DETERMINATION > FINANCIAL ARRANGEMENTS > GENERAL

Agreements for Sale and Purchase of Property Denominated in Foreign Currency: Exchange Rate to Determine the Acquisition Price and method for spreading income and expenditure

Issued: 27 September 1996

G29

This Determination may be cited as "Determination G29: Agreements for Sale and Purchase of Property Denominated in Foreign Currency: Exchange Rate to Determine the Acquisition Price and method for spreading income and expenditure".

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

What financial arrangements does this determination apply to?

1. This determination applies to any agreement for the sale and purchase of property (or "ASAP") which is subject to the accrual rules, if the price for the property is denominated in a foreign currency (a "foreign currency ASAP"), and certain other conditions are met. It does not apply to a short term ASAP or a private or domestic ASAP (as those terms are defined in the Act), because these agreements are excepted financial arrangements.

General Principles of taxation of foreign currency ASAPs

2. For all ASAPs (whether or not denominated in a foreign currency) which are subject to the accrual rules, you must calculate a core acquisition price. This is the total of:

    (a) the lowest price that you and the other party would have agreed upon for the property at the time the ASAP was entered into, on the basis of payment in full at the time the first right in the specified property is to be transferred;

    or if there is no such lowest price, the discounted value of the amounts payable for the property, calculated in accordance with Determination G21A;

    and

    (b) any other amounts paid by the seller to the buyer (for purposes of explanation, these can safely be ignored).

3. The difference, if any, between the NZ$ value of the core acquisition price (plus or minus certain non-contingent fees) and the NZ$ value of the amount paid by the buyer to the seller (the price) is income or expenditure, under the accrual rules. This difference may arise for a number of reasons:

    (a) In the case of an ASAP where the price is fixed in NZ$, the reason for this difference will generally be the time value of money. If the buyer pays in advance for the goods, the buyer will often require a discount from the cash price. If the buyer pays on a deferred basis, the seller will often require an additional amount as compensation for the deferral. This can be equivalent to:

    - a loan from the buyer to the seller in the case of a pre-payment, with the discount to the purchase price representing interest payable by the seller; or

- a loan from the seller to the buyer in the case of a deferred settlement, with the additional amount required by the seller representing interest payable by the buyer.

(b) In the case of a foreign currency ASAP, there can be another reason for the difference between the NZ$ value of the core acquisition price and the NZ$ value of the price paid by the buyer to the seller. That is that different exchange rates could be used to convert these amounts into NZ$. The price must be converted into NZ$ using the spot exchange rate on payment date, while the core acquisition price is converted into NZ$ using the forward exchange rate from the contract date to either the date of payment or the date of transfer of the property. If the exchange rates are different, then there will be a difference between the NZ$ value of the core acquisition price and the NZ$ value of the price, even if the amounts are identical when determined in the foreign currency.

4. Regardless of why it arises, this difference will be recognised:

- under section EH 1(5) of the Act, if you are a party to the ASAP at the end of an income year, by way of an allocation of income or expenditure to that income year;
- under the base price adjustment in section EH 4 of the Act, when the ASAP matures or is transferred by you.

5. Section OB 7(1) deals with the calculation of the core acquisition price in the case of a foreign currency ASAP. It provides that the lowest price is the lowest price the parties would have agreed to in the foreign currency, converted into NZ$ using:

- the forward exchange rate, on the contract date, for exchange of the foreign currency into NZ$ on the rights date (this is the date on which first rights in the property pass to the buyer, and will often be the date on which goods are delivered) under the foreign currency ASAP (Rate A); or
- the forward exchange rate, on the contract date, for exchange of the foreign currency into NZ$ on the final payment date under the foreign currency ASAP (Rate B); or
- such other rate as is approved by the Commissioner by determination.

What this determination does

6. This determination approves the adoption of three alternative exchange rates for converting the foreign currency lowest price into NZ$. This is in accordance with paragraph (c) of section OB 7(1) (which clarifies the calculation of the "core acquisition

price" in the case of a foreign currency ASAP) and section 90(1)(k) of the Tax Administration Act 1994. This determination also prescribes the method you must use to calculate income or expenditure from a foreign currency ASAP under section EH 1(5). The method you must use depends on the exchange rate you have used. The rates approved by this determination are:

- **Spot rate on the rights date** (Rate C). The effect of using this rate is that currency fluctuations between the rights date and the payment date will give rise to income or expenditure under the accrual rules. This rate can only be used for ASAPs which are for trading stock (excluding land or shares). If you use this rate you must apply Method C to calculate income or expenditure from the ASAP under section EH 1(5).
- **Spot rate on the contract date** (Rate D). The effect of using this rate is that currency fluctuations between the contract date (the date on which you enter into the ASAP) and the payment date will give rise to income or expenditure under the accrual rules. This rate can only be used for ASAPs which are for trading stock (excluding land or shares). If you use this rate you must apply Method D to calculate income or expenditure from the ASAP under section EH 1(5).
- **Spot rate on payment date** (Rate E). The effect of using this rate is to ensure that foreign currency fluctuations do not give rise to accrual income or expenditure under the foreign currency ASAP. You can only use Rate E if your annual gross income is less than $2,500,000 in the income year you become a party to the ASAP. In calculating that amount, you should exclude income from foreign currency ASAPs not completed at balance date. As an anti-avoidance measure, in calculating the $2,500,000 you must also take into account the annual gross income of associated persons. If you use this rate you must apply Method E to calculate income or expenditure from the ASAP under section EH 1(5).

7. The NZ$ value of the foreign currency lowest price is also the price at which the property is deemed to have been sold or acquired by you for income tax purposes (under section EH 8(2)). If you use Rate E and Method E, you may have to convert the relevant payments into NZ$ using the spot rate at the first balance date following acquisition of the property. This ensures that the price can be established in the year the property is transferred to you.

2 Reference

This determination is made under paragraphs (c) and (k) of section 90(1) of the Tax Administration Act 1994.

3 Scope

General

1. Subject to (3), (4) and (5) below, this determination applies to the calculation of income or expenditure under any foreign currency ASAP with respect to which you either:
   - become a party in your 1996–97 income year or a subsequent income year; or
   - calculate the core acquisition price using section OB 7(1)(a), (b) or (c), under section EZ 10(2).
2. Method A is available to all taxpayers for all foreign currency ASAPs if they use Rate A.
3. Method B is available to all taxpayers who use Rate B, which may only be used if the period between the rights date and the settlement date (date of final payment) is not more than five years.
4. Rates C and D, and Methods C and D

   You may use rates C or D, and Methods C or D only if the property that is the subject of the ASAP is trading stock in relation to you, other than land or shares.
5. Rate E and Method E

   You may apply Rate E and Method E only if the aggregate of your gross income (as defined in the Act) and that of all associated persons, in the income year you became a party to the foreign currency ASAP, does not exceed $2,500,000. For this purpose, gross income should be adjusted by excluding any income from foreign currency ASAPs which are subject to section EH 1 in the income year.
6. Where both this determination and Determination G9A could apply to an ASAP, you should apply this determination, and not Determination G9A to the ASAP. You may however apply G9A to a loan which is part of the ASAP (see paragraph 6(4)).

4 Principle

1. Under the qualified accrual rules a foreign currency ASAP gives rise to income or expenditure equal to the difference between the NZ$ value of the acquisition price of the ASAP and the NZ$ value of the price.

2. The acquisition price is equal to the core acquisition price, less (in the case of the holder) or plus (in the case of the issuer) any non-contingent fees paid by that party that qualify as item z in the definition of acquisition price in section OB 1.

3. The core acquisition price is defined in section OB 1. The main component of the core acquisition price is, broadly, the lowest price the parties would have agreed upon, assuming payment in full at the time of delivery. You should refer to the detailed definition of core acquisition price contained in the Act.

4. In the case of a foreign currency ASAP, the lowest price is denominated in a foreign currency, and must be converted into NZ$. Section OB 7 allows the use of two forward rates, Rates A and B (contained in paragraphs (a) and (b) of section OB 7(1) and described in paragraph 1(5) of this determination), but not all taxpayers will wish to use forward rates. This determination approves the use of the spot rate on certain alternative dates.

5. If you are a party to an ASAP you will have to determine the lowest price, using either one of the statutory rates, or one of the rates prescribed by this determination. You will then have to spread any income or expenditure arising from the ASAP using the method described in this determination which is applicable to the rate you are using.

5 Interpretation

In this determination:

1. a reference to the “Act” is a reference to the Income Tax Act 1994.

2. “ASAP” means an agreement for sale and purchase of property which is subject to the accrual rules;

   “Contract date” means the date on which the foreign currency ASAP was entered into;

   “Foreign currency ASAP” means an ASAP under which the price for the property the subject of the ASAP is denominated in foreign currency;

   “Forward rate” means the rate for a forward contract as defined in paragraph 6(4) of Determination G6D: Foreign Currency Rates;

"Lowest price" is the lowest price referred to in paragraph (c) of the definition of "core acquisition price";

"Payment date" means a date on which any part of the price for the property transferred under an ASAP is paid by the buyer;

"Price" means the foreign currency price agreed to be paid in consideration for the property under an ASAP, including any agreed interest charges;

"Rights date" is the day on which the first right in the specified property subject to an ASAP is to be transferred;

"Settlement date" means the day on which final payment is to be made under the financial arrangement;

"Spot rate" means the rate for a spot contract as defined in paragraph 6(3) Determination G6D: Foreign Currency Rates.

3. all other terms used have the same meaning given to them for the purposes of the qualified accruals rules in the Act.

As an aid to interpretation only, and not as a definitive list, the following are the terms defined in the Act that are of particular note: right in the specified property, trading stock, associated persons, agreement for the sale and purchase of property.

6 Rate and method – general

1. All the methods approved by this determination require you to treat yourself as a party to a foreign currency loan or loans. The nature of the foreign currency loan or loans is set out in paragraphs (2) to (4).

2. To the extent that the price is paid before the rights date, treat yourself as a party to a loan:

   - from the buyer to the seller:
   - of an amount equal to the amount of the price paid before the rights date;
   - advanced on the date the amounts are paid;
   - repaid on the rights date;
   - with a repayment amount equal to the amount of the lowest price, less any amount paid on the rights date, and less the amount attributable to the advance under any loan referred to in (3).

3. To the extent that the price is paid after the rights date, treat yourself as a party to a loan:

    - from the seller to the buyer;
    - of an amount equal to the lowest price, less any amount paid on the rights date, and less any amount attributable to the repayment of any loan referred to in (2);
    - advanced on the rights date;
    - repaid on the payment date or payment dates occurring after the rights date;
    - with a repayment amount equal to the price, less any amount paid on or before the rights date.

4. In many cases you may be able to apply Determination G9A to the loan.

7 Method A – forward rate to rights date

1. If you adopt method A you must use Rate A to calculate the NZ$ value of the lowest price.

2. In a year before the year in which you are required to do a base price adjustment for the foreign currency ASAP, calculate your income or expenditure by applying an available method under the qualified accruals rules as if you were party to a loan or loans as set out above in "Method — General".

   Also take into account, as income or expenditure in any year up to and including the year in which the rights date occurs, the amount

$$a - b$$

   where

   a is the NZ$ value of the lowest price converted using either

   (i) if the rights date is after the end of the year, the forward rate from the last day of the relevant income year to the rights date;

   (ii) in any other case, the spot rate on rights date.

   b is the NZ$ value of the lowest price converted using the forward rate to the rights date from whichever is the later of:

   (i) the last day of the previous income year;

(ii) the contract date.

using a reasonable estimate of the rights date at that time (unless a(ii) applies).

3. If a − b is a negative, this amount will be income if you are the buyer, and expenditure if you are the seller. If a − b is a positive, the amount will be income if you are the seller, and expenditure if you are the buyer.

8 Method B – forward rate to settlement date

1. If you adopt method B, you must use Rate B to calculate the NZ$ value of the lowest price.
2. In a year before the year in which you are required to do a base price adjustment for the foreign currency ASAP, calculate your income or expenditure by applying an available method under the qualified accruals rules to calculate the foreign currency income or expenditure you would have if you were party to a foreign currency loan or loans as set out above in “Method — General”.
3. In calculating this income or expenditure, treat the foreign currency loan or loans as if they were in NZ$. In particular, do not apply Determination G9A to the loan contract. Then convert the foreign currency income or expenditure into NZ$ using the spot rate on the payment date. If there is more than one payment date, use the weighted average of the spot rates. For payment dates occurring after the last day of the year, use the spot rate on that day.
4. Also take into account as income or expenditure in any year up to and including the year in which the settlement date occurs, the amount

$$a - b$$

where

a is the NZ$ value of the lowest price converted using either

(i) if the settlement date is after the end of the year, the forward rate from the last day of the relevant income year to the settlement date;

(ii) in any other case, the spot rate on settlement date.

b is the NZ$ value of the lowest price converted using the forward rate to the settlement date from whichever is the later of:

(i) the last day of the previous income year;

(ii) the contract date.

using a reasonable estimate of the settlement date at that time (unless a(ii) applies).

5. If a − b is a negative, this amount will be income if you are the buyer, and expenditure if you are the seller. If a − b is a positive, the amount will be income if you are the seller, and expenditure if you are the buyer.

9 Rate C and method C – spot rate at rights date

1. If you adopt Method C, you must use rate C to calculate the NZ$ value of the lowest price.
2. In a year before the year in which you are required to do a base price adjustment for the foreign currency ASAP, calculate your income or expenditure by applying an available method under the qualified accruals rules as if you were party to a loan or loans as set out above in "Method — General".
3. Because you are using the spot rate at rights date to convert the foreign currency core acquisition price to NZ$, you will not have any income or expenditure for tax purposes in the period between the contract date and the earlier of the rights date or the first payment date.

10 Rate D and method D – spot rate at contract date

1. If you adopt Method D, you must use Rate D to calculate the NZ$ value of the lowest price.
2. If you adopt Method D, then even if there is no difference between the foreign currency price and the foreign currency lowest price, you will have income/expenditure if there is a change in the spot rate from the contract date to the payment date.
3. In a year before the year in which you are required to do a base price adjustment for the Foreign currency ASAP, calculate your income or expenditure by applying an available method under the qualified accruals rules as if you were party to a loan or loans as set out above in "Method — General".
4. Because you are using the spot rate at contract date to convert the foreign currency core acquisition price to NZ$, you must take into account as income or expenditure, in any year up to and including the year in which the rights date occurs, the amount

$$a - b$$

where:

a is the NZ$ value of the lowest price converted using the spot rate on the earlier of the last day of the relevant income year and the rights date

b is the NZ$ value of the lowest price converted using the spot rate on whichever is the later of the last day of the previous income year and the contract date.

5. If a – b is negative, this will be income if you are the buyer, and expenditure if you are the seller. If a – b is positive, this will be income if you are the seller, and expenditure if you are the buyer.

11 Rate E and method E – spot rate at payment date

1. If you adopt Method E, you must use Rate E to calculate the NZ$ value of the lowest price, subject to (2)(ii) below. If there is more than one payment date, you must use the weighted average of the spot rates on the payment dates.

2. If you need to know the NZ$ price of the property for the purpose of calculating your assessable income for an income year (other than under the qualified accrual rules), and any payments under the foreign currency ASAP are made after the end of the relevant year, you must determine the NZ$ value of the lowest price by converting those payments into NZ$ at either:

   (i) the spot rate on the payment date if the agreement is completed before you are required to file your income tax return for the relevant year, and you elect to use that rate; or

   (ii) the spot rate on the last day of the relevant year.

3. If you choose to use Method E, and if there is no difference between the foreign currency price and the foreign currency lowest price (plus any amount comprised in item x in the core acquisition price definition), you will have no income or expenditure under the qualified accruals rules from the foreign currency ASAP (unless paragraph 2(ii) applies).

4. In a year before the year in which you are required to do a base price adjustment for the foreign currency ASAP, calculate your income or expenditure from the ASAP as the result of

$$a - b - c$$

where:

a is the NZ$ value of the price. Determine this NZ$ value by converting the price into NZ$ using the spot rate on the payment date or payment dates. Convert any payments required to be made after the end of the year:

at the spot rate on the last day of the year; or

if the agreement matures before the date on which you must file your tax return for the year, at the spot rate on the relevant payment date, if you elect to use that rate;

b is the NZ$ value of the lowest price. Determine this NZ$ value by converting the lowest price into NZ$ using the spot rate used to calculate "a", or the weighted average of the spot rates if there is more than one payment date. However, if you have taken the cost of the property into account in calculating your assessable income (other than under the qualified accrual rules) in a previous income year, you must calculate the NZ$ value of the lowest price using the same exchange rate used to calculate the lowest price in that previous income year.

c is the NZ$ value of the unaccrued difference between the price and lowest price, calculated in accordance with paragraph (6).

5. If the result of the calculation in paragraph (4) is positive, that amount will be income if you are the seller of the property and expenditure if you are the buyer. If the result is negative, the amount will be income if you are the buyer of the property and expenditure if you are the seller.

6. "c" in paragraph (4) is calculated as follows:

Apply an available method under the accrual rules to calculate the foreign currency income or expenditure you would have if you were a party to a foreign currency loan or loans as set out above in "Rate and Method — General". In calculating this expenditure, treat the foreign currency loan or loans as if they were in NZ$. In particular, do not apply Determination G9A to the loan contract;

Convert this foreign currency income or expenditure into NZ$ using the exchange rate used to calculate "a" in paragraph (4).

12 Example

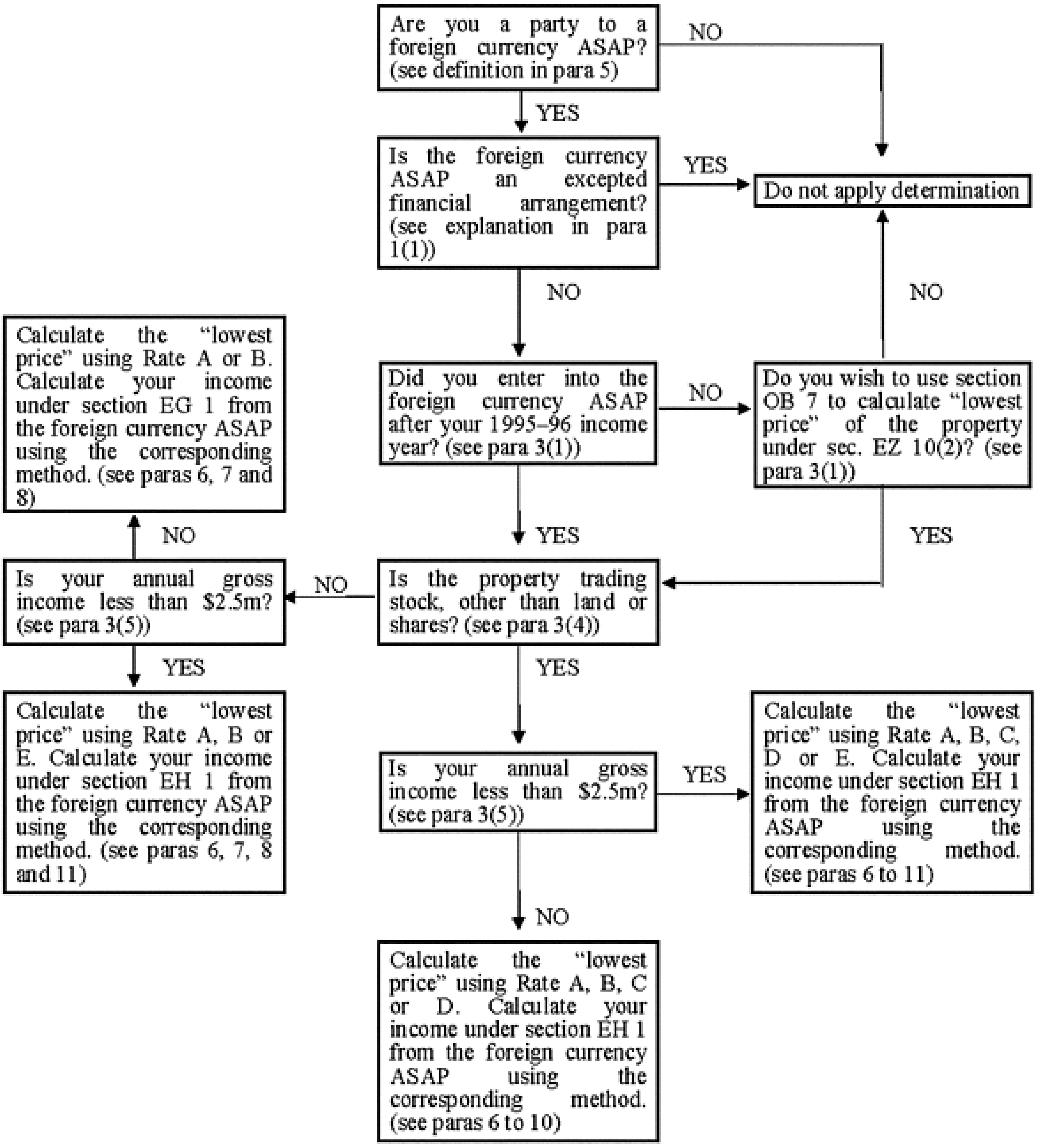
1. A US resident agrees to sell a quantity of plate glass to a New Zealand resident glass wholesaler for US$140,000. The parties agree that the price will be paid six months after the glass is landed in Auckland, and will remain the seller's risk until it is landed.

The parties also agree that if the price were paid at the time the glass is landed, the price would be US$130,000.

2. The New Zealand resident wholesaler must calculate the "lowest price" by converting the US$130,000 to NZ$ using one of the rates set out in section OB 7(1) of the Act, or in this determination. The difference between that amount in NZ$, and US$140,000 at the spot rate on payment date, will be income or expenditure to the New Zealand resident. It must then apply the appropriate method to spread that income or expenditure over the life of the ASAP.

Summary flowchart — calculating accrual income from foreign currency agreements for sale and purchase

This chart is included for illustration purposes only. It does not form part of the determination.



Example 1: Purchase of a motor vehicle: payment in arrears and 10% deposit

Calculation of a lowest price by buyer for section EH 4 using various rates and methods

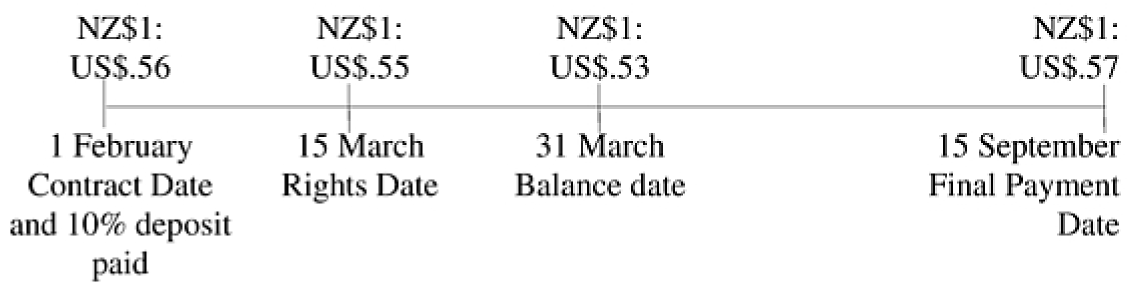
This is a simple example of a Foreign Currency ASAP with a deposit, payment in arrears, and no charge for the deferral of the payment. It shows the different results that will arise under the base price adjustment (section EH 4), using Rates C, D and E to calculate the core acquisition price. It also shows how Method E would apply to the calculation of income/expenditure from the arrangement.

1.1 On 1 February 1997 a NZ resident with a 31 March balance date agrees to purchase a motor vehicle from a US resident for US$14,000. The buyer pays a deposit of US$1,400 on 1 February 1997. The Rights Date will be 15 March 1997, when the vehicle is delivered to the buyer in Los Angeles. The final payment of US$12,600 does not have to be made until 15 September 1997. The price that the buyer would have had to pay for a cash sale is US$14,000. The car is acquired for business use.

1.2 The US$/NZ$ exchange rates for the various dates are:

1 February 1997	0.5600
15 March 1997	0.5500
31 March 1997	0.5300
15 September 1997	0.5700

1.3 This fact situation can be represented diagrammatically as follows:



Rate and Method C

1.4 If the buyer applies Rate C, the NZ$ Lowest Price will be the US$14,000 Lowest Price converted into NZ$ at the spot exchange rate on the Rights Date, ie.

$$\frac{\text{US\$14,000}}{.5500}$$

which is $25,454.

1.5 Leaving aside any income or expenditure that might be recognised by the buyer under the accrual rules in the 1997 year, the base price adjustment in the 1998 year would be:

$24,605 − $25,454 = ($849).

This would be income to the buyer.

Rate and Method D

1.6 If the buyer applies Rate D, the NZ$ Lowest Price will be the US$14,000 Lowest Price converted into NZ$ at the spot exchange rate on the Contract Date, ie.

$$\frac{\text{US\$14,000}}{.5600}$$

which is NZ$25,000.

1.7 Leaving aside any income or expenditure that might be recognized by the buyer under the accrual rules in the 1997 year, the base price adjustment in the 1998 year would be:

$24,605 − $25,000 = ($395).

This would be income to the buyer.

Rate and Method E

1.8 If the buyer applies Rate E to calculate the NZ$ Lowest Price, it must apply Method E to calculate its income/expenditure from the Foreign Currency ASAP in the 1997 year. Method E requires it to calculate the result of the formula:

$$a - b - c$$

where

a is the NZ$ value of the price. This is the total of:

(a) US$1,400/.56 = $2,500;

(b) US$12,600/.53 = $23,774. The buyer uses the spot rate on balance date to convert the final payment, because it is required to file its tax return for the 1997 tax year before the agreement is completed.

"a" is therefore $2,500 + $23,774 = $26,274;

b is the Lowest Price converted into NZ$ using the weighted average of the spot rates used to calculate "a". The weighted average is:

$$\frac{\text{US\$14,000}}{(\text{US\$1,400/.56}) + (\text{US\$12,600/.53}}$$

which is .53285. "b" is therefore US$14,000/.53285 = $26,274;

c is the unaccrued interest, treating the agreement as two US$ loans as follows:

(a) a loan

(i) from the buyer to the seller;

(ii) advanced on 1 February 1997 (the Contract Date);

(iii) of US$1,400;

(iv) repaid on 15 March 1997 (the Rights Date);

(v) with a payment of $ 1,400.

(b) a loan

(i) from the seller to the buyer;

(ii) advanced on 15 March 1997 (the Rights Date);

(iii) of US$12,600;

(iv) repaid on 15 September 1997 (the date of the second payment);

(v) with a repayment amount of US$12,600.

The buyer must calculate its income from this arrangement in US$, and then convert it into NZ$ using the same rate used to calculate "a". Because the US$ amount paid by the purchaser is the same as the US$ Lowest Price, the buyer has no unaccrued income or expenditure from the notional loans in the income year ended 31 March 1997.

1.9 The result of Method E is therefore \$26,274 − \$26,274 − 0 = 0. The buyer has no income or expenditure under section EH 1 in the 1997 year.

1.10 In the income year ended 31 March 1998, the buyer applies the base price adjustment in section EH 4. This will be calculated as follows:

a = all amounts of consideration paid by the issuer. This is the US\$ price of the vehicle, converted into NZ\$ at the Spot Rate when paid. This will be:

(i) in relation to the deposit, US\$1.400/.56 = \$2.500

(ii) in relation to the final payment, US\$12,600/.57 = \$22,105

giving a total of \$24,605;

b = the acquisition price, calculated converting the Lowest Price in US\$ into NZ\$ using the weighted average Spot Rate on the Payment Dates. The weighted average spot rate is:

$$\frac{\text{US\$14,000}}{(\text{US\$1,400/.56}) + (\text{US\$12,600/.57})}$$

which is .5690. The acquisition price is therefore \$24.605;

c = expenditure already recognised, of 0.

The base price adjustment is therefore \$24,605 − \$24,605 = 0.

Example 2: Payment in arrears; charge for deferral

Calculation of income by buyer under sections EH 1 and EH 4 using various methods and rates

This example involves deferred payment with a charge being made for the deferral. It shows how Rates and Methods A to D would apply to calculate the buyer's income/expenditure under sections EH 1 and EH 4.

2.1 On 1 February 1997 a US resident agrees to sell a quantity of plate glass to a NZ resident glass wholesaler for US\$140,000. The parties agree that the price will be paid six months after the date the glass is landed in Auckland, which is expected to occur on 1 March. The glass will be at the seller's risk until it is landed in Auckland. The date it is landed will be the Rights Date. If payment were made at that time, the price would be US\$130,000.

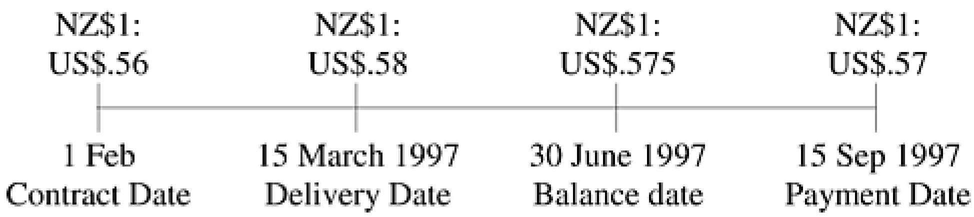
2.2 The glass is unloaded in Auckland on 15 March 1997. Therefore the term of the arrangement is 1 February 1997 to 15 September 1997 — 226 days. The purchaser's balance date is 30 June.

The US$/NZ$ spot and forward exchange rates for the various dates are

Date	Spot exchange rate	Forward rate to 1 Mar	Forward rate to 1 Sep	Forward rate to 15 Sep
1 Feb 1997	0.56	0.55	0.585	
15 Mar 1997	0.58	n/a	0.585	
30 Jun 1997	0.575	n/a	0.58	0.577
15 Sep 1997	0.57	n/a	n/a	

The purchaser is the “issuer” for the purposes of the qualified accruals rules.

2.3 This transaction can be represented diagrammatically as follows:



General

2.4 Whichever method the purchaser decides to use, it will have to treat itself as party to a notional foreign currency loan:

(a) from the seller to the buyer;

(b) advanced on 15 March (the Rights Date);

(c) of an amount equal to the Lowest Price of US$130,000;

(d) repaid on 15 September (the payment date);

(e) with a repayment amount of US$140.000.

Rate and Method A

2.5 If the purchaser applies section OB 7(1)(a) and calculates the Lowest Price of the glass using the forward rate on the Contract Date for delivery on the expected Rights Date, it must apply Method A to calculate income/expenditure in the year ended 30 June 1997.

2.6 In calculating its income/expenditure in the year ended 30 June 1997 the purchaser first calculates its income from the notional foreign currency loan set out in paragraph 2.4. The purchaser uses Determination G9A.

2.7 Under Determination G9A, income or expenditure will be:

$$a + b - c - d$$

where

a is the value in NZ$ of the closing tax book value, using the spot rate at balance date; and

b is the sum of the value in NZ$ of all consideration given during the income year to or for the benefit of the purchaser in relation to the financial arrangement, using the spot rate when that consideration is given; and

c is the value in NZ$ of the opening tax book value, using the spot rate at the start of the year; and

d is the sum of the value in NZ$ of all consideration given during the income year by or on behalf of the person in relation to the financial arrangement, using the spot rate when that consideration is given.

2.8 The closing tax book value is calculated as follows:

$$e + f + g - h - i$$

where

e is—

(i) the opening tax book value at the beginning of the period, if the person was a party to the arrangement at that time; and

(ii) in every other case, nil; and

f is the sum of the US$ value of all consideration given during the income year by or on behalf of the purchaser in relation to the financial arrangement; and

g is the purchaser's US$ income in respect of the financial arrangement during the year; and

h is the sum of the US$ value of all consideration given during the income year to or for the benefit of the purchaser in relation to the financial arrangement; and i is the US$ expenditure of the purchaser in relation to the financial arrangement.

2.9 In this case:

(a) “e”, “f” and “g” are zero;

(b) “h” is the amount advanced under the notional loan, ie. US$130,000;

(c) to calculate “i”, the purchaser allocates the US$10,000 of expenditure over the period on a straight line basis. For the year ended 30 June 1997, this gives expenditure of:

$$(107/184) \times \text{US\$}10{,}000 - \text{US\$}5{,}815.$$

The closing book value of the financial arrangement is therefore (US$135,815).

2.10 To calculate “a” in the formula, the purchaser converts this closing tax book value into NZ$ using the spot rate on the balance date. This gives a figure of (US$ 135,815)/.5750 = ($236,200).

2.11 “b” in the formula is the amount advanced under the notional loan, converted into NZ$ at the spot rate on the Rights Date. This is US$130,000/.58 = $224,138.

2.12 “c” and “d” in the formula are zero. The result of the formula in Determination G9A in the year ended 30 June 1997 is therefore ($236,200) + $224,138 = ($12,062). Because this is a negative amount, it is expenditure to the purchaser.

2.13 The second step requires the purchaser to calculate the amount:

$$a - b$$

where

a is the NZ$ value of the Lowest Price converted using the spot rate on the Rights Date. This is US$130,000/.58 = $224,138;

b is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Rights Date, ie. 1 March. This is US$130,000/.55 = $236,364.

The result is therefore ($12,226). Since this is a negative amount and the taxpayer is the purchaser, it will be income to the purchaser.

2.14 The purchaser's income/expenditure for the 1997 year is therefore ($12,062) + $12,226 which gives income of $164.

2.15 In the 1998 income year, the purchaser applies the base price adjustment in section EH 4. This will be equal to:

$$a - (b + c)$$

where

a is all amounts of consideration paid by the purchaser. This is the US$ price of the glass, converted into NZ$ at the Spot Rate when paid. This is US$140,000/.57 = $245,614;

b is the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using Rate A, the Forward Rate on the Contract Date for delivery on the expected Rights Date, ie. US$130,000/.55 = $236,364;

c is income already recognized, of $164.

The base price adjustment is therefore $9,086. Since this is a positive amount and the purchaser is the issuer of the Foreign Currency ASAP, this will be expenditure to the purchaser in the 1998 year.

2.16 Under section EH 8(2) of the Act, the acquisition price of $236,364 for the glass will also be its cost price for depreciation purposes.

Rate and Method B

2.17 If the purchaser applies section OB 7(1)(b) and calculates the NZ$ Lowest Price of the glass using the forward rate on the Contract Date for delivery on the expected Settlement Date it must apply Method B to calculate income/expenditure in the year ended 30 June 1997.

2.18 In calculating its income/expenditure in the year ended 30 June 1997 the purchaser first calculates its income from the notional foreign currency loan set out in paragraph 2.4. However, in calculating this income or expenditure, it does not use Determination G9A. Instead, it must treat the foreign currency loan as if it were in NZ$, and convert the resulting foreign currency income or expenditure into NZ$ using the spot rate on payment date (or year end, if payment date is after year end).

2.19 To calculate the foreign currency income/expenditure, the purchaser allocates the US$10,000 expenditure (ie. the difference between the Lowest Price and the price) over the period from 15 March to 15 September on a straight line basis. For the year ended 30 June 1997, this gives expenditure of:

$$(107/184) \times \text{US\$}10{,}000 = \text{US\$}5{,}815.$$

2.20 The purchaser converts this amount into NZ$ using the spot rate at year end, which gives NZ$ expenditure of US$5.815/.575 = $10.113.

2.21 The second step requires the purchaser to calculate the amount:

$$a - b$$

where

> a is the NZ$ value of the Lowest Price converted using the forward rate on 30 June to 15 September (the expected Settlement Date on 30 June). This is US$130,000/.577 = $225,303;
>
> b is the NZ$ value of the Lowest Price converted using the forward rate on 1 February (the Contract Date) to 1 September (the expected Settlement Date on 1 February). This is US$130,000/.585 = $222,222.

The result is $3,081. Since this is a positive amount and the taxpayer is the purchaser, it will be expenditure to the purchaser.

2.22 The purchaser's income/expenditure for the 1997 year is therefore ($10,113) + ($3,081) which gives expenditure of $13,194.

2.23 In the 1998 income year, the purchaser applies the base price adjustment in section EH 4. This will be calculated as follows:

> a is all amounts of consideration paid by the purchaser. This is the US$ price of the glass, convened into NZ$ at the Spot Rate when paid. This is US$140,000/.57 = $245,614;
>
> b is the acquisition price, calculated convening the Lowest Price in US$ into NZ$ using Rate B, the Forward Rate on the Contract Date for delivery on the expected Settlement Date ie. US$130,000/.585 = $222,222;
>
> c is expenditure already recognised, of $13,194.

The base price adjustment is therefore $10,198. Since this is a positive amount and the purchaser is the issuer of the Foreign Currency ASAP, this will be expenditure to the purchaser in the 1998 year.

2.24 Under section EH 8(2) of the Act, the acquisition price for the glass of $222,222 will also be its cost price for depreciation purposes.

Rate and Method C

2.25 If the purchaser applies Rate C, it will calculate the NZ$ value of the Lowest Price of the glass using the spot rate on the Rights Date, and must apply Method C to calculate its income/expenditure under section EH 1 from the contract in the year ended 30 June 1997.

2.26 In calculating its income/expenditure in the year ended 30 June 1997 the purchaser first calculates its income from the notional US$ loan set out in paragraph 2.4. The purchaser uses determination G9A to determine its income or expenditure from the loan. The calculations are set out in paragraphs 2.7 to 2.12, which will give it expenditure of $12,062 from the notional loan.

2.27 In the 1998 income year, the purchaser applies the base price adjustment in section EH 4. This will be calculated as follows:

> a is all amounts of consideration paid by the purchaser. This is the US$ price of the glass, converted into NZ$ at the Spot Rate when paid. This is US$140,000/.57 = $245,614;
>
> b is the acquisition price, calculated convening the Lowest Price in US$ into NZ$ using Rate C, the spot rate on the Rights Date, ie. US$130,000/.58 = $224,138;
>
> c is expenditure already recognized, of $12,062.

The base price adjustment is therefore $9,414. Since this is a positive amount and the purchaser is the issuer of the Foreign Currency ASAP, this will be expenditure to the purchaser in the 1998 year.

2.28 Under section EH 8(2) of the Act, the acquisition price of $224,138 for the glass will also be its cost price for tax purposes.

Rate and Method D

2.29 If the purchaser applies Rate D it will calculate the NZ$ value of the Lowest Price of the glass using the spot rate on the Contract Date, and must apply Method D to calculate income/expenditure under section EH 1 from the contract in the year ended 30 June 1997.

2.30 In calculating its income/expenditure in the year ended 30 June 1997 the purchaser first calculates its income from the notional US$ loan set out in paragraph 2.4. The purchaser uses determination G9A to determine its income or expenditure from the loan. The calculations are set out in paragraphs 2.7 to 2.12, which will give it expenditure of $12,062 from the notional loan.

2.31 The second step requires the purchaser to calculate the amount:

a – b

where

a is the NZ$ value of the Lowest Price converted using the spot rate on the Rights Date. This is US$130,000/.58 which is $224,138;

b is the NZ$ value of the Lowest Price converted using the spot rate on the Contract Date. This is US$130,000/.56 = $232,143.

The result is ($8,005). Since this is a negative amount and the taxpayer is the purchaser, it will be income to the purchaser.

2.32 The purchaser's income/expenditure for the 1997 year is therefore ($12,062) + $8,005 which gives expenditure of $4,057.

2.33 In the 1998 income year, the purchaser applies the base price adjustment in section EH 4. This will be calculated as follows:

a is all amounts of consideration paid by the purchaser. This is the US$ price of the glass, converted into NZ$ at the Spot Rate when paid. This is US$140,000/.57 = $245,614;

b is the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using Rate D, the spot rate on the Contract Date, ie. US$130,000/.56 = $232,143;

c is expenditure already recognized, of $4,057.

The base price adjustment is therefore $9,414. Since this is a positive amount and the purchaser is the issuer of the Foreign Currency ASAP, this will be expenditure to the purchaser in the 1998 year.

2.34 Under section EH 8(2) of the Act, the acquisition price for the glass of $232.143 will also be its cost price for depreciation purposes.

Example 3: Sale of trading stock: payment in arrears

Calculation of income by seller under sections EH 1 and EH 4 using various rates and methods

This is an example of a contract with payment in arrears and no charge for the deferral. It shows how Rates and Methods A to D would apply to calculate a seller's income/expenditure under sections EH 1 and EH 4. Initially, it is on the basis that both delivery and payment are after balance date. Then the balance date is changed so that the delivery is before balance date.

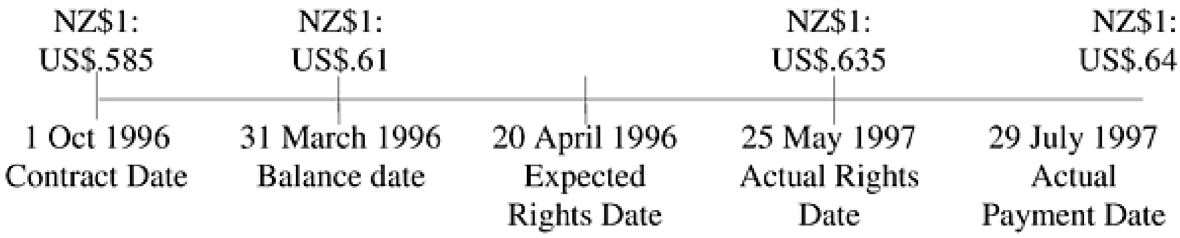
3.1 On 15 October 1996 the taxpayer, a NZ wool exporter, agrees to sell 10,000kg of wool for US$3 per kilo, delivered to a Japanese port specified by the buyer. On both the Contract Date and 31 March, the exporter reasonably expects that delivery will occur on 20 April 1997. US$3 is the price the parties would agree for payment on the delivery date. Payment is required 60 days after delivery. The exporter has a 31 March balance date.

3.2 The wool is actually delivered on 25 May 1997, and payment is made on 29 July 1997.

3.3 The US$/NZ$ exchange rates in the 1997 income year are as follows:

Date	Spot exchange rate	Forward rate to 20 April 1997	Forward rate to 20 June 1997
15 Oct 1996	0.585	0.605	0.62
31 Mar 1997	0.61	0.612	0.615
25 May 1997	0.635		
30 June 1997	0.645	n/a	0.58
29 July 1997	0.64	n/a	n/a

3.4 Diagrammatically, the transaction can be represented as follows:



General

3.5 Whichever method the exporter decides to use, it will have to treat itself as party to a notional foreign currency loan:

(a) from the exporter to the buyer;

(b) advanced on 25 May 1997 (the Rights Date);

(c) of an amount equal to the Lowest Price of US$30,000:

(d) repaid on 29 July 1997 (the payment date);

(e) with a repayment amount of US$30,000.

Rate and Method A

3.6 If the exporter applies section OB 7(1)(a) and calculates the Lowest Price of the wool using the forward rate on the Contract Date for delivery on the expected Rights Date, it must apply Method A to calculate income/expenditure in the year ended 31 March 1997.

3.7 In calculating its income/expenditure in the year ended 31 March 1997 the exporter first calculates its income from the notional foreign currency loan set out in paragraph 3.5 above. As no amounts have been advanced under the loan at this date, there is no income or expenditure.

3.8 The second step requires the exporter to calculate the amount:

$$a - b$$

where

> a is the NZ$ value of the Lowest Price converted using the forward rate on the balance date for delivery of currency on the expected Rights Date, ie. 20 April 1997. This is US$30,000/.612 = $49,020;
>
> b is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Rights Date, ie. 20 April 1997. This is US$30,000/.605 = $49,587.

The result is therefore ($567). Since this is a negative amount and the exporter is the seller, it will be expenditure to it. This will be the exporter's expenditure from the agreement for the year.

3.9 The exporter must perform a base price adjustment for the wool contract in the 1998 year. This will be equal to:

$$a - (b + c)$$

where

> a is the NZ$ value of the price on the date of payment, ie. US$30,000/.64 = NZ$46,875;
>
> b is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate A, the Forward Rate on 15 October 1996 (the Contract Date) for delivery on 20 April 1997 (the expected Rights Date). This is US$30,000/.605 which is NZ$49,587;
>
> c is income/expenditure already recognized, which in this case is (NZ$567).

The base price adjustment is therefore ($2,145) which is an allowable deduction to the exporter. This amount is attributable to the fluctuation in the US$/NZ$ exchange rate between the balance date and the payment date. The exporter will be treated as having sold the wool for $49,587.

3.10 Suppose that the facts are the same except that the taxpayer had a 30 June balance date. The spot exchange rate on 30 June 1997 is NZ$1:US$0.645. With respect to the notional loan, made on 25 May, the taxpayer applies Determination G9A to calculate its income/expenditure for the 1997 year. Since there is no implied interest component, this will be equal to the NZ$ currency fluctuation, from delivery date to balance date, in the principal amount of US$30,000. This will be:

$$\frac{30{,}000}{.645} - \frac{30{,}000}{.635}$$
$$= 46{,}512 - 47{,}244$$
$$= (\$732).$$

This will be expenditure to the taxpayer.

3.11 The second step requires the exporter to calculate the amount:

$$a - b$$

where

a is the NZ$ value of the Lowest Price converted using the spot rate on the Rights Date, ie. 25 May. This is US$30,000/.635 = $47,244;

b is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Rights Date, ie. 20 April. This is US$30,000/.605 = $49,587.

The result is therefore ($2,343). Since this is a negative amount and the taxpayer is the seller, it will be expenditure to the seller.

3.12 The taxpayer's total expenditure from the wool contract for the 1997 year is therefore $3,075.

3.13 In the 1998 year the wool contract will mature, so a base price adjustment will have to be calculated. This will be equal to:

$$a - (b + c)$$

where

a is the amount received by the taxpayer. This is the US$ price received, on the day it is received, ie. US$30,000/.64 = $46,875;

b is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate A, the forward exchange rate on the Contract Date for delivery on the expected Rights Date, ie. it is NZ$49,587;

c is income/expenditure already recognised, which in this case is ($3,075).

The base price adjustment is therefore $363, which will be income to the taxpayer.

Rate and Method B

3.14 If the exporter applies section OB 7(1)(b) and calculates the NZ$ Lowest Price of the wool using the forward rate on the Contract Date for delivery on the Settlement Date it must apply Method B to calculate income/expenditure in the year ended 31 March 1997.

3.15 In calculating its income/expenditure in the year ended 31 March 1997 the exporter first calculates its income from the notional foreign currency loan described in paragraph 3.5. However, in calculating this income or expenditure, it does not use determination G9A. Instead, it must treat the foreign currency loan as if it were in NZ$, and convert the resulting foreign currency income or expenditure into NZ$ using the spot rate on Payment Date (or year end, if Payment Date is after year end).

3.16 As no amounts have been advanced under the loan at 31 March, there is no income or expenditure.

3.17 The second step requires the exporter to calculate the amount:

$$a - b$$

where

a is the NZ$ value of the Lowest Price converted using the forward rate on 31 March for delivery of currency on the expected Settlement Date, ie. 20 June. This is US$30,000/.615 = $48,780;

b is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Settlement Date, ie. 20 June. This is US$30,000/.62 = $48,387.

The result is therefore $393. Since this is a positive amount and the taxpayer is the seller, it will be income to it. This will be the exporter's income from the agreement for the year.

3.18 The exporter must perform a base price adjustment for the wool contract in the 1998 year. This will be equal to:

$$a - (b + c)$$

where

a is the NZ$ value of the price on the date of payment, ie. US$30,000/.64 = NZ$46,875;

b is the acquisition price calculated by converting the US$ into NZ$ using Rate B, the Forward Rate on the Contract Date for delivery on the expected Settlement Date. This is US$30,000/.62 which is NZ$48,387;

c is income already recognized, which in this case is NZ$393.

The base price adjustment is therefore ($1,905) which is an allowable deduction to the exporter. The exporter will be treated as having sold the wool for $48,387.

3.19 Suppose that the facts are the same except that the exporter had a 30 June balance date. The spot exchange rate on 30 June is NZ$1:US$.645. With respect to the notional loan, made on 25 May, the exporter does not use Determination G9A. Instead, it must treat the foreign currency loan as if it were in NZ$, and convert the resulting foreign currency income or expenditure into NZ$ using the spot rate on payment date (or year end, if payment date is after year end). Since there is no US$ income from the notional loan, there will also be no NZ$ income using this method.

3.20 The second step required is for the exporter to calculate the amount:

$$a - b$$

where

a is the NZ$ value of the Lowest Price converted using the forward rate on the balance date (now 30 June) for delivery of currency on the expected Settlement Date. Although the expected Settlement Date on the Contract Date was 20 June, the wool has been delivered late, and the expected Settlement Date is now 29 July. Assume that the forward rate from 30 June to 29 July is .61. “a” is therefore US$30,000/.61 = $49,180;

b is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Settlement Date at that time, ie. 20 June. This is US$30,000/.62 = $48,387.

The result is therefore $793. Since this is a positive amount and the taxpayer is the seller, it will be income to it. The exporter's total income from the wool contract for the 1997 year is therefore $793.

3.21 In the 1998 year the wool contract will mature, so a base price adjustment will have to be calculated. This will be equal to:

a − (b + c)

where

a is the NZ$ value of the US$ price received, on the day it is received, ie. US$30,000/.64 = $46,875;

b is the acquisition price calculated by converting the US$30,000 into NZ$ using Rate B, the forward exchange rate on the Contract Date for delivery on the expected Settlement Date, ie. it is US$30,000/.62 = NZ$48,387.

c is income/expenditure already recognised, which in this case is $793.

The base price adjustment is therefore ($2,305), which is an allowable deduction to the taxpayer.

Rate and Method C

3.22 If the exporter applies Rate C, it will calculate the NZ$ value of the Lowest Price of the wool using the spot rate on the Rights Date, and must apply Method C to calculate its income/expenditure under section EH 1 from the contract in the year ended 31 March 1997.

3.23 In calculating its income/expenditure in the year ended 30 June 1997, the exporter first calculates its income from the notional US$ loan, set out in paragraph 3.5. As no amounts have been advanced under the loan at 31 March, there is no income or expenditure in that year.

3.24 In the 1998 income year the exporter applies the base price adjustment in section EH 4 to the contract to sell the wool. This will be calculated as follows:

a = all amounts of consideration paid by the buyer. This is the US$ price of the wool, converted into NZ$ at the Spot Rate when paid. This is US$30,000/.64 = $46,875;

b = the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using Rate C (the spot rate on the Rights Date), ie. US$30,000/.635 = $47,244;

c = expenditure already recognized, of 0.

The base price adjustment is therefore ($369). Since this is a negative amount and the exporter is the holder of the Foreign Currency ASAP, this will be an allowable deduction to the exporter in the 1998 year.

3.25 Under section EH 8(2) of the Act, the acquisition price for the wool will also be its sale price for tax purposes.

3.26 Suppose that the facts are the same except that the exporter had a 30 June balance date. The spot exchange rate on 30 June is NZ$1:US$.645. With respect to the notional loan, made on 25 May, the exporter applies determination G9A to calculate its income/expenditure for the 1997 year. Since there is no implied interest component, this will be equal to the NZ$ currency fluctuation, from the Rights Date to balance date, in the NZ$ value of principal amount of US$30,000. This will be:

$$\frac{30{,}000}{.645} - \frac{30{,}000}{.635}$$
$$= 46{,}512 - 47{,}244$$
$$= (\$732).$$

This will be expenditure to the exporter in the 1997 year.

3.27 In the 1998 year the wool contract will mature, so a base price adjustment will have to be calculated. This will be equal to:

$$a - (b + c)$$

where

> a is the amount received by the exporter. This is the US$ price received, on the day it is received, ie. US$30,000/.64 = $46,875;
>
> b is the acquisition price calculated converting the Lowest Price into NZ$ using the spot rate on the Rights Date, ie. it is NZ$47,244;
>
> c is income/expenditure already recognised, which in this case is ($732).

The base price adjustment is therefore $363, which will be income to the taxpayer.

Rate and Method D

3.28 If the exporter applies Rate D it will calculate the NZ$ value of the Lowest Price of the wool using the spot rate on the Contract Date, and must apply Method D to calculate income/expenditure in the year ended 31 March 1997.

3.29 In calculating its income/expenditure in the year ended 31 March 1997 the exporter first calculates its income from the notional US$ loan set out in paragraph 3.5. As no amounts have been advanced under the loan at 31 March, there is no income or expenditure in that year.

3.30 The second step requires the exporter to calculate the result of:

$$a - b$$

where

a is the NZ$ value of the Lowest Price using the spot rate on balance date. This is US$30,000/.61 which is $49,180;

b is the NZ$ value of the Lowest Price using the spot rate on Contract Date. This is US$30,000/.585 which is $51,282.

The result is therefore ($2,102). As this is negative and the exporter is the seller, this is expenditure to the exporter. This will be all of its expenditure in the 1997 year from the wool contract. This expenditure is solely attributable to the fluctuations in the US$/NZ$ spot exchange rate.

3.31 The exporter must perform a base price adjustment for the wool contract in the 1998 year. This will be equal to:

$$a - (b + c)$$

where

a is the NZ$ value of the price on the date of payment, ie. US$30,000/.64 = NZ$46,875;

b is the acquisition price. Because the exporter is using Rate D, this is calculated by converting the US$ into NZ$ using the exchange rate on the Contract Date, ie. it is US$30,000/.585 which is NZ$51,282;

c is income/expenditure already recognized, which in this case is (NZ$2,102).

The base price adjustment is therefore $2,305 which is an allowable deduction to the exporter. The exporter will be treated as having sold the wool for $51,282.

3.32 Suppose that the facts are the same except that the exporter had a 30 June balance date. The spot exchange rate on 30 June is NZ$1:US$.645. With respect to the notional loan, made on 25 May, the exporter applies Determination G9A to calculate its income/expenditure for the 1997 year. Since there is no implied interest component, this will be equal to the NZ$ currency fluctuation, from delivery date to balance date, in the principal amount of US$30,000. This will be:

$$\frac{30{,}000}{.645} - \frac{30{,}000}{.635}$$
$$= 46{,}512 - 47{,}244$$
$$= (\$732).$$

This will be expenditure to the exporter.

3.33 The exporter will also have to make the adjustment a − b. In this case:

a is the NZ$ value of the Lowest Price converted using the spot rate on the Rights Date. This is US$30,000/.635 which is $47,244;

b is the NZ$ value of the Lowest Price converted using the spot rate on the Contract Date. This is US$30,000/.585 which is $51,282.

The result is therefore ($4,038). Since the exporter is the seller, and this amount is negative, it is expenditure.

3.34 The exporter's total expenditure from the wool contract for the 1997 year is therefore $4,770.

3.35 In the 1998 year the wool contract will mature, so a base price adjustment will have to be calculated. This will be equal to:

$$a - (b + c)$$

where

a is the amount received by the exporter. This is the US$ price received, on the day it is received, ie. US$30,000/.64 = $46,875;

b is the acquisition price. Because the exporter is using Rate D, the US$30,000 is convened into NZ$ using the exchange rate on the Contract Date, ie. it is US$30,000/.585 which is NZ$51,282;

c is income/expenditure already recognised, which in this case is ($4,770).

The base price adjustment is therefore $363, which will be income to the exporter.

Example 4: Further example of income calculation by seller under sections EH 1 and EH 4 using various rates and methods

This is an example with payments in advance and in arrears, and no difference between the actual price and a cash settlement price. It shows how Rates and Methods A to D would apply to calculate a seller's income/expenditure under sections EH 1 and EH 4.

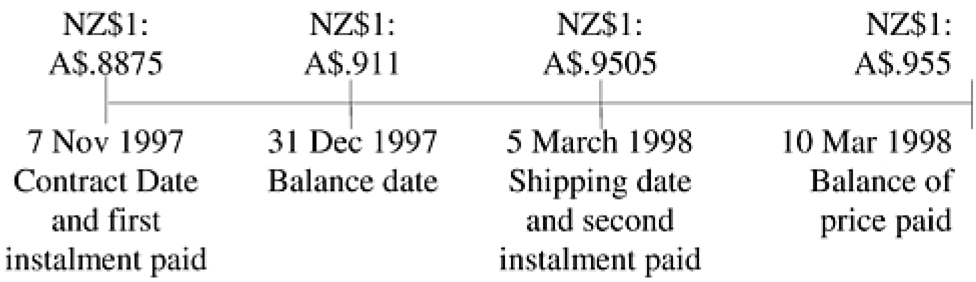
4.1 On 7 November 1997, a NZ furniture manufacturer with a December 31 balance date sells a consignment of pine furniture to an Australian purchaser for A$2,000,000. The furniture is to be shipped on a FOB basis, ie. the purchaser takes property in it once it is loaded on the vessel. A$150,000 is payable on 7 November, a further A$150,000 is payable once the furniture has been accepted by the shipper, and the remainder of the price is payable once the furniture is unloaded in Sydney, which is expected to be at the end of February.

4.2 Because the furniture is shipped FOB, the Rights Date is the date it is loaded, which is expected to be 20 February 1998. The parties agree that A$2,000,000 is the price they would have agreed on for the furniture on the basis of payment in full on 20 February.

4.3 The goods are in fact shipped on 5 March 1998, and arrive in Sydney on 10 March 1998. The A$/NZ$ Spot Rates on the relevant dates, and the resulting NZ$ spot values, are:

Date	Spot exchange rate	Forward rate to 20 February	Forward rate to 28 February
7 Nov 1997	0.8875	0.9205	0.9250
31 Dec 1997	0.9110	0.9300	0.9275
5 Mar 1998	0.9505	n/a	n/a
10 Mar 1998	0.9550	n/a	n/a

4.4 Diagrammatically, the transaction can be represented as follows:



General

4.5 Whichever method the manufacturer decides to use, it will have to treat itself as party to two notional foreign currency loans, as follows:

4.5.1 A loan from the buyer to the seller:

(a) advanced on 7 November (the Contract Date);

(b) of A$150,000;

(c) repaid on 5 March 1998 (the Rights Date);

(d) with a repayment amount of A$150,000.

4.5.2 A loan from the seller to the buyer:

(a) advanced on 5 March (the Rights Date);

(b) of A$1.7m;

(c) repaid on 10 March 1998 (the Settlement Date);

(d) with a repayment amount of A$1.7m.

Rate and Method A

4.6 If the manufacturer applies section OB 7(1)(a) and calculates the Lowest Price of the furniture using the forward rate on the Contract Date for delivery on the Rights Date it must apply Method A to calculate income/expenditure in the year ended 31 December 1997.

4.7 In calculating its income/expenditure in the year ended 31 December 1997 the manufacturer first calculates its income from the notional foreign currency loan set out in paragraph 4.5.1 above. Applying the formula in Determination G9A, the furniture manufacturer's income/expenditure in the year ended 31 December 1997 will be calculated in accordance with the following formula:

$$a + b - c - d$$

where:

a is the value of NZ$ of the closing tax book value, using the spot rate at balance date; and

b is the sum of the value in NZ$ of all consideration given during the income year to or for the benefit of the person in relation to the financial arrangement, using the spot rate when that consideration is given; and

c the value in NZ$ of the opening tax book value, using the spot rate at the start of the year; and

d is the sum of the value in NZ$ of all consideration given during the income year by or on behalf of the person in relation to the financial arrangement, using the spot rate when that consideration is given.

4.8 The closing tax book value is calculated as follows:

$$e + f + g - h - i$$

where

e is the opening tax book value at the beginning of the year, if the person was a party to the arrangement at that time. This will be zero because the transaction was entered into during the year; and f is the sum of the A$ value of all consideration given during the income year by or on behalf of the seller in relation to the notional loan. This will be zero for the year, since the manufacturer does not repay the loan until the 1998 year; and

g is the manufacturer's A$ income in respect of the loan during the year. This will be zero, since there is no difference between the A$ amounts lent and repaid; and

h is the sum of the A$ value of all consideration given during the income year to or for the benefit of the manufacturer in relation to the notional loan. This will be A$150,000; and

i is the A$ expenditure of the manufacturer in relation to the notional loan. This will be zero.

The closing tax book value is therefore (A$150,000).

4.9 To calculate “a” in the formula, the manufacturer converts this closing tax book value into NZ$ using the spot rate on the balance date.

This gives a figure of (A$150,000)/.911 = ($164,654).

4.10 “b” in the formula is the A$150,000 paid to the manufacturer during the income year, converted into NZ$ using the spot rate on the date of payment, ie. A$150,000/.8875, which is $169,014.

4.11 “c” and “d” in the formula are both zero. The manufacturer therefore has income from the notional foreign currency loan in the year ended 31 December 1997 of $4,360.

4.12 The second step requires the manufacturer to calculate the amount:

$$a - b$$

where

a is the NZ$ value of the Lowest Price converted using the forward rate on the balance date for exchange of currencies on the expected Rights Date, ie. 20 February. This is A$2,000,000/ .9300 = $2,150,538;

b is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date for exchange of currencies on the expected Rights Date, ie. 20 February. This is A$2,000,000/.9205 = $2,172,732.

The result is therefore ($22,194). Since this is a negative amount and the manufacturer is the seller, it will be expenditure to the seller.

4.13 The manufacturer's income/expenditure for the year ended 31 December 1997 is therefore $4,360 + ($22,194) which gives expenditure of $17,834.

4.14 In the year ended 31 December 1998, the furniture manufacturer calculates a base price adjustment. This will be equal to:

$$a - (b + c)$$

where

a is the total of the amounts received by the manufacturer. This will be the total of

(a) A$150,000/.8875 = $169,014 (the payment on the Contract Date); plus

(b) A$150,000/.9505 = $157,812 (the payment on the shipment date); plus

(c) A$1,700,000/.955 = $1,780,105 (the final payment)

which gives a total of $2,106,931.

b is the acquisition price, calculated by converting the Lowest Price into NZ$ using Rate A, the forward rate on the Contract Date for delivery on the expected Rights Date, ie. it is $2,172,732 (A$2,000,000/.9205);

c which is income/expenditure already recognized will be ($17,834).

The base price adjustment will therefore be ($47,967). Since the furniture manufacturer is a holder of the Foreign Currency ASAP, and since the base price adjustment is a negative figure, this will be an allowable deduction to the furniture manufacturer.

4.15 The furniture will be treated as sold for NZ$2.172.732.

Method B

4.16 If the manufacturer applies section OB 7(1)(b) and calculates the Lowest Price of the furniture using the forward rate on the Contract Date for delivery on the Settlement Date it must apply Method B to calculate income/expenditure in the year ended 31 December 1997.

4.17 In calculating its income/expenditure in the year ended 31 December 1997 the manufacturer first calculates its income from the notional foreign currency loan described in paragraph 4.5.1. However, in calculating this income or expenditure, it does not use Determination G9A. Instead, it must treat the foreign currency loan as if it were in NZ$, and convert the resulting foreign currency income or expenditure into NZ$ using the spot rate on payment date (or year end, if payment date is after year end). Since there is no A$ income on the notional loan there is also no NZ$ income.

4.18 The second step required is for the manufacturer to calculate the amount:

$$a - b$$

where

> a is the NZ$ value of the Lowest Price converted using the forward rate on the balance date for delivery of currency on the expected Settlement Date, ie. 20 February. This is A$2,000,000/.9275 = $2,156,334;
>
> b is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Settlement Date, ie. 20 February. This is A$2,000,000/.9250 = $2,162,162.

The result is therefore ($5,828). Since this is a negative amount and the taxpayer is the seller, it will be expenditure to it. This will be the manufacturer's expenditure from the agreement for the year.

4.19 In the 1998 year, the manufacturer calculates a base price adjustment. This will be:

$$a - (b + c)$$

where

> a is the total of the amounts received by the manufacturer, which will be A$150,000/.8875 + A$150,000/.9505 + A$1,700,000/.955 which gives a total of $2,106,931;
>
> b is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate B, the forward rate on the Contract Date for delivery on the Settlement Date, ie. it is A$2,000,000/.9250 = $2,162,162;
>
> c which is income/expenditure already recognized will be ($5,828).

The base price adjustment will therefore be ($49,403). Since the furniture manufacturer is a holder of the Foreign Currency ASAP, and since the base price adjustment is a negative figure, this will be an allowable deduction to the furniture manufacturer.

4.20 The furniture will be treated as sold for NZ$2,162,162.

Rate and Method C

4.21 If the manufacturer applies Rate C, it will calculate the NZ$ value of the Lowest Price of the furniture using the spot rate on the Rights Date, and must apply Method C to calculate its income/expenditure under section EH 1 from the contract in the year ended 31 December 1997.

4.22 Under Method C, the manufacturer treats itself as being party to a notional A$ loan, as set out in paragraph 4.5.1. It applies Determination G9A to calculate its income/expenditure for the year ended 31 December 1997. It therefore undertakes the calculations set out in 4.7

to 4.11 above, and has income from the notional foreign currency loan in the year ended 31 December 1997 of $4,360.

4.23 In the year ended 31 December 1998, the furniture manufacturer calculates a base price adjustment. This will be:

a − (b + c)

where

a is the total of the amounts received, ie. A$150,000/.8875 + A$150,000/.9505 + A$1,700,000/.955 which gives a total of $2,106,931;

b is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate C, ie. the spot rate on the Rights Date. This is A$2,000,000/.9505 = $2,104,156;

c is income/expenditure already recognized which will be $4,360.

The base price adjustment will therefore be ($1,585). Since the furniture manufacturer is a holder of the Foreign Currency ASAP, and since the base price adjustment is a negative figure, this will be an allowable deduction to the furniture manufacturer.

4.24 The furniture will be treated as sold for NZ$2,104,156.

Rate and Method D

4.25 If the manufacturer applies Rate D it will calculate the NZ$ value of the Lowest Price of the furniture using the spot rate on the Contract Date, and must apply Method D to calculate income/expenditure in the year ended 31 December 1997.

4.26 In calculating its income/expenditure in the year ended 31 March 1997 the manufacturer first calculates its income from the notional A$ loan set out in paragraph 4.5.1. It applies Determination G9A to calculate its income/expenditure for the year ended 31 December 1997. It therefore undertakes the calculations set out in 4.7 to 4.11 above, and has income from the notional foreign currency loan in the year ended 31 December 1997 of $4,360.

4.27 The furniture manufacturer must also take into account as income or expenditure the amount:

a − b

where

a is the NZ$ value of the Lowest Price calculated using the Spot Rate on the balance date. This is A$2,000,000/.9110 which is $2,195,390;

b is the NZ$ value of the Lowest Price calculated using the Spot Rate on the Contract Date. This is A$2,000,000/.8875 which is $2,253,521.

The result is therefore ($58,131). Since the furniture manufacturer is the seller, this will be expenditure to the seller.

4.28 The furniture manufacturer's expenditure from the contract for the year ended 31 December 1997 will therefore be $4,360 + ($58,131) = ($53,771).

4.29 In the 1998 year, the furniture manufacturer calculates a base price adjustment. This will be:

$$a - (b + c)$$

where

a is the total of the amounts received by the manufacturer, ie. A$150,000/.8875 + A$150,000/.9505 + A$1,700,000/.955 which gives a total of $2,106,931;

b is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate D, the spot rate on the Contract Date of the Foreign Currency ASAP, will be $2,253,521;

c which is income/expenditure already recognized will be ($53,771).

The base price adjustment will therefore be ($92,819). Since the furniture manufacturer is a holder of the Foreign Currency ASAP, and since the base price adjustment is a negative figure, this will be an allowable deduction to the furniture manufacturer.

4.30 The furniture will be treated as sold for NZ$2,253,521.

Example 5: Purchase of a building: payment in arrears

Calculation of income by buyer under sections EH 1 and EH 4 using rate and method E

This is an example with payment in arrears, and a charge for the deferral. It shows how Rate and Method E would apply to calculate a buyer's income/expenditure under sections EH 1 and EH 4.

5.1 A commercial property is sold by a US resident to a NZ resident for US$1,400,000 on 1 February 1997. The parties agree that the price will be paid six months after the date possession passes, which is expected to occur in March, after the seller has undertaken certain repairs. They also agree that if payment were made on the date of possession, the price would have been US$1,300,000.

5.2 Possession of the property passes on 15 March 1997, which is the Rights Date. Therefore the term of the agreement is 1 February 1997 to 15 September 1997 — 226 days.

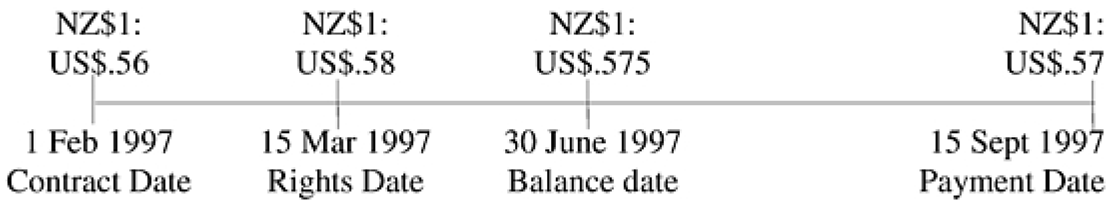
5.3 The purchaser's balance date is 30 June.

5.4 The US$/NZ$ spot exchange rates for the various dates are:

1 February 1997	0.5600
15 March 1997	0.5800
30 June 1997	0.5750
15 September 1997	0.5700

In this case the purchaser is the “issuer” for the purposes of the qualified accruals rules.

5.5 This fact situation can be represented diagrammatically as follows:



5.6 The purchaser is entitled to use Rate and Method E, and elects to do so. For the year ended 30 June 1997, it calculates its income using the formula:

$$a - b - c$$

where

> a is the NZ$ value of the price. This is US$1,400,000/.57 = $2,456,140. Although the payment date is after the end of the relevant year, it is before the taxpayer is required to file its return for the year (for a 30 June year, 7 October — see section 37 of the Tax Administration Act 1994);
>
> b is the NZ$ value of the Lowest Price, using the same exchange rate used to calculate “a”. This is US$1,300,000/.57 = $2,280,702;
>
> c is the unaccrued difference between the price and the Lowest Price, treating the agreement as a loan:
>
> > (i) from the seller to the buyer;

(ii) advanced on 15 March 1997 (the Rights Date);

(iii) of US$1,300,000;

(iv) repaid on 15 September 1997;

(v) with a repayment amount of US$1,400,000.

5.7 To calculate this unaccrued difference, the purchaser allocates the resulting US$100,000 of expenditure over the period using an available method under the qualified accruals rules. For a loan of less than one year's duration, a straight line basis is available, and the purchaser elects to use this.

5.8 For the period after the end of the year ended 30 June 1997, this gives expenditure of:

$$(77/184) \times \text{US}\$100{,}000 = \text{US}\$41{,}848.$$

5.9 The purchaser converts this amount into NZ$ using the same spot rate used to calculate "a". This gives an unaccrued difference of:

$$\text{US}\$41{,}848/.57 = \$73{,}417.$$

5.10 The result of a − b − c is therefore $2,456,140 − $2,280,702 − $73,417 = $102,021. Because this is a positive amount, it will be expenditure for the purchaser.

5.11 For the year ended 30 June 1998, the purchaser applies the base price adjustment in section EH 4. This will be calculated as follows:

a = all amounts of consideration paid by the purchaser. This is the US$ price of the building, converted into NZ$ at the spot rate when paid. This will be US$1,400,000/.57 = $2,456,140;

b = the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using the spot rate on the Payment Date. This is US$1,300,000/.57 = $2,280,702;

c = expenditure already recognized, of $102,021.

The base price adjustment is therefore $73,417, which will be expenditure to the purchaser in the 1998 year.

5.12 If the seller did not complete the repairs until July so that the purchaser did not take possession until after June, the buyer would have no expenditure under section EH 1 in the year ended 30 June 1997, since no payment under the notional loan contract would have been made during the 1997 year.

5.13 Under section EH 8(2) of the Act, the acquisition price of $2,280,702 for the building will also be its cost price for depreciation purposes.

About this document

General determinations set out the Commissioner's view on how the financial arrangements rules apply to a specific type of financial arrangement. All general determinations are binding on the Commissioner and some are also binding on taxpayers.