

**EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY**

Deadline for comment: **24/12/2020**

Please quote reference: **PUB00321**

Send feedback to [Public.Consultation@ird.govt.nz](mailto:Public.Consultation@ird.govt.nz)

Note for submitters: This draft Interpretation Statement follows on from [IS 19/02](#) *Income Tax – Attribution rule for income from personal services*. IS 19/02 explains in detail when the attribution rule will apply. We have been asked to provide further guidance on the rules – specifically how to calculate the amount of income that needs to be attributed to the working person. This draft Interpretation Statement sets out the Commissioner’s view on how the calculation rules operate, and covers specific issues that have been raised with us since IS 19/02 was published.

**INTERPRETATION STATEMENT**

# **Income tax – Calculating income from personal services to be attributed to the working person**

Issued: Issue date

**Publication #**

This Interpretation Statement provides guidance on how to calculate the amount of income from personal services that is attributed to the working person under the attribution rule in the Income Tax Act 2007.

The attribution rule may apply if an entity earns income from supplying services that are personally performed by an associated person (the working person). The rule is aimed at ensuring the appropriate amount of income is recognised as being the working person’s income – so taxpayers in this situation can’t use associated entities to achieve a tax advantage.

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

**RELATED ITEM**

- [IS 19/02](#) *Income Tax – Attribution rule for income from personal services*

## Table of Contents

Summary .....	2
Introduction.....	5
Overview of when the attribution rules apply.....	6
Calculating the income to be attributed to the working person.....	7
The general rule.....	7
Things specifically taken into account and not taken into account in the income attribution calculations.....	8
Paragraph (a) – the general income attribution calculation.....	10
Paragraph (b) – where the entity has a separate loss-making activity.....	15
Paragraph (c) – where the entity has carried forward losses from supplying personal services .....	20
How to divide the attribution income where there is more than one working person	21
The extent to which the look-through status of LTCs and partnerships is ignored.....	24
Treatment of dividends .....	26
Post-year dividends.....	28
In-year dividends .....	29
When FTCs can be claimed.....	31
Other implications of the income attribution rule .....	33
Child support, student loans, and Working for Families .....	33
Reduction of beneficiary income if the attribution rule would result in the trust having a tax loss.....	34
Interaction between the attribution rule and the excessive remuneration rules.....	34
Appendix I – Legislation .....	35
References.....	43
Legislative references.....	44
Other references.....	44

About this document.....44

## Summary

1. This Interpretation Statement provides guidance on how to calculate the amount of income from personal services that is attributed to the working person under the attribution rule in ss GB 27 to GB 29. The key points discussed in the Interpretation Statement are summarised as follows:
  - The attribution rule may apply if an entity earns income from supplying services that are personally performed by an associated person (the working person). The attribution rule is aimed at ensuring the appropriate amount of income is recognised as being the working person's income. This prevents taxpayers from using associated entities to avoid the highest personal income tax rate on income from the supply of services that they personally perform. Income attributed under the rule is also taken into account for child support, student loan and Working for Families purposes.
  - The general rule is that the amount of the entity's income that has to be attributed to the working person is **the lowest of the following three amounts** (set out in paragraphs (a) to (c) of s GB 29(1)):
    - (a) The entity's net income for the tax year, calculated as if its only income were derived from personal services

*[This will be the relevant paragraph unless either (b) or (c) apply];*
    - (b) The entity's net income for the corresponding tax year

*[This paragraph will be relevant if the entity has another business or activity that was loss-making in the tax year]; or*
    - (c) The entity's net income for the tax year less any losses carried forward from an earlier year from supplying personal services.
  - The rules for calculating net income under **paragraph (a)** are as follows:
    - If the only income the entity derives is from supplying the services that are performed by the working person, the net income amount is simply the entity's net income for the year.
    - However, if the entity carries on another income-earning activity as well, the net income calculation excludes costs that solely relate to the non-personal services income.
  - The rules for calculating net income under **paragraph (b)** are as follows:

- The net income amount is simply the entity's net income for the tax year. All allowable deductions that are allocated to the income year come into the entity's net income.
- Not all loss-making activities will be taken into account in the calculation. This is because not all loss-making activities affect net income. There are deduction allocation rules that apply in some situations to limit the deductions that are allocated to an income year if a particular activity is loss-making. Examples of this are the residential property ring-fencing rules, the bright-line expenditure quarantine rules, and the mixed-use asset expenditure quarantine rules.
- In addition, tax losses carried forward from an earlier income year are not taken into account under paragraph (b). Only current year loss-making activities will come into the calculation. This is because available tax losses from earlier years do not reduce net income; rather, they are deducted from net income in calculating the person's taxable income. If the entity has losses carried forward from an earlier year, these can potentially be taken into account under paragraph (c).
- The rules for calculating net income under **paragraph (c)** are as follows:
  - The net income amount is the entity's net income for the tax year (as discussed for paragraph (b)) **less** any carried forward losses the entity has *if the loss is from a business or trading activity of supplying personal services*.
- In addition to the general calculation rules in paragraphs (a), (b) and (c), referred to above, there are various things that are specifically either taken into account or not taken into account in the income attribution calculations. The things **not taken into account** are:
  - the deduction the entity can claim for the amount of income attributed to the working person;
  - distributions of beneficiary income, if the entity is a trust; and
  - look-through status, if the entity is a look-through company (LTC) or a partnership.

*Note: the tax transparency of LTCs and partnerships is only overridden for the purposes of calculating the attribution income. LTCs and partnerships are still transparent for other tax purposes.*

The things **taken into account** are:

- the salary the entity paid to the working person, and the taxable value of any fringe benefits the entity provided the person;
- distributions from the entity to the working person; and

- the market value of any unpaid administrative services provided by another person to the entity, if the entity is a partnership.
- If the personal services are performed by more than one person associated with the entity, the amount to be attributed needs to be split between the working persons. This needs to be done based on the respective value of the services performed by each working person. There are no specific rules for how to work out the respective value of the services. The most appropriate method will depend on the particular circumstances. The Commissioner will accept any reasonable basis.
- Where the entity is a company, it will at some stage pay a dividend to distribute the cash that has been attributed as income to the working person. If certain requirements are met, the company can choose the following tax treatment for these dividends (which ensures the attributable income is not subject to double taxation):
  - If the dividend is paid during the income year in which the attributable income was derived, or within six months of the end of that year, the dividend is taxable in the hands of the shareholder, but deductible to the company when calculating its net income for the purposes of the attribution rule.
  - If the dividend is paid later than six months after the end of the income year in which the attributable income was derived, the dividend is tax free in the hands of the shareholder, provided it is paid from income that has previously been attributed to the working person.
- The attribution rule may apply in relation to income from services performed overseas. In that situation, the working person may be able to claim a foreign tax credit (FTC) for tax paid by the associated entity on foreign sourced income that is attributed to the working person. If they can, the entity cannot claim an FTC for that amount. The requirements for the working person being able to claim the FTC instead of the entity are that:
  - the entity is tax resident in New Zealand;
  - the entity derived assessable income sourced outside New Zealand;
  - the amount of foreign sourced income is attributed to the working person; and
  - the working person was tax resident in New Zealand when the entity derived the attributed amount.
- There is a specific rule that applies where the entity is a trustee of a trust, and the amount attributable would cause the entity to have a tax loss for the year. In this

situation, beneficiary income from the trust for the year must be reduced. There are specific rules on how this is to be done.

- The attribution rule works alongside the excess remuneration rules in ss GB 23 to GB 25B. If the remuneration subject to the excess remuneration rules is paid by a company, the way the two sets of rules work together is that the excess amount is taxed twice – both as a dividend in the hands of the person who was paid the excess remuneration, and as income to the person it is attributed to under the attribution rule. This is aimed at ensuring the correct levels of remuneration are paid and that taxpayers cannot structure their affairs in this way to split income and avoid higher personal tax rates (and gain the other advantages that may flow from splitting the income).

## Introduction

2. This Interpretation Statement provides guidance on how to calculate the amount of income from personal services that is attributed to the working person under the attribution rule in ss GB 27 to GB 29.
3. The attribution rule may apply if an entity earns income from supplying services that are personally performed by an associated person (the working person). The attribution rule ensures that taxpayers cannot benefit from diverting income from personal services to an associated entity such as a company, trust, partnership or LTC. The rule prevents taxpayers from using such entities to avoid the highest personal income tax rate. It also prevents taxpayers from inappropriately reducing their child support or student loan repayment obligations, or reducing the income that is taken into account in determining Working for Families entitlements.
4. [IS 19/02](#) *Income tax – attribution rule for income from personal services* explains in detail **when** the attribution rule will apply. There is a brief summary of when the rule will apply at [6].
5. This Interpretation Statement will be relevant if you have established that the attribution rule does apply. This Interpretation Statement:
  - provides guidance on **how** the attribution rule applies – that is, how to calculate the amount of income to be attributed to the working person in different circumstances; and
  - answers common questions about the implications of the attribution rule applying.

## Overview of when the attribution rules apply

6. [IS 19/02](#) explains in detail when the attribution rule will apply. But in summary, the rule will apply where:

- a person (the working person) provides personal services;
- the working person is associated with an entity (the associated entity);
- the associated entity is inserted between the working person and the party who acquires the services (the buyer);
- the working person performs the services, but the associated entity derives the income;
- the following threshold tests (discussed in detail in IS 19/02) are satisfied:
  - 80% or more of the associated entity's income from personal services during the income year is derived from the supply of services to the buyer, an associate of the buyer, or a combination of them;
  - 80% or more of the associated entity's income from personal services during the income year is derived from services that are performed by the working person, a relative of the working person, or a combination of them;
  - the working person's net income for the income year exceeds \$70,000, including any amounts that would be attributed if the rule applied;
  - substantial business assets are **not** a necessary part of the business structure used to derive the entity's income from personal services; and
- none of the exemptions in s GB 27(3) apply.

The exemptions in s GB 27(3) are discussed in detail in IS 19/02, but in short, they cover the following situations:

- the associated entity and the working person are non-residents;
- the associated entity is a natural person, and is neither a partner of a partnership nor a trustee of a trust;
- the services performed by the working person are essential support for a product supplied by the associated entity;
- the amount to be attributed to the working person is less than \$5,000 (though there are exclusions to this); and
- various situations where the associated entity is a controlled foreign company.

# Calculating the income to be attributed to the working person

## The general rule

7. Once it is established that the attribution rule applies, it is necessary to calculate the amount of the entity's income that has to be attributed to the working person.
8. The general rule for this calculation is set out in s GB 29(1), which provides that the working person is treated as deriving **the lowest of three amounts** – described in paragraphs (a), (b) and (c):

### GB 29 Attribution rule: calculation

#### *Amount attributed*

- (1) A working person is treated as deriving income in an income year equal to the least of the following amounts:
  - (a) the associated entity's net income for the corresponding tax year, calculated as if their only income were derived from personal services:
  - (b) the associated entity's net income for the corresponding tax year:
  - (c) if and to the extent to which the associated entity is a company or a trust that has a loss balance to be carried forward under section IA 4 (Using loss balances carried forward to tax year) arising from a business or a trading activity of supplying personal services, the associated entity's net income for the corresponding tax year after subtracting the loss balance carried forward from an earlier corresponding tax year.

## Which paragraph applies

9. It is not necessary to calculate each of the three amounts set out in s GB 29(1). Paragraphs (a), (b) and (c) cover different situations. Paragraph (a) (see from [22]) will be the relevant paragraph **unless**:
  - the entity has another business or activity that was loss-making in the particular tax year – in which case paragraph (b) will be relevant (see from [34]);

**OR**

  - the entity has carried forward losses from a business or activity of supplying personal services – in which case paragraph (c) will be relevant (see from [42]).



## What this Interpretation Statement covers

10. The discussion in this Interpretation Statement is set out as follows:
- It explains the things that are taken into account or not taken into account in the income attribution calculations regardless of which of paragraphs (a), (b) or (c) is relevant (see from [11]).
  - Following that, there is more detailed discussion on:
    - Each of the calculation paragraphs:
      - Paragraph (a) – the general paragraph for calculating the attribution income, which is relevant *except in* (b) or (c) situations (see from [22]);
      - Paragraph (b) – which is relevant if the entity has another business or activity that was loss-making in the particular tax year (see from [34]); and
      - Paragraph (c) – which is relevant if the entity has carried forward losses from a business or activity of supplying personal services (see from [42]).
    - How to divide the attribution income where there is more than one working person (see from [51]).
    - How ignoring the look-through status of LTCs and partnerships works (see from [58]).
    - The treatment of dividends, if the entity is a company (see from [63]).
    - When FTCs can be claimed (see from [71]).
    - Other implications of income attribution (see from [77]).

## Things specifically taken into account and not taken into account in the income attribution calculations

11. Section GB 29 sets out various things that are specifically either taken into account or not taken into account in the income attribution calculations.
12. The things **not taken into account** are:
- the deduction the entity can claim for the amount of income attributed to the working person (see [14]);
  - distributions of beneficiary income, if the entity is a trust (see [15]); and
  - look-through status, if the entity is an LTC or a partnership (see from [16]).

13. The things **taken into account** are:
- the salary the entity paid to the working person, and the taxable value of any fringe benefits the entity provided the person (see [18]);
  - distributions from the entity to the working person (see [19]); and
  - the market value of any unpaid administrative services provided by another person to the entity, if the entity is a partnership (see from [20]).

### **The entity's deduction for attributed income**

14. When the attribution rule applies, the entity is allowed a deduction for the amount of income attributed to the working person (s DC 8). That deduction is ignored in calculating the entity's net income for the purposes of the attribution rule (s GB 29(1B)). This rule is necessary to ensure there is no circularity in the legislation or lack of clarity about what is included in the net income calculation.

### **Distributions of beneficiary income, if the entity is a trust**

15. If the entity is a trustee of a trust, distributions of beneficiary income out of the particular tax year's income are generally ignored in calculating the entity's net income for the purposes of the attribution rule (s GB 29(2)). However, beneficiary income derived by the working person is taken into account (see [19]).

### **Look-through status, if the entity is an LTC or a partnership**

16. If the entity is an LTC or a partnership, the provisions that provide for the transparency (or look-through status) of those entities do not apply in calculating the entity's net income for the purposes of the attribution rule (s GB 29(2)(b) and (c)). This means that in doing the attribution calculation, the LTC or partnership is treated as a taxpayer. The activities, property, arrangements, entitlements etc of the LTC or partnership are not treated as flowing through to the shareholders or partners, as they usually are.
17. There are some examples in the discussion from [58] showing how this ignoring of the look-through status of LTCs and partnerships works in practice.

### **The working person's salary and fringe benefits**

18. The entity may pay the working person a salary, or provide them with benefits that are subject to the fringe benefit tax rules. In calculating the entity's net income for the purposes of the attribution rule, these are taken into account (s GB 29(3)). Specifically:

- any employment income the entity paid to the working person during the income year; and
- the taxable value of any fringe benefit that the entity provided or granted to the working person during the income year.

See Example 2 on page 13.

## Distributions from the entity to the working person

19. If the entity has made distributions to the working person, those are also taken into account in calculating the entity's net income for the purposes of the attribution rule (s GB 29(4)). The entity's net income under the attribution rule is reduced by:
- **if the entity is a trustee of a trust:** the amount of any beneficiary income the working person derived from the trust in the income year;
  - **if the entity is a partnership:** the share of profits allocated to the working person by the partnership; and
  - **if the entity is a company:** the amount of any dividend the entity paid to the working person during the income year or within six months of the end of the year, provided it was paid from income derived in the income year. There is further discussion of the treatment of dividends from [63].

## Market value of unpaid administrative services

20. If there are administrative services provided to the entity that have not been paid for, these may be taken into account under attribution rule. This will be the case where:
- the entity is a partnership;
  - another person (not the working person) has provided the partnership with administrative services that relate to the partnership's income from personal services; and
  - the partnership has not paid for the administrative services.
21. In this situation, the amount to be attributed to the working person is reduced by the market value of the administrative services provided by the other person (s GB 29(5)). See Example 3 on page 14.

## Paragraph (a) – the general income attribution calculation

22. As noted above, the amount of the entity's income that has to be attributed to the working person is the **lowest of the three amounts** described in paragraphs (a), (b)

and (c) of s GB 29(1) – subject to some potential adjustments, as discussed in this Interpretation Statement.

23. As mentioned at [9], paragraph (a) will be the relevant paragraph **unless**:
- the entity has another business or activity that was loss-making in the particular tax year – in which case paragraph (b) will be relevant (see from [34]); or
  - the entity has carried forward losses from a business or activity of supplying personal services – in which case paragraph (c) will be relevant (see from [42]).
24. If neither of those circumstances are the case and paragraph (a) applies, the amount to be attributed is:
- (a) **the associated entity's net income for the corresponding tax year, calculated as if their only income were derived from personal services:**
- [Emphasis added]
25. However, bear in mind that the amount to be attributed to the working person may be reduced further in two situations:
- if the entity is a partnership, and another person provides administrative services to the partnership but these have not been paid for (if this is relevant, see from [20]); or
  - if there is more than one working person – in which case the attribution income needs to be divided between the working persons (if this is relevant, see from [51]).
26. So, the starting point for paragraph (a) is determining the amount that would be the entity's net income, calculating the net income as if the entity's only income were derived from personal services.
27. If the only income the entity derives is from supplying the services that are performed by the working person, the net income under paragraph (a) is simply the entity's net income for the year.
28. However, if the entity carries on another income-earning activity as well, there may be some costs in each of the following categories:
- costs that relate only to earning the personal services income;
  - costs that relate only to earning the other (non-personal services) income; and
  - costs that relate to earning both the personal services income and the other income.

29. Costs that relate only to earning the personal services income are therefore clearly included in the paragraph (a) net income calculation, and costs that relate only to earning the other (non-personal services) income are clearly not included.
30. However, there are two approaches that could be taken for costs that relate to earning both the personal services income and the other income (ie, the entity's overhead costs). One approach would be to apportion these "mixed expenses" between the personal services income earning activity and the other income earning activity, and then work out what part of the entity's net income relates to the personal services activity. The other approach would be to include in the net income calculation any costs that would have been incurred irrespective of the non-personal services income earning activity.
31. The Commissioner's view is that paragraph (a) takes the second approach. Paragraph (a) does not contain words to indicate that apportionment is required, like "to the extent that", which other provisions in the Act do. What paragraph (a) requires is a hypothetical consideration of what the entity's net income would be had it earned only the personal services income. As such, there is no need to apportion "mixed expenses"; they are included in the net income calculation if they would have been incurred irrespective of the non-personal services income earning activity (eg, the cost of renting premises used for both activities).
32. The Commissioner does not consider that this requires consideration of whether the entity would have incurred the same overheads if the only income earning activity was the supply of the personal services. The hypothetical net income calculation just excludes costs that solely relate to the non-personal services income. It does not require a hypothetical consideration of what overhead costs the entity would have incurred if it derived only the personal services income (eg, if it would have leased a smaller office space).
33. There may be situations where an expense, or a component of an expense, can be identified as relating solely to one income earning activity or another. In that situation, that expense or component would not be a mixed expense. An example of this are some motor vehicle costs, where the vehicle is used for both income earning activities. There are some fixed costs in relation to the vehicle – eg, registration, warrants of fitness, and insurance. Those costs would be included in the net income calculation under paragraph (a), as they would be incurred irrespective of the non-personal services income earning activity. However, there are also some costs in relation to the vehicle that are attributable to usage – eg, petrol, and usage related repairs such as tire replacement. Those costs should be apportioned between the different business uses of the vehicle (based on mileage), with only the portion that relates to the personal services income taken into account in the paragraph (a) net income calculation.

### Example 1 – Two income earning activities – treatment of overheads

The attribution rule applies to Company A, which supplies services performed by Jane (the working person). Company A also carries on another income earning activity. Under paragraph (a), Company A's net income would be calculated as follows:

#### Company A – income

Income from the supply of personal services	\$150,000
Income from the other activity	\$120,000

#### Company A – expenses

Expenses solely related to the personal services income	\$5,000
Expenses solely related to the other activity	\$3,000
Office overheads	\$20,000

#### Net income for the attribution rules, under paragraph (a)

Income from the supply of personal services	\$150,000
---	-----------

*Less:*

Expenses solely related to the personal services income	\$5,000
Office overheads	\$20,000

*Equals:*

Net income under (a), to be attributed to Jane	<b>\$125,000</b>
--	------------------

### Example 2 – Two income earning activities – salary paid to working person

This example is based on Example 1, but Jane is paid a salary of \$80,000.

#### Company A – income

Income from the supply of personal services	\$150,000
Income from the other activity	\$120,000

#### Company A – expenses

Expenses solely related to the personal services income	\$5,000
Expenses solely related to the other activity	\$3,000
Office overheads	\$20,000
General salary paid to Jane	\$80,000

#### Net income for the attribution rules, under paragraph (a)

Income from the supply of personal services	\$150,000
---	-----------

*Less:*

Expenses solely related to the personal services income	\$5,000
Office overheads	\$20,000
Salary paid to Jane	\$80,000

*Equals:*

Net income under (a), to be attributed to Jane	<b>\$45,000</b>
--	-----------------

The salary paid to Jane is taken into account in the calculations whether it relates solely to her performing the personal services or not. Employment income the entity pays to the working person is one of the specific things s GB 29 says is to be taken into account in calculating the entity's net income for the purposes of the attribution rule (s GB 29(3)) – see [18].

**Example 3 – Two income earning activities – salary paid to working person and unpaid administrative services**

This example is based on Example 1, but:

- the entity is a partnership;
- Jane is paid a salary of \$80,000; and
- Jane's partner Nick provides administrative services for the partnership but is not paid for those services.

The market value of the administrative services Nick provides in relation to the personal services income the partnership derives (from the work Jane does) is \$15,000.

**Partnership income**

Income from the supply of personal services	\$150,000
Income from the other activity	\$120,000

**Partnership expenses**

Expenses solely related to the personal services income	\$5,000
Expenses solely related to the other activity	\$3,000
Office overheads	\$20,000
General salary paid to Jane	\$80,000

**Net income for the attribution rules, under paragraph (a)**

Income from the supply of personal services	\$150,000
---	-----------

*Less:*

Expenses solely related to the personal services income	\$5,000
Office overheads	\$20,000

Salary paid to Jane	\$80,000
Market value of the unpaid administrative services Nick provides in relation to the personal services income	\$15,000

*Equals:*

Net income under (a), to be attributed to Jane	<b>\$30,000</b>
--	-----------------

The market value of the administrative services Nick provides the partnership in relation to the personal services income is taken into account in the calculations because Nick has not been paid for those services. Unpaid administrative services provided to a partnership are one of the specific things s GB 29 says are to be taken into account in calculating the entity's net income for the purposes of the attribution rule, if certain requirements are met (s GB 29(5)) – see [20].

## Paragraph (b) – where the entity has a separate loss-making activity

34. As mentioned at [9], paragraph (b) is the relevant paragraph for calculating the income to be attributed to the working person in situations where the entity has:
- income from supplying personal services; and
  - another business or activity that was loss-making in the tax year.
35. Where paragraph (b) applies, the amount to be attributed is:
- (b) **the associated entity's net income for the corresponding tax year:**
- [Emphasis added]
36. However, again, bear in mind that the amount to be attributed to the working person may be reduced further in two situations:
- if the entity is a partnership, and another person provides administrative services to the partnership but these have not been paid for (if this is relevant, see from [20]); or
  - if there is more than one working person – in which case the attribution income needs to be divided between the working persons (if this is relevant, see from [51]).
37. The net income calculation under paragraph (b) does not just take into account expenses that the entity would have incurred if its only income earning activity was the supply of personal services, as the calculation under paragraph (a) does. The net income under paragraph (b) is simply the entity's net income for the tax year. All



allowable deductions that are allocated to an income year come into a person's net income – this is discussed further from [39].

38. The effect of paragraph (b) is to reduce the income to be attributed to the working person in most situations where the entity carries on another activity that is loss-making in the year. The rationale for allowing the loss-making activity to be taken into account is that in many cases the loss would be able to be accessed and used by the working person anyway (ie, through the LTC or partnership rules).

#### Example 4 – Personal services income and loss-making share-trading activity

The attribution rule applies to Company B, which is an LTC. Company B supplies services performed by Jeremy (the working person), and also trades shares. The share trading activity is loss-making this tax year. Under paragraph (b), Company B's net income would be calculated as follows:

##### Company B – income

Income from the supply of personal services	\$150,000
Income from the sale of shares	\$80,000

##### Company B – expenses

Expenses solely related to the personal services income	\$10,000
Deductions in relation to the share trading activity	\$100,000

##### Net income for the attribution rules, under paragraph (b)

Total income	\$230,000
(\$150,000 income from the supply of personal services + \$80,000 income from the sale of shares)	

##### Minus:

Total deductions	\$110,000
(\$10,000 in relation to the personal services income + \$100,000 in relation to the share trading activity)	

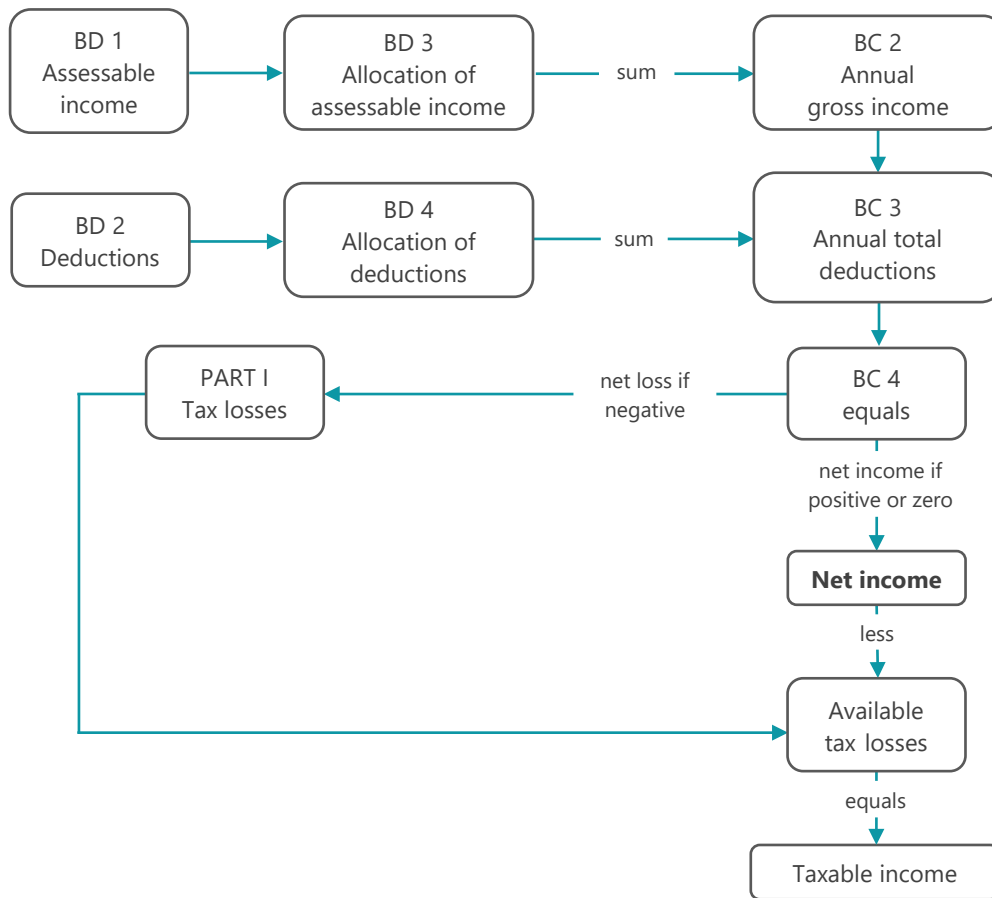
##### Equals:

Net income under (b), to be attributed to Jeremy	<b>\$120,000</b>
--	------------------

Under the paragraph (a) calculation – in which the entity's net income is calculated as if the entity's only income were from personal services – the attribution income would be \$140,000 (\$150,000 less \$10,000). However, paragraph (b) is relevant here because Company B has a share trading loss. The effect of paragraph (b) is to allow the share trading loss (\$20,000) to reduce the income attributable to Jeremy.

39. It is important to note that not all loss-making activities will be taken into account in the paragraph (b) calculation. This is because not all loss-making activities will affect a person's (in this case the entity's) net income. There are deduction allocation rules that apply in some situations to limit the deductions that are allocated to an income year if a particular activity is loss-making. Examples of this are the ring-fencing rules for residential rental property deductions (in Subpart EL), the bright-line expenditure quarantine rules (in s EL 20), and the mixed-use asset expenditure quarantine rules (in ss DG 15 to DG 19).
40. In addition, tax losses carried forward from an earlier income year are not taken into account in the paragraph (b) calculation. Only current year loss-making activities come into the calculation. This is because available tax losses from earlier years do not reduce a person's net income; rather, they are deducted from net income in calculating the person's taxable income. If the entity has losses carried forward from an earlier year, these can potentially be taken into account in calculating the income to be attributed to the working person – but *only if the loss is from a business or trading activity of supplying personal services*. This situation is covered by paragraph (c), which is discussed from [42].
41. "Net income" – which is what paragraph (b) is concerned with – is calculated by deducting **annual total deductions** from **annual gross income**, as shown in the diagram below:

Figure 1 - Calculating net income under the core provisions



### Example 5 – Personal services income and loss-making residential rental property

The attribution rule applies to Company C, which is an LTC. Company C supplies services performed by Kirsten (the working person), and owns a residential rental property. The rental property is loss-making this tax year, and is subject to the ring-fencing rules in Subpart EL. Under paragraph (b), Company C's net income would be calculated as follows:

#### Company C income

Income from the supply of personal services	\$200,000
Income from the rental property	\$40,000

#### Company C expenses

Expenses solely related to the personal services income	\$15,000
Expenses in relation to the rental property	\$50,000

#### Net income for the attribution rules, under paragraph (b)

Total income	\$240,000
(\$200,000 income from the supply of personal services + \$40,000 income from the rental property)	

#### Minus:

Total deductions allocated to the income year	\$55,000
(\$15,000 in relation to the personal services income + \$40,000 in relation to the rental activity (s EL 4))	

#### Equals:

Net income under (b), to be attributed to Kirsten	<b>\$185,000</b>
---	------------------

In this situation, the result under paragraph (b) is the same as it would be under paragraph (a). This is because the rental property deductions are only allocated to the income year up to the amount of rental income for the year (s EL 4). To the extent the property deductions exceed the rental income (\$10,000), they are suspended as a deduction for the income year and carried forward to the next year that Company C derives income from residential property. Because the excess rental property deductions are *not allocated to the income year*, they do not come into Company C's **net income** for the year. The fact that the rental property is loss-making therefore does not reduce the income attributable to Kirsten.

## Paragraph (c) – where the entity has carried forward losses from supplying personal services

42. As mentioned at [9], paragraph (c) is the relevant paragraph for calculating the income to be attributed to the working person in situations where the entity has carried forward losses from a business or activity of supplying personal services.
43. Where paragraph (c) applies, the amount to be attributed is:
- (c) if and to the extent to which the associated entity is a company or a trust that has a loss balance to be carried forward under section IA 4 (Using loss balances carried forward to tax year) arising from a business or a trading activity of supplying personal services, **the associated entity's net income for the corresponding tax year after subtracting the loss balance carried forward from an earlier corresponding tax year.**
- [Emphasis added]
44. However, again, bear in mind that the amount to be attributed to the working person may be reduced further in two situations:
- if the entity is a partnership, and another person provides administrative services to the partnership but these have not been paid for (if this is relevant, see from [20]); or
  - if there is more than one working person – in which case the attribution income needs to be divided between the working persons (if this is relevant, see from [51]).
45. The attribution income calculation under paragraph (c) takes into account the entity's net income for the year (this is discussed from [34] – it is the amount that would be attributed under paragraph (b)) but **in addition** allows for the subtraction of carried forward personal services losses.
46. This means that the paragraph (c) calculation will include both:
- current year loss-making activities, whether from the personal services activity or not (provided these come into the entity's net income for the year – see from [39]); and
  - carried forward prior year losses, provided they are from a business or activity of providing personal services.
47. For carried forward losses to be subtracted from the entity's net income under paragraph (c), the entity must:
- be a company or a trust; and

- have a loss balance carried forward under s IA 4 that arises from a business or trading activity of supplying personal services.
48. This means that the entity cannot subtract carried forward losses it has from *some other* business activity, not involving the supply of personal services. It is only carried forward losses that relate to supplying personal services that are taken into account under paragraph (c).
49. It is generally unlikely that there would be losses generated from a business of supplying personal services. But this could be the case, for example where the entity is going through a start-up process and the business of supplying personal services is not profitable early on. In that situation, the losses arising from the personal services business can offset the income in subsequent years, reducing the amount attributable to the working person.
50. However, it is noted that the carried forward losses that are taken into account under paragraph (c) are not limited to losses from a business of providing personal services that the entity itself has carried on. While it would not be common, if the entity is a company that has a tax loss made available to it (under s IC 5) by another company in the same group, provided it is a loss arising from a business or activity of providing personal services, that loss can be subtracted in the paragraph (c) calculation.

## How to divide the attribution income where there is more than one working person

51. If the personal services are performed by more than one person associated with the entity, the amount to be attributed needs to be split between the working persons. The requirement for this is set out in s GB 29(7), which says:

*Attribution to more than 1 working person*

- (7) If the amount attributable is to be attributed to more than 1 working person, **the share attributed to each working person must reflect the respective value of the services personally performed by each working person.**

[Emphasis added]

52. There are no statutory rules for determining the respective value of the services each working person performs. The most appropriate method of determining the respective value of the services performed by each working person will depend on the particular circumstances.
53. If the working persons perform the same type of services, to the same standard, the relative working hours might provide an appropriate method of determining the value

each provides. However, there could be situations where the working persons provide the same type of services, but the respective value of what each of them provides is different. For example, the working persons may be in the same profession and providing professional services through the entity, but one may have substantially more experience and expertise than the other. In this case, it would be appropriate to take into account both the hours worked and the relative value of the work done by each person. It may be that there are different charge-out rates for the work done by each person – if so this may be an appropriate basis for determining the respective value of the services each person performs, providing the charge-out rates accurately reflect the value of the work each does.

54. Similarly, if the working persons perform different types of services, the relative value of the different services performed will need to be determined. Again, respective charge-out rates and hours worked may be an appropriate way to determine the respective value of the services each person performs.
55. Another method might be to look at the market rates charged for the type of work each person performs, and apply those rates to the hours worked. This might be the most appropriate method where the services are provided on a fixed-fee basis.
56. The Commissioner will accept any reasonable basis for determining the respective value of services provided by the working persons. The methods above are just examples of possible approaches – the particular circumstances may indicate a different method is more appropriate.
57. Once the respective values of the services provided by each working person have been ascertained, the amount of the entity's income to be attributed (calculated under paragraph (a), (b) or (c), as explained in this Interpretation Statement) should be split between the working persons in proportion to the relative value each provides.

#### **Example 6 – Attribution of income to more than one working person**

The attribution rule applies to Company D, which supplies engineering services performed by Michael and draughting services performed by Michael's partner Katie. The company does not carry on any other income earning activity and does not have any carried forward losses. Paragraph (a) is therefore the relevant paragraph for calculating the amount to be attributed under the attribution rule. Because the only income the company derives is from supplying the engineering services, the net income under paragraph (a) is simply the company's net income for the year. This is calculated as follows:

#### **Company D – income**

Income from the supply of services	\$350,000
------------------------------------	-----------

**Company D – expenses**

Office overheads	\$5,000
Transport	\$3,000
Salary paid to Michael	\$70,000
Salary paid to Katie	\$30,000

**Net income for the attribution rules, under paragraph (a)**

Income from the supply of services	\$350,000
------------------------------------	-----------

*Less:*

Office overheads	\$5,000
Transport	\$3,000
Salary paid to Michael	\$70,000
Salary paid to Katie	\$30,000

Net income under (a), to be attributed to the working persons	<b>\$242,000</b>
--	------------------

Because Michael and Katie are both working persons, the amount attributable (\$242,000) needs to be split between them. This split has to reflect the respective value of the services they each perform.

Clients are charged either an agreed set fee or an hourly rate. The hourly rate charged is a flat rate – there are not different rates for different aspects of the work performed. Company D therefore determines the respective value of the services Michael and Katie perform based on the standard market rates for the type of work each does.

The standard market rate for engineering services like those Michael provides is \$200 per hour, and the standard market rate for draughting services like those Katie provides is \$100 per hour.

During the year, Michael worked 1,600 hours and Katie worked 720 hours. Based on these hours of work and the market rates for the work performed, Company D calculates the respective value of the services Michael and Katie worked as follows:

<b>Michael:</b>	1,600 hours × \$200 = \$320,000
<b>Katie:</b>	720 hours × \$100 = \$72,000

Based on the respective value of the work performed by each of Michael and Katie, the amount of Company D's income to be attributed should be split between them in the following proportions:



$$\text{Michael: } \frac{320,000}{392,000} \times 100 = 81.63\%$$

$$\text{Katie: } \frac{72,000}{392,000} \times 100 = 18.37\%$$

As a result, \$197,544.60 of Company D's income is attributed to Michael (81.63% of \$242,000), and \$44,455.40 is attributed to Katie (18.37% of \$242,000).

## The extent to which the look-through status of LTCs and partnerships is ignored

58. As noted at [11], s GB 29 sets out various things that are specifically either taken into account or not taken into account in the income attribution calculations. One of the things **not taken into account**, if the entity is an LTC or a partnership, is the look-through status the entity would otherwise have for tax purposes.
59. Under the LTC rules (in Subpart HB) and the partnership rules (ss HG 2 to HG 12), LTCs and partnerships are treated as transparent for tax purposes. The income, deductions, losses etc are passed through to the holders of look-through interests in the company or partners in the partnership, in proportion to their effective look-through interest or partnership share. In addition, the holders of look-through interests or partners are treated as carrying on any activity carried on by the entity; having the status, intention or purpose the entity has; holding property the entity holds; being party to the entity's arrangements; and doing or being entitled to anything the entity does or is entitled to. Essentially, these rules put the shareholders or partners in the shoes of the LTC or partnership for tax purposes.
60. The reason the attribution rule overrides these tax transparency provisions is that otherwise the income flowing to the working person (shareholder or partner) would be based on their shareholding or partnership interest, not on the amount of income that is rightly attributable based on the work they have performed. In particular, the aims of the attribution rule could be thwarted where there are more shareholders or partners than working persons, or where there is disparity between the value of the personal services provided by the working person and the income that would flow to them under the LTC or partnership rules based on their shareholding or partnership interest relative to that of others.
61. Example 7 shows how the tax treatment under the attribution rule differs to what the position would be under the LTC rules or partnership rules.

### Example 7 – Treatment under the attribution rule compared with under the LTC rules

The attribution rule applies to Company E, an LTC that supplies services performed by Kamal (the working person). Kamal and Priti hold equal effective look-through interests in Company E.

Table 1 shows the income that would flow through to Kamal and Priti ordinarily under the LTC rules, and what instead happens under the attribution rule.

Table 1 - Difference of treatment between LTC rules and attribution rule

	Under the LTC rules (no attribution) (\$000)	Under the attribution rule (\$000)
<b>Income from personal services</b>	150	150
<b>Deductions</b>	50	50
<b>Pre-allocation income</b>	100	100
<b>Income to Kamal</b> (50% shareholder / working person)	<b>50</b>	<b>100</b>
<b>Income to Priti</b> (50% shareholder / non-working person)	<b>50</b>	<b>0</b>

62. It is important to note that the tax transparency of LTCs and partnerships is only overridden for the purposes of calculating the entity's net income under s GB 29(1) (the general attribution calculations). LTCs and partnerships are still transparent for other tax purposes. The following example (Example 8) demonstrates this.

### Example 8 – LTC transparency overridden only in applying the attribution rule; not for all tax purposes

This example assumes the same facts as in Example 7, but in addition Company E derives income from the sale of land that was acquired with the intention of resale (s CB 6).

Table 2 shows the income that would flow through to Kamal and Priti under the attribution rule and the LTC rules – the LTC’s tax transparency only being overridden in relation to the attribution calculation, not the land sale income and deduction.

*Table 2 – Interaction of attribution rule and LTC rules where there is attributable income as well as income not subject to the attribution rule*

	(\$000)
<b>Income from personal services</b>	150
<b>Deductions relating to personal services</b>	50
<b>Pre-allocation personal services income</b>	100
<b>Income from land sale</b>	1400
<b>Deduction relating to land sale</b>	1000
<b>Income to Kamal</b> (50% shareholder / working person)	<b>800</b>
	(100 attributed in respect of personal services provided + 700 from the land sale)
<b>Deduction to Kamal</b>	<b>500</b>
<b>Income to Priti</b> (50% shareholder / non-working person)	<b>700</b>
<b>Deduction to Priti</b>	<b>500</b>

## Treatment of dividends

63. Where the entity is a company, it will at some stage distribute the cash that has been attributed as income to the working person. There are specific rules the company may be able to choose to apply in this situation, to ensure the attributable income is not subject to double taxation – once in the hands of the working person (when it is

attributed to them) and again in the hands of the shareholder (when a dividend is paid to them).

64. These rules are set out in s GB 27(4), which provides:

*Treatment of certain dividends*

(4) If a company that is required to attribute an amount to the working person under this section and section GB 29 pays a dividend, sections HA 14 to HA 19 (which relate to qualifying companies) are treated as applying to the company and the dividend if—

(a) the dividend is paid—

- (i) no earlier than the end of 6 months after the end of the income year referred to in subsection (1); and
- (ii) from income that has been attributed to the working person under this section and section GB 29; and

(b) the company,—

- (i) for each tax year that corresponds to an income year in which it derived income from which it pays the dividend, has no net income other than income attributed under this section and section GB 29, ignoring interest income that is incidental to the company's business; and
- (ii) is not a qualifying company; and
- (iii) chooses to have the dividend treated as if it were paid by a qualifying company; and
- (iv) keeps sufficient records to enable the Commissioner to verify the matters referred to in paragraph (a).

65. Under these rules, the treatment of dividends paid by the company differs depending on whether the dividend is paid:

- during the income year in which the attributable income was derived and is to be attributed, or within six months of the end of that year (referred to in this Interpretation Statement as an **"in-year dividend"**); or
- later than six months after the end of the income year in which the attributable income was derived and is to be attributed (referred to in this Interpretation Statement as a **"post-year dividend"**).

66. Effectively, a “post-year dividend” is tax free in the hands of the shareholder, provided it is paid from income that has previously been attributed to the working person.
67. In contrast an “in-year dividend” is taxable in the hands of the shareholder, but deductible to the company when calculating its net income for the purposes of the attribution rule (s GB 29(4)).
68. For these rules to apply, the company has to:
  - have had no net income other than income that is attributed under the attribution rules for each year in which it derived income that the dividend is paid from (interest income that is incidental to the company’s business is ignored);
  - not be a qualifying company;
  - choose this treatment; and
  - keep sufficient records for the Commissioner to be able to confirm that the requirements have been met.

## Post-year dividends

69. The following example (Example 9) shows the tax treatment of a “post-year dividend”, which is paid from income attributed to the working person in an earlier year.

**Note:** *There are two special rules for calculating imputation credits/debits that apply to companies subject to the attribution rule. These are set out in ss OB 16 and OB 40. In Examples 9 and 10 below, the imputation credit and debit amounts have been calculated in accordance with those rules.*

### Example 9 – “Post-year dividend” in year two, distributing year one attribution income

This example shows the tax consequences in year two, when the company pays a dividend to a shareholder (who is also the working person) to distribute the income that was attributed to the working person in year one.

There was no dividend paid in year one. All of the income in year one was taxed in the hands of the working person (either as salary or attribution income) at 33%.

In year two, the company distributes the previously taxed attribution income to the working person, by paying a “post-year dividend” that is sourced from year one attribution income. The working person is also paid a salary and derives attribution income.

The tax consequences for the company and for the shareholder working person are as shown in Table 3.

*Table 3 – Year two “post-year dividend” distributing year one attribution income*

<b>Tax consequences for the company: year two</b>	<b>(\$000)</b>
Pre-attribution income of the company	150
Salary paid to working person (s GB 29(3))	(80)
Net income of the company to be attributed (s GB 29(1)(a))	70
Deduction for amount of attributed income (s DC 8)	(70)
Amount of imputation credit (s OB 16)	27
Amount of imputation debit (s OB 40)	(27)
Balance of imputation credit account	0
<i>Non-deductible “post-year dividend” paid to working person</i>	25
<b>Tax consequences for the working person: year two</b>	
Salary	80
Attribution income (s GB 29 and s CE 8)	70
<i>“Post-year dividend”</i>	25
Imputation credit account credit (s HA 15(4), s OB 40, s OB 16)	0
<i>Less exempt “post-year dividend” (s GB 27(4) and s HA 14(2))</i>	(25)
Taxable income	150
Tax at 33%	(50)
After tax income	100

## In-year dividends

70. The following example (Example 10) shows the tax treatment of an “in-year dividend”, which is paid from the company’s pre-attribution income, during the income year the attributable income was derived or within six months of the end of the year.

### Example 10 – distributing some of the pre-attribution income by way of an “in-year dividend”

This example shows the tax consequences when the company distributes some of its pre-attribution income by way of an “in-year dividend” paid to a shareholder (who is also the working person). As in Example 9, there is also a “post-year dividend” paid, sourced from prior year attribution income that was taxed in the hands of the working person.

The tax consequences for the company and for the shareholder working person are as shown in Table 4.

Table 4 – Distributing some of the pre-attribution income by way of an “in-year dividend”

<b>Tax consequences for the company</b>	<b>(\$000)</b>
Pre-attribution income of the company	150
Salary paid to working person (s GB 29(3))	(80)
<b>Deductible dividend paid to working person (s GB 29(4))</b>	<b>(50)</b>
<i>Non-deductible “post-year dividend” paid to working person</i>	25
Net income of the company to be attributed (s GB 29(1)(a))	20
Deduction for amount of attributed income (s DC 8)	(20)
Amount of post-attribution income	0
Amount of imputation credit (s OB 16)	8
Amount of imputation debit (s OB 40)	(8)
Balance of imputation credit account	0
 <b>Tax consequences for the working person</b>	
Salary	80
Attribution income (s GB 29 and s CE 8)	20
“In-year dividend”	50
“Post-year dividend”	25
<i>Less exempt “post-year dividend” (s GB 27(4) and s HA 14(2))</i>	<i>(25)</i>

Imputation credit account credit (s HA 15(4), s OB 40, s OB 16)	0
Taxable income	150
Tax at 33%	(50)
After tax income	100

## When FTCs can be claimed

71. The attribution rule may apply in relation to income from services performed overseas. This is because the s GB 27(3)(a) exemption from the attribution rule will only apply if the entity and the working person are **both** non-resident in New Zealand at all times during the relevant income year.
72. There are some examples showing when the s GB 27(3)(a) will apply or not apply in [IS 19/02](#) (see from [16] of that Interpretation Statement). However, those examples did not go into whether the working person could claim FTCs in relation to tax paid by the entity.
73. The rules in relation to FTCs in this situation are set out in s LJ 2, which provides (relevantly):

### **LJ 2 Tax credits for foreign income tax**

#### *Amount of credit*

- (1) A person described in section LJ 1(2)(a) has a tax credit for a tax year for an amount of foreign income tax paid on a segment of foreign-sourced income, determined as if the segment were the net income of the person for the tax year. The amount of the New Zealand tax payable is calculated under section LJ 5.

...

#### *When subsections (9) and (10) apply*

- (8) Subsections (9) and (10) apply **when a person (the associated entity) resident in New Zealand** derives an amount (the attributed amount) that—
  - (a) **is assessable income of the associated entity that is sourced from outside New Zealand;** and
  - (b) **is attributed under sections GB 27 to GB 29** (which relate to the attribution rule for income from personal services) in an income year **to another person (the working person) who is resident in New Zealand when the associated entity derives the attributed amount.**



*Tax credit: attributed income from personal services*

- (9) Despite section LJ 1(2)(a), **the working person has a tax credit under this subpart for foreign income tax paid on the attributed amount by the associated entity or withheld in relation to the attributed amount.** The calculation of the maximum amount of the tax credit is made under section LJ 5(2), modified so that the item segment in the formula is the attributed amount for the income year.

*No tax credit for associated entity*

- (10) **The associated entity does not have a tax credit under this subpart for foreign income tax paid on or withheld in relation to the attributed amount.**

[Emphases added]

74. The effect of the above provisions is that:
- the working person can claim an FTC for tax paid by the associated entity on foreign sourced income that is attributed to the working person; and
  - the associated entity cannot claim an FTC for that amount.
75. The requirements for this to be the case are that:
- the associated entity is tax resident in New Zealand;
  - the associated entity derived assessable income sourced outside New Zealand;
  - the amount of foreign sourced income is attributed to the working person; and
  - the working person was tax resident in New Zealand when the entity derived the attributed amount.
76. The following examples (Example 11 and Example 12) show when a working person can claim an FTC in relation to tax paid by the entity. They replicate the facts from Example 3 and Example 4 in [IS 19/02](#), but look only at the FTC issue.

#### **Example 11 – FTCs not claimable; the working person is not tax resident in New Zealand**

John is a non-resident who owns all of the share capital of NZCO, which is a New Zealand incorporated company. John is the working person and NZCO is the associated entity. NZCO provides consulting services to one buyer – an Australian company. The services are provided to the buyer in Australia and the work is done by John in Australia.

The income attribution rule applies. This is discussed in Example 3 in [IS 19/02](#).

In this situation, John cannot claim any FTCs in relation to tax paid by NZCO in Australia. This is because John was not tax resident in New Zealand when the entity derived the attributed amount.

### **Example 12 – FTCs claimable; all requirements met**

Michelle is New Zealand tax resident who is living in France. She owns all of the share capital of NZCO, which is a New Zealand incorporated company. Michelle is the working person and NZCO is the associated entity. NZCO provides consulting services to FranceCo, which is the sole buyer of the services that NZCO provides. Michelle provides the services in France.

The income attribution rule applies. This is discussed in Example 4 in [IS 19/02](#).

In this situation, Michelle can claim FTCs in relation to tax paid by NZCO in France. This is because:

- NZCO is tax resident in New Zealand;
- NZCO derived assessable income sourced outside New Zealand;
- the amount of foreign sourced income is attributed to Michelle under the attribution rule; and
- Michelle was tax resident in New Zealand when NZCO derived the attributed amount.

## **Other implications of the income attribution rule**

### **Child support, student loans, and Working for Families**

77. As noted at [3], the attribution rule ensures that taxpayers cannot benefit from diverting income from personal services to an associated entity, to avoid the highest personal income tax rate on that income. However, in addition to that, as mentioned, the rule also prevents taxpayers from inappropriately reducing their child support or student loan repayment obligations, or reducing the income that is taken into account in determining Working for Families entitlements. Attributed income is added to any other income the working person derives, and feeds into the income amounts taken into account for child support, student loan and Working for Families purposes.

## Reduction of beneficiary income if the attribution rule would result in the trust having a tax loss

78. There is a specific rule that applies where the entity is a trustee of a trust, and the amount attributable would cause the entity to have a tax loss for the year. If that is the case, beneficiary income from the trust for the year must be reduced – with the reduction divided among the beneficiaries (other than the working person). This ensures that a tax loss (which could be used in later years) cannot be generated for the trust by the distribution of amounts representing income attributed under the attribution rule. The rule is set out in s GB 29(6), which provides:

*Reduction of beneficiary income when rule results in trust having tax loss*

- (6) If the associated entity is a trustee and the amount attributable would cause the associated entity to have a tax loss for the corresponding tax year, for the purposes of this Act,—
- (a) beneficiary income from the trust for the income year must be reduced to the extent to which the associated entity's taxable income for the corresponding tax year is zero; and
  - (b) the reduction in beneficiary income must be divided among the beneficiaries other than the working person—
    - (i) according to proportions determined by the trust's trustees:
    - (ii) if the trustees do not make the determination, according to the proportion that each beneficiary's beneficiary income bears to the total beneficiary income from the trust for the income year.
79. This rule is beyond the scope of this Interpretation Statement, but is noted here for completeness.

## Interaction between the attribution rule and the excessive remuneration rules

80. The final point to note is how the attribution rule interacts with the excess remuneration rules in ss GB 23 to GB 25B.
81. The excessive remuneration rules are specific anti-avoidance provisions that the Commissioner can invoke if she considers that:
- excessive remuneration or income has been paid to a relative (s GB 23);
  - a partner's share of partnership profits or losses is excessive (s GB 23);

- excessive remuneration has been paid by a close company to a shareholder or director, or a relative of a shareholder or director (s GB 25); or
  - excessive income is allocated under the LTC rules to a person aged under 20 who owns an effective look-through interest in an LTC, where a relative of the person also owns an effective look-through interest in the LTC (s GB 25B).
82. There are some exemptions to the rules, but generally in any of these situations the Commissioner can reallocate the income or losses based on what she thinks is reasonable.
83. If the remuneration is paid by a company, the excess is treated as a dividend. It cannot be deducted by the company (s DB 58). The effect of this is that the company's net income is increased by the amount of the excess remuneration. This results in a corresponding increase to the amount to be attributed under the attribution rule.
84. The overall effect of the way the excessive remuneration rules and the attribution rule work alongside each other is that the excess amount is taxed:
- firstly, in the hands of the person who received the excessive remuneration, as a dividend; and
  - secondly, as income to the person it is attributed to under the attribution rule (s CE 8).
85. While this result may seem harsh, it is aimed at ensuring the correct levels of remuneration are paid and that taxpayers cannot structure their affairs in this way to split income and avoid higher personal tax rates (and gain the other advantages that may flow from splitting the income).
86. The excessive remuneration rules are discussed in more detail in [QB 14/09 Income Tax – Meaning of “excessive remuneration” and “excessive profits or losses” paid or allocated to relatives, partners, shareholders or directors.](#)

## Appendix I – Legislation

### Income Tax Act 2007

#### BC 2 Annual gross income

A person's **annual gross income** for a tax year is the total of their assessable income that is allocated to the corresponding income year.

#### BC 3 Annual total deduction

A person's **annual total deduction** for a tax year is the total of their deductions that are allocated to the corresponding income year.

#### **BC 4 Net income and net loss**

##### *Income more than deductions*

- (1) If, for a tax year, a person's annual gross income is more than their annual total deduction, the difference is their **net income** for the year.

##### *Income equal to deductions*

- (2) If, for a tax year, a person's annual gross income equals their annual total deduction, their **net income** for the year is zero.

...

#### **BC 5 Taxable income**

A person's **taxable income** for a tax year is determined by subtracting any available tax loss that the person has from their net income under Part I (Treatment of tax losses).

#### **BD 1 Income, exempt income, excluded income, non-residents' foreign-sourced income, and assessable income**

##### *Amounts of income*

- (1) An amount is income of a person if it is their income under a provision in Part C (Income).

...

#### **CE 8 Attributed income from personal services**

##### *When this section applies*

- (1) This section applies when, under sections GB 27 to GB 29 (which relate to the attribution rule), a person is required to attribute an amount to another person.

##### *Income*

- (2) The amount attributed is income of the person to whom it is attributed.

##### *Timing of income*

- (3) The amount is allocated to the income year in which it is attributed.

#### **DC 8 Attribution of personal services**

##### *When this section applies*

- (1) This section applies when, under sections GB 27 to GB 29 (which relate to the attribution rule for income from personal services), an amount of income of a person (the associated entity) is attributed to another person (the working person).

##### *Deduction*

- (2) The associated entity is allowed a deduction for the amount attributed.

*Timing of deduction*

- (3) The deduction is allocated to the income year in which the amount is attributed to the working person.

*Link with subpart DA*

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

**GB 27 Attribution rule for income from personal services***Application of section GB 29*

- (1) An amount of income in an income year of a person (the **associated entity**) is attributed to another person (the **working person**) under section GB 29 for the working person's corresponding tax year if,—
- (a) during the income year, a third person (the buyer) acquires services from the associated entity, and the services are personally performed by the working person; and
  - (b) the working person is associated with the associated entity; and
  - (c) the threshold test in subsection (2) is met; and
  - (d) none of the exemptions in subsection (3) applies.

*Threshold for application of attribution rule*

- (2) The attribution occurs only if—
- (a) 80% or more of the associated entity's total income from personal services during the income year is derived from the supply of services to the buyer, a person associated with the buyer, or a combination of them; and
  - (b) 80% or more of the associated entity's income from personal services during the income year is derived through services personally performed by the working person, a relative of the working person, or a combination of them; and
  - (c) the working person's net income for the income year, assuming section GB 29 applies in relation to the associated entity and working person, is more than \$70,000; and
  - (d) substantial business assets are not a necessary part of the business structure that is used to derive the total income referred to in paragraph (a).

*Exemptions*

- (3) The attribution does not occur—
- (a) if both the associated entity and the working person are non-residents at all times during the associated entity's income year;
  - (b) if the associated entity is a natural person and is neither a partner of a partnership nor a trustee of a trust:

- (c) to the extent to which the services personally performed by the working person are essential support for a product supplied by the associated entity:
- (d) if the total amount to be attributed to the working person, for the associated entity and the income year, is less than \$5,000, unless—
  - (i) the application of this paragraph would prevent income being attributed to the working person for the income year in relation to another associated entity:
  - (ii) the associated entity is a CFC and a person who holds an attributing interest in the CFC files, after the date (the **Royal assent date**) on which the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 receives the Royal assent, a return of income in which the amount of income attributed to the working person is determined under this section:
- (e) if the associated entity is a CFC and—
  - (i) the amount gives rise to attributed CFC income under section CQ 2(2B) (When attributed CFC income arises) or attributed CFC loss under section DN 2(2) (When attributed CFC loss arises) for a person who holds an attributing interest in the CFC; and
  - (ii) the person who holds the attributing interest in the CFC files, after the Royal assent date, a return of income in which the amount attributed to the working person is determined under section EX 20B (Attributable CFC amount).

*Treatment of certain dividends*

- (4) If a company that is required to attribute an amount to the working person under this section and section GB 29 pays a dividend, sections HA 14 to HA 19 (which relate to qualifying companies) are treated as applying to the company and the dividend if—
  - (a) the dividend is paid—
    - (i) no earlier than the end of 6 months after the end of the income year referred to in subsection (1); and
    - (ii) from income that has been attributed to the working person under this section and section GB 29; and
  - (b) the company,—
    - (i) for each tax year that corresponds to an income year in which it derived income from which it pays the dividend, has no net income other than income attributed under this section and section GB 29, ignoring interest income that is incidental to the company's business; and
    - (ii) is not a qualifying company; and

- (iii) chooses to have the dividend treated as if it were paid by a qualifying company; and
- (iv) keeps sufficient records to enable the Commissioner to verify the matters referred to in paragraph (a).

#### *Cancellation of notional imputation credits*

- (5) For the purposes of subsection (4), to the extent to which the dividend paid by the company would have had an imputation credit attached that arose under section OB 16 (ICA attribution for personal services) in the absence of the election made under subsection (4)(b)(iii), the credit is treated as cancelled immediately before it would have been attached under sections HA 14 to HA 19 (which relate to dividends paid by qualifying companies).

### **GB 28 Interpretation of terms used in section GB 27**

#### *When this section applies*

- (1) This section applies for the purposes of section GB 27.

#### *Associated persons*

- (2) A person is treated as being associated with another person if they are associated at the time the services are personally performed by the working person.

#### *Non-associated buyers*

- (3) For the purposes of section GB 27(2)(a), a buyer is not treated as being associated with another buyer if either—
  - (a) both buyers are public authorities; or
  - (b) the working person cannot be reasonably expected to know that a particular buyer is associated with another buyer, other than by making a specific enquiry.

#### *Relatives*

- (4) For the purposes of section GB 27(2)(b), a person is a relative of the working person only if the person is a relative at the beginning of the relevant income year of the working person.

#### *Fringe benefits included*

- (5) For the purposes of section GB 27(2)(c), the working person's annual gross income includes the taxable value of a fringe benefit, as determined under sections RD 25 to RD 63 (which relate to fringe benefit tax), provided or granted by a person associated with the working person.

#### *Meaning of substantial business assets*

- (6) **Substantial business assets** means depreciable property that—
  - (a) at the end of the associated entity's corresponding income year, has a total cost of more than either—



- (i) \$75,000; or
  - (ii) 25% or more of the associated entity's total income from services for the income year; and
- (b) is not for private use.

*Assets subject to finance lease, hire purchase agreement, or specified lease*

- (7) For the purposes of subsection (6)(a), the cost of depreciable property includes—
- (a) the consideration provided to the lessee in the case of property subject to a finance lease or a hire purchase agreement, including expenditure or loss incurred by the lessee in preparing and installing the finance lease asset for use, unless the lessee is allowed a deduction for the expenditure or loss, other than a deduction for an amount of depreciation loss:
  - (b) the cost price, in the case of property subject to a specified lease.

*Private use of assets*

- (8) Subsection (6)(b) does not apply to depreciable property if 20% or less of the property's use is for private use.

*Calculation of private proportion of use*

- (9) For the purposes of subsection (8), the percentage of a property's use for private purposes for an income year is calculated according to—
- (a) the proportion that the number of days for which fringe benefit tax is payable by the associated entity in relation to the property bears to the total number of days in the income year in which the property is owned by or is subject to a finance lease, hire purchase agreement, or specified lease, involving the associated entity, if the property is subject to the FBT rules:
  - (b) the proportion that the expenditure incurred in relation to the property, for which a deduction is denied to the associated entity, bears to all expenditure incurred by the associated entity in relation to the property in the income year, if the property is not subject to the FBT rules.

**GB 29 Attribution rule: calculation**

*Amount attributed*

- (1) A working person is treated as deriving income in an income year equal to the least of the following amounts:
- (a) the associated entity's net income for the corresponding tax year, calculated as if their only income were derived from personal services:
  - (b) the associated entity's net income for the corresponding tax year:
  - (c) if and to the extent to which the associated entity is a company or a trust that has a loss balance to be carried forward under section IA 4 (Using loss balances carried

forward to tax year) arising from a business or a trading activity of supplying personal services, the associated entity's net income for the corresponding tax year after subtracting the loss balance carried forward from an earlier corresponding tax year.

*Associated entity's net income calculated before attribution*

- (1B) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1), section DC 8 (Attribution of personal services) is ignored.

*Calculation for trustee or partnership*

- (2) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1),—
- (a) if the associated entity is a trustee of a trust, the trustees are treated as not having made a distribution of beneficiary income out of the year's income:
  - (b) if the associated entity is a partnership, the associated entity is treated as a taxpayer and section HG 2 (Partnerships are transparent) does not apply:
  - (c) if the associated entity is a look-through company, the associated entity is treated as a taxpayer and section HB 1 (Look-through companies are transparent) does not apply.

*Salary paid or fringe benefits treated as deductions*

- (3) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1),—
- (a) the associated entity is allowed a deduction for employment income paid to the working person during the income year:
  - (b) the associated entity is allowed a deduction for the taxable value of a fringe benefit provided or granted by the associated entity to the working person during the income year, and for the fringe benefit tax payable on the fringe benefit.

*Reduction of attributable income for distributions*

- (4) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1), the amount of net income of the associated entity for the corresponding tax year is reduced by—
- (a) in the case of a trustee of a trust, the amount of beneficiary income derived by the working person from the trust in the income year:
  - (b) in the case of a partnership, the share of profits allocated by the partnership to the working person:
  - (c) in the case of a company, a dividend paid—
    - (i) by the associated entity to the working person during the income year or before the end of 6 months after the end of the income year; and

- (ii) from income derived in the income year.

*Attribution reduced by market value of administrative services*

- (5) If the associated entity is a partnership that receives administrative services from another person related to their income from personal services and has not paid for the administrative services, the amount to be attributed to the working person is reduced by the market value of the administrative services provided by the other person.

*Reduction of beneficiary income when rule results in trust having tax loss*

- (6) If the associated entity is a trustee and the amount attributable would cause the associated entity to have a tax loss for the corresponding tax year, for the purposes of this Act,—
  - (a) beneficiary income from the trust for the income year must be reduced to the extent to which the associated entity's taxable income for the corresponding tax year is zero; and
  - (b) the reduction in beneficiary income must be divided among the beneficiaries other than the working person—
    - (i) according to proportions determined by the trust's trustees:
    - (ii) if the trustees do not make the determination, according to the proportion that each beneficiary's beneficiary income bears to the total beneficiary income from the trust for the income year.

*Attribution to more than 1 working person*

- (7) If the amount attributable is to be attributed to more than 1 working person, the share attributed to each working person must reflect the respective value of the services personally performed by each working person.

**LJ 2 Tax credits for foreign income tax**

*Amount of credit*

- (1) A person described in section LJ 1(2)(a) has a tax credit for a tax year for an amount of foreign income tax paid on a segment of foreign-sourced income, determined as if the segment were the net income of the person for the tax year. The amount of the New Zealand tax payable is calculated under section LJ 5.

...

*When subsections (9) and (10) apply*

- (8) Subsections (9) and (10) apply when a person (the associated entity) resident in New Zealand derives an amount (the attributed amount) that—
  - (a) is assessable income of the associated entity that is sourced from outside New Zealand; and

- (b) is attributed under sections GB 27 to GB 29 (which relate to the attribution rule for income from personal services) in an income year to another person (the working person) who is resident in New Zealand when the associated entity derives the attributed amount.

*Tax credit: attributed income from personal services*

- (9) Despite section LJ 1(2)(a), the working person has a tax credit under this subpart for foreign income tax paid on the attributed amount by the associated entity or withheld in relation to the attributed amount. The calculation of the maximum amount of the tax credit is made under section LJ 5(2), modified so that the item segment in the formula is the attributed amount for the income year.

*No tax credit for associated entity*

- (10) The associated entity does not have a tax credit under this subpart for foreign income tax paid on or withheld in relation to the attributed amount.

*Draft items produced by the Tax Counsel Office represent the preliminary, though considered, views of the Commissioner of Inland Revenue.*

*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

Sections BC 2, BC 3, BC 4, BD 1, BD 2, BD 3, BD 4, CB 6, CE 8, DB 58, DC 8, DG 15 to DG 19, EL 4, EL 20, GB 23, GB 25, GB 25B, GB 27 to GB 29, HA 14(2), HA 15(4), HG 2 to HG 12, IA 4, IC 5, LJ 2, OB 16, and OB 40, Subparts EL and HB, and Part I

### Other references

[QB 14/09](#) *Income Tax – Meaning of “excessive remuneration” and “excessive profits or losses” paid or allocated to relatives, partners, shareholders or directors* (Inland Revenue)

[IS 19/02](#) *Income tax – attribution rule for income from personal services* (Inland Revenue)

## About this document

Interpretation Statements set out the Commissioner’s views and guidance on how New Zealand’s tax laws apply to specific situations. While they set out the Commissioner’s considered views, Interpretation Statements are not binding on the Commissioner. However, they can generally be relied on by taxpayers in determining their tax affairs. See [Status of Commissioner’s advice \(December 2012\)](#).