

EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

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QUESTIONS WE'VE BEEN ASKED

Can a payment that compensates for the time value of money be taxable income if it is outside the statutory definition of “interest”?

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Publication number QB XX/XX

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

Key provisions

Income Tax Act 2007 – ss CA 1(2), CC 4(1) and YA 1

REPLACES: [QB 09/03](#) *Decisions on application of CA 1(2) – common law interest and income under ordinary concepts*

Question

Can a payment that compensates for the time value of money be taxable income if it is outside the statutory definition of “interest”?

Answer

Yes. If a payment to compensate for the time value of money (which may be described as common law interest) is outside the scope of the statutory definition of “interest” in the Act, the payment may still be income under a provision other than s CC 4(1) (which taxes interest). For example, such a payment may be taxed as income under ordinary concepts (under s CA 1(2)), if it has the necessary characteristics of income, or it may be taxed as income under another provision.

This means that a common law interest payment may be taxable income, even if it is outside the scope of the statutory definition of “interest”.

Key term

Common law interest is used in this item to describe an amount paid to a person to compensate that person for the time value of money owed to them, where the payment is outside the scope of the statutory definition of interest.

Explanation

1. In 2009, the Commissioner issued a Question We’ve Been Asked titled [QB 09/03](#) *Decisions on application of CA 1(2) – common law interest and income under ordinary concepts*. QB 09/03 sets out the Commissioner’s view on the decision in *CIR v Buis and Anor* (2005) 22 NZTC 19,278 (HC) and what it means for the potential taxability of common law interest under s CA 1(2). In QB 09/03, the Commissioner did not agree with the judgment to the extent it suggested that s CA 1(2) could not apply to common law interest payments that did not fall within the specific provision taxing interest (s CC 4(1)). On review, the Commissioner now considers that the judgment in *CIR v Buis* can be read consistently with the Commissioner’s view on how s CA 1(2) applies. The Commissioner’s interpretation of the law has not changed; all that has changed is her view on whether *CIR v Buis* is consistent with that interpretation. This item does not concern the correctness of the conclusion reached in *CIR v Buis* that the particular payments at issue in that case were not income.

2. This item clarifies the Commissioner's view, which is summarised below:
 - The relevant enquiry under s CA 1(2) is whether an amount has the character of income, and this is consistent with the decision in *CIR v Buis*.
 - The outcome in *CIR v Buis* is confined to its particular facts.
 - *CIR v Buis* does not stand for a broader proposition that common law interest cannot be income under ordinary concepts or income under another provision.
 - The decision in *CIR v Buis* is not inconsistent with the role of s CA 1(2) as a supplement to the specific income provisions of the Income Tax Act.

Background

CIR v Buis

3. *CIR v Buis* concerned whether payments made to two claimants under s 72 of the Accident Rehabilitation and Compensation Insurance Act 1992 (now the Accident Compensation Act 2001) were assessable income. The payments were described in s 72 as "interest", but were not within the statutory definition of "interest" in s OB 1 of the Income Tax Act 1994 (now s YA 1) as they were not payments for money lent.
4. The Commissioner argued in *CIR v Buis* that the payments were interest under the common law definition of that concept. On that basis, the Commissioner argued that the payments were income under ordinary concepts for the purpose of s CD 5 of the Income Tax Act 1994 (now s CA 1(2)).
5. France J determined that the Accident Compensation Corporation (ACC) payments in question were not income under ordinary concepts. At paragraphs [45] to [49], France J stated the following in relation to the Commissioner's argument:

[45] **The Commissioner's proposition is that the payment is interest at common law and therefore caught by s CD 5. In my view this gives s CD 5 too broad a scope in that it gives it an application that is in conflict with other parts of the** [Income Tax Act 1994].

[46] **One can hardly imagine a more encompassing provision than s CE 1** [which captured interest payments as gross income under the Income Tax Act 1994, now section CC 4(1)]. It is not a case of the Act, despite its comprehensibility, not addressing a particular situation. **Section CE 1 starkly captures all interest payments as gross income.** On its face the Commissioner should not need s CD 5, but the "problem" lies

with the definition of "interest". It fixes interest by reference to the concept of money lent, and it is common ground that makes it inapplicable to the s 72 payment.

[47] The important aspects of the s OB 1 definition, however, are the opening words:

Interest, **in relation to the deriving of gross income**, means ...

[48] **In my view s CD 5 must be read subject to this since it deals with gross income. The Act defines what interest is for gross income purposes, and that must apply to both ss CD 5 and CE 1.** The contrary argument is that there are two definitions of interest – the statutory one, and the common law one, and both continue by virtue of s CD 5. I prefer the view that the s OB 1 definition, expressed as it is as capturing the concept of interest for gross income purposes, applies to both ss CD 5 and CE 1. Such an approach accords with ordinary statutory interpretation principles concerning general and specific provisions. It also accords with s AA 3(1) which places weight on the reading of the statute in context.

[49] I accordingly conclude that, **since the Commissioner relies on s CD 5 applying on the basis that the payment is interest, the argument fails because s OB 1 defines interest exhaustively** for the purpose of determining if a payment is gross income. **It is appropriate, however, to address the underlying proposition of the Commissioner that s CD 5 applies.**

[Emphasis added]

6. France J then went on to consider whether the ACC payments were income under ordinary concepts on any other basis, and concluded that they were not.

QB 09/03

7. QB 09/03 stated the following regarding the reasoning in *CIR v Buis*:

In *Buis* and *Burston* France J held that section CD 5 of the Income Tax Act 1994 (now section CA 1(2)) could not apply to tax common law interest payments, because interest could be taxed only under the provision dealing with interest so defined (section CE 1 of the Income Tax Act 1994 (now section CC 4(1))). **In his Honour's view, common law interest payments were not taxable because they did not come within the definition of "interest" in section OB 1 of the Income Tax Act 1994** (now section YA 1).

[Emphasis added]

8. QB 09/03 stated that the Commissioner does not accept the correctness of that aspect of the decision as a generally applicable principle, and intends to have the matter considered further by the courts when an opportunity arises in the future.

9. This statement was made because the Commissioner was, and remains, of the view that amounts that might be described as interest at common law can be taxable as income under ordinary concepts (under s CA 1(2)), or under other provisions, if those amounts have the necessary characteristics to be income under the relevant provision. This means an amount that might be described as common law interest is not excluded from taxable income purely because it is outside the statutory definition of interest.

Commissioner's view after reconsideration

CIR v Buis

10. The Commissioner has reviewed QB 09/03 and reconsidered the judgment in *CIR v Buis*. The Commissioner now considers that the decision in *CIR v Buis* does not preclude time value of money payments from being income under a provision other than s CC 4(1).
11. At paragraph [49], France J states that the statutory definition of interest in s OB 1 of the Income Tax Act 1994 "defines interest exhaustively" for the purpose of determining whether a payment is taxable. The Commissioner's view is that those comments were specifically responding to arguments the Commissioner raised in the context of the case. In other words, France J was not suggesting that all payments that could be described as common law interest were precluded from taxation. Instead, he was disagreeing with the specific argument raised in the case that the ACC payments were taxable **on the basis** that they were described as "interest".
12. This interpretation is supported by France J's comment at paragraph [49] that it was appropriate to address the underlying proposition that the payments in that case were income under ordinary concepts, and by the following consideration of this in the judgment. In determining whether the payments were income under ordinary concepts, France J considered the various characteristics of income and the nature of the payments in question — that is the relevant enquiry under what is now s CA 1(2). France J concluded that the payments did not have the required characteristics of income. Instead, he stated there were indications that the payments were a penalty Parliament had adopted to encourage the efficient disposal of ACC claims.
13. On reflection, for these reasons the Commissioner no longer considers *CIR v Buis* stands for a broader proposition that common law interest cannot be income under ordinary concepts or income under another provision. The Commissioner considers that *CIR v Buis* is consistent with her view that the relevant enquiry under s CA 1(2) is whether an amount has the character of income. The outcome, in terms of the

taxability of the payments at issue in *CIR v Buis*, is confined to the particular facts of that case and the nature of the specific ACC payments being considered.

14. The Commissioner considers that France J's comments about the exhaustive nature of the definition of "interest" are not inconsistent with the role of s CA 1(2) as a supplement to the specific income provisions of the Income Tax Act. As noted above, those comments were made in the context of the Commissioner's argument that the ACC payments were taxable on the basis of being interest.
15. The Commissioner therefore takes the view that this comment was not intended as a wider statement about the interaction between s CA 1(2) and specific income provisions. As France J went on to address whether the payments were income under ordinary concepts on any other basis, this indicates he was treating s CA 1(2) as supplementary to the specific provision for taxing interest.
16. The interaction of s CA 1(2) and specific income provisions in the context of *CIR v Buis* was briefly raised in [QB 09/01](#) *Payments made in addition to financial redress under Treaty of Waitangi settlements – income tax treatment*. To the extent that any comments in QB 09/01 may be inconsistent with the view in this item regarding these provisions, QB 09/01 is superseded by this QWBA.

Tax treatment of common law interest payments

17. If a payment is made to compensate for the time value of money, or may otherwise be described as "interest", but is outside the statutory definition, whether it is taxable needs to be considered on a case-by-case basis. The answer will usually depend on a number of factors, including what the payment is for, and its nature in the hands of the recipient.
18. In *CIR v Buis*, the payments were determined to be in the nature of a penalty, despite s 72 of the Accident Rehabilitation and Compensation Insurance Act 1992 referring to them as "interest". On the other hand, if a payment of "interest" were made in relation to mistakenly underpaid salary or wages, this would likely be taxable as employment income. Similarly, an "interest" payment to compensate for late payment under a compensation clause in a contract would likely be income under ordinary concepts, if not income under another provision (for example, business income under s CB 1).
19. Inland Revenue has other publications that give guidance on the characteristics of income in particular contexts. For example, [QB 17/05](#) *Income tax – whether YouTube receipts are taxable* contains some guidance from paragraph [11] on the meaning of income under ordinary concepts. See also Interpretation Statement [IS 16/04](#) *Income*

tax – treatment of the receipt of lump sum settlement payments for guidance on determining whether a payment is revenue in nature.

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In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

References

Legislative References

Income Tax Act 2007 – s CA 1(2), CC 4(1) and YA 1

Case References

CIR v Buis and Anor (2005) 22 NZTC 19,278 (HC)

Other References

[QB 09/01](#) *Payments made in addition to financial redress under Treaty of Waitangi settlements – income tax treatment*

[QB 17/05](#) *Income tax – whether YouTube receipts are taxable*

[IS 16/04](#) *Income tax – treatment of the receipt of lump sum settlement payments*

About this document

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