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TAX INFORMATION Bulletin

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Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

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

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

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

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

IN SUMMARY

Legal decisions – case notes

BINDING RULINGS

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

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

PRODUCT RULING BR PRD 15/03: MINISTRY OF BUSINESS, INNOVATION AND EMPLOYMENT

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by the Ministry of Business, Innovation and Employment (the MBIE).

Taxation Laws

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

This Ruling applies in respect of ss 5 and 8 and the definition of "consideration" in s 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the charging of an annual levy (Levy) under s 89 of the Telecommunications Act 2001 (the TA) on liable telecommunication operators by the Minister of Communications and Information Technology (Minister), currently responsible for the administration of the TA.

The Levy was introduced by the Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011 by substituting the current ss 87 to 92 into the TA.

The Levy is collected by the MBIE (the Ministry responsible for administering the TA for the Minister).

Pursuant to s 90 of the TA, the Levy may be used for the following purposes:

- to pay telecommunications service obligations (TSO) charges:
- to pay for non-urban telecommunications infrastructure development:
- to pay for upgrades to the emergency service calling system:
- any other purpose that the Minister considers will facilitate the supply of certain telecommunications services to groups of end-users within New Zealand to whom those telecommunications services may not otherwise be supplied on a commercial basis or at a price that is considered by the Minister to be affordable to those groups of end-users.

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

Background

1. The New Zealand telecommunications market is regulated by the TA, which provides the regulatory framework for the supply of certain telecommunications services.
2. In 2011, the Telecommunications (TSO, Broadband, and Other Matters) Bill (2011 Bill) was introduced into Parliament and referred to the Commerce Select Committee for consideration. The 2011 Bill introduced the Levy as a levy that "will be collected from industry participants annually" to "consolidate the statutory mechanisms for industry funding of telecommunications service and sector development obligations". The Explanatory Note to the 2011 Bill relevantly stated that:

> The Telecommunications (TSO, Broadband, and Other Matters) Amendment Bill (the **Bill**) amends the Telecommunications Act 2001 (the **Act**) to support the implementation of the Government's policy programme for the telecommunications sector. The Bill achieves this intent by providing for amendments to—
>
> - streamline the administration of TSO instruments:
> - consolidate the statutory mechanisms for industry funding of telecommunications service and sector development obligations:
> - establish a regulatory framework for the enhanced broadband networks that will be developed under the UFB Initiative and the RBI with the support of Crown funding.
>
> ...
>
> **Overview of the Telecommunications (TSO, Broadband, and Other Matters) Amendment Bill**
>
> *Part 1*
>
> *Part 1* of the Bill contains amendments to Part 3 of the Act, which sets out a legislative framework for the

declaration and management of TSO instruments. These instruments are service agreements between the Crown and a service provider for the delivery of telecommunications services that would not otherwise be delivered on a commercial basis or at an affordable price.

The Bill—

- *amends the basis for calculation of the net cost* of deemed TSO instruments, including the Telecommunications Service Obligations (TSO) Deed for Local Residential Telephone Service (the **Local Service TSO**) provided by Telecom, to ensure that the full benefits a provider accrues from provision of the required services are considered when determining whether additional compensation should be paid to the provider; and
- *streamlines the legislative funding mechanisms* for TSO instruments by introducing a new Telecommunications Development Levy (the **TDL**), which will be collected from industry participants annually and be used for the payment of TSO-related compensation, non-urban telecommunications infrastructure development, and upgrades to the emergency services calling system.

3. The amendments to Part 3 of the TA came into force on 1 July 2011. The Levy is payable under s 89 of the TA by liable persons who exceed the minimum telecommunications revenue threshold, as set out in ss 80 and 81 of the TA (meaning they earned more than $10 million in gross telecommunications revenue in the year preceding the year being considered in calculating the Levy).

4. Section 5 of the TA defines "liable person" as:

> **Liable person** means a person who provides a telecommunications service in New Zealand by means of some component of a PTN [public telecommunications network] that is operated by the person

5. "Minimum telecommunications revenue" is defined in s 80 of the TA as:

> **minimum telecommunications revenue** means $10 million, or such other amount, as may be prescribed by regulations made under section 101(1)(a), of gross revenue (as may be determined in accordance with any specifications set by the Commission) that a liable person receives during a financial year for supplying either or both of the following (excluding any amount paid to a liable person by the Crown as compensation for the cost of complying with a TSO instrument that contains a specified amount):
>
> (a) telecommunications services by means of its PTN:
>
> (b) telecommunications services by means that rely primarily on the existence of its PTN or any other PTN.

6. Section 81(1) of the TA provides that the Levy is not imposed on all liable persons:

> **81 Subpart does not apply to certain liable persons**
>
> (1) This subpart does not apply to a liable person in respect of a financial year (**financial year** A) if—
>
> (a) the liable person was not trading in the financial year preceding financial year A; or
>
> (b) the liable person's telecommunications revenue for the year preceding financial year A was less than the minimum telecommunications revenue.

7. The Levy is payable under s 89 of the TA. Pursuant to s 90 of the TA, the Levy may be used for the following purposes:
   - to pay TSO charges:
   - to pay for non-urban telecommunications infrastructure development:
   - to pay for upgrades to the emergency service calling system:
   - any other purpose that the Minister considers will facilitate the supply of certain telecommunications services to groups of end-users within New Zealand to whom those telecommunications services may not otherwise be supplied on a commercial basis or at a price that is considered by the Minister to be affordable to those groups of end-users.

8. The Crown will contract a service provider or service providers for goods and services that need to be provided under ss 90(1)(c) and (d) of the TA, rather than provide the goods and services itself.

9. Sections 82 to 88 of the TA set out the annual procedure for determining amounts payable by liable persons to the Crown. The process of charging, collecting and allocating the Levy is summarised in the following paragraphs.

Charging, collecting and allocating the Levy

10. At the end of the financial year, liable persons must provide the Commerce Commission (Commission) with information regarding their qualified revenue for the financial year: s 83 of the TA. The Commission prepares a draft liability allocation determination that is publicly notified and open for submissions: s 84 of the TA.

11. Under s 85 of the TA, the amount of the Levy payable by each liable person for the financial year is calculated using the following formula:

$$\frac{a}{b} \times c$$

where—

a is the amount of the liable person's qualified revenue b is the sum of all liable persons' qualified revenue

c is the telecommunications development levy specified for the relevant year in Schedule 3B of the TA.

12. The Levy is then paid by liable persons into the MBIE's Crown bank account.

13. In accordance with s 89(2) of the TA, if the Levy is not paid on or before the 20th working day after the date the determination is publicly notified, it becomes a debt to the Crown recoverable in any court of competent jurisdiction. Interest is payable on any unpaid amount at the 90-day bank bill rate plus 5% for the period any amount is outstanding.

14. Except as provided in s 94L of the TA, the Crown is not required to use any Levy amount within any particular time: s 90(3) of the TA. Under s 94L of the TA, the Crown must pay the TSO provider the amount set out in the final TSO cost calculation determination not later than 30 working days after the date that determination is publicly notified.

How the Taxation Laws apply to the Arrangement

Subject in all respects to the assumption stated above, the Taxation Laws apply to the Arrangement as follows:

a) The Levy does not constitute "consideration" (as defined in s 2(1)) for any "supply" (as defined in s 5) of goods and services made by the Crown.

b) The Levy charged to liable telecommunications operators under the TA by the MBIE is not subject to GST under s 8.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 November 2014 and ending on 1 November 2017.

This Ruling is signed by me on the 23 day of October 2015.

Dave Hames

Investigations Manager, Investigations and Advice

PRODUCT RULING BR PRD 15/04: HARBOUR FUND II GP LIMITED

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by Harbour Fund II GP Limited.

Taxation Laws

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

The Ruling applies in respect of ss BD 1(4), BD 1(5), BG 1, and YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the entering into of the Funding Agreement, and the receipt by Harbour Fund II Limited Partnership (the Fund) of proceeds (Proceeds) pursuant to individual funding agreements that the Fund will enter into with litigation claimants (the Claimants) to a class action against James Hardie New Zealand and the other James Hardie entities, under which the Fund will agree to pay all legal and other costs incurred by the Claimants, in return for a share of the proceeds.

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

Background to the Arrangement

1. The Fund is situated in the Cayman Islands and has been established to make litigation and arbitration funding available for all types of claims other than personal injury, divorce or defamation proceedings.
2. Under the law of Cayman Islands, the Fund does not have separate legal personality from its partners. The Fund is not the beneficial owner of its assets, which are held by Harbour Fund II GP Limited (the General Partner), in accordance with the terms of the Fund's limited partnership agreement.
3. The Fund provides funding for litigation claimants all around the world who have met certain criteria. The criteria include the creditworthiness of the defendant, the legal merits of the case, the expertise of the legal team and the likely legal fees.
4. The Fund is advised by Harbour Advisors Cayman Limited (the Investment Advisor) a company incorporated in the Cayman Islands. The Investment Advisor has been contracted by the General Partner under an investment advisory agreement (Investment Advisory Agreement) to perform investigation, evaluation and due diligence services in respect of potential claims for which funding is sought.
5. Preliminary investigation and due diligence services have in turn been subcontracted by the Investment Advisor to Harbour Litigation Funding Limited (the Sub-Advisor) which is a company incorporated in England and Wales, under a sub-advisory agreement (Sub-Advisory Agreement).
6. Details of the activities undertaken by the Investment Advisor and by the Sub-Advisor (together the Advisors) when investigating and evaluating potential claims are set out below.

Summary of the normal investment procedure

7. The Advisors ensure that the business of the Fund is known to interested parties. However, the Advisors do not actively or routinely seek to identify and locate specific claims for which funding might be provided.
8. Once a request for funding is received a confidentiality agreement is entered into, and the Advisors conduct a preliminary assessment. Information is gathered regarding the claim, and an immediate analysis is conducted to assess whether the claim is likely to satisfy the Fund's criteria. If the claim is unlikely to satisfy the criteria, it will generally be rejected at this stage.
9. If a claim passes the first stage of analysis, the Sub-Advisor will, if appropriate, enter into a letter of intent, usually with the claimant directly, but in the case of a class/group action, with the legal representative seeking funding on behalf of the claimants. This procedure has been adopted because there are too many claimants to execute separate documents with and they may not yet have been identified. The Sub-Advisor will then conduct a more detailed due diligence to ascertain whether the claim would be likely to meet the criteria for funding.
10. An Investment Committee established by the Investment Advisor then meets monthly to evaluate the legal merits of the cases for which funding is sought which satisfy the Fund's criteria. The Investment Committee reviews updates on the progress of existing funded claims.
11. At the conclusion of each meeting the Investment Committee, where appropriate, make a formal recommendation to the Board of the Investment Advisor, about investing in proposed new claims. The Investment Committee also reports to the Board of the Investment Advisor on existing funded claims if there have been material adverse developments in the case of existing funded claims.

12. The Board of the Investment Advisor then considers the recommendations made by the Investment Committee at its monthly meeting. Where the Board of the Investment Advisor considers that a proposed claim is likely to meet the Fund's criteria for funding, a recommendation is made by the Board of the Investment Advisor to the Board of the General Partner, which has the authority to invest in claims on behalf of the Fund.
13. The Board of the General Partner then meets monthly to consider the recommendations made by the Board of the Investment Advisor.
14. Where the Board of the General Partner (on behalf of the Fund) considers that a recommended claim is meritorious, the Fund will make funds directly available for the claim by entering into a funding agreement or funding agreements with the claimants.

How the decision to fund this Claim was made

15. The Sub-Advisor was approached in November 2014, via email, by a barrister working with Adina Thorn lawyers in relation to the possible funding of a representative action in relation to cladding supplied and fitted in buildings throughout New Zealand. The potential claim, would be based in negligence and breach of statutory duties, and was expected to involve over 500 Claimants with a claim for damages in excess of NZD $100m (the Claim).
16. In accordance with normal procedure summarised above, this approach for funding was subjected to the preliminary review and assessment process. It was subsequently concluded that the Claim could potentially satisfy the Fund's criteria.
17. Due diligence was then undertaken by the Advisors, and ultimately a recommendation was made to the Board of the General Partner that the Claim be approved for funding.
18. At its March 2015 meeting in the Cayman Islands, the Board of the General Partner approved the Claim for funding.
19. The parties then attended to the finalisation of anticipated timetables and funding amounts, and appropriate documentation was prepared for the Fund to record the terms on which funding would be provided to Claimants.
20. A draft of the Funding Agreement (the Funding Agreement) was prepared, to record the terms on which the Fund will make funding available to Claimants for their legal and other costs incurred in relation to the Claim. A draft relationship agreement (Relationship Agreement) was prepared to record the various invoicing and reporting requirements that will apply to the legal representative (the Legal Representative) acting for the funded Claimants throughout the proceedings.
21. The Relationship Agreement was finalised and entered into on 19 May 2015 by the Board of the General Partner and the Legal Representative. At the date that this Ruling is signed Adina Thorn lawyers are the Legal Representative, but the Claimants have the ability to appoint a replacement Legal Representative. The Funding Agreement was finalised around early August 2015 with Claimants progressively entering into the Funding Agreement from that time.

Funding Agreement

22. The Funding Agreement records the terms on which the Fund agrees to make funds available to Claimants (ie, individuals or groups who have suffered damage within the scope of the Claim) for Claimants Legal Costs. The phrase Claimants Legal Costs is defined in clause 20.1 of the Funding Agreement. It includes legal fees incurred in relation to the Claim, and any costs incurred by the Claimants (subject to certain exclusions) should the Claimants be ordered to pay the legal costs of the defendant or any other party involved in the Claim. Pursuant to the terms of clause 9, the Claimants have agreed that in the event that the Claimants are successful, the Fund will receive the Proceeds.
23. The Claimants will comprise individuals, groups of individuals and companies (or their respective representatives, such as liquidators or administrators) that are home and building owners, affected by defects in cladding used in the construction of their homes and buildings. Some of these Claimants are unable to bring a claim under the Weathertight Homes Resolution Services Act 2006 (WHRS Act) on account of their buildings having been constructed outside the 10 year limitation period imposed by the WHRS Act.
24. While the Claimant group is located in both New Zealand and other countries, including Australia and the United Kingdom, it is the applicant's understanding that all the properties to which the Claim relates are located in New Zealand.

Funding process

25. Funding for the Claimants Legal Costs will be made available under the Funding Agreement in two stages. The first stage comprises the point up to which all the pre-conditions for full funding are satisfied, and a statement of claim has been filed.
26. The Applicant advised that due to the process of confirming Claimants taking time, Claimants will be

confirmed as being part of the Claimant group on a progressive basis during the first stage of funding. Claimants will continue to be confirmed up until (and potentially after) the time that the statement of claim is filed. It is possible that Claimants could be confirmed and enter into the Funding Agreement after the second stage of funding has commenced.

27. During the first stage, legal fees will be incurred for work which will benefit all Claimants including Claimants who are accepted towards the end of the first stage. The definition of Claimants Legal Costs (clause 20.1 of the Funding Agreement) overcomes a potential problem associated with the timing of, and allocation of, legal costs, which were incurred before a Claimant entered into the Funding Agreement. This clause provides that Claimants will agree that each Claimant's proportionate share will be allocated by reference to the value of their claim, regardless of when each Claimant entered into the Funding Agreement.

28. Provided that the Claim satisfies the preconditions for full funding, the Fund will, after the completion of the first stage, fund the second stage of the Claim. Funding will be provided for the second stage of the Claim until such time as the Fund terminates its obligations under the Funding Agreements or the proceedings are concluded (whether by settlement or judgment of the courts).

Fund's entitlement to Proceeds

29. In the event that the Fund funds stage one and two of the Claim, and the Claim is successful, the Fund will be entitled to receive the Proceeds. The amount of the Proceeds will be calculated on the basis set out in the Funding Agreement. Clause 9.1 (a)(i) to (vi) outlines how the Proceeds will be allocated between the Fund and the Claimants.

30. In accordance with the Funding Agreement, the Legal Representative will receive and hold any damages, costs and settlement sums received in respect of a Claim on bare trust for the Fund and the Claimants in the proportions agreed until such time as the relevant amounts are paid to the Fund and to the Claimants. All amounts received from the defendant must first be paid to the Fund who will be paid in priority to the Claimants, who shall each receive such sum as is equal to their share of the remaining damages, costs or settlement sum.

Control of Claim

31. Control of the Claim will rest with the Claimants. The Fund will have no ability to instruct the Legal Representative or dictate how the proceedings are to be conducted. Clause 5 of The Funding Agreement expressly acknowledges that the Fund has no control over or right to make decisions about the proceedings. Only the Claimants, through the Representative Claimant (the Representative Claimant) may instruct the Legal Representative and determine, for example, that the claims that will be pursued and what actions will be taken or decisions made on a day to day basis in respect of the conduct of the proceedings.

32. Clause 6.1 (f) of the Funding Agreement provides that at any time Claimants will be entitled to change the Legal Representative. While the prior written agreement of the Fund is required, this clause provides that the Fund's consent to such a change is not to be unreasonably withheld. However, in order to continue to receive funding under the Funding Agreement, the Claimants will be required to ensure that the new Legal Representative executes a deed in favour of the Fund under which the new Legal Representative agrees to be bound by the terms of the Relationship Agreement as if they were the prior Legal Representative.

33. Clauses 5, 6 and 13 outline the Claimants obligations under the Funding Agreement. They include taking certain actions and to provide certain instructions to the Legal Representative in relation to certain anticipated future events including: in relation to the pursuit of an appeal should the Fund wish to provide funding for an appeal, and in relation to settlement decisions should settlement be recommended or not recommended (as the case may be) by the Legal Representative.

34. The Applicant states that because this is a class action, Claimants will also agree on entering into the Funding Agreement the manner in which the proceedings will be conducted and the Representative Claimant will instruct the Legal Representative. This is to ensure that the funded Claimants agree at the outset how the proceedings will be conducted, and so that the Fund can be confident that the proceedings are being conducted in an optimal manner.

Termination

35. Clause 1 of the Funding Agreement contains an initial cooling off period of 20 days. Clause 12 provides that a Claimant will not be able to unilaterally terminate its obligations under the Funding Agreement. Claimants will only be entitled to actively terminate their obligations if there has been a material breach by the Fund which has adversely affected the Claimant's interests and which has not been remedied by the Fund within 30 days.

36. Clause 12 of the Funding Agreement enables a Claimant to opt out of the class action if the Claimant gives instructions to the Legal Representative or otherwise exercises a right to opt out of the proceedings. However if the Claim is subsequently successful the Fund is still entitled to recover its share of the Proceeds as if the Claimant had not opted out of the class action.
37. Clause 11 of the Funding Agreement provides that the Fund will have the right at any time to terminate its obligation to contribute to future legal costs in respect of the Claim.

Key contractual terms relating to process

38. Claimants will agree to take certain actions and provide certain instructions to the Legal Representative in relation to the manner in which the proceedings will be conducted, and in relation to certain potential future events. These obligations are contained in the following clauses:
    - Clause 5 Conduct of Proceedings.
    - Clause 6 Claimant's Obligations.
    - Clause 9 Application of Proceeds.
    - Clause 13 Settlement Decisions.
    - Clause 19 General Provisions.
39. Pursuant to clauses 5, 6 and 13 of the Funding Agreement, each Claimant will agree:
    - That the Representative Claimant will determine in consultation with the Legal Representative what claims will be pursued clause 5.1 (a);
    - That the Representative Claimant will give day to day instructions to the Legal Representative and will make binding decisions on behalf of Claimants clause 5.1 (b);
    - That the Claimant will provide all information and documents required by the Legal Representative, will deal promptly with all requests made by the Legal Representative and will co-operate generally with the Legal Representative clause 6.1 (n);
    - That the Claimant will act reasonably and commercially in the prosecution of the proceedings and in accordance with the advice of the Legal Representative clause 6.1 (d);
    - That the Claimant will accept and follow the Legal Representative reasonable legal advice including in relation to settlement clause 6.1 (j);
    - That the Representative Claimant is authorised to make or take any action constituting a settlement decision provided that the Legal Representative has advised such action is reasonable clause 13.1;
    - That the Legal Representative is authorised to and instructed to accept on the Claimant's behalf, any settlement proposed where the Claimant has not initially wanted to act in accordance with the advice of the Legal Representative and the matter has been referred to independent counsel for opinion, with the independent counsel having recommended that the Legal Representative's advice is reasonable in all the circumstances clause 13.3 and 13.4.
40. In addition, each Claimant will agree under the Funding Agreement that the Fund is entitled to communicate directly with the Legal Representative, and that the Fund is entitled to receive any information which has or may have a material impact on the Claim or the proceedings clause 6.1 (c).

The Relationship Agreement between the Legal Representative and the Fund

41. The terms and conditions in the Relationship Agreement are consistent with the above provisions in the Funding Agreement. The Relationship Agreement provides that the Legal Representative must:
    - Act consistently with all authorisations and instructions given by the Claimant as contemplated in the Funding Agreement, subject to having received such instructions or authorisations clause 2.4;
    - Only enter into a retainer with a Claimant if the Claimant gives the Legal Representative all the authorisations and instructions contemplated and referred to in the Funding Agreement;
    - Ensure the Claimant is given all necessary information to facilitate informed instructions clause 8.2;
    - Keep the Fund fully informed by providing a monthly report in the form set out in the Relationship Agreement clause 8.1 (a);
    - Give the Fund access to, and when requested provide the Fund with copies of, all material documents produced by or for the Claimants in relation to the proceedings clause 8.1 (b);
    - Immediately inform the Claimant, and in accordance with the Claimant's instructions as contemplated in the retainer and the Funding Agreement, notify the Fund if the Legal Representative becomes aware of any information which has or may have a material impact on the Claim clause 8.2 (b);
    - Immediately notify the Fund in the event that the Claimant receives a settlement offer, and prepare for the Claimant a written recommendation on whether to accept such an offer and provide a copy of that recommendation to the Fund clause 8.1 (e).

Conditions made by the Commissioner

This Ruling is made subject to the following conditions:

a) None of the General Partner, the limited partners of the Fund, nor the Investment Advisor or Sub-Advisor is resident in New Zealand for income tax purposes.

b) None of the General Partner (whether on its own account or on behalf of the Fund), the Investment Advisor or Sub-Advisor own or lease any property located in New Zealand.

c) None of the General Partner (whether on its own account or on behalf of the fund), the Investment Advisor or Sub-Advisor has any employees based in New Zealand.

d) Funds made available by the Fund under the Funding Agreement will be paid to the Legal Representative from a bank account maintained by the Fund outside New Zealand.

How the Taxation Laws apply to the Applicant and the Arrangement

Subject in all respects to the conditions stated above, the Taxation Laws apply to the Applicant and the Arrangement as follows:

a) Amounts received by the Fund and the Limited Partners under the Arrangement are not "interest" as defined in s YA 1.

b) Amounts received by the Fund and the Limited Partners under the Arrangement are "non-residents' foreign-sourced income" pursuant to s BD 1(4).

c) Amounts received by the Fund and the Limited Partners under the Arrangement are not assessable income pursuant to s BD 1(5).

d) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 6 November 2015 and ending on 23 October 2020.

This Ruling is signed by me on the 6th day of November 2015.

Howard Davis

Director (Taxpayer Rulings)

PUBLIC RULINGS BR PUB 15/11: FRINGE BENEFIT TAX – EXCLUSION FOR CAR PARKS PROVIDED ON AN EMPLOYER'S PREMISES AND BR PUB 15/12: FRINGE BENEFIT TAX – EXCLUSION FOR CAR PARKS PROVIDED ON THE PREMISES OF A COMPANY THAT IS PART OF THE SAME GROUP OF COMPANIES AS AN EMPLOYER

These public rulings address the on-premises exclusion from FBT for car parking provided to employees in car parks that are owned or leased by an employer. BR Pub 15/11 sets out that car parks provided by an employer to an employee will be exempt from FBT where the car park is on premises that the employer owns or leases. BR Pub 15/12 sets out the rule for group companies.

PUBLIC RULING BR PUB 15/11: FRINGE BENEFIT TAX – EXCLUSION FOR CAR PARKS PROVIDED ON AN EMPLOYER'S PREMISES

This is a public ruling made under s 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 ss CX 2 and CX 23.

The Arrangement to which this Ruling applies

The Arrangement is the provision of a benefit by an employer (or a group company) to an employee in connection with their employment. The benefit is the provision of a car park that the employer owns or leases. This includes a parking space in a car parking facility or building that the employer has a right to use that is, in fact or effect, substantially exclusive.

For the purposes of this Ruling, the term "group company" means a company that is part of the same group of companies as the employer of the employee.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- For the purposes of s CX 2, the car park provided by an employer (or a group company) to its employee is excluded from being a fringe benefit, so the employer is not liable to pay fringe benefit tax in these circumstances.
- Where s CX 23(2)(c) applies the car park will not be excluded from being a fringe benefit by s CX 23.

The period or tax year for which this Ruling applies

This Ruling will apply indefinitely from 17 November 2015.

This Ruling is signed by me on 17 November 2015.

Susan Price

Director, Public Rulings

PUBLIC RULING BR PUB 15/12: FRINGE BENEFIT TAX – EXCLUSION FOR CAR PARKS PROVIDED ON THE PREMISES OF A COMPANY THAT IS PART OF THE SAME GROUP OF COMPANIES AS AN EMPLOYER

This is a public ruling made under s 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 ss CX 2 and CX 23.

The Arrangement to which this Ruling applies

The Arrangement is the provision of a benefit by an employer (or a group company) to an employee in connection with their employment. The benefit is the provision of a car park that a group company owns or leases. This includes a parking space in a car-parking facility or building that the group company has a right to use that is, in fact or effect, substantially exclusive.

For the purposes of this Ruling, the term "group company" means a company that is part of the same group of companies as the employer of the employee.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- For the purposes of s CX 2, the car park provided by the employer (or a group company) to its employee is excluded from being a fringe benefit, so the employer is not liable to pay fringe benefit tax in these circumstances.
- Where s CX 23(2)(c) applies the car park will not be excluded from being a fringe benefit by s CX 23.

The period or tax year for which this Ruling applies

This Ruling will apply indefinitely from 17 November 2015.

This Ruling is signed by me on 17 November 2015.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULINGS BR PUB 15/11 AND BR PUB 15/12

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Rulings BR Pub 15/11 and BR Pub 15/12 ("the Rulings").

Legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

Summary

1. Certain benefits provided by employers to employees are not subject to fringe benefit tax (FBT) if they are used or consumed by an employee on the premises of the employer. This is referred to as the "on-premises" exclusion from FBT. BR Pub 15/11 and BR Pub 15/12 address how the on-premises exclusion applies to car parking owned or leased by an employer.
2. BR Pub 15/11 sets out that car parks provided by an employer to an employee will be exempt from FBT where the car park is on premises that the employer owns or leases. BR Pub 15/12 sets out the rule where the car parking is on the premises of a company that is part of the same group of companies as an employer. (As appropriate in this commentary "employer" should be read as including a "group company". A "group company" means a company that is part of the same group of companies as the employer of the employee.)
3. Parking provided to employees on land owned by the employer, on land leased by the employer, or in car parks leased by the employer will usually be excluded from FBT because it is a benefit provided on the premises of the employer for FBT purposes. It is not necessary for the employer to carry on business activities on or near those premises for the exclusion to apply.
4. However, the premises of an employer will not usually include a car park that an employer is merely licensed to use, *unless* the employer can show they have a **right to use** the car park that **is in fact or effect substantially exclusive**.
5. To establish whether an employer's use of a car park is substantially exclusive, account needs to be taken of what is actually occurring between the parties and the actual effect of any agreement between the parties. It does not matter if an employer's use of the car park does not amount to "legal" possession at common law, but the use must be substantially exclusive.
6. In the Commissioner's view an employer's use of a car park will be substantially exclusive when no one else (including the owner or car park operator) uses, or controls the overall use of, the car park preventing the employer from enjoying a substantially exclusive right to use the car park.
7. Deciding whether a car park is employer's premises may involve weighing a number of factors before deciding, on balance, whether the employer can be said to:
   - own,
   - lease, or
   - enjoy substantially exclusive use of that car park.

   For example, merely stating that the employer is to have exclusive use of the car park will not on its own be sufficient to establish the car park as the premises of the employer but, when considered alongside other factors, it may be persuasive.
8. In forming her view, the Commissioner considers it is significant that the term "licence" was not explicitly included in the definition of "premises of a person" in s CX 23(2)(a), in para (a) of the definition of "lease" or in the related definitions of "leasehold estate", "estate in relation to land, interest in relation to land, estate or interest in land, estate in land, interest in land, and similar terms", "interest" or "possession" in s YA 1. This indicates to the Commissioner that Parliament never intended s CX 23(2)(a) to be interpreted as enabling *all* premises that are licenced by an employer to be treated as the employer's premises.
9. BR Pub 15/11 and BR Pub 15/12 focus on the application of the on-premises exclusion and, in particular, on the scope of para (a) of s CX 23(2) (ie, the first limb of the definition of "premises of a person"). The Rulings do not consider whether FBT may apply to car parking provided by employers under any other provision of the FBT Rules.

Practical considerations

10. To help establish whether a car parking arrangement falls within the definition of a "lease" for the purposes of s CX 23 listed below are some common examples of the types of features the Commissioner might expect to find where an employer has a right to

use a car park that is in fact or effect substantially exclusive. Sometimes in an arrangement there might be conflicting features, and in those circumstances an assessment needs to be made of the nature of the overall arrangement, keeping in mind it is essentially a question of the degree of control granted to the employer under the arrangement. The more control an employer has, the more likely it is that the car parking spaces are the employer's premises.

11. The list below is not definitive and there may be other features that indicate the employer has a use of the car parking space that is substantially exclusive:
    - the owner or car park operator acknowledges that the employer and their employees have the exclusive use of the employer's car parking spaces and no one else (including the owner or car park operator) can park cars on the parking spaces;
    - the car parking spaces are allocated exclusively to the employer and cannot be re-allocated at the discretion of the owner or car park operator without a variation of the arrangement or a new arrangement being agreed;
    - the employer has unrestricted access to the car park;
    - the car parking spaces remain unoccupied if not being used by the employer (or someone authorised by the employer);
    - the employer may permit others to use the employer's car parking spaces;
    - if an unauthorised person parks in an employer's car parking space, the employer may take steps to have the unauthorised vehicle towed; and
    - the employer may decide how the car parking space is used (eg, if desired, the employer may park a trailer in the car parking space).

12. The Commissioner accepts that a car parking arrangement for fixed hours (eg, during business hours) can be an employer's premises so long as the employer can demonstrate a right to use the car park that is in fact or effect substantially exclusive for those fixed hours.

13. To help establish whether a car parking arrangement falls within the definition of a "lease" for the purposes of s CX 23 listed below are some common examples of the types of features that might suggest a car parking arrangement is not a "lease". The list is not definitive:
    - the employer is not allocated any particular car parking spaces within the car park;
    - where the employer is allocated particular car parking spaces, the owner or car park operator retains the ability to reallocate car parking spaces at their discretion;
    - the owner or car park operator may alter the car park's operating hours or restrict access to the car park at their discretion;
    - the employer cannot remove unauthorised vehicles from the car park or otherwise enforce rights over the car park against third parties, including bringing any action for trespass; and
    - there is no signage showing the employer's car parking spaces as being "reserved".

14. Examples illustrating the Commissioner's application of the Rulings are provided at [152] to [168] below.

Background

15. A benefit provided by an employer to an employee in connection with their employment is a fringe benefit and subject to the FBT rules unless it is excluded (s CX 2). An employee's use of a car park provided by an employer is on the face of it a benefit and is subject to FBT. These Rulings are based on the assumption that the provision by an employer of a car park to an employee is a benefit for FBT purposes. While Parliament could have excluded all car parks from the FBT regime, it has not done so. Nonetheless car parks might still be exempt from FBT if any one of the exclusions in the FBT rules applies to the benefit. Section CX 23 excludes from FBT benefits provided to an employee on an employer's premises. Therefore if an employer can establish a car park is on its premises the benefit will not be subject to FBT.

16. FBT and car parks was the subject of an expired Public Ruling BR Pub 99/6 issued in 1999. (BR Pub 99/6 was not re-issued when it expired in 2002 but was extended to apply until 31 March 2005.) In BR Pub 99/6, the Commissioner established that for the purposes of the FBT exclusion "premises" were those land and buildings that an employer owned or leased (in a common law sense), and so had exclusive possession of. Land and buildings that were merely licensed to an employer were not considered to be the employer's "premises". The distinction relied on the established land law concept of "exclusive possession", which determines the difference between a lease and a licence—leases being an estate in land akin to ownership, and licences being simply a personal permission to enter and use the land for a particular purpose. A licence to use or occupy land does not create a legal estate or interest in the land. As a result, a licensee cannot sue in trespass or register a caveat against the title of land in the way that a lessee can.

17. With effect from 1 April 2005, changes were made to the FBT legislation as a result of the re-writing of the Income Tax Act. Further legislative changes were made to the on-premises exclusion in 2006. Work on re-issuing BR Pub 99/6 was undertaken with the release of an exposure draft for external consultation in August 2009. However, due to policy considerations the 2009 draft was never finalised. Issues concerning FBT and car parks were addressed by Policy & Strategy in the issues papers *Streamlining the Taxation of Fringe Benefits* (government discussion document, Policy Advice Division of the Inland Revenue Department, December 2003) and *Recognising Salary Trade-offs as Income* (officials' issues paper, Policy Advice Division of Inland Revenue and the Treasury, April 2012). Legislative amendments to the FBT treatment of car parks were proposed in the *Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Bill* 2013. These proposed amendments did not proceed.
18. As a result of BR Pub 99/6 expiring, and legislative changes being made to the on-premises exclusion, it was identified that aspects of the Commissioner's position on the application of the FBT on-premises exclusion to car parks needed clarification.

Application of the Legislation

19. The main issue addressed by these Rulings is the application of the FBT on-premises exclusion in s CX 23, and in particular the scope of the first limb of the definition of "premises of a person" in s CX 23(2)(a), to car parking provided by an employer to an employee. This issue is addressed by considering:
    - the scheme and purpose of the FBT rules,
    - the scheme of the on-premises exclusion in s CX 23, and
    - the wording and interpretation of the first limb of the definition of "premises of a person" in s CX 23(2)(a) and any related definitions in s YA 1.

Scheme and purpose of the fringe benefit tax rules

20. The purpose of the FBT rules is to tax non-monetary benefits provided by employers to employees. The regime was introduced to ensure this form of remuneration did not escape the tax net. Car parking can be a benefit when provided to employees.
21. When FBT was introduced, Parliament decided it should apply only to fringe benefits for which the tax was practical to administer. Parliament agreed that the administrative and taxpayer-compliance cost of valuing benefits provided to an employee on an employer's premises were excessive. For this reason, benefits an employee uses or consumes (subject to some limited exceptions) on an employer's premises are expressly excluded from FBT. This includes the benefit of car parking provided to employees on an employer's premises.

On-premises exclusion

22. In essence, the on-premises exclusion in s CX 23 provides that a benefit (other than free, discounted, or subsidised travel, accommodation, or clothing) is not a fringe benefit, if it is provided to an employee by an employer and used or consumed on the premises of the employer:

    CX 23 Benefits provided on premises

    When not fringe benefit

    (1) A benefit, other than free, discounted, or subsidised travel, accommodation, or clothing, is not a fringe benefit if the benefit is—
        (a) provided to the employee by the employer of the employee and used or consumed by the employee on the premises of—
            (i) the employer:
            (ii) a company that is part of the same group of companies as the employer:
        (b) provided to the employee by a company that is part of the same group of companies as the employer of the employee and used or consumed by the employee on the premises of—
            (i) the employer:
            (ii) the company that provides the benefit.
23. Section CX 23(1)(a)(ii) extends the on-premises exclusion to also include a benefit an employer provides to an employee that is used or consumed by the employee on the premises of a group company. Section CX 23(1)(b) further extends the exclusion to include a benefit a group company provides to an employee, either on the premises of the employer or on the group company's premises.
24. To establish whether a benefit is used or consumed on the premises of the employer (or on the premises of a group company) there is a definition of "premises of a person" in s CX 23(2):

    Premises of person

    (2) In this section, the premises of a person—
        (a) include premises that the person owns or leases:
        (b) include premises, other than those referred to in paragraph (a), on which an employee of the person is required to perform duties for the person:
        (c) do not include premises occupied by an employee of the person for residential purposes.

Definition of "premises of a person"

25. The definition of "premises of a person" was added to the FBT rules as part of the rewrite of the Income Tax Act in 2004. Initially, a definition for "employer's premises" was added but it was later changed to "premises of a person" when the rules for group companies were added in 2006.

26. Before 1 April 2005, the on-premises exclusion operated without a definition of "premises". The Commissioner's stance was that car parks provided on land or in car parks that an employer owned or leased at common law would be covered by the on-premises exclusion. Car parks that were licensed to an employer were not the employer's premises and fell outside the on-premises exclusion.

27. With the addition of the definition of "premises of a person" the Commissioner now seeks in these Rulings to clarify the scope of s CX 23(2)(a) as it applies to car parking:

> **Premises of person**
>
> (2) In this section, the premises of a person—
>
> (a) **include premises** that the person **owns** or **leases**:
>
> [Emphasis added]

28. For the purposes of these Rulings "person" is read as employer but it could also be a group company.

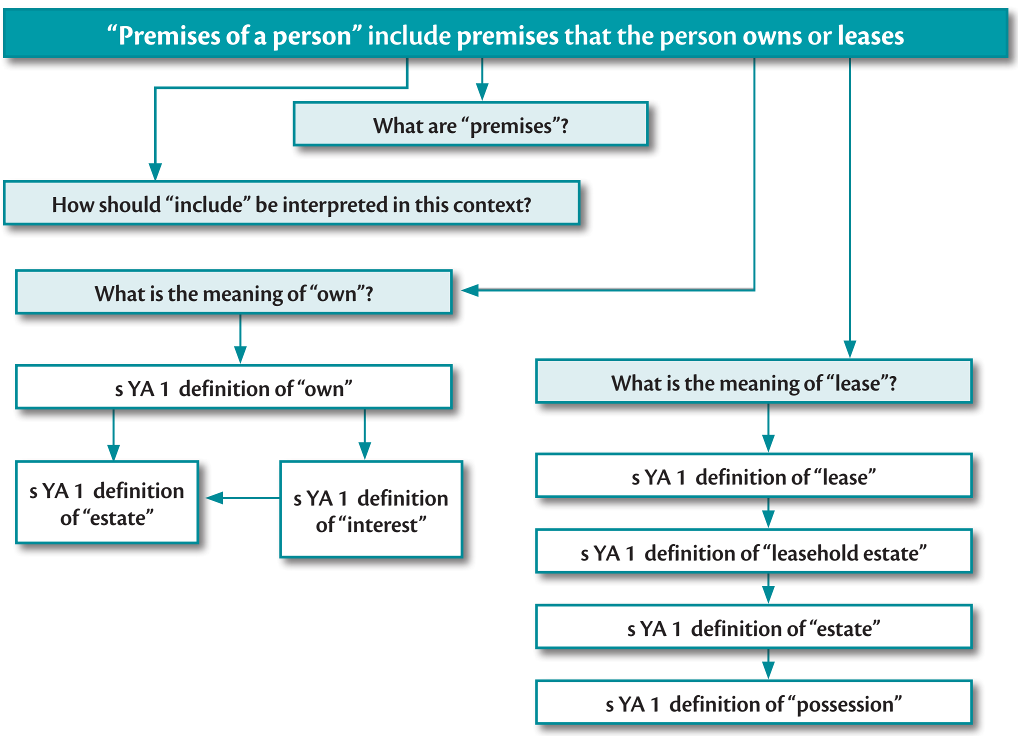
Commissioner's approach to this analysis

29. The key interpretative issues to be resolved to clarify when car parks provided by employers to employees are exempt from FBT are the meanings to be given to the words "include", "premises", "owns" and "leases" as these words are used in the definition of "premises of a person" in s CX 23(2)(a). This analysis will determine the Commissioner's view on the scope of s CX 23(2)(a) and the situations she considers will be excluded from FBT under the section. The analysis is fairly complex because of the potential layers of definitions that may apply.

30. The Commissioner's approach to the analysis of these issues is to:

- consider the meaning of the word "premises" as it is used in the definition;
- interpret the meaning to be given to the word "'include" in the context of the definition—to decide whether the first limb of the definition is limited to car parks that the employer owns or leases;
- address the application of the relevant s YA 1 definitions to the words "owns" and "leases";
- consider the meaning of the s YA 1 definitions of the terms "own" and "lease";
- consider the application, meaning and effect of the related s YA 1 definitions of "estate" and "possession"; and
- consider the first limb of the definition as a whole and its application to the on-premises exclusion in s CX 23.

31. This approach is summarised as follows:



32. Examples at [152] to [168] illustrate the Commissioner's interpretation.

Meaning of "premises"

33. To understand the definition of "premises of a person" it is necessary to consider the meaning of the word "premises" as it is used in the definition.

34. The term "premises" is not defined. The *Concise Oxford Dictionary* (12th ed, Oxford University Press, 2011) defines "premises" as:

> A house or building, together with its land and outbuildings, occupied by a business or considered in an official context.

35. The ordinary meaning of "premises" has a wide meaning that includes houses and buildings together with their land. This meaning includes land and buildings occupied by a business.

36. Case law indicates that the word "premises" is difficult to interpret because it is capable of many shades of meaning: *Northern Hotel IUOW v Bay of Islands College Board of Trustees* [1991] 1 ERNZ 710. Case law also suggests "premises" should take its meaning from the context in which it is used: *Maunsell v Olins* [1975] 1 All ER 16. In some contexts "premises" may mean land, buildings on land (including the land surrounding the buildings) and any easements granted as appurtenant to the land and buildings: *Grandi v Milburn* [1966] 2 All ER 816; *Whitley v Stumbles* [1930] AC 544. In other contexts premises might be restricted to simply mean buildings situated on the land: *McKenna v Porter Motors Ltd* [1955] NZLR 832.

37. In *Gardiner v Sevenoaks Rural District Council* [1950] 2 All ER 84, Lord Goddard said (at 85):

> "Premises" is, no doubt, a word which is capable of many meanings. How it originally became applied to property is, I think, generally known. It was from the habit of conveyancers when they were drawing deeds of conveyance referring to property and speaking of "parcels". They set out the parcels in the early part of the deed, and later they would refer to "the said premises", meaning strictly that which had gone before, and gradually by common acceptance "premises" became applied, as it generally is now, to houses, land, shops, or whatever it may be, so that **the word has come to mean generally real property of one sort or another**. There is no doubt that from time to time the word "premises" has been given different meanings, either extended or more restricted.
>
> [Emphasis added]

38. His Lordship said that the word "premises" generally means real property of one sort or another, although at different times it has been given different meanings, either extended or restricted.

39. Applying this approach to the word "premises" as it is used in the definition of "premises of a person" in the on-premises exclusion, the Commissioner considers that "premises" should be interpreted as including land, buildings, and parts of land or buildings. This is consistent with both the ordinary meaning and the common law meaning of "premises". The Commissioner considers it is also consistent with the scheme and purpose of the FBT rules. In the explanatory commentary to the FBT legislation published when the rules were first introduced in 1985 (see *Public Information Bulletin* No 136, Part 1 (May 1985) at 22) it was stated:

> The term "premises" refers to land, buildings or [appurtenances] thereto.

40. Further, in the Commissioner's view, the definition of "premises of a person" is not limited to "business" premises. Unlike in other jurisdictions (such as Australia) the definition does not use the word "business" premises and does not include a business-type test. The Commissioner considers her view to be consistent with the stated intention of the FBT rules for car parks when the rules were introduced (also set out in the commentary mentioned above at 22):

> The term "premises" refers to premises owned by, or rented or leased by, the employer for use in the carrying on of a business. In the case of car parks, parking provided on land owned by the employer, land leased by the employer, or in respect of car parks over which the employer has a long term lease will be eligible for the exemption. It is not necessary that the employer also carry on normal business activities on or near those premises.

41. For these reasons, the Commissioner considers that the better view is that the term "premises" was intended by Parliament to be a physical concept that refers to land, buildings, and parts of land or buildings owned or leased by the employer for use in the carrying on of a business and is not to be interpreted as being restricted to premises from which the employer carries out its normal business operations.

Meaning of "include"

42. The word "include" is used within the definition of "premises of a person". Its use raises the question as to whether Parliament intended for the "premises of a person" to be something broader than simply land and buildings that the employer or group company owns or leases. Depending on the meaning given to the word "include" in the first limb of the definition of "premises of a person", an employer's premises may arguably extend beyond premises that an employer "owns" or "leases" (as those terms are defined in s YA 1).

43. The use of the word "include" raises a number of interpretative questions. In some statutory contexts the word "include" is indicative of a non-exhaustive definition; in other contexts it may be read as equivalent to the narrower "means and includes" construction: *Dilworth v Commissioner of Stamps* (1899) NZPCC 578 (PC).

44. When "include" is used to enlarge the meaning of a defined word (ie, where it is non-exhaustive), as it generally is, it may not extend the meaning to something that was not intended in the scheme of the Act: *Harley v CIR* [1971] NZLR 482 (CA).

45. Other case law indicates that the scope of the word "include" depends on the genus or class of items already defined in the definition: *Whitsbury Farm and Stud Ltd v Hemens (Valuation Officer)* [1988] AC 601 (HL).

46. If the word "include" is given a non-exhaustive meaning in the context of s CX 23(2)(a), then arguably an employer's premises are not restricted to car parks that an employer "owns" or "leases" but might also include other car parks, such as any car parks licensed by an employer. The Commissioner disagrees with this interpretation (although, as discussed below, the Commissioner accepts that some licenced car parks may satisfy the extended statutory definition of "lease" and therefore qualify as employer premises in that way).

47. While it is not free from doubt, the Commissioner considers the better view, in this context, is to interpret "include" in the definition of "premises of a person" exhaustively. In the Commissioner's view such an interpretation is supported by:
    - the intended purpose of the FBT rules;
    - the construction of the definition of "premises of a person" in s CX 23(2);
    - the nature of the "class" of items in s CX 23(2)(a); and
    - the implication that if Parliament had intended the class to be broader than premises that an employer "owns" or "leases" (eg, to include all licences) it could have explicitly provided for it. [This is discussed in more detail below.]

48. As noted above the Commissioner considers that the original commentary to the FBT legislation indicates that the purpose of the on-premises exclusion was that it applied to land an employer owns or leases or to car parks an employer leases.

49. This interpretation is arguably further supported by the construction of the definition in s CX 23(2). Paragraphs (a) and (b) of s CX 23(2) distinguish between premises an employer owns and leases and premises of an employer, other than those it owns or leases, on which an employee is required to perform duties for the employer.

50. Further, in the Commissioner's view the class of items in the first limb of the definition of "premises of a person" (ie, "owned" or "leased" premises) indicates an intention that an employer's premises will include only premises that are essentially in the nature of an estate in the land. At common law, an estate in land exists when a person owns or leases land so that they have exclusive possession of the land. An estate in land does not exist when a person merely has a licence to use the land or is granted permission to enter the land for some specified purpose.

51. The Court of Appeal in *Fatac Ltd (in liq) v CIR* [2002] 3 NZLR 648 (which followed the House of Lords' decision in *Street v Mountford* [1985] 2 All ER 289) considered whether a licence creates an estate in land. In his judgment, Fisher J said (at 658):

> A licence is a mere permission to be on the land, with or without additional permission to perform additional specified acts there. The former creates an estate in the land; the latter does not.

52. This shows that a licence does not create an estate in land, in the same way that owning or leasing land does. Therefore, premises that are licenced arguably are not in the same class of items specified in the first limb of the definition of "premises of a person" (ie, "owned" or "leased" premises).

53. By Parliament not explicitly adding premises that are licensed to the first limb of the definition of "premises of a person", it can be inferred they are to be excluded. This conclusion is supported by the application of the *expressio unius est exclusio alterius* (to express one thing is to exclude another) principle of statutory interpretation. Section CX 23(2)(a) expressly states the definition of "premises of a person" includes premises of the type that employers own or lease. This implies premises held under some other arrangement such as a licence are excluded from the definition.

54. When the definition of "premises of a person" was added to the on-premises exclusion in 2004 the intention was for the definition to reflect the existing position with respect to the scope of the exclusion by preserving the accepted boundary between leases and licences.

55. Finally, since FBT was introduced in 1985 there has been much discussion about and opportunities for amendments to the FBT legislation, yet Parliament has

refrained from making any express exclusion from FBT for car parks that are licensed to employers or from excluding all car parks from the on-premises exclusion.

56. The Commissioner considers all these factors support the view that "include" in s CX 23(2)(a), in the context of the definition of "premises of a person", the exclusion and the FBT rules, should be read as equivalent to the narrower "means and includes" construction. This means s CX 23(2)(a) is to be read as being limited to premises an employer "owns" or "leases".

Application of s YA 1 definitions to "premises of a person"

57. Having established that the definition of "premises of a person" is to be read as being limited to premises that an employer owns or leases, it is now appropriate to consider the s YA 1 definitions of "own" and "lease".

58. "Own" means to have an "estate" or "interest" in land. An "interest" in land is defined under the definition of "estate". A "lease" is any "estate" in land, other than a freehold estate. The definition of "lease" expressly includes licences in some circumstances; but not for the purposes of the FBT rules. The second limb of the definition of "estate" extends the general meaning of "estate" to include a right to the possession of the land. "Possession" is in turn defined as including a use of the land that is, in fact or effect, substantially exclusive.

59. The relevant parts of the s YA 1 definitions are as follows:

> **own,—**
>
> (a) for land, means to have an estate or interest in the land, alone or jointly or in common with any other person:
>
> **interest,—**
>
> (d) in relation to land, **interest in land, estate or interest in land**, and similar terms are defined under the definition of **estate**
>
> **lease—**
>
> (a) means a disposition that creates a leasehold estate
>
> **leasehold estate** includes any estate, however created, other than a freehold estate.
>
> **estate** in relation to land, **interest** in relation to land, **estate or interest in land, estate in land, interest in land**, and similar terms – –
>
> (a) mean an estate or interest in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and
>
> (b) include a right, whether direct or through a trustee or otherwise, to—
>
> (i) the possession of the land (for example: a licence to occupy, as that term is defined in section 121A(1) of the Land Transfer Act 1952):
>
> …
>
> **possession** includes a use that is in fact or effect substantially exclusive.

60. On the face of it, Parliament may not have intended the s YA 1 definitions of "own" and "lease" (and the other related definitions in s YA 1 like "estate" and "possession") to apply in the context of the definition of "premises of a person". Instead Parliament might have intended for the definitions in s YA 1 to be disregarded in the context of the definition of "premises of a person" and for the common law meanings to apply in their place. Applying the s YA 1 definitions to s CX 23(2)(a) arguably broadens the scope of the on-premises exclusion.

61. However, on balance, the Commissioner does not accept this argument.

62. When *Rewriting the Income Tax Act 1994* (exposure draft, Inland Revenue, 2001) was released for consultation "employer's premises" were defined in s CX 27(2)(a) as "includes premises to which the employer has a right of possession". The term "possession" in s YA 1 was included in the list of defined terms for that section. Although the definition of "employer's premises" was subsequently changed and, in time, became the definition of "premises of a person", the link to the definitions in s YA 1 (including indirectly the link to the definition of "possession") were retained.

63. The courts impose a high threshold before a definition can be disregarded for the purposes of interpreting a defined word in an Act. There need to be strong indications to the contrary in the context: *Police v Thompson* [1966] NZLR 813.

64. The Commissioner does not think that after initially including the term "possession" in the first draft of the rewritten Act, it can be argued that it was intended that the s YA 1 definitions be disregarded in the context of s CX 23.

65. However, as noted above, the Commissioner does think it is significant that the word "licence" was not added to the new definition of "premises of a person" in s CX 23(2)(a) or to the existing definition of "lease" or "estate" in s YA 1 for these purposes. This indicates to the Commissioner that Parliament never went so far as to necessarily intend licences in general to be included within the on-premises exclusion.

Meaning of "owns" and "leases"

66. Accepting that the relevant s YA 1 definitions are intended to be applied in the context of s CX 23, the

starting point is the meaning of the defined terms "own" and "lease":

> **Own—**
>
> (a) for land, means to have an estate or interest in the land, alone or jointly or in common with any other person:
>
> (b) for the ownership of depreciable property, is defined in sections EE 2 to EE 5 (which relate to depreciation)
>
> **Lease—**
>
> (a) means a disposition that creates a leasehold estate:
>
> (b) in sections DZ 9 (Premium paid on land leased before 1 April 1993) and EZ 8 (Premium paid on land leased before 1 April 1993),—
>
> (i) means a disposition by which a leasehold estate is created; and
>
> (ii) includes a licence:
>
> (c) for the purposes of subpart EE (Depreciation), includes a licence to occupy:
>
> …
>
> (d) (iii) includes a licence to use intangible property; and
>
> …
>
> (f) in the financial arrangements rules, means—
>
> (i) a lease as described in paragraph (d):
>
> (ii) an arrangement that would be a lease as described in paragraph (d) if the arrangement did not relate to real property, livestock, or bloodstock

67. "Own" is defined for land as "to have an estate or interest in the land".

68. The definition of "lease" in s YA 1 has six limbs, three of which (paras (b), (c), and (d)) directly, and one (para (f)) indirectly, include a reference to some form of licence. However, para (a), which sets out the general meaning of "lease" for the purposes of the Act (including for the purposes of the FBT rules), does not refer to licences. The general meaning of "lease" in para (a) is "a disposition that creates a leasehold estate". A "leasehold estate" is defined to include "any estate … other than a freehold estate".

Definition of "estate"

69. In s YA 1, the definition of "estate" in relation to land includes definitions of interest in relation to land, estate or interest in land, estate in land, interest in land, and similar terms. Those terms are each defined to mean an estate or interest in the land … and include a right to the possession of the land:

> **estate** in relation to land, **interest** in relation to land, **estate or interest in land, estate in land, interest in land,** and similar terms – –
>
> (a) mean an estate or interest in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and
>
> (b) include a right, whether direct or through a trustee or otherwise, to—
>
> (i) the possession of the land (for example: a licence to occupy, as that term is defined in section 121A(1) of the Land Transfer Act 1952):
>
> (ii) the receipt of the rents or profits from the land:
>
> (iii) the proceeds of the disposal of the land; and
>
> (c) do not include a mortgage

70. For ease of reference, the above definition is referred to in this analysis as the definition of "estate".

71. At common law an estate includes freehold estates (such as a fee simple, stratum estates and life interests) that give rise to a bundle of rights to the person who owns that estate and also leasehold estates. A *profit-à-prendre* is an example of an interest in land because it creates property rights that can be enforced *in rem* even though it does not grant exclusive possession. However, at common law, an arrangement that is a licence is never an estate or interest in land.

72. The definition of "estate" is a "means and includes" type definition. Where the words "means" and "includes" are used together within a provision the standard approach is for the "included" matters to extend the meaning of the generally defined term. Paragraph (a) of the definition provides that the term means an "estate or interest in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder". It appears the purpose of para (a) is to establish a meaning of "estate" by recognising the many different types of estates or interests in land at common law.

73. Paragraph (b) of the definition then extends that meaning by listing three other rights in respect of land. In the Commissioner's view, the three rights listed in para (b) are separate rights, any one of which may qualify as an estate.

74. The Commissioner considers that Parliament intended these three rights in para (b) to broaden the definition of "estate". The rights listed in para (b) usually arise from the ownership or control of land, but that ownership or control may not necessarily be "legally" recognised as ownership or akin to ownership. (For example, para (b)(i) of the definition of "estate" includes the example of a licence to occupy as that term is defined in section 121A(1) of the Land Transfer Act 1952. This refers to rights arising from a

shareholding in a flat or office owning company. While a shareholding in a flat or office owning company may not be an estate in land at common law, it is still recognised as creating a registrable interest for land transfer purposes.)

75. The definition of "estate" (and the definitions of "lease", "leasehold estate" and "possession") originated in response to the avoidance of land tax and were enacted into New Zealand tax legislation in 1912 before being rewritten in 1916. It appears they were intended to extend the common law to include situations where a person artificially divested themselves of the legal ownership of land while still retaining one or more of the key features of ownership, such as possession, the right to receive rents and profits or the right to sale proceeds. The definition could also be applied to long term purchase agreements where a purchaser obtained one or more of the benefits of ownership but to avoid being "named" as the owner delayed obtaining legal title. The rules were designed to apply equally to freehold and leasehold estates.

76. The definition of "estate" was included in s 2 of the Land and Income Tax Act 1916, the general definition section. The definition applied for the purposes of the whole Act, not only for the land tax provisions of the 1916 Act. Since 1916 the definition of "estate" has continued to be used in New Zealand tax legislation without substantive amendment.

77. The Commissioner considers para (b) of the definition of "estate" in s YA 1 should be read as extending the definition of "estate" beyond its meaning in para (a).

Definition of "possession"

78. Accepting that para (b) of the definition of "estate" extends the general definition of "estate" in para (a), it is next necessary to consider the effect that the definition of "possession" may have on the meaning of the words in para (b)(i) of the definition of "estate".

79. Paragraph (b)(i) of the definition of "estate" includes a right to the possession of the land:

> (b) includes a right, whether direct or through a trustee or otherwise, to -
>
> (i) the possession of the land (*for example*: a licence to occupy, as that term is defined in section 121A(1) of the Land Transfer Act 1952):

80. "Possession" is defined in s YA 1 as including a use that is in fact or effect substantially exclusive:

> **possession** includes a use that is in fact or effect substantially exclusive

81. Therefore reading-in the definition of "possession", it follows that the general definition of "estate" is broadened to include a right to a use of the land that is in fact or effect substantially exclusive. Taking this to the next level, for the purposes of the definition of "lease" as it applies for FBT purposes, this means an agreement will be a lease if it is a disposition that creates a use of the land that is in fact or effect substantially exclusive. Therefore, if an employer has an agreement with a third party that creates a use of the land that is in fact or effect substantially exclusive, then that land will be the premises of the employer for the purposes of the on-premises exclusion.

82. Determining the meaning of the words in the definition of "possession" is therefore important to understanding the scope of the definition of "premises of a person" in s CX 23(2)(a). Section 5(1) of the Interpretation Act 1999 provides:

> (1) The meaning of an enactment must be ascertained from its text and in the light of its purpose.

83. The requirements of s 5(1) of the Interpretation Act 1999 were explained by the Supreme Court in *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36; [2007] 3 NZLR 767 at [22] and [24]:

> 22. It is necessary to bear in mind that s 5 of the Interpretation Act 1999 makes text and purpose the key drivers of statutory interpretation. The meaning of an enactment[10] must be ascertained from its text and in the light of its purpose. Even if the meaning of the text may appear plain in isolation of purpose, that meaning should always be cross checked against purpose in order to observe the dual requirements of s 5. In determining purpose the court must obviously have regard to both the immediate and the general legislative context. Of relevance too may be the social, commercial or other objective of the enactment.[11]
>
> …
>
> 24. Where … the meaning is not clear on the face of the legislation, the court will regard context and purpose as essential guides to meaning.
>
> [Footnotes:
>
> [10] "Enactment" means "the whole or a portion of an Act or regulations": see s 29 of the Interpretation Act 1999;
>
> [11] See generally *Auckland City Council v Glucina* [1997] 2 NZLR 1 at p 4 (CA) per Blanchard J for the Court, and Burrows, *Statute Law in New Zealand* (3rd ed, 2003), p 146 and following.]

84. Therefore, when ascertaining the meaning of the definition of "possession" it is necessary to consider not only its plain meaning but also its purpose.

Meaning of "a use" of the land

85. The plain meaning of the words "a use" is arguably quite broad when the words are considered in isolation, distinct from the whole of the definition. The *Concise Oxford Dictionary* (12th ed, Oxford University Press, 2011) defines "use" (when used as a noun) as:

> The action of using something or the state of being used for a purpose
>
> The ability or power to exercise or manipulate one's mind or body
>
> A purpose for or way in which something can be used

86. This suggests the words "a use" refers to a use of land for some purpose created by or allowed pursuant to some legal right. For example, "a use of the land" might include a right to use the land for a particular purpose, such as with an easement. It might also include a right to use the land by occupying it or deriving income from it (although this latter type of "use" is covered by para (b)(ii) of the definition of "estate"). Importantly it may also include a personal permission "to use" land in a certain way.

87. The decision in *Merrill v Wilson* [1900] 1 QB 35 (CA) considered whether ship-owners had "actual use" of a portion of a quay within the meaning of the Factory and Workshop Act, 1895 (UK), so were "undertakers" in respect of a factory and liable to pay compensation to the dependants of a workman who died. The Court of Appeal held (at 43) that the use of the quay by the ship-owners was something less than legal occupation, but was an "actual use":

> I think that full effect is given to the words of the Act by holding them to apply to the exclusive use of part of the quay by the shipowners as regards the purposes of unloading and loading, which practically involves the exclusion of most other persons, though not necessarily of all. At the time when the accident happened to the deceased man, the respondents appear to have had **substantially the full enjoyment of a definable portion of the quay, namely, that beside which the ship lay, for the essential purpose for which the quay was intended, to the exclusion of any use of it by others for that purpose**.
>
> [Emphasis added]

88. This case is interesting because it brings together some of the different elements from the definition of "possession". However, it also demonstrates that in the context of land the term "a use" is a right to enjoy land for a particular purpose. This is consistent with the dictionary definitions of "a use" as being a way in which something can be used.

Meaning of "in fact or effect"

89. The Act does not define "in fact or effect". When the definition of "possession" was added to the income tax legislation in 1916, there were many large landowners. Land tax was payable annually on land owned on 31 March each year. To reduce their liability for land tax, some large landowners would enter into dummy sales—they "sold" portions of their land while still effectively retaining the benefits of ownership. In other situations, purchasers would enter into long-term lease agreements with compulsory acquisition clauses designed to delay the transfer of legal title to the purchaser. The definitions of "estate" and "possession" were drafted to ensure these "dummy sales" were not an effective means of avoiding land tax by broadening the definitions of "own" and "lease" to include land over which the landowners or purchasers had de facto control.

90. This legislative purpose was explained by the Supreme Court in *Yule v Commissioner of Taxes* [1918] NZLR 890. This case concerned the application of land tax to a property that was leased for seven years to a purchaser under a long term lease agreement before eventually being sold. It was held the purchaser/lessee was liable for the land tax because he was in possession, and the owner/lessor was not liable:

> To give effect to the object of preventing dummy sales possession ought to be given a wide rather than a narrow meaning which might lead to evasion. It is in this spirit doubtless that the Act itself now defines possession as including any use which is in fact or effect substantially exclusive, whether by virtue of exclusive occupation or not.

91. The phrase "in fact or effect" is disjunctive in nature and relates to the use of the land. It supports the view that the intended purpose of the definition of "possession" was to include as estates in land uses of land that only "in fact or effect" gave rise to possession (ie, possession enjoyed by the landowner or purchaser that may not have been considered "legal possession").

Possession "in fact"

92. The courts have made a distinction between factual and legal possession. For land law purposes, legal possession has traditionally been decisive in deciding whether an estate in land is created. For instance, in *Western Australia v Ward* [2002] 213 CLR 1 the High Court of Australia held that:

> **When the cases talk of exclusive possession, they speak of legal possession. It is the right to legal possession that constitutes a lease … It is the legal right to possession, not the physical fact of exclusive 'possession' or occupation, that is decisive.** That is

> why a lessee can bring an action for ejectment although driven from the premises and why at common law a lessee could bring an action for ejectment although he or she had not yet entered upon the land.
>
> [Emphasis added]

93. Similarly, in *Radaich v Smith* (1959) 101 CLR 209, Windeyer J stated (at 223):

> … **persons who are allowed to enjoy sole occupation in fact are not necessarily to be taken to have been given a right of exclusive possession in law**. If there be any decision which goes further and states positively that a person legally entitled to exclusive possession for a term is a licensee and not a tenant, it should be disregarded for it is self-contradictory and meaningless.
>
> [Emphasis added]

94. Windeyer J recognises that sometimes a person who is in sole occupation (and who therefore has de facto possession of land) is not necessarily going to be recognised as being the person in legal possession of the land for land law purposes.

95. Lord Templeman in *Street v Mountford* also recognised that there can be circumstances where an arrangement may still only be a licence notwithstanding that de facto exclusive possession can be established. For example, an owner can sometimes have a genuine need to continue to have access to land for some reason (eg, to provide services or to repair), and occupancy by the "tenant" can sometimes be referable to another legal relationship (such as employment or a mortgage) or where a purchaser is let into occupation before settlement. These legal relationships are the reason for the exclusive occupation rather than demonstrating the existence of a lease.

96. The approach taken in *Street v Mountford* was followed by the New Zealand Court of Appeal in *Fatac*. The decision in *Fatac* concerned Puhinui Quarries Ltd's sale of land in 1996 to a third party, Mt Wellington Nurseries Ltd, subject to what was described as a "licence". The licence was a right to operate the quarry granted by Puhinui to Atlas Consolidated Ltd in 1991. If the quarry right was a licence (rather than a lease), then there was a liability for GST as the sale could not be zero-rated as a sale of a tenanted property.

97. The Court of Appeal discussed the history of the lease/licence distinction in the United Kingdom, Australia and New Zealand. The court noted that New Zealand had over time adopted a broader approach than had the United Kingdom. The Court of Appeal took the opportunity to reject that broader approach in favour of a return to the United Kingdom's approach as set out in *Street v Mountford*. The Court of Appeal held (at [38] and [39]):

> [38] In our view first principles support the right to exclusive possession as the litmus for tenancies. Exclusive possession allows the occupier to use and enjoy the property to the exclusion of strangers. Even the reversioner is excluded except to the extent that a right of inspection and/or repair is expressly reserved by contract or statute. A tenant enjoys those fundamental, if temporary, rights of ownership that stem from exclusive possession for a defined period. Stipulated reservations stem from that premise. The reverse is true for a licensee. Lacking the right to exclusive possession, a licensee can merely enter upon and use the land to the extent that permission has been given. It is this reversal of starting point that provides the rationale for recognising an estate in the land, in the one case, and a mere personal right or permission to enter upon it, in the other: see further *Street v Mountford*, supra, at 816B-D.
>
> [39] Because the tenancy/licence distinction turns on those substantive rights granted to the occupier, it remains unaffected by the label which the parties choose to place upon their transaction. **It has sometimes been said that the distinction between tenancies and licences turns on the intention of the parties. This can be misleading unless it is appreciated that the only intention that matters is intention as to substantive rights, not intention as to legal classification.**
>
> [Emphasis added]

98. The Court of Appeal went on to discuss several refinements to the exclusive possession test that adopted the approach laid down in *Street v Mountford* (at [40]–[42]):

> [40] Analysis of the case law reveals a series of ancillary principles for the purpose of distinguishing tenancies from licences. None of these, however, undermines exclusive possession as the fundamental test. Exclusive possession terminable by the owner at will would, at least as against the owner, be possession in name only. Accordingly a necessary incident of a meaningful right to exclusive possession is a defined term, whether fixed or periodic (see further Street v Mountford, supra, at 816G). The same is true of an intention to be legally bound (ibid at 819-822).
>
> [41] Rent would seem relevant to the presence or absence of an intention to be legally bound but not a precondition for a tenancy per se. ….
>
> [42] Limitations upon the purposes to which the occupier can put the land do not negate a tenancy: *Glenwood Lumber Co Ltd v Phillips*, supra, at 408-409 (PC). **Exclusive possession is not synonymous with an unqualified range of permitted uses. Equally consistent with the critical role of exclusive possession is the refusal to recognise a tenancy where the owner is prevented by statute from granting a tenancy (*Street v Mountford* at 821), where the landlord's right of entry to provide services is inconsistent with**

> **exclusive possession (ibid at 818, 824-825), or where the right to exclusive possession can be terminated pursuant to some legal relationship extraneous to that of landlord and tenant.**
>
> [Emphasis added]

99. The examples in [42] are situations where a court may overlook the decisive fact of a person's exclusive possession and find that the arrangement is not a lease.

100. The Court of Appeal (at [45]) then discussed how de facto possession can be used as a guide to whether a person has exclusive possession:

> [45] Equally consistent with the exclusive possession test are the many decisions concerned with interpretation of the contract or grant conferring the right to occupation. The fundamental question here is whether the parties intended that the occupier would have the right to exclusive possession. On that subject **de facto exclusive possession can be an important guide to contractual intentions**. That would seem the best explanation for the significance often attached to possession in fact - see, for example, *Isaac v Hotel de Paris Ltd* at p 245; *Street v Mountford* at p 823; and *Daalman v Oosterdijk* [1973] 1 NZLR 717.
>
> [Emphasis added]

101. This decision demonstrates that the courts recognise the concept of de facto possession. However, for the purposes of the common law distinction between leases and licences de facto possession is only an indicator and not decisive. In contrast, for the purposes of the definition of "possession" in s YA 1, de facto (substantially exclusive) possession is a decisive factor.

Possession "in effect"

102. The courts have also discussed situations where the effect of an agreement is decisive as to its true nature rather than the descriptions used in the form of the agreement. In *Radaich v Smith* Menzies J held (at 220):

> 2. The deed is called a "license" (sic) and the parties thereto "licensors" and "licensee", and it was argued that not only did these descriptions in a formal document show the intention of the parties but also that the substance of its provisions justified these descriptions. **When looked at as a matter of both form and substance, the deed seems to me to speak with two voices, but what I regard as decisive in favour of its creating the relationship of landlord and tenant is that it gives the "licensee" the right of exclusive possession of the premises for the term granted thereby.**
>
> [Emphasis added]

103. Furthermore, Lord Davey in *Glenwood Lumber Co Ltd v Phillips* [1904] AC 405 held (at 408):

> In the so-called licence itself it is called indifferently a licence and a demise, but in the Act it is spoken of as a lease, and the holder of it is described as the lessee. It is not, however, a question of words but of substance. **If the effect** of the instrument is to give the holder an exclusive right of occupation of the land, though subject to certain reservations or to a restriction of the purposes for which it may be used, it is in law a demise of the land itself ...
>
> [Emphasis added]

104. As noted above, in *Fatac* the New Zealand Court of Appeal stated (at [39] and [46]):

> [39] Because the tenancy/licence distinction turns on those substantive rights granted to the occupier, it remains unaffected by the label which the parties choose to place upon their transaction. It has sometimes been said that the distinction between tenancies and licences turns on the intention of the parties. This can be misleading unless it is appreciated that the only intention that matters is intention as to substantive rights, not intention as to legal classification. As Lord Templeman put it in *Street v Mountford*, supra, at p 819:
>
>> ... The consequences in law of the agreement, once concluded, can only be determined by consideration of the effect of the agreement. If the agreement satisfied all the requirements of a tenancy, then the agreement produced a tenancy and the parties cannot alter the effect of the agreement by insisting that they are only creating a licence. The manufacture of a five-pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade.
>
> Windeyer J made the same point in *Radaich v Smith*, supra, when he said at p 222:
>
>> Whether the transaction creates a lease or a licence depends upon intention only in the sense that it depends upon the nature of the right which the parties intend the person entering upon the land shall have in relation to the land.
>
> [46] Terminology traditionally used to describe a tenant's right of occupation (eg the right "to enter upon, use, and enjoy" the land) is significant only if and to the extent that it indicates an intention that the occupier enjoy exclusive possession (*Addiscombe Garden Estates Ltd & Anor v Crabbe & Ors* [1957] 3 All ER 563 (CA) at p 567).

105. In *National Car Parks Ltd v Trinity* [2001] 2 EGLR 43 the agreement included a provision that stated the agreement did not give any proprietary interest to the occupier in the premises. Judge Rich QC considered the real issue to be the effect the agreement actually had and not what the agreement was that the parties expressed themselves as intending to make (at 44):

> This indicates the intention of the parties, and it is not to be assumed that they failed in such intention, although the need to express it raises a question, and that is, what is the effect of the agreement that they actually made, and not, what was it that they expressed themselves as intending to make?
>
> There is no issue between the parties as to the proper approach to that question. It is thus expressed in *Hill and Redman's Law of Landlord and Tenant* at para A-5632:
>
>> **In deciding whether a grant amounts to a lease, or is only a licence, regard must therefore be had to the substance rather than the form of the agreement**, for the relationship between the parties is determined by the law and not by the description which they choose to put on it. To put it another way, **it is the effect of the agreement in law which determines its category and not what the parties say their intention was – – still less the label they put on the agreement**.
>>
>> One must look at the transaction as a whole and at any indications one finds in the terms of the contract between the two parties to find whether in fact it is intended to create a relationship of landlord and tenant or that of a licensor and licensee.
>
> [Emphasis added]

106. These cases demonstrate that the courts consistently consider the rights a person actually has in the land to determine whether an estate in land exists. If the person is found to have rights to legal exclusive possession—howsoever the arrangement is described, the arrangement will be treated as, in effect, being an estate in land.

Conclusions on "in fact or effect"

107. In the Commissioner's view the words "in fact" in the definition of "possession" extend the concept of possession for the purposes of the Act to include situations where the user is actually occupying or using the land without the requisite legal exclusive right to possession of the land. This is broader than the common law concept of "possession".

108. The Commissioner considers the reference to "in effect" in the definition of "possession" emphasises the need to have regard to the substance of the arrangement in law between the parties. These words do not extend but reflect the common law in this regard. The words "in effect" may also cover the situation where a lessee may not in fact be exercising their right to possession, despite being legally entitled to do so.

109. In summary, the words "in fact or effect" in the definition of "possession" mean that in limited circumstances a person who is, in fact, in occupation or has use of the land may be considered to be in "possession" of the land even though they may not satisfy the requirements for legal possession of the land. Also, a person who is not in occupation or is not actually using the land may still be considered to be in possession of the land, if they in effect have a right to use the land. These words give effect to the purpose of the definition as it was explained by the court in *Yule*.

Meaning of "substantially exclusive"

110. As explained above (at [92]), the common law approach to possession turns on the substantive rights granted to the occupier. Anything less than *exclusive* possession is insufficient for an estate or interest in land at common law. (It is recognised that sometimes a lessor will reserve certain rights or impose restrictions on a lessee but it is generally accepted that this need not disturb a lessee's exclusive possession.)

111. In contrast, the definition of "possession" in s YA 1 provides that a use that is "substantially exclusive" is sufficient for tax purposes. The Act does not define when a use will be "substantially exclusive". The courts have not tested this phrase.

112. The ordinary meaning of "substantially" in the *Concise Oxford Dictionary* (12th ed, Oxford University Press, 2011) is:

> 1 To a great or significant extent
>
> 2 For the most part; essentially

113. *Black's Law Dictionary* (6th ed, West Publishing, 1990) defines the term "substantially" as:

> without material qualification; in the main; in substance; materially.

114. In case law, the meaning given to the term "substantially" depends on the context in which it is used and the facts. For example in *R v Lloyd* [1965] 1 QB 175 and *Troon Place Investments Ltd v CIR* (1995) 17 NZTC 12,175 "substantially" refers to something less than totally or wholly but more than trivial or minimal (see also *Jolly v Palmer* [1985] 1 NZLR 658). The meaning falls somewhere in between. It is a word of degree with the cases suggesting it is closer to the "totally or wholly" end of the spectrum than to the "trivial or minimal" end. The courts have found that "substantially" may refer to a significant part of something (*Lloyd*). In this context the Commissioner considers "significant" means a relatively large amount so as to be important or noteworthy. The meaning of "substantially" has also been equated with the words significant, real and considerable when used as a negative test (*Plato v Ashton* (CA 25/84, 1 October 1984)).

115. When "substantially" is used to qualify an unambiguous term (such as "full-time"), "substantially" has been interpreted by equating it to phrases such as "to all intents and purposes", and "in the main". In *Troon Place Investments* Tompkins J considered that in the context of s 190 of the Income Tax Act 1976, which limited a deduction for excessive remuneration paid to a director of a company who was employed substantially full-time in the business of a company, "substantially" meant "to all intents and purposes, in the main" and that to be employed substantially full time, a person need not be employed full time.

116. Tompkins J commented (at 12,180) on the meaning of the phrase "employed substantially full time":

> The phrase is one of degree. A person does not have to be employed full time - it is sufficient if the employment is "substantially" full time. In my view, in the phrase and in the context of the section, the word is used in the sense given to it by the *New Shorter Oxford Dictionary* as meaning "to all intents and purposes, in the main". If the person is to all intents and purposes employed full time or is in the main employed full time, then such a person would be employed substantially full time.

117. In the Commissioner's view the decision in *Troon Place Investments* is helpful. This is because the word "substantially" is being considered in the context of the Income Tax Act and modifies an otherwise "definite" word (that is, the words "full-time" and "exclusive" are similarly definite in their scope).

118. *Simpson v ACC* (Decision 206-2009, AI 250-04), is an Accident Compensation Corporation decision that attempted to identify the cause of a person's ill health. Although the decision is not factually relevant to the matters being addressed in the Rulings, Judge Barber's discussion does offer a contextual example of the words "substantially" and "exclusive" being used together. In the case, age-related degeneration was not found to be the exclusive cause of the appellant's symptoms; nor was degeneration found to be substantially the cause of the symptoms. This was because the appellant could point to an earlier injury that had a significant causal connection with the symptoms.

119. Applying Judge Barber's thinking to the words in the definition of "possession", a use of land by a person may not be "substantially exclusive" if there is another person with a competing right to also use the land.

120. Based on the dictionary meanings and the limited case law, on balance, the Commissioner considers the better view is that, in the context of the definition of "possession" in s YA 1, the words "substantially exclusive" are referring to a use of the land by a person that is, to all intents and purposes, or in the main, exclusive. In other words, no other person has (or retains) a competing right to use the same land such that it could be said that the first person is prevented from having a use of the land that is substantially exclusive.

Similarities with English cases on occupiers

121. Various United Kingdom cases included reference to the term "substantially exclusive" in the context of the occupation of land. Although not directly relevant to the definition of "possession", these cases offer some insights into the expression "substantially exclusive" as it is used in the context of land.

122. The Court of Appeal in *Hutt Valley Electric-Power Board v Lower Hutt City Corp* [1949] NZLR 611 discussed the rights that power companies are granted over land in respect of poles and power lines. The Court of Appeal (at 616) referred to the English decision of *Newcastle-under-Lyme Corp v Wolstanton, Ltd* [1946] 2 All ER 447:

> In the case of a right-of-way, there is merely the right of passage, but here is a *de jure* occupation—physical occupation of a piece of land—and no inference is permitted in respect of the poles or power lines, the right being statutory. **The plaintiff Board is a licensee with substantially exclusive rights to part of the soil; and occupation is a question of fact ....**
>
> [Emphasis added]

123. The decision in *Newcastle-under-Lyme* concerned whether a gas company had an exclusive right of occupation of the land through which its pipes or cables passed that would enable it to sue for nuisance. It was held that the company did. In reaching its decision, the court considered (at 454) the status of gas companies (and the like) as occupiers of the land for rating purposes:

> It is to be observed that in all the rating cases the question before the court was whether the subject sought to be rated was an "occupier of lands" within the meaning of the Poor Relief Act, 1601. As regards the word "lands" the effect of the cases has been to give a wide interpretation to it; and **as regards the word "occupier" the effect has been to establish that the question is one of fact—whether (to state the matter briefly and without attempting a definition) the subject sought to be rated was in de facto possession to the substantial exclusion of any enjoyment of the land by others and in circumstances importing some degree of permanence. It has been clearly laid down that the question is not a matter of title and does not depend upon title**.
>
> In the words of Lord Russell of Killowen ([1936] 2 All ER 322, at p 329), in the *Westminster City* case:

'... it is immaterial whether the title to occupy is attributable to a lease, a licence, or an easement.'

I cite also the language of Wightman J (1 E & E 716, at p 720) in the *West Middlesex Waterworks* case, which was quoted with approval by Lord Davey ([1895] AC 117, at p 132) in the *Halkyn Drainage* case:

'... the first question is whether the company are rateable for their mains, which are laid under the surface of the highway, without any freehold or leasehold interest in the soil thereof being vested in the company. We think they are. These mains are fixed capital vested in land. The company is in possession of the mains buried in the soil, and so is *de facto* in possession of that space in the soil which the mains fill, for a purpose beneficial to itself. The decisions are uniform in holding gas companies to be rateable in respect of their mains, although the occupation of such mains may be *de facto* merely, and without any legal or equitable estate in the land where the mains lie, by force of some statute.'

[Emphasis added]

124. This decision makes it clear that to be an occupier for rating purposes it was not necessary for the occupier to have a legal estate in the land. Instead it was sufficient to be in de facto possession to the substantial exclusion of any enjoyment of the land by others. In the Commissioner's view this is essentially the same test as is provided for in the definition of "possession".

125. The court in *Newcastle-under-Lyme* followed the approach to rating occupiers of land as it was explained by Lord Russell of Killowen in the House of Lords decision of *Westminster City v Southern Railway Co* [1936] 2 All ER 322. That case concerned premises at Victoria Station in London. The question was whether the premises (including shops, stalls, a bank, kiosks, and the like) were "so let out as to be capable of separate assessment" for rates purposes. It was held that the occupiers of the premises had sufficient de facto and exclusive occupation of the premises to be assessed for rates as occupiers.

126. Lord Russell of Killowen commented that sometimes more than one person may have claims to the use or occupancy of premises (eg, a landlord and a tenant). He said (at 326):

The question in every such case must be one of fact, - namely, whose position in relation to occupation is paramount, and whose position in relation to occupation is subordinate; but, in my opinion, the question must be considered and answered in regard to the position and rights of the parties in respect of the premises in question, and in regard to the purpose of the occupation of those premises.

127. He gave the example of a lodger in a lodging house not being treated as an occupier for rating purposes. While Lord Russell acknowledged that this was a pragmatic result, he noted sound legal reasons also existed for the decision (at 327):

But it can I think be justified and explained when we remember that the landlord, who is the person held to be rateable, is occupying the whole premises for the purpose of his business of letting lodgings, that for the purpose of that business he has a continual right of access to the lodgers' rooms, and that he, in fact, retains the control of ingress and egress to and from the lodging house, notwithstanding that the power of ingress and egress at all hours, is essential to the lodger. The general principle applicable to the cases where persons occupy parts of a larger hereditament seems to be that if the owner of the hereditament (being also in occupation by himself or his servants) **retains to himself general control over the occupied parts**, the owner will be treated as being in rateable occupation; if he retains to himself no control, the occupiers of the various parts will be treated as in rateable occupation of those parts.

[Emphasis added]

128. Lord Russell then noted that this principle had been applied in cases other than lodgers. He referred to cases involving ships using wharves to load and unload cargo. He noted that each case depends on its facts and an examination of the degree of control the landlord or owner can exercise to interfere with the occupier's enjoyment of the premises.

129. It is interesting to consider the similarities between the issues addressed by Lord Russell and those being considered in these Rulings. Lord Russell of Killowen's analysis can be read as suggesting that an occupier for rating purposes is a person who is in fact or effect enjoying the use of the relevant land to the substantial exclusion of all others, and in particular the owner. When read this way, it is similar to the definition of "possession" in s YA 1. The English cases clarify that when an owner (or landlord) occupies the land along with a "tenant", then the dominant occupier needs to be established for rating purposes. This is determined by considering whether the owner retains such a degree of control over the land that it interferes with the tenant's enjoyment of the land so the tenant is prevented from enjoying a use of the land that is substantially exclusive.

Reading definition of "possession" as a whole

130. Having considered the separate elements of the definition of "possession", it is now appropriate to consider the definition of "possession" in s YA 1 as a whole:

... a use that is in fact or effect substantially exclusive

131. In the Commissioner's view a person's use of the land will be substantially exclusive when to all intents and purposes, or in the main, no other person (including the owner) has (or retains) a competing right to use the same land.

132. In the context of car parks and the FBT on-premises exclusion, in most situations "possession" will be established by determining whether, in granting a right to use the land for parking, anyone else, including the owner of the land or car park operator has (or retains) a degree of control over the land such that it prevents the employer from having, to all intents and purposes, exclusive use of the land. If someone else, including the owner or car park operator, does have or retain such a degree of control over the parking spaces then the employer will not have a substantially exclusive right to use the land and the car parks will not be the premises of the employer.

133. When establishing whether a use of land is substantially exclusive account is to be taken of what is actually occurring between the parties and to the actual effect of any agreement between the parties. It does not matter whether the employer's use does not satisfy the concept of "legal possession" at common law, but it must be substantially exclusive.

134. In the Commissioner's view this interpretation of the definition of "possession" is consistent with the purpose of the definition as explained by the Supreme Court in *Yule*.

135. The Commissioner also thinks her interpretation of the definition of "premises of a person" when read as a whole is consistent with the natural and ordinary meaning of the words "premises of the employer". The Supreme Court of Western Australia considered the phrase "premises of an employer" in *Molina v Zaknich* (2001) 125 A Crim R 401. *Molina* concerned, among other things, access by union officials to an employer's premises. Hasluck J held that the natural and ordinary meaning of the phrase "premises of an employer" refers to a site under the control of the employer. The Commissioner considers this is consistent with her interpretation of the definition.

Absence of word "licence" from definitions

136. In forming her view, the Commissioner considers it is significant the term "licence" is not explicitly included in s CX 23, in para (a) of the definition of "lease" (although it is expressly included in other parts of the definition of "lease"), or in the related definitions of "leasehold estate", "estate", "interest" or "possession". (It is noted that para (b)(i) of the definition of "estate" includes an example of a licence to occupy arising from a share in a flat or office owning company. The Commissioner does not consider this very specific example to be in any way suggestive that licences to occupy in general are included within the definition of "estate".)

137. It is generally acknowledged for common law purposes that a clear distinction exists between a lease and licence, and that legally the two concepts are mutually exclusive. If Parliament had intended for *all* licences to be treated as leases, then it would have explicitly provided for this as it has in other situations.

Alternative views

138. The Commissioner is aware of possible counter-arguments suggesting that all car parking spaces provided by an employer for employees should be treated as being the employers "premises" under s CX 23(2)(a).

139. There is an argument that the word "include" in the definition of "premises of a person" in s CX 23(2)(a) should be interpreted non-exhaustively, so that any car parks that are licenced by employers can be included as an employer's premises. The Commissioner accepts that the word "include" normally indicates an inclusive definition. However, as noted above, the Commissioner considers the better view, in this context, is to interpret "include" in the definition of "premises of a person" exhaustively. In the Commissioner's view such an interpretation is supported by:

- the intended purpose of the FBT rules;
- the construction of the definition of "premises of a person" in s CX 23(2);
- the nature of the "class" of items in s CX 23(2)(a); and
- the implication that if Parliament had intended the class to be broader than premises that are owned or leased it could have explicitly provided for it.

140. Another counter-argument is that the definition of "lease", as extended by the definition of "possession", supports all licences being included as "leases". However, in the Commissioner's view, when the definition of "possession" is interpreted in light of its text and its purpose, an employer will only have substantially exclusive use of the car park when they have a substantial degree of control over the car park. Without such a degree of control, the Commissioner does not consider that the car park is "leased" for the purposes of the definition of "premises of a person".

Conclusions

141. The premises of an employer include car parks owned or leased by the employer. The premises of an employer are not restricted to business premises of the employer.

142. When determining whether premises are leased by an employer, regard must be had to the relevant definitions in s YA 1 of "lease", "estate", "leasehold estate" and "possession".

143. At common law (and for the purposes of the general definition of "estate" in para (a) of the definition), land is leased when the employer has legal possession of the land to the exclusion of all others, including the owner. Where an employer is granted something less than exclusive possession of the land (such as a licence to occupy the land) there is no lease at common law or for the purposes of the general definition of "estate".

144. Paragraph (b) of the definition of "estate" extends the general definition of "estate" to include a right to possession of the land. "Possession" is defined as a right to use the land that is in fact or effect substantially exclusive.

145. The premises of an employer will not usually include a car park that an employer is merely licensed to use, *unless* the employer's right to use the car park is in fact or effect substantially exclusive.

146. An employer will have a right to use a car park that is in fact or effect substantially exclusive when no-one else (including the owner, the car park operator, or any third party) has a competing right to use the car park premises that could be said to prevent the employer from enjoying a use that is substantially exclusive.

147. Sometimes when an owner or landlord is operating their business from the land that they have granted rights over, they will seek to retain some degree of control over the land (eg, the owner of a lodging house or a port company over its wharves). In the context of car parking, if the owner or the car park operator retains a degree of control over the relevant car park that might be sufficient to prevent the employer from enjoying substantially exclusive use of that park.

148. In the Commissioner's view the words "in fact" in the definition of "possession" extend the common law concept of "possession" to include situations where the user is actually controlling the land without the requisite legal exclusive right to possession.

149. The Commissioner considers the reference to "in effect" in the definition of "possession" emphasises the need to have regard to the substance of the arrangement in law between the parties. These words do not extend but reflect the common law in this regard. The words "in effect" may also cover the situation where a lessee may not in fact be exercising their right to possession, despite being legally entitled to do so.

150. Therefore, when determining whether an employer has substantially exclusive use of the land it is not the legal form of the arrangements that is decisive but the substance of the arrangements demonstrated either through the fact of what is actually occurring or through the effect of the true arrangements between the parties.

151. The Commissioner accepts that the definition of "lease" for the purposes of s CX 23 is wider than the common law meaning of "lease" as it includes a car park which the employer has a right to use that is in fact or effect substantially exclusive. However, the Commissioner does not consider this to mean every right to use a car park will be a "lease" for tax purposes. Many car parking arrangements will continue to fall outside the definition of "lease" for the purposes of s CX 23.

Examples

152. The following examples illustrate the way in which an employer's overall arrangement with a car park owner or operator needs to be considered to determine if the employer has a right to use a car park that is in fact or effect substantially exclusive. The conclusions in the examples are based on the facts as stated. It is important to bear in mind that every situation is different, and the different features of parking arrangements may result in different FBT outcomes. In each example it is assumed that the provision of a car park by the employer to its employee is a benefit for FBT purposes.

Example 1: Leased car parks on vacant land adjacent to business

153. Diane provides some of her employees with car parks on vacant land across the road from the property from which she carries on her business. Diane is the lessee of that land under an enforceable and written lease agreement with the owner of the land.

154. Because the rights granted to Diane under the agreement are enforceable against third parties, she has exclusive possession of the land, and the definition of "lease" for the purposes of establishing the "premises of a person" is satisfied. The car parks Diane provides to her employees are excluded from being a "fringe benefit" by s CX 23, and so no FBT is

payable in respect of the car parks. Diane does not have to carry on her business on the leased land for the exclusion to apply.

Example 2: Allocated parking under a lease agreement with a group company

155. Eastern City Limited, a company in the same group as Eastern Port Limited, enters into a deed of lease with Wharf St Developments Limited, a company that provides parking in a car parking building. Under the arrangement, Eastern City is granted a lease of 12 parking spaces. The parking spaces are identified on a plan of the car park, and the plan is attached to the lease agreement. The parking spaces cannot be changed unless a new deed of lease or a variation of lease is executed.

156. Under the deed of lease Eastern City is responsible for monitoring and requesting removal of any unauthorised cars that park in its parking spaces. Eastern City is restricted to using the car parks for parking cars, but can approach Wharf St Developments to make improvements to the car parks, or arrange for other types of vehicles to use the parks, which Wharf St Developments cannot unreasonably deny.

157. The Commissioner considers that in these circumstances the car parks are the premises of Eastern City, because Eastern City in fact and effect has a right to use the car parks that is substantially exclusive.

158. Employees of Eastern Port, a company in the same group as Eastern City, use the car parks for parking while at work. The car parking benefit provided by Eastern Port to its employees will be used or consumed on the premises of Eastern City, a company in the same group as Eastern Port, so the exclusion in s CX 23 applies and no FBT is payable in respect of the car parks.

Example 3: Allocated parking in a commercial car park

159. Southern City Limited wants to provide parking in a commercial car park for 50 of its employees. It enters into a standard month-by-month agreement with a commercial car park operator close to Southern City's office.

160. Under the agreement 50 parking spaces in the commercial car park are allocated to Southern City's employees for them to park in from 7am to 7pm Monday to Friday. These car parks are each marked with a sign that reads "Reserved for Southern City 7am to 7pm Mon-Fri". Southern City is issued with 50 access cards enabling the cardholders to access the car park between those hours. Under the terms of the agreement, if an unauthorised person parks in one of Southern City's car parking spaces during those hours, Southern City has the right to request the car park operator remove the vehicle. The car park operator is only able to re-allocate Southern City's car parks or alter the hours of access with Southern City's prior agreement.

161. The Commissioner considers that in these circumstances the car parks are the premises of Southern City. This is because the employer in fact has a right to use the car parks that is substantially exclusive during the agreed period. No-one else, including the car park operator, has a competing right to use the reserved car parks at those times. As a result the exclusion in s CX 23 applies and no FBT is payable in respect of Southern City's car parks. The Commissioner considers the same result would apply regardless of the number of car parks "leased" by Southern City.

Example 4: Allocated parking floor

162. Coastal City Limited has many employees who use parking facilities provided by a nearby commercial car park. It decides there are enough employees that need parking that it could use the whole top floor of the car park. The proprietor of the commercial car park agrees to install a card access gate so that only Coastal City's employees can use the top floor. A car parking agreement is prepared using the proprietor's standard-form licence agreement. Signage is erected identifying the floor as being reserved for Costal City's employees' use.

163. The Commissioner considers that in these circumstances the top floor of the car parking building is the premises of Coastal City even though under the agreement Coastal City is only licensed to use the parks. This is because the employer in fact has a right to use the top floor of the building that is substantially exclusive. The car park proprietor retains only a minimal degree of control over the floor. No-one else has a competing right to use the floor. As a result the exclusion in s CX 23 applies and no FBT is payable in respect of the parking on the top floor.

Example 5: Unallocated parking in commercial car park

164. Northern City Limited wants to provide parking in a commercial car park for three of its employees. It enters into a one year agreement with a commercial car park operator close to Northern City's office.

The agreement is described as a lease however no particular parking spaces are designated for Northern City's employees. Instead the car park operator has set aside some parking spaces in a reserved area of the car park to be shared with other businesses. Three parking spaces will always be available for Northern City's employees in the reserved area, although not the same spaces every time.

165. The Commissioner considers that neither the car park, nor any part of it, is the premises of Northern City. Despite the agreement being called a lease, the parking spaces are not owned or leased by Northern City, because Northern City (and its employees) cannot be said to have in fact or effect a use of specific parking spaces that is substantially exclusive. Other authorised business users of the car park can also park in the reserved area, sharing the same spaces at the same time they are made available to Northern City. Northern City simply has permission to enter and use the reserved area of the car park with no substantially exclusive right to use any particular car parking space. Northern City has no right to arrange for vehicles to be removed from the car parking spaces in the reserved area.

166. The provision of car parking by Northern City to its three employees is not excluded from being a "fringe benefit" by s CX 23(2)(a). As a result FBT may be payable in respect of the car parks.

Example 6: Prepaid parking in a public car park

167. Sunny Gifts, a retail store in a busy tourist town, provides parking for two of its employees in an open air public car park behind the town's main street. The car park is open to the public on an hourly fee-basis, however store owners can purchase parking permits for workers. The permits are displayed in the front windscreen of the car and entitle the holder to all-day parking every day. There are no designated spaces in the car park for parking permit holders.

168. The provision of car parking by Sunny Gifts to its two employees is not excluded from being a "fringe benefit" by s CX 23(2)(a). The Commissioner considers neither the car park, nor any part of it, to be the premises of Sunny Gifts. As a result FBT may be payable in respect of the car parks.

References

Expired Ruling(s)
BR Pub 99/6 Car parks provided by employers – fringe benefit tax exemption
Subject references
Car park, fringe benefit, fringe benefit tax, possession, premises
Legislative references
Income Tax Act 2007, ss CX 2, CX 23, YA 1
Case references
Dilworth v Commissioner of Stamps (1899) NZPCC 578 (PC)
Fatac Ltd (in liq) v CIR [2002] 3 NZLR 648
Gardiner v Sevenoaks Rural District Council [1950] 2 All ER 84
Glenwood Lumber Co Ltd v Phillips [1904] AC 405
Grandi v Milburn [1966] 2 All ER 816
Harley v CIR [1971] NZLR 482 (CA)
Hutt Valley Electric-Power Board v Lower Hutt City Corp [1949] NZLR 611 (CA)
Jolly v Palmer [1985] 1 NZLR 658
Maunsell v Olins [1975] 1 All ER 16
McKenna v Porter Motors Ltd [1955] NZLR 832
Merrill v Wilson [1900] 1 QB 35 (CA)
Molina v Zaknich (2001) 125 A Crim R 401 (SC WA)
Newcastle-under-Lyme Corp v Wolstanton Ltd [1946] 2 All ER 447
National Car Parks Ltd v Trinity [2001] 2 EGLR 43
Northern Hotel IUOW v Bay of Islands College Board of Trustees [1991] 1 ERNZ 710
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Plato v Ashton (CA 25/84, 1 October 1984)
R v Lloyd [1965] 1 QB 175
Radaich v Smith (1959) 101 CLR 209
Simpson v ACC (Decision 206-2009, AI 250-04)
Street v Mountford [1985] 2 All ER 289 (HL)
Troon Place Investments Ltd v CIR (1995) 17 NZTC 12,175
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Westminster City v Southern Railway Co [1936] 2 All ER 322
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Whitsbury Farm and Stud Ltd v Hemens (Valuation Officer) [1988] AC 601 (HL)
Yule v Commissioner of Taxes [1918] NZLR 890 (SC)

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Rewriting the Income Tax Act 1994 (exposure draft, Inland Revenue, 2001) **http://taxpolicy.ird.govt.nz/publications/2001-dd-rewrite-exposure-draft/overview**
Streamlining the Taxation of Fringe Benefits (government discussion document, Policy Advice Division of the Inland Revenue Department, December 2003) **http://taxpolicy.ird.govt.nz/publications/2003-dd-fringe-benefit-tax/overview**

APPENDIX – LEGISLATION

1. Section CX 2(1) defines what is meant by a fringe benefit:

CX 2 Meaning of fringe benefit

Meaning

(1) A **fringe benefit** is a benefit that—
   (a) is provided by an employer to an employee in connection with their employment; and
   (b) either—
      (i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or
      (ii) is an unclassified benefit; and
(c) is not a benefit excluded from being a fringe benefit by any provision of this subpart

2. Section CX 23 provides an exclusion from fringe benefit tax for benefits provided on an employer's (or group company's) premises:

CX 23 Benefits provided on premises

When not fringe benefit

(1) A benefit, other than free, discounted, or subsidised travel, accommodation, or clothing, is not a fringe benefit if the benefit is—
   (a) provided to the employee by the employer of the employee and used or consumed by the employee on the premises of—
      (i) the employer:
      (ii) a company that is part of the same group of companies as the employer:
(b) provided to the employee by a company that is part of the same group of companies as the employer of the employee and used or consumed by the employee on the premises of—
   (i) the employer:
   (ii) the company that provides the benefit.

Premises of person

(2) In this section, the premises of a person—
   (a) include premises that the person owns or leases:
   (b) include premises, other than those referred to in paragraph (a), on which an employee of the person is required to perform duties for the person:
   (c) do not include premises occupied by an employee of the person for residential purposes.

3. The definitions in s YA 1 that relate to the terms "owns" or "leases" as they are used in s CX 23 are:

YA 1 Definitions

In this Act, unless the context requires otherwise,—

estate in relation to land, **interest** in relation to land, **estate or interest in land, estate in land, interest in land**, and similar terms – –
(a) mean an estate or interest in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and
(b) include a right, whether direct or through a trustee or otherwise, to—
   (i) the possession of the land (for example: a licence to occupy, as that term is defined in section 121A(1) of the Land Transfer Act 1952):
   (ii) the receipt of the rents or profits from the land:
   (iii) the proceeds of the disposal of the land; and
(c) do not include a mortgage

land—
(a) includes any estate or interest in land.
(b) includes an option to acquire land or an estate or interest in land:
(c) does not include a mortgage:
(d) is defined in section CB 19(3) (Business exclusion from sections CB 6 to CB 11) for the purposes of that section:
(e) is defined in section IZ 1(12) (Use of specified activity net losses) for the purposes of that section:
(f) in the definitions of **permit area, petroleum mining asset, prospecting expenditure,** and **residual expenditure,**—
   (i) means all land within the territorial limits of New Zealand; and

(ii) includes land below the territorial sea of New Zealand or any other waters within the territorial limits of New Zealand; and

(iii) includes the continental shelf; and

(iv) includes the seabed and subsoil below any sea that is beyond the territorial sea of New Zealand but that, by New Zealand legislation and under international law, has been or may be designated as an area in which the rights of New Zealand relating to natural resources may be exercised

interest,—

(a) for a person's income,—

(i) means a payment made to the person by another person for money lent to any person, whether or not the payment is periodical and however it is described or calculated; and

(ii) does not include a redemption payment; and

(iii) does not include a repayment of money lent:

(b) for the RWT rules and the NRWT rules, includes a redemption payment:

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

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

(ii) does not include interest to which section DB 1(1)(e) (Taxes, other than GST, and penalties) applies:

(d) in relation to land, **interest in land, estate or interest in land**, and similar terms are defined under the definition of **estate**

lease—

(a) means a disposition that creates a leasehold estate.

(b) in sections DZ 9 (Premium paid on land leased before 1 April 1993) and EZ 8 (Premium paid on land leased before 1 April 1993),—

(i) means a disposition by which a leasehold estate is created; and

(ii) includes a licence:

(c) for the purposes of subpart EE (Depreciation), includes a licence to occupy:

(d) in sections EJ 10 (Personal property lease payments), EX 21(30) and (31) (Attributable CFC amount and net attributable CFC income or loss: calculation rules), FA 6 to FA 11 (which relate to finance leases), FZ 2 to FZ 4 (which relate to specified leases) and in the definitions of **cost price** (paragraphs (b) to (e)), **finance lease, guaranteed residual value, initial period, instalment, lessee** (paragraph (b)), **lessor** (paragraph (b)), **operating lease, outstanding balance, personal property lease asset, specified lease,** and **term of the lease,—**

(i) means an agreement under which a lessor transfers to a lessee for the term of the lease a personal property lease asset or the right to possess a personal property lease asset in consideration for a personal property lease payment; and

(ii) includes a sublease; and

(iii) includes a licence to use intangible property; and

(iv) includes a hire or bailment; and

(v) includes a lease that is 2 or more consecutive or successive leases treated as 1 lease because the same personal property lease asset had been leased to the same lessee or an associated person of the lessee under the consecutive or successive leases and the Commissioner, having regard to the tenor of this paragraph, regards the consecutive or successive leases as 1 lease; and

(vi) does not include a hire purchase agreement, the definition of which applies, for this purpose, as if it did not contain paragraph (f); and

(vii) does not include an assignment of a hire purchase agreement, the definition of which applies, for this purpose, as if it did not contain paragraph (f):

(e) is defined in section GC 5(5) (Leases for inadequate rent) for the purposes of that section:

(f) in the financial arrangements rules, means—

(i) a lease as described in paragraph (d):

(ii) an arrangement that would be a lease as described in paragraph (d) if the arrangement did not relate to real property, livestock, or bloodstock

leasehold estate includes any estate, however created, other than a freehold estate.

own,—

(a) for land, means to have an estate or interest in the land, alone or jointly or in common with any other person:

(b) for the ownership of depreciable property, is defined in sections EE 2 to EE 5 (which relate to depreciation

possession includes a use that is in fact or effect substantially exclusive

COMMISSIONER'S OPERATIONAL POSITION ON FBT AND CAR PARKS

The purpose of this item is to inform taxpayers of the operational position being adopted by the Commissioner in relation to this matter.

Inland Revenue has released BR Pub 15/11 and BR Pub 15/12. These rulings cover car parks an employer owns or leases and whether they will qualify for the "on-premises" exemption from FBT. BR Pub 15/11 relates to car parks provided on premises that the employer owns or leases while BR Pub 15/12 relates to car parks provided on the premises of a company that is part of the same group of companies as an employer.

The rulings provide that the premises of an employer will not usually include a car park that an employer is merely licensed to use, *unless* the employer can show they have a **right to use** the car park that **is in fact or effect substantially exclusive**.

This is different from the Commissioner's previously published view on FBT and car parks in BR Pub 99/6. That public ruling determined that licensed car parks could **never** be an employer's premises, and so the provision of licensed car parks by employers to employees was always subject to FBT. BR Pub 99/6 expired in 2005, and since then the relevant legislation has changed.

The Commissioner recognises that some taxpayers may have continued to adopt the approach in expired BR Pub 99/6 in relation to licenced car parks when determining their FBT liability.

Accordingly, as Inland Revenue considers that the legal analysis contained in the public rulings BR Pub 15/11 and BR Pub 15/12 represents the correct view of the law, employers can ask Inland Revenue to apply the analysis in the public rulings to tax positions taken in earlier years. The Commissioner will apply the principles set out in the Standard Practice Statement on s 113 of the Tax Administration Act 1994 to determine whether to amend past assessments subject to the statutory time limits for refunds (usually four years).

Every request made under s 113 will be considered by the Commissioner on a case by case basis taking into account all of the relevant individual circumstances of the employer and their parking arrangements. Relevant supporting documents need to accompany any request.

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

SPS 15/02: REMISSION OF PENALTIES AND USE-OF-MONEY INTEREST

Introduction

Standard Practice Statements describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This statement sets out the Commissioner's practice when granting remission of penalties and use-of-money interest[1] under ss 183A, 183ABA and 183D of the Tax Administration Act 1994 (the TAA).

Unless specified otherwise, all legislative references in this statement refer to the TAA. The relevant provisions are:

- ss 140B, 140CB, 141AA, 141B(1D), 141ED, 183A, 183ABA, 183D, 183H; and
- s YA 1 of the Income Tax Act 2007 (definition of "emergency event").

The statement does not apply to requests for remission of penalties and use-of-money interest charged on:

- Child Support payments by receiving carers or liable parents;
- student loan repayments; or
- shortfall penalties, except for shortfall penalties imposed by s 141AA (Shortfall penalty if non-resident contractor relieved from all liability to pay tax on contract payment) or s 141ED (Not paying employer monthly schedule amount).

Application

Taxpayers are encouraged to contact Inland Revenue as soon as possible if they think that they may have trouble paying their tax in full by the due date, or that they may experience serious hardship, so that the options for financial relief can be discussed. Taxpayers need not wait for a due date to pass before applying for financial relief.[2]

This statement applies to remission requests received on or after 24 November 2015. It replaces SPS 05/10 *Remission of penalties and interest* (*Tax Information Bulletin* Vol 17, No 9 (November 2005): 68), which was issued on 17 October 2005.

Reviewing a decision

If a taxpayer is concerned that their request for remission has not been given proper consideration, they should raise their concern and ask for the decision to be reviewed.

If a taxpayer is still not satisfied with the level of service they receive, they can obtain more information about the Inland Revenue Complaints Management Service at **http://www.ird.govt.nz/aboutir/who-we-are/structure/complaints/** or phone 0800 274 138 (Monday to Friday between 8am and 5pm).

STANDARD PRACTICE

Summary

1. The following standard practice will apply for taxpayers requesting remission of penalties and use-of-money interest under ss 183A, 183ABA and 183D.
2. Inland Revenue recognises that penalising a taxpayer for a small non-compliant action may be counterproductive and may actually reduce voluntary compliance. Inland Revenue considers it important to treat taxpayers requesting a remission of penalties and use-of-money interest and those in a similar tax position fairly and consistently. For example, while allowing a penalty to remain could affect that taxpayer's future compliance, a lenient remission practice may also mean that compliant taxpayers, who have met their obligations on time, may be less likely to do so in the future.

Form of the application

3. Requests for remission of the following penalties and use-of-money interest must be made in writing, via the myIR secure online service or addressed to the Commissioner of Inland Revenue, PO Box 39010, Wellington Mail Centre, Lower Hutt 5045:
   - imputation penalty tax imposed by s 140B;
   - Māori authority distribution penalty tax imposed by s 140CB;

[1] Use-of-money interest is calculated daily on the amount of unpaid tax including penalties. This is compensation for not having use of the unpaid tax and is to encourage taxpayers to pay the correct amount of tax on time. Use-of-money interest is not a penalty.

[2] For information on Inland Revenue's practice for accepting tax payments as having been made in time, please see SPS 14/01 *Tax Payments – when received in time*, available to view at **http://www.ird.govt.nz/technical-tax/standard-practice/processing/sps1401-taxpayments-whenreceivedintime.html.**

- a shortfall penalty imposed by s 141AA; and
- use-of-money interest.

4. Requests for the remission of the following penalties do not need to be made in writing, but may be sent via the myIR secure online service or by phone 0800 227 771 (personal customers), 0800 377 771 (business customers) or 0800 443 773 (for large enterprises):
   - a late filing penalty;
   - a non-electronic filing penalty; and
   - initial and incremental late payment penalties.

Remission on application

5. Section 183H provides that a taxpayer seeking remission of use-of-money interest or penalties under ss 183A or 183D must make written application to the Commissioner if the requested remission is of:
   - an imputation penalty tax imposed by s 140B;
   - a Māori authority distribution penalty tax imposed by s 140CB;
   - a shortfall penalty imposed by s 141AA; or
   - use-of-money interest under Part 7.
6. The taxpayer must also provide supporting information for the remission of use-of-money interest and all tax penalties covered by ss 183A, 183ABA and 183D if requested by the Commissioner.
7. Requests may be sent to Inland Revenue via the myIR secure online mail service. Alternatively, go to the Inland Revenue website **http://www.ird.govt.nz/contact-us/?id=globalnav** for more contact details.

Section 183A – Remission for reasonable cause

8. If the Commissioner is satisfied that the non-compliance has been caused by an event or circumstance beyond the control of the taxpayer and the non-compliance was rectified as soon as practicable (that is, as soon as it was feasible or realistic), remission will be granted under s 183A(1A) for:
   - a late filing penalty;
   - a non-electronic filing penalty;
   - initial and incremental late payment penalties;
   - imputation penalty tax;
   - Māori authority distribution penalty tax;
   - a shortfall penalty imposed by s 141AA;
   - a civil penalty imposed by s 215 of the KiwiSaver Act 2006; and/or
   - a penalty for not paying an employer monthly schedule amount imposed by s 141ED.
9. Requests for remission of penalties under s 183A will only be considered when the returns relevant to the request for remission have been filed and any outstanding core tax (that is, not including any interest or penalties that have been charged) has been paid.

Section 183ABA – Remission in circumstances of emergency event

10. The Commissioner will remit use-of-money interest under s 183ABA when:
    - an emergency event physically prevents a taxpayer from making a tax payment; and
    - the taxpayer has applied for remission of use-of-money interest as soon as practicable; and
    - the taxpayer made the payment of tax as soon as practicable; and
    - the taxpayer is a member of a class of persons to whom remission is available under an Order in Council declaring the emergency event; and
    - the Commissioner is satisfied that the effect on the taxpayer of the occurrence of the emergency event makes the remission equitable.

Section 183D – Remission consistent with collection of highest net revenue over time

11. If it is consistent with the Commissioner's duty to collect the highest net revenue over time, the Commissioner will remit the following penalties and interest under s 183D:
    - a late filing penalty;
    - a non-electronic filing penalty;
    - initial and incremental late payment penalties;
    - a shortfall penalty imposed by s 141AA;
    - a civil penalty imposed by s 215 of the KiwiSaver Act 2006;
    - a penalty for not paying an employer monthly schedule amount imposed by s 141ED; and/or
    - use-of-money interest.
12. The Commissioner will remit use-of-money interest in limited circumstances and will consider each case on its merits.

Background

13. Under the Inland Revenue Acts, taxpayers are expected to pay their tax in full and on time. Penalties provide an incentive to all taxpayers to comply with the law.
14. The remission provisions in the TAA allow the Commissioner to accommodate circumstances where enforcing a penalty or use-of-money interest may be inappropriate. The Commissioner will weigh

the particular circumstances in each taxpayer's case against the standard practice outlined in this statement and the relevant legislation.

15. Remission will occur when the penalty or use-of-money interest is correctly charged at the time, but it is decided to relieve the taxpayer of their liability to pay.

16. When the tax, penalty or use-of-money interest was incorrectly charged at the time, the penalty will be reversed rather than remitted.

Detailed discussion

Section 183A – Remission for reasonable cause

17. Section 183A of the TAA provides:

> **183A Remission for reasonable cause**
>
> (1) This section applies to—
>
> (a) a late filing penalty:
>
> (b) a non-electronic filing penalty:
>
> (c) a late payment penalty:
>
> (d) imputation penalty tax imposed by section 140B:
>
> (e) [Repealed]
>
> (f) Māori authority distribution penalty tax imposed by section 140CB:
>
> (g) a shortfall penalty imposed by section 141AA:
>
> (h) a civil penalty imposed under section 215 of the KiwiSaver Act 2006:
>
> (i) a penalty for not paying employer monthly schedule amount imposed by section 141ED.
>
> (1A) The Commissioner may remit the penalty if the Commissioner is satisfied that—
>
> (a) a penalty to which this section applies arises as a result of an event or circumstance beyond the control of a taxpayer; and
>
> (b) as a consequence of that event or circumstance the taxpayer has a reasonable justification or excuse for not furnishing the tax return or an employer monthly schedule, or not furnishing an employer monthly schedule in a prescribed electronic format, or not paying the tax on time; and
>
> (c) the taxpayer corrected the failure to comply as soon as practicable.
>
> (2) Without limiting the Commissioner's discretion under subsection (1), an event or circumstance may include—
>
> (a) an accident or a disaster; or
>
> (b) illness or emotional or mental distress.
>
> (3) An event or circumstance does not include—
>
> (a) an act or omission of an agent of a taxpayer, unless the Commissioner is satisfied that the act or omission was caused by an event or circumstance beyond the control of the agent—
>
> (i) that could not have been anticipated; and
>
> (ii) the effect of which could not have been avoided by compliance with accepted standards of business organisation and professional conduct; or
>
> (b) a taxpayer's financial position.

18. Section 183A does not apply to use-of-money interest. Nor does it apply to shortfall penalties, with the exception of those imposed by ss 141AA and 141ED.

19. A penalty may be remitted if the Commissioner is satisfied that the penalty arose as the result of an event or a circumstance beyond the taxpayer's control and there is reasonable justification for the breach of the relevant tax laws. In addition, the taxpayer must have filed the relevant return and paid any outstanding core tax as soon as practicable after the event or circumstance that caused the breach.

20. The taxpayer will also have to provide other information for a s 183A request if asked to do so by the Commissioner.

Is there a reasonable justification or excuse?

21. In *CIR v Fuji Xerox New Zealand Limited* (2002) 20 NZTC 17,470 (CA), it was determined that before an event or circumstance can be considered to provide a taxpayer with reasonable justification for failing to meet their obligations:

- the event or circumstance relied on by the taxpayer must be identified;
- it must be determined whether the event or circumstance was beyond the control of the taxpayer; and
- consideration must be given to whether the event or circumstance provided the taxpayer with reasonable justification.

22. Whether there is a reasonable justification for the omission caused by an event or circumstance will be determined objectively.

23. Section 183A(3)(a) expressly excludes an event or circumstance caused by an act or omission by an agent of the taxpayer from being a relevant event or circumstance. However, remission can be considered if the act or omission was caused by an event or circumstance that was beyond the control of the agent, could not have been anticipated, and the effect of which could not have been avoided by compliance with acceptable standards of business and professional conduct.

STANDARD PRACTICE STATEMENTS

24. The term "agent of the taxpayer" is not defined in the TAA. For Inland Revenue purposes, it is someone who has been given due authority by the taxpayer to act on their behalf in relation to their general, or specific, tax matters. It could include tax agents, intermediaries or other nominated persons.

25. Section 183A(3)(b) excludes a taxpayer's financial position from the definition of "event or circumstance". Requests for financial relief are dealt with under ss 176 and 177.[3]

Factors the Commissioner will consider for a s 183A remission

26. The TAA provides that an "event or circumstance" may include "an accident or a disaster or illness or emotional or mental distress". However, the Commissioner also has the discretion to consider other circumstances that are not specifically included in the legislation.

27. In deciding whether remission is appropriate, the Commissioner will consider the following factors:
    - Was the penalty correctly charged?
    - Why did the taxpayer pay or file late?
    - Was the late payment caused by an event or circumstance that was beyond the control of the taxpayer?
    - Was the tax paid or return filed as soon as practicable (that is, as soon as it was feasible and realistic)? This will depend on the circumstances of each case. Specifically, was the default corrected as soon as possible after the event or circumstance passed?
    - Was the late payment the result of an act or omission of the taxpayer's agent? Did an event or circumstance beyond the control of the agent cause the non-compliance? Could the default have been avoided by compliance with accepted standards of business organisation and professional conduct?
    - Any other information that the Commissioner considers relevant in assessing the application.

Examples

Emotional or mental distress (late filing penalty)

A taxpayer's return was due on 7 July. However, before the due date, the taxpayer's daughter became seriously ill and was hospitalised. Her condition steadily deteriorated and the family spent a great deal of time at the hospital, where she was in intensive care until the first week in September.

During this time a reminder notice was issued advising the taxpayer that a late filing penalty would be charged if the current year's income tax return was not filed within 30 days. The taxpayer filed the overdue return in mid-October, along with a letter from the daughter's doctor to confirm her illness and hospitalisation. This was after the penalty was charged.

In these circumstances, the illness of the taxpayer's daughter is out of the taxpayer's control. Although the taxpayer filed the return three months after the due date, this would be considered a "practicable" timeframe after the event or circumstance, as it allowed a reasonable time for the taxpayer to get their affairs in order after their daughter had recovered sufficiently from her illness. Therefore, remission would be appropriate in this case.

Circumstance beyond agent's control (late payment penalty)

A tax agent was entrusted to pay a client's income tax by the due date of 7 April, as the taxpayer would be travelling overseas on the due date. The taxpayer could not make an online payment as they would not have access to the internet while in transit or at the location they were headed to. The agreed plan between the taxpayer and their tax agent was for the tax agent to hand deliver the taxpayer's cheque to the local Inland Revenue office on the due date. The cheque was made out for the correct amount, signed and post-dated for the due date. The cheque was given to the tax agent and placed in the tax agent's office safe.

On the night of 6 April, the tax agent's office was burgled and the safe and its contents were destroyed. The tax agent contacted Inland Revenue on the due date and explained the situation regarding the burglary and the absence of the taxpayer. Inland Revenue requested information supporting these events such as a police report. A month later, the tax agent finally managed to contact the taxpayer about the burglary and the taxpayer arranged a direct credit to their tax agent's account. The tax agent paid the outstanding tax. The tax agent also provided a New Zealand Police report verifying the date and location of the burglary that confirmed the safe and its contents were destroyed and also provided a copy of the taxpayer's travel itinerary.

[3] For further details refer to SPS 11/01 *Instalment Arrangements for Payment of Tax*, available to view at: **http://www.ird.govt.nz/technical-tax/standard-practice/returns-debt/sps-11-01-instalment-arrangements-for-payment-of-tax.html**.

In these circumstances, the taxpayer paid the tax as soon as they became aware of the burglary and that their tax had not been paid, even though it was over a month after the due date. The tax agent also notified Inland Revenue immediately of the circumstances and provided supporting information. This is considered to be an event "beyond the agent's control".

Whether the taxpayer applied for the remission as soon as practicable (late filing penalty)

The Governor-General has declared a storm in the Auckland area as a qualifying event. A taxpayer's business premises were severely damaged by the storm. The taxpayer was unable to access his records and file a tax return until two months later. Due to the taxpayer's oversight, another seven months elapsed before the taxpayer applied for remission of the late filing penalty. In this case, the Commissioner will not exercise the discretion to remit the penalty because the taxpayer did not apply for the remission as soon as practicable.

Section 183ABA – Remission in circumstances of emergency event

28. Section 183ABA of the TAA provides:

> **183ABA Remission in circumstances of emergency event**
>
> (1) This section applies for a taxpayer if—
>
> (a) an emergency event physically prevents the taxpayer from making a payment required by a tax law on or before the due date for the payment; and
>
> (b) the taxpayer is charged with interest under Part 7 for failing to make the payment by the due date; and
>
> (c) the taxpayer is a member of a class of persons to whom a remission under this section is available, if such a class of persons is described in the Order in Council declaring the emergency event.
>
> (2) The taxpayer may ask the Commissioner to remit the interest.
>
> (3) The Commissioner may remit the interest if the Commissioner is satisfied that—
>
> (a) it is equitable that the interest be remitted; and
>
> (b) the taxpayer asked for the relief as soon as practicable; and
>
> (c) the taxpayer made the payment as soon as practicable.
>
> (4) The Governor-General may from time to time by Order in Council—
>
> (a) declare an event that meets the requirements of paragraphs (a) and (b) of the definition of emergency in section 4 of the Civil Defence Emergency Management Act 2002, to be an emergency event:
>
> (b) describe a class or classes of persons to whom a remission under this section is available in relation to the emergency event.
>
> (5) An Order in Council (the **order**) made under subsection (4) or this subsection—
>
> (a) may relate to an event that occurred after the commencement of this Act and before the commencement of the order:
>
> (b) expires, if not renewed under paragraph (c), after—
>
> (i) the period given in the order, if such a period is given; or
>
> (ii) if no such period is given, 6 months from the promulgation of the order:
>
> (c) may be renewed or replaced from time to time by an Order in Council made before or after the date on which the order would otherwise expire.

29. Section 183ABA allows the Commissioner to remit use-of-money interest (but not penalties) when:

- an Order in Council has declared an emergency event (see [33] to [34]);
- the emergency event physically prevents a taxpayer from making a tax payment; and
- the Commissioner is satisfied that:

  i) it is equitable that the use-of-money interest be remitted;

  ii) the taxpayer has applied for remission of the use-of-money interest as soon as practicable; and

  iii) the taxpayer made the payment as soon as practicable.

30. Taxpayers may be unable to comply with their tax obligations when an emergency event significantly affects them in the following ways:

- they are unable to access their records, for example, through evacuation or destruction of a home or business; or
- they are unable to make payments because they are physically prevented from doing so, for example, extensive infrastructure damage that prevents any local movements, disrupts postal deliveries or damages phone lines.

31. Relief under s 183ABA may be granted if the effect of the emergency event on the taxpayer makes it equitable that the interest be remitted. Inland Revenue will consider remission of interest when the taxpayer's personal situation makes it unjust or unfair not to remit the interest.

32. A taxpayer who is seeking remission should pay the tax and apply for the remission as soon as practicable after the event. Case law defines the term "as soon as practicable" to mean "as soon as is feasible or realistic". Again, this will depend on the circumstances of each case.

What is an emergency event?

33. Section 183ABA applies only in the circumstances of an emergency event. An emergency event is an event that meets the definition of "emergency" in s 4 of the Civil Defence Emergency Management Act 2002 and has been declared to be an emergency event by Order in Council for the purposes of s 183ABA. For example, the Canterbury earthquakes of September 2010 and February 2011 were declared emergency events by Order in Council.[4]

34. An emergency event can be natural or otherwise and can include an earthquake, tsunami, technological failure, riot or a warlike act. The key is that the emergency event falls within the definition of "emergency" in the Civil Defence Emergency Management Act 2002 and has been declared to be so by an Order in Council for the purposes of s 183ABA.

Examples

Whether a taxpayer is physically prevented by an emergency event from making a tax payment by the due date

The Governor-General, by Order in Council, has declared the 2011 earthquake in the Canterbury area to be an emergency event.

A taxpayer resides in Christchurch, where he owns business premises. All the taxpayer's business records were stored at the business premises. The business was in the red zone and the taxpayer was not permitted to access the business. Therefore, the taxpayer was physically prevented from accessing records that were needed to calculate his tax and file his returns, and also his business systems to organise and pay his tax. The taxpayer eventually managed to obtain copies of bank statements and other information, and he filed his return and paid his tax based on this information. However, as a consequence, the tax was paid late and the Commissioner imposed use-of-money interest and a late payment penalty. The taxpayer requested remission and provided supporting evidence (for example, a report on the damaged business premises from the taxpayer's insurance company and confirmation that the building was in a restricted zone). The taxpayer's request for remission of the use-of-money interest will be accepted because the Commissioner is satisfied the taxpayer was physically prevented by the emergency event from paying his tax by the due date. The taxpayer's request for the remission of the late payment penalty will also be accepted, as the inability to access his records due to the earthquake was a reasonable justification for not paying the tax on time as per s 183A (Remission for reasonable cause).

Assume the same facts, except that the taxpayer's business records were stored at his residence, which was unaffected by the earthquake. In this case, the taxpayer's request for remission of use-of-money interest (or the late payment penalty under s 183A) will not be accepted, as the Commissioner is not satisfied the taxpayer was physically prevented by the emergency event from paying his tax by the due date.

Whether the taxpayer applied for the remission as soon as practicable

The Governor-General, by Order in Council, has declared a storm in the Auckland area to be an emergency event. A taxpayer's business premises were severely damaged by the storm. The taxpayer was unable to access his records and calculate and pay tax owing by the due date. The taxpayer calculated and paid the tax as soon as possible after gaining access to his records. However, as a result of oversight, a further seven months elapses before the taxpayer applies for remission of the use-of-money interest charged. In this case, the Commissioner will not exercise the discretion to remit the use-of-money interest because the taxpayer did not apply for the remission "as soon as practicable".

Section 183D – Remission consistent with collection of highest net revenue over time

35. Section 183D of the TAA states:

> **183D Remission consistent with collection of highest net revenue over time**
>
> (1) The Commissioner may remit—
>
> (a) a late filing penalty; and
>
> (aa) a non-electronic filing penalty; and
>
> (b) a late payment penalty; and
>
> (bb) a shortfall penalty imposed by section 141AA; and
>
> (bc) a civil penalty imposed under section 215 of the KiwiSaver Act 2006; and
>
> (bd) a penalty for not paying employer monthly schedule amount imposed by section 141ED; and
>
> (c) interest under Part 7—

[4] Tax Administration (Emergency Event – Canterbury Earthquake) Order 2010.

payable by a taxpayer if the Commissioner is satisfied that the remission is consistent with the Commissioner's duty to collect over time the highest net revenue that is practicable within the law.

(2) In the application of this section, the Commissioner must have regard to the importance of the penalty, and interest under Part 7, in promoting compliance, especially voluntary compliance, by all taxpayers and other persons with the Inland Revenue Acts.

(3) The Commissioner must not consider a taxpayer's financial position when applying this section.

36. Section 183D provides for the remission of penalties and use-of-money interest if the remission is consistent with the Commissioner's duty to collect over time the highest net revenue that is practicable within the law. Furthermore, in applying s 183D the Commissioner must have regard to how the imposition of penalties and use-of-money interest is used in promoting compliance, especially voluntary compliance.

37. The Commissioner recognises that pursuing the collection of penalties in some circumstances will not be consistent with those aims, for example, when a penalty may have been imposed due to:

- a genuine error; or
- a one-off situation.

38. Section 183D does not apply to shortfall penalties other than those imposed by ss 141AA and 141ED.

39. There is no requirement to remit any of the penalties and use-of-money interest and each case will be considered on its own merits.

40. When considering remission under s 183D, the taxpayer's financial situation cannot be taken into account; that is, the taxpayer's inability to pay the tax owing is not grounds for remission.

Remission of use-of-money interest

41. Applications for the remission of use-of-money interest will be considered under s 183D. The use-of-money interest may be remitted in full or in part. Section 183E also provides for remission of use-of-money interest, but only as a consequence of the underlying tax being remitted.

42. The remission of use-of-money interest will only be given in limited circumstances. Consistent with s 183D(2), the test of whether interest should be remitted focuses on whether the charging of interest (in the case under consideration) would be inconsistent with the purposes of charging interest, that is, to compensate the Commissioner or the taxpayer for the loss of use of money and also to encourage voluntary compliance.

43. Each application for remission will be considered on the merits of the case, including taking into account:

- whether the charging of use-of-money interest was appropriate;
- whether remission would undermine the purpose of use-of money interest or promoting voluntary compliance; and
- whether remission is consistent with the Commissioner's duty to collect over time the highest net revenue that is practicable within the law.

Factors the Commissioner will consider for a s 183D remission

44. In deciding whether remission is appropriate, the Commissioner will consider the following factors:

- Has the penalty or use-of-money interest been correctly charged?
- If it has been incorrectly charged, it will not be remitted but the penalty or use-of-money interest will be reversed.
- Why did the taxpayer pay or file late, or not file electronically?
- Whether the non-compliant action was the result of a genuine oversight or a one-off situation:
  - i) Requests for remission because of a genuine oversight or a one-off situation apply to penalties only. Inland Revenue will not remit use-of-money interest in these cases as it is compensation to the Crown for the loss of the use of the money over time.
  - ii) The Commissioner is unlikely to remit use-of-money interest charged because of a third party default. In these situations the Commissioner considers the taxpayer should look to that third party for compensation.
- Has Inland Revenue given incorrect advice to the taxpayer, or was there an error in an Inland Revenue publication that has resulted in the taxpayer incurring the penalty or interest?
  If an Inland Revenue officer has given incorrect advice to a taxpayer (for example, the taxpayer has directly been given an incorrect date or amount for a tax payment) or the taxpayer relies on incorrect information contained in an Inland Revenue publication, it would be unreasonable for the Commissioner to impose a penalty or charge interest.
- Any other information that Inland Revenue considers relevant in assessing the application. In particular, how will the remission contribute to the collection of the highest net revenue over time and otherwise promote voluntary compliance by all taxpayers?

Examples

One-off situation (late filing penalty and late payment penalty)

An employer has a computer payroll package set up to prepare the employer monthly schedule for ir-File. A computer virus was detected on 4 August when the schedule was due for transmission on 5 August. The software developer was called but the problem was not fixed until 7 August, when the schedule was prepared and transmitted. On the same day, the remittance slip and payment were sent, together with the software developer's report confirming when the virus was detected, the actual location of the virus in the computer system, the effect of the virus on transmission of the employer monthly schedule, and when the problem was finally resolved. The late filing and late payment penalties will be remitted, as this is a situation beyond the taxpayer's control. The use-of-money interest will not be remitted and will remain payable.

Incorrect advice (late payment penalty)

A small business taxpayer registered for GST as a six-monthly payer. However, as business improved the taxpayer elected to file GST returns two-monthly. The taxpayer sought advice from the nearest Inland Revenue office but, unfortunately, confusion arose over the date the next return was due to be filed. This resulted in the imposition of a late payment penalty. The taxpayer sought penalty remission and provided supporting documentation confirming the name of the Inland Revenue officer who gave the advice, the date of obtaining that advice and the contents of that advice. Remission of the late payment penalty would be granted under s 183D due to incorrect information being given by Inland Revenue.

Relying on the Commissioner's official opinion

45. Section 120W provides that a taxpayer is not liable to pay interest to the Commissioner on unpaid tax to the extent that the interest arises because the taxpayer relied on a "Commissioner's official opinion" as defined in s 3:

    Commissioner's official opinion—

    (a) means, for a taxpayer, —

    (i) an opinion of the Commissioner concerning the tax affairs of the taxpayer, given by the Commissioner, either orally or in writing, after all information relevant to forming the opinion has been provided to the Commissioner, if that information is correct:

    (ii) a finalised official statement of the Commissioner, in writing, if it specifically applies to the taxpayer's situation:

    (b) does not include a private binding ruling

46. Section 120W does not apply to misinterpretations of what is written in an Inland Revenue publication.

Examples

Incorrect advice (interest)

A taxpayer is advised of an incorrect date for PAYE and incurs a late payment penalty and interest. As the late payment penalty and interest were caused by Inland Revenue's error, the late payment penalty would be remitted and the interest cancelled. The taxpayer would be expected to provide evidence to support the assertion that incorrect information was given by Inland Revenue. Relevant evidence may include the name of the Inland Revenue officer who gave the advice, the date of obtaining that advice and the contents of that advice. Section 120W provides that a taxpayer is not liable to pay interest where the interest arises because the taxpayer relied on the Commissioner's official opinion.

Incorrect advice (partial remission of interest)

A taxpayer rang Inland Revenue to find out what interest was accruing on their 2013 income tax account, as they had just received a statement of account showing some interest payable. The due date for the actual income tax was shown as 7 February 2014. They were advised that interest was not accruing so the taxpayer did not make payment immediately. Subsequently, the taxpayer was charged further interest.

The taxpayer applied to have the interest cancelled under section 120W on the grounds that payment would have been made immediately had it been known there was an on-going liability. Cancellation of interest was granted in part—the interest that had accrued until the time the taxpayer telephoned Inland Revenue was still payable. However, the taxpayer would be expected to provide evidence to support the assertion that incorrect information was given by Inland Revenue. Relevant evidence may include the name of the Inland Revenue officer who gave the advice, the date of obtaining that advice and the contents of that advice.

This Standard Practice Statement is signed on 24 November 2015.

Rob Wells

LTS Manager, Technical Standards

SPS 15/03: WRITING OFF OUTSTANDING TAX

Introduction

Standard Practice Statements describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This statement sets out the Commissioner's practice for granting financial relief by permanently writing off outstanding tax using the Commissioner's discretionary power under s 177C of the Tax Administration Act 1994 (the TAA). For relief purposes, outstanding tax includes any civil penalty and use-of-money interest.

Unless specified otherwise, all legislative references in this statement refer to the TAA. The relevant legislative provisions are:

- ss 3, 6, 6A, 14B, 138E, 139B, 139BA, 141D, 141E, 174AA, 176, 177, 177A to 177C; and
- s LE 3 of the Income Tax Act 2007.

Application

Taxpayers are encouraged to contact Inland Revenue as soon as possible if they think that they may have trouble paying their tax in full by the due date, or that they may experience serious hardship, so that the options for financial relief can be discussed. Taxpayers need not wait for a due date to pass before applying for financial relief.

The form of the application

Taxpayers who wish to apply for financial relief may do so by telephone or in writing (including mail sent through Inland Revenue's secure online services). Once an application is received, the Commissioner will determine whether the outstanding tax can be written off on the grounds of serious hardship.

In some cases, the Commissioner will require that the application for financial relief is made in writing (rather than verbally) under s 177(2). This may be where a taxpayer's inability to pay the outstanding tax is caused by a number of factors that require evidence in writing or when a taxpayer has related parties, such as a partnership or company, that have outstanding tax to pay. Where a taxpayer is required to apply for financial relief in writing, they may do so by:

- delivering the notice in person to an Inland Revenue office during office opening hours;
- sending the notice by facsimile to an Inland Revenue office;
- sending mail through Inland Revenue's secure online services; or
- sending the notice by post to PO Box 39050, Wellington Mail Centre, Lower Hutt 5045.

For Child Support purposes, this statement applies to an amount payable by a "payer", as defined in s 153 of the Child Support Act 1991. That is, a person required to withhold money in accordance with a deduction notice issued by Inland Revenue. However, this statement does not apply to "financial support", as defined in s 2(1) of the Child Support Act 1991 (that is, child support and/or domestic maintenance payable under that Act) or to student loan repayment obligations.[1]

This SPS applies to write-off decisions made on or after 24 November 2015. This statement replaces SPS 06/02 *Writing off outstanding tax*, which was published in *Tax Information Bulletin* Vol 18, No 5 (June 2006): 55.

Reviewing a decision

Section 138E(1)(e)(iv) provides that there is no statutory right of challenge to any decision of the Commissioner to grant relief, decline to grant relief, or to cancel relief.

However, if a taxpayer is concerned that their circumstances have not been given proper consideration, they should raise their concern and ask for the decision to be reconsidered. If a taxpayer is still not satisfied, they also have the option to have a decision reviewed by the Office of the Ombudsman or by way of judicial review.

If a taxpayer is not satisfied with the level of service they have received, they can obtain more information about the Inland Revenue Complaints Management Service at **http://www.ird.govt.nz/aboutir/who-we-are/structure/complaints/** or phone 0800 274 138 (Monday to Friday between 8am and 5pm).

STANDARD PRACTICE

Summary

1. This statement sets out the factors the Commissioner of Inland Revenue will take into account when considering whether to write off outstanding tax.
2. Taxpayers who cannot afford to pay their tax in full may apply to Inland Revenue for financial relief under s 177(1). It is better to contact Inland Revenue as early as possible to discuss the options for resolving the debt.

[1] For Inland Revenue's practice on providing financial relief by way of instalment arrangement, please refer to SPS 11/01 *Instalment arrangements for payment of tax*. In addition, SPS 15/02 *Remission of penalties and use-of-money interest* explains that interest will continue to accrue on any outstanding tax on a daily basis. Inland Revenue may provide financial relief by remitting penalties or interest rather than writing off assessment debt. Both SPSs are available on Inland Revenue's website at **www.ird.govt.nz/technical-tax/standard-practice/returns-debt/**.

3. Inland Revenue will negotiate with a taxpayer to determine as soon as possible whether they are eligible for financial relief, what form of relief may be provided and the extent of relief.
4. Upon receiving a taxpayer's application for financial relief, the Commissioner has four options:
   a) accept the taxpayer's request;
   b) seek further information from the taxpayer (this may include financial information and the filing of any outstanding returns);
   c) make a counter offer; or
   d) decline the request.
5. The Commissioner will take into account the following factors when considering whether to write off outstanding tax:
   - whether the taxpayer is in a position to pay all or part of the outstanding tax immediately;
   - whether collection of the outstanding tax (in full or part) will place the taxpayer, being a natural person, in serious hardship;
   - whether the value of the taxpayer's proposal, when compared to other recovery options, would maximise the recovery of outstanding tax from the taxpayer;
   - whether the taxpayer has filed all required returns; and
   - any other relevant factors.
6. To help the Commissioner make a decision on granting relief, a taxpayer may be required to provide additional relevant information (such as financial information) and will also be asked to file any outstanding returns.
7. If further information is requested, the taxpayer must provide that information within 20 working days (or within any longer period allowed by the Commissioner). Information received outside that timeframe will be treated as a new request for financial relief.
8. If the Commissioner subsequently declines to grant financial relief, initial and incremental late payment penalties will be imposed and interest will accrue, as if the request for financial relief had not been made.

Amounts to be written off

9. The Commissioner must write off outstanding tax that cannot be recovered in the event of a:
   - bankruptcy;
   - liquidation; or
   - distribution of a taxpayer's estate.
10. The Commissioner has the discretion to write off outstanding tax that cannot be recovered. Where it is agreed that part of the outstanding tax will be paid under an instalment arrangement and the balance written off, the write-off will be made at the time the instalment arrangement is entered into.
11. Section 177C(3) prohibits the write off of outstanding tax (including the shortfall penalty imposed) when a taxpayer is liable to a shortfall penalty for an abusive tax position under s 141D(2) or evasion or a similar act under s 141E(1).
12. Any tax write-off will be permanent unless:
    - the taxpayer, being a natural person, declares bankruptcy, or is subject to bankruptcy proceedings being brought by a creditor, within a year of the outstanding tax being written off on the grounds of serious hardship;
    - the taxpayer, being a company, is liquidated, or in the course of being liquidated, within a year of the outstanding tax being written off on the grounds of serious hardship; or
    - the tax was written off on the basis of false or misleading information provided by the taxpayer.
13. The Commissioner may permanently write off outstanding tax under s 174AA(a) when the balance of the tax payable is less than $20.
14. When a taxpayer enters into an insolvency arrangement under voluntary administration or the "no asset procedure" provisions of the Insolvency Act 2006, the Commissioner will not consider writing off outstanding tax until the taxpayer has been released from debts covered by their insolvency arrangement. Once they are released from their debts, the balance of related outstanding tax will be written off on the basis that it is not recoverable.
15. A natural person acting as a trustee can apply for financial relief under s 177(1)(a) in respect of the trust's tax debt that the trustee is personally liable for. Any relief that the Commissioner provides to an individual trustee does not extend to other trustees who are jointly and severally liable for payment of a trust's taxes. The Commissioner will action a write-off in such circumstances after all other avenues for collection have been exhausted.

Tax losses and imputation credits

16. If the Commissioner decides to write off outstanding tax, she must extinguish all or part of any tax losses carried forward and/or any imputation credits from the taxpayer's most recently filed return of income, to the extent of the write-off.

17. When a taxpayer has both tax losses and imputation credits carried forward from a previous year, the losses will be extinguished first.
18. For the Commissioner to accurately determine the value of any losses or imputation credits, a taxpayer must file all outstanding returns of income before a write-off of outstanding tax will be considered.
19. When the Commissioner writes off outstanding tax, the taxpayer will be notified of this in writing and, if losses or imputation credits remain, the value of any tax losses or imputation credits carried forward.

Discussion

20. Taxpayers may apply for financial relief under s 177(1). The financial relief may be in the form of:
    - an instalment arrangement for all of the outstanding tax;
    - an instalment arrangement for part of the outstanding tax and a write-off of the remaining balance (a partial write-off); or
    - a write-off of all of the outstanding tax.

Considering a taxpayer's application

21. Section 3(1) defines "outstanding tax" as tax that is payable before or after a due date. Therefore, taxpayers need not wait for a due date to pass before applying for financial relief.
22. Upon receiving an application for financial relief, the Commissioner may:
    - accept that not all the outstanding tax will be collectable and consider that a partial or full tax write-off is appropriate in the taxpayer's circumstances;
    - seek further information from the taxpayer;
    - make a counter-offer; or
    - decline the taxpayer's request.

Consider that a write-off is appropriate

23. The initial late payment penalty payable on outstanding tax under s 139B(2)(a) is charged in two stages—1% payable on the day after the due date, and 4% payable seven days after the due date. The 1% initial late payment penalty will apply regardless of a request for relief being received before the due date. In addition, interest (charged on a daily basis) is payable on the outstanding tax after the due date. However, if the taxpayer requests financial relief before the payment is due, the second stage 4% initial late payment penalty will not be charged from the date a request for relief is received and/or while an instalment arrangement is maintained.
24. If the outstanding tax is written off, the taxpayer will be advised of that in writing. That notification will include:
    - the tax type(s), the relevant period(s) and the amount(s) of tax written off; and
    - any remaining net losses and/or excess imputation credits carried forward (see discussion at [83] to [87]); and/or
    - where applicable, the amount of outstanding tax under an instalment arrangement, including any amount of use-of-money interest.

Seek further information from the taxpayer

25. When considering an application for financial relief, the Commissioner will consider the taxpayer's financial circumstances by looking at the information provided with the application, as well as information already held by Inland Revenue. However, the Commissioner may also ask the taxpayer to provide further information. The Commissioner will also ask that any outstanding returns be filed (if applicable).

Example

A taxpayer has outstanding income tax for the 2013 tax year and applies for relief on the ground that the payment will place them in serious hardship. Their income tax return for the 2013 tax year shows a net loss carried forward from an earlier period. However, the 2012 income tax return is yet to be filed.

The Commissioner will require the taxpayer to file their 2012 income tax return, and perhaps provide other information, before a decision can be made on the taxpayer's request for financial relief.

26. Under s 177(4), if further information is required, the taxpayer needs to provide this information within 20 working days (or a longer period as allowed by the Commissioner). If the further information is not provided until after the time allowed, that information will be treated as a new request when it is received.
27. Under s 139BA, incremental late payment penalties will not be imposed while waiting for the additional information, provided financial relief is granted. Use-of-money interest will continue to be accrued and charged for this period, even if relief via an instalment arrangement is granted. If relief is provided via a write-off of outstanding tax, the related use-of-money interest will also be remitted under s 183E.

Make a counter-offer

28. After reviewing all the information (including additional information that may have been requested),

the Commissioner may make a counter offer. This may occur where she considers that:

- the taxpayer can afford to make a lump-sum payment; or
- a partial write-off is more appropriate, as an instalment arrangement for part of the outstanding tax can be entered into.

Decline the taxpayer's request

29. The Commissioner will decline the taxpayer's request for a write-off if she considers the taxpayer is able to pay the outstanding tax in full or that an instalment arrangement is a better option. For example, the taxpayer may have term deposits or other investments that can be used, or the taxpayer may have the ability to borrow money to pay the outstanding tax.

30. The Commissioner may also decline a taxpayer's request for a write-off if they have not provided sufficient information to support their request.

31. When the Commissioner declines a taxpayer's request for financial relief, both initial and incremental late payment penalties will be imposed, and use-of-money interest will accrue, as if the taxpayer had not made the request.

Factors relevant to the consideration of financial relief

32. The Commissioner may have regard to a number of factors when considering applications for financial relief. In *Clarke & Money v CIR*,[2] Priestley J referred to the following factors as relevant to the exercise of the discretion under s 177:

    a) the circumstances that led to a taxpayer's outstanding tax;

    b) the nature and extent of a taxpayer's co-operation and negotiating stance;

    c) the speed with which a taxpayer has provided requested information and the quality of that information; and

    d) the Commissioner's duties under ss 6 and 6A(3).

Maximising the recovery of outstanding tax

33. Under s 176, the Commissioner has a duty to maximise the recovery of outstanding tax from a taxpayer. The Commissioner is therefore obliged to compare the value of the likely recovery from accepting a taxpayer's proposal to any other viable options for recovery. In some cases, it is clear which option will maximise recovery. In other cases, there may be options that could yield similar returns. Accordingly, it is necessary to determine which option will maximise recovery.

The relationship between the duties in s 176 and ss 6 and 6A

34. While s 176 provides that the Commissioner must maximise recovery of outstanding tax, this duty is subject to the overriding obligations to protect the integrity of the tax system (s 6) and to collect over time the highest net revenue that is practicable within the law (s 6A). Interpretation Statement IS 10/07 *Care and management of the taxes covered by the Inland Revenue Acts* provides the Commissioner's view on the application of ss 6 and 6A.[3]

35. In *Raynel v CIR*,[4] Randerson J referred to the following "general compromise" approach to the application of ss 6 and 6A:

    - The obligation to collect the highest net revenue is not absolute. The Commissioner is required to take practicable and lawful steps to recover revenue.
    - The Commissioner is required to have regard to the resources available to her, the importance of promoting compliance (especially voluntary compliance) by all taxpayers, and the compliance costs incurred by taxpayers.
    - Sections 6 and 6A(3)(b) emphasise that there is a broader public interest in the integrity of the tax system and in ensuring that taxpayers meet their obligations.

36. Although the Commissioner will consider each application for financial relief on its own merits, the duty to protect the integrity of the tax system will sometimes require the Commissioner to take action that (in the short term) might not be consistent with the requirement to maximise recovery of outstanding tax.

37. When a negotiated agreement for payment of all or part of the outstanding tax (such as an instalment arrangement) would yield more than bankruptcy or liquidation action, the Commissioner will usually enter into such an agreement. Any amount not recoverable under the agreement will be written off at the time the agreement is entered into.

Example

A taxpayer has outstanding tax of $100,000 and makes an offer to pay $75,000 over 3 years. The Commissioner considers that bankruptcy would yield only $50,000 and that there are no other viable avenues for recovery. In this instance, the Commissioner would consider writing

[2] (2005) 22 NZTC 19,165 (HC)

[3] This statement is published in *Tax Information Bulletin* Vol 22, No 10 (November 2010): 17 and available on Inland Revenue's website.

[4] (2004) 21 NZTC 18,583 (HC)

off $25,000 and entering into an instalment arrangement over three years for $75,000.

Alternatively, a taxpayer has significant outstanding tax as a result of evasion and offers part payment of the tax owing. Information available to Inland Revenue indicates the taxpayer has accumulated an investment property that they could dispose of or use as collateral to raise funds to settle their arrears. As the tax shortfall was due to an evasion offence, the Commissioner is not able to write off the outstanding tax. She would decline the offer and pursue other options.

38. Randerson J, in *Raynel*, further noted that, in certain circumstances, the Commissioner may be justified in initiating or continuing enforcement proceedings to secure the wider interests identified by the legislation. This is where there has been a flagrant and on-going failure by a taxpayer to comply with their tax obligations and where recovery is dubious or is likely to result only in a relatively minor proportion of the overall outstanding tax being recovered.

39. In *Rogerson v CIR*,[5] Potter J held that the Commissioner is entitled to consider a taxpayer's whole history of compliance in the context of the obligation to preserve the integrity of the tax system.

Inefficient use of the Commissioner's resources

40. Consistent with the Commissioner's duty under s 6A(3), s 176(2)(a) provides that the Commissioner may not recover outstanding tax if the recovery of the outstanding tax would be an inefficient use of her limited resources. This includes the Commissioner's ability to write off tax under s 177C.

41. However, a taxpayer cannot require that outstanding tax be written off under s 176(2) simply because they consider that collection would be an inefficient use of the Commissioner's resources. It is for the Commissioner to determine how her limited resources are allocated.

42. There will be some instances where the cost of collection may be higher than the outstanding tax. Consistent with the Commissioner's obligations under ss 6 and 6A to protect the integrity of the tax system, promote compliance and collect over time the highest net revenue, recovery action may still be considered appropriate.

43. Decisions to write off are made on a case-by-case basis and will take into account the effect of the proposed write-off on the overall compliance of all taxpayers, not just the taxpayer who has outstanding tax.

Instances where the Commissioner must write off outstanding tax

44. Under s 177C(2)(a), the Commissioner must write off amounts that, because of bankruptcy, cannot be recovered.

45. When a person is bankrupt, the Commissioner will write off outstanding tax that cannot be recovered upon receiving a final dividend or advice from the Official Assignee that there will be no dividend to Inland Revenue (provided that we do not challenge the Official Assignee's advice).

46. Under s 177C(2)(b), the Commissioner must write off a company's outstanding tax that cannot be recovered because the company is in liquidation.

47. When an estate has been distributed, the Commissioner must write off any outstanding tax that cannot be recovered upon receiving confirmation from the administrator that the estate has been distributed. However, if, for example, the estate has forgiven a debt owing to the estate without having regard to the estate's ability to meet its tax obligations, the Commissioner may seek payment from the administrator of the estate.

Serious hardship

48. Under s 176(2)(b), the Commissioner may not recover outstanding tax to the extent that the recovery would place a taxpayer, being a natural person, in serious hardship.

49. A natural person who applies for financial relief under s 177(1)(a) on the grounds of serious hardship must be able to explain why recovery would place them in serious hardship. The application should include supporting financial information.

50. The Commissioner will consider each application on its own merits, bearing in mind her obligations to protect the integrity of the tax system (s 6) and to collect over time the highest net revenue that is practicable within the law (s 6A).

Applying the serious hardship provisions

51. Under s 177A, when a taxpayer applies for financial relief, the Commissioner must consider whether recovery of the outstanding tax would place the taxpayer (being a natural person) into serious hardship. The reason why that tax is outstanding is not taken into account in determining serious hardship.

52. Section 177A(3) also states that compliance, and non-compliance, with tax obligations must not be considered by the Commissioner when making a

[5] (2005) 22 NZTC 19,260 (HC)

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decision as to whether a taxpayer would be in serious hardship.

53. Under s 177A, the Commissioner makes the decision whether recovering the outstanding tax would place a taxpayer in serious hardship by considering the taxpayer's financial information she holds on the date of the decision. After allowing for payment of a relevant amount of outstanding tax, the Commissioner must determine whether the financial information shows that the taxpayer would likely have significant financial difficulties.

54. The taxpayer is likely to have significant financial difficulties if, after the application, the following occurs:
    - the taxpayer or their dependant has a serious illness;
    - the taxpayer would be unlikely to meet minimum living expenses estimated according to normal community standards of cost and quality;
    - the taxpayer would be unlikely to meet the cost of medical treatment for an illness or injury of the taxpayer, or of their dependant; or
    - the taxpayer would be unlikely to meet the cost of education for their dependant.

55. The Commissioner may also take into account any other factors she thinks relevant. What those other relevant factors may be will depend on a taxpayer's individual circumstances.

56. While "normal community standards of cost and quality" must be considered in the context of the wider community of all New Zealand, the actual expenditure of taxpayers in different parts of the country may vary. When calculating a taxpayer's minimum living expenses, the Commissioner will consider the costs of food, heating and accommodation in that taxpayer's area, based on information provided by Statistics New Zealand.

57. Whether a person is a taxpayer's "dependant" will be determined on a case-by-case basis. In determining dependancy, the Commissioner will consider:
    - whether the person depends on the taxpayer for financial support;
    - what degree of financial support is provided by the taxpayer; and
    - to what extent providing financial support affects the taxpayer's ability to meet minimum living expenses according to normal community standards.

Financial information

58. To determine whether a taxpayer would be placed in serious hardship, the Commissioner will request relevant details of that taxpayer's financial position. The requested financial information may include, among other items:
    - details of income and expenditure (including income and expenditure in relation to relationship property, family and spousal income where appropriate);
    - assets and liabilities (including relationship property);
    - a 12-month cash flow projection;
    - asset valuations;
    - a statement of financial performance (a profit and loss statement);
    - a statement of financial position (a balance sheet);
    - a list of debtors and creditors, including how much is owed to or by the taxpayer, and any vested interest held in another entity (such as a trust).

59. Written applications for write-off will not be required when it is evident from information already available to the Commissioner that recovery would place a taxpayer in serious hardship. This may happen where a taxpayer requests relief by way of an instalment arrangement, but the information provided shows that repayment, even by way of an instalment arrangement, would place them in serious hardship.

Part payment of outstanding tax

60. In some instances, a taxpayer may be able to pay part of the outstanding tax, but recovery of the full amount would place the person in serious hardship. In these cases, the Commissioner may negotiate a lump-sum payment and/or an instalment arrangement with the taxpayer, with the possibility of writing off any amount considered to be irrecoverable. The irrecoverable amount will be written off at the time the instalment arrangement is entered into.

Example

A taxpayer has outstanding tax of $8,000 and has been putting funds aside to clear this amount by the due date. However, at the due date they have only managed to save $2,000 towards this amount. The taxpayer has the ability to pay $2000 more if it is spread out over 3 months, otherwise they will have difficulty in meeting day-to-day living expenses.

Provided there are no other feasible options for recovery of tax, the Commissioner would accept the lump-sum payment of $2,000, enter into an instalment arrangement for the additional $2,000 and write off the balance of unpaid tax on the grounds of serious hardship.

Writing off a company's outstanding tax

61. The Commissioner may also write off a company's outstanding tax under s 177C(1). This is if doing so is consistent with the duty to maximise recovery under s 176(1), subject to the obligations in ss 6 and 6A. As with individuals, Inland Revenue may enter into an instalment arrangement with the company for part of the company's outstanding tax and then write off the remaining balance.

62. When a company is in liquidation (provided Inland Revenue does not challenge the liquidator's advice), the Commissioner must write off outstanding tax that cannot be recovered upon receiving:
    - a final distribution; or
    - advice from the liquidator that there will be no distribution to Inland Revenue.

Serious hardship and relief companies

63. Serious hardship generally applies to natural persons only. A company cannot apply for outstanding tax to be written off on the grounds of serious hardship.

64. However, the Commissioner will have to consider whether the recovery of outstanding tax owed by a company would cause serious hardship for a shareholder who:
    - alone or jointly with one other person, owns 50% or more of the shares in the company; or
    - is a shareholder-employee of a relief company.

65. Section 3(1) defines a "relief company", in relation to a taxpayer, as a company in which:
    - the taxpayer owns 50% or more of the shares; or
    - the taxpayer and 1 other person jointly own 50% or more of the shares; or
    - the taxpayer is a shareholder-employee, and the company has five or fewer natural persons whose total voting or market value interests in the company exceed 50% and it is not a special corporate entity.

Example

A relief company owes outstanding tax of $300,000 and its only asset is a debit balance in the principal shareholder's current account of $300,000. The shareholder's personal assets are a house and a car. Inland Revenue recognises that any action taken to liquidate this company would place the shareholder in serious hardship. The company agrees to pay Inland Revenue the sum of $220,000, borrowed against the principal shareholder's house. The balance of the outstanding tax will be written off, as collection of the amount would cause the shareholder serious hardship.

Struck-off companies

66. The Commissioner cannot consider an application for financial relief of a company that has been removed from the New Zealand register at the Companies Office (been struck off) until that company is restored to the register. This is because the struck-off company has ceased to be a person and therefore is not a taxpayer.

67. When a company has been struck off, the Commissioner can discuss outstanding tax matters with a person who was a director or authorised officer of the company immediately before it was struck off.

68. In some cases, the Commissioner may apply to have the company restored to the New Zealand register in order to recover outstanding tax.

69. The Commissioner may apply to the High Court for appointment of a liquidator to liquidate the struck-off company under s 241 of the Companies Act 1993. The Commissioner may do so even if there is no prospect of recovering the outstanding tax from the struck-off company.

Voluntary administration

70. When a company seeks an arrangement with creditors under the voluntary administration provisions, the process is subject to the rules in the Companies Act 1993.

71. Where the watershed meeting with creditors has resolved that a company may proceed to execute a deed of company arrangement (deed), all parties to the deed are bound in respect of claims as at the "cut-off day". The company is released from its debts to the extent provided in the deed under s 239ACW of the Companies Act 1993.

72. As a deed may be varied by the creditors or terminated by the court or by creditors, there is no certainty of the amount of tax that will be recovered until the deed moratorium period has elapsed. Consequently, alternative recovery action or write-off will not be considered unless the court or creditors have cause to have the deed overturned. If a deed is terminated, the Commissioner may consider other ways to recover

any outstanding tax under s 156 or consider whether the tax should be written off under s 177C(1) on the basis that money received under the deed was the best outcome.

73. Any subsequent tax outstanding (for example, on-going GST or PAYE obligations not met) during the period of the deed will be the liability of the voluntary administrator within the agreed parameters of Inland Revenue's expectations. Alternatively the Commissioner may reject the proposed deed or an application may be made to the court to overturn the deed. Outstanding tax not recovered under the deed is quantified when the agreed term for a deed has expired and following a final report from the voluntary administrator to the Registrar of Companies advising of the dividend paid to creditors.

74. As the voluntary administration process is governed by the provisions under the Companies Act 1993, the Commissioner will not consider the financial relief provisions under s 177C until the term of the deed has elapsed and a company has been released from debts to the extent provided in the deed. The Commissioner will then write off the balance not collected under s 177C on the basis that the tax is irrecoverable.

Writing off a trust's outstanding tax

75. Trustees are personally liable for trust debts (including tax debts). Consequently, if there is insufficient trust property to pay a trust debt, a trustee may have to pay the debt out of their own resources.

76. When there is more than one trustee of a trust, those trustees are jointly and severally liable for the trust's tax obligations.

77. Trustees, in their capacity as natural persons, may experience serious hardship as a result of having to meet a trust's tax debt from their personal resources. The Commissioner will consider serious hardship applications from natural person trustees on a case by case basis and may write off tax on grounds of serious hardship when no other avenue is available for collection.

No asset procedure

78. The "no asset procedure" is a one-off process that provides a fresh start to natural persons. The no asset procedure is available as an alternative to bankruptcy for those people who have insufficient income and no assets left to sell to repay debts from $1,000 up to $40,000. The no asset procedure is governed by rules under Part 5 of the Insolvency Act 2006.

79. Unless the Commissioner has cause to persuade the Official Assignee to reject or overturn the no asset procedure, any tax owed by a taxpayer who is subject to the procedure is effectively frozen and the Commissioner cannot take any recovery action.

80. Once a taxpayer has been released from debts covered by a no asset procedure, the Commissioner will then write off the balance of the outstanding tax under s 177C(1) on the basis that it is irrecoverable.

Writing off small amounts of outstanding tax

81. The Commissioner may permanently write off outstanding tax under s 174AA(a) when the balance of the tax payable is $20 or less.

82. If it is established later that a taxpayer's assessment or related use-of-money interest calculation was wrong, the Commissioner must amend the taxpayer's account to show the correct tax payable. It follows that any earlier write-off made under s 174AA may also be adjusted to the correct amount of tax payable.

Tax losses and excess imputation credits

83. Sections 177C(5), 177C(5B), 177C(5C) and 177C(6) cover what happens when the Commissioner writes off outstanding tax for a taxpayer who has tax losses or imputation credits carried forward from a previous year.

84. If the Commissioner writes off outstanding tax for a taxpayer who has net losses, part or all of the taxpayer's tax losses will also be extinguished. The amount extinguished is calculated by dividing the amount written off by 0.33 (if the taxpayer is not a company) or 0.28 (if the taxpayer is a company) and reducing the tax losses by that amount.

85. If the Commissioner writes off outstanding tax for a taxpayer who has imputation credits carried forward from a previous year, all or part of these credits will be extinguished on a dollar-for-dollar basis.

86. When a taxpayer has both tax losses and imputation credits carried forward from a previous year, the net losses will be extinguished first. A taxpayer's tax losses and/or imputation credits can be extinguished even if the tax written off is not income tax.

87. The Commissioner needs to know the correct value of losses or imputation credits when making the adjustments required after writing off outstanding tax. Therefore, a taxpayer must file all outstanding tax returns (that is, outstanding returns relating to tax years prior to the tax year in which the outstanding tax arises) before their application for a write-off will be considered. The Commissioner will then calculate the tax losses using the taxpayer's most recently filed income tax return.

Example

In July 2014, a taxpayer asks that their outstanding income tax for the 2014 tax year be written off due to financial difficulties. The taxpayer's 2012 income tax return shows tax losses carried forward to the 2013 tax year. However, the 2013 income tax return remains outstanding.

The write-off will not be considered until the taxpayer has filed their 2013 income tax return, as this will enable the Commissioner to have a full picture of the taxpayer's circumstances.

When the Commissioner cannot write off outstanding tax

88. Under s 177C(3), the Commissioner cannot write off outstanding tax if a taxpayer is liable to pay, in relation to that outstanding tax, a shortfall penalty for taking an abusive tax position under s 141D(2) or for evasion or a similar act under s 141E(1), irrespective of whether the taxpayer has been assessed for the shortfall penalty.

89. With the exception of some prosecution cases, in all instances where a taxpayer is liable to pay a shortfall penalty for either an abusive tax position or evasion, it is the Commissioner's practice for that shortfall penalty to be assessed.

90. However, with respect to prosecution cases, s 149(5) provides that the imposition of a shortfall penalty precludes the subsequent prosecution of the taxpayer for that tax position. Therefore, the Commissioner's practice is not to assess a shortfall penalty in such cases until after the prosecution has been concluded, at which time the Commissioner has a discretion under s 149(4) whether to assess a shortfall penalty. A decision not to assess the shortfall penalty does not mean that the taxpayer was not "liable to pay" the relevant shortfall penalty for the purposes of s 177C(3).

91. The Commissioner will distinguish between outstanding tax arising from such assessments and other outstanding tax so that part of a taxpayer's total outstanding tax may be written off if the required criteria are met, leaving the tax to which the shortfall penalty applies and the penalty itself outstanding. The other outstanding tax may include any late filing/late payment penalties imposed and accrued use-of-money interest that is payable in the same period as the tax shortfall and related shortfall penalty.

92. When s 177C(3) prevents a write-off, the only other situation where the Commissioner has the ability to write off the tax shortfall and related penalty is under s 177C(2); that is, in situations of bankruptcy, liquidation or where a taxpayer's estate has been distributed.

Example

A taxpayer has outstanding GST for the 31 March 2014 return period and income tax for the 2013 year. The outstanding income tax of $85,000 includes core tax of $25,000 and a tax shortfall and shortfall penalty amounting to $60,000 for taking an abusive tax position.

The taxpayer meets the criteria for serious hardship, so the outstanding GST may be written off.

However, the outstanding tax and penalty amounting to $60,000 cannot be written off, as the taxpayer is "liable to pay" a shortfall penalty for taking an abusive tax position in relation to that outstanding tax. The Commissioner can write off the $25,000 portion of the outstanding tax that is not related to the abusive tax position and related shortfall penalty.

93. Consideration of a write-off application will be suspended when a taxpayer challenges the imposition of a shortfall penalty for taking an abusive tax position or evasion in a hearing authority. The Commissioner will not consider writing off that taxpayer's outstanding tax until after the hearing authority has made its ruling.

Reinstatement of outstanding tax

94. Under s 177C(4), the Commissioner may only reinstate tax that has been written off if:
    - she receives, by operation of law, additional funds in respect of a taxpayer after that taxpayer has become bankrupt or has been liquidated; or
    - additional funds due to a taxpayer's estate are discovered after that taxpayer's estate has been distributed.

Example

The Commissioner writes off a bankrupt taxpayer's outstanding tax under s 177C(2) after the Official Assignee declares that no dividend will be payable. The Official Assignee subsequently discovers a previously unknown bank account with a credit balance and makes a dividend payment to creditors. The Commissioner will reinstate the outstanding tax under s 177C(4) to the extent of the dividend payment and credit the money received to the taxpayer's account.

Reversal of a write-off

95. Section 177C(7) allows the Commissioner to reverse a write-off made on the grounds of serious hardship when:

- the taxpayer, being a natural person, declares bankruptcy or is subject to bankruptcy proceedings being brought by a creditor, within a year of the outstanding tax being written off on the grounds of serious hardship; or
- the taxpayer, being a company is, within a year of the outstanding tax being written off on the grounds of serious hardship, liquidated or in the course of being liquidated; or
- tax was written off on the basis of false or misleading information provided by the taxpayer.

This Standard Practice Statement is signed on 24 November 2015.

Rob Wells

LTS Manager, Technical Standards

APPENDIX – LEGISLATION

Tax Administration Act 1994

3(1) Relief company means, in relation to a taxpayer, a company in which—

(a) the taxpayer owns 50% or more of the shares:

(b) the taxpayer and 1 other person jointly own 50% or more of the shares:

(c) the taxpayer is a shareholder-employee, and the company satisfies paragraphs (a) and (c) of the definition of close company in section YA 1 of the Income Tax Act 2007

6 Responsibility on Ministers and officials to protect integrity of tax system

(1) Every Minister and every officer of any government agency having responsibilities under this Act or any other Act in relation to the collection of taxes and other functions under the Inland Revenue Acts are at all times to use their best endeavours to protect the integrity of the tax system.

(2) Without limiting its meaning, **the integrity of the tax system** includes—

(a) taxpayer perceptions of that integrity; and

(b) the rights of taxpayers to have their liability determined fairly, impartially, and according to law; and

(c) the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers; and

(d) the responsibilities of taxpayers to comply with the law; and

(e) the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers; and

(f) the responsibilities of those administering the law to do so fairly, impartially, and according to law.

6A Commissioner of Inland Revenue

(1) The person appointed as chief executive of the department under the State Sector Act 1988 is designated the Commissioner of Inland Revenue.

(2) The Commissioner is charged with the care and management of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.

(3) In collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to—

(a) the resources available to the Commissioner; and

(b) the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts; and

(c) the compliance costs incurred by taxpayers.

139BA Imposition of late payment penalties when financial relief sought

(1) If a taxpayer has outstanding tax and contacts the Commissioner seeking financial relief before the due date, the Commissioner must impose the late payment penalty under section 139B(2)(a)(i) on unpaid tax but must not impose the late payment penalty under section 139B(2)(a)(ii).

(2) If a taxpayer has outstanding tax and contacts the Commissioner seeking financial relief on or after the due date, the Commissioner must not impose an incremental late payment penalty on unpaid tax on and after the date of the request.

(3) Subsections (1) and (2) apply until the earlier of—

(a) the date that the Commissioner makes a decision not to give financial relief; and

(b) the last day of the response period allowed by section 177(4) if the taxpayer does not provide the information sought or respond to a counter offer.

(4) If an instalment arrangement is entered into, an incremental late payment penalty is not to be added if, for a month during which the tax to pay remains unpaid, the taxpayer complies with all of their obligations under the arrangement.

(5) If an instalment arrangement is cancelled on the basis of false or misleading information provided by the taxpayer, the Commissioner must impose those late payment penalties not imposed as if the instalment arrangement had not been entered into.

(6) If financial relief is not given, the Commissioner must impose those late payment penalties not imposed as if the request for financial relief had not been made.

174AA Power of Commissioner in respect of small amounts of refunds or tax payable

Despite any other provision of this Act or the Income Tax Act 2007, the Commissioner may write off tax, refrain from making an assessment of tax, refrain from collecting tax or refrain from refunding tax if—

(a) the balance of the tax payable is not more than $20; or

(b) the tax paid, withheld, or deducted is $5 or less than the amount of the tax for which the taxpayer is liable.

176 Recovery of tax by Commissioner

(1) The Commissioner must maximise the recovery of outstanding tax from a taxpayer.

(2) Despite subsection (1), the Commissioner may not recover outstanding tax to the extent that—

- (a) recovery is an inefficient use of the Commissioner's resources; or
- (b) recovery would place a taxpayer, being a natural person, in serious hardship.

(3) Despite subsection (2)(b), the Commissioner may take steps preparatory to, or necessary to, bankrupt the taxpayer, including debt proceedings in the District Court or the High Court.

177 Taxpayer may apply for financial relief

(1) A taxpayer, or a person on a taxpayer's behalf, applies for financial relief by either—

- (a) making a claim stating why recovery of the taxpayer's outstanding tax or a relief company's outstanding tax would place the taxpayer, being a natural person, in serious hardship; or
- (b) requesting to enter into an instalment arrangement with the Commissioner by telephone or in writing.

(1B) For the purposes of this section, the Commissioner must consider the taxpayer's financial position at the date on which the application for financial relief is made.

(2) The Commissioner may require a taxpayer, or a person on a taxpayer's behalf, to apply for financial relief under subsection (1)(a) by notice.

(3) Upon receiving a request, the Commissioner may—

- (a) accept the taxpayer's request; or
- (b) seek further information from the taxpayer; or
- (c) make a counter offer; or
- (d) decline the taxpayer's request.

(4) A taxpayer has 20 working days, or a longer period allowed by the Commissioner, to provide the information sought or to respond to a counter offer.

(5) If the Commissioner receives information or a response from a taxpayer outside the time period allowed under subsection (4), the receipt of the information or the response will be treated as a new request for financial relief.

177A How to apply serious hardship provisions

(1) Subsections (2), (3), and (4) provide the rules for the Commissioner to decide (the **decision**) whether,—

- (a) for the purposes of section 176, recovery of outstanding tax would place a taxpayer, being a natural person, in serious hardship:
- (b) for the purposes of section 177, the Commissioner may accept the taxpayer's request for financial relief on the basis of a claim that recovery of the taxpayer's outstanding tax or a relief company's outstanding tax would place the taxpayer, being a natural person, in serious hardship:
- (c) for the purposes of section 177B, an instalment arrangement entered into by a taxpayer or a relief company would place the taxpayer, being a natural person, in serious hardship:
- (d) for the purposes of section 177C, recovery of the outstanding tax would place the taxpayer, being a natural person, in serious hardship.

(2) The Commissioner makes a decision under this section by determining whether financial information, after allowing for payment of a relevant amount of outstanding tax, and subject to subsections (3) and (4), shows that the taxpayer would, after the application under section 177 (the **application**), likely have significant financial difficulties because, after the application,– –

- (a) the taxpayer or their dependant has a serious illness:
- (b) the taxpayer would likely be unable to meet– –
  - (i) minimum living expenses estimated according to normal community standards of cost and quality:

(ii) the cost of medical treatment for an illness or injury of the taxpayer, or of their dependant:

(iii) the cost of education for their dependant:

(c) other factors that the Commissioner thinks relevant would likely arise.

(3) Compliance with, and non-compliance with, tax obligations must not be considered by the Commissioner when making a decision under this section.

(4) The Commissioner must use only financial information that the Commissioner has at the date on which the decision is made.

177B Instalment arrangements

(1) The Commissioner must not enter into an instalment arrangement with a taxpayer or a relief company to the extent that the arrangement would place the taxpayer, being a natural person, in serious hardship.

(2) The Commissioner may decline to enter into an instalment arrangement if—

(a) to do so would not maximise the recovery of outstanding tax from the taxpayer; or

(b) the Commissioner considers that the taxpayer is in a position to pay all of the outstanding tax immediately; or

(c) the taxpayer is being frivolous or vexatious; or

(d) the taxpayer has not met their obligations under a previous instalment arrangement.

(3) A taxpayer may renegotiate an instalment arrangement at any time.

(4) The Commissioner may renegotiate an instalment arrangement at any time after the end of 2 years from the date on which the instalment arrangement was entered.

(5) The renegotiation of an instalment arrangement is treated as if it were a new request for financial relief.

(6) The Commissioner may cancel an instalment arrangement if—

(a) it was entered into on the basis of false or misleading information provided by the taxpayer; or

(b) the taxpayer is not meeting their obligations under the arrangement.

(7) Despite sections LA 6(2) and LH 2(6) of the Income Tax Act 2007, a taxpayer with an instalment arrangement who is meeting their obligations under it may choose to have an amount of refundable tax credit remaining for a tax year paid to them rather than used under the ordering rules set out in those sections.

177C Write-off of tax by Commissioner

(1) The Commissioner may write off outstanding tax that cannot be recovered.

(1BA) The Commissioner may use, as a ground for deciding whether or not to write off the outstanding tax of a taxpayer or of a relief company, the basis that recovery of the outstanding tax would place the taxpayer, being a natural person, in serious hardship. The Commissioner is not required to write off the outstanding tax if the ground exists.

(1B) The Commissioner may write off an amount of outstanding tax to the extent to which the amount—

(a) is outstanding from the 2008–09 tax year; and

(b) is tax payable under section MF 5(2) or MF 6(2) of the Income Tax Act 2007, or is otherwise the result of WFF tax credit overpayment or overcrediting; and

(c) is outstanding due to amendments to the family scheme made by the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Act 2008.

(1C) The Commissioner must write off an amount, not exceeding $100, of outstanding tax to the extent to which the amount– –

(a) is outstanding from the 2008–09 tax year; and

(b) is tax payable under section MF 5(2) or MF 6(2) of the Income Tax Act 2007, or is otherwise the result of WFF tax credit overpayment or overcrediting.

(1D) The Commissioner must write off an amount, not exceeding $30, of outstanding tax to the extent to which the amount– –

(a) is outstanding from the 2010–11 tax year; and

(b) is tax payable under section MF 5(2) or MF 6(2) of the Income Tax Act 2007, or is otherwise the result of WFF tax credit overpayment or overcrediting.

(2) The Commissioner must write off outstanding tax that cannot be recovered in the following situations:

(a) bankruptcy:

(b) liquidation:

(c) a taxpayer's estate has been distributed.

(3) Despite subsection (1), the Commissioner must not write off outstanding tax (inclusive of any shortfall penalties), if a taxpayer is liable to pay, in relation to the outstanding tax, a shortfall penalty for an abusive tax position or evasion or a similar act.

(4) Despite subsection (2), the Commissioner may reinstate all or part of the outstanding tax written off if the Commissioner receives, by operation of law, additional funds in respect of a taxpayer after the taxpayer becomes bankrupt, is liquidated or if additional funds due to the taxpayer's estate are discovered after the taxpayer's estate has been distributed.

(5) If the Commissioner writes off outstanding tax for a taxpayer who has a tax loss, the Commissioner must extinguish all or part of the taxpayer's tax loss, by– –

(a) dividing the amount written off by 0.33 and reducing the tax loss by that amount, if the taxpayer is not a company; or

(b) dividing the amount written off by 0.28 and reducing the tax loss by that amount, if the taxpayer is a company.

(5B) If the Commissioner writes off outstanding tax for a taxpayer who has a tax credit carried forward under section LE 3 of the Income Tax Act 2007, the Commissioner must extinguish an amount of the tax credit on a one-for-one basis.

(5C) If a taxpayer has both a tax loss to which subsection (5) applies and a tax credit to which subsection (5B) applies, the Commissioner must extinguish the tax loss before extinguishing the tax credit.

(6) For the purpose of subsection (5), the tax loss that may be extinguished is the tax loss of the taxpayer at the time at which the outstanding tax is written off and the Commissioner may use a figure for that tax loss based on the most recent return of income furnished by the taxpayer.

(7) The Commissioner may reverse a write-off if—

(a) outstanding tax is written off on the grounds of serious hardship, and the taxpayer for whom the debt was written off is a natural person who—

(i) declares bankruptcy within a year of the outstanding tax being written off; or

(ii) is subject to bankruptcy proceedings brought by a creditor within a year of the outstanding tax being written off; or

(b) outstanding tax is written off on the grounds of serious hardship, and the taxpayer for whom the debt was written off is a relief company which, within a year of the outstanding tax being written off, is, or is in the course of being, liquidated; or

(c) the outstanding tax was written off due to false or misleading information provided by the taxpayer.

(8) If the Commissioner enters into an instalment arrangement that provides for some outstanding tax to be written off, the Commissioner may not reverse the write-off even if, during the term of the instalment arrangement, the taxpayer does not meet the instalment arrangement's terms.

Income Tax Act 2007

LE 3 Use of remaining credits by others

When this section applies

(1) This section applies when a person other than a person referred to in section LE 2(2) or a life insurer has an amount of tax credit remaining for a tax year under section LA 5(4) (Treatment of remaining credits).

Amount carried forward

(2) The amount may be carried forward to the next tax year as a credit carried forward.

Amount of reduction

(3) The person's credit is reduced by an amount equal to the amount carried forward and extinguished by the Commissioner under section 177C of the Tax Administration Act 1994.

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

SPECIAL DETERMINATION S43: VALUATION OF SHARES ISSUED BY BANK AND NZHOLDCO FOLLOWING A NON-VIABILITY TRIGGER EVENT

This Determination may be cited as Special Determination S43: Valuation of Shares issued by Bank and NZHoldCo following a Non-Viability Trigger Event.

1. Explanation (which does not form part of the determination)

1.1 This determination relates to a funding transaction involving the issue of Notes by Bank to the public pursuant to a Deed Poll. The Notes will contain a conversion mechanism to allow them to be recognised as Tier 2 capital for the purposes of the Reserve Bank of New Zealand and Australian Prudential Regulation Authority frameworks relating to the capital adequacy of banks.

1.2 At the same time that the Deed Poll is entered into, Bank, NZHoldCo, AusHoldCo and Parent will enter into a Coordination Agreement, which will set out the steps that will occur if a Non-Viability Trigger Event occurs, requiring conversion of the Notes. If a Non-Viability Trigger Event occurs, the relevant number of Notes must be immediately and irrevocably converted into ordinary shares in Parent. The Coordination Agreement provides for a series of share subscriptions and payments from Bank to NZHoldCo, from NZHoldCo to AusHoldCo, and from AusHoldCo to Parent.

1.3 The Arrangement is the subject of private ruling BR Prv 15/66 issued on 5 November 2015 and is fully described in that ruling.

1.4 Each agreement to subscribe for shares provided for in the Coordination Agreement is a financial arrangement (as defined in s EW 3) and an "agreement for the sale and purchase of property or services" (as defined in s YA 1). The Notes and the Coordination Agreement are together part of a wider financial arrangement.

2. Reference

This determination is made under s 90AC(1)(i) of the Tax Administration Act 1994.

3. Scope of determination

3.1 This determination applies to a funding transaction involving the issue of Notes by Bank to the public pursuant to a Deed Poll. At the same time the Deed Poll is entered into, Bank, NZHoldCo, AusHoldCo and Parent will enter into a Coordination Agreement, which will set out the steps that will occur if a Non-Viability Trigger Event occurs, requiring conversion of the Notes.

3.2 If a Non-Viability Trigger Event occurs, the relevant number of Notes must be immediately and irrevocably converted. In summary, the steps for the conversion of the Notes will be as follows:

a) Each Note (subject to conversion) will be immediately and irrevocably transferred by the Holder to NZHoldCo.

b) In consideration for the Holders transferring their Notes to NZHoldCo, Parent will allot and issue a specified "Conversion Number" of Parent ordinary shares to such Holders for each Note to be converted.

c) Immediately following the transfer referred to in (a), the Notes will become immediately due and payable and Bank will be required to repay the Issue Price of the Notes to NZHoldCo as transferee. Under the terms of the Coordination Agreement, the Issue Price owed to NZHoldCo will be repaid by being applied on NZHoldCo's behalf to subscribe for ordinary shares in Bank. The number of ordinary shares in Bank to be subscribed for will be calculated based on the Equity Value of Bank, in accordance with a formula in the Coordination Agreement.

d) Under the Coordination Agreement, NZHoldCo will be required to pay a sum to AusHoldCo (in NZ dollars) equal to the Issue Price of each Note to be converted. This amount will be automatically applied on AusHoldCo's behalf to subscribe for ordinary shares in NZHoldCo. The number of ordinary shares in NZHoldCo to be subscribed for will be calculated based on the Equity Value of NZHoldCo in accordance with a formula in the Coordination Agreement.

e) Under the Coordination Agreement, AusHoldCo will be required to pay a sum to Parent equal to the Australian dollar equivalent of the Issue Price of each Note to be converted. This amount will be automatically applied on Parent's behalf to subscribe for ordinary shares in AusHoldCo. The number of ordinary shares in AusHoldCo to be subscribed for will be calculated based on the Equity Value of AusHoldCo, in accordance with a formula in the Coordination Agreement.

3.3 This determination applies if shares are issued by Bank and NZHoldCo following a Non-Viability Trigger Event to determine the value of the shares for the purposes of the financial arrangements rules.

4. Principle

4.1 The Notes and the transactions under the Coordination Agreement are, together, part of a financial arrangement (as defined in s EW 3). The agreement to subscribe for shares in Bank by NZHoldCo and the agreement to subscribe for shares in NZHoldCo by AusHoldCo contained in the Coordination Agreement are both an "agreement for the sale and purchase of property and services" (as defined in s YA 1), because they are conditional agreements to acquire property.

4.2 Each agreement to subscribe for shares is not a "short-term agreement for sale and purchase" (as defined in s YA 1), because settlement is not required to occur within 93 days of the Coordination Agreement being entered into. Therefore, they are not excepted financial arrangements under s EW 5.

4.3 For the purposes of determining the consideration paid or payable under the financial arrangements rules, the value of the shares issued by Bank and NZHoldCo must be established under s EW 32. None of subs (2B) to (5) of s EW 32 applies to the share subscriptions.

4.4 Under s EW 32(6), the Commissioner is required to determine the value of the property. Bank and NZHoldCo are both required to use this amount.

5. Interpretation

In this determination, unless the context otherwise requires:

- All legislative references are to the Income Tax Act 2007, unless otherwise stated.
- **Arrangement** is the Arrangement as described in private ruling BR Prv 15/66, issued on 5 November 2015.
- **Bank** means the bank issuing the Notes.
- **NZHoldCo** means the New Zealand incorporated company holding 100% of the shares in Bank.
- **AusHoldCo** means the Australian incorporated holding company holding 100% of the shares in NZHoldCo.
- **Parent** means the Australian incorporated parent company of Bank, NZHoldCo and AusHoldCo.
- **Non-Viability Trigger Event** has the same meaning as described in private ruling BR Prv 15/66, issued on 5 November 2015.
- **Notes** means the Notes issued to the public pursuant to a Deed Poll.
- **Deed Poll** has the same meaning as described in private ruling BR Prv 15/66, issued on 5 November 2015.
- **Coordination Agreement** means that agreement entered into by Bank, NZHoldCo, AusHoldCo, and Parent at the same time as the Deed Poll.
- **Equity Value** has the same meaning as described in the Coordination Agreement.
- **Conversion Number** has the same meaning as described in the Deed Poll.

6. Method

6.1 The Arrangement does not involve the advancement or deferral of income or expenditure.

6.2 For the purposes of s EW 32(6), the value of the shares issued by Bank is equal to the amount NZHoldCo paid for those shares and the value of the shares issued by NZHoldCo is equal to the amount AusHoldCo paid for those shares.

7. Example

This example illustrates the application of the method set out in this determination.

Following a Non-Viability Trigger Event, Notes having an Issue Price of $100 are to be converted into ordinary shares in Parent.

Bank immediately repays the Issue Price of the Notes to NZHoldCo. This amount is automatically applied on NZHoldCo's behalf to subscribe for ordinary shares in Bank. Bank issues the number of shares to NZHoldCo calculated in accordance with the formula in the Coordination Agreement. The value of the shares, for the purposes of s EW 32, is $100.

NZHoldCo then pays an amount equal the Issue Price of the Notes to AusHoldCo. This amount is automatically applied on AusHoldCo's behalf to subscribe for ordinary shares in NZHoldCo. NZHoldCo issues the number of shares to AusHoldCo calculated in accordance with the formula in the Coordination Agreement. The value of the shares, for the purposes of s EW 32, is $100.

This Determination is signed by me on the 5th day of November 2015.

Fiona Heiford

Manager, Taxpayer Rulings

SPECIAL DETERMINATION S44: SPREADING OF INCOME AND EXPENDITURE UNDER VARIED PARTICIPANTS' DEBT ARRANGEMENTS

This Determination may be cited as "Special Determination S44: Spreading of income and expenditure under varied participants' debt arrangements".

1. Explanation (which does not form part of the Determination)

1.1 This Determination relates to financial arrangements between New Zealand Company Limited, the other Debtors and Participant Creditors, whose terms have been amended under a Restructured Debt Deed (RDD) in accordance with a Deed of Company Arrangement (DOCA).

1.2 The Debtors owe a significant amount of money to various parties. The Debtors have been in financial distress and, immediately prior to the implementation of the DOCA and the RDD, were unable to repay all of their financial obligations.

1.3 The Debtors entered into a voluntary administration, aimed at providing balance sheet relief and enabling a controlled sale of the Debtors' assets. This involved the Debtors entering into, amongst other things, the DOCA and the RDD. These documents have restructured the Debtors' liabilities and have affected the claims of many of the Debtors' creditors, including the Participant Creditors.

1.4 This Determination applies in respect of the Participants' Debts, which are owed to parties outside of the New Zealand Company Limited group of companies.

1.5 Each Participant Creditor had amounts owing to it by the Debtors under the terms of existing agreements, being the Participant Creditor Claims. The amounts include any interest, fees or other amount accrued, but unpaid, under the existing agreements up to, and excluding, the Restructuring Effective Date.

1.6 From the Restructuring Effective Date, the Participant Creditor Claims have been compromised, amended and are now owed on common terms in accordance with the RDD and the DOCA.

1.7 Prior to the Restructuring Effective Date, the Debtors will use the IFRS financial reporting method in s EW 15D to allocate their income and expenditure from the Participants' Debts to income years. This requires the Debtors to allocate their income and expenditure from the Participants' Debts in accordance with their IFRS accounting treatment.

1.8 As a consequence of the RDD and DOCA, the Debtors' IFRS accounting method may change from the effective interest rate method to the fair value method.

1.9 This Determination sets out a method the Debtors may use as an alternative to the IFRS financial reporting method in s EW 15D to allocate their income and expenditure from the Participants' Debts in and from the income year in which their IFRS accounting method changes, if their IFRS accounting method changes.

2. Reference

This Determination is made under s 90AC(1)(bb) of the Tax Administration Act 1994.

3. Scope of Determination

3.1 This Determination applies to the Debtors in respect of the Participants' Debts. The Participants' Debts have the following key terms.

3.2 The Participants' Debts have been apportioned on the basis of one third into Tranche A and two thirds into Tranche B. The two tranches are not legally separate debts.

3.3 The Debtors' liability in respect of any amounts due to the Participant Creditors under the Participants' Debts is limited to the aggregate amount available for distribution by the Debtors (or any receiver, liquidator, voluntary administrator or statutory manager or similar insolvency practitioner) under and in accordance with the relevant Payment Waterfall contained in the RDD.

3.4 The rate of interest applicable to Tranche A of a Participants' Debts in any Interest Period shall be the rate per annum (as determined by the Calculation Agent) equal to the sum of the relevant Margin and the Base Rate for the period applicable to the Tranche A amount outstanding from the Restructuring Effective Date. Each Interest Period is three months.

3.5 The rate of interest applicable to Tranche B of a Participants' Debts in any Interest Period shall be 0% per annum for the period applicable to the Tranche B amount outstanding from the Restructuring Effective Date.

3.6 Interest shall be calculated on a daily basis at the applicable interest rate and accrued interest shall (subject to the Payment Waterfall and Limited Recourse provisions) be payable monthly on the Tranche A Debt on each Payment Date, on and from a specified date.

3.7 The Debtors shall (subject to the Payment Waterfall and Limited Recourse provisions) repay the Participants' Debts, together with all unpaid interest accrued on the Tranche A amount of the Participants' Debts and any other sum due under the RDD, on the first to occur of the Final Distribution Date and the Final Maturity Date. The Participants' Debts are all denominated in New Zealand dollars.

3.8 The Debtors will be released and discharged from all Claims against them by the Participant Creditors on and from the Final Distribution Date.

3.9 This Determination may be used by a Debtor for the Participants' Debts on the condition that the Debtor's accounting treatment for the Participants' Debts under IFRS changes from the effective interest rate method to the fair value method.

3.10 This Determination does not apply to any of the Participants' Debts that are:

- a mandatory convertible note;
- an optional convertible note;
- an agreement for the sale and purchase of property denominated in foreign currency;
- treated as an equity instrument under IFRS;
- treated under IFRS by the relevant Debtor as a hedge; or
- not a financial arrangement (as defined in s EW 3).

3.11 This Determination is made on the condition that:

- The amendment to the terms of the Participant Creditor Claims under the DOCA and the RDD did not result in the cancellation of those Participant Creditor Claims.

4. Principle

4.1 The Debtors may account for income and expenditure on a Participants' Debts using the same method as Method A or Method B (as appropriate) provided for in Determination G26: Variable Rate Financial Arrangements (Determination G26).

4.2 For the purposes of applying these methods, the maturity date of the Participants' Debts is deemed to be the Final Maturity Date. If the actual maturity date changes so that it falls in a different income year to the deemed maturity date, then the maturity date will be treated as extended (or reduced) to the actual maturity date. An adjustment under Determination G25: Variations in the Terms of a Financial Arrangement (Determination G25) will be required on the actual maturity date, on the basis that the extension or variation is a change in the terms of the Participants' Debts.

4.3 Under these methods, the income deemed to be derived or expenditure deemed to be incurred by the Debtors in a Period or an income year is calculated by adding together:

a) The amount of the Total Finance Charges Excluding Interest allocated to that Period (or income year); and

b) The amount of Interest payable or receivable in that Period (or income year).

4.4 Method A and Method B find and then allocate the Total Finance Charges Excluding Interest to each Period or income year of the financial arrangement. Once this amount has been allocated, the amount of Interest payable or receivable in that Period or income year is added to it. This gives the income or expenditure for each Period or income year of the financial arrangement.

a) Method A may only be applied to Small Discount or Premium Financial Arrangements. It results in an allocation to each Period proportionate to the amount of principal outstanding in that Period, and the length of that Period.

b) Method B may be applied to other financial arrangements. It assumes that the rate, price or index known to apply in the first Period applies to all subsequent Periods. The Act and Determinations are used to spread the Total Finance Charges over the term of the financial arrangement. The assumed Interest content of the Total Finance Charges in each Period (or in each income year) is then subtracted.

The yield to maturity method or other permissible method would be used for calculation purposes.

5. Interpretation

In this Determination, unless the context otherwise requires:

- Legislative references are to the Income Tax Act 2007 unless otherwise stated.
- Capitalised terms not otherwise defined in this Determination have the meanings set out in Determination G26, the RDD and the DOCA (as appropriate). In addition:
  - "Debtors" means the various debtor companies within the New Zealand Company Limited group.
  - "DOCA" means the Deed of Company Arrangement entered into between the Debtors, the Deed Administrators and the Directors of the Debtors, following approval by the requisite majority of the Debtors' creditors at a Watershed Meeting.

- "Final Distribution Date" means the date on which the final payment is made to the Participant Creditors in accordance with cl 12.3 of the DOCA.
- "Final Maturity Date" means the date that is a specified period from the Deed Commencement Date.
- "IFRS" means the New Zealand equivalents to the International Financial Reporting Standards in effect under the Financial Reporting Act 2013.
- "Participants' Debts" means the Participant Creditor Claims with the key terms (from the Restructuring Effective Date) specified in the Scope of this Determination.
- "Participant Creditor" means a creditor under a Participant Creditor Claim.
- "Participant Creditor Claims" means the various specified creditor claims. "RDD" means the Restructured Debt Deed entered into between the Debtors, the Deed Administrators and the Security Trustee in favour of the Participant Creditors.
- "Restructuring Effective Date" means the date on which the conditions precedent to the DOCA were satisfied, and is accordingly the date on which the Participant Creditor Claims became compromised, amended and owed on the terms set out in the RDD and the DOCA.

6. Method

6.1 The Debtors may use a method that is the same as Method A or Method B, as appropriate, contained in Determination G26 for the Participants' Debts in and from the income year in which their IFRS accounting method changes, if their IFRS accounting method changes.

6.2 Method A may only be applied to Small Discount or Premium Financial Arrangements. Method B may be applied to other financial arrangements.

6.3 For the purposes of using these methods, the maturity date of the Participants' Debts is deemed to be two years and six months from the Restructuring Effective Date.

6.4 If the actual maturity date occurs in a different income year to the deemed maturity date, the maturity date will be treated as having been extended or varied. An adjustment under Determination G25 will then be required, on the basis that there will have been an extension or variation in the terms of the financial arrangement.

7. Example

This example illustrates the application of the methods set out in this Determination from the date the method applies (for an income year other than an income year in which a base price adjustment is performed).

The example is based on a Participant's Debt, as follows:

Tranche A portion:	1/3 of $100
Tranche B portion:	2/3 of $100
Interest on Tranche A portion:	6% per year
Accrued interest per year:	$2 (1/3 of $100 at 6%)

Total Finance Charges Excluding Interest: nil

Because there are no Total Finance Charges Excluding Interest, the Debtor may use Method A. The Debtor will have expenditure of $2 for the accrued interest that is payable in that income year under Method A. Because there are no Total Finance Charges Excluding Interest, the Debtor will not be required to spread anything further. Therefore, the Debtor will not have any other income or expenditure for that income year in respect of either the Tranche A portion or the Tranche B portion.

For further examples, including examples of Method B where there are Total Finance Charges Excluding Interest, see the examples provided in Determination G26.

This Determination is signed by me on the 21st day of December 2015.

Howard Davis

(Director, Taxpayer Rulings)

SPECIAL DETERMINATION S45: SPREADING OF INCOME AND EXPENDITURE UNDER VARIED INTRA-GROUP DEBT ARRANGEMENTS

This Determination may be cited as "Special Determination S45: Spreading of income and expenditure under varied intra-group debt arrangements".

1. Explanation (which does not form part of the Determination)

1.1 This Determination relates to financial arrangements the terms of which have been amended under a Restructured Debt Deed (RDD) entered into by New Zealand Company Limited (NZCo) and the Administration Subsidiaries in favour of Participant Creditors, in accordance with a Deed of Company Arrangement (DOCA).

1.2 NZCo and the Administration Subsidiaries owe a significant amount of money to various parties. NZCo and the Administration Subsidiaries have been in financial distress and, immediately prior to the implementation of the restructure, were unable to repay all of their financial obligations.

1.3 NZCo and the Administration Subsidiaries entered into a voluntary administration, aimed at providing balance sheet relief and enabling a controlled sale of their assets. This involved NZCo and the Administration Subsidiaries entering into, amongst other things, the DOCA and the RDD. These documents have restructured the liabilities of NZCo and the Administration Subsidiaries and have affected the claims of many of their creditors.

1.4 This Determination relates to the Intercompany Obligations, which are owed within the NZCo group of companies.

1.5 Prior to the Restructuring Effective Date, certain Intercompany Obligations were owed between Administration Subsidiaries and NZCo. As from the Restructuring Effective Date, the Intercompany Obligations owing immediately prior to that date have become compromised and amended by each applicable Administration Subsidiary to NZCo, or by NZCo to the applicable Administration Subsidiary, in accordance with the RDD and the DOCA.

1.6 Prior to the Restructuring Effective Date, NZCo and the Administration Subsidiaries will use the IFRS financial reporting method in s EW 15D to allocate their income and expenditure from their financial arrangements to income years. This requires NZCo and the Administration Subsidiaries to allocate their income and expenditure from their financial arrangements in accordance with their IFRS accounting treatment.

1.7 As a consequence of the RDD and DOCA, the IFRS accounting method of NZCo and the Administration Subsidiaries may change from the effective interest rate method to the fair value method.

1.8 This Determination sets out a method NZCo and the Administration Subsidiaries may use, as an alternative to the IFRS financial reporting method in s EW 15D, to allocate their income and expenditure from the Intercompany Obligations in and from the income year in which their IFRS accounting method changes, if their IFRS accounting method changes.

2. Reference

This Determination is made under s 90AC(1)(bb) of the Tax Administration Act 1994.

3. Scope of Determination

3.1 This Determination applies to NZCo and the Administration Subsidiaries in respect of the Intercompany Obligations with the key terms set out below.

3.2 Other than the Subsidiary Loan, the Intercompany Obligations are not interest bearing and will continue to be not interest bearing following the Restructuring Effective Date.

3.3 The Subsidiary Loan is interest bearing and will remain interest bearing following the Restructuring Effective Date. Interest is payable on the Subsidiary Loan at the rate notified by Subsidiary, being the amount Subsidiary considers, in its reasonable opinion, is required to fund the outstanding balance of the loan. The interest rate is currently set at 5%. Interest is due and payable monthly, but any unpaid interest will be capitalised and form part of the principal.

3.4 The liability of NZCo and each Administration Subsidiary in respect of any amounts due to each member of the NZCo Administration Group in respect of its Intercompany Obligations at any time is limited to the aggregate amount available for distribution by NZCo or any Administration Subsidiary, the Security Trustee, or any receiver, liquidator, voluntary administrator or statutory manager (or similar insolvency practitioner) of NZCo and/or an Administration Subsidiary at that time.

3.5 The Intercompany Obligations are expressed to be repayable on demand under their original terms.

Under the RDD, repayment may only be made to the extent it is necessary to facilitate a payment to third party creditors. The Intercompany Obligations are all denominated in New Zealand dollars.

3.6 The Intercompany Obligations will be released and discharged, on and from the Final Distribution Date.

3.7 This Determination is made on the conditions that:

- The Intercompany Obligations do not have any discount, premium, establishment fee or other finance charge.
- The accounting treatment under IFRS for the Intercompany Obligation of any party applying this Determination changes to the fair value method.
- Both parties to an Intercompany Obligation use the method in this Determination if the method is available for use by the respective parties.
- The amendment to the terms of the Intercompany Obligations under the DOCA and the RDD did not result in the cancellation of the Intercompany Obligations.

4. Principle

4.1 The Intercompany Obligations (other than the Subsidiary Loan) do not have any interest or discount, premium, establishment fee or other finance charge. Consequently, there is no income or expenditure arising for the parties to these Intercompany Obligations prior to the year in which a base price adjustment is required. Consequently, there is no amount of income or expenditure to allocate to any income year prior to the year in which a base price adjustment is required.

4.2 The Subsidiary Loan has a variable interest rate, but no discount, premium, establishment fee or other finance charge. Accordingly, the income or expenditure allocated to an income year (other than an income year in which a base price adjustment is required) in respect of the Subsidiary Loan equals the interest receivable or payable for that income year, provided that the amount of expenditure allocated to an income year of the borrower under this Determination shall not exceed the amount of income allocated to the same income year of the lender (whether under this Determination or otherwise).

5. Interpretation

In this Determination, unless the context otherwise requires:

- Legislative references are to the Income Tax Act 2007.
- Capitalised terms not otherwise defined in this Determination have the meanings set out in the RDD and the DOCA. In addition:
  - "Administration Subsidiaries" means the various subsidiaries under administration.
  - "DOCA" means the Deed of Company Arrangement entered into between NZCo and the Administration Subsidiaries, the Deed Administrators and the Directors of NZCo and the Administration Subsidiaries, following approval by the requisite majority of their creditors at a Watershed Meeting.
  - "Final Distribution Date" means the date on which the final payment is made to the Participant Creditors in accordance with cl 12.3 of the DOCA.
  - "Final Maturity Date" means the date that is a specified period from the Deed Commencement Date.
  - "IFRS" means the New Zealand equivalents to the International Financial Reporting Standards in effect under the Financial Reporting Act 2013.
  - "Intercompany Obligations" means any claim that NZCo or the Administration Subsidiaries has against another member of NZCo or the Administration Subsidiaries.
  - "NZCo" mean New Zealand Company Limited (subject to deed of company arrangement).
  - "RDD" means the Restructured Debt Deed entered into between NZCo and the Administration Subsidiaries, the Deed Administrators and the Security Trustee in favour of the Participant Creditors.
  - "Restructuring Effective Date" means the date on which the conditions precedent to the DOCA were satisfied, and is accordingly the date on which the Intercompany Obligations became compromised and amended under the RDD and the DOCA.
  - "Subsidiary" means a specified subsidiary.
  - "Subsidiary Loan" means the Intercompany Obligation owed by NZCo to Subsidiary.

6. Method

6.1 No income or expenditure will arise for the parties to the Intercompany Obligations, other than the Subsidiary Loan, prior to the income year in which a base price adjustment is required.

6.2 For the Subsidiary Loan, the income or expenditure allocated to an income year by a party (other than an income year in which a base price adjustment is required) equals the interest receivable or payable for that income year, provided that the amount of expenditure allocated to an income year of the borrower under this Determination shall not exceed the amount of income allocated to the same income year of the lender (whether under this Determination or otherwise).

7. Example

These examples illustrate the application of the methods set out in this Determination. The examples relate to an income year in which a base price adjustment is not required for the relevant Intercompany Obligation.

Example A

This example applies to an Intercompany Obligation, other than the Subsidiary Loan. The terms of the example Intercompany Obligation are as follows:

Principal: $100

Interest: 0%

Non Interest Finance costs: nil

There is no amount of income or expenditure to spread under this Determination.

Example B

This example applies to the Subsidiary Loan. The terms of the example Subsidiary Loan are as follows:

Principal $100

Interest 5% per year

Accrued interest per year: $5

Non Interest Finance costs: nil

NZCo has expenditure of $5 in the income year from the Subsidiary Loan under this Determination. Subsidiary has income of $5 from the Subsidiary Loan in the income year under this Determination.

This Determination is signed by me on the 21st day of December 2015.

Howard Davis

(Director, Taxpayer Rulings)

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 15/13: INCOME TAX – WHETHER THE COST OF ACQUIRING AN OPTION TO ACQUIRE REVENUE ACCOUNT LAND IS DEDUCTIBLE

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

This Question We've Been Asked is about s DB 23 and the financial arrangements rules (the FA rules).

Question

1. Where revenue account land is acquired through the exercise of an option, is the cost of acquiring the option deductible?

Answer

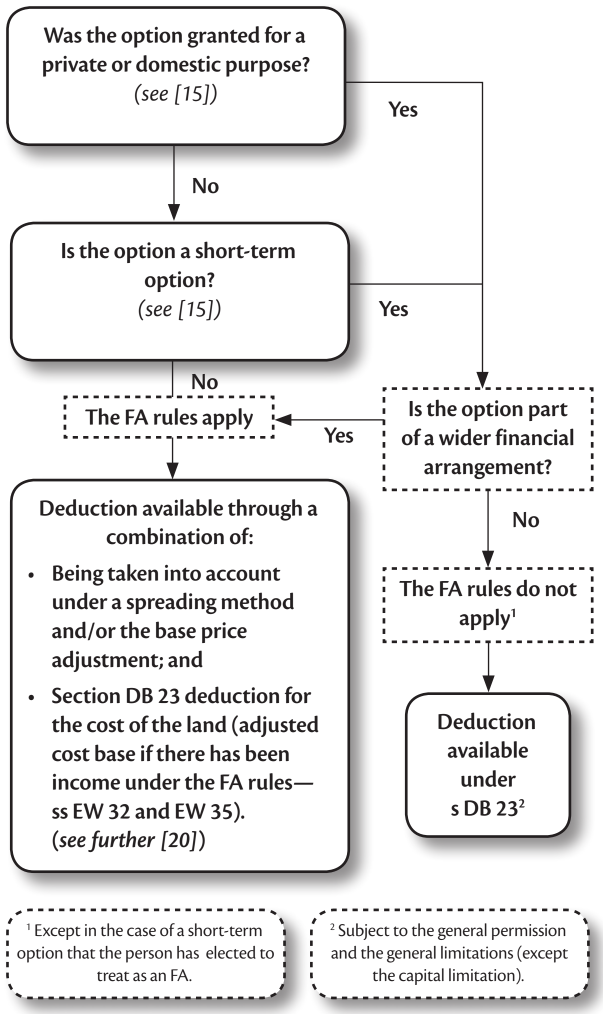
2. Yes, the cost of acquiring the option is deductible as follows:
   - If the FA rules apply to the option (and consequent agreement for sale and purchase of the land), the cost of the option and the other consideration for the land are in effect deductible. Those costs will be taken into account under the FA rules, and the FA rules will then establish the cost base of the land, which will be deductible under s DB 23 on the ultimate sale of the land.
   - Where the FA rules do not apply, the cost of acquiring the option is deductible under s DB 23 because it is part of the cost of acquiring the revenue account land (together with the other consideration for the land).

   [Note: throughout this QWBA, references to deductibility under s DB 6 or s DB 23 are subject to the general permission being satisfied, and no general limitation (excluding the capital limitation) applying.]
3. The FA rules **will apply** unless the option is a short-term option to acquire land, or was granted to the person for a private or domestic purpose.[1] However, the FA rules will apply in those situations if the option is part of a wider financial arrangement. See further from [14] on deductibility where the FA rules apply.
4. If the FA rules **do not** apply, the only question is whether the cost of the option is part of the cost of the revenue account land. The Commissioner considers that it is, as it is part of what is outlaid in order to acquire the underlying land. See further from [21] on deductibility under s DB 23.

[1] Where certain criteria are met—see [15].

5. If the FA rules apply, the deduction of the cost of the revenue account land may be partly taken through the operation of those rules, and partly taken under s DB 23. The deduction under s DB 23 would be allocated to the income year in which the person disposes of the property.
6. This QWBA also considers the deductibility of the cost of an option that is itself on revenue account—see further from [39].
7. The following flowchart shows how the cost of revenue account land acquired through the exercise of an option is deductible:

How is the cost of revenue account land acquired through the exercise of an option deductible?



Explanation

Background

8. The question we have been asked is whether the cost of acquiring an option to acquire revenue account land is deductible.

9. The question has arisen in the context of the enactment of s CB 15B, which concerns the timing of acquisition of land for the purposes of subpart CB of the Act.[2] The question is not about the application of s CB 15B as such. However, it has been suggested that s CB 15B requires the separate consideration of different estates or interests in, or options to acquire estates or interests in, the same underlying physical land. As a consequence, it has been suggested that the cost of acquiring an option (which is itself "land" for the purposes of the Act) will only be deductible if the option is revenue account property.

Revenue account property

10. Section YA 1 defines "revenue account property" (relevantly) as:

> **YA 1 Definitions**
>
> In this Act, unless the context requires otherwise,—
>
> …
>
> **revenue account property**, for a person, means property that—
>
> (a) is trading stock of the person:
>
> (b) **if disposed of for valuable consideration, would produce income for the person** other than income under section EE 48 (Effect of disposal or event), FA 5 (Assets acquired or disposed of after deductions of payments under lease), or FA 9 (Treatment when lease ends: lessee acquiring asset):
>
> …
>
> [Emphasis added]

11. There are a number of provisions in subpart CB of the Act which include as income amounts derived by a person from disposing of land. For example, an amount will be income if derived from disposing of land:
    - that was acquired with an intention or purpose of disposing of it (s CB 6);
    - that was acquired by a person (or someone associated with them) for the purpose of a business of dealing in land, developing land, dividing land into lots, or erecting buildings[3] (s CB 7); or
    - within 10 years of its acquisition, if at the time of acquisition the person was (or was associated with someone who was) in the business of dealing in land, or developing or dividing land (ss CB 9 and CB 10); or
    - within 10 years of the completion of improvements to the land, if at the time the land was acquired the person was (or was associated with someone who was) in the business of erecting buildings (s CB 11); or
    - that was part of an undertaking or scheme, meeting certain criteria, that involved the development of land or the division of land into lots (ss CB 12 and CB 13).

    Land can therefore be held as "revenue account property".

Deduction for the cost of revenue account property

12. Section DB 23 allows a deduction for expenditure incurred as the cost of revenue account property. However, if the FA rules apply, they will determine what the cost of the property is regarded as being for the purposes of s DB 23 (see ss EW 2(2)(d) and EW 35).

13. An option (and any consequent agreement for sale and purchase of the land) may be a "financial arrangement" to which the FA rules apply. If it is, the application of the FA rules, which calculate and spread income and expenditure over the term of the financial arrangement, may give rise to income or expenditure. As noted above, the FA rules will then determine what the cost of the property is regarded as being for the purposes of s DB 23 (see ss EW 2(2)(d) and EW 35).

Do the financial arrangements rules apply?

14. The FA rules override any other provision relating to the timing or quantification of income or expenditure under a financial arrangement, unless the other provision expressly or by necessary implication requires otherwise (s EW 2). An option to acquire land, and any consequent agreement for sale and purchase of the land, will be a financial arrangement unless it is an excepted financial arrangement (see ss EW 3 and EW 4(3), and the definition of "specified option" in s YA 1). Therefore, in considering the deductibility of the cost of acquiring an option to acquire land, it is necessary to first consider whether the FA rules apply, and what their effect is.

15. As noted above, an option to acquire land, and any consequent agreement for sale and purchase of the land, may be a "financial arrangement" to which the FA rules apply. However, the option and agreement for sale and purchase (a "specified option", as noted above) **will not** be a financial arrangement if it is either:

[2] It is noted that as at the time of publication, there is a proposal for the introduction of a new legislative provision in subpart CB, for which there may be a different time of acquisition rule.

[3] If the business is of erecting buildings, the provision also requires that the person, or the associated person, has made improvements to the land—either before or after acquiring it.

- **granted to the person, for a private or domestic purpose**, where:
  - the purchase price for the land is less than $1m; and
  - the option requires settlement of the property, if an agreement is entered into as a result of the exercise of the option, to take place on or before the 365th day after the date on which the option is granted.

OR

- **a short-term option**—which is:
  - an option under which settlement must take place on or before the 93rd day after the date on which the option is entered into; or
  - if that date cannot be established, an option under which settlement must take place before the 93rd day after the earlier of the date on which the buyer first makes a payment to the seller and the date on which the first right in the property is transferred,

  (though such an option will be a financial arrangement for a party who makes an election under s EW 8 to treat it as one).

16. In either of the above situations, the "specified option" will be an excepted financial arrangement. However, an excepted financial arrangement may be part of a wider financial arrangement. Generally, amounts that are solely attributable to excepted financial arrangements are **not** taken into account under the FA rules. However, in either of the above situations, if the specified option is part of a wider financial arrangement, any amount solely attributable to the excepted financial arrangement **will need to be** taken into account under the FA rules (s EW 6(3)).
17. Therefore, if an option (and any consequent agreement for sale and purchase of the land) falls into one of the above two categories, the deductibility of the cost of the option (together with the other consideration for the land) will fall for consideration under s DB 23, unless the specified option is part of a wider financial arrangement, in which case the FA rules would need to be considered first.
18. Any other option to acquire land, and any consequent agreement for sale and purchase of the land, will be a financial arrangement (a "specified option") to which the FA rules apply.

What is the effect of the financial arrangements rules applying?

19. A "cash basis person" is not required to apply any of the spreading methods under the FA rules to their financial arrangements, but may choose to do so under s EW 61 (ss EW 13(3) and EW 55(1)). A person will be a cash basis person for an income year if the value of financial arrangements to which they are a party does not exceed the prescribed thresholds in s EW 57(1)–(3) (s EW 54).
20. Where the FA rules apply, the deductibility of the cost of acquiring an option to acquire land (together with the other consideration for the land) is determined as follows:
    - Income or expenditure under the financial arrangement is calculated and allocated to each income year of the financial arrangement's term under the appropriate spreading method (if spreading is required) and base price adjustment in the year that is required.
    - Any expenditure under the financial arrangement is interest (as defined in s YA 1), and may be deductible under s DB 6 or s DB 7.
    - Any income under the financial arrangement is income under s CC 3 and would need to be returned in the year(s) to which it is allocated under the FA rules.
    - Presuming there is no wider financial arrangement, the base price adjustment would typically be required in either the year the option expires or is disposed of, or in the year that any consequent agreement for sale and purchase of the land is settled.[4]
    - The cost of the option, and the other consideration paid for the land (if the option was exercised) would be taken into account in calculating the amount of income (if any) under the FA rules.
    - Where the option is exercised and the land acquired, the purchaser is paid consideration that includes property. The value of the property for the purposes of the FA rules is determined under s EW 32. This value may be more or less than what the option holder paid for it. As such, the purchaser may have income or expenditure under the FA rules.
    - If the land the subject of the option was acquired and is revenue account property, when the person disposes of that land the amount derived on the

[4] The base price adjustment could be required at a different time—see s EW 29.

disposal will be income. A deduction for the cost of the land will be allowed against the sale proceeds, under s DB 23.[5] Section EW 35 provides that for the purposes of determining the amount of that deduction, the person will be treated as acquiring the land for the value determined under s EW 32. What this means in effect is that if the purchaser has already returned some income under the FA rules because the value of the property under s EW 32 was more than what was paid for it, that higher value is the cost base for the property. Similarly, if the purchaser has already had expenditure under the FA rules because the value of the property under s EW 32 was less than what was paid for it, that lower value is the cost base for the property.

Cost of revenue account property

21. Whether or not the FA rules apply, the deductibility of the cost of revenue account land acquired by way of an option will be determined by s DB 23. It just may be that the FA rules determine what the "cost" of the land is considered to be.

22. Section DB 23 provides for the deductibility of expenditure incurred as the cost of revenue account property, stating:

> **DB 23 Cost of revenue account property**
>
> *Deduction*
>
> (1) **A person is allowed a deduction for expenditure that they incur as the cost of revenue account property**.
>
> *No deduction*
>
> (2) Despite subsection (1), a person is denied a deduction for expenditure incurred as the cost of revenue account property if—
>
> (a) [Repealed]
>
> (b) section CX 55, CX 56B, or CX 56C (which relate to portfolio investment income) applies to income derived by the person from the disposal of the revenue account property.
>
> *Relationship with sections CU 2 and DU 3*
>
> (2B) Sections CU 2 (Treatment of mining land) and DU 3 (Acquisition of land for mining operations) override this section in relation to land or an interest in land as described in section CU 2(1)(b) that a mineral miner acquires for the purposes of their mining operations or associated mining operations.
>
> *Link with subpart DA*
>
> (3) Subsection (1) overrides the capital limitation but the general permission must still be satisfied. Subsection (2) overrides the general permission. The other general limitations still apply.
>
> [Emphasis added]

23. If a deduction is allowed under s DB 23, it is allocated to the earlier of the income year in which the person disposes of the property or the income year in which the property ceases to exist (s EA 2(2)).

24. Where land is revenue account property for a person, the cost of acquiring the land[6] would obviously be expenditure incurred as the cost of acquiring revenue account property. The question we have been asked is whether the cost of acquiring an option, which is then exercised in order for the land to be acquired, will also form part of the cost of acquiring the land, and therefore be deductible.

Meaning of "cost"

25. The Act does not define "cost" for the purposes of s DB 23, however, numerous cases have considered its meaning, for example *Tasman Forestry Limited v CIR* (1999) 19 NZTC 15,147 (CA) and *CIR v Atlas Copco (NZ) Ltd* (1990) 12 NZTC 7,327, which are discussed below.

26. *Tasman Forestry* involved consideration of what the cost of certain forestry assets acquired by the taxpayer was, as the taxpayer was allowed a deduction for this cost against profits or gains derived from the sale of timber.

27. Following a merger, it was decided that Tasman Forestry Limited (Tasman) would hold the forestry holdings of approximately 20 forestry companies in the group. Tasman acquired the shares of those companies at fair market value. Each of those companies was then wound up, and the forestry assets of the company were distributed to Tasman (referred to as an *in specie* distribution). In addition, Tasman entered into an agreement with another company, under which forestry assets were exchanged.

28. As noted above, the issue in *Tasman Forestry* was what the cost of the forestry assets Tasman acquired was.

29. The Court of Appeal discussed the meaning of "cost", and adopted the *Shorter Oxford English Dictionary* definition, being "that which must be given in order to acquire something". The court also stated that "cost" has a wider meaning than payment on purchase, and the fact that determination of cost may require a valuation exercise does not mean there is no cost.

[5] As noted above, this is subject to the general permission being satisfied, and no general limitation (excluding the capital limitation) applying.

[6] Excluding any interest element under the FA rules—though there is unlikely to be any.

30. In terms of the mechanism through which the forestry assets were acquired, the court noted at 15,157:

> [37] We consider the correct course is not to dissect the transactions by which the forests were acquired, but to view them in their commercial reality. As the Judge found, the shares were purchased as the means for, and with the intention of, acquiring the forests. For practical purposes the cost to Tasman in acquiring the forests was the amount paid for the company shares which gave access to the forest assets. The appropriate proportion of that cost is to be treated as the cost of the timber.
>
> [38] This accords with the approach that would be taken in respect of other personal property in applying the third limb of s 65(2)(e) relating to profit making schemes. It also accords with the approach taken by *Mason* J at first instance and *Gibbs* J in the Full Court of the High Court of Australia in *Steinberg v Federal Commissioner of Taxes*. *Gibbs* J said (697):
>
>> In the circumstances of the present case, where the shares were bought to enable the land to be acquired, the cost of the shares and of the winding up of the company and distribution of the assets can rightly be regarded as the amount actually outlayed for the purpose of, and in the process of, acquiring the land, although the acquisition was effected not directly, but by a number of steps. In my opinion, therefore, Mason J was right for the reasons which he gave.
>
> [39] *Barwick* CJ, dissenting, held there was no profit-making scheme. Accordingly he did not consider the present point and his earlier analysis (683) was directed to the other limb of the Australian provision, the counterpart of the second limb of s 65(2)(e), concerned with the narrower issue of the calculation of profits on sale of property, acquired for the purpose of sale at a profit.
>
> [40] In each case involving acquisition by Tasman on distribution in specie there was no question that the purchase of the company shares was made for the purpose of acquiring the forests. Accordingly the cost of timber for Tasman was that proportion of the price paid for the shares allocated to the standing timber. Only in the case of the Matahina forest does the cost differ from that for which Tasman contended. In that case the subsequent revaluation of the forest by Crista cannot be taken into account in the cost of timber for Tasman.

31. The right to receive a distribution of the forestry assets on the winding up of the companies flowed from Tasman's ownership of the shares in those companies. Therefore, the court considered that the cost of the forestry assets to Tasman was the amount paid for those shares.

32. The meaning of "cost" was also considered in *Atlas Copco*. The issue in that case was what the value of fringe benefits provided by the taxpayer to its employees was. The legislation provided that the value of the benefits was to be determined based on the "cost" of the benefits to the taxpayer. The taxpayer argued that this cost did not include the GST component of the relevant expenditure, because ultimately the taxpayer was able to recover that component by claiming input tax deductions. The Commissioner argued that the taxpayer being able to claim back the GST component did not change the fact that the GST component was part of the cost incurred.

33. The High Court found for the taxpayer, and considered that the approach suggested by the Commissioner was unduly restrictive and would not give effect to the realities of the situation, noting at 738:

> I have reached the conclusion that the approach suggested by the Commissioner is unduly restrictive and does not give effect to the realities of the situation. The Commissioner contends that the Court should focus only upon one element of the statutory scheme - the payment of the purchase price - and should turn a blind eye to other integral steps in the scheme such as the subsequent deduction of input tax by the registered purchaser. In reality, and in law, there are three components of a sale transaction between a registered vendor and a registered purchaser; the vendor's obligation to pay output tax, the purchaser's payment of the purchase price and the purchaser's subsequent deduction of input tax. The deduction of input tax is not analogous to "a later transaction with a third party" as contended by the Commissioner in the example cited - it is a fundamental part of the whole transaction, and is necessary to give effect to the statutory intention that GST be a tax upon the end-user.

34. The court also had regard to the evidence given by two accountants as to the commonly held commercial understanding of the word "cost". The court observed that where the meaning of words in a statutory context is unclear or ambiguous, the court may derive some assistance from common business parlance and practice, as well as international standards. The accountants were in agreement about the normal accounting usage of the term "cost". One of the accountants had stated that there is "an internationally recognised concept of cost which has been applied in a number of jurisdictions and which has been given a consistent meaning over the years in each of them". He then went on to say that "the general principle is that cost is the economic sacrifice incurred in economic activities—that which is given up or forgone to consume, to save, to exchange, to produce and so forth".

35. *Tasman Forestry*, *Atlas Copco* and other authorities have established that:
    - The word "cost" is capable of various meanings, depending on the context.
    - "Cost" means that which must be given in order to acquire something, and has a wider meaning than payment on purchase.
    - In determining "cost", a transaction must be viewed in its commercial reality, and some assistance may be derived from common business parlance and practice.

36. Despite this, as noted above, if the FA rules apply, they will determine what the cost of the property is regarded as being for the purposes of s DB 23 (see ss EW 32 and EW 35). The following discussion is premised on the FA rules not applying. If the FA rules apply, see the last bullet point at [20] in relation to the cost base of the property.

Is the cost of acquiring an option to acquire land part of the "cost" of acquiring the land?

37. It is noted that an option to acquire land or an estate or interest in land is itself land for the purposes of the Act (definition of "land" in s YA 1). It has been suggested that s CB 15B (which concerns the timing of acquisition of land for the purposes of subpart CB) requires the separate consideration of different estates or interests in, or options to acquire estates or interests in, the same underlying physical land. As a consequence, it has been suggested that the cost of acquiring an option (which is itself "land" under the Act) will only be deductible if the option is revenue account property. The Commissioner does not agree. Under s CB 15B, an estate or interest in land may be acquired at the time an earlier estate or interest in the land first arose. However, the issue of the timing of acquisition of land is entirely separate from the issue of what the cost of the land is.

38. On the basis of the meanings that the courts have given to the word "cost", the Commissioner considers that where an option is acquired in order to acquire land, the cost of acquiring the option will form part of the cost of acquiring the underlying land. The cost of acquiring the option is part of what is outlaid in order to acquire the land. Where the FA rules do not apply, and the land is revenue account property of the taxpayer, the cost of acquiring the option will therefore be deductible under s DB 23 against the proceeds derived from the disposal of the underlying land. As noted above, this is subject to the general permission (s DA 1(1)) being satisfied.[7]

39. There may be situations where the option is itself revenue account property (for example, because it was acquired with the intention of being sold), but is not in fact sold (ie, because it is instead exercised or expires). The option would be revenue account property even though it was not sold. As noted at [10], revenue account property for a person includes property that **if** disposed of for valuable consideration, would produce income for the person.[8] The cost of acquiring the option would clearly be expenditure incurred as the cost of acquiring the revenue account property (the option). However, although s DB 23 overrides the capital limitation, the general permission (s DA 1(1)) must still be satisfied in order for the person to be able to claim a deduction under s DB 23 on the exercise or expiry of the option.

40. The general permission requires there to be a nexus between the expenditure and the derivation of assessable and/or excluded income, or for the expenditure to have been incurred in the course of the person carrying on a business for the purposes of deriving assessable and/or excluded income. In the example noted above, the option was on revenue account because it was acquired with the intention of being sold. As such, the general permission would be satisfied, even though there would not be any income derived on the exercise or expiry of the option (see for example *CIR v Inglis* [1993] 2 NZLR 29 (CA) and *CIR v Stockwell* [1993] 2 NZLR 40 (CA)). The cost of acquiring the option would therefore be able to be deducted in the year in which the option is exercised or expires.

41. If the option is exercised, and the underlying land was also revenue account property, the cost of acquiring the option would be part of what is outlaid in order to acquire the underlying land, even though it was not intended at the time the option was acquired that it would be exercised and the underlying land acquired. However, the cost of acquiring the option would have been deducted in the year the option was exercised. As such, no further deduction for the cost of the option would be allowed on the disposal of the revenue account land that is the subject of the option (s BD 4(5)).

42. A further scenario that has been raised is if someone acquires an option with no intention to dispose of the option, but intending to acquire the land the

[7] Although s DB 23 overrides the capital limitation, the general permission (s DA 1(1)) must still be satisfied.

[8] Other than under ss EE 48, FA 5 or FA 9.

option relates to. However, instead of acquiring the underlying land as intended, the option was either disposed of or expired without being exercised. In this scenario, the fact that the underlying land may have been revenue account property if acquired is not relevant, as it was not acquired. Unless the option was revenue account property, the cost of its acquisition would not be deductible under s DB 23, as there simply was no revenue account property. If the option was revenue account property, the general permission would need to be satisfied for a deduction to be permitted under s DB 23, as noted above.

Examples

43. The following examples are included to assist in explaining when the cost of acquiring an option to acquire land (together with the other consideration for the land, if the option is exercised) will be deductible. They assume that none of the general limitations (excluding the capital limitation, which s DB 23 is not subject to) apply.

Example 1: Cost of option part of cost of revenue account land

44. Company A, a hotel developer, wished to acquire a piece of land in Taupo to build a hotel on. Company A sought an option to acquire the land, to enable it time to establish whether the necessary consents and planning permissions would be forthcoming. The owner of the land agreed to grant an option, under which Company A had the right to purchase the land for an agreed sum, provided that settlement took place within 3 months of the date the option was granted. Company A paid a $20,000 option fee for the grant of the option. Once Company A was satisfied that the required consents and permissions would be able to be obtained, it exercised the option and acquired the land. Once the hotel construction was completed, Company A sold the land to a local hotelier. The land was revenue account property of Company A.

45. The option was a "short-term option", and company A had not made an election under s EW 8, so the option was an excepted financial arrangement. The option was not part of a wider financial arrangement. As such, the FA rules do not apply, and the deductibility of the cost of the option (together with the other consideration for the land) is determined by s DB 23.

46. The option was acquired in order for Company A to acquire the land, which was revenue account property of Company A. The option fee was part of what Company A outlaid in order to acquire the land. As such, the cost of acquiring the option ($20,000) formed part of the cost of Company A's acquisition of the land, and would be deductible under s DB 23[9] (together with the other consideration for the land) in the income year in which Company A disposed of the land (s EA 2(2)).

Example 2: Deduction for cost of revenue account property when the FA rules apply but there was no income under those rules in respect of the option and ASAP to acquire the property

47. Kylie paid $10,000 for an option to acquire a house in Nelson for $1.1m at any time in the six months from the date the option was granted. Kylie was planning to acquire the property, do some minor renovations to it, and sell it at a profit. Five months into the term of the option, once Kylie sold another property she owned, she exercised the option and acquired the property. The sale of the property was settled six weeks later. Kylie undertook the renovations, and sold the property for $1.5m just over two years later. Kylie is a cash basis person (see [19]) and has not elected to use a spreading method.

48. Kylie did not acquire the option for a private or domestic purpose, and in any event, the purchase price for the property was more than $1m. The option is not a short-term option (see [15]). The option and agreement for sale and purchase was therefore not an "excepted financial arrangement" but a financial arrangement (a "specified option") to which the FA rules apply. As such, a base price adjustment was required when the agreement for sale and purchase (under which Kylie acquired the property) was settled.

49. The base price adjustment formula requires Kylie to deduct the amount of consideration paid **by** her under the financial arrangement (the option and consequent agreement for sale and purchase of the land) from the amount of consideration paid **to** her under the financial arrangement. None of the other elements of the base price adjustment formula are relevant in this case.

50. The consideration paid **by** Kylie under the financial arrangement was $1,110,000 (the cost of acquiring

[9] The general permission is satisfied because Company A acquired the property intending to sell it.

the option, and the purchase price for the land). The consideration paid **to** Kylie under the financial arrangement is the value of the land as determined by applying s EW 32. In this case, that is the lowest price the parties (Kylie and the person she purchased the property from) would have agreed on for the land, on the date the option was granted, if payment had been required in full at the time of settlement under the agreement for sale and purchase. The Commissioner and Kylie agree that the lowest price the parties would have agreed, at the time the option was granted, if payment had been required in full at settlement, is $1,110,000.

51. The result of Kylie's base price adjustment calculation is therefore $0 ($1,110,000 – $1,110,000 = $0). That means that Kylie does not have any income or expenditure under the FA rules.

52. The underlying (freehold) land, which Kylie ended up acquiring, was revenue account property for her, as she acquired it with the intention of disposing of it after undertaking some renovations. The amount Kylie derived from selling the land ($1.5m) is therefore income to Kylie (s CB 6[10]), and the cost of acquiring the land is deductible under s DB 23[11] against the sale proceeds. For the purposes of determining the amount of that deduction, Kylie is treated as having acquired the land for the value determined under s EW 32 ($1,110,000)—the same as what she actually paid for the land. This means that Kylie will pay tax on net proceeds of $390,000 from the sale.

Example 3: Deduction for cost of revenue account property when there has been earlier income under the FA rules in respect of the option and ASAP to acquire the property

53. Simon incurred $30,000 to acquire an option from a farmer to purchase a tract of farm land near a large suburban subdivision that was being undertaken. Simon was entitled to exercise the option to purchase the land during a period of three years, for $2m. Simon did not plan to exercise the option; he had acquired the option in anticipation of the first stage of the subdivision being successful and the subdivision being expanded further, at which time Simon envisaged that he would be able to sell the option to the developer for a profit. By two and a half years later (six months before the option period was over), it had become clear that the development was proceeding more slowly than expected, and the developer was not yet interested in further expansion of the development. Simon felt further expansion was inevitable, but since he could not make any profit selling the option, he decided to exercise it and acquire the land from the farmer, intending to on-sell the land to the developer once it was needed for further subdivision. Simon ended up selling the land to the developer three years later for $3.5m. Simon is a cash basis person (see [19]) and has not elected to use a spreading method.

54. Simon did not acquire the option for a private or domestic purpose, and it is not a short-term option (see [15]). The option and consequent agreement for sale and purchase of the land was therefore a financial arrangement (a "specified option") to which the FA rules apply. As such, a base price adjustment was required when the agreement for sale and purchase was settled.

55. The base price adjustment formula requires Simon to deduct the amount of consideration paid **by** him under the financial arrangement (the option and consequent agreement for sale and purchase of the land) from the amount of consideration paid **to** him under the financial arrangement. None of the other elements of the base price adjustment formula are relevant in this case.

56. The consideration paid **by** Simon under the financial arrangement was $2,030,000 (the cost of acquiring the option, and the purchase price for the land). The consideration paid **to** Simon under the financial arrangement is the value of the land as determined by applying s EW 32. In this case, that is the lowest price the parties (Simon and the farmer) would have agreed on for the land, on the date the option was granted, if payment had been required in full at the time of settlement under the agreement for sale and purchase. The Commissioner and Simon agree that the lowest price the parties would have agreed, at the time the option was granted, if payment had been required in full at settlement, is $2,035,000.[12]

[10] It is assumed for the purposes of this example that there are no applicable exclusions from s CB 6.

[11] The general permission is satisfied because Kylie acquired the property intending to sell it.

[12] Depending on the commercial drivers in different situations, it may be that the lowest price the parties would have agreed at the time an option is granted, if payment had been required in full at the time of settlement, is **less than** the option fee plus the purchase price under the agreement for sale and purchase. If that is the case, the purchaser would have expenditure under the FA rules, and a corresponding decrease in the cost base of the land. The fact that Simon in this example has income under the FA rules is for illustrative purposes only.

57. The result of Simon's base price adjustment calculation is therefore $5,000 ($2,035,000 – $2,030,000 = $5,000). That $5,000 is income to Simon under s CC 3 (see s EW 31(3)) in the year the base price adjustment is required (the year the agreement for sale and purchase was settled).

58. The underlying (freehold) land, which Simon ended up acquiring, was revenue account property for him, as he acquired it with the intention of disposing of it. The amount Simon derived from selling the land to the developer ($3.5m) is therefore income to Simon (s CB 6), and the cost of acquiring the land is deductible under s DB 23 against the sale proceeds. For the purposes of determining the amount of that deduction, Simon is treated as having acquired the land for the value determined under s EW 32 ($2,035,000), rather than the $2,030,000 he actually paid for the land. This in effect takes account of the fact that Simon had $5,000 of income under the FA rules in the year he purchased the land. This means that Simon will pay tax on net proceeds of $1,465,000 from the sale.

References

Subject references
Income tax, cost of land that is revenue account property, options
Legislative references
Income Tax Act 2007 – ss CC 3, BD 4(5), CB 15B, DB 6, DB 7, DB 23, EW 2, EW 3, EW 4(3), EW 6(3), EW 8, EW 13(3), EW 32, EW 35, EW 54, EW 55(1), EW 57, ZA 3, the definitions of "land", "revenue account property" and "specified option" in s YA 1, and Schedule 51
Income Tax Act 2004 – s EH 26(1A)
Income Tax Act 1994 – s YA 3 and Schedule 22A
Case references
CIR v Atlas Copco (NZ) Ltd (1990) 12 NZTC 7,327
CIR v Inglis [1993] 2 NZLR 29 (CA)
CIR v Stockwell [1993] 2 NZLR 40 (CA)
Tasman Forestry Limited v CIR (1999) 19 NZTC 15,147 (CA)

QB 15/14: GOODS AND SERVICES TAX – PROGRESS PAYMENTS ON BOATS TO BE EXPORTED BY SUPPLIER

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

This Question We've Been Asked is about ss 9(3)(aa), 11(1), 11(4) and 11(5).

Question

1. We have been asked when a GST registered boat builder can zero-rate progress payments made by an overseas buyer for the construction of a boat that will be entered for export (or deemed to be entered for export) by the supplier.

Answer

2. A supply of goods that will be exported will be zero-rated where the supplier will enter (or be deemed to enter) the goods for export in the course of, or as a condition of, making the supply. The general rule is that export must occur within 28 days beginning on the day of the time of supply.
3. Where an agreement provides for progress payments to be made periodically during the term of the agreement, each payment will have its own time of supply. Therefore, the first progress payment will trigger the 28-day export requirement. The requirement to export within 28 days is unlikely to be satisfied. Therefore, a supplier wishing to zero-rate the supply will need to apply to the Commissioner for an extension of the 28-day requirement. The application should be made before the end of the first 28-day period.
4. The application must be in writing and should include relevant documents (including the supply contract), the date construction is intended to be completed and the intended date of export. Applications should be sent to:

    Inland Revenue
    PO Box 5542
    Auckland 1141
5. Each application will be considered on a case-by-case basis. However, the Commissioner will usually grant an extension in this situation. Where an extension is granted, the supply can be zero-rated as long as export occurs within the term of the extension.
6. This QWBA is focused on agreements for the construction of boats. However, the same principles apply to other engineering works that involve progress payments and where the goods will ultimately be exported.

Explanation

7. "GST and Progress Payments on Boats" *Public Information Bulletin* No 179, May 1989 set out the GST treatment for a GST registered boat builder who constructed a boat for an overseas buyer and charged progress payments during the construction. The item considered the zero-rating provisions and, in particular, when the Commissioner would extend the 28-day period for export. The purpose of this QWBA is to update and replace the PIB item.
8. This QWBA discusses the situation where a registered person builds and exports a boat to an overseas buyer. This QWBA does **not** look at the situation where a registered person sells a boat to an overseas buyer and the overseas buyer or their agent exports the boat (under its own power). That situation is covered by s 11(1)(i), (7) and (8) (see QB 07/01 "Zero-rating of supplies of sail-away boats – use as security or offered for sale" *Tax Information Bulletin* Vol 19, No 3 (April 2007): 22).

Time of supply for progress payments

9. Section 9(3)(aa)(ii) alters the time of supply for certain goods and services by deeming a single supply to be a number of successive supplies. It applies where goods and services are supplied:
    - directly in the construction, major reconstruction, manufacture, or extension of a building or an engineering work; and
    - pursuant to an agreement that provides for the consideration for that supply to become due and payable in instalments or periodic progress payments.
10. Each successive supply is deemed to take place at the earlier of:
    - any payment in respect of the supply becoming due;
    - any payment in respect of the supply being received; or
    - any invoice relating only to that payment being issued.

Example 1: Time of supply

Isaac (GST registered) enters into an agreement with Liam (resident in Dubai) to construct Liam a boat. The agreement provides for 12 bi-monthly progress payments during the construction phase. Under s 9(3)(aa)(ii), each of the bi-monthly payments will be deemed to be for a

QUESTIONS WE'VE BEEN ASKED

separate supply. Each supply will be deemed to be made at the earlier of any payment being received or becoming due, or an invoice being issued (solely) for that payment.

Zero-rating exported goods

11. A supply of goods will be zero-rated where:
    - the supplier will enter the goods for export under the Customs and Excise Act 1996 in the course of, or as a condition of, making the supply, and will export the goods (s 11(1)(d)); or
    - the goods will be deemed to be entered for export under the Customs and Excise Act 1996 and will be exported by the supplier in the course of, or as a condition of, making the supply (s 11(1)(e)).
12. However, these zero-rating provisions are subject to s 11(4) and do not apply unless the supplier exports the goods within 28 days from the time of supply (or a longer period allowed by the Commissioner). As noted above, where an agreement provides for progress payments, each progress payment has its own time of supply. This means that the time of supply of the first progress payment would trigger the 28-day rule in s 11(4). It is unlikely that the boat would be able to be exported within 28 days of the first time of supply. If the 28-day requirement is not met, then the whole supply would have to be standard-rated.
13. However, s 11(5) gives the Commissioner a discretion to extend the 28-day period within which the goods must be exported. Section 11(5) requires the supplier to apply in writing to the Commissioner. Section 11(5) also requires the Commissioner to determine that either:
    - the export of the goods within 28 days could not occur due to circumstances beyond the control of the supplier and the recipient; or
    - due to the nature of the supply, it is not practicable for the supplier to export the goods within 28 days.
14. The second of the possible grounds seems to be more relevant in this situation. That is, due to the nature of the supply, it is not practicable for the supplier to export the goods within 28 days. This is because the start of the 28–day period is triggered by the first progress payment.
15. An application must be made in writing and should include relevant documents (including the supply contract) and the intended date of export. Each application will be considered on a case-by-case basis. However, the Commissioner will usually grant an extension in this situation. Where an extension is granted, the supply can be zero-rated as long as export occurs with the term of the extension.
16. Even though the supply of a boat is treated as multiple successive supplies, a single application can be made to cover all of the deemed supplies in relation to a boat to be exported.
17. A separate application will usually need to be made for each boat exported as the Commissioner needs to consider the relevant details to determine whether the discretion should be exercised. However, s 11(5) allows the Commissioner to grant an extension for a "class of goods". This may be appropriate where the goods being supplied and the contractual terms of the supplies are sufficiently similar.

Example – application for extension of 28-day export period

18. The following example is included to assist in explaining the application of the law.

19. Ryan (GST registered) enters into an agreement with Sophie to build her a boat and to export it to Australia where Sophie is resident. The agreement provides for monthly progress payments throughout its term. The boat is expected to be ready for export in 12 months. The first progress payment is invoiced at the end of the first month. The boat will not be ready for export within 28 days of the invoice.
20. Ryan realises when he enters into the contract that it will not be possible to meet the 28-day export requirement. As he wishes to zero-rate the payments, he immediately makes a written application to the Commissioner under s 11(5) seeking an extension. The Commissioner accepts Ryan's application and extends the period for export by 12 months. Ryan is now able to zero-rate the payments as long as he exports the boat within the extended period.

References

Related rulings/statements
"GST and Progress Payments on Boats" *Public Information Bulletin* No 179, May 1989
QB 07/01 "Zero-rating of supplies of sail-away boats – use as security or offered for sale" *Tax Information Bulletin* Vol 19, No 3 (April 2007): 22
Subject references
Boats, export, goods and services tax, zero rating
Legislative references
Goods and Services Tax Act 1985 – ss 9(3)(aa), 11(1)(d) and (e), 11(4) and 11(5)

QB 15/15: INCOME TAX – FIRST AID ALLOWANCES

During a review of *Public Information Bulletins* a number of items relating to the tax treatment of employee allowances were identified as needing to be reviewed. This QWBA replaces "First Aid Allowance" (*Public Information Bulletin* No 149, July 1986).

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

This Question We've Been Asked is about ss CE 1 and CW 17.

Question

1. Is an allowance paid by an employer to an employee because they hold a first aid qualification taxable?

Answer

2. Yes. An allowance paid by an employer to an employee because they hold a first aid qualification is taxable as employment income under s CE 1(1)(a), and subject to PAYE. Such an allowance is not paid to reimburse the employee for expenditure incurred in connection with their employment duties. Rather it is a regular amount paid to the employee because they are first aid qualified and take on obligations to provide first aid services in the workplace if required. Such a payment is therefore income to the employee.
3. If a regular allowance or one-off payment is made to the employee to reimburse them for first aid related costs incurred in performing their first aid obligations or duties in the workplace (eg, the cost of getting a first aid qualification, if this is required, or the cost of an employee keeping their own work-related first aid kit up-to-date), this would be exempt income under s CW 17(2). This is because the payment is reimbursing the employee for expenditure the employee would be able to deduct if the employment limitation did not exist. A payment to reimburse an employee for the employer's expenses (eg, buying supplies for the employer's first aid kit) is not income to the employee (ss CE 1 and CE 5(3)).

Explanation

Background

What is an allowance?

4. An allowance is a payment of an agreed amount by an employer to an employee. It is paid either on a regular basis (such as daily or weekly), or when certain events happen. It is taxable to the employee as employment income under s CE 1(1)(a) unless an exemption applies.
5. There are two main types of allowances, commonly referred to as benefit allowances and reimbursing allowances. Benefit allowances are taxable to the employee as employment income under s CE 1(1)(a) and are subject to PAYE. However, reimbursing allowances may be exempt from income tax under the general exemption in s CW 17.

What is a reimbursing allowance?

6. A reimbursing allowance is an allowance paid by an employer to an employee for expenses that an employee incurs or is likely to incur in connection with their employment.
7. A reimbursing allowance is not an exact reimbursement of expenditure. Operating expenses are expenses that the employee would be allowed a deduction for if the employment limitation did not exist (s CW 17(2)). Under s CW 17(2B) the expenditure will be treated as incurred in connection with an employee's employment if it is a necessary expense incurred in performing an employment obligation from which they earn income.

What is a benefit allowance?

8. A benefit allowance is an allowance paid by an employer to compensate an employee for the conditions of their service, such as using a dangerous piece of equipment, working in a dangerous or dirty environment, or working in a remote location. Unlike a reimbursing allowance, a benefit allowance is taxable to the employee as employment income under s CE 1(1)(a) and is subject to PAYE.

First aid allowances

9. There are legal requirements in New Zealand under health and safety legislation for employers to take all practicable steps to provide first aid facilities, and to have procedures for dealing with emergencies. This may include the need for an appropriate number of suitably trained first aiders. Employers often pay allowances to employees who are designated workplace first aiders.
10. A first aid allowance is a regular amount paid to an employee because they are first aid qualified and take on obligations to provide first aid services in the workplace if required. It is a benefit allowance, paid to compensate the employee for taking on additional responsibilities. It is not paid to reimburse the employee for expenditure incurred in connection with their employment duties. Such an allowance is therefore taxable as employment income under

s CE 1(1)(a). Employers need to account for PAYE on the amount of the allowance.

Reimbursement for first aid related expenses

11. If a regular allowance or one-off payment is made to an employee to reimburse them for first aid related costs incurred in performing their first aid obligations or duties in the workplace (eg, the cost of getting a first aid qualification if this is required, or the cost of an employee keeping their own work-related first aid kit up-to-date), this would be exempt income under s CW 17(2). This is because the payment is reimbursing the employee for expenditure the employee would be able to deduct if the employment limitation did not exist. There is the requisite nexus between the expenditure being reimbursed and the employee deriving their income. A payment to reimburse an employee for the employer's expenses (eg, buying supplies for the employer's first aid kit) is not income to the employee (ss CE 1 and CE 5(3)).
12. As is the case with other reimbursing allowances, in setting the amount of a regular reimbursing allowance, an employer can estimate the total amount of expenditure an employee is likely to incur in performing their first aid obligations or duties in the workplace. Section CW 17(3) allows employers to make a "reasonable estimate" of the amount of expenditure likely to be incurred by an employee or a group of employees.
13. A reasonable estimate is one that has some basis. For example, the estimate might be based on actual historical data, or from an employer asking a sample of their employees about the first aid related costs they have incurred in performing their obligations. Employers must retain sufficient information about how the estimate was calculated to substantiate the allowance amount. Employers should review their estimates periodically to ensure they remain reasonable.

References

Related rulings/statements
"First Aid Allowance" (*Public Information Bulletin* No 149, July 1986)
Subject references
Allowance, first aid
Legislative references
Income Tax Act 2007 – ss CE 1 and CW 17

NEW LEGISLATION

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

ORDERS IN COUNCIL

INCOME TAX (FRINGE BENEFIT TAX, INTEREST ON LOANS) AMENDMENT REGULATIONS 2015

The prescribed interest rate used to calculate fringe benefit tax on low-interest loans provided by employers to their employees has been changed to 5.99%. The new rate applies for the quarter beginning on 1 October 2015 and for subsequent quarters. The previous rate was 6.22%.

The FBT rate on employer-provided low-interest loans is reviewed regularly to align it with the results of the Reserve Bank's survey of variable first mortgage housing rates. This ensures the prescribed rate is in line with market interest rates.

The new rate was set by Order in Council on 23 November 2015.

Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2015 (No 2) 2015 (LI 2015/293)

INCOME TAX (MINIMUM FAMILY TAX CREDIT) ORDER 2015

Low-income working families who are eligible for the minimum family tax credit (MFTC) will receive an increase for the 2016–17 tax year.

The tax credit currently guarantees recipients an after-tax income of $23,036 a year ($443 a week). This will increase to $23,764 a year ($457 a week) for the 2016–17 tax year, beginning on 1 April 2016.

The minimum family tax credit provides a top-up to after-tax income that gives a working family a guaranteed minimum level of income, provided a couple is employed for at least 30 hours a week, or 20 hours a week for a sole parent.

The tax credit is a transitional measure, to help working families moving off a benefit into paid employment.

The increase, which takes into account rises in inflation and the Budget 2015 increases to benefit rates and the in-work tax credit, was approved by Order in Council on 23 November 2015.

The new rate comes into force on 1 April 2016.

Income Tax (Minimum Family Tax Credit) Order 2015 (LI 2015/294)

TAX ADMINISTRATION (INFORMATION SHARING WITH ACCIDENT COMPENSATION CORPORATION) ORDER 2015

An Order in Council has been made under the information sharing provisions in section 81BA of the Tax Administration Act 1994.

The Tax Administration (Information Sharing with Accident Compensation Corporation) Order 2015 provides for the provision of information from Inland Revenue to the Accident Compensation Corporation (ACC).

Inland Revenue identified that some of the sharing of information with ACC, which was taking place under the provisions of a Memorandum of Understanding, fell outside the remit of the Tax Administration Act 1994. This information is necessary to enable the calculation of levies, the provision of invoices for payment and the determination of the level of entitlements/compensation that an injured individual is entitled to receive.

The Order came into force on 1 January 2016.

Tax Administration (Information Sharing with Accident Compensation Corporation) Order 2015 (2015/300)

TAXATION (BRIGHT-LINE TEST FOR RESIDENTIAL LAND) ACT 2015

Sections CB 6A, CB 13, CB 14, CB 15B, CB 16A, CB 23B, DB 18A, DB 18AB, DB 29, FB 3A, FC 3, FC 4, FC 9, FO 10, FO 17, GB 52, GB 53, and YA 1 of the Income Tax Act 2007; sections 3 and 43B of the Tax Administration Act 1994

The Taxation (Bright-line Test for Residential Land) Bill was introduced into Parliament on 24 August 2015. The bill received its first reading on 8 September 2015, the second reading on 3 November 2015 and the third reading on 12 November 2015. The resulting Act received Royal assent on 16 November 2015.

The Taxation (Bright-line Test for Residential Land) Act 2015 introduces a new "bright-line" test that will require income tax to be paid on any gains from residential property that is disposed of within two years of acquisition, subject to some exceptions.

The new legislation amends the Income Tax Act 2007 and the Tax Administration Act 1994.

Background

As part of Budget 2015, the Government announced its intention to introduce a new land sale rule to supplement the "intention test" in the land sale rules. Under those rules, gains from the sale of land are taxable when the land is bought with an intention or purpose of resale, and the taxpayer is required to return any gain as income. Because of the subjective nature of the intention test however, it can be difficult to enforce. To deal with this problem, the new legislation introduces a new easy-to-enforce bright-line test.

The bright-line test is the second of three stages of the Government's reform package to tighten the property investment rules announced as part of Budget 2015.

The first stage—new information requirements for land transfers and offshore persons—came into force on 1 October 2015, and information about the new rules was published in the November edition of the *Tax Information Bulletin* (Vol 27, No 10, November 2015).

The third stage—a withholding tax for offshore persons selling New Zealand residential property—was introduced into Parliament on 16 November 2015 in the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill, following consultation in August 2015.

Key features

Gains from the disposal of residential land acquired and disposed of within two years will be taxable, subject to some exceptions.

The two year bright-line period generally starts at the point a person has title for the property transferred to them and ends at the time the person enters into a contract to sell the property. For sales "off the plan", the two-year period runs from the date the person enters into a contract to buy the property to the time when a person enters into a contract to sell the property.

The bright-line test applies only to residential land. Residential land includes land that has a dwelling on it, land where the owner has an arrangement to build a dwelling on it, and bare land that could have a dwelling erected on it under the relevant district plan. "Residential land" does not include business premises or farmland.

The bright-line test does not apply to a person's main home. A person can only have one main home. If a person has more than one home, their main home is the one with which the person has the greatest connection.

The main home exclusion is generally available to properties held in trust. There are additional requirements to ensure that people cannot use the main home exclusion for multiple properties through the use of trusts.

The bright-line test does not apply to property acquired through an inheritance. There is rollover relief for property transferred as a result of a relationship property agreement. This means that any potential tax liability will be deferred until a subsequent sale.

Taxpayers will be allowed deductions according to ordinary tax rules for property that is subject to the bright-line test.

Losses arising from the bright-line test will be ring-fenced so that they may only be used to offset taxable gains from other land sales.

There are specific anti-avoidance rules to counter companies and trusts being used to circumvent the bright-line test.

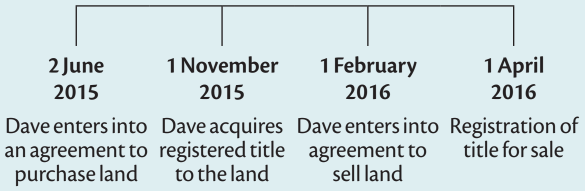
Application dates

The bright-line test came into force on 1 October 2015.

The bright-line test will only apply to a person's disposal of land if the person acquires their "first interest" in the land on or after 1 October 2015. The date a person acquires their "first interest" is the same date as when they acquire land for the purposes of section CB 15B in the Income Tax Act 2007. As a result, guidance on section CB 15B can be used to help determine when a person's "first interest" in land was acquired.

When there is a standard acquisition of land, the date a person acquires their "first interest" will generally be the date of entry into an agreement to purchase the land. This means the bright-line test will only apply to the sale of land if the agreement for purchase of the land was entered into on or after 1 October 2015.

Example: Application date



The sale by Dave is not subject to the bright-line test. This is because Dave acquired his "first interest" in the land when he entered into an agreement to purchase the land on 2 June 2015. As this is before 1 October 2015, the bright-line test does not apply.

For non-standard sales of land, the date of "first interest" may be different for different circumstances. For example, for a gift, the date of "first interest" will usually be the date of registration of title.

The amendments for the non-active trust filing exception came into force on 16 November 2015.

The amendments for the definition of "land", and clarifying the treatment of land transferred under a resident's restricted amalgamation came into force on 1 October 2015.

DETAILED ANALYSIS

Two-year time period

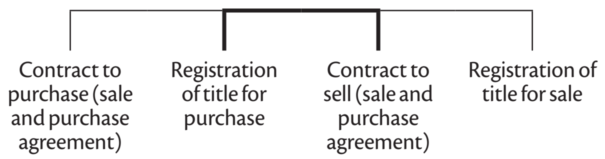
Section CB 6A of the Income Tax Act 2007

Under the bright-line test any gain a person derives from disposing of residential land is treated as income of the person if the property is disposed of within two years of acquisition.

The start and end date for the purposes of this two-year period are specifically defined for the purposes of the bright-line test. Start and end dates for different transactions may differ depending on the nature of the transaction.

Standard sales of land

There are four steps in the land sale process of relevance to the bright-line test:



For standard sales of land, the start date for the bright-line period is the date the transfer of the land is registered to the person under the Land Transfer Act 1952. The end date is the date that a person enters into an agreement to dispose of the land.

There are a number of situations when land is acquired and disposed of that do not follow the standard land sale process. For these situations, there are separate rules for when the bright-line period starts and ends.

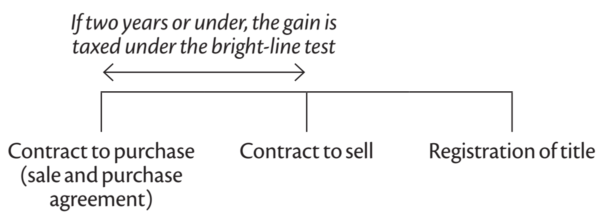
Start dates

Type of acquisition	**Start date of bright-line test**
Standard purchase of land	Registration
Sales when there is no registration of title	Latest date property acquired (according to ordinary rules)
Sales "off the plan" (as outlined in the section below)	Date of entry into a contract to purchase
Subdivided land	The original date of registration for the undivided land
Converting a lease with a perpetual right of renewal into freehold title	Date the lease with a perpetual right of renewal is acquired

Sale when there is no registration of title

When there is registration of title, generally the start date for the bright-line is the date of registration. However, there are situations when there is no registration of title. In these circumstances, the start date for the bright-line test is the latest date the person acquired the land under ordinary rules.

For a sale of a contract to buy land, this will be the date that a person enters into a contract to purchase the property. This means that for a sale of a contract to buy, the bright-line period runs from the date that a person enters into a contract to purchase the land to the date that a person enters into a contract to sell the land.



Earlier start dates than given under standard rules

There are three specific scenarios where a person is entitled to an earlier start date than would be the case under the two rules outlined above. These are for:

- sales "off the plan";

- subdivided land; and
- leases with a perpetual right of renewal converted into freehold title.

Sales "off the plan"

A sale "off the plan" for the bright-line test occurs when a person enters into a contract to acquire a parcel of land that is being developed or subdivided. At the time the person enters into the contract, the title for the land they are agreeing to purchase does not yet exist (as the land needs to be subdivided or developed before separate title can be issued). The person agrees to acquire registered title in the land once a separate title exists.

In this situation, the person may use an earlier start date than would be the case under the standard rule. The start date in this situation is the date the person enters into an agreement for the sale and purchase of the land.

Example: Sale "off the plan"

2 July 2016	**1 September 2018**	**1 March 2019**	**1 April 2019**
Denise enters into contract to purchase land "off the plan"	Denise obtains registered title	Denise enters into contract to sell	Registration of title for sale

Denise is not subject to the bright-line test as the start date for the bright-line is 1 July 2016 (the date she entered into a contract to purchase "off the plan") and the end date is 1 March 2019 (the date she entered into a contract to sell).

Subdivided land

The start date for the bright-line period when land is subdivided is the date the owner originally acquired the undivided land.

Example: Subdivision

1 May 2016	**1 May 2021**	**1 May 2022**
Bob acquires registered title to residential land	Bob subdivides the land into two sections and builds a house on the second section	Bob enters an agreement to sell the second section to Carla

The start date for the bright-line period is 1 May 2016 and the end date is 1 May 2022. As a result, Bob's sale of the second section to Carla is not covered by the bright-line test.

Conversion of a lease with a perpetual right of renewal into freehold title

When a person has a lease with a perpetual right of renewal which they then convert into freehold land, the start date for the bright-line period is the date the person is granted the lease. This is consistent with other tax provisions that treat a lease with a perpetual right of renewal similar to freehold estates.

Example: Lease with perpetual right of renewal

1 July 2016	**1 January 2017**	**1 March 2018**	**1 April 2019**	**1 May 2019**
Kelly obtains lease with perpetual right of renewal	Kelly enters into agreement to acquire land	Registration of title for purchase	Kelly enters into agreement to sell land	Registration of title for sale

The start date for Kelly's bright-line period is 1 July 2016 (the date the lease with perpetual right of renewal is granted) and the end date is 1 April 2019 (the date she entered into agreement to sell the land).

Gains from Kelly's sale of the land are not taxable under the bright-line test.

End date for bright-line period

For standard sales of land the end date for the bright-line period is the date a person enters into an agreement to dispose of the property.

There are several situations when land is disposed of but there is no agreement in place to dispose of the property. In these situations, the proposed end date for the bright-line period differs from the standard rule.

Type of disposal	**End date of bright-line period**
Standard purchase of land	Date of entry into agreement for sale
Gift	Date of gift (generally registration of title)
Compulsory acquisition	Date of compulsory acquisition
Mortgagee sale	Date land disposed of by mortgagee
Other disposals where no contract to sell	Date of disposal according to ordinary rules

Gifts

For gifts, the end date for the bright-line period is the date the person makes the gift of the residential land. This will be the date when the donor has done everything necessary in order to transfer the property and render the settlement binding.

For a gift of a registerable interest in land, this will mean the end date for the bright-line period is the date the interest is registered.

Example: Gift

1 May 2016	1 December 2017	1 February 2018
Henrietta obtains registered title to residential land (purchase price of $400k)	Henrietta says she will gift land to Ingrid	Henrietta registers the transfer of land to Ingrid (market value of land is $450k)

The start date for the bright-line period is 1 May 2016 (the date Henrietta acquired registered title) and the end date is 1 February 2018 (the date Ingrid acquired registered title). Henrietta will be subject to the bright-line test for her gift of land.

Under ordinary tax rules, gifts of land are treated as if they are transferred at market value.

As a result, Henrietta will be deemed to have transferred the land to Ingrid at market value and the $50k gain will be taxable.

Compulsory acquisition

When the land is compulsorily acquired by the Crown, the end date of the bright-line period is the date that the land is compulsorily acquired. This will generally be 14 days after the proclamation that the land is to be acquired, is published in the *Gazette*.[1]

Mortgagee sale

When land is disposed of by a mortgagee exercising their right to dispose of the property, the end date for the bright-line period is the date when the land is disposed of by the mortgagee.

Other sales

If there is another type of disposal of land, the date of disposal is the date that the land is disposed of according to ordinary rules.

Example: Standard sale

1 May 2016	1 December 2017	1 July 2018
Amy acquires registered title to residential land	Amy enters into an agreement to sell the land to Bob with final payment and settlement to follow	Bob makes final payment for the property and registered title to the land is transferred to him

The bright-line period starts on 1 May 2016 (the date registered title is acquired) and ends on 1 December 2017 (the date of entry into agreement to sell the land).

Amy receives payment for the property in the 2018–19 income year. This means that Amy is required to return the income in her annual income tax return for the year.

Example: Cancelled contract

1 May 2016	1 July 2017	1 December 2017	1 July 2018
Elizabeth obtains registered title to residential land	Elizabeth enters into an agreement to sell the land to Fred	Fred is unable to obtain the funds to purchase the land so the sale is cancelled	Elizabeth enters into an agreement to sell the land to Georgina

The sale of the land from Elizabeth to Fred falls within the two-year period for the bright-line test. However, because the sale is cancelled, Elizabeth has not derived any income from the disposal of land and will not have any income tax liability.

The sale of the land from Elizabeth to Georgina is not subject to the bright-line test because the agreement for sale (1 July 2018) was not entered into within two years of Elizabeth obtaining registered title (1 May 2016).

Example: Standard lease (no perpetual right of renewal)

1 July 2016	1 January 2017	1 March 2018	1 April 2019	1 May 2019
Jo obtains lease	Jo enters into agreement to acquire land	Registration of title for purchase	Jo enters into agreement to sell land	Registration of title for sale

The start date for the bright-line test is 1 March 2018 (the date of registration of title for purchase) and the end date is 1 April 2019 (the date she entered into agreement to sell the land). Jo's proceeds from the sale of the land are taxable under the bright-line test.

[1] Public Works Act 1981, section 26(3)

Example: Deed of nomination[2]

1 January 2016	1 February 2016	1 March 2016	1 January 2019
Andrew enters into agreement to purchase land. Under the agreement, title to the land is to be given to Andrew or his nominee.	Andrew enters into a deed nomination with Bart. Under the deed, Andrew nominates Bart as the person to acquire the property.	Registered title is transferred to Bart	Bart enters into an agreement to sell land to Carla

With a nomination there are two acquisitions and disposals of land.

Andrew acquired an interest in the land by entering into a contract to purchase on 1 January 2016 (the date he acquired the right to buy the land). When Andrew entered into a deed of nomination with Bart he transferred this interest (the right to buy the land) to Bart.

The start date for Andrew is the date he entered into the contract to purchase the land. This is because it is a sale where there is no registration. The start date is the latest date Andrew acquired an interest in the residential land. The latest date Andrew acquired an interest in the residential land is 1 January 2016 when he acquired his right to buy.

The end date for Andrew is 1 February 2016, being the date he entered into an agreement for the disposal of his interest in the land. The deed of nomination is an agreement for the disposal of the land.

As a result, Andrew is subject to the bright-line test and any gain he has made will be taxable.

Bart's acquisition and disposal of the land will not be covered by the bright-line test. This is because the start date was on 1 March 2016 (date of registration of title) and the end date was 1 January 2019 (the date he entered into agreement to sell).

Residential land

Sections CB 6A and YA 1 of the Income Tax Act 2007

The bright-line test only applies if the land disposed of is residential land at the date of disposal.

"Residential land" is land that either:

- has a dwelling on it;
- the seller of the land is a party to an arrangement that relates to erecting a dwelling on it; or
- is bare land that may be used for erecting a dwelling under the rules in the relevant operative district plan.

However, even if one of these three criteria is met, land is not treated as "residential land" if it is used predominantly as business premises or is farmland (as discussed below).

Dwelling

The first criterion includes land that has a dwelling on it. The definition of "dwelling" is the same as that currently used in the Income Tax Act 2007 and the Goods and Services Tax Act 1985. However, there are two adjustments to the definition of "dwelling" for the purposes of the bright-line test. The first adjustment includes serviced apartments within the definition of "residential land", while the second excludes all rest homes and retirement villages from the definition.

The second criterion means that the bright-line test covers land that does not have a dwelling on it at present but there is a plan or understanding to build a dwelling on it. For example, this criterion would apply when the owner of a commercial office has an arrangement to convert it into dwellings.

The third criterion means the bright-line test covers bare land that could be used for a dwelling. To determine whether a parcel of bare land meets this criterion, a person will need to look at the relevant rule in the operative district plan to see whether they are able to build a dwelling on it.

Example: Development

Andrew buys an empty plot of land that is zoned for residential purposes. He plans to develop the plot by subdividing it into four lots and building houses on each of the lots.

Andrew sells lot 1 "off the plan" to Bob. One month later, Bob sells lot 1 to Carla.

Lot 1 would be "residential land" and Bob's sale would be subject to the bright-line test. This is because there is an arrangement to build a dwelling on the land, and because it is bare land that can have a dwelling erected on it under the relevant district plan.

Business premises

"Residential land" does not include land used predominantly as business premises.

"Business premises" has its ordinary meaning under the Income Tax Act 2007. This will generally require there to be a building on the land, and this building to be occupied by a person in the course of running their business.

[2] The nomination in this example refers to a nomination under a "purchaser or nominee" clause in an agreement for sale and purchase for land. This example does not deal with nominees under section YB 21 of the Income Tax Act 2007; these have a different tax treatment.

The exemption does not require that the land be occupied by the owner as their business premises. As a result, properties rented out by the owner to other persons to use as their business premises are also covered by this exemption. However, the exemption would not apply when a property is rented out for residential purposes (such as a residential rental property).

Example: Bed and breakfast

Mary owns a bed and breakfast. Mary provides meals to the residents, room service and cleans the rooms she lets out every day.

The land has a dwelling on it so meets the first criterion for residential land. However, the land would not be "residential land" as the land is used predominantly as the business premises for the bed and breakfast.

Example: Workers' quarters

Steve owns land which contains a factory which is used to process food. The land also has workers' quarters on it, which Steve provides to his employees to use as residences.

The land is used predominantly as business premises and so is entitled to the business premises exception.

Example: Empty factory

Velma purchases an empty factory which she plans to develop into an apartment building.

Before beginning construction, and within two years of her acquisition, Velma receives a good offer for the building and sells it to William.

Velma has an arrangement to put a dwelling on the land and so meets the first criterion for residential land. The land does not qualify for the business premises exemption as the factory is empty and not being used as business premises at the time of disposal. As a result, the land is "residential land" and subject to the bright-line test.

Farmland

"Residential land" does not include farmland.

"Farmland" means land that either:

- is being worked on as part of a farming or agricultural business by the owner of the land; or
- because of its area and nature, is capable of being worked as a farming or agricultural business.

Determining whether there is a farming or agricultural business on the land requires looking at the same factors that determine whether there is "a business" under general tax law. This requires looking at the nature of the activities carried on and the intention of the taxpayer in undertaking the activities.

Even if there is no farming business being run on the land, it can still be considered "farmland" if the land is capable of being worked as a farming or agricultural business. Determining whether land is capable of being worked requires looking at the capability of the land at the time of the disposal. Land that requires significant investment or modification to be used as a farming business would therefore not qualify.

Example: Land that because of its area is not capable of being used as farmland

Marama purchases a lifestyle block with a house and a small area of farmland. A small number of sheep are kept on the land to keep the grass down.

The land is not "farmland" as the land is not being worked as a farming business nor is it capable of being worked as a farming business. It is a hobby farm rather than a genuine farming business.

If the area of farmland was larger and capable of being used for farming purposes, it would likely be "farmland".

Example: Land that because of its nature is not capable of being used as farmland

Tina owns a 50 hectare plot of land. The land is covered in gorse.

The land is not "farmland" as it is not currently capable of being used for farming purposes.

Example: Small plot of land that is farmland

Uri has a five hectare plot of land that is suitable for use as a rose farm.

This land is "farmland" as it is currently capable of being used for farming purposes.

Main home

Sections CB 16A and YA 1 of the Income Tax Act 2007

The bright-line test does not apply to the disposal of a person's main home.

Requirements for the "main home" exclusion

To qualify for the "main home" exclusion the land must have been used predominantly, for most of the time the person owned the land, for a dwelling that was the main home of the person or a beneficiary of a trust that owned the property (subject to some limitations).

Used predominantly as a person's main home

To be used predominantly as a "main home", means that most of the area of the land must have been actually used for the home. The test is based on a person's actual use of the property and not the person's intended use of the property.

In some circumstances, a person will be required to determine the area of land used for their private residential purposes and the area of land used for other purposes. For example, when a single property has been used by the owner partly as a residential home and partly as a rental property, the relative areas will need to be determined. In many cases, a taxpayer will have determined the relative areas in working out the tax deductions (insurance and rates, for example) that can be claimed. The determination of the areas includes any land used for the relevant purposes (for example, a backyard or garage for the home).

The main home exclusion can only apply when the property is actually used as the main home. The exclusion can only apply in full or not at all; it does not apply on a proportionate basis. As a result, if a property is used less than 50 percent of the time as the main home of the person, the main home exclusion will not apply.

Used for most of the time as their main home

The land must have been used for most of the time that the person owns the land as their main home. This requires the property to have been used more than 50 percent of the time as their main home for the period the person owns the land. The land does not need to have been used without interruption as their main home. For example, a main home can be rented out for short periods while the owner is on holiday or before settlement of the sale of the property, as long as the time is less than the private residential use.

The owner must have resided in the property as their main home. The main home exclusion will not apply when only a family member and not the owner has used the property as their main home.

More than one home

A person can only have one main home. When a person has two houses that they reside in, the property that is their main home is determined according to which property the person has the greatest connection with. The "greatest connection" test operates only as a tie-breaker when a person has more than one home.

The greatest connection test determines, on an objective basis, which property is the person's main home. The test does not allow a person to elect their main home. Various factors may be relevant in determining which property the person has the greatest connection with, including:

- the time the person occupies the dwelling;
- where their immediate family (if any) live;
- where their social ties are strongest;
- the person's use of the dwelling;
- the person's employment, business interests and economic ties to the area where the dwelling is located; and
- whether the person's personal property is in the dwelling.

These factors are similar to those used to determine if a person has a "permanent place of abode" under current tax law. Therefore, existing guidance on the "permanent place of abode" test could assist in determining which property the person has the greatest connection with.

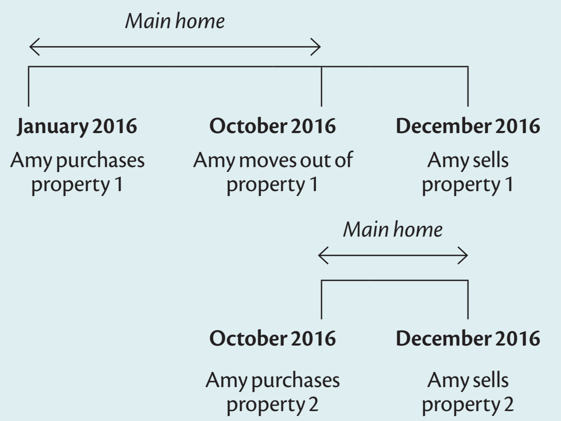
Using the "main home" exclusion for two properties

Under limited circumstances, a person may use the main home exclusion for two properties sold at the same time.

An example is when a person lives in a home for less than one year as their main home, and moves into a new home while trying to sell the original home. The original home may satisfy the requirements to be the person's main home (as discussed above) for the period before moving into the main home. The new home may also satisfy the requirements to be the person's main home for the subsequent period.

The ownership overlap of the properties will not mean the original home fails to satisfy the requirements to be a main home for the previous period. If the two properties were sold at the same time, the owner would be able to use the main home exclusion for both properties (if they both satisfied the requirements to be a main home for the different periods).

Example: Main home exception for multiple properties



The main home exclusion is available for both of Amy's properties. Property 1 was the main home for 9 out of the 11 months that Amy owned the property. Property 2 was the main home for the entire time Amy owned it.

Different owners can have different main homes

Co-owners of property can have different main homes. For example, a person living in one city may have a different main home from their spouse living in another city. The bright-line test will only apply to the extent the property is not the main home of an owner on disposal.

Habitual sellers

A person who habitually sells their main home cannot use the main home exclusion.

A person is considered a habitual seller if they either:

- previously used the main home exclusion twice in the previous two years from the date the property is disposed of; or
- have engaged in a regular pattern of acquiring and disposing of residential land.

If either of these apply, the main home exclusion is not available for this person.

Determining whether there is a regular pattern is a question of fact and degree. Examining transactions that occurred before the disposal of the property in question can help to establish whether the seller has a regular pattern of similar transactions.

Main home and trusts

The trustee of a trust can generally use the main home exclusion if they dispose of a property that is the main home of a beneficiary of the trust. To obtain the exception the land must be used predominantly as the beneficiary's main home for most of the time the trust owns the land.

A trust cannot use the main home exclusion when a principal settlor of the trust has another main home. This rule is to ensure that people cannot get the main home exclusion multiple times through the use of a trust.

Who is a principal settlor?

A principal settlor is the person who has provided the most value to the trust (by market value).

For the purposes of determining a principal settlor, all provisions of value are counted except for the provision of services at below market value. If there are multiple people who have provided the greatest equal value to the trust, they are all considered principal settlors.

In addition, a person is not a principal settlor if they have provided a "no-strings attached" gift to the trust. This means that for the purposes of determining who has provided the most value to the trust, provisions of value transferred by a person if the person is none of the following are disregarded:

- a beneficiary;
- a trustee;
- a person with the power of appointment or removal of trustees;
- a person with a contingent interest in the trust property, in the case that the trust fails; or
- a decision-maker under the trust.

Example: Holiday home

Lisa rents an apartment in Wellington, where she lives with her son. The apartment is close to her office from which she runs her consulting business fulltime. She is a member of a local tramping club and is on the Board of Trustees of her son's school in central Wellington.

She owns a house on Lake Taupo with views over the lake. She does not let the Lake Taupo property out when she is not using it. She spends four weeks with her son in this property over Christmas and New Year, and also uses the property for about five weekends during the ski season.

When Lisa sells the Lake Taupo property, she cannot use the main home exclusion because it is not the property with which she has the greatest connection.

Example: Multiple dwellings

Bill buys an apartment block on a single title. He lives in one of the apartments as his main home and rents out the remaining six apartments. Bill sells the apartment block to a third party.

Bill cannot use the main home exclusion because the land (contained on the single title) was not used predominantly as his main home. The majority of the land was used as rental property.

Example: Two properties

Mr and Mrs Brown and their children live in a house on a small lifestyle block in Oamaru. Mrs Brown works in Christchurch for three days a week, and works from the Oamaru house two days a week while her husband looks after the children fulltime. Mrs Brown buys an apartment in Christchurch city. She lives in that apartment while she works in Christchurch.

Taking into account the fact that the majority of Mrs Brown's time is spent at the Oamaru house, and her family is located at the Oamaru house, the main home exclusion will not apply in relation to Mrs Brown's Christchurch apartment as it is not the home with which she has the greatest connection.

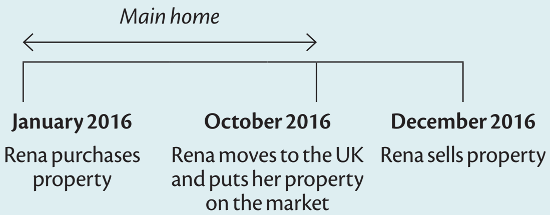
Example: Country store and house

Barbara buys a country store that has living quarters attached. She resides in the living quarters and runs a retail business from the front half of the property. She estimates that the retail business uses 45 percent of the property and claims expenses (insurance and rates) on that basis against the retail income. Barbara sells the property.

Barbara is not able to use the business premises exception as the land is not used predominantly for her retail business (45 percent).

However, Barbara can use the main home exclusion because she has used the property predominantly (55 percent) as her main home during the time she has owned the property. She uses her previous estimate for her expenses to prove her actual use of the property.

Example: Non-resident



Rena is entitled to the main home exclusion. This is because she has used the property as her main home for the majority of the time she has owned it.

Example: Trusts – student flat

Dave has two properties, a family home which he lives in, and a student flat which his son lives in while studying. Dave settles the student flat on a trust and makes his son a discretionary beneficiary of the trust.

The trust cannot use the main home exclusion because the principal settlor of the trust (Dave) has another main home.

Inheritance

Sections CB 6A(3) and FC 9 of the Income Tax Act 2007

When a person dies, their property may be sold or transferred to a beneficiary, who may subsequently sell the property. These transfers and disposals will not be subject to tax under the bright-line test.

How property is transferred through an inheritance

When a taxpayer dies, an estate can be dealt with in several ways, depending on whether a will exists. A will usually provides for the appointment of one or more executors. In the absence of a will, a court will appoint someone to administer the deceased's estate.

The executor or administrator is vested with legal and beneficial ownership of the deceased's property from the time of death to the end of the period of executorship or administration. The beneficiaries have a right to have the deceased's estate administered properly during this period but do not have a legal or beneficial interest in the assets.

The duties of the executor or administrator are to collect the assets of the deceased, pay all debts, testamentary expenses and taxes and to distribute the legacies. At the end of the period of executorship or administration, the executor or administrator becomes a trustee of the residual assets on behalf of the beneficiaries.

Property that has been bequeathed or devised under a will may be gifted as a specific legacy, general legacy or residuary gift. Specific legacies are treated as taking effect from the date of transfer to take effect from the date of death, so income arising from the property is derived by the beneficiary from the date of death. A general or residuary legacy vests in a beneficiary at the time of distribution.

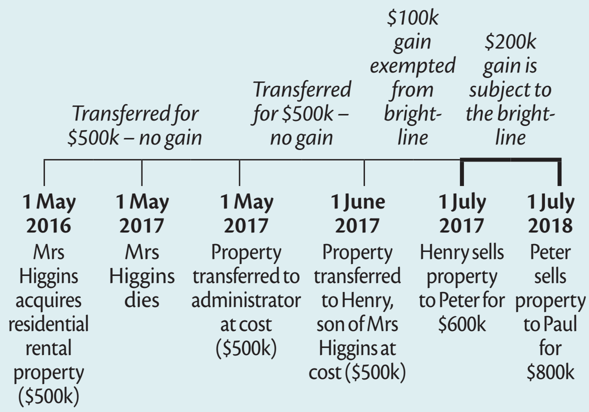
Inheritance exception from bright-line test

The bright-line test provides rollover relief for all transfers following a death and an exemption for any disposals by the executor or administrator or subsequent disposals by the beneficiaries.

The rollover relief is achieved by treating the transfers from the deceased person to the executor or administrator, and from the executor or administrator to the beneficiary, as a disposal and acquisition of the property, at the total cost of the land to the deceased person at the date of transfer (rather than at the land's market value). The effect is that no tax liabilities under the bright-line test arise under the transfers.

Disposals by a beneficiary, executor or administrator of residential land transferred to them on the death of a person are specifically excluded from the bright-line test. However, the disposals may still be subject to tax under the current land sale rules.

Example: Inheritance



Relationship property

Section FB 3A of the Income Tax Act 2007

When a relationship breaks down, property may be transferred between the spouses or partners. The property may then subsequently be sold. Transfers of property under a relationship property agreement are excluded from the bright-line test. However, any subsequent sale of the transferred property will be subject to the bright-line test.

How property is transferred under a relationship property agreement

During a marriage, civil union or de facto relationship, the parties hold any property according to the conventional laws relating to property. As a result, the parties are free to deal with their property during the relationship without regard to the provisions of the Property (Relationships) Act 1976.

When a relationship breaks down, the Property (Relationships) Act 1976 may be invoked by a court order or an agreement between the parties. When the statutory regime is invoked, new property rights operate from the date of the court order or agreement. The property of the spouses or partners is reapportioned between them under principles from the statutory regime. Each item of property is divided into one of two statutory categories:

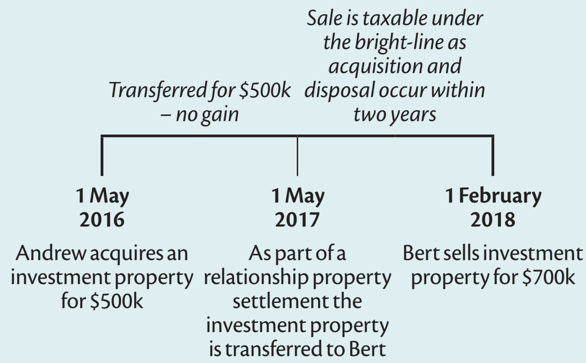
- relationship property; or
- separate property.

The fact that a particular item of property is placed within one of these two categories then produces a *prima facie* result in the way it is treated as between the two spouses or partners. *Prima facie*, all relationship property is divided in equal shares, while separate property is retained by the owner.

Rollover for relationship property

A transfer of property under a relationship property agreement will be entitled to the current rollover relief that applies to such transfers. This will mean that no tax liability under the bright-line test arises for the transfer of the property under the relationship property agreement. However, the person to whom the relationship property has been transferred may be liable under the bright-line test for any subsequent disposal of the property. This will occur if the person receiving the relationship property enters into an agreement to dispose of the property within two years of the original registration of title for the property.

Example: Relationship property



Rollover for land transferred under a resident's restricted amalgamation

Sections FO 10 and FO 17 of the Income Tax Act 2007

Under the bright-line test there is rollover relief for amalgamations. This rollover relief extends the existing rollover relief for amalgamations to property that is revenue account property of an amalgamating company due to the application of the new bright-line test.

Current amalgamation rules

The amalgamation rules in the Income Tax Act 2007 contain a rollover provision for property transferred as a result of an amalgamation.[3]

The rules provide that when property is held on revenue account by an amalgamating company solely due to the application of a 10-year rule in sections CB 9 to CB 11 and CB 14, the property is transferred to the amalgamated company at cost.

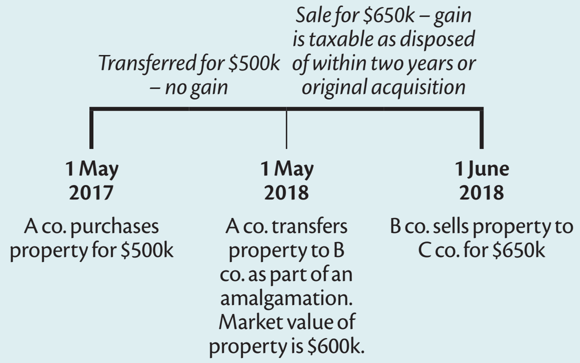
If the amalgamated company disposes of the property within 10 years of the original date of acquisition of the property by the amalgamating company, any gain from the sale is taxable.

Extending current rules to bright-line test

Under the bright-line rules this rollover relief is extended to property that is revenue account property of an amalgamating company due to the application of the bright-line test.

[3] That meets the criterion to be a "resident's restricted amalgamation" under section FO 3.

Example: Land held on revenue account solely due to bright-line test



On 1 May 2018 the property is transferred from A co. to B co. at cost ($500k). A co. does not have a tax liability from the transfer as there is no gain from the disposal.

On 1 June 2018, B co. is taxable on the $150k gain from the sale. This is because B co. disposed of the property within two years of the original date of acquisition of the property by A co. (1 May 2017).

Deductions

For property that is liable for tax under the bright-line test, taxpayers will be able to deduct expenditure according to the ordinary tax rules.

The cost of the property can be deducted

A person who sells property that is subject to the bright-line test will be allowed a deduction for the cost of the property at the time of sale.

The cost of the property includes the amount that was paid to acquire the property (the initial acquisition price of the property). The cost of the property also includes any expenditure related to the acquisition. As a result, the costs of lawyers, valuers, surveyors and real estate agents are deductible. The incidental costs of disposing of the property are also deductible as part of the cost of the property. The cost of the property also includes any capital improvements to the property made after acquisition, such as renovations.

When holding costs are deductible

While a property is owned there will be periodic holding costs (of a non-capital nature) such as interest, insurance, rates and repairs, and maintenance expenses.

To be deductible as incurred, the holding costs must satisfy the normal deduction requirements. In other words, the holding costs are deductible to the extent they have a nexus with income and to the extent they are not private in nature (or otherwise subject to any of the general limitations on deductions).

A deduction will be considered to be of a private nature if it is exclusively related to living as an individual. This will be determined by the specific facts of any given situation. However, interest costs can automatically be deducted if the property is owned by a company (subject to some limitations).

For example, when the property is part of a business or profit-making undertaking or scheme, and there is no private use, it is likely that the nexus would be satisfied. Further, when the property is rented out there would likely be a nexus between the holding costs and the rental income. However, if a person purchases a bach for family use, but sells the bach within two years, the holding costs would not be deductible because of the private limitation.

Ring-fencing losses

Section DB 18A of the Income Tax Act 2007

Losses from deductions that are claimable solely against bright-line income (bright-line deductions) are ring-fenced, so they can only be offset against gains on other land sales that are taxable under any of the land sale provisions.

The amount of bright-line deductions allowed in any income year is limited to the amount of bright-line income and net land income for that year. Net land income is the amount of net income for the year as if the person's only income was derived from the disposal of land under sections CB 6 to CB 14.

Any excess deductions not allocated to the income year will be treated as the cost of revenue account property and carried forward to the next income year. However, any excess deductions will not be able to be carried forward if the general continuity requirements for carrying forward tax losses are not satisfied.

Example: Ring-fenced loss

In June 2017 Zac sells residential land that is taxable solely due to the bright-line test. Zac acquired the land for $600,000 and sold it for $540,000. For the 2017–18 income year, Zac also earned $80,000 in salary.

The $60,000 loss for the sale of residential land is ring-fenced so that it may only be used to offset income from other land sales. Zac cannot use the $60,000 loss to offset his income from salary and wages.

In August 2019 Zac sells land that he purchased with an intention of resale. Zac made a gain of $100,000 from the sale. Zac may offset his previous $60,000 loss against the $100,000 gain. As a result, Zac only has to pay tax on $40,000 of the gain in the 2019–20 income year.

Losses from transfers to associated persons

Section DB 18AB of the Income Tax Act 2007

A person cannot recognise a loss arising from a transfer of property to an associated person if that loss is taxable solely due to the bright-line test.

However, to avoid genuine losses being denied permanently, the associate may increase the cost base of the land by the amount of the denied deduction.

Example: Transfer to associate

1 January 2016	**1 January 2017**	**1 June 2018**
Steve acquires residential property for $500k	Property has decreased in value to $400k. Steve transfers property to his wife Tara.	Tara sells land to Uri for $450k

Steve's deductions are capped at $400k for the transfer on 1 January 2017. He cannot claim the $100k loss for the year.

When Tara sells the land on 1 June 2018, she can deduct $500k. This is made up of the $400k cost of acquisition as well as the $100k of denied deductions.

Land-rich companies and trusts

Sections GB 52, GB 53

To address the risk of people using land-rich companies and trusts to circumvent the bright-line test, a specific anti-avoidance rule applies.

Land-rich companies

The anti-avoidance rule for land-rich companies applies when all four of the following are met:

- The company is land-rich—this means at least 50 percent of the value of the company is attributable to residential land.
- 50 percent of the shares in the company are disposed of within a 12-month period.
- Some of the company's residential land was acquired within two years of the disposal of the shares.
- The disposal of shares had a purpose or effect of defeating the intent and application of the bright-line test.

Definition of "land-rich company"

A "land-rich" company is one where at least 50 percent of the value of the company is attributable to residential land either directly or indirectly. This is intended to mirror similar provisions contained in international double tax agreements. Residential land can be attributable to a company either through the company owning the residential land in its own name or holding shares in another land-rich company.

Deemed disposal

When the requirements are met the land-rich company is treated as disposing of residential land that it acquired within two years of the share disposal to the shareholder at cost. The amount of residential land and the price are at the cost proportional to the shareholding of the relevant shareholder.

The shareholder is then treated as immediately disposing of the residential land back to the company at market value.

Example: Land-rich company

1 January 2016	**2 January 2016**	**1 January 2017**
Steve and Tara set up X co. Steve and Tara each own 50% of the shares in X co.	X co. buys residential land for $500k	The residential land now has a market value of $600k. Steve sells all of his shares in X co. to Uri.

X co. will be treated as disposing of 50 percent of the residential land to Steve for $250k.

Steve will then be treated as disposing of the residential land back to the company for $300k.

As a result, Steve will have to pay income tax on the $50k gain from the deemed sale.

Land-rich trusts

Section GB 53 treats a trustee as having disposed of residential land at market value if all three of the following apply:

- The trust is land-rich—this means that at least 50 percent of the value of the trust is attributable to residential land.
- Any of the following changes are made:
  - the trust deed changes; or
  - a decision-maker under the trust deed changes; or
  - an arrangement under the trust changes.
- The change was made with a purpose or effect of defeating the intent and application of the bright-line test.

OTHER REMEDIAL AMENDMENTS

Non-active trust filing exception

Section 43B of the Tax Administration Act 1994

An amendment to the Tax Administration Act 1994 allows non-active trusts (which are currently required to file nil income tax returns) to apply to be exempted from the obligation to file, thereby reducing compliance costs.

Requirements for exception

Trusts that are non-active will no longer be required to file annual income tax returns if:

- throughout the tax year the trust is a non-active complying trust; and
- the trustee of the trust has filed a declaration that the trust is non-active (and the trust has not become active since making the declaration).

A trust will be non-active if it has:

- not derived or been deemed to have derived any income;
- no deductions; and
- not been a party to, or perpetuated or continued with, any transactions with assets of the trust in the tax year, which give rise to income in any person's hands, or fringe benefits to any employee or to any former employee.

Certain minimal amounts of income or deductions can be ignored in determining whether a trust is non-active. This includes:

- reasonable fees paid to professional trustees to administer the trust;
- up to $200 of bank charges or other minimal administration costs;
- up to $200 of interest earned on trust assets in a bank account during the tax year; and
- insurance, rates, and other expenditure incidental to the occupation of a dwelling owned by the trust and incurred by the beneficiaries of the trust.

The amendment sets out the process by which a non-active trust may apply for exemption from filing income tax returns. This process entails completing a declaration—first, that the trust is a non-active trust and secondly, that a trustee of the trust will inform the Commissioner if it ceases to be so. The trustees of the trust are thereby placed under a statutory obligation to inform the Commissioner upon the cessation.

The Commissioner will retain the power to request the trustees of a trust to file a return of income even if it holds an exemption under the amended provision.

The amendment is based on a similar provision for non-active companies in section 43A of the Tax Administration Act 1994.

Definition of "land"

Section YA 1 of the Income Tax Act 2007

As a result of the rewrite of income tax legislation, there was an unintended change to the definition of "land". This change created uncertainty over whether it included an interest in land.

To resolve this, the definition of "estate" and "interest" in land have been replaced with a definition of estate and interest in land that clearly includes interests in land. The definition of land clearly included an interest in land before the rewrite of the definition.

In addition, the new definition clarifies that an interest in land includes the right to possession of land.

Clarifying treatment of land transferred under a resident's restricted amalgamation

Section FO 17 of the Income Tax Act 2007

The new Act clarifies the treatment of revenue account property transferred as a result of a resident's restricted amalgamation when, at the time of the amalgamation, it is unclear whether the amalgamated company holds the property on revenue or capital account.

Current amalgamation rules

When two companies merge under an amalgamation, the transfer of assets between the companies is generally exempt from tax. However, the transfer is not exempt from tax if the property leaves the tax base.

The amalgamation rules achieve this result by transferring property either at cost or at market value, depending on whether the amalgamating and amalgamated company hold the property on revenue or capital account. This is illustrated in Table 1.

Table 1

		Amalgamated company		
		Holds on capital account	**Holds on revenue account (except if solely due to 10-year rule)**	**Holds on revenue account solely due to 10-year rule**
Amalgamating company	**Holds on capital account**	Cost	Market	Market
	Holds on revenue account (except if solely due to 10-year rule)	Market	Cost	~~*Cost*~~ *Market*
	Holds on revenue account solely due to 10-year rule	Cost	Cost	Cost

However, when the amalgamated company holds the property on revenue account, if it disposes of the property within 10 years, it is unclear for the amalgamating company whether it transfers the property at cost (and has no tax liability) or at market value (and has a tax liability).

Deemed market value transfer

The amendment applies so that property is deemed to be transferred at market value when:

- the land is held on revenue account for the amalgamating company; and
- the land is, or may be, revenue account property of the amalgamating company solely because of the 2-year bright-line test or a 10-year rule in any of sections CB 9 to CB 11, and CB 14.

When the two criteria above are met the property is deemed to be transferred at market value.

TAXATION (SUPPORT FOR CHILDREN IN HARDSHIP) ACT 2015

As part of Budget 2015, the Government announced changes to help provide financial relief for children in very low income families. These changes were introduced into Parliament in the Support for Children in Hardship Bill. At the Committee of the whole house stage on 10 November 2015 the aspects relating to Revenue Acts were divided out to form the Taxation (Support for Children in Hardship) Bill. The Support for Children in Hardship Bill had also provided for a $25 per week payment to families in receipt of a main benefit under the Social Security Act, among other changes (see the Social Security Amendment Act (No 2) 2015).

The Taxation (Support for Children in Hardship) Bill was passed and granted Royal assent in December 2015. The new legislation, the Taxation (Support for Children in Hardship) Act 2015, amends the Income Tax Act 2007 to provide for an increase to the base rate of the in-work tax credit. The increase is targeted at low income working families with dependent children. It is part of a wider Budget 2015 package to provide support for families with children in hardship and to encourage families into paid work.

The new Act also increases the abatement rate for Working for Families tax credits WfFTC to target the increase in assistance, and the other WfFTC at low income working households. Consequential changes have been made to the Taxation (Annual Rates and Budget Measures) Act 2011, which sets out a timetable for future changes to the WfFTC abatement regime.

CHANGES TO IN-WORK TAX CREDIT AND THE FAMILY CREDIT ABATEMENT RATE

Sections MD 10(3)(a), MD 13(3)(a) (i) and (ii) of the Income Tax Act 2007

The two main changes in the new Act amend sections MD 10(3)(a) and MD 13(3)(a) (i) and (ii) of the Income Tax Act 2007 to increase the base rate of the in-work tax credit by $12.50 a week and to increase the family credit abatement rate by 1.25%.

Background

The in-work tax credit can be claimed by working families with dependent children as long as they are not receiving a main benefit (or Student Allowance) and are normally working either 20 hours a week or more, in the case of a sole parent, or 30 hours a week or more in total for a couple.

The base rate of the in-work tax credit is $60 per week ($3,120 per annum) for eligible working families.

The abatement rate for WfFTC, referred to as the family credit abatement rate, is 21.25 cents in the dollar. It applies when a WfFTC recipient's family scheme income is more than $36,350 a year.

Key features

Amendments have been made to section MD 10(3)(a) of the Income Tax Act 2007 to increase the in-work tax credit base rate by $12.50 per week to $72.50 per week ($3,770 per annum). The eligibility criteria for the in-work tax credit remain the same and there is no change to the additional rate payable for families with four or more children ($780 per annum per additional child).

The increase in the in-work tax credit base rate provides some additional assistance to low-income working families not in receipt of a main benefit. The increase in the base rate helps ensure there continues to be a reasonable gap between income people can receive on a main benefit and income low and middle income families can receive from paid work.

Amendments have also been made to sections MD 13(3)(a)(i) and (ii) of the Income Tax Act 2007 to increase the family credit abatement rate from 21.25 cents per dollar to 22.5 cents per dollar. The increase applies to both sole parents and couples.

The increase in the abatement rate for WfFTCs aims to ensure that the $12.50 per week increase in the in-work tax credit, and the other WfFTCs, are targeted at the lowest income families likely to be experiencing hardship.

Application dates

The increase in the in-work tax credit rate and the family credit abatement rate come into force on 1 April 2016, this means they apply for the 2016–17 and later tax years. These changes are timed to occur when the main benefit rate for families increases by $25 a week, and the minimum family tax credit (a work-related payment for very low income families) also increases by $14 a week.

Combined impact of main changes

The combined impact of the increase in the in-work tax credit rate and the increase in the family credit abatement rate will depend on whether the family is eligible for the in-work tax credit and the level of their family scheme income. In general, those who are eligible for WfFTC and have income under $36,350 will receive an increase of $12.50 per week of work. Families with family scheme income over $36,350 and less than $88,000 will receive a smaller increase per week worked, and those with family scheme income over $88,000 will likely see a decrease in WfFTC paid. For families who do not qualify for the in-work tax credit, the increased abatement rate will reduce the amount of WfFTC they receive if their family scheme income is above $36,350.

CONSEQUENTIAL CHANGES TO THE TAXATION (ANNUAL RATES AND BUDGET MATTERS) ACT 2011

Sections 2(3), (4) and (5), 5, 14B of the Taxation (Annual Rates and Budget Measures) Act 2011

Sections 2(3), (4) and (5), and 5 of the Taxation (Annual Rates and Budget Measures) Act 2011 have been amended to ensure the Budget 2011 scheduled changes to the WfFTC abatement regime are updated to include the increase to the abatement rate on 1 April 2016.

A new section 14B in the Taxation (Annual Rates and Budget Measures) Act 2011 has been created to ensure each time the abatement threshold is reduced as per the Budget 2011 planned changes, the schedule the Commissioner uses to estimate the amount of WfFTC to pay recipients during the year is updated.

Background

Budget 2011 included changes to WfFTC to ensure the scheme is financially sustainable over time, with proportionally more assistance going to the most vulnerable families. The two main changes were to progressively lower the abatement-free threshold, and progressively increase the family credit abatement rate. The first small phased increase to the abatement rate and reduction to the threshold was made in 2012. Three other similar phased changes were planned to occur alongside increases to the family tax credit rate. The family tax credit rate increases when accumulated inflation reaches 5% since the prior increase. The rate change is made by Order in Council under MF 7 of the Income Tax Act 2007.

The Act brings the second planned adjustment to the family credit abatement rate forward to 1 April 2016, but does not bring forward the reduction in the abatement-free threshold. As a consequence, the planned changes outlined in the Taxation (Annual Rates and Budget Measures) Act 2011 have been updated.

Key features

Amendments have been made to sections 2(3), (4) and (5), and 5 of the Taxation (Annual Rates and Budget Measures) Act 2011 to ensure the Budget 2011 scheduled changes are updated to include the increase to the abatement rate on 1 April 2016.

The table below shows the previous and planned increases to the abatement rate and reductions to the threshold in the new Act.

	Previous (threshold and abatement rate)		**Planned (threshold and abatement rate)**	
1 April 2015	$36.350	21.25%	$36,350	21.25%
1 April 2016	$36,350	21.25%	$36,350	22.5%
Next Order in Council	$35,900	22.5%	$35,900	23.75%
Subsequent Order in Council	$35,450	23.75%	$35,450	25%
Last Order in Council	$35,000	25%	$35,000	25%

The Act changes the timing of the phased changes, but does not change the ultimate proposal of a family credit abatement rate of 25% and abatement threshold of $35,000.

Amendments have also been made to introduce a new section 14B in the Taxation (Annual Rates and Budget Measures) Act 2011, which changes the income bands in Schedule 31 of the Income Tax Act 2007 to reflect each planned reduction to the abatement threshold. This ensures that the Commissioner is able to correctly perform the calculation that estimates the amount of WfFTC to pay recipients as instalments during the year.

Application date

The consequential changes came into force on 10 December 2015 (the day after the date of Royal assent) but do not apply until after 2016 when the family tax credit rate is increased by Order in Council.

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.

APPLICATION TO RAISE NEW PROPOSITIONS OF LAW AND ISSUES DISMISSED

Case	TRA 018/12 [2015] NZTRA 17
Decision date	8 October 2015
Act(s)	Tax Administration Act 1994, Goods and Services Tax Act 1985, Income Tax Act 2007
Keywords	Application to raise new propositions of law and new issues in challenge proceedings

Summary

This was an application of the disputant to raise new propositions of law and new issues in challenge proceedings. The Taxation Review Authority ("the Authority") found that the disputant had not identified any propositions of law or new issues that the disputant could not have discerned with due diligence at the time of delivery of his Statement of Position ("SOP"). Accordingly, the application was dismissed.

Impact

The Authority must be satisfied that s 138G(2) of the Tax Administration Act 1994 ("TAA") has been met before an applicant can raise new propositions of law and new issues in challenge proceedings.

Facts

This was an application brought by the disputant, pursuant to s 138G(2) of the TAA, to raise new propositions of law and new issues in the challenge proceeding.

The disputant sought to raise new propositions of law and new issues relating to a purported finding at paragraph [6] in a judgment of Williams J, delivered in August 2013. The August 2013 case was an appeal from a decision of the Environment Court.

The disputant also made oral and written submissions with other propositions of law and new issues that the Authority addressed.

Decision

The disputant's application under s 138G(2) of the TAA was dismissed.

New propositions of law and new issues raised in notice of application

The disputant wished to raise in his challenge, new propositions of law and new issues related to the judgment of Williams J at paragraph [6], which states:

> [6] In 1977, TLL built the 410 metre diversion of the Kawau Stream accordingly (I call this the [name] diversion to differentiate it from the runway diversion). The appellant's father piped 205 odd metres of the downstream end of the diversion before his death in 1977, and the appellant completed the upstream section after his father's death. This section was not piped. The appellant used open channelling.

The Authority found that there were no findings of fact at paragraph [6] of the judgment of Williams J. Furthermore, it simply formed part of the narrative which Williams J considered was necessary to set out before considering the matters for determination in that case.

The disputant made oral submissions that the statement made by Williams J at paragraph [6] is particularly significant having regard to the definition of land inserted into the Goods and Services Tax Act 1985 with effect from 1 April 2011. As the goods and services tax ("GST") periods subject to this proceeding predate 1 April 2011, the Authority found that the definition has no application.

The disputant stated that the judgment of Williams J referred to the disputant's late father and the disputant as joint "special powers" for the 1977 year diversion of the Kawau Stream in four "private lands" in Palmerston North. The Authority agreed with the Commissioner that the disputant's submission in this regard was misleading and wrong. The Authority noted that there was certainly no finding of the existence of a joint "special power" made in the judgment of Williams J.

The Authority concluded that the disputant had not identified any propositions of law or new issues that the disputant could not have discerned with due diligence at the time of delivery of his SOP.

Other propositions of law and new issues raised in the disputant's submissions

Aviation-related service

The disputant submitted that he was supplying an "aviation related service" as defined in s 2 of the Civil Aviation Act 1990 to the [named] airport on every day of every year since 1977.

The Authority agreed with the Commissioner's submission that if the service has been provided since 1977, the issue of whether the disputant has been providing such a service is not one which he could not, at the time of delivery of his SOP, with due diligence, have discerned. Accordingly, the Authority found that that the disputant's application in respect of this alleged issue also failed at the first stage under s 138G(2).

Alleged trustee income under s 93B of the TAA

The disputant submitted that the Authority may determine in a fair and reasonable manner the amount of trustee income of the disputant, for each year since 1977 under s 93B(1)(e) and s 93B(2) of the TAA.

The Authority found that s 93B provides that the Commissioner may assess a trust for income tax not a Taxation Review Authority (the powers of a Taxation Review Authority are set out in s 138P of the TAA). The Authority also noted that this proceeding is not about income tax and therefore s 93B is not relevant.

Section HR 6(6) of the Income Tax Act 2007

The disputant claimed that failing an agreement between the airport operator and the Commissioner, a Taxation Review Authority may determine disputes concerning value or timing under s HR 6(5) of the Income Tax Act 2007. The Authority found that any question in respect of value of assets or timing issues for the purposes of income tax must be resolved by agreement between the Commissioner and the airport operator, or failing agreement, the Commissioner (not a Taxation Review Authority).

Furthermore, the Authority noted that this provision involves the assessment of income tax, which is not relevant in this case.

Trustee income

The Authority noted that the disputant's submission under this heading was somewhat difficult to follow and found that the current proceeding concerned the disputant's GST claims for specific periods and did not involve any other GST-related matters. The Authority therefore found the issue not relevant.

DISMISSAL OF APPLICATION TO DISPENSE WITH SECURITY FOR COSTS

Case	Musuku v Commissioner of Inland Revenue
Decision date	28 October 2015
Act(s)	High Court Rules, r 20.13
Keywords	Security for costs, impecuniosity, vexatious appeal

Summary

The High Court dismissed Mr Musuku's application for an order dispensing with, or postponing payment of, security for costs in accordance with High Court Rules, r 20.13.

Facts

Mr Musuku is appealing the Taxation Review Authority's ("the Authority") decision to dismiss his challenge to the Commissioner's income tax assessment for 2006. In relation to the appeal, Mr Musuku made an application for an order dispensing with, or postponing payment of, security for costs relying on High Court Rules, r 20.13.

Decision

Muir J recognised the Supreme Court decision *Reekie v Attorney-General* [2014] NZSC 63, [2014] 1 NZLR 737 (*Reekie*) as the leading authority on security for costs. Although *Reekie* concerned the application of the Court of Appeal (Civil) Rules 2005, his Honour referenced previous authorities confirming the application of the same principles to matters governed by r 20.13 (*Jones v Waitemata District Health Board* [2014] NZHC 3370; *Skagen v Wellington Standards Committee of the New Zealand Law Society* [2015] NZHC 675).

Muir J summarised the following principles from *Reekie*:

1. Impecuniosity does not, in itself, warrant an order dispensing with security.
2. Security for costs should only be dispensed with if it is right to require the respondent to defend the judgment under challenge without the usual protection as to costs provided by security.
3. As to whether it is right to require security for costs to be dispensed with, discretion should be exercised so as to:

a) preserve access to the Court by an impecunious appellant in the case of an appeal which a solvent appellant would reasonably wish to prosecute; and

b) prevent the use of impecuniosity to secure the advantage of being able to prosecute an appeal which would not be sensibly pursued by a solvent litigant.

4. Where an impecunious appellant has secured representation from non-legal aid counsel, any dispensation from security for costs will be based on whether the case is of the kind which would be appropriate for a grant of legal aid.

5. Protecting respondents from vexatious appeals is a legitimate purpose of the security for costs regime, and an appeal or its conduct may be considered vexatious for such purposes even though it does raise some points which are arguable.

6. Cost and benefit are not to be assessed in purely financial terms.

7. In terms of establishing impecuniosity, an appellant without liquid assets may be required to borrow money to provide security, or it may be appropriate to investigate whether another party (for example, a relative or family trust) might provide the necessary funding.

Muir J regarded the absence of direct evidence of Mr Musuku's impecuniosity as decisive. His Honour further held, consistent with *Reekie*, that if impecuniosity had been demonstrated it would not of itself warrant an order dispensing with security.

On a preliminary basis, Muir J found that Mr Musuku's prospects of success on appeal were not encouraging.

The first ground of appeal is that the Commissioner's assessment did not represent an honest appraisal and a genuine exercise of judgement. His Honour referred to the Authority's finding that there was no merit in this argument.

The second ground of appeal is that the Commissioner's assessment is incorrect. Muir J referred to the Authority's finding that Mr Musuku's arguments were "completely without merit". His Honour then referred to Mr Musuku's argument that all payments made to him were in his capacity as creditor. In response, Muir J stated: "[t]hat seems to me a difficult argument on the facts as found by Judge Sinclair and having regard to the absence of evidence supporting the proposition".

The third ground of appeal is that sufficient evidence was available as to the amount by which the Commissioner's assessment is incorrect. In response, Muir J referred to the finding of the Authority that there was little benefit from the evidence adduced on Mr Musuku's behalf, and stated that on a provisional basis the High Court was likely to come to a similar conclusion.

His Honour also found that, had it been necessary, Mr Musuku's history of pursuing unsuccessful litigation and failing to meet costs awards would have been relevant to his exercise of judgment under High Court Rules, r 20.13.

In conclusion, Muir J held that Mr Musuku's appeal should not proceed without security. His Honour considered that the Commissioner would otherwise be exposed to an appeal in respect of which there are only slight prospects of success and with little prospect of the Commissioner otherwise recovering costs.

THE COMMISSIONER'S APPLICATION TO STRIKE OUT DISPUTANT'S NOTICE OF CLAIM

Case	TRA 027/14 [2015] NZTRA 19
Decision date	22 October 2015
Act(s)	Tax Administration Act 1994
Keywords	Application to strike out notice of claim, service on the Commissioner, want of prosecution

Summary

The Commissioner of Inland Revenue ("the Commissioner") applied to strike out the disputant's Notice of Claim for non-compliance with s 138B of the Tax Administration Act 1994 ("TAA") and, in the alternative, for want of prosecution. The Taxation Review Authority ("the Authority") held that the proceeding must be treated as having been discontinued as the claim was not effected on the Commissioner. In the alternative, the Authority held that there has been inordinate delay and that the dismissal of the disputant's claim is justified as the Commissioner will suffer serious prejudice if the disputant was permitted at this stage to pursue his claim.

Impact

The Authority's decision reinforces the importance of service of a Notice of Claim on the Commissioner in accordance with regs 8(2) and 13 of the Taxation Review Authorities Regulations 1998 ("the Regulations").

Also, in dismissing the proceeding for want of prosecution, the Authority considered whether any fault on the Commissioner's part led to the delay, whether any steps have been taken to gather and preserve evidence, and time and costs incurred by the Commissioner.

Facts

The Commissioner applied to strike out a Notice of Claim alleged by the disputant to have been filed with the Authority on or about 8 December 2011, for non-compliance with s 138B of the TAA. In the alternative, the Commissioner applied to dismiss the proceeding for want of prosecution.

Evidence was given by the investigator ("Mr Brown") who was responsible for the disputant's file, and by the disputant's accountant ("Mr Jones").

On 6 December 2011, before the final assessments for the relevant tax years were issued, Mr Jones sent an email to the Authority, which he copied to Mr Brown and to which he attached a letter stating that a notice of claim and a cheque for the filing fee were attached.

On 7 and 8 December 2011, discussions took place to resolve the outstanding issues before final assessments were issued. In an email on 8 December 2011, Mr Jones stated: "I will communicate with Ministry of Justice and try & put a hold on presenting the cheque so mailed yesterday?".

Mr Jones gave evidence that he did call the Tribunals Unit but he was informed that the cheque and claim had already been processed.

On 21 May 2012, the case manager at the Tribunals Unit sent an email to Mr Jones seeking to confirm whether the matter was going to proceed with the Authority. No reply was ever sent to the case manager.

Deduction notices pursuant to s 157 of the TAA, were issued and funds sufficient to clear the disputant's tax liabilities were deducted from the disputant's account.

In December 2014, the proceeding was registered on a without prejudice basis.

Decision

The Authority held that the proceeding is treated as discontinued pursuant to r 5.68 of the District Court Rules. In the alternative, the Authority dismissed the proceeding for want of prosecution.

Was the notice of claim filed in the Authority in accordance with s 138B(2)(c) of the TAA?

The Authority considered that it is reasonable to expect that the claim would have been received (at the earliest) on 8 December 2011 and the cheque was banked on this date. The Authority held that the disputant was entitled under s 138B(2) of the TAA to bring challenge proceedings on 8 December 2011, the date on which the notice of claim was filed.

The Authority held that the claim was filed in accordance with s 138B(2)(c) of the TAA and that the events that followed did not alter the fact that the notice of claim was filed with the Authority and that the requisite fee was paid.

Was the notice of claim served on the Commissioner?

The Authority referred to regulations 8(2) and 13 of the Regulations which set out the requirements for service of a notice of claim.

The Authority stated that there is no evidence to support Mr Jones' assertion that "as far as he was concerned" Mr Brown had accepted service of the notice of claim.

The Authority held that the proceeding must therefore be treated as having been discontinued pursuant to r 5.68 of the District Court Rules 2014.

In the alternative, has the disputant failed to prosecute the claim?

The Authority held that there has been inordinate delay by the disputant as the notice of claim was filed in December 2011 and no progress was made until the matter came to life in September 2014. The Authority did not consider that there was any credible excuse for the delay.

The Authority accepted that the Commissioner did not know the claim had been filed and is now prejudiced in that no steps have been taken to gather and preserve evidence. The Authority also did not consider that this is a case where there has been any fault on the part of the Commissioner which has led to the delay.

Having regard to the interests of justice, the Authority held that the dismissal of the disputant's claim is justified as the Commissioner will suffer serious prejudice if the disputant was permitted at this stage to pursue his claim.

DIRECTOR'S LIABILITY FOR ASSET STRIPPING UNDER SECTION HD 15

Case	TRA 021/11 [2015] NZTRA 20
Decision date	27 November 2015
Act(s)	Tax Administration Act 1994, Goods and Services Tax Act 1985, Income Tax Act 2007
Keywords	Director's liability, asset stripping, section HD 15, bankruptcy, Official Assignee

Summary

The Taxation Review Authority ("the Authority") upheld the Commissioner of Inland Revenue's ("the Commissioner") assessment of a director as agent for companies pursuant to s HD 15 of the Income Tax Act 2007 ("ITA"). In finding the director liable, the Authority considered arrangements had been entered into which resulted in the companies not meeting their tax liability to the Commissioner. The Authority also considered a number of issues in relation to the director's bankruptcy and ultimately concluded that the director had no standing to bring the tax challenge, as the challenge vests in the Official Assignee.

Impact

This is a significant case as it considers a director's liability as agent for a company under the asset stripping provisions under s HD 15 of the ITA (and s 61 of the Goods and Services Tax Act 1985 ("GSTA")).

Facts

The disputant commenced challenge proceedings after he was assessed under s 61 of the GSTA as agent for three companies, AB 1 Limited, AB 3 Limited and AB Ventures Limited ("the Companies"), which were placed into liquidation on 30 June 2010 for goods and services tax ("GST") liabilities totalling $1,779,568.

The matter initially came before the Authority on 31 October 2012 following which, further matters were raised and eventually heard on 24 August 2015.

Property Limited was incorporated in 1997 and acted as the GST group representative member under s 55 of the GSTA for a number of companies that were part of the Property Group of Companies ("the GST Group"). The disputant was managing director of Property Limited until the company was liquidated in July 2010. The Companies were included in the GST Group and the disputant was also the managing director of the Companies.

By April 2008, Property Limited and a number of its subsidiaries had substantial outstanding liabilities to creditors. Property Limited was also owed significant amounts by some of its subsidiary companies including AB 1 Limited, AB 3 Limited and AB Ventures Limited. The directors of Property Limited decided to sell certain assets of its subsidiaries to generate funds to pay the debts of Property Limited. The disputant negotiated the agreements for sale and purchase of the assets.

In July 2006, Property Limited provided a financial guarantee to a finance company in relation to the indebtedness of the largest subsidiary in the GST Group. In July 2008 the subsidiary was placed in receivership.

After taking legal advice, the disputant and other directors decided to incorporate PQR Holdings Limited ("PQR") and for that company to acquire shares in certain subsidiaries of Property Limited and to acquire, by way of assignment, the intercompany debts owed by those subsidiaries to Property Limited. PQR was incorporated on 1 August 2008. The disputant was its sole director.

On 4 August 2008, Property Limited and PQR entered into a Deed of Assignment assigning debts. To secure these debts, the Companies granted mortgages over the land contained in the various certificates of title that were subject to the sale and purchase agreements. On 6 August 2008, GST invoices were issued by the solicitors acting for the Companies. Each of the sale and purchase agreements settled on 14 August 2008.

The disputant in his capacity as managing director of each of the Companies, Property Limited and PQR made the decision to apply the net proceeds to pay the inter-company debts, which had been assigned to PQR. He subsequently used those funds to pay certain debts of Property Limited and some of its subsidiaries.

On 23 October 2008, Property Limited and PQR entered into a deed titled "Agreement" signed by the disputant as director of Property Limited and as director of PQR. After the net proceeds had been paid to PQR there were no remaining funds or assets left in the Companies to pay the GST liabilities.

The Companies failed to comply with statutory demands served on them by the Commissioner. In June 2010, the High Court made orders putting each of the Companies into liquidation.

On 25 August 2009, the disputant was assessed as agent. In 2010 the disputant was subsequently adjudicated bankrupt and the present challenge proceedings were issued by the disputant in May 2011.

Decision

Jurisdiction

Regarding the extent of the Authority's jurisdiction, Judge Sinclair initially considered and dismissed a number of the disputant's arguments contending that the Authority has no power to make orders. Judge Sinclair then concluded that the disputant, as an un-discharged bankrupt, had no standing to bring the challenge.

Effect of s 76 of the Insolvency Act 2006

Judge Sinclair agreed with the Commissioner that a tax challenge is not a proceeding to recover a debt that would be halted by s 76 of the Insolvency Act 2006 ("IA 2006") and noted a similar view taken in Case H85 (1985) 8 NZTC 592 at 596. For that reason s 76 of the IA 2006 was not relevant to this case.

Contingent debt prior to adjudication

Judge Sinclair referred to *Allen v Commissioner of Inland Revenue* (2004) 21 NZTC 18,718 (CA) at [58] regarding assessments remaining valid until set aside by a court of competent jurisdiction, which is supported by the clear policy that underpins s 109 of the Tax Administration Act 1994 ("TAA").

Her Honour agreed with the Commissioner that the TAA contemplates a tax debt being an actual debt despite a challenge to the underlying assessment being on foot.

Position on bankruptcy

Judge Sinclair considered that there was no merit in the disputant's argument that a further contingency arose on bankruptcy. The disputant argued that as the Commissioner's proof of debt had not been accepted or rejected by the Official Assignee (as no funds were available for distribution), no debt survived the adjudication of bankruptcy.

Disputant's standing to bring these proceedings

Judge Sinclair looked at the status of the bankrupt's property following adjudication and citing s 101 of the IA 2006 where it is defined as meaning "property of every kind, whether tangible or intangible, real or personal, corporeal or incorporeal, and includes rights, interests, and claims of every kind relation to property however they arise".

Her Honour stated she was satisfied that the right of the disputant to issue challenge proceedings passed to the Official Assignee on the disputant's bankruptcy pursuant to s 101(1) of the IA 2006.

Judge Sinclair held that it was apparent that the Official Assignee did not assign or otherwise consent to the disputant issuing challenge proceedings. Furthermore, Her Honour held that the right to issue these challenge proceedings vested in the Official Assignee and the disputant has no standing to bring these proceedings.

Section 61 of the GSTA and s HD 15 of the ITA

In the event that the Authority was wrong on the standing issue, Judge Sinclair went on to consider the application of s 61 of the GSTA. Her Honour held that the requirements of s 61 of the GSTA were met and that the Commissioner was correct in treating the disputant as an agent of the Companies and in assessing him as jointly and severally liable for the Companies' respective GST liabilities.

Was an "arrangement" entered into?

Judge Sinclair considered both the definition of "arrangement" in s YA1 of the ITA and the meaning of "arrangement" considered in *Ben Nevis Forestry Ventures Limited v Commissioner of Inland Revenue* ([2009] 2 NZLR 289, 331 at [105]).

The disputant contended in the present case that there was no relevant arrangement because the payments:

1. discharged debts owing to PQR which existed prior to any alleged arrangement being entered into;
2. were the result of a unilateral decision by the disputant to prefer the debts rather than to pay the funds to the disputant.

Payment of pre-existing debts

Her Honour agreed with the Commissioner that while the Companies had pre-existing debts, which they owed to Property Limited, they did not have pre-existing debts owing to PQR. Those debts arose only after the debts had been assigned to PQR as part of the Arrangement.

Unilateral decision

Judge Sinclair considered *Peterson v Commissioner of Inland Revenue* [2012] 1 NZLR 450 (CA) at [43] and [50] where the Privy Council had considered whether an arrangement requires a consensus or meeting of the minds between the parties involved. The Judge noted that the Court of Appeal in *Russell v Commissioner of Inland Revenue* [2012] NZCA 128, (2012) 25 NZTC 201,120 had held that there was still an arrangement where one taxpayer acted unilaterally in circumstances where he controlled all of the entities and was the architect of the overall plan [101].

Her Honour held the disputant is the director and consequently controlling mind of all the relevant companies involved in the various transactions making up the arrangement. Her Honour also held that the transactions were closely connected; they all occurred over a relatively short period and formed part of an overall plan. She went on to find that the disputant also played an active role in the implementation of various transactions.

Judge Sinclair found that for the purposes of s 61 of the GSTA, an arrangement was entered into involving each of the Companies and consisting of transactions collectively referred to as the "arrangement".

Was it an effect of the arrangement that each company cannot meet a tax liability?

Judge Sinclair adopted the approach in *Auckland Harbour Board v Commissioner of Inland Revenue* (1999) 19 NZTC 15,433 at 15,451 where Richardson P had stated that the word "effect" had its standard meaning of "the end accomplished or achieved", and that the word "effect" should be similarly interpreted in s 61 of the GSTA.

Her Honour stated that the sale of the properties converted the Companies' assets from one form to another. The net sale proceeds were then stripped from the Companies under the arrangement. After the transactions that made up the arrangement had been completed, the Companies were unable to satisfy their GST liabilities. Judge Sinclair agreed with the Commissioner's submission that this was the effect of the arrangement.

Is it reasonable to conclude that a purpose of the arrangement is that a company cannot meet a tax liability?

Her Honour noted that s HD 15(1)(c)(1) of the ITA uses the indefinite article "a purpose of the arrangement" and that accordingly, if any purpose of the arrangement was to have the effect of depleting the assets of the company, that purpose is sufficient.

Judge Sinclair noted that the principles relevant to determining the purpose of an arrangement have not been considered by any Court in respect of s 61 of the GSTA and applied the approach of the Supreme Court in *Glenharrow Holdings Limited v Commissioner of Inland Revenue* [2008] NZSC 116, [2009] 2 NZLR 359 when dealing with an arrangement in the avoidance context.

Her Honour stated that viewed objectively it is reasonable to conclude that a purpose of the arrangement in this case was the effect that the Companies cannot meet their respective GST liability.

Is it reasonable to conclude that if the disputant made reasonable enquiries he could have anticipated at the time that the GST liability would or would likely be required to be met?

Judge Sinclair held that it is reasonable to conclude if the disputant as director of the Companies at the time of the arrangement had made reasonable enquiries he would have anticipated that the GST liabilities arising would, or would likely, be required to be met.

COURT OF APPEAL UPHOLDS STRIKE-OUT OF REMAINING TRINITY TAX CHALLENGES

Case	Muir and Ors v Commissioner of Inland Revenue
Decision date	8 December 2015
Act(s)	Income Tax Act 1994, Tax Administration Act 1994
Keywords	Issue estoppel, tax avoidance, Trinity, mutuality of interest, privity

Summary

The Court of Appeal dismissed an appeal by the Trinity investors against the decision of the High Court striking out their tax challenges. The Court of Appeal considered that issue estoppel prevented the appellants from challenging the tax years already decided by the Supreme Court. In respect of other years, the appellant was unable to recreate or sever off facts or components of the Trinity scheme to suit his new purpose and the investors faced the absolute bar of a finding that the Trinity Scheme was tax avoidance. In awarding the Commissioner of Inland Revenue ("the Commissioner") indemnity costs, the Court considered the appeal was a collateral attack on the Supreme Court's decision and brought for an improper purpose.

Impact

The preliminary view of the impact of the judgment is as follows:

1. If there is a sufficient mutuality of interest between (as here) a stayed case and a test case, then the final determination of the test case will bind the stayed case.
2. The sequence of analysing if the deduction is technically available and then considering whether the general tax-avoidance provision applies, may not need to apply where the features of the arrangement which make it tax avoidance under one provision must inevitably also apply if the scheme, steps or elements are used to seek a deduction under another provision.

Facts

This is an appeal by Garry Muir and Peter Maude against the decision of the High Court to strike out their Trinity scheme challenges and appeals.

Messrs Muir and Maude appealed the strike-out decision on two related grounds. Firstly, that they were not privies to the Supreme Court *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115 ("*Ben*

Nevis") judgment for the 1997 and 1998 years and, secondly or alternatively, that they could claim deductions from 1999 onwards under subpart EH of the Income Tax Act 1994 ("ITA"). Mr Maude adopted Mr Muir's arguments and the Court of Appeal judgment refers to Mr Muir alone, effectively as representing the interests of both appellants.

The Commissioner had successfully applied in the High Court to strike out the appellants' proceedings on a number of grounds, arguing that they could not argue they were entitled to the deductions originally claimed under subpart EG and now claimed under subpart EH. *Ben Nevis* had determined the appropriate legal analysis of the Trinity scheme in terms of subpart EG.

Decision

1997/1998 tax years

The first ground of appeal challenged the High Court's conclusion that an issue estoppel arose because the appellants were privies to *Ben Nevis* and two later Supreme Court judgments (*Commissioner of Inland Revenue v Redcliffe Forestry Venture Ltd* [2012] NZSC 94, [2013] 1 NZLR 804 ("*Redcliffe*"); and *Bradbury v Commissioner of Inland Revenue* [2014] NZSC 174, (2014) 26 NZTC 21-112 ("*Bradbury*")) as they had sufficient mutuality of interest with the parties to the various proceedings.

The Court rejected Mr Muir's submission that issue estoppel can only arise if the parties, the facts and the issue in both proceedings are identical.

Firstly, there is no dispute that where a New Zealand Court having competent jurisdiction over the parties to and subject matter of the litigation has pronounced a final judicial decision, any party or its privy is estopped from disputing the decision on its merits in subsequent litigation.

Privity in this context does not require a complete identity or coincidence of legal interests between parties. The law allows for a more flexible standard, consistent with a Court's power to determine whether issuing a fresh proceeding would produce an unfair or unjust result. The prerequisite is proof of a derivative interest such that a mutuality of interest exists. The question is whether the appellants had the same kind of interest as Redcliffe in *Ben Nevis* or its subject matter.

In looking at the question of interest it was noted that Mr Muir owned 80% of Redcliffe's shares and Mr Maude owned 10%. Mr Muir also acknowledged that the losses associated with Redcliffe's investment were transferred to its shareholders including the appellants. Redcliffe, as their loss attributing qualifying company ("LAQC"), was party to the *Ben Nevis* appeal. Redcliffe had no interest independent of its shareholders in perusing the *Ben Nevis* litigation. The Court concluded that the mutuality of interest between Redcliffe and the appellants as its shareholders could not be more compelling.

The Court of Appeal noted that from reviews of the scheme in the numerous judgments, it is a safe inference that Mr Muir encouraged investors by projecting the extent of deductions their participation could generate under subpart EG. The Court considered it would be disingenuous for such a designer to distance himself from the corporate conduit he used to participate in the scheme, for the purposes of attempting to run at a later date a different construction of the arrangements once he appreciated that the Courts were satisfied the scheme was implemented for the purpose of avoiding liability to tax.

The Court also dismissed Mr Muir's arguments that Redcliffe could not have claimed a deduction under subpart EH in its 1997 and 1998 returns noting numerous attempts to re-analyse *Ben Nevis* in terms of subpart EH have already been litigated and dismissed.

The Court was satisfied that *Ben Nevis* created an issue estoppel against Messrs Muir and Maude and it was also an abuse of process to attempt to re-litigate issues which could have been determined in a previous proceeding. These proceedings were no more than another collateral attack on *Ben Nevis*, continuing what has become an extended pattern or course of conduct. The first ground of appeal must fail.

1999 onwards

Mr Muir's second ground of appeal was that for the taxation years from 1999 onwards, he and Mr Maude could arguably pursue subpart EH deductions on a different factual foundation from the deductions in 1997 and 1998.

Mr Muir alleged the existence of a financial arrangement in terms of the accrual rules under subpart EH and what he called "the statutory facts" under which subpart EH deductions may be claimed, which he says are very different facts from *Ben Nevis*.

The Court found that Mr Muir's argument fell at two related hurdles. Firstly, the transactions considered in *Ben Nevis* were identical to those upon which Mr Muir seeks to rely. The Court considered what Mr Muir calls different facts are no more than arguments based on the same facts, designed to support a different result from *Ben Nevis* for taxation purposes.

Secondly, the syndicate's liability to pay a licence premium to Trinity was the foundation for claiming the existence of a deferred property agreement, and thus a financial arrangement under subpart EH. However, based on the findings in *Ben Nevis*, a Court would necessarily conclude that the agreement to pay the licence premium was an essential step in a tax avoidance arrangement.

The Supreme Court in *Ben Nevis* found that the 50-year timing mismatch between investors incurring the liability to pay the licence premium and the date of due payment could only be justified for tax avoidance purposes.

In some cases where the Commissioner resorts to the general anti-avoidance provision to disallow deductions claimed under one taxing provision, her analysis might not be transposable to assert a tax avoidance purpose if the taxpayer sought to claim a deduction under different provisions. As a matter of sequence, the Commissioner must first accept the deduction claimed is technically available to the taxpayer and resort to the anti-avoidance provision where the use of the specific provisions were not within Parliament's purpose and contemplation.

Mr Muir's argument was that the Commissioner could not use the defence that the scheme amounted to tax avoidance until she had also analysed the taxpayer's entitlement to claim the deduction under subpart EH.

While there may be cases where the sequence must be followed, the Court was satisfied that the features of the Trinity scheme which make it a tax avoidance arrangement when deductions are claimed under subpart EG, must inevitably also apply if the scheme or steps in or elements of it were used to seek a different deduction under subpart EH. Mr Muir's argument depended upon adopting the same contractual instrument—the agreement to pay the licence premium—which the Supreme Court found lacked commercial force and was part of an illusory arrangement with tax avoidance as its purpose or effect.

Mr Muir is unable to recreate or sever off facts or components of the Trinity scheme to suit his new purpose. He would always face the absolute bar of a finding that the agreement to pay a licence premium had no commercial purpose and could only be justified as part of a wider scheme to avoid tax.

The Court concluded it would be an abuse of the Court's processes to allow Mr Muir to continue his claim, it would commit judicial resources for no purpose and bring the administration of justice into disrepute. It would also be unfair to require the Commissioner to expend further costs in defending a position on taxation liability which has been unequivocally and authoritatively answered in the Commissioner's favour.

The Court of Appeal considered the appeal was hopeless from the outset. Further, it was a collateral attack on the Supreme Court's decision and brought for an improper purpose. Accordingly, an award of indemnity costs to the Commissioner was justified.

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