning of “arrangement” as used in commerce-

related legislation (for example, the Commerce Act 1986). This case law makes clear the following:

- An “arrangement” exists where each party intentionally creates in the other party an expectation that the first party will act in a certain way. In so doing, the parties agree to mutual rights and obligations in respect of the course of action to be undertaken.
- An “arrangement” is unlikely to exist when only one party makes a commitment to the proposed course of action.

(See *New Zealand Apple and Pear Marketing Board v Apple Fields Ltd* [1991] 1 NZLR 257; *Re British Basic Slag Ltd’s Agreements* [1963] 2 All ER 807; *Trade Practices Commission v Email Ltd* (1980) 31 ALR 53.)

41. In summary, the definition of “arrangement” in section YA 1 encompasses various degrees of formality and enforceability. An “arrangement” may be a legally enforceable contract, a less formal agreement or plan that may or may not be legally enforceable, or an informal, unenforceable understanding. An implication of this is that an “arrangement” may exist even if no consideration is given by the employer to the third party so as to create a legally binding contract.
42. In the context of section CX 2(2), the term “arrangement” will include situations where the employer arranges with the third party to provide a benefit, where the employer agrees to allow the third party to approach the employees, or where the employer agrees to allow an employee to join a scheme promoted by the third party.
43. In terms of the application to section CX 2(2), for there to be an “arrangement” that is caught under the section, it must be an arrangement “for” a benefit to be “provided” to an employee. This means that not every “arrangement” that exists between an employer and a third party will be caught by section CX 2(2). Similarly, not every instance where a benefit is provided to an employee by a person who is not their employer will be caught by the section.

What is the meaning of “for” as used in section CX 2(2)?

44. Section CX 2(2) provides that the “arrangement” made between the employer and another party be “for the benefit to be provided”.
45. The word “for” can have a wide variety of meanings depending on its context. The Court of Appeal in *Wilson & Horton v CIR* (1995) 17 NZTC 12,325 stated (at page 12,330):

Reference to any standard dictionary brings home the wide variety of senses in which the preposition “for” may be employed. The *Oxford English Dictionary* (2nd ed) identifies 11 separate categories of meaning and many distinct usages within particular categories. The discussion in the text extends over 9 columns in the dictionary. Again the *Tasman Dictionary* which as its name suggests is directed to Australian English and New Zealand English, lists 33 meanings of the word. **The particular meaning intended necessarily hinges on the context in which the word is used and how it is used in that context.**

[Emphasis added]

46. The use of the word “for” was interpreted in *Patrick Harrison & Co v AG for Manitoba* [1967] SCR 274 as imposing a purpose test. In this case, the court held that “for the extraction of minerals” meant “with the object or purpose of extracting minerals”.
47. In *G v CIR* [1961] NZLR 994, McCarthy J held that the word “for” points to intention, which is similar to looking at a person’s purpose. McCarthy J stated (at page 999):

“For” points to intention ... the essential test as to whether a business exists is the intention of the taxpayer as evidenced by his conduct, and that the various tests discussed in the decided cases are merely tests to ascertain the existence of that intention. I think that it conforms with this approach to construe the word “for”, when considering a phrase such as “carried on for pecuniary profit” used in relation to an occupation, as importing intention.
48. These cases show that in several statutory contexts the courts have interpreted the word “for” to mean “for the purpose” or “with the object of” something. It is noted that in this context, a person’s purpose is similar to their intention. However, to determine the word’s meaning in the current section, it is necessary to look at the section’s wording.
49. As already noted, section CX 2(2) requires that the benefit provided to the employee was through an arrangement made between the employer and another person “for the benefit to be provided” (emphasis added). The use of the term “for” in this context can mean that the arrangement entered into is concerned only with the provision of these benefits. That is to say, the “arrangement” must have been made “for” the provision of a benefit to an employee.
50. In the Commissioner’s opinion, based on the case law and dictionary definitions, for an “arrangement” to satisfy section CX 2(2) it must be “made for the purpose” of providing a benefit to an employee or “with the object” of providing such a benefit.

Is section CX 2(2) concerned with the purpose of the arrangement or the purpose of the parties in making the arrangement?

51. Given that the words “for the benefit to be provided” mean for the purpose or object of providing the benefit, the issue arises as to who or what must have this purpose or object. This requires interpreting the words “an arrangement made between the employer and another person for the benefit to be provided”. There are two possible interpretations of these words.
52. First, the words “for the benefit to be provided” could be read as relating to the word “made”. Under this interpretation, section CX 2(2) applies if the purpose or object of the parties in making the arrangement was for a benefit to be provided to an employee of the employer.
53. Second, the words “for the benefit to be provided” could be read as relating to the word “arrangement”. Under this interpretation, section CX 2(2) applies if the arrangement has the purpose or object of providing a benefit to an employee of the employer. This would require an objective inquiry into the arrangement itself, and would not consider the purpose or object of the parties to the arrangement.
54. Under this second interpretation, section CX 2(2) could have a wider scope of application than under the first interpretation. It could be possible that, objectively, an arrangement has the purpose or object of providing an employee of the employer with a benefit in circumstances where, subjectively, the parties did not make the arrangement for the purpose or object of providing a benefit to an employee.
55. The other words in section CX 2(2) do not appear to suggest that one interpretation is preferable to the other. It is consequently considered that the meaning of the words “an agreement made between their employer and another person for the benefit to be provided” is ambiguous. Therefore, it is necessary to consider whether the scheme of the FBT regime, and of the Act as a whole, favours one interpretation over the other.
56. Interpreting section CX 2(2) as requiring consideration of the purpose or object of the parties could be seen as consistent with the FBT regime. The FBT regime applies where there is a “fringe benefit”, which is defined in section CX 2(1)(a) as being a benefit that “is provided by an employer to an employee in connection with their employment”. This indicates that the focus of the FBT regime is on benefits that the employer has chosen to give its employees. Understood in this way, the purpose of section CX 2(2) appears to be to prevent employers

from deliberately avoiding liability for FBT by arranging for the third party to provide the benefit instead.

57. An argument favouring interpreting section CX 2(2) as requiring consideration of the purpose or object of the arrangement is that this interpretation is consistent with section BG 1. Under section BG 1, it is only the objective purpose or effect of the “arrangement”, and not the intention of the parties to the arrangement, that is relevant to whether there is a “tax avoidance arrangement”: *Newton v FC of T* (1958) 11 ATD 442; *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116; *Ben Nevis Forestry Ventures v CIR, Accent Management v CIR* [2008] NZSC 115. Arguably, it is appropriate that section CX 2(2) is interpreted consistently with section BG 1, given they both have an anti-avoidance purpose and share the same definition of “arrangement”.
58. However, it might be argued that interpreting section CX 2(2) as requiring consideration of the purpose or object of the parties is not inconsistent with section BG 1. Unlike section CX 2(2), the wording in section BG 1 is unambiguous in requiring consideration of the purpose or effect of the arrangement. Section YA 1 provides that “tax avoidance arrangement”:
- Means an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly—
- (a) has tax avoidance as its purpose or effect; or
- (b) has tax avoidance as 1 of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.
59. Moreover, interpreting section CX 2(2) as requiring consideration of the purpose or object of the arrangement arguably creates the potential for overlap with section GB 31. Section GB 31 provides an anti-avoidance rule that applies when “a purpose or effect of the arrangement [entered into by two or more persons] is to defeat the intent and application of any of the FBT rules”. Section CX 2(5)(a) provides that a benefit may be treated as having been provided by an employer to an employee under section GB 31.
60. Section GB 31(1) makes clear that it is concerned with the purpose or effect of the arrangement and not with the purpose or object of the parties to the arrangement. This arguably suggests that if section CX 2(2) were interpreted as requiring consideration of the purpose or object of the arrangement, then section CX 2(2) might cover only situations that would fall within section GB 31. By contrast, interpreting section CX 2(2) as requiring consideration of the purpose or object of the parties might reduce the potential for overlap, because

sections CX 2(2) and GB 31 would have different focuses and apply in different circumstances. If the drafters had intended the purpose or object of the arrangement to be relevant under section CX 2(2), it would be reasonable to expect that the drafters would have adopted language similar to that used in sections BG 1 and GB 31.

61. This suggests that the scheme of the FBT regime favours interpreting section CX 2(2) as requiring consideration of the purpose or object of the parties. The legislative history to section CX 2(2) will now be examined to assess whether this conclusion is correct.
62. The background to section CX 2(2) and its predecessors in the Income Tax Acts 1994 and 2004 does not provide useful guidance on this issue. However, the background to section 336N(2) of the Income Tax Act 1976, which is the earliest predecessor to section CX 2(2), does assist in understanding Parliament’s purpose in enacting that provision and the FBT regime generally. Section 336N(2) provided:

For the purposes of this Part of this Act, where a benefit is provided for or granted to an employee by a person with whom the employer of the employee has entered into an arrangement for that benefit to be so provided or granted, that benefit shall be deemed to be a benefit provided for or granted to the employee by the employer of the employee.

Section 336N of the Income Tax Act 1976 was enacted by the Income Tax Amendment Act (No 2) 1985, which also enacted the FBT regime.

63. The FBT regime was enacted in light of the recommendations in *Report of the Task Force on Tax Reform* (Wellington, Government Printer, 1982). The task force was chaired by PM McCaw. Before the enactment of the FBT regime, fringe benefits were generally not taxed. The task force noted that generally fringe benefits did not amount to assessable income under the tax legislation at that time. It considered that the non-taxable status of fringe benefits was unsatisfactory, because it increased the inequity in the tax system and narrowed the tax base (at paragraph 6.185). The task force did not discuss the situation where an employer arranges for a third party to provide an employee with a benefit.
64. Also relevant is the speech of the then Minister of Finance, the Hon RO Douglas, in the third reading debate of the Income Tax Amendment Bill (No 2). The Minister stated that the purpose of the fringe benefit tax was to “close ... off loopholes that are a major source of unfairness in income distribution”, and that (NZPD vol 462 1985, at page 3,920):

In the Government's view it is fair to tax the employers, the basic reason being that it is the employers which have been using fringe benefit payments to lower the cost structures of their business. I gave the example in the Committee of an employer who might want to put together a package of \$100,000. He could pay \$40,000 in terms of salary, then put together a fringe benefit package of about \$20,000 in various forms, which was the equivalent of tax paid income of \$60,000. In other words, for \$60,000 in terms of cost structure to the business the employer was able to put together a salary package equivalent of \$100,000. In those circumstances the Government believes it is fair and equitable to tax the employer.

65. The Minister of Finance's speech indicates that the mischief Parliament sought to remedy by enacting the FBT regime was the ability of employers to decrease the costs of employment by substituting assessable income with non-assessable fringe benefits. While the Minister did not specifically discuss the clause of the Bill that became section 336N(2) of the Income Tax Act 1976, his comments suggest that section 336N(2) was intended to cover the specific situation of an employer that knowingly seeks to avoid liability for FBT by arranging for a benefit to be provided to an employee by a third party.
66. In summary, the words "an arrangement made between their employer and another person for the benefit to be provided" are ambiguous. These words can be interpreted as requiring consideration of the purpose or object of **the arrangement** or the purpose or object of **the parties** in making that arrangement. It is considered that the scheme of the FBT regime and the legislative history suggest that the better view is that section CX 2(2) requires determining the purpose or object of the parties in making the arrangement.

Whose "purpose" is relevant under section CX 2(2)?

67. The discussion so far has proceeded on the basis that the parties' (that is, the employer's and the third party's) purpose or object in making the arrangement is relevant. Where both the employer and the third party share the same purpose, then determining whether section CX 2(2) applies will be straightforward. However, in some situations it might be possible to argue that the employer and third party each have a different purpose for making the arrangement. For example, where the third party agrees to provide the benefit because the employer has stated that it will withhold business from the third party unless it does so, it might be argued that the third party has not made the arrangement for the purpose or object of providing a benefit to an employee. Instead it might be argued that

the third party made the arrangement for the purpose or object of preserving its business with the employer. In such situations, the issue arises as to whose purpose should be considered determinative when deciding whether section CX 2(2) applies.

68. It is considered that the scheme of the FBT regime supports the employer's purpose being determinative in both these situations.
69. Liability for FBT is imposed on benefits provided by employers to their employees. The FBT regime is not, as a rule, concerned with benefits provided to employees by persons who are not their employers. An exception to this rule is in section CX 2(2). Section CX 2(2) has an anti-avoidance purpose. It seeks to prevent employers from avoiding liability for FBT by arranging for third parties to provide benefits to their employees.
70. The scheme of the FBT regime supports section CX 2(2) applying where the employer, but not the third party, makes the arrangement with the purpose of providing a benefit to an employee. In such cases, liability for FBT is avoided in circumstances where it would have arisen if the benefit had instead been provided by the employer directly. Moreover, the third party is not seeking to avoid liability for FBT, because it has no prospective liability. At most, the third party might be a knowing participant in the employer's arrangement. More likely, perhaps, the third parties would be pursuing their own commercial non-tax objectives and may be ignorant of, or indifferent to, the employer's purpose.
71. By contrast, the scheme of the FBT regime does not support section CX 2(2) applying where the third party, but not the employer, makes the arrangement with the purpose of providing a benefit to an employee. If section CX 2(2) were to apply in such cases because of the third party's purpose, then FBT would be imposed despite the employer not having the purpose of providing a benefit to its employee. The imposition of FBT in these circumstances seems unfair and illogical.
72. In summary, it is considered that section CX 2(2) applies where the purpose of the employer for making the arrangement is for a benefit to be provided to an employee of the employer.

Should the test to determine the employer's purpose in making the arrangement with the third party be objective or subjective?

73. The above conclusions combine to show that for an "arrangement" to be caught under section CX 2(2), the purpose of the employer must have been to provide the employee with a benefit. This part of the commentary considers whether the test to determine whether

the employer's purpose in making the arrangement is for the purpose of providing a benefit should be a subjective or an objective one.

74. A subjective approach requires consideration of the intention of the parties in entering into the arrangement. In the current context, a subjective test would look at what the particular employer had in mind when the arrangement with the third party was entered into. An objective approach, however, might consider what a reasonable person in the position of the employer ought to have had in mind.
75. Additionally, case law, particularly in the area of GST, indicates that the correct test for determining purpose is a mixed test, considering both subjective and objective factors in reaching a conclusion as to the taxpayer's purpose. In several cases the courts have held that the test for purpose is dependent on the statutory context in which it is found (see, for example, *CIR v Haenga* (1985) 7 NZTC 5,198).
76. It is, therefore, necessary to look closely at the wording of the section. Section CX 2(2) does not contain the word "purpose". It requires that the "arrangement" be "made between" the employer and the third party "for the benefit to be provided".
77. In the Commissioner's view, section CX 2(2) requires consideration of the reason that the employer "made" the "arrangement" with the third party. This means the test to determine the employer's purpose in making the arrangement should be subjective, looking at the particular reasons the employer had in mind. However, objective factors may be taken into account to aid in this interpretation.
78. This approach could be seen as being supported by McCarthy J in *G v CIR* where he held that the word "for" points to intention, clearly indicating a subjective approach. McCarthy J stated (at page 999):
- "For" points to intention ... the essential test as to whether a business exists is the intention of the taxpayer as evidenced by his conduct, and that the various tests discussed in the decided cases are merely tests to ascertain the existence of that intention. I think that it conforms with this approach to construe the word "for", when considering a phrase such as "carried on for pecuniary profit" used in relation to an occupation, as importing intention.
79. Therefore, the test to determine the employer's purpose is a subjective one that looks at the intention of the employer, but objective factors should be considered to ensure the employer's stated purpose is honestly held. That is, for section CX 2(2) to apply, the reason the employer made the arrangement must have been to provide a benefit to its employee.
- ### What test should be used to determine the employer's purpose?
80. This part of the commentary considers the appropriate test to be used in determining the purpose of the employer making the "arrangement" with a third party.
81. A spectrum of tests could be used to determine the purpose of the employer in making the arrangement with the third party.
82. At one end of the spectrum is a sole purpose test. This test requires that the provision of a benefit to an employee is the sole or only purpose of the employer in making the arrangement. In the Commissioner's opinion, this would be an unduly restrictive test for section CX 2(2), because it would not apply in any situation where there was another purpose, no matter how secondary or minor.
83. At the other end of the spectrum, is the test that the section will apply if any one of the purposes of the employer in making the arrangement is that the employee be provided with a benefit. In the Commissioner's opinion, this is also not an appropriate test in the context of section CX 2(2), because the section would catch all benefits that were provided to employees if the employer had some form of arrangement with the third party and the fact the employees were receiving a benefit had crossed the employer's mind when they entered into the arrangement with the third party. If the provision of the benefit is not a part of the arrangement between the parties, but is truly incidental to the purpose of the employer, then the section should not apply.
84. Between these two extremes are the dominant purpose test and the more than incidental purpose test.
85. A dominant purpose test would require that the main reason why the employer made the arrangement with the third party is for the benefit to be provided to the employee. This test would allow the employer to have other purposes in making the arrangement, but that, in order for the section to apply, the main purpose of the employer in making the "arrangement" needs to be the provision of a benefit. This test would also mean that if the employer had more than one purpose in making the "arrangement" and the provision of a benefit to employees was not the most important purpose, then section CX 2(2) would not apply.
86. Several cases have determined that the word "purpose" used on its own in statutory language without any apparent qualifier means the dominant purpose of the taxpayer, for example, in relation to the third limb of section CB 4 (and predecessor provisions) and in relation to section 108 of the Land and Income Tax Act 1954 (the former section BG 1).

87. In the Commissioner's opinion, there is no reason to conclude that section CX 2(2) requires a dominant purpose test. There is no indication on the words of section CX 2(2) that a dominant purpose test is necessary. This can be contrasted with section CD 4, where the section clearly refers to "the purpose" (emphasis added). Therefore, it is the Commissioner's opinion that it would not be appropriate to apply a dominant purpose test in determining whether section CX 2(2) applies.
88. A more than incidental purpose test would be similar to the test in section BG 1, where, as long as the purpose of providing a benefit is more than incidental to any other purpose of the employer in making the "arrangement", the section will apply. In the context of section CX 2(2), this means that if the provision of the benefit is incidental to other purposes of the "arrangement", such as the provision of credit cards to employees or obtaining a good package deal for the employer, then the section would not apply. The use of this test could be seen as being supported by the fact section CX 2(2) is an anti-avoidance provision and that it is appropriate to have a similar test as in other avoidance contexts. Alternatively, it could be argued that a more than incidental test is not appropriate, because the language of section BG 1 explicitly provides for the test of more than merely incidental in the legislation itself, whereas section CX 2(2) does not.
89. Overall, it is the Commissioner's opinion that the more than incidental test is the appropriate test to be adopted in interpreting section CX 2(2). This approach means that if the purpose of providing a benefit to the employees is no more than incidental to some other purpose of the employer making the arrangement, the arrangement would not be caught within the section. A more than incidental test means that the purpose of the employer must be significant in order for the benefit to be caught within the section, but does not need to be the most important (or dominant) reason or purpose of the employer in making the "arrangement".
90. In the Commissioner's opinion, if an employer has more than one purpose when they made the "arrangement" with the third party, it is appropriate to exclude incidental purposes from section CX 2(2), but there is no reason why an employer with a significant, but not dominant, purpose of providing a benefit to employees should not be caught by the section.
91. Therefore, to establish whether section CX 2(2) applies, it is necessary to look at what the arrangement between the employer and the third party is for, and whether the provision of the benefit to employees is incidental to another purpose of the employer, or whether it is a separate, significant purpose in its own right. If the provision of a benefit is no more than incidental to some other purpose of the employer in making the arrangement with the third party, then section CX 2(2) will not apply.
92. The relevant consideration is whether the purpose of the employer of providing a benefit to employees is incidental to another purpose of the employer, not whether the benefit received is incidental to the arrangement with the third party. It is the purpose of the employer that is relevant, not the purpose of the arrangement.
93. If the employer does not have a purpose of providing a benefit to employees (or the purpose is not more than incidental), section CX 2(2) will not apply to any benefit that may be provided by a third party.
- Which "arrangement" must be the one "for" the benefit?**
94. In some cases where a benefit is provided to an employee by a third party, it might be possible to argue that there are two arrangements "for" that benefit to be provided: one arrangement between the employer and the third party and another between the employee and the third party. In such cases, the issue may arise as to whether the presence of an arrangement between the employee and third party for the provision of a benefit means that same benefit cannot have been provided under an arrangement between the employer and third party.
95. For instance, an employer makes an arrangement with a local gym under which the gym agrees to provide free membership to the employer's employees. To obtain this free membership, employees must undertake the gym's membership process (including agreeing to its standard terms and conditions of use). In this situation it might be argued that section CX 2(2) cannot apply, because the gym membership should be considered to have been provided through an arrangement between the gym and the employee, and therefore, not through the arrangement between the employer and the third party.
96. In the Commissioner's view, there appears to be no reason to conclude that merely because there is an **employee**-third-party arrangement for a benefit to be provided that it is not also possible for that same benefit to be considered to have been provided through an **employer**-third-party arrangement to which section CX 2(2) applies. Section CX 2(2) does not expressly or implicitly exclude itself from applying only because the benefit concerned can also be considered to have been provided through an **employee**-third-party

arrangement. Accordingly, section CX 2(2) may apply even if the benefit can also be considered to have been provided through an employee–third-party arrangement.

What is required for there to be a benefit to the employees?

97. Under section CX 2(1), the definition of what amounts to a fringe benefit is broad and intended to include all non-cash payments made by an employer to an employee in respect of their employment. However, it is not clear, given that section CX 2(2) is an anti-avoidance provision, whether what the employee receives from the third party needs to be a benefit that the employee would not usually be able to receive or if something else is needed. The issue arises of whether a benefit under section CX 2(2) must be something that the public is unable to receive.

98. In *Case M9* (1990) 12 NZTC 2,069, District Court Judge Bathgate held that the provision of the motor vehicle was subject to FBT and stated (at page 2,073):

A benefit is often regarded as being given voluntarily, rather than compulsorily. A benefit may however be given under compulsion in some circumstances – *Yates v Starkey* [1951] 1 All ER 732 ... “Fringe benefits” are defined in s 336N(1) [of the Income Tax Act 1976] as the benefits “received or enjoyed”, in the sense that it is from the employee’s view they are to be considered a benefit, which is the object and purpose of such.

99. In *Case M59* (1990) 12 NZTC 2,339, District Court Judge Bathgate stated (at page 2,343):

Only the receipt or enjoyment occurred after FBT was imposed, but that was not sufficient, as that is only a part of a fringe benefit, and not the whole fringe benefit. By 31 March 1985 the objector had provided a benefit, although it was not enjoyed by B and C until after that date. That enjoyment however was not for the purposes of the Act a fringe benefit. Although the objectors would be taxable in that period after 1 April 1985, they were not subject to the tax because when the benefit was provided by them it was not chargeable to FBT.

100. This means two separate elements must exist for there to be a “benefit” for FBT purposes: provision to the employee and enjoyment by that employee. Accordingly, for a benefit to exist under section CX 2(2), there must be both the provision of something by a third party who has entered into an arrangement with the employer to provide that benefit, and enjoyment by the employee.

101. Accordingly, on the basis of the above cases, all that is necessary for there to be a benefit to an employee under section CX 2(2) is for the employee to receive, or be provided, something by a third party, and to enjoy, or

take advantage of, that thing. There is no requirement that a fringe benefit is something the employee could not receive on their own account, or that the public cannot receive it provided the requirements of the definition in section CX 2(1) are met and the benefit is provided in respect of the employment of the employee.

102. This interpretation is supported by the scheme of the FBT rules. Section CX 2(1) defines the term “fringe benefit” broadly. It is not necessary for the purposes of the FBT rules for the benefit to be something that the employee could not otherwise be able to receive or that the public is unable to receive. All that is required is that something needs to be provided to the employee that falls within the definition of “fringe benefit” in section CX 2(1). In the Commissioner’s opinion, this applies equally to section CX 2(2). If something is provided to the employee by a third party that would have been a fringe benefit had it been provided by the employer, it will be subject to FBT by virtue of section CX 2(2).

103. Therefore, for there to be a benefit under section CX 2(2) all that is required is that a “fringe benefit” (as defined in section CX 2(1)) is provided to the employee by a third party (in addition to regular salary or wages) pursuant to an arrangement between the employer and the third party for the provision of that thing, and the employee must take advantage of or use that thing. This conclusion is consistent with “The meaning of ‘benefit’ for FBT purposes”, *Tax Information Bulletin* Vol 18, No 2 (March 2006), which states that “[i]n terms of the scheme of the FBT regime, a ‘benefit’ means what is received by the employee, without regard to any contribution made by the employee”.

Meaning of “provision”

104. Section CX 2(2) requires that a benefit be “provided to an employee through an arrangement”. For a benefit to be caught under section CX 2(2) it must have been provided to the employee by the third party. It is not sufficient that there is an “arrangement” between the parties that is merely for access to premises, the “arrangement” must be “for” the provision of a benefit for section CX 2(2) to apply.

105. The *Concise Oxford English Dictionary* (11th ed, revised, 2006) defines the term “provide” as “make available for use; supply”.

106. Several cases have discussed the meaning of the word “provide”. These cases show that the meaning of “provide” depends on the facts and circumstances of each case. For example, in *Ginty v Belmont Building Supplies Ltd* [1959] 1 All ER 414, Pearson J stated (at page 422):

I do not think that there is any hard and fast meaning of the word “provided”; it must depend on the circumstances of the case as to what is “provided” and how what is “provided” is going to be used.

107. In *Norris v Syndi Manufacturing Co Ltd* [1952] 1 All ER 935, an employee had removed the safety guard from a machine in order to carry out tests. His employer was aware that the employee took the guard off to test the machine, and had told him to replace it “after testing and before operation”. The employee inadvertently injured himself while working without the guard one day. The Court of Appeal found that the guard had been “provided” by the employer, and that the duty to provide the guard did not require that the employer should have to order the workers to use it. Romer LJ stated (at page 940):

The primary meaning of the word “provide” is to “furnish” or “supply”, and accordingly, on the plain, ordinary interpretation of s. 119 (1), a workman’s statutory obligation is to use safety devices which are furnished or supplied for his use by his employers.

108. The meaning of “provide” has been considered by the Employment Court of New Zealand in *Tranz Rail Ltd (T/A Interisland Line) v New Zealand Seafarers’ Union* [1996] 1 ERNZ 216. In that case, the issue was whether a statutory requirement that the employer provide food and water to the seafarers meant the employer had to provide them with free food and water or merely ensure facilities were available for the employees to have access to food and water. Colgan J stated (at page 227):

The applicant’s principal argument is that the plain words of the statute allow an employer of seafarers either to agree to provide food and water without cost to an employee or to do otherwise whether by negotiation as part of a collective employment contract or by the imposition of charges for such provisions. Ms Dyhrberg submitted that to achieve an interpretation as sought by the respondents, the Court would be required to add to the statutory words a phrase such as “without cost to such employees” or the like. Ms Dyhrberg submitted that the word “provide” means make available but no more. Counsel conceded that this interpretation would mean that an employer of seafarers would be entitled to charge an employee for water consumed, although stressed that such an outcome would be unlikely in any event.

Ms Dyhrberg submitted that to “provide” is to provide the opportunity of having the appropriate supplies of food and water. I find however that in this context the natural and ordinary meaning of the word “provide” in relation to food and water on ships is to supply without cost to the recipient seafarer.

109. The Australian Administrative Appeals Tribunal in *Pierce v FCT* 98 ATC 2240, considered whether a car had

been provided to an employee. The tribunal stated (at page 2,247):

There is no reason why “provides” should not be given its ordinary English meaning, namely “to furnish or supply” (Macquarie Dictionary).

110. For something to have been “provided” to an employee by a third party in the context of section CX 2(2), it must be supplied, furnished, or made available to that employee.

Salary sacrifice situations

111. This Ruling does not consider or rule on the taxation implications of salary sacrifice situations. In the context of the Ruling, this includes situations where the remuneration given by an employer to an employee is reduced because of a benefit being received by the employee from the third party (or because of the possibility of a benefit being received), or where the remuneration of the employee otherwise takes the receipt of a benefit provided by a third party into account.

112. It is considered that different considerations may apply to the tax treatment of such situations, for example, the benefit may have been provided by the employer in such a situation, or there may be other relevant aspects of the arrangement, and this Ruling has not considered the taxation implications of salary sacrifice situations.

Period of Ruling

113. This Ruling commences on the first day of the 2008/09 income year. The previous Ruling expired on 19 May 2007. Given the terms of section 91C of the Tax Administration Act 1994, it is not possible to issue a ruling in respect of the Income Tax Act 2004 for the period beginning 20 May 2007 to the end of the 2007/08 income year. However, the Commissioner’s view is that the same principles and conclusions as set out in this Ruling apply to an arrangement of the type covered by the Ruling for this period.

Examples

114. The following examples are included to assist in explaining the application of the law. They consider whether the requirements of section CX 2(2) are satisfied. The examples do not consider whether FBT will be payable on a benefit provided through an arrangement to which section CX 2(2) applies. It might be possible that section CX 2(2) applies but FBT will not be payable, as a result of the other provisions in subpart CX or because of the operation of the valuation rules contained in subpart RD.

115. These examples all assume that there has been no sacrifice of salary by the employee receiving the benefit.

Example 1

116. ABC Bank wishes to offer the employees of XYZ Ltd a low-interest loan facility. ABC approaches XYZ, which agrees to ABC's offer and agrees to pay ABC the difference between the interest rate offered to employees and the current market interest rate.

117. On the facts of this example, the requirements of section CX 2(2) are clearly satisfied. An "arrangement" exists between ABC and XYZ, and the purpose of the employer is to allow the provision of a benefit to XYZ's employees. This is evidenced by the fact consideration has been passed between the employer and the third party in respect of the benefit being provided.

Example 2

118. A credit card company approaches the manager of BCE, and asks whether BCE would allow it to approach BCE's employees to offer them credit cards (for the employees' personal use). The credit card company proposes that all staff members who choose to receive cards would be allowed to join the credit card company's loyalty scheme (which has no joining fee, but is available only to selected cardholders). BCE agrees to this request, but suggests that the credit card company might wish to provide a slightly discounted interest rate to the employees, so that the offer does not waste the employees' time. The credit card company agrees to this change. BCE provides no consideration to the credit card company. The credit card company is keen to secure BCE employees as customers and is happy to agree to offer the employees the additional benefits.

119. In this example, there is an "arrangement" between the employer and the third party. The employer and third party have agreed to the third party undertaking a particular course of action. However, section CX 2(2) will not apply in this situation. The agreement does not include the provision of a benefit, but merely allows the credit card company access to BCE's employees to offer them a benefit. The main purpose of the employer in entering into the arrangement is to allow the credit card company to offer a benefit to their employees that will be of potential interest to the employees. The provision of a benefit, if it is a purpose of the employer, will be incidental to this. Therefore, any benefit received by the employee from the credit card company will not amount to a "fringe benefit" under section CX 2(2).

Example 3

120. A local retailer approaches MNO Ltd, and asks permission to display advertising brochures on MNO's premises and for MNO to place an advertisement on the company's intranet. After a cursory inspection of the brochures and advertisement, MNO agrees. MNO also agrees to allow the retailer to email interested staff with updated specials (staff are given the opportunity not to receive the email updates). The brochures and subsequent email messages invite the employees to join a loyalty programme, which gives them the possibility of receiving rewards.

121. In this example, there will be an "arrangement" between the employer and the third party, as they have agreed on a future course of action. However, the arrangement will not be "for" the provision of a benefit. The employer has agreed only to allow the third party access to its employees, and this is their main purpose in entering into the arrangement. Any purpose the employer may have of benefiting their employees is incidental to this purpose. The "arrangement" is "for" access to the employer's premises or to allow the third party to communicate with the employees directly or by electronic means, not to provide a benefit to employees. Hence, any reward received by an employee under the loyalty programme will not amount to a "fringe benefit" under section CX 2(2).

Example 4

122. BB Ltd is a large company with several high net worth employees. BB contacts its bank and asks the bank to offer a low interest mortgage facility to BB's employees, which would also permit employees to obtain a mortgage with a smaller deposit than would usually be required. BB believes the bank will agree to this request because BB has a lot of business with the bank. Additionally, it is expected that the bank will get a great deal of business from the employees of BB, because BB has told the bank it is aware of a reasonable number of staff members who would be interested in such a facility. The bank is attracted by the level of business it might achieve with the employees, and is also keen to maintain the good relationship it has with BB, so it puts together a proposal, which it presents to BB. BB considers that the proposal is worthwhile, so asks the bank to make the facility available to employees. BB also agrees to help promote the facility by putting up posters and

making brochures available in the workplace, and by sending an email message to staff informing them of the facility.

123. In this example, there is an “arrangement” between BB and the bank that is “for” the provision of a benefit to employees. The course of action agreed to by the parties involves the provision of a benefit to employees. BB has not simply entered into the arrangement with the purpose of allowing the bank access to the employees. Rather, BB has entered into the arrangement with a more than incidental purpose of providing employees with a benefit. This is evidenced by the fact BB has an expectation that the bank would comply with its request and because it is aware of staff members who would be interested in the facility. Therefore, section CX 2(2) will apply to this arrangement.

Example 5

124. STU Ltd and VWX Ltd are both companies in the same group of companies. The group has a widely understood policy that all companies in the group will provide discounted products or services to all employees of companies in the group, although this policy has never been put into writing. STU, therefore, provides interested VWX employees with discounts on its products.
125. In this example, there will be an “arrangement” for the provision of a benefit, and VWX will be liable to FBT on any benefits received by its employees from STU. There is a group policy that each company will provide the employees of the other companies in the group with benefits. Therefore, there is an understanding between the employer and the third party that each will act in a particular way, that understanding extending to the provision of a benefit, and the purpose of the policy is to allow employees to be provided with benefits by a third party. Therefore, section CX 2(2) will apply.

Example 6

126. DFG, a travel agent, employs several staff and enters into a scheme with YTR, an airline, to strengthen its relationship with YTR. The scheme involves YTR agreeing to give a certain number of free domestic flights per year to employees of DFG who excel in promoting and selling YTR flights. In return, DFG agrees to have its employees promote YTR flights and convert flights to YTR wherever possible.

To determine which employees are entitled to free flights, DFG awards its staff with points for outstanding customer service. Once a staff member has accumulated the required number of points, they are entitled to a free flight from YTR. There is no cost to DFG for those flights.

127. In this example, section CX 2(2) will apply. There is an “arrangement” between the parties, as the course of action agreed to by DFG and YTR involves the provision of a benefit to employees. One of the main purposes of DFG in entering into the arrangement is to provide the staff with free flights. Although DFG has another significant purpose in entering into the arrangement, which is to strengthen its relationship, the purpose of providing a benefit to employees is not incidental to that purpose.

Example 7

128. HJK is a large nationwide employer with many staff. A senior manager of HJK approaches LMN, a nationwide chain of retail stores, and suggests that LMN might like to consider offering a discount to HJK employees. LMN agrees to consider this idea, and later decides to allow a 10% discount to all HJK staff at all of its stores. (This is achieved by providing all employees with a discount card.) HJK does not give any consideration for this, has made no suggestion that it will do business with LMN if a discount is permitted, and has not been involved in discussions about the level of the discount or any other details of the offer. LMN has decided to offer the employees the discount, because it believes LMN will obtain a substantial amount of business.
129. Section CX 2(2) will not apply in this situation. There is no “arrangement” between the parties that encompasses the provision of the benefit, as the only course of action agreed to by the parties is that LMN will consider the idea. HJK has done no more than initiate discussions with LMN, and the decision to offer a benefit to employees was made unilaterally by LMN. Although the purpose of HJK could be argued to be the provision of a benefit, there is no “arrangement” with LMN that is “for” such provision.

Example 8

130. An employee works for a company. She obtains a personal credit card and joins its associated points reward scheme. Under that scheme, she can accumulate points as goods and services are charged

on the credit card. After the employee accumulates 10,000 points, she can transfer those points, at her option, to any one of several airlines' frequent flyer schemes affiliated to the credit card company's points reward scheme. Once she accumulates a specified number of points on the airline frequent flyer scheme, she can exchange them for free or discounted travel.

131. In the course of the employee's work, she incurs several employment-related charges on the credit card as well as private expenditure. The employee accumulates points on the credit card points reward scheme for both types of expenditure. She soon reaches the specified threshold of points, and transfers them to a particular airline's frequent flyer scheme, exchanging them for a free trip to Fiji.
132. Section CX 2(2) will not apply on the facts of this example. The receipt of the points under the credit card company's points reward scheme is because of the contractual arrangement between the credit card company and the employee. No arrangement exists between the employer and the credit card company to provide the employee with entitlements under its points reward scheme or the associated airline's frequent flyer scheme. It does not matter that some of the points that give the entitlement result from employment-related expenditure.

Example 9

133. Following from example 8, in the following year the employee is promoted in the company and receives a corporate charge card on which she is specified as the cardholder. The charge card is from a different company to that which issued her personal card. This particular charge card company also allows cardholders to join its points reward scheme. The employee joins the points rewards scheme as an individual member and pays the membership fee personally. The employee's employer is not involved in encouraging the employee to join the scheme. This scheme also allows an accumulation of points as goods and services are charged on the card and a transfer of points, subject to certain conditions, to a participating airline's frequent flyer scheme.
134. Any entitlement received by the employee under the credit card company's points reward scheme will not amount to a "fringe benefit" under section CX 2(2). There is no arrangement between the employer and the credit card company to provide entitlements to the employee under the points reward scheme.

The employee receives those entitlements because of her contractual relationship with the credit card company.

Example 10

135. QRS purchases motor vehicles for business purposes from a motor vehicle dealer. As a result of QRS' substantial custom, the dealer states that it will discount QRS' future purchases. It also informs QRS that the more vehicles purchased, the greater the discount. In order to increase the discount, QRS suggests to the dealer that it offer the same discount to the employees of QRS. QRS tells the dealer that many of its employees would like to purchase vehicles and it expects that they would be induced to buy vehicles from the dealer if they were offered the same discount. The dealer agrees that it will offer the employees the same discount as it provides to QRS.
136. In this example, QRS has requested that the dealer provide its employees with a discount on any vehicles they purchase. Because of QRS' substantial custom, the dealer agreed to offer the discount to the employees. There is an arrangement between the dealer and QRS that is for the provision of a benefit (i.e. the discount) to the employees. Although the dominant purpose of QRS may be to obtain a higher discount on its future vehicle purchases, a significant purpose of it entering into the arrangement is so that the same discount is offered to its employees. Therefore section CX 2(2) will apply, because QRS made the arrangement with a more than incidental purpose to provide its employees with a benefit.

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.

DIRECTOR TO REPRESENT COMPANIES IN APPEAL

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| Case | Commissioner of Inland Revenue v Chesterfields et al |
| Decision date | 31 July 2009 |
| Act | Not applicable |
| Keywords | Legal representation, director, company, <i>Mannix</i> rule |

Summary

The Court of Appeal has allowed the director of two companies to represent them in Court, finding the case was an exception to the established rule in the *Mannix* case.

Impact of decision

The decision is a conventional use of the exception to the *GJ Mannix* rule. The fact the director was already before the Court in his personal capacity was a key consideration.

It was made clear that the individual could expect no "indulgences" when presenting the case for the taxpayers and only strict compliance with the court rules was acceptable.

The parties have been involved in a long-running judicial review which the Commissioner is appealing. Previous decisions are reported at (2007) 23 NZTC 21,125 and (2009) 24 NZTC 23,148. The taxpayers are one individual (Mr Hampton) together with two partnerships involving Mr Hampton and two companies of which Mr Hampton is the director.

The taxpayers had been represented at the High Court by legal counsel but that counsel had withdrawn for the conduct of the appeal. Mr Hampton, as director of two companies that were parties to the matter, sought to appear for the companies. Mr Hampton is legally trained but is not a practicing lawyer. He was able to appear in his own right and as a partner in two partnerships involved in the matter (he could not purport to represent the other partner).

The Commissioner opposed Mr Hampton's application on the basis that the rule in *Re GJ Mannix Ltd* [1984] 1 NZLR 309 applies. That rule requires any company in proceedings to be represented by a legal counsel and does not allow a director to appear for the company except in exceptional circumstances.

Decision

The Court accepted the continuing application of the rule established in the *GJ Mannix* case (par [12]–[14]), but considered this was a case where an exception to the rule should be made (par [18]).

In allowing the director's application the Court said:

[16] Of the factors in this case which strike us as being of great importance, Mr Hampton has the right to represent himself as second respondent, and in respect of his partnership interests in the third and fourth respondents. In short, he is already "in court" as it were, and will continue to be so. Further, there is a linkage between him and the companies and he has some legal training.

Noting that his "legal work" (Courts own quote marks) is "well below what this Court would normally expect of somebody with a legal qualification" (at par [17]), the Court concluded with a warning:

[19] We therefore allow Mr Hampton's application, but we make this observation. Mr Hampton cannot expect indulgences. He has to comply strictly with the rules of court, as do all other litigants in this Court.

“STRUCTURED FINANCE” TRANSACTIONS ARE TAX AVOIDANCE ARRANGEMENTS

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| Case | BNZ Investments Limited & Ors v Commissioner of Inland Revenue |
| Decision date | 15 July 2009 |
| Act | Income Tax Act 1994 |
| Keywords | Structured finance, rulings, conduit regime, tax avoidance |

Summary

Six structured finance transactions entered into by BNZ are tax avoidance arrangements and are therefore void as against the Commissioner for income tax purposes.

Impact of decision

As with all tax avoidance cases, the decisions are specific to the facts. However, this decision is an indication of how a Court of first instance will apply the indicia and criteria as set out in the Supreme Court’s *Ben Nevis* decision in a tax avoidance case.

It is likely that this decision will be considered by the Courts when deciding other structured finance cases that come before them.

The decision has been appealed by the disputant.

Facts

BNZ Investments Limited (“BNZ”), during 1998 and 2005 entered six “structured finance” transactions. BNZ borrowed money to fund those transactions and incurred interest costs in relation to that borrowing. The return on those transactions was by way of income that was free of income tax because of, in one transaction, a foreign tax credit (“FTC”) and, in the other five, the operation of the conduit regime. Each of these transactions involved the provision of NZD\$500 million of funding.

As part of the transactions, BNZ paid a guarantee procurement fee (“GPF”) to the counter-party in the transactions for that counter-party to obtain a guarantee from its parent that the funds would be repaid.

Before entering the above six transactions, BNZ had obtained positive Rulings from the Commissioner in respect of two arguably similar transactions.

The Commissioner disallowed the deductions claimed in respect of the incurred interest costs and the GPF on the basis that the transactions were tax avoidance arrangements and were therefore void as against the Commissioner. The Commissioner further disallowed the

GPF on a black letter law basis. It was these disallowances that were challenged by BNZ.

The transactions were complex and involved numerous steps but the above issues were the key elements for publication purposes.

Decision

The Court decided that the obtained Rulings were not relevant. The reasons for this were twofold:

1. that a binding ruling only applies to the transactions ruled upon
2. that the six transactions were not identical to the transactions that were ruled upon (paragraph 45 of the decision).

The Court decided that the GPF was deductible on a black letter law basis as it was by definition a “financial arrangement” (paragraphs 143–162).

Before the Court proceeded to consider whether the transactions were tax avoidance arrangements, it considered the Supreme Court’s decision in *Ben Nevis* [2009] 2 NZLR 289. This was to determine how the law relating to tax avoidance should be applied. The Court determined that to apply *Ben Nevis* correctly a two-step inquiry was required.

That two-step inquiry was summarised as follows (paragraph 137):

- a) Step 1 requires me, upon an ordinary interpretation of the applicable specific provisions to decide whether the arrangements comply with those provisions.
- b) Step 2 requires me to decide, upon the scheme and purpose of the Act including section BG 1, whether the legislature would have contemplated and intended that the specific provisions be deployed as they were deployed by the taxpayer in the transactions in issue.

As the Commissioner had not disputed the claimed interest deductions on a black letter law basis and the Court had found that the GPF was deductible at a black letter law level the Court proceeded to step 2.

The Court found that the transactions were not within the scheme and purpose of the FTC regime or the conduit regime (paragraphs 487 and 491).

The Court found that the GPF was a contrivance (paragraph 511).

The Court set out six principal reasons why it considered that the transactions were caught by section BG 1 and were therefore tax avoidance arrangements (paragraph 526).

The Court held that all the deductions disallowed by the Commissioner were integral parts of the tax avoidance

arrangements and were therefore correctly treated as void under section BG 1 (paragraph 539). Therefore the Commissioner's reconstruction was correct.

NO EXCEPTIONAL CIRCUMSTANCES TO ALLOW A CHALLENGE OUTSIDE THE RESPONSE PERIOD

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| Case | TRA Decision No 12/2009 |
| Decision date | 19 June 2009 |
| Act | Tax Administration Act 1994 sections 3, 113 and 138D |
| Keywords | Challenge proceedings, extension of time, accounting error, agent, exceptional circumstances, event or circumstance beyond taxpayer's control |

Summary

The Taxation Review Authority ("TRA") could not allow the taxpayer to commence challenge proceedings after the statutory response period because the exceptional circumstances required by section 138D of the Tax Administration Act 1994 ("TAA") did not exist in this case. The alleged errors of the taxpayer's accountant were not beyond the control of the accountant as the taxpayer's agent, and could have been anticipated. Whether personnel are to be treated as employees or as contractors is a basic element of business, and the error could have been avoided by compliance with accepted standards of business organisation and professional conduct. The failure of the taxpayer's director to discover the errors in time was also not an event or circumstance beyond the taxpayer's control.

Impact of decision

The Authority held that a taxpayer may not challenge a decision by the Commissioner to not exercise his discretion in section 113 of the TAA to make an amended assessment; ie a taxpayer may not challenge a decision by the Commissioner to not amend an assessment under section 113 of the TAA. If the Commissioner does make a new assessment under section 113 of the TAA, then the new assessment is amenable to challenge in the usual way notwithstanding section 138(1)(e)(iv) of the TAA.

The decision also illustrates the implementation of the test in the Court of Appeal decision *CIR v Fuji Xerox NZ Ltd* (2002) 20 NZTC 17,470, on "exceptional circumstances" for allowing a challenge to be filed outside the response period.

Facts

The Disputant (a company), having filed its returns on the basis that its staff were employees, when faced with

liquidation proceedings brought by the Commissioner, sought to amend its assessments to reduce the tax debt upon which the liquidation was based.

The Disputant asserted that its various returns between 1 April 2004 and 31 March 2007 were in error, and that the mistake was occasioned by its external accountants incorrectly treating its staff as employees, when they were allegedly contractors. The Commissioner declined to exercise his discretion under section 113 of the TAA to amend the assessments.

Decision

There were no "exceptional circumstances" within the meaning of section 138D(2) of the TAA, and as such the Authority did not have jurisdiction and/or discretion to grant the application to file a challenge after the response period (at [4] [13]).

The Disputant had not clarified the errors which were claimed to be "exceptional circumstances" that caused the challenge to not be filed within time. Hence, the Authority considered the relevant act or omission to be the two alternatives as stated by the Commissioner. The first was the accountant's alleged ongoing error in treating the staff as employees when they were allegedly contractors. The second was the omission of the director of the Disputant to take timely independent advice despite, on his own evidence, the fact he was aware that there was a taxation problem "over the years from 2003 to 2007".

Applying the test in *CIR v Fuji Xerox NZ Ltd*, the Authority (at [27]) reached the view that in respect of the accountant's error none of the elements of the conditions in section 138D(2) of the TAA were satisfied, when all three must be satisfied together for an agent's conduct to be an "exceptional circumstance". The acts or omissions were not beyond the control of the accountant, could have been anticipated and the ongoing misunderstanding as to the proper accounting treatment of the staff for tax purposes could have been avoided by compliance with accepted standards of business organisation and professional conduct. The actions or omissions of the accountant (agent) were not beyond the control of the Disputant; the accountant acted at the direction of the Disputant.

In respect of the alternative (ie, that the relevant error was the omission of the director of the Disputant to take independent advice despite becoming aware that there was a taxation problem), that omission was a routine business decision and not an "exceptional circumstance" either (at [31]). The Authority further applied *Milburn NZ Ltd v CIR* (1998) 18 NZTC 14,005, reaching the view that it could not say that the omission by the director was "beyond the control" of the Disputant (at [32]).

The Authority considered that section 138E(1)(e)(iv) of the TAA means what it says, and that in this case, there was no right for the Disputant to challenge a decision of the Commissioner to not exercise his discretion in section 113 of the TAA in favour of the Disputant (at [36]).

The Authority specifically noted that, to be fair to the accountant, it may be that the accountant has at all times acted competently and properly but that the Disputant is retrospectively attempting to change the status of its employees.

DECISION TO IMPOSE SECTION HK 11 DISPUTABLE

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| Case | Commissioner of Inland Revenue v Colin Skudder |
| Decision date | 15 July 2009 |
| Act | Income Tax Act 1994, Tax Administration Act 1994 |
| Keywords | HK 11 disputable decision |

Summary

The Commissioner assessed the director of the company under the provisions of section HK 11 ITA 1994 without first issuing a Notice of Proposed Adjustment (“NOPA”). When debt recovery action was taken, the District Court found that it could not impose judgment on the director because the Commissioner’s decision to impose the provision of section HK 11 was subject to dispute in the Taxation Review Authority.

Impact of decision

The Commissioner does not intend to appeal this decision. He considers that, although there are arguments to the contrary, the Court, following the decision in *Spencer & Anor v CIR* (2004) 21 NZTC18, 818, has held that a decision to transfer tax liability to a company director under section HK 11 of the Income Tax Act 1994 (now section HD 15) is a “disputable decision”.

Facts

The defendant was the sole director of a company which was assessed for pre-liquidation tax on 10 February 2002. The Commissioner imposed the provisions of section HK 11(1) and (3) of the Income Tax Act 1994 and claimed that the defendant was liable for the pre-liquidation debt of the company.

No notice of proposed adjustment was filed by either the company or the defendant in relation to the pre-liquidation assessments of the company. On 25 April 2005 the Commissioner sent the defendant a notice purporting to

make the company and the defendant joint and severally liable for the debt. Recovery proceedings were commenced on 20 May 2006.

The Statement of Defence by the defendant challenged the decision of the Commissioner to invoke section HK 11 and claimed that it was a “disputable decision” in terms of Part VIII A of the Tax Administration Act 1994 (“TAA”), making the decision amenable to challenge before the Taxation Review Authority (“TRA”) and therefore outside the jurisdiction of the District Court to determine. The counsel for the defendant also issued a NOPA to the Commissioner in relation to the decision to invoke section HK 11 but not in relation to the tax assessed to the company.

Decision

Gittos DCJ held:

The Commissioner has argued that the decision under HK 11 as to whether the defendant’s liability as an agent is properly made is not by statutory definition a disputable decision (section 138E of the TAA), and accordingly not a matter which may be challenged within the statutory code before the TRA.

Spencer is an obstacle to the Commissioner’s argument. Despite the defendant’s failure to put in returns with his NOPA, his case could not, on the facts, be distinguished from *Spencer*.

While it appears there are some parts of HK 11 which may be amenable to being regarded as non-disputable decisions under section 138E of the TAA, neither the findings of fact to be made under HK 11(1)(a), (b) and (c) which are necessary to trigger the operation of HK 11(3), nor the substantive decision to treat any person as an agent under HK 11(3) are to be so construed.

LEGAL EXPENDITURE ALLOWED IF MEETS “PRINCIPAL PURPOSE” TEST

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| Case | Commissioner of Inland Revenue v Trustees in the Mangaheia Trust and Trustees in the Te Mata Property Trust |
| Decision date | 29 July 2009 |
| Act | Goods and Services Tax Act 1985 |
| Keywords | Input tax credits, section 3A(1)(a), principal purpose |

Summary

The High Court found that the trustees of the Mangaheia and Te Mata Property Trusts were entitled to deduct GST input tax credits in relation to legal services acquired for litigation proceedings. Legal services acquired by

the trustees were acquired for the principal purpose of making taxable supplies. The High Court also found that the “principal purpose” test has to be met before GST on services and supplies can be claimed as an input tax under section 3A(1)(a) of the Goods and Services Tax Act 1985 (“GST Act”).

Impact of decision

The High Court has clarified the law in regard to the meaning of section 3A of the GST Act. If there is sufficient nexus between the services acquired and the making of the taxable supplies, the services will have been obtained for the principal purpose of making taxable supplies.

Each case requires a factual inquiry and the “principal purpose” test has to be met before the GST on services and supplies can be claimed as an input tax credit.

Whilst not overturning the Taxation Review Authority’s findings of fact, the High Court has confirmed the Commissioner’s view that section 3A(1)(a) of the GST Act is more than just a “filter” and stated the law in a fashion not inconsistent with the Commissioner’s view that section 3A(1)(a) is to be read in conjunction with section 21 of the GST Act.

For clarity, the Commissioner’s position is not that accounting and valuation fees were (and often are) allowed because they do not amount to large sums.

The Commissioner will not appeal this decision.

Facts

The trustees of the two disputant trusts claimed GST input tax credits for fees for legal services arising out of protracted litigation concerning a number of trusts. The Commissioner disallowed the claims and the disputants successfully challenged that in the Taxation Review Authority; TRA Nos 67/05 and 70/05.

The Commissioner appealed against the decision of the Taxation Review Authority that the Commissioner acted incorrectly in disallowing the two disputant trusts GST input tax credits claimed by the trustees for legal fees.

The Commissioner brought this appeal on the basis of the following:

- a) The Authority was incorrect in finding that the legal services acquired and the fees paid by the trusts were acquired for the principal purpose of making taxable supplies.
- b) The Authority erred in law by reading down the “principal purpose” test required under section 3A of the GST Act.

- c) The Authority’s approach to the “principal purpose” test was flawed and it was incorrect to say that section 3A(1)(a) of the GST Act operates as a “filter” between the making of taxable supplies and exempt supplies.

Decision

Whether the Authority erred in law by reading down the principal purpose test under section 3A of the GST Act 1985

The High Court found that considering whether there is sufficient nexus is an eminently sensible way of approaching the principal purpose test because:

... if there is an insufficient nexus between the acquisition of goods or services in the making of taxable supplies, then logically it could not follow that the goods or services were acquired for the principal purpose of making taxable supplies. [23]

This nexus must be a question of fact. One way of approaching the factual inquiry whether the services were acquired for the principal purpose of making taxable supplies is to ask whether there is a sufficient nexus between the services acquired and the making of the taxable supplies. If the principal purpose was something other than the making of taxable supplies then the conclusion should be there was insufficient nexus.

Inherent in the definition of a taxable supply is that it must be in the course or furtherance of the taxable activity.

In terms of claiming for a business expenditure, the reference to “making taxable supplies” is to be read widely. There is no requirement that the specific expenditures on which input tax credits are claimed need to be directly linked to the specific resulting products. This would be contrary to the overall balancing out effect which the legislation seeks to achieve; see *Glenharrow Holdings v Commissioner of Inland Revenue* [2009] 2 NZLR 359

On the finding of the Taxation Review Authority that section 3A of the GST Act is a filter, the Court found that:

The reference to there being a “filter” was not entirely apt. The principal purpose test has to be met before the GST on services and supplies can be claimed as input tax. [36]

The High Court found that the Taxation Review Authority’s reference to section 3A of the GST Act as a “filter” is ambiguous, but reading the decision as a whole, there is no doubt that the Authority’s decision does not involve any departure from the ordinary meaning of the words “principal purpose”.

Whether the legal services acquired (and fees paid) by the trusts were for the principal purpose of making taxable supplies

It is not appropriate that a presumptive approach that virtually anything a trustee, and thus the trust, does *intra vires* might meet the “principal purpose” test. There may be circumstances where the “principal purpose” threshold is not met even though a trustee is acting *intra vires*. Every case is a factual inquiry and in the case of the trusts, regard had to be given to the terms of the trust deed, the taxable activity and the exact nature of the trustee’s actions so as to establish on the facts whether the “principal purpose” test has been satisfied.

The High Court found that the Authority did address the need for some nexus between the expenditure on legal fees and the taxable activity of the two trusts.

The Authority was aware of the statutory requirement to apply the exact wording of section 3A of the GST Act and, as a whole, the Authority’s decision did not depart from the ordinary meaning of the words “principal purpose”.

The Court found that the Authority was correct on the facts and the law, and the two trusts were entitled to claim the GST input tax credits for fees for legal services acquired by the trusts for the purpose of the litigation. The High Court dismissed the Commissioner’s appeal.

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