Inland Revenue
Te Tari Taake

INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

Income tax implications of providing sponsorship

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IS 26/10

This interpretation statement considers the income tax implications for a business that provides sponsorship to an organisation, event, person or cause, where the taxpayer (the sponsor) intends that the sponsorship will promote or advertise the business. The sponsorship may be provided in the form of money or by providing products or services.

All legislative references in this statement are to the Income Tax Act 2007 (the Act).

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What is "sponsorship"?

1. In this interpretation statement, the term "sponsorship" refers to supporting an organisation, event, person or cause either monetarily or by providing products or services, where the taxpayer (the sponsor) intends that the sponsorship will promote or advertise their business.

When sponsorship expenditure will be deductible

The general permission

2. For sponsorship expenditure to potentially be deductible, the general permission must be satisfied. This means there must be a sufficient nexus or connection between the expenditure and an income-earning process the taxpayer has. If the general permission is satisfied, there are some general limitations to deductibility that may apply (see from [12]).

3. To determine whether the general permission is satisfied, it is necessary to ascertain the true character of the expenditure, and consider the relationship between the advantage the taxpayer was seeking to gain from the expenditure and the taxpayer's income-earning process.

4. Determining the advantage the taxpayer was seeking to gain from the expenditure is a subjective matter. It requires considering the taxpayer's purpose at the time the expenditure was incurred.

5. If no income is derived as a result of the expenditure, this does not necessarily mean the expenditure was not incurred for the purpose of deriving income. Ultimately, a taxpayer's subjective purpose or purposes in incurring expenditure will be a question of fact. Determining the taxpayer's purpose involves an objective analysis of surrounding circumstances, including the effect of the expenditure.

6. In the absence of associated party or avoidance concerns, the quantum of the expenditure is not material to whether expenditure is deductible. That is, deductibility does not depend on the amount of expenditure being "reasonable".

7. Expenditure may be only partly deductible where it is in part incurred for a purpose unrelated to the taxpayer's business or income-earning activity, or when a deduction for part of the expenditure is prohibited.

8. However, the fact that a third party may benefit from expenditure a taxpayer incurs does not necessarily preclude that expenditure from being fully deductible.

9. In a situation where a taxpayer has two or more distinct purposes for making the expenditure, not all of which relate to the taxpayer's business or income-earning activity, apportionment will generally be required. However, in a situation where the third-party benefit is incidental to the purpose relating to the taxpayer's business or income-earning activity, apportionment is not required.

10. The fact there may be some philanthropic motivation for a taxpayer incurring expenditure does not necessarily preclude it from being fully deductible. While there may be some philanthropic motivation for expenditure being incurred, there may often also be a business motivation. If it can be shown that the expenditure is intended to benefit the business, such that the general permission is satisfied, the expenditure will be deductible.[1] For example, if there is promotion and exposure of the business to a relevant market audience.

11. For expenditure to meet the nexus test in the general permission, a taxpayer will need to be able to show it was intended that the business would be promoted or advertised by incurring the expenditure. The following factors may support a taxpayer's contention that this is the case:

- the specific terms of the sponsorship arrangement (which does not necessarily need to be in writing);
- the place of the sponsorship arrangement in a coherent marketing strategy;
- the relationship between the market, or potential market, and the taxpayer's business; and
- the relationship between the expenditure and the resulting income derived.[2]

Limitations to deductibility

12. If the general permission is satisfied, there are some general limitations to deductibility that may apply. The two general limitations potentially relevant to sponsorship expenditure are the capital limitation and the private limitation.

13. It is also possible that the entertainment expenditure rules (in subpart DD) may apply to reduce the deduction to 50% of what would otherwise be allowed.

[1] Subject to any limitations applying – see from [12].

[2] It is not normally possible to identify particular income as being derived as a result of particular expenditure, but if it can be shown that the expenditure gave rise to income, that would be a strong supportive factor.

The capital limitation

14. The capital limitation denies deductibility to the extent an amount of expenditure or loss is of a capital nature.

15. The following factors are relevant in determining whether expenditure is of a capital nature:

- the need or occasion that calls for the expenditure;
- whether the expenditure is recurrent in nature;
- whether the expenditure creates an identifiable asset;
- whether the expenditure creates an advantage that is of enduring benefit to the business;
- whether the expenditure is on the profit-making structure or process;
- whether the payment is made from fixed or circulating capital; and
- the treatment of the expenditure under ordinary principles of commercial accounting.

16. In the context of sponsorship expenditure, some of these factors will be more relevant than others. In considering any given circumstances, it is necessary to weigh up the factors to determine whether all or part of the sponsorship expenditure is of a capital nature.

17. If the capital limitation applies to deny deductibility because the taxpayer acquires an asset that is made available for use under a sponsorship arrangement, a deduction for depreciation may be available (see from [26]).

The private limitation

18. The private limitation denies deductibility to the extent an amount of expenditure or loss is of a private or domestic nature.

19. Where a private or domestic benefit arises because this was a purpose of the expenditure, distinct from the business promotion purpose, then apportionment will be necessary. However, where a benefit of a private or domestic nature arises incidentally to the income-earning or business activity of the person incurring the expenditure, apportionment is not required.

20. A company cannot incur private expenditure, given its separate legal and non-natural person character. However, if a company's expenditure has some private or domestic character in the hands of the recipient, this may be relevant in determining the purpose or purposes of the expenditure and whether the general permission is satisfied.

The entertainment expenditure limitation rule

21. If the entertainment expenditure limitation rule applies, it will reduce the deduction to 50% of what would otherwise be allowed.

22. The limitation rule may apply to expenditure[3] on corporate boxes, holiday accommodation, yachts and other pleasure craft, and the provision of food and drink.

23. There are various circumstances where the limitation rule will not apply, which may be relevant in the context of sponsorship. For example, if the entertainment is sponsored mainly to advertise or promote a taxpayer's business to the public, and the public has the same access to the entertainment as employees, business contacts or people associated with the business. See further from [98].

Expenditure not all used up by the end of an income year

24. If a deduction for expenditure is allowed, it is necessary to consider whether all of the expenditure is 'used up' in the income year. If it is not, this impacts the tax treatment.

25. If some or all of the expenditure is 'unexpired' at the end of the income year (that is, it is not used up – because some relates to future income years), the unexpired portion is included in the taxpayer's income for the year. It is then allowed again as a deduction in the following income year.

Depreciation

26. It may be that a taxpayer provides sponsorship through allowing use of depreciable property (for example, allowing a sports team to use a business-branded motor vehicle owned by the taxpayer on weekends for transport). In this situation, a deduction will be allowed for depreciation. The amount of the depreciation loss is determined under subpart EE.

27. The amount of the depreciation loss allowed as a deduction will depend on whether the depreciable property is wholly used or available for use by the taxpayer in deriving income or in carrying on a business for the purpose of deriving income and whether there is any private use of the depreciable property. If the depreciation deduction needs to be apportioned, how this is done depends on which rules apply – the standard deductibility rules or the mixed-use asset rules.

[3] "Expenditure" is specifically defined in the entertainment expenditure rules – see [101].

Sponsorship through providing goods that are trading stock

28. A taxpayer may provide sponsorship by providing goods that are 'trading stock' of a business (property that the business has for the purpose of selling or exchanging in the ordinary course of the business).

29. Where this is the case, the value of the trading stock will be deductible through the trading stock rules.

30. There may be deemed income where the goods that the taxpayer provides are trading stock and the taxpayer disposed of them for less than market value consideration. There will **not** be deemed income where the taxpayer provides the trading stock:

    - in the course of carrying on a business;[4]
    - to a donee organisation;[5] or
    - to a non-associated person for their use in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event.[6]

Sponsorship through providing services

31. A taxpayer may also provide sponsorship by providing services. Where they do this, the costs associated with providing the services will be deductible for the business under the general permission if it can be shown that the sponsorship is intended to benefit the business.

32. If the taxpayer provides the services for no remuneration, no income will arise. But if the sponsor business provides services at a reduced rate, there will be income to the extent the business is remunerated for the services.

Sponsorship of an employee

33. If an employer sponsors an employee (for example, paying their entry fee for an event they will take part in) in return for brand exposure, this may be sponsorship expenditure to which the deductibility principles explained in this statement would be relevant.

[4] So long as the taxpayer does not provide the trading stock to an associated person or take it for their own use or consumption.

[5] Whether or not the taxpayer provides the trading stock in the course of carrying on a business and whether or not the donee organisation is associated with the person providing the trading stock.

[6] Whether or not the taxpayer provides the trading stock in the course of carrying on a business.

34. However, it may simply be the case that the amount is deductible because what the employer provides is employment income for the employee or gives rise to a fringe benefit. In either case, there will be no need to consider any element of 'sponsorship'.

Analysis | Tātari

What is "sponsorship"?

35. In this interpretation statement, the term "sponsorship" refers to supporting an organisation, event, person or cause either monetarily or by providing products or services, where the taxpayer (the sponsor) intends that the sponsorship will promote or advertise their business.

36. If the taxpayer can demonstrate the required degree of nexus or connection between the expenditure and income-earning process because of the promotional or advertising aim of the expenditure, the expenditure is essentially just a form of marketing. However, the fact that a third party may benefit from expenditure may mean the expenditure is not fully deductible.

37. The following discussion covers the deductibility principles that are relevant to whether sponsorship expenditure, or expenses associated with providing sponsorship by providing goods or services, will be deductible, and if so to what extent.

When will sponsorship expenditure be deductible?

There must be a sufficient connection between the expenditure and the income-earning activity or business

38. The first requirement for expenditure to be deductible is that it must be incurred by a person either:

- in deriving assessable income or excluded income or a combination of the two (s DA 1(1)(a)); or
- in the course of the person carrying on a business for the purpose of deriving assessable income or excluded income or a combination of the two (s DA 1(1)(b)).

39. This rule is known as the general permission. The general permission is set out in s DA 1:

DA 1 General permission

Nexus with income

(1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—

(a) incurred by them in deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income; or

(b) incurred by them in the course of carrying on a business for the purpose of deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income.

General permission

(2) Subsection (1) is called the **general permission**.

...

40. This means that to be (potentially) deductible, the expenditure has to have the necessary relationship with the taxpayer and with the gaining or producing of assessable income or with the carrying on of a business for that purpose. In other words, there must be a sufficient nexus between the expenditure and an income-earning process the taxpayer has.

41. If the general permission is satisfied, there are some general limitations (in s DA 2) to deductibility that may apply. Of relevance to sponsorship, this includes that deductions are denied to the extent expenditure is:

- of a capital nature (this is known as the capital limitation) – discussed from [67]; or
- of a private or domestic nature (this is known as the private limitation) – discussed from [89].

42. It is also possible that the entertainment expenditure rules (in subpart DD) may apply to further restrict the deduction that would otherwise be allowed. See from [98].

The nexus requirement under the general permission

43. The degree of nexus, or connection, required to satisfy each of the two limbs of deductibility (s DA 1(1)(a) and s DA 1(1)(b)) is the same. But what the expenditure must have a sufficient nexus with is different. For the first limb, the required nexus is between the expenditure and the deriving of income,[7] and for the second limb it is between the expenditure and the carrying on of a business for the purpose of deriving income[8] (*NRS Media Holdings v CIR* (2018) 28 NZTC 23,079 (CA)).

44. To determine whether there is a sufficient nexus between expenditure and an income-earning process the taxpayer has, it is necessary to ascertain the true character of the expenditure, and consider the relationship between the advantage the taxpayer was seeking to gain from the expenditure and the taxpayer's income-earning process. See, for example, *CIR v Banks* [1978] 2 NZLR 472 (CA) and *Buckley & Young Ltd v CIR* [1978] 2 NZLR 485 (CA). The character of the receipt in the hands of the recipient is not determinative (*Regent Oil Co Ltd v Strick* [1965] 3 All ER 174 (HL)).

45. Determining the advantage the taxpayer was seeking to gain from the expenditure is a subjective matter. It requires considering the taxpayer's purpose at the time they incurred the expenditure (*CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA)). If it transpires that no income is derived as a result of the expenditure, this does not necessarily mean the expenditure was not incurred for the purpose of deriving income. Ultimately, a taxpayer's subjective purpose or purposes in incurring expenditure will be a question of fact. Determining the taxpayer's purpose involves an objective analysis of surrounding circumstances, including the effect of the expenditure (*National Distributors*).

The amount of the expenditure is generally not relevant

46. The amount of expenditure is not material. That is, deductibility does not depend on the amount of expenditure being "reasonable" (see, for example, *Europa Oil (NZ) Limited v CIR (No. 2)*; *CIR v Europa Oil (NZ) Limited (No. 2)* (1976) 2 NZTC 61,066 (PC); and *Ronpibon Tin NL & Tongkah Compound NL v FCT* (1949) 78 CLR 47 (HCA)). As noted in *Ronpibon Tin* (at 60):

> It is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent.

[7] Assessable income, excluded income, or a combination of the two.

[8] Again, assessable income, excluded income, or a combination of the two.

47. In the absence of associated party or avoidance concerns, the quantum of the expenditure is not material to whether expenditure is deductible. The expenditure will be deductible,[9] provided it is directed to income-earning or business ends.

A third party benefitting from the expenditure does not necessarily impact deductibility

48. The words "to the extent to which" in s DA 1 contemplate apportionment, in terms of how much expenditure may be deductible. For example, expenditure may be only partly deductible where the taxpayer incurs it in part for a purpose unrelated to their business or income-earning activity, or when a deduction for part of the expenditure is prohibited.

49. However, the fact that a third party may benefit from expenditure a taxpayer incurs does not necessarily preclude that expenditure from being fully deductible. For example, in *Usher's Wiltshire Brewery Ltd v Bruce* [1915] AC 433 (KB), Lord Atkinson considered that a brewery company's expenditure on repair and maintenance of tied houses (where the publicans (lessees of the premises) were required to buy all beers, wines and spirits from the brewery company only) was wholly and exclusively for the brewery company's trade, even though it benefitted the publicans incidentally.

50. In a situation where a taxpayer has two or more distinct purposes for making the expenditure, not all of which relate to their business or income-earning activity, apportionment will generally be required. However, based on the approach in *Usher's*, it is considered that in a situation where the third-party benefit is incidental to the purpose relating to the taxpayer's business or income-earning activity, apportionment is not required.

Philanthropy being a motivation for incurring the expenditure does not necessarily impact deductibility

51. The fact there may be some philanthropic motivation behind the expenditure does not necessarily preclude it from being fully deductible.

52. It is common for businesses, especially large corporations, to give back to the community through expenditure, providing trading stock, or providing services. While there may be some philanthropic motivation for this, there may often also be a business motivation. For instance, if it is done in part for the purpose of the business reputation and profile, as being **seen to be** doing good or giving back to the community is intended to be beneficial to the business in terms of being an attractive employer, attracting business, attracting investment, or enabling access to different

[9] Subject to any limitations applying – see from [65].

sources of funding or better costs of funding. If it can be shown that the expenditure is intended to benefit the business in this way, the general permission will be satisfied.

53. For example, many businesses (large corporates in particular) publish annual ESG[10] or sustainability reports, which may mean they can show that this 'social good' activity is done for the purposes of the business, such that the expenditure satisfies the general permission and is deductible. The fact there may also be some philanthropic motivation will not preclude deductibility.

54. Even if it cannot be shown that ESG-type expenditure satisfies the general permission, if the expenditure is a "charitable or other public benefit gift"[11] made by a company to a "donee organisation"[12] it will be deductible under s DB 41 (subject to the limit in s DB 41(3) – which is that the deduction for the total of all gifts in an income year is limited to what the company's net income would be in the absence of s DB 41).

Factors that will help show a sufficient connection between sponsorship expenditure and the income-earning activity or business

55. For expenditure to come within the definition of "sponsorship" used in this statement, and so *prima facie* meet the nexus test in the general permission, a taxpayer needs to be able to show that in incurring the expenditure they **intended that the business would be promoted or advertised**. Promoting or advertising the business to a relevant market or potential market for the purpose of gaining or producing income would demonstrate that there is the degree of nexus or connection between the expenditure and the income-earning process that the general permission requires. The following factors may support a taxpayer's contention that this is the case:

- **The specific terms of the sponsorship arrangement.**

  For example, is there a specific requirement for the recipient to promote the taxpayer's business? If so, what is the extent and prominence of the business exposure specified in the agreement?

  A sponsorship arrangement or agreement does not necessarily need to be in writing.

- **The place of the sponsorship arrangement in a coherent marketing strategy.**

  For example, if a business's market research has identified that potential customers frequently attend cultural events, then part of its marketing strategy

[10] ESG (environmental, social and governance) is a framework used to assess a company or organisation's operations in terms of environmental, social and governance factors.

[11] Defined in s YA 1 and s LD 3.

[12] Defined in s YA 1 (see [138]).

may be to sponsor such events in return for having its name and products promoted during the event.

- **The relationship between the market, or potential market, and the taxpayer's business.**

  For example, market exposure at a tennis tournament that is directly related to the business of a sports equipment retailer.

- **The relationship between the expenditure and the resulting income derived.**

  While it is not normally possible to identify particular income as having been derived as a result of particular expenditure, if it can be shown that the expenditure resulted in income being derived, that would be a strong supporting factor.

56. The South African case *ITC 696* (1950) 17 SATC 86 (HC) is an example of where sponsorship expenditure was held to be incurred in deriving income. In this case, a company that dealt in agricultural equipment purchased some footballs printed with words associated with the equipment in which the company traded. The company gave the footballs to various school football clubs. It also acquired two silver trophies engraved with its name and the names of various pieces of equipment in which it traded. The company gave these trophies to agricultural societies. The court held that the expenditure incurred on the footballs and trophies was deductible. Newton Thompson J commented (at 87):

> I am satisfied that this expenditure is for advertisement purposes, that it has that effect; that it assists in selling articles in which the appellant deals; that it is incurred in the production of income …

57. The evidence supporting the deductibility of the expenditure was described as follows by Mr Galbraith (at 91):

> … the company annually incurs expenditure on advertising the agricultural implements in which it deals. This advertising takes various forms, such as circulating pamphlets, distributing calendars, pocket-books, copper ash-trays, etc. It never takes the form of press advertising because the potential and actual customers of the company are too few to warrant advertising in newspapers.

58. This description illustrates that provision of the footballs and trophies fit within the company's marketing strategy, which included advertising on various articles to be distributed.

59. The taxpayer in *Case P16* (1992) 14 NZTC 4,107 (TRA) was a national courier that acquired and raced a Jaguar motor car that was marked with the company's logo. This case illustrates that evidence of a relationship between the potential market exposure from the expenditure and the taxpayer's business will support a contention that the

expenditure is deductible. It also illustrates that the amount of expenditure is not necessarily relevant to whether the expenditure is deductible. In response to the company's contention that the racing promotion was intended to associate the company with speed and efficiency, Keane J stated (at 4,114):

> … the company's decision was inherently logical from a business perspective, and the related steps taken wholly explicable from that perspective even if the level of expenditure ultimately incurred was greater than was first anticipated.

60. There was also evidence of a direct relationship between the sponsorship expenditure and the taxpayer's income, as the taxpayer could show that business turnover had increased markedly as a result of the racing promotion. This supported Keane J's conclusion that the related revenue expenditure was deductible.[13]

61. In the Australian Board of Review case, *Case F67* (1974) 74 ATC 397 (TBR), evidence that the potential market that could be reached as a result of the expenditure had a relationship to the taxpayer's business supported a conclusion that the expenditure was deductible. This case concerned a consulting engineer who also derived commission income as the sole representative of several foreign boat designers in Australia. To promote commission sales, the taxpayer had a power boat built to one of the designs for which he was the Australian representative. He had the names of his business and of the designer painted on the hull, along with his address and phone number. The boat was then raced. No commission sales were made in the income year in question, but this did not preclude deductibility of the revenue expenditure. In addition, the relatively high cost involved did not stop the Board of Review from finding that the revenue expenditure was deductible.

62. In *Cliffs International Inc v FCT* (1985) 85 ATC 4374 (WASC), the court held that sponsorship expenditure was deductible on the basis of evidence showing that the sponsorship arrangement was part of a coherent marketing strategy, and the market exposure from the expenditure had a relationship with the taxpayer's business. In this case, the taxpayer contributed to the annual running of a golf tournament in which their joint venture partners and key Japanese customers participated. In finding that the sponsorship expenditure was deductible, Kennedy J stated (at 4,392):

> This event was a carefully planned annual function, which was specifically directed to enhancing the relationship between the Robe River joint venture and its customers in Japan, being six of the major steel mills. It was the only formal social function held each year and was carefully adapted to the nature of the Japanese business. It was attended by senior executives from Cliffs, whilst Mitsui & Co was represented by the highest ranking personnel within its iron ore department, together with one of its corporate

[13] As noted at [55], it is not normally possible to identify particular income as having been derived as a result of particular expenditure, but if it can be shown that the expenditure resulted in income being derived, that would be a strong supporting factor.

> executive vice presidents. Each of the mills was represented by its highest ranking purchasing officer and two or three of his subordinates. The day was meticulously planned, so that those whom it was desired to bring together for business reasons were brought together. The day concluded with formal speeches of goodwill and presentations.

63. The issue of the relationship between the expenditure and the resulting income was referred to in *ITC 696*, but in that case the majority of the court gave little weight to the absence of any supporting evidence (at 92):

> With regard to this expenditure being too remote from the income to be an allowable deduction, I consider that it can fairly be stated that it is normally impossible to connect any particular sales with any particular advertising, though many companies go to considerable lengths in an endeavour to ascertain which media of advertisements produce the best results.

64. The issue of the remoteness of sponsorship expenditure from income derived was also referred to in the Canadian case *No 511 v MNR* (1959) 58 DTC 307 (TAB). In this case, the taxpayer was in the lumber business, and sponsored a local baseball team with the intention of building up its declining sales through promoting its name and products. In this case, it was considered that the fact the sponsorship was not direct advertising (in contrast to traditional forms of advertising, such as in newspapers or on signs, billboards, radio or television) was not sufficient to preclude deductibility. It was noted that sponsorship of sports events was a method of advertising which businesses often now use, and there was evidence that by sponsoring the baseball team the company in this case intended to advertise itself in order to improve its profits.

Example | Tauira 1 – Expenditure fully deductible; incurred solely for business promotion

Andrew is a sole trader who operates a motor mechanic business. He sponsors the local tennis club. Under the terms of the sponsorship agreement, which covers the year to 31 March, Andrew agrees to pay an upfront sum of $3,000 towards the club's running costs. In return, the club agrees to display Andrew's business logo on all uniforms, bags and vehicles that the club uses during the year.

The expenditure Andrew incurs will be fully deductible. The requirement for the club to display Andrew's business logo and name on its uniforms and other items indicates that Andrew incurred the expenditure to promote his business. It is therefore deductible because there is the necessary connection between the expenditure and the carrying on of the business to derive income.

Example | Tauira 2 – Expenditure not deductible; while donation resulted in some business promotion, that was not a purpose for which the expenditure was incurred, or was only incidental to other purposes

Elizabeth operates a business in Wellington as a sole trader. She gives $500 to the boarding school her son attends in Auckland, in the name of her business. She makes no stipulations about how the school is to use the money or that her business is to be promoted in return for the payment. Her business's name subsequently appears in a list of donors on the back page of the school's annual magazine. In all, the page lists 20 donors, and does not distinguish Elizabeth's business name in any way from the other 19 donors.

The $500 is not deductible under s DA 1. Elizabeth made no stipulation that her business be promoted. Although an element of business promotion arose when her business name appeared in the magazine, that is not determinative, unless Elizabeth can show that such promotion was a purpose of the expenditure. While every case must be considered on its particular facts, it is considered that here any marketing exposure resulting from the business name appearing on the back page of an annual school magazine is likely to be minimal as the business is one of 20 donors listed and is given no more prominence than the names of the other donors. This supports the view that there was no business promotion purpose for the expenditure, or if there was that it is incidental to other purposes (eg, private reasons) for making the payment. In addition, the fact that Elizabeth's son's school is in Auckland is likely to mean there would be little, if any, promotional impact in respect of her business which operates in Wellington. Therefore, based on an objective analysis of the surrounding circumstances, it is considered that the expenditure does not have the required nexus with the earning of Elizabeth's business's income.

While the $500 is not deductible, a donation tax credit may be available under s LD 1.

Limitations to deductibility

65. As noted at [41], if the general permission is satisfied, it is then necessary to consider whether any of the general limitations to deductibility (in s DA 2) apply. The two general limitations potentially relevant to sponsorship expenditure are the capital limitation and the private limitation. These are discussed, in the context of sponsorship expenditure, below – the capital limitation first (from [67]) and then the private limitation (from [89]).

66. As noted at [42], it is also possible that the entertainment expenditure rules (in subpart DD) may apply to reduce the deduction to 50% of would otherwise be allowed. Those rules are discussed from [98].

The capital limitation

67. In addition to the words in s DA 1 (the general permission) requiring apportionment, the capital limitation (s DA 2(1)) also requires apportionment, denying deductibility "to the extent" an amount of expenditure or loss is of a capital nature. Section DA 2(1) provides:

> **DA 2 General limitations**
>
> *Capital limitation*
>
> (1) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature. This rule is called the **capital limitation**.
>
> ...

68. Case law establishes that the following factors are relevant in determining whether expenditure is of a capital nature:

- **The need or occasion that calls for the expenditure.**

  This involves considering what prompted or made it necessary for the taxpayer to incur the expenditure and whether the surrounding circumstances and ultimate objective of the expenditure support a capital or revenue classification.

- **Whether the expenditure is recurrent in nature.**

  If expenditure is recurrent, this may indicate it is of a revenue nature, whereas if expenditure is one-off this may indicate it is of a capital nature. However, whether expenditure is recurrent or one-off is not determinative. This factor is closely aligned with the previous one; expenditure that is an ordinary incident of carrying on a business may be of a revenue nature whether it is one-off or recurrent.

- **Whether the expenditure creates an identifiable asset.**

  Expenditure will be of a capital nature if the taxpayer acquires an identifiable capital asset through the expenditure.

- **Whether the expenditure creates an advantage that is of enduring benefit to the business.**

  This is similar to the previous factor. If the taxpayer acquires an enduring advantage through the expenditure, the expenditure is likely to be of a capital nature. This factor is often linked to the question of recurrence. However, an enduring benefit is to be distinguished from a situation where the expenditure merely relieves the taxpayer from making revenue payments for a period of time.

- **Whether the expenditure is on the profit-making structure or process.**

  This factor is about distinguishing between expenditure that relates to the business's structure (that is, expenditure incurred on establishing, replacing or enlarging the profit-making structure of the business) and expenditure that relates to the business's operation (that is, expenditure incurred as part of the process by which the business's structure operates).

  This factor is often linked to the identifiable asset and enduring advantage factors. Combining those factors enables the correct classification to be made. For example, expenditure made as an ordinary incident of the business, to maintain the profit-making structure, is likely to be of a revenue nature despite relating to the profit-making structure. On the other hand, expenditure made to enable the business to operate differently is likely to be of a capital nature, despite relating to the profit-making process.

- **Whether the payment is made from fixed or circulating capital.**

  Expenditure made from fixed capital (that is, capital on which the taxpayer seeks a return through the business's operation) is more likely to be of a capital nature. Expenditure made from circulating capital (that is, capital that returns to the business as a result of the business's operation) is more likely to be of a revenue nature. The courts do not give much weight to this factor, as it is easy for a business to choose whether to finance an asset, say, from fixed or circulating capital, irrespective of the nature of the asset financed.

- **The treatment of the expenditure under ordinary principles of commercial accounting.**

  How expenditure is classified according to ordinary commercial accounting principles may support the classification made from applying the other factors. However, accounting classification is not usually determinative, as tax and accounting have different aims and may differ in their treatments.

(See, for example, *Sun Newspapers Limited and Another v FCT* (1938) 61 CLR 317 (HCA); *BP Australia Limited v FCT* (1965) 14 ATD 1 (PC), *CIR v L D Nathan & Co Limited* [1972] NZLR 209 (CA), *Buckley & Young*; *CIR v McKenzies New Zealand* (1988) 10 NZTC 5,233 (CA); *Christchurch Press Company Limited v CIR* (1993) 15 NZTC 10,206 (HC); *CIR v Wattie* (1998) 18 NZTC 13,991 (PC); *Poverty Bay Electric Power Board v CIR* (1999) 19 NZTC 15,001 (CA); and *Birkdale Service Station Ltd v CIR* (2000) 19 NZTC 15,981 (CA)).

69. In the context of sponsorship expenditure, some of these factors will be more relevant than others. In relation to any given circumstances, it is necessary to weigh up the factors to determine whether all or part of the sponsorship expenditure is of a capital nature.

70. Some examples from case law that illustrate how these considerations may be relevant to sponsorship expenditure are discussed below.

The need or occasion that calls for the expenditure

71. This factor is likely to be of limited use in the context of sponsorship expenditure, where in many cases the principal reason or need for incurring the expenditure is to promote or advertise the business. This would indicate that the expenditure is not of a capital nature, but is not enough on its own to support that classification.

72. However, this factor may indicate the expenditure is capital where, for instance, the business promotion relates to establishing a market for a new business. That said, in that situation, the expenditure is unlikely to have satisfied the general permission in the first place, being preliminary expenditure (prior to a business existing) rather than expenditure incurred in the course of carrying on a business (*Calkin v CIR* (1984) 6 NZTC 61,781 (CA)).

Recurrence

73. Whether sponsorship expenditure is recurrent is, by itself, unlikely to be determinative of whether the expenditure is of a revenue or capital nature. Sometimes sponsorship expenditure will be only one-off (for example, a once-only sponsorship of a sports event). Other times it will be recurrent (for example, regularly sponsoring the sports event).

74. An example of circumstances where recurrence would have supported a finding of sponsorship expenditure being of a revenue nature, had it been at issue, is *Cliffs International* (see [62]). In that case, the golf tournament was held annually.

75. An example of once-only sponsorship expenditure nonetheless being of a revenue nature is *ITC 696* (see from [56]). While the expenditure on the trophies was one-off, the majority considered that the expenditure was of a revenue nature. While this finding was principally based on the fact that no enduring asset was acquired by the company, since it divested itself of the ownership of the trophies, it nevertheless indicates that recurrence is not determinative.

76. Expenditure that is an ordinary incident of carrying on a business may be of a revenue nature whether it is one-off or recurrent. In the context of sponsorship expenditure, it is considered that not much weight should be placed on whether the expenditure is recurrent. This is because a taxpayer's business promotion purpose, necessary to establish that the expenditure satisfies the general permission, would likely be sufficient to show that the expenditure was an ordinary incident of business.

An identifiable asset

77. One of the factors most likely to be relevant in considering the capital limitation in the context of sponsorship expenditure is whether the expenditure results in an identifiable asset that the taxpayer owns. If it does, the capital limitation is likely to apply. However, if the expenditure is on an asset that the taxpayer divests itself of, the capital limitation is unlikely to apply.

78. This is illustrated in the majority decision in *ITC 696*, where the expenditure was not considered to be capital. As discussed from [56], in this case the taxpayer purchased footballs and trophies and branded them with the company's name and the names of various pieces of agricultural equipment in which it traded. The taxpayer gave the footballs and trophies to football clubs and agricultural societies, respectively. The majority of the court distinguished the taxpayer's circumstances from cases where the taxpayer retained an identifiable asset and therefore the expenditure incurred to acquire the asset was held to be of a capital nature (*ITC 217* (1931) 6 SATC 137 (HC) and *ITC 469* (1940) 11 SATC 261 (HC)). The majority in *ITC 696* stated (at 93):

> In my opinion this case is clearly distinguishable. Appellant company purchased cups and immediately presented them to agricultural societies, **thereby divesting itself of ownership. It had no asset as a result of this advertising expenditure** …
>
> [Emphasis added]

Example | Tauira 3 – Capital limitation does not apply; no enduring asset as the taxpayer does not own the asset

Andrew from Example 1, on page 15, also agrees to reimburse the tennis club for the purchase of its van provided his business logo is prominently displayed on the van.

Although the van is a capital item, the capital limitation does not apply as Andrew does not own the van. Therefore, no enduring asset results to Andrew from this expenditure. Andrew is, in effect, paying for the promotion of his business on the van.

However, if Andrew purchased the van and retained ownership of it, using it in his business and allowing the club to use it on weekends, the capital limitation would apply. This is because the expenditure in this scenario would result in Andrew owning an enduring asset (the van). In this situation, depreciation deductions will be allowed – see from [112].

Example | Tauira 4 – Capital limitation does not apply; the taxpayer does not retain an enduring asset

Jacob Jones runs a sporting goods store called Jones' Sports. Jones' Sports sponsors an annual soccer competition for the three local primary schools, to be named the Jones Competition. Jacob believes that the sponsorship arrangement will result in increased sales for the business.

Jones' Sports purchases soccer balls and goals branded with the business name and provides these to each school. Jones' Sports also purchases a trophy to be presented to the winner of the competition. The trophy is labelled "Jones Competition sponsored by Jones' Sports", and each year the trophy is to be engraved with the winner's name. Jones' Sports incurs a total of $5,000 in the first year of this arrangement.

Here, there is a relationship between Jacob's business and the sponsorship, both being related to sport. Even though it may be impossible to identify what sales, if any, resulted from the sponsorship arrangement, Jacob's contention that the expenditure was incurred in order to increase sales is reasonable as the equipment and trophy carry the business name so create brand recognition and advertising. Therefore, the expenditure satisfies the general permission.

The expenditure does not result in Jones' Sports owning an identifiable asset, so the capital limitation does not apply to preclude deductibility of the expenditure.

Enduring advantage

79. Any expenditure to obtain long-term advertising merely relieves the taxpayer from making revenue payments for a period of time. It is not considered that this type of 'enduring advantage' is of a capital nature (*Anglo-Persian Oil Co Ltd v Dale* (1931) 16 TC 253 (KB)). However, if not all the expenditure is 'used up' in the income year, the portion that relates to future income years may need to be brought back in as income (see from [106]).

80. If sponsorship expenditure results in an enduring advantage of branding or goodwill, it is considered that gaining this advantage is intrinsically linked to the business exposure itself. The advantage is not one that results from the business's prior operation (in contrast to goodwill acquired when the business is purchased, which would be a capital asset). Although the advantage may endure beyond the end of the sponsorship agreement, this is no different from ordinary advertising. In both cases, any 'branding' benefit gained will usually dissipate rapidly unless the exposure or advertising is repeated in order to maintain it. For this reason, it is considered that any incremental contribution to long-term goodwill or brand value is properly regarded as incidental, because similar increments can be achieved in other ways such as through ordinary

advertising, giveaways to customers, good customer service, and product quality. Therefore, it is considered that the expenditure on it is of a revenue nature and the capital prohibition will not apply. This conclusion is in line with the majority judgment in *ITC 696* (at 92):

> There is little doubt that the benefit of this advertising was not confined to the year of assessment, but the same can probably be said about most advertising except in connection with special "bargain sales". With regular advertising in various forms it is normally impossible to state when and for how long any benefit may be received and if, to be allowable as a deduction, its effect must be confined to the year of assessment, it appears to me that very little advertising expenditure could be allowed as a deduction. **I am of the opinion that all successful advertising must inevitably tend to increase the goodwill of the advertiser or of the merchandise advertised, but I am unable to agree that, therefore, such advertising becomes expenditure of a capital nature.**
>
> [Emphasis added]

Profit-making structure or profit-making process

81. This factor is about distinguishing between expenditure relating to the business's profit-making structure and that relating to the business's operation.

82. As noted at [68], this factor is often linked to the identifiable asset and enduring advantage factors. As such, in the context of sponsorship expenditure, this test would not appear to add anything to the analyses of those other factors.

83. The business promotion aspect of sponsorship expenditure, as it is defined in this statement, would appear ordinarily to be related to the profit-making process rather than to the profit-making structure. The principal exception would be where a taxpayer acquires an identifiable asset as a result of expending the money. In that case, the sponsorship expenditure enhances the profit-making structure and so the capital limitation would apply.

Whether the payment is made from fixed or circulating capital

84. As noted at [68], the courts do not give much weight to this factor, as it is easy for a business to choose whether to finance an asset, say, from fixed capital or circulating capital, irrespective of the nature of the asset financed. Similarly, a business may finance sponsorship expenditure from either fixed or circulating capital, without changing its inherent nature by doing so. Therefore, it is considered that this test is unhelpful in this context.

The treatment of the expenditure under ordinary principles of commercial accounting

85. Sponsorship and promotional expenditure would ordinarily be classified as being of a revenue nature according to generally accepted accounting practice. This supports treating sponsorship expenditure as deductible. However, as noted at [68], this test is not usually determinative, as tax and accounting have different aims and may therefore differ in their treatments.

86. Nevertheless, in the context of sponsorship expenditure, if for some reason a taxpayer treated such expenditure as being of a capital nature for accounting purposes, there may be some grounds for analysing whether the taxpayer should follow that accounting classification for tax purposes.

Conclusion – capital limitation

87. The factors that the courts have developed to distinguish between capital and revenue expenditure are not necessarily all relevant in the context of sponsorship expenditure. Of the various factors, the identifiable asset test is likely to be the most important. While the question of whether there is an enduring advantage also appears relevant, frequently the nature of the enduring benefit resulting from sponsorship expenditure will not warrant a capital classification because the benefit is intrinsically linked to the means of exposure.

88. If the capital limitation applies to deny deductibility because the taxpayer has acquired an asset that is made available for use under a sponsorship arrangement, a deduction for depreciation may be available – see from [112].

The private limitation

89. The private limitation (s DA 2(2)) also requires apportionment, denying deductibility "to the extent" an amount of expenditure or loss is of a private or domestic nature. Section DA 2(2) provides:

> **DA 2 General limitations**
>
> ...
>
> *Private limitation*
>
> (2) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. This rule is called the **private limitation**.
>
> ...

90. An outgoing is of a private nature if it is referable to living as an individual member of society. Domestic expenses are those relating to the household or family unit. (*CIR v Haenga* (1985) 7 NZTC 5,198 (CA)).

91. Where a private or domestic benefit arises because this was a purpose of the expenditure, distinct from the business promotion purpose, then apportionment will be necessary. However, based on the approach in *Usher's*, it is considered that where a benefit of a private or domestic nature arises **incidentally** to the income-earning or business activity of the person incurring the expenditure, apportionment is not required.

92. A number of Taxation Review Authority cases have involved situations where someone (usually an employee of the taxpayer) gained private enjoyment from the sponsorship expenditure. Those and some other Taxation Review Authority cases aside, the Commissioner does not consider that a company can incur private expenditure, given its separate legal and non-natural person character. However, if expenditure of a company has some private or domestic character in the hands of the recipient, this may be relevant in determining the purpose or purposes of the expenditure and whether the general permission is satisfied (see from [38]). In addition, if the person benefitting from the expenditure is a shareholder and/or employee of the company it will be necessary to consider whether there is a dividend, fringe benefit, or a payment that is to be treated as salary or wages. For companies, the discussion below may be helpful in determining whether a third-party benefit is incidental to a business objective, and so whether the general permission requires apportionment (see [48] to [49]).

93. In *Case L7* (1989) 11 NZTC 1,052 (TRA), the taxpayer was a radiator manufacture and repair company whose principal was interested in go-kart racing. The company decided to become involved in go-kart racing as a means of promoting the business. The go-kart displayed the name of the company, the principal drove the go-kart, the pit crew (company employees) wore company colours, and the company was promoted on a billboard at the racetrack and in the racing programme.

94. The issue before the Taxation Review Authority was whether the associated expenditure should be apportioned between business promotion (deductible) and private enjoyment (no deduction allowed). Barber DJ concluded that the expenditure was fully deductible, as the private enjoyment was purely incidental, stating (at 1,055):

> I agree with the submission of Mr Nation, that the fact that Mr S obtained substantial enjoyment from the kart racing is not a significant factor in deciding whether or not the expenses incurred in that activity should be tax deductible. In my view, the issue is whether the expenditure is bona fide advertising expenditure in character, or is wholly or partly expenditure in the pursuance of go kart racing as a sport or recreational pastime. That factual issue pivots on the credibility of the evidence. I accept Mr S as an honest witness. I find that although he enjoyed his involvement in kart racing and had

> previously been quite strongly interested in racing in general, he made a calculated decision to boost his business enterprise by participating in kart racing with a high business profile. He sought business contacts in the motor trade and work from those contacts and from the general public. I am satisfied that these aims were achieved, and continue to be retained, in a substantial manner. I do not suggest that advertising must have good results to be deductible. I appreciate that, after much consideration, the respondent took the view that there were two equal factors in relation to the advertising expenditure, namely, the obtaining of personal pleasure in go kart racing and the attracting of business from that activity. **On the evidence which I have heard, I find on the balance of probability that the business expended money on go-kart racing predominantly to advertise the business and that any private intentions or purposes of Mr S were quite incidental to the predominant objective of business expansion.** In other words, I am satisfied that there was a sufficient link between the expenditure and the income earning process of the radiator manufacturing and repair business, with regard to the entire expenditure and not merely to 50% of it.
>
> [Emphasis added]

95. The same approach was taken in *Case P16* (discussed at [59]), where the company's principal was interested in car racing. In that case, Keane J held that he saw no reason to elevate the principal's private enjoyment of racing the car to the status of a competing purpose.

96. In *Case M131* (1990) 12 NZTC 2,850 (TRA), Bathgate DJ approved of the approach in *Case L7*. The taxpayer in this case owned a building business that had a substantial connection, both business and private, with the horse racing industry. To maintain and extend the business relationship, the taxpayer purchased and raced a horse and sponsored several races in return for the business name appearing on the race books of the races sponsored. While the horse was raced under the names of the individual owners, it was soon identified with the company. The percentage of income that the company derived from the racing industry increased following the increased promotional activity. While the deductibility of the sponsorship expenditure was not at issue in this case, in relation to remaining revenue expenditure, Bathgate DJ held that the statutory nexus was satisfied and that the element of private enjoyment was incidental to the main purpose of business promotion.

97. It is important to note that the decisions in these cases were based on the particular facts. In each case, there was evidence that the decision to promote and advertise the business was the purpose for which the expenditure was incurred, and any private purposes were incidental to that objective. A different conclusion could well be reached on different facts. For example, if someone had been engaged in a particular pastime and then decided to start funding it through their business with some signage or other promotion, it would be necessary to closely consider whether there was a genuine business purpose for the expenditure and, if there was, whether there was also a non-incidental private purpose for the expenditure. Relevant considerations in this

regard may include the connection between what the taxpayer incurred the expenditure on and the business or the market they were targeting, the marketing strategy of the business, and the anticipated or actual financial results (see further [55]).

Example | Tauira 5 – Expenditure only partly deductible; apportionment required because private advantage not just incidental to business purposes

Bruce is a builder, in business as a sole trader, trading as Bruce Builders. He agrees to build a new gym at his daughter's school (an elite private school) in return for an annual 50% discount on school fees for the entire time his daughter attends the school.

The school will provide the materials, but Bruce will supply the labour (himself and three of his employees). The school agrees that while the gym is being built Bruce can erect signage on the construction site stating that Bruce Builders is constructing the gym. After the construction is completed, the school will display a prominent plaque on the front of the gym stating that Bruce Builders constructed it.

Does the prohibition for expenditure of a private or domestic nature apply to the expenditure Bruce incurs on staff wages in relation to the construction of the gym?

Bruce incurred the expenditure on his staff's wages during the period of construction in the course of carrying on his business for the purpose of deriving his gross income, as there is a business promotion purpose, with signage and a permanent plaque agreed as part of the arrangement.

However, another purpose Bruce had in incurring the expenditure was to obtain the 50% discount on his daughter's school fees. This advantage that he seeks is of a private nature.

On these facts, it is not considered that this private advantage was just incidental to the business promotion that Bruce contemplated in entering into the arrangement with the school. Therefore, it would be necessary to apportion the expenditure between the private and business promotion purposes he had in incurring the expenditure, with the portion relating to the private benefit being non-deductible. The burden of proof is on Bruce to show what part of the expenditure was deductible.

Alternative facts: Instead of being a sole trader, Bruce operates through a company, Bruce Builders Ltd. Bruce is a shareholder-employee of the company. The company negotiated the agreement to build the gym in return for the discount on Bruce's daughter's school fees.

In this case, Bruce Builders Ltd can choose to treat the benefit of the discounted school fees as either a fringe benefit or a dividend, for the reasons below.

The discount on the school fees would be an unclassified benefit under the fringe benefit tax rules. This is because the benefit (the discount) is provided to Bruce, an employee of the company, through an arrangement made between the employer (the company) and another person (the school). On these facts it is not considered that the company's purpose or object of the benefit of reduced school fees being provided to Bruce is just incidental to the business promotion purpose. The benefit is therefore treated as having been provided by the employer (the company) (s CX 2(2)).[14]

If a company provides a non-cash benefit to an employee who holds shares in the company (which is the case here, because the company is treated as having provided the benefit), the benefit is treated as having been provided in connection with the employment (s CX 17(1)).

The company may generally choose (under s CX 17(2)) to treat the benefit as a fringe benefit or a dividend.[15] If the company makes no election, the benefit is treated as a fringe benefit. If the company chooses to treat the benefit as a dividend, it is a dividend (s CD 20) and the fringe benefit tax rules do not apply (s CX 17(2)).

Example | Tauira 6 – Expenditure fully deductible; apportionment not required because private enjoyment just incidental to business purposes

A firm, AAA Accounting, has entered into an agreement with the national opera company, under which the firm will cover the cost to the opera company of financing the orchestra that accompanies the operas. In return, the opera company will prominently display the words "proudly sponsored by AAA Accounting" on the buildings where its operas are performed, on all concert programmes it sells, and in all advertisements for its operas.

AAA Accounting's purpose in entering into the agreement was to provide exposure of its business to influential members of the audience, as confirmed in its marketing plan. A survey that it had commissioned showed that a significant proportion of opera attendees were individuals from whom the firm sought business, being people who were of high net worth or who were influential in the corporate and government sectors. Based on the results of the survey, AAA Accounting considered that the

[14] See further **BR Pub 14/10:** Fringe benefit tax – Provision of benefits by third parties – section CX 2(2).

[15] The exception to this in s DG 2(4) is not relevant here.

exposure it gained from sponsoring the opera company would attract these people or their businesses as clients.

In the opera company's annual report, the managing director referred to the agreement with AAA Accounting and noted that two of the three partners in the firm had personally had a long association with opera, being "opera lovers" themselves.

Although AAA Accounting is not in a business related to opera, it obtains business exposure through the agreement, reaching a target audience it has identified in its marketing plan as being desirable. While the private enjoyment of opera by two of the three partners in the firm may arguably indicate that the expenditure was also incurred for private purposes, it is considered that the rationale for the sponsorship given in the marketing plan shows that the expenditure was incurred for business purposes and any private enjoyment will be incidental to the business purpose of incurring the expenditure.

The entertainment expenditure rules

98. The entertainment expenditure rules (in subpart DD) may need to be considered if, in deriving income, a person incurs expenditure on entertainment that provides both a 'private' and a business benefit.

99. Under these rules, a deduction for expenditure on certain specified types of entertainment may be reduced to 50% of the amount that would otherwise have been allowed. This is known as the "limitation rule" (s DD 1).

100. The expenditure the limitation rule may apply to is expenditure on:

- corporate boxes;
- holiday accommodation;
- yachts and other pleasure craft; and
- the provision of food and drink, on or off the business premises.

101. "Expenditure" is specifically defined in the entertainment expenditure rules (s DD 1(7)). It includes: an amount of depreciation loss; expenditure or loss on running costs, maintenance and similar; and incidental expenditure on things such as hireage of crockery, glassware or utensils, waiting staff, and music or other entertainment provided in association with the types of entertainment listed at [100].

102. The limitation rule will not apply in various circumstances. Most relevantly in the context of expenditure that may be considered to be 'sponsorship', this includes in the following situations:

- Where the entertainment is sponsored mainly to advertise or promote a taxpayer's business, goods, or services to the public, provided that the public has the same access to this as the taxpayer's employees, business contacts or people associated with the business.
- Where the entertainment is merely an incidental part of:
  - a trade display mainly held to advertise or promote a business, goods, or service; and/or
  - a function open to the public and mainly held to advertise or promote a business, goods, or services.
- Where the expenditure is on samples that are provided (to someone who is not an employee or associated person) for promotion or advertising purposes.
- Where the expenditure is on entertainment provided to a person who is reviewing the entertainment for a book, magazine, paper, or other medium of communication.
- Where the expenditure is on entertainment provided to members of the public for charitable purposes.
- Where the expenditure is on entertainment that is either income of the person who consumes it or a fringe benefit to which fringe benefit tax applies.

103. The entertainment expenditure rules do not apply to expenditure incurred in relation to private use of an asset that the mixed-use asset rules apply to (s DG 2(2)).

104. The entertainment expenditure rules are not the focus of this statement, as most expenditure that falls within the term "sponsorship", as used in this statement, will not be within the specific types of expenditure the limitation rule may apply to, or will be within one of the circumstances where the limitation rule will not apply. But Example 7 illustrates a situation where sponsorship would be subject to the limitation rule.

105. For further information on the entertainment expenditure rules see Inland Revenue's website (Entertainment expenses) and **IR268: Entertainment expenses** (which can be downloaded from the "Entertainment expenses" webpage).

Example | Tauira 7 – Entertainment limitation rule applies to limit deductibility to 50% of what would otherwise be allowed

Jules and Nate have a fitness and nutrition business. They provide catered lunch to a local sports club for the players and opposition players when the club hosts home games, to promote their business to this pool of clients and potential clients.

The expenditure the business incurs in providing the catering is expenditure on food provided off the business premises. It may therefore be subject to the entertainment expenditure limitation rule. In this case it is, as none of the exclusions from the limitation rule apply. In particular (as they are the potentially relevant exclusions here):

- The exclusion in s DD 5(1) (*sponsored promotions*) does not apply. This is because the entertainment is not sponsored mainly to advertise or promote a taxpayer's business, goods, or services to the public, but rather to a particular pool of clients and potential clients, and the public does not have the same access to the entertainment (the food provided) as the clients and potential clients (business contacts) the food is provided to.
- The exclusion in s DD 6(2) (*entertainment for charitable purposes*) does not apply. This is because the entertainment is not provided to members of the public for charitable purposes.

The limitation rule therefore applies and 50% of the cost of the catering is deductible.

Treatment of expenditure that is not used up by the end of an income year

106. Even if a deduction for expenditure is allowed under the general permission in s DA 1 and is not prohibited by any of the general limitations in s DA 2, it is necessary to consider whether all of the expenditure is 'used up' in the income year. If it is not, this impacts the tax treatment.

107. Section EA 3 applies where a deduction for expenditure has been allowed under the Act, but some or all of it is 'unexpired' (that is, not used up) at the end of the income year. Essentially, the unexpired portion of expenditure is the portion that relates to future income years.

108. There are some exclusions from s EA 3 (see EA 3(2) and certain circumstances where a taxpayer is excused from complying with s EA 3 (see DET E12: **Persons excused from complying with section EA 3 of the Income Tax Act 2007**). Most relevantly in the context of sponsorship, DET E12 may mean s EA 3 does not need to be complied with in respect of expenditure on the cost of advertising (which "sponsorship", as defined in this statement, is a form of).

109. If s EA 3 applies, and the taxpayer is not excused from complying with it, any "unexpired portion" of the expenditure at the end of the income year is included in the taxpayer's income for the year and then allowed again as a deduction in the following income year.

110. Where the expenditure relates to the purchase of goods, the current-year deduction is effectively restricted to goods used in that year in deriving income. Where the expenditure relates to a payment for services, the current-year deduction is effectively restricted to the amount incurred on services performed in that year. Where the expenditure relates to a chose in action,[16] the deduction is deferred for the portion relating to the unexpired part of the period that the chose is enforceable.

111. The mechanism in s EA 3 effectively means the deduction is spread over the sponsorship term to which it relates. This generally aligns with standard accounting treatment, so no additional tax adjustments would typically be required.

Example | Tauira 8 – Adding back expenditure not 'used up' at the end of the income year

Joey owns and operates a restaurant. He enters into a sponsorship agreement with the local brass band. Under the agreement, Joey agrees to pay $9,000 upfront towards the band's running costs for the next 3 years in return for having the name of his restaurant displayed prominently on the drums for that period.

As a result of the expenditure, Joey acquires a chose in action consisting of the right to have his restaurant name displayed on the drums for the 3-year period. Therefore, the unexpired portion of the expenditure at the end of the income year will be the portion of the $9,000 that relates to the unexpired part of the 3-year period in respect of which the chose in action is enforceable.

For example, if a full 12 months under the agreement falls within the first income year, the unexpired portion will be $6,000 (the amount that relates to the 2 years remaining under the agreement). The $9,000 expenditure will be deductible in the income year, but the restaurant must include the $6,000 unexpired portion in its income for the year (so the net effect is a $3,000 deduction for the first year). The $6,000 will be allowed as a deduction in the following income year, with the unexpired portion at the end of that year ($3,000) added back in as income. This effectively means the $9,000 deduction is spread over the 3-year sponsorship term to which it relates.

Joey would not be excused from complying with s EA 3 under DET E12, because one of the requirements of the determination is that the length of time between the balance date for the income year and the subsequent expiry date of the expenditure does not exceed the relevant specified time period. In the case of expenditure on the cost of

[16] A right to something that does not confer possession of a tangible object, which can be enforced. In the context of sponsorship, an example is the right to have business advertising displayed somewhere.

advertising, the time period between the balance date and the expiry of the expenditure cannot be more than 6 months. That is not the case here.

Example | Tauira 9 – Adding back expenditure not 'used up' at the end of the income year

PQR Ltd pays a local trust $3 million toward the cost of construction of a swimming complex, in return for naming rights for a 10-year period. PQR pays the $3 million in one lump sum in the current income year.

The company gains business exposure through the expenditure, in that its name appears on the complex. Therefore, PQR Ltd is allowed a deduction for $3 million in the income year in which it incurs the expenditure.

Any enduring advantage from the expenditure, namely business exposure for a 10-year period, is of the same nature as advertising, and so is revenue in nature. The fact that the expenditure is made in a lump sum does not change its revenue character; it merely relieves the company from making revenue payments throughout the 10-year period. Therefore the capital limitation does not apply to preclude the expenditure being deductible.

However, the right to the exposure through the naming rights is a chose in action that continues to be enforceable beyond the income year. The period of enforceability is the 10-year period for which the naming rights are granted. Therefore, s EA 3 applies to require PQR Ltd to include the unexpired portion of the expenditure in its income at the end of each income year until there is no longer any unexpired portion.

The unexpired portion at the end of each income year will be the amount of the $3 million expenditure that relates to the unexpired part of the 10-year period in respect of which the chose in action is enforceable. For example, if at the end of the current income year, the naming rights have been in place for 6 months and so 9½ years remain, the unexpired portion will be $2,850,000 (95% of the $3 million expenditure, because the 9½ years remaining is 95% of the 10-year period). PQR Ltd must include this amount in its income for the current income year, but it will be allowed as a deduction in the next income year. At the end of that next year, the unexpired period will be 8½ years and so PQR Ltd must include $2,550,000 in its income in that income year. And so on until the 10-year period has expired.

PQR Ltd would not be excused from complying with s EA 3 under DET E12, because one of the requirements of the determination is that the unexpired portion of the expenditure together with all other unexpired portions of expenditure of the same type does not exceed the relevant specified maximum total amount. In the case of

expenditure on the cost of advertising, the maximum total amount of unexpired expenditure of that type is $14,000. That is not the case here, as even at the start of the last year, the unexpired expenditure (for this advertising alone – let alone any other advertising) will be 6 months' worth of the $3 million (so $150,000).

Depreciation

112. It may be that a taxpayer provides sponsorship through allowing use of depreciable property[17] (for example, allowing a sports team to use a business-branded motor vehicle owned by the taxpayer on weekends for transport). In this situation, a deduction will be allowed for depreciation. The amount of the depreciation loss is determined under subpart EE.

113. The amount of the depreciation loss allowed as a deduction will depend on whether the depreciable property is used or available for use by the taxpayer in deriving income or in carrying on a business for the purpose of deriving income and whether there is any private or other non-income-earning use of the depreciable property. If the depreciation deduction needs to be apportioned, how this is done depends on which rules apply.

Apportionment of depreciation under the standard deductibility rules

114. If the standard deductibility rules apply, the amount of depreciation loss that can be deducted cannot be more than the amount calculated under the formula in s EE 50. Under the formula, depreciation loss deductions would be disallowed in respect of any days on which the asset is used or available for use that are not "qualifying use days". Qualifying use days are days an asset is used or available for use for income-earning or in a way that is subject to fringe benefit tax.

115. So, for example, if there is private or other non-income-earning use of an asset on a particular day and the asset is not used or available for use for income-earning on that day, the formula in s EE 50 will determine the maximum amount of the depreciation loss that is deductible.

116. If there are days there is private use of the asset but it is also used or available for use for income-earning, the depreciation loss will still need to be apportioned between income-earning use and private use, because of the private limitation (s DA 2(2)).

[17] Defined in ss YA 1 and EE 6.

Apportionment of depreciation under the mixed-use asset rules

117. If the mixed-use asset rules apply, they override the formula in s EE 50 and the private limitation.[18] The mixed-use asset rules set out a specific formula[19] to reduce available deductions on account of private use.

118. Land, aircraft, and ships, boats or other similar watercraft may be subject to the mixed-use asset rules. This will generally be the case if the asset is:

- used in the income year to derive income;
- used privately in the income year; and
- unused for at least 62 days in the income year.[20]

119. Assets can move in or out of the rules from year to year, so whether the rules apply needs to be tested for each income year.

120. There are some exclusions from the mixed-use asset rules that may apply. Relevantly for present purposes, an asset is excluded from the operation of the rules if all of the following criteria are met:[21]

- the private use of the asset is minor;
- the main use of the asset is use in a business that is not a rental or charter business; and
- for a company or a trustee of a trust, the use of the asset places an obligation on the company or the trustee, as applicable, to pay fringe benefit tax or income tax.

121. Private use, for the purposes of the mixed-use asset rules, includes use of an asset by a natural person who is associated with the owner of the asset.[22] This means that for the purposes of the mixed-use asset rule, there can be private use of an asset owned by a company. For example, if there is use of the asset by a natural person that has a voting interest of 25% or more in a company (in which case the person and the company will be associated).[23]

122. A day on which a fringe benefit tax liability arises is an income-earning day for the purposes of the mixed-use asset apportionment formula,[24] so will not reduce the level

[18] Section DG 8(3).

[19] Set out in s DG 9.

[20] Or, if the asset is typically used only on working days, if it is unused for at least 62 working days in the income year (s DG 3).

[21] Section DG 3(4).

[22] Section DG 4.

[23] Section YB 3.

[24] Section DG 9(3)(b)(iii).

of deductibility. However, if a company shareholder is also an employee of the company, and a non-cash benefit is provided to the person in circumstances where s CX 17 applies, the company must choose to treat the benefit as a dividend, and no liability to pay fringe benefit tax arises.[25] Therefore, days on which the shareholder-employee uses the asset may be "counted days" for the purposes of the mixed-use asset apportionment formula, and reduce the level of deductibility. However, if a day is an income-earning day it is not a "counted day". So, for example, if there is private use of an asset on a day that is also an income-earning day, that day will not count towards reducing the level of deductibility.

123. Example | Tauira 10 illustrates how the mixed-use asset rules may apply to limit the allowable depreciation deduction.

124. For detailed information on the mixed-use asset rules, see: **Special report on mixed-use assets** (Inland Revenue, 2013).

Example | Tauira 10 – Depreciation loss fully deductible; while there is a third-party benefit, the asset is still used in deriving income or carrying on a business to derive income

Paul owns and operates a plant nursery. He purchases a van on which he displays his business name prominently. He makes the van available to the local garden society on weekends, but retains ownership of it and uses it for business purposes during the week.

The cost of the van is not deductible because of the capital limitation. However, a deduction for depreciation will be allowed.

In this case, a question arises as to whether the van is wholly or only partly used or available for use by Paul in carrying on his business for the purposes of deriving income. If it is only partly used or available for use in this way because the garden society members use it on weekends, those days would not be 'qualifying use days' for depreciation, so the allowable depreciation loss would need to be reduced accordingly (s EE 50).

It could be thought that when the van was being used by the garden society members, it would not be used or available for use by Paul for business purposes and that, therefore, s EE 50 would apply to limit the depreciation deduction otherwise available. However, because Paul's business name is prominently displayed on the van, this provides business exposure. In addition, the garden society members are a potential market for Paul's plant nursery business. Therefore, it is considered that the van is

[25] Section DG 2(4) (if the mixed-use asset rules do not apply, the company may choose to treat the benefit as a fringe benefit or as a dividend).

being used for business purposes, even when it is being used by the garden society members. As such, s EE 50 does not apply to limit the deduction available for depreciation.

Example | Tauira 11 – Depreciation loss partially deductible under the mixed-use asset rules

John is a shareholder-employee of ABC Ltd, a marine products supplier. He has a 100% voting interest in the company. Racing yachts is a hobby of John's. ABC Ltd decides to advertise and promote the business by purchasing a yacht that John will race. The yacht cost $100,000, and ABC Ltd has the hull sign-written with the company's name and logo. The yacht is docked at the local marina. John uses it on weekends and races it in various yachting competitions, creating brand exposure for the business to other yachties in the area the business operates. The yacht is used by John on 100 days in the income year in question. ABC Ltd charters the yacht for corporate events on 25 days in the income year in question.

The cost of the yacht is not deductible, but a depreciation deduction will be allowed

The cost of the yacht is not deductible because of the capital limitation. However, a deduction for depreciation will be allowed. This is because the company's name is displayed on the yacht, and its business of supplying marine products is promoted when the yacht is used and when it is docked at the marina. In addition, it is chartered during the income year. The yacht is therefore used or available for use in deriving income or carrying on a business for the purpose of deriving income.

The fact that John enjoys yachting does not necessarily reduce the amount of depreciation deduction that is allowed. To determine the extent to which the depreciation deduction is allowed, it is necessary to consider whether the mixed-use asset rules or the standard deductibility rules apply. The mixed-use asset rules override the formula in the depreciation rules (s EE 50) for determining the amount of depreciation allowed for assets partly used to derive income. As such, the mixed-use asset rules are considered first below.

Do the mixed-use asset rules apply?

On these facts, the mixed-use asset rules in subpart DG apply to the yacht. This is because:

- the rules can apply to boats (that cost or had a market value when acquired of more than $50,000);

- the rules can apply to close companies (which ABC Ltd is, because it has five or fewer natural persons whose voting interest in the company is more than 50%);[26]
- the yacht is actively used in the income year to derive income, when it is chartered;
- the yacht is used privately in the income year (John's use of the yacht is "private use" for the purposes of the rules, because he is a natural person associated with the company); and
- the yacht is unused for at least 62 days in the income year.

No exclusion from the mixed-use asset rules applies. The potentially relevant exclusion, mentioned at [120], requires the private use to be minor, and the main use of the asset to be in a business that is not a rental or charter business. That is not the case here. There are 100 private use days (when John uses the yacht), which is more than 'minor' private use.

As the yacht is within the mixed-use asset rules, it is then necessary to consider the apportionment formula in s DG 9, to determine what level of deduction is allowed.

How much of the depreciation deduction is allowed under the mixed-use asset rules?

The days the yacht is chartered are "income-earning days" for the purposes of the apportionment formula in the mixed-use asset rules.

However, the days John uses the yacht are not considered "income-earning days". This is because income-earning days in the formula are (broadly) "days in the income year for which the person derives income from the use of the asset".[27] While there is advertising exposure of ABC Ltd's business when John sails the yacht, there is no income that can be identified as having been derived from this use of the yacht. This is supported by the definition of "use" of an asset in the mixed-use asset rules, being "the active use of the asset for its intended purpose".[28] While John is actively using the asset for its intended purpose (sailing), the company derives no identifiable income from this. Any income it may ultimately derive as a result of the advertising exposure is not income it derives from the active use of the yacht.

Days on which a fringe benefit tax liability arises are included in the formula as "income-earning days". However, as discussed below, because John is a shareholder-employee, his use of the yacht is a dividend and the fringe benefit tax rules do not

[26] Section DG 3(3) and the definition of "close company" in s YA 1.

[27] Section DG 9(3)(b).

[28] Section DG 3(7).

apply. The days John uses the yacht are therefore not included as "income-earning days" on the basis that a fringe benefit tax liability arises for those days, as it does not.

Under the formula in s DG 9, 20% of the depreciation loss for the year is deductible (25 income-earning days / 125 counted days).

The formula in the depreciation rules (s EE 50) for determining the amount of depreciation allowed for assets partly used to derive income is not relevant. This is because the yacht is within the mixed-use asset rules, which override s EE 50.

The entertainment expenditure rules

Expenditure on yachts or other pleasure craft may be subject to the entertainment expenditure limitation rule. As noted at [101], expenditure is defined for the purposes of the entertainment expenditure rules as including an amount of depreciation loss. However, in this case the limitation rule does not apply. This is because:

- The depreciation loss that is deductible relates to the 25 days the yacht is chartered for corporate events. The exclusion in s DD 5(1) (*sponsored promotions*) applies. This is because the expenditure (the depreciation loss) is on entertainment that is sponsored mainly to advertise or promote ABC Ltd's business, and business contacts, employees and associated parties of ABC Ltd do not have greater opportunity to enjoy the entertainment (ie, charter the yacht) than the general public.
- The depreciation loss does not relate to the days John uses the yacht. As these are "private use" days for the purposes of the mixed-use asset rules, the apportionment under those rules results in there being no depreciation loss deduction allowed in respect of those days. Further, s DG 2(3) confirms that the entertainment expenditure rules do not apply to expenditure incurred in relation to the private use of an asset that the mixed-use asset rules apply to.

Other considerations because John is a shareholder-employee

Because John is a shareholder-employee of the company, there are fringe benefit and dividend implications to consider.

If a company provides a non-cash benefit to an employee who holds shares in the company, in circumstances where s CX 17 applies, the benefit is treated as having been provided in connection with the employment. The company may generally choose to treat the benefit as a fringe benefit or a dividend. If the company makes no election, the benefit is treated as a fringe benefit. If the company chooses to treat the benefit as a dividend, the fringe benefit tax rules do not apply. (Section CX 17).

However, as noted at [122], if the mixed-use asset rules apply and a non-cash benefit is provided to a shareholder-employee of a company in circumstances where s CX 17 applies, the company **must** choose to treat the benefit as a dividend. That is the case here. The benefit (John's use of the yacht) is therefore a dividend.

If John were an employee but not a shareholder in the company, whether his use of the yacht is a fringe benefit would depend on whether it is considered to be in connection with his employment. This would be the case if John's employment is at least a substantial reason for the benefit (use of the yacht) being provided. For further information see: **The meaning of "benefit" for FBT purposes** *Tax Information Bulletin* Vol 18, No 2 (March 2006): 26.

Sponsorship through providing goods that are trading stock

125. A taxpayer may provide sponsorship by providing goods that are 'trading stock' of the business (property that the business has for the purpose of selling or exchanging in the ordinary course of the business).

The value of the trading stock is deductible

126. Where this is the case, the value of the trading stock will be deductible through the trading stock rules (s DB 49). Section DB 49 supplements the general permission,[29] which means the general permission does not need to be satisfied for the deduction to be allowed.[30]

Will there be deemed income where the goods provided are trading stock?

127. It is then necessary to consider whether s GC 1 will apply to treat the business as having derived an amount equal to the market value of the trading stock. Section GC 1 provides (relevantly):

> **GC 1 Certain disposals of trading stock at below market value**
>
> *When this section applies*
>
> (1) This section applies when—

[29] Section DB 49(5).

[30] Section DA 3(1).

(a) a person (**person A**) disposes of trading stock for—

(i) no consideration; or

(ii) an amount that is less than the market value of the trading stock at the time of the disposal; and

(b) 1 or more of the following apply:

(i) the disposal is effected by person A taking the trading stock for their own use or consumption:

(ii) the disposal is not made by person A in the course of carrying on a business for the purpose of deriving their assessable income, or their excluded income, or a combination of their assessable income and excluded income:

(iii) the disposal is to an associated person.

Market value consideration

(2) Person A is treated as deriving an amount equal to the market value of the trading stock at the time of the disposal.

…

Exclusions

(5) This section does not apply to a disposal of trading stock—

(a) to a donee organisation:

…

(c) by a person to another person, who is not associated with them, for use by the other person in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event:

…

Is the disposal one to which s GC 1 may apply?

128. Section GC 1 may potentially apply where a business disposes of trading stock for no consideration or for less than market value consideration. In the context of sponsorship through providing goods that are trading stock, it is likely that this criterion will be met. However, that is not necessarily always the case, as the value of the business promotion or exposure agreed as part of the arrangement may be equal to or exceed the market value of the trading stock. If that is the case, s GC 1 will not apply, and the discussion below will not need to be considered.

129. If the trading stock is disposed of for no consideration or for less than market value consideration, it will be necessary to consider whether the disposal is:

- effected by the trading stock owner taking the trading stock for their own use or consumption;
- not made in the course of carrying on a business for the purpose of deriving income; or
- to an associated person.

130. In any of those situations, s GC 1 will apply, unless an exclusion is available.

131. Two exclusions from s GC 1 may be relevant in the context of sponsorship expenditure. These are where the trading stock is disposed of to:

- a donee organisation; or
- a non-associated person for their use in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event.

132. The upshot of the requirements for s GC 1 to potentially apply and the exclusions from the provision is that s GC 1 **will not apply** to sponsorship through providing trading stock where the trading stock is provided:

- in the course of carrying on a business (so long as the trading stock is not provided to an associated person or taken by the trading stock owner for their own use or consumption);
- to a donee organisation (whether or not the trading stock is provided in the course of carrying on a business and whether or not the donee organisation is associated with the person providing the trading stock); or
- to a non-associated person for their use in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event (whether or not the trading stock is provided in the course of carrying on a business).

Section GC 1 will apply where the trading stock owner takes the stock for their own use or consumption

133. Section GC 1 will apply where the trading stock owner takes the stock for their own use or consumption. This is unlikely to occur in the context of sponsorship expenditure. However, it could arise in some circumstances where it could be the case, as illustrated in the following example.

Example | Tauira 12 – Trading stock taken for own use; market value consideration treated as being derived and must be included as income

Tony is a sole trader running a business selling skateboards and streetwear, which he operates through an Instagram account and linked online shop. Tony skateboards at

the local park most weekends and competes at amateur skateboarding competitions around the country each year. When he needs a new board, he takes one that is his trading stock, for his own use. A sticker on the board displays Tony's Instagram account name and a QR code that, when scanned, directs to the Instagram account.

There is arguably some element of 'sponsorship' here as Tony is supporting his own sporting endeavours while also getting some promotional benefit from other skateboarders seeing the sticker on his board.

However, Tony takes the board for no consideration and for his own use. If a taxpayer takes trading stock for their own use or consumption for less than market value, s GC 1 will apply,[31] even if it could be considered a disposal made in the course of carrying on a business to derive income. As such, s GC 1 will apply to treat Tony as having derived an amount equal to the market value of the board. Tony must include that amount in his income.

Section GC 1 will generally <u>not apply</u> if the trading stock is disposed of in the course of carrying on a business for the purpose of deriving income

134. If the taxpayer does **not** make the disposal of the trading stock for sponsorship purposes in the course of carrying on a business for the purpose of deriving income,[32] s GC 1 may apply. Conversely, if the taxpayer can show that the trading stock **was** provided in the course of carrying on a business for the purpose of deriving income, s GC 1 will generally not apply. The only exceptions to this are where the trading stock, while disposed of in the course of carrying on a business, is provided to an associated person or taken by the trading stock owner for their own use or consumption.

135. The discussion in this statement about the general permission is relevant to whether the taxpayer provides trading stock in the course of carrying on a business. While the provision of trading stock is not 'expenditure', the discussion about the degree of nexus or connection is equally relevant to whether there is a sufficient connection between the provision of the trading stock and the carrying on of the business for the purpose of deriving income.

136. If the taxpayer can show it was intended that the business would be promoted by providing the trading stock, s GC 1 will not apply.[33] The factors set out at [55] will similarly be relevant to whether a taxpayer can show a business promotion purpose in the context of sponsorship through the provision of trading stock.

[31] Unless an exclusion applies – which is not the case here (see [132]).

[32] Whether assessable income, excluded income, or a combination of the two.

[33] Provided that the trading stock is not provided to an associated person or taken by the trading stock owner for their own use or consumption.

Example | Tauira 13 – Trading stock disposed of in the course of carrying on business to derive income, so no market value consideration treated as being derived

CC Cosmetics Ltd provides make-up (trading stock of the company) to a make-up artist who is a social media influencer with a very large following, who regularly showcases and reviews new products in her social media posts.

As the influencer regularly reviews and discusses new cosmetics on her channels, CC Cosmetics Ltd anticipates that the influencer will review the products on her social media. The company is confident the influencer will love the products, so her posts will create positive publicity for the company and its cosmetics.

In this scenario, CC Cosmetics Ltd would be disposing of the trading stock in the course of carrying on the business, as it provides the trading stock seeking publicity or promotion of the business to a relevant audience. This is the case even though the company does not have a formal agreement with the influencer to review the products on her social media. The company reasonably anticipates the influencer will review the products on her social media channels.

As such, s GC 1 will not apply and CC Cosmetics Ltd will not be treated as having derived income from disposing of the products to the influencer.

The value of the trading stock provided to the social media influencer will be deductible through the trading stock rules (s DB 49).

Example | Tauira 14 – Trading stock disposed of to an associated person; market value consideration treated as being derived and must be included as income

The same facts apply as in Example 1 on page 41, with the exception that Tony is not a sole trader, but instead runs his business through a company in which he is the sole shareholder and has a 100% voting interest.

Section GC 1 will apply here even if it could be argued that because the sticker on Tony's board gives some promotional benefit, the company is providing the trading stock to Tony in the course of carrying on its business for the purpose of deriving income. This is because the company is disposing of the trading stock to an associated person. Tony and the company are associated persons under s YB 3.[34]

Section GC 1 will treat Tony's company as having derived an amount equal to the market value of the board. The company must include that amount in its income.

[34] See the definition of "associated person" in s YA 1 and the tests of association in ss YB 1 to YB 16.

Section GC 1 will <u>not apply</u> if the recipient of the trading stock is a donee organisation

137. If the taxpayer provides trading stock to a donee organisation, s GC 1 will not apply. This is the case whether or not the trading stock is provided in the course of carrying on a business (though, in the context of sponsorship, often it will be). It is also the case whether or not the donee organisation is associated with the person providing the trading stock.

138. "Donee organisation" is defined in s YA 1 as follows:

> **YA 1 Definitions**
>
> In this Act, unless the context requires otherwise,—
>
> ...
>
> **donee organisation** means an entity described in section LD 3(2) (Meaning of charitable or other public benefit gift) or listed in schedule 32 (Recipients of charitable or other public benefit gifts)

139. Most relevantly for the purposes of this statement, donee organisations include:

- societies, institutions, associations, organisations, or trusts that are not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic or cultural purposes within New Zealand; and
- funds established and maintained exclusively for the purpose of providing money for one or more of the purposes described above.

Example | Tauira 15 – Trading stock disposed of to a donee organisation (and in the course of carrying on business to derive income), so no market value consideration treated as being derived

A supermarket provides a local high school rowing club with sausages, bread, onions and condiments (trading stock of the company) for a fundraising sausage sizzle.

The rowing club agrees to hang signage at the event, thanking the supermarket for its support and displaying the supermarket's logo.

Sporting purposes are not necessarily charitable, but when directed to young people or schools they take on an educational element and are considered charitable.[35]

Section GC 1 will not apply and the supermarket will not be treated as having derived income from disposing of the trading stock to the rowing club, as the club is a donee organisation. This is the case whether or not the supermarket can show that it provided the trading stock in the course of carrying on its business for the purposes of deriving income (which may depend on whether there is any agreed promotion as part of the arrangement – which in this case there is in any event).

Section GC 1 will not apply where trading stock is disposed of in certain adverse event situations

140. If a taxpayer provides trading stock to a non-associated person for their use in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event, s GC 1 will not apply. This is the case whether or not the trading stock is provided in the course of carrying on a business.

141. "Self-assessed adverse event" is defined in s YA 1 as follows:

> **YA 1 Definitions**
>
> In this Act, unless the context requires otherwise,—
>
> ...
>
> **self-assessed adverse event**, for a person and a farming, agricultural, or fishing business of the person, means an event that—
>
> (a) is 1 of the following:
>
> (i) drought, fire, flood, or some other natural event:
>
> (ii) disease or sickness of livestock; and
>
> (b) materially affects the business; and
>
> (c) is described, together with the effect on the business, by the person in a statutory declaration given to the Commissioner

142. It is important to note that to fall within this exclusion from s GC 1, the trading stock must have been disposed of to the recipient for their use in a farming, agricultural, or

[35] *Laws of New Zealand* Charities (online ed, accessed 3 July 2025) at [51]. Also, for more information, search for "sports and charity" on charities.govt.nz. Note, for gifts of money to be eligible for a donation tax credit, the requirements of s LD 3 must be met, which will not be the case for all organisations with charitable purposes.

fishing business. General philanthropy through donating trading stock in adverse events will not fall within this exclusion (for example, if a supermarket provides groceries to families affected by a flood). However, if there are both philanthropic and promotional / business reputation purposes behind the trading stock being provided, it may be that the trading stock is provided in the course of carrying on a business (for example, the supermarket chain promotes its assistance by way of advertising aimed at encouraging customers to shop at the supermarket).

Example | Tauira 16 – Market value consideration will not be treated as being derived if there is a "self-assessed adverse event" or the trading stock is provided in the course of carrying on a business to derive income

In the immediate aftermath of a natural disaster, a farm supply shop provides hay (trading stock of the business) to affected farmers for use in their farming business, to feed their stock.

It is possible that s GC 1 will not apply in this situation. This will not be a disposal of trading stock to a donee organisation (as the hay is given directly to people in the community who need it). It is also unlikely to be a disposal made in the course of carrying on a business (as there is unlikely to be any business promotion). However, the provision of the trading stock may potentially fall within the exclusion in s GC 1(5)(c).

On these facts, the trading stock the supply shop disposes of is for the farmers who receive it to use in their farming businesses. For the exclusion from s GC 1 to apply, the farmer recipients would need to provide the Commissioner with a statutory declaration containing the required information for it to be a "self-assessed adverse event" as defined in s YA 1 (see [141]).

Otherwise, s GC 1 would likely apply, and the farm supply shop would be treated as having derived income from disposing of the trading stock (the hay) to the affected farmers.

If the self-assessed adverse event exclusion does not apply, s GC 1 would nonetheless not apply if the farm supply shop could show that it has provided the trading stock to the affected farmers in the course of carrying on its business for the purposes of deriving income. This would be the case if the shop could show that while there was some philanthropic purpose for providing the hay, another purpose was to gain the benefit of promotion and exposure of the business to a relevant market audience.

There may be various motivations for a business donating trading stock. There being some philanthropic or community–minded motivation does not preclude the donation

nonetheless being in the course of carrying on the business. Whether this is the case will be highly fact specific.

Sponsorship through providing services

143. Another way that a taxpayer may provide sponsorship is through providing services. Where a business does this, the costs associated with providing the services will be deductible under the general permission if the taxpayer can show that the sponsorship is intended to benefit the business (for example, through promotion or brand recognition).

144. To the extent the services are provided for no remuneration, there will be no income arising to the sponsoring business. But if the business provides services at a reduced rate, there will be income to the extent the business is remunerated for the services.

Example | Tauira 17 – Sponsorship through providing services; expenditure in providing the services is deductible

Dave is a cricket coach who provides one-on-one coaching. He provides an annual emerging player scholarship in conjunction with a cricket club. The person awarded the scholarship receives 10 hours of free coaching with Dave.

Dave's coaching business receives market exposure through the advertising for the scholarship, which is the reason Dave has entered into the scholarship arrangement with the club.

Dave incurs some expenditure in providing the free coaching (for petrol travelling to the coaching sessions and net hire). This expenditure is deductible, as Dave incurs it in providing the free coaching that he does in order for his business to benefit from the market exposure it gets from the scholarship advertising.

Dave is not remunerated at all for providing the coaching, so he has no income from this. If under the scholarship Dave provided 10 hours of coaching at a 50% discount, the reduced remuneration Dave receives for the coaching would be income.

Sponsorship of an employee

145. There may be occasions where an employer sponsors an employee, monetarily or through providing goods or services, in return for brand exposure (eg, on clothing the employee wears at the event, on equipment the employee uses at the event, or in some other way such as through signage or in the event programme). For example, an

employer may sponsor an employee to take part in a sporting event by paying their entry fee, or by providing goods (for example, sporting equipment) or services (for example, a garage providing free servicing to an employee who has a sports car they race).

146. These may be other instances of sponsorship expenditure, to which the deductibility principles explained earlier in this statement would be relevant.

147. That may be the case. However, it may simply be that the amount is deductible because what the employer provides is employment income for the employee or gives rise to a fringe benefit. In either case, there will be no need to consider any element of 'sponsorship'.

148. It may be that the sponsorship provided is neither employment income nor a fringe benefit. For example, if the garage referred to at [145] sponsored the driver because of their ranking, talent, and the relevance to the business of the market exposure, and would have offered the sponsorship regardless of whether they also happened to be an employee. In that case, the employment would not be a substantial reason for providing the benefit, so it would not be provided in connection with the employee's employment. In that situation, the deductibility of the associated costs of providing the sponsorship would be determined in accordance with the deductibility principles explained in this statement.

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Interpretation statements are issued by the Tax Counsel Office. They set out the Commissioner's views and guidance on how New Zealand's tax laws apply. They may address specific situations we have been asked to provide guidance on, or they may be about how legislative provisions apply more generally. While they set out the Commissioner's considered views, interpretation statements are not binding on the Commissioner. However, taxpayers can generally rely on them in determining their tax affairs. See further Status of Commissioner's advice (Commissioner's statement, Inland Revenue, December 2012). It is important to note that a general similarity between a taxpayer's circumstances and an example in an interpretation statement will not necessarily lead to the same tax result. Each case must be considered on its own facts.