

INTERPRETATION STATEMENT: IS 19/02

INCOME TAX – ATTRIBUTION RULE FOR INCOME FROM PERSONAL SERVICES

All legislative references are to the Income Tax Act 2007 (ITA 2007) unless otherwise stated. Relevant legislative provisions are reproduced in the appendix to this Interpretation Statement.

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Summary

1. This Interpretation Statement provides guidance on when the attribution rule for income from personal services in ss GB 27 to GB 29 will apply. It expands on

"Attribution of Income" *Tax Information Bulletin* Vol 12, No 12 (December 2000): 49. It does not discuss or explain the calculation rules contained in s GB 29.

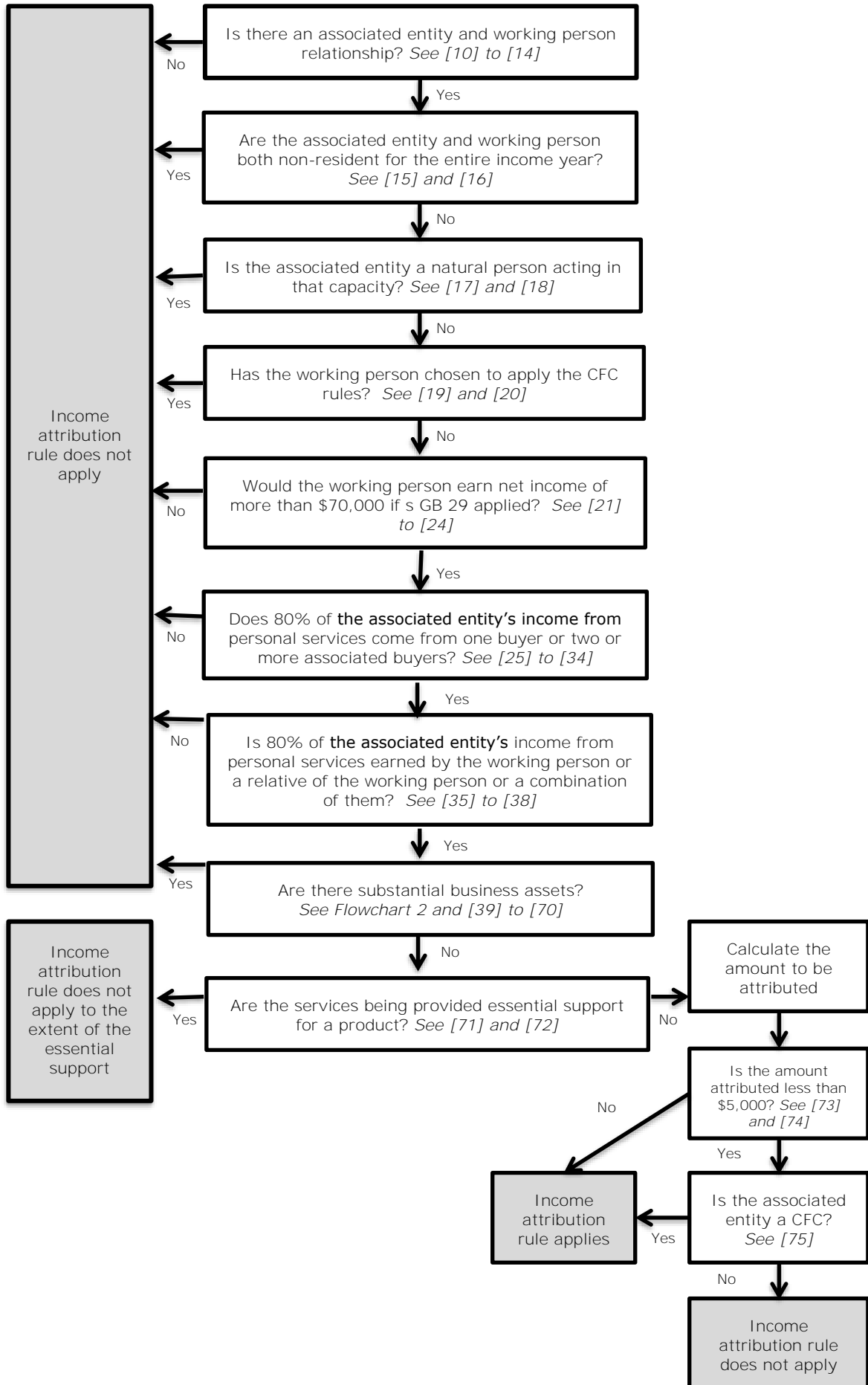
2. The attribution rule for income from personal services in ss GB 27 to GB 29 is a specific anti-avoidance rule that prevents an individual avoiding the top personal tax rate by diverting income to an associated entity. Essentially, the income attribution rule applies when an individual (the working person), who performs personal services, is associated with an entity (the associated entity) that provides personal services to a third person (the buyer).
3. The income attribution rule only applies where various threshold tests are met and no exemptions apply. This Interpretation Statement provides guidance on the application of each of those threshold tests and exemptions, to assist readers in determining whether the income attribution rule applies to their situation.
4. This Interpretation Statement makes minor amendments to and replaces IS 18/03: Income Tax – attribution rule for income from personal services, published in *Tax Information Bulletin* Vol 30 No 9 (October 2018).

Introduction

5. The income attribution rule applies where (s GB 27(1)):
 - a person (the working person) provides personal services;
 - the working person is associated with an entity (the associated entity);
 - the associated entity is inserted between the working person and the party who acquires the services (the buyer);
 - the working person performs the services, but the associated entity derives the income;
 - various threshold tests in s GB 27(2) are satisfied; and
 - none of the exemptions in s GB 27(3) apply.
6. This Interpretation Statement focuses on the application of the threshold tests in s GB 27(2), and the exemptions in s GB 27(3).
7. The threshold tests that must be satisfied for the income attribution rule to apply are:
 - **80% or more of the associated entity's income from personal services** during the income year is derived from the supply of services to the buyer or an associate of the buyer or a combination of them (s GB 27(2)(a)); and
 - **80% or more of the associated entity's income from personal services** during the income year is derived from services that are performed by the working person or a relative of the working person or a combination of them (s GB 27(2)(b)); and
 - **the working person's** net income for the income year exceeds \$70,000, including any amounts that would be attributed if the rule applied (s GB 27(2)(c)); and
 - substantial business assets are not a necessary part of the business **structure used to derive the entity's assessable** income (s GB 27(2)(d)).

8. However, even if the threshold tests are satisfied, a working person and an associated entity will be exempt from applying the income attribution rule where:
 - the associated entity and the working person are non-residents;
 - the associated entity is a natural person, and is neither a partner of a partnership nor a trustee of a trust;
 - the services performed by the working person are essential support for a product supplied by the associated entity;
 - the amount to be attributed to the working person is less than \$5,000 (although there are exclusions to this); or
 - in various situations where the associated entity is a controlled foreign company (CFC).
9. A process for considering the application of the various thresholds and exemptions is illustrated in Flowchart 1 on the next page.
10. The analysis following the flowchart discusses each of the threshold tests and any exclusions in the order that they appear in the flowchart.

Flowchart 1: Does the income attribution rule apply?



Is there an associated entity and working person relationship?

11. The income attribution rule will only apply where the entity is associated with the working person.
12. The rules in subpart YB apply to determine whether a working person and an entity are associated persons. A company and a person (other than a company) will be associated if the person has a voting interest in the company of 25% or more (s YB 3).
13. If the entity and the working person are not associated, the income attribution rule will not apply.

Example 1. Identifying the parties

Paul employs Andrea. Andrea is paid a salary of \$150,000.

Andrea incorporates a company called A&M Co Ltd which contracts her services to Paul. Andrea is the sole shareholder of A&M Co Ltd. Paul pays A&M Co Ltd \$150,000 for the services provided. A&M Co Ltd pays Andrea a salary of \$80,000 and retains the remaining \$70,000.

Question

Who are the relevant parties under the income attribution rule?

Answer

Under the new arrangement, Paul is the buyer, A&M Co Ltd is the associated entity and Andrea is the working person for the purposes of the income attribution rule.

Who	Attribution party	Contractual party	Original party
Paul	Buyer	Buyer	Employer
A&M Co Ltd	Associated entity	Employer	None
Andrea	Working person	Employee	Employee

14. The income attribution rule is not restricted to reorganisations of existing situations. It also applies to new structures where the appropriate relationships are created. The income attribution rule is also not confined to a corporate structure. The associated entity could be, for example, a trust or a partnership, and the working person could be a partner, trustee or beneficiary of a trading trust. The rules in subpart YB will also apply to determine whether a working person is associated with a partnership or trust. In particular, a partner and a partnership will be associated persons (s YB 12), and a trustee of a trust will be associated with the beneficiaries (s YB 6) (and people related to the beneficiaries (s YB 5)) and settlors of the trust (s YB 8), and with a person with the power to appoint or remove the trustee (s YB 11).
15. Most of the examples given in this item are based on a corporate structure because that is likely to be the most common structure. However, the analysis is equally applicable to other less common business structures where the income attribution rule may apply such as a trading trust or partnership.

Example 2. Identifying the parties

Jane and Megan have just established the JM Partnership. Jane completes all the work for the partnership while Megan has contributed the capital. The JM Partnership has entered into a substantial contract with Bug Eliminators Ltd which will take almost all of **Jane's time**.

Question

Who are the relevant parties under the income attribution rule?

Answer

Under the arrangement Bug Eliminators Ltd is the buyer, JM Partnership is the associated entity and Jane is the working person for the purposes of the income attribution rule.

Are the associated entity and working person both non-resident for the entire income year?

16. Under s GB 27(3)(a), the income attribution rule will not apply if the associated person and the working person are both non-resident during the relevant income year under the tests in ss YD 1 (Residence of natural persons) and YD 2 (Residence of companies). For more guidance on the application of the residence tests **see** "IS 16/03: Tax Residence" *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.
17. The residence or non-residence of the working person is the first matter to address when considering this exemption. It will only be necessary to consider the residence of the associated entity if the working person is a non-resident.

Example 3. Non-resident working person and resident associated entity

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

Question:

Does the income attribution rule apply?

Answer:

Yes, the income attribution rule applies. The exemption in s GB 27(3)(a) provides that both the associated entity (NZCO) and working person (John) must be non-residents at all times. While John is not a New Zealand tax resident, NZCO is incorporated in New Zealand so is a company that is a New Zealand resident for tax purposes. There may be some relief for a working person under the Australia/New Zealand double tax agreement, but this item does not consider the application of any relevant double tax agreements.

Example 4. Tax resident working person

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

Question:

Does the income attribution rule apply?

Answer:

Yes, the income attribution rule applies. The exemption in s GB 27(3)(a) provides that both the associated entity (NZCO) and the working person (Michelle) must be non-residents at all times. In this example Michelle (the working person) is a New Zealand tax resident. This means the requirements of s GB 27(3)(a) are not met.

Example 5. Non-resident associated entity

Bryan was a New Zealand tax resident but he currently lives in the United Kingdom and is a non-resident at all relevant times. He owns all of the share capital of BRITCO which is a UK company. Bryan is the working person and BRITCO is the associated entity. BRITCO provides consulting services to UKCO, which is the sole buyer of the services that BRITCO provides. Bryan provides the services in the United Kingdom.

Question:

Does the income attribution rule apply?

Answer:

No, the income attribution rule does not apply. The exemption in s GB 27(3)(a) provides that both the associated entity (BRITCO) and the working person (Bryan) must be non-residents during the relevant income year. In this example the associated entity (BRITCO) is not a New Zealand tax resident and neither is Bryan (for the time being). This means the requirements of s GB 27(3)(a) have been satisfied even though the working person (Bryan) is a New Zealander.

Is the associated entity a natural person acting in that capacity?

18. The income attribution rule will not apply if the associated entity is a natural person and is neither a partner of a partnership nor a trustee of a trust (s GB 27(3)(b)). The income attribution rule is designed to prevent higher income earners from diverting personal services income to associated people by using companies, trusts and look-through companies. Section GB 27(3)(b) was added after the income attribution rule was enacted so that if a sole trader employs relatives to carry out personal services of a type to which the income attribution rule would otherwise apply, all the income from those services is not directed to those relatives. If the income attribution rule did apply the sole trader would have no income from those services.
19. However, if the natural person is acting in their capacity as a partner of a partnership, or a trustee of a trust, opportunities may still exist for the natural person to divert personal services income. Accordingly, the exemption does not apply in these situations.

Has the working person chosen to apply the controlled foreign company rules?

20. The income attribution rule will not apply (s GB 27(3)(e)) if:
 - the associated entity is a CFC (that is, a foreign company that is controlled by five or fewer New Zealand residents); and
 - the amount that would be attributed to the working person under the income attribution rules would also be attributed CFC income under s CQ 2(2B) (When attributed CFC income arises) or an attributed CFC loss under s DN 2(2) (When attributed CFC loss arises); and
 - the working person files a return of income in which they return the amount as attributed CFC income.
21. This exemption prevents double taxation through the application of multiple regimes by allowing the working person to choose to apply the CFC rules or the income attribution rules.

Would the working person earn net income of more than \$70,000 if s GB 29 applied?

22. The income attribution rule will only apply if the **working person's net income** for the income year is more than \$70,000, assuming the income derived by the associated entity is attributed to the working person under the income attribution rule (s GB 27(2)(c)). The income attributed to the working person must be calculated by applying all of the calculation rules contained in s GB 29 including the loss restriction rules contained in s GB 29(1). The \$70,000 **threshold is based on the working person's net income which includes all income** including from sources such as income from business, dividends, interest, rent, wages and salary, and attribution income.
23. This threshold is designed to ensure the income attribution rule does not apply if **the working person's net income for the year**, calculated in accordance with all of the rules contained in s GB 29, is less than \$70,000 (which is the income level at which the 33% top marginal rate of tax commences). **If the working person's** net income from all sources including the amount of attribution income calculated in accordance with all of the rules contained in s GB 29, is less than \$70,000, there are limited tax advantages from interposing the associated entity between the working person and the buyer.
24. The **working person's** income is calculated by reference to income that would have been earned if the income attribution rule applied. This is effectively the income that the working person would have had, if the associated entity had not been interposed.

Example 6. Income earned by working person

Lauraco (the associated entity) earns \$100,000 this year and pays a salary of \$60,000 to Laura (the working person).

Question

Has Laura earned more than \$70,000 for the purposes of the attribution rule?

Answer

Yes, Laura has earned more than \$70,000 if the income attribution rule applies. As the amount paid as a salary to Laura is under the \$70,000 threshold Laura might argue that the income attribution rule does not apply. However, if the income attribution rule applied a further \$40,000 would be attributed by the associated entity. Accordingly, **Laura's net income for the purposes of this threshold requirement is \$100,000, not just the \$60,000 paid.**

Example 7. \$70,000 threshold for net income

Mattco (the associated entity) earns \$50,000 this year and paid a salary of \$30,000 to Matt (the working person). Matt also received \$10,000 of rental income from a rental property he owns.

Question

Has Matt earned more than \$70,000 for the purposes of the attribution rule?

Answer

No, Matt has only earned \$60,000 net income if the income attribution rule applies. **Matt's \$60,000 net income consists of \$10,000 rent, \$30,000 salary and \$20,000 of attribution income.**

The answer would be yes if Matt received \$26,000 of rental income. Matt would then earn \$76,000 which would consist of \$26,000 rent, \$30,000 salary and \$20,000 of attribution income.

25. When calculating the amount of income for the working person it is necessary to also consider the taxable value of any fringe benefit the working person receives (s GB 28(5)).

Does 80% of **the associated entity's** income from personal services come from one buyer or two or more associated buyers?

26. The income attribution rule will only apply where 80% of the associated **entity's** total income from personal services is from one buyer or from two or more buyers if those buyers are associated persons (s GB 27(2)(a)).
27. The inclusion of this requirement ensures that contracts are not divided between existing entities associated with the buyer, or that the buyer does not incorporate new companies to ensure the 80% threshold is not met.
28. To determine whether two buyers are associated, the general associated persons rules in subpart YB apply. In summary, the associated persons rules treat two people as being associated where they are:
- two companies, if either a group of persons hold total voting interests in each company of 50% or more, or if the group of persons control both companies by any other means;
 - a company and a person (other than a company) if the person has a voting interest in the company of 25% or more;
 - relatives;
 - a trustee of a trust and:
 - o a beneficiary of the trust;
 - o the settlor of the trust;
 - o a person who is related to a beneficiary;
 - o a trustee of another trust with the same settlor; or
 - o a person with the power to appoint or remove the trustee;
 - a settlor of a trust and a beneficiary of the trust;
 - a partnership and a partner (excluding limited partnerships, which are treated as companies);
 - a look-through company and a look through owner who is a director or employee; or
 - each associated with a third person.
29. This Interpretation Statement does not go into detail about the application of the **associated persons provisions**. For more information see "New Definitions of 'Associated Persons'" *Tax Information Bulletin* Vol 21, No 8 (October/November 2009): 75.

Example 8. Associated persons – two buyers

Bob owns all of the share capital of Bobco and is the sole employee of Bobco. Bob is the working person and Bobco is the associated entity. The buyers of **Bobco's services** are AUSCO and its wholly owned subsidiary NZCO. Both of the buyer companies have entered into separate contracts with Bobco **which will each provide 40% of Bobco's** total income. Bobco is aware that NZCO is a wholly owned subsidiary of AUSCO.

Question:

Does Bob earn 80% of his income from the buyer and a person associated with the buyer?

Answer:

Yes, Bob does earn 80% of his income from the buyer and a person associated with that buyer. AUSCO and NZCO are associated with each other, which means 80% of **Bobco's total income is derived from the supply of services to a combination of the buyer and a person associated with the buyer (that is, AUSCO and NZCO).**

Example 9. Associated persons – buyer with multiple customers

Ann owns all of the share capital of Service Ltd and is the sole employee of Service Ltd. The buyer of Service Ltd's services is Computersupport Ltd which provides a wide variety of computer services to 15 third party clients. Service Ltd has no clients apart from Computersupport Ltd. The contract between Service Ltd and Computersupport Ltd requires Service Ltd **to provide direct "helpdesk" services as and when required to all of the 15 third party clients of Computersupport Ltd.**

Question

Is Ann providing her services to one buyer?

Answer:

Yes, Ann is providing her services to one buyer. Ann is the working person and Service Ltd is the associated entity. The associated entity Service Ltd has only one client, Computersupport Ltd, which is the buyer. It is irrelevant that Service Ltd is providing computer helpdesk services to Computersupport Ltd's 15 clients. **There are no contracts between Service Ltd and the 15 third party clients of Computersupport Ltd.**

Example 10. Associated persons – buyer and associated entity associated

Alan owns all of the share capital of Parent Ltd, Manufacturing Ltd, Distribution Ltd and Retail Ltd. Alan is the sole employee of Parent Ltd and is the working person. Parent Ltd is the associated entity that provides services to the three sister companies Manufacturing Ltd, Distribution Ltd and Retail Ltd, which are the buyers. Parent Ltd does not provide services to any other taxpayers.

Question:

Is Alan providing all his services to one buyer?

Answer:

Yes, Alan is providing all his services to one buyer. Parent Ltd, Manufacturing Ltd, Distribution Ltd and Retail Ltd are associated with each other which means all of Parent Ltd's income is derived from the supply of services to a combination of the buyer and persons associated with the buyer (that is, Manufacturing Ltd, Distribution Ltd and Retail Ltd).

30. The income attribution rule may apply one year to an associated entity and cease to apply the next year. This could happen where an associated entity is working for one buyer but changes its contract midway through the year to a different, unassociated buyer.
31. This situation was considered when the income attribution rule was enacted and the decision was that although the rule may be arbitrary in this regard, the preference was to keep the rule simple to understand and apply.

Example 11. Change of buyers

Fiona (the working person) has been providing 100% management services, through her associated entity FJH Ltd, to a payroll company for years. Six months into the current income year, that contract ends and Fiona and the associated entity contracts for six months with a different, unassociated, independent payroll company. The new contract is on the same terms and for the same amount as the previous contract.

Question:

Will the income attribution rule apply to FJH Ltd for the current income year?

Answer:

No, the income attribution rule will not apply to FJH Ltd for the current income year. Because Fiona is earning the same amount in relation to each unassociated buyer, she can only be earning 50% from one buyer and the income attribution rule will not apply.

There was only one buyer in the year before the change, so the income attribution rule does apply to that year. It is also possible that the income attribution rule may apply to the year after the change (if there are no other buyers).

32. Section GB 28 also contains rules relating to associated persons that are relevant when determining whether two buyers are associated. A person is only treated as being associated with another person for the income attribution rule if they are associated at the time the working person performs the services (s GB 28(2)). Also, no association exists between two buyers where both of them are public authorities (s GB 28(3)(a)).
33. Finally, there will be no association between two buyers where the working person cannot reasonably be expected to know that the two buyers are associated, other than by making a specific inquiry (s GB 28(3)(b)). An example of this would be if the working person were providing services to a company (an **arm's length third party**) that is part of a large group, and that company had **several related companies (also arm's length) that were also contracting with the working person.**
34. **There is a difference between a person "knowing" that parties are associated (which would be subjective) and being "reasonably expected to know".** The use of the words "reasonably expected to know" rather than just "know" indicates that it is an objective test. Accordingly, the question is whether a reasonable person should know.
35. The Commissioner considers that the working person should reasonably be able to know that two buyers may be associated where the associated buyers have similar names, where the working person was contracting with the same person on behalf of two buyers, where there is obvious and immediately accessible public information available to the working person about the buyers, or where there is local or regional knowledge of the association. **The requirement that the person should be "reasonably expected to know" will depend on the facts and circumstances of each case.**

Example 12. Associated persons - knowledge

Clare owns all of the share capital of Clareco and is the sole employee of Clareco. Clare is the working person and Clareco is the associated entity. The buyers of Clareco services are AUSCO and its wholly owned subsidiary NZCO. Both buyer companies have entered into separate contracts with the associated entity that will each provide 50% of Clareco's total income. **Clare is not aware that NZCO is a wholly owned subsidiary of AUSCO.** The buyers have different company names, and different employees entered into the contracts with the associated entity.

Question:

Can Clare be reasonably expected to know that AUSCO and NZCO are associated buyers?

Answer:

No, Clare cannot be reasonably expected to know that a particular buyer (NZCO) is associated with another buyer (AUSCO) without making specific enquires. The working person (Clare) is not aware of the 100% common shareholding between AUSCO and NZCO and would not reasonably be expected to know they are associated because:

- The two buyers have different company names.
- The two contracts were negotiated and entered into with different employees of NZCO and AUSCO.

However, the answer might be different if AUSCO and NZCO were in the same industry and the services Clare provided were very similar with overlap between the first and the second contract in terms of timeframes, price and so on.

Is 80% of **the associated entity's** income from personal services earned by the working person or a relative of the working person or a combination of them?

36. The income attribution rules will only apply where 80% or more of the associated **entity's income from personal services during the income** year is derived through services personally performed by the working person, a relative of the working person, or a combination of both of them (s GB 27(2)(b)). The inclusion of personal services performed by a relative of the working person is designed to ensure personal services cannot be split between relatives to make them appear to fall outside the income attribution rules. A common example would be where the services are provided by spouses or by a parent and an adult child.
37. **"Relative" is defined in s YA 1** as a person connected with another person by being:
- within the second degree of blood relationship to the other;
 - in a marriage, civil union, or de facto relationship with the other;
 - in a marriage, civil union, or de facto relationship with a person who is within the second degree of blood relationship to the other;
 - adopted as a child of the other or as a child of a person who is within the first degree of relationship to the other; or
 - the trustee of a trust under which a relative has benefited or is eligible to benefit.
38. This definition is consistent with the meaning of "relative" in the associated persons provisions, and covers parents, siblings and children.
39. **The definition of "relative" is**, however, limited by s GB 28(4) for the purposes of the income attribution rules. Section GB 28(4) states that a person is a relative of the working person only if the person is a relative at the beginning of the relevant income year. As an example, if during an income year two persons who each provide services to the entity begin a de facto relationship, they will not be caught within the provision until the next income year. However, if two people are in a de facto relationship, but split up during the year, they will be treated as being associated for the purposes of the income attribution rule for that income year.

Example 13. Relatives of working person

Dawn and her spouse Richard own all of the share capital of D&Dco. Dawn is the only full time employee of D&Dco. Richard and their adult children Diana and David are equally capable of providing the same services that would otherwise have been provided by Dawn. D&Dco is the associated entity. There is a single buyer of D&Dco services. The contract between D&Dco *and the buyer* provides that 50% of the services will be provided by Dawn and 50% of the services will be provided by Richard. The contract also provides that Richard can arrange for all or a proportion of his services to be provided by Diana or David or both.

Question:

Are Dawn and her relatives providing more than 80% of their services to a buyer?

Answer:

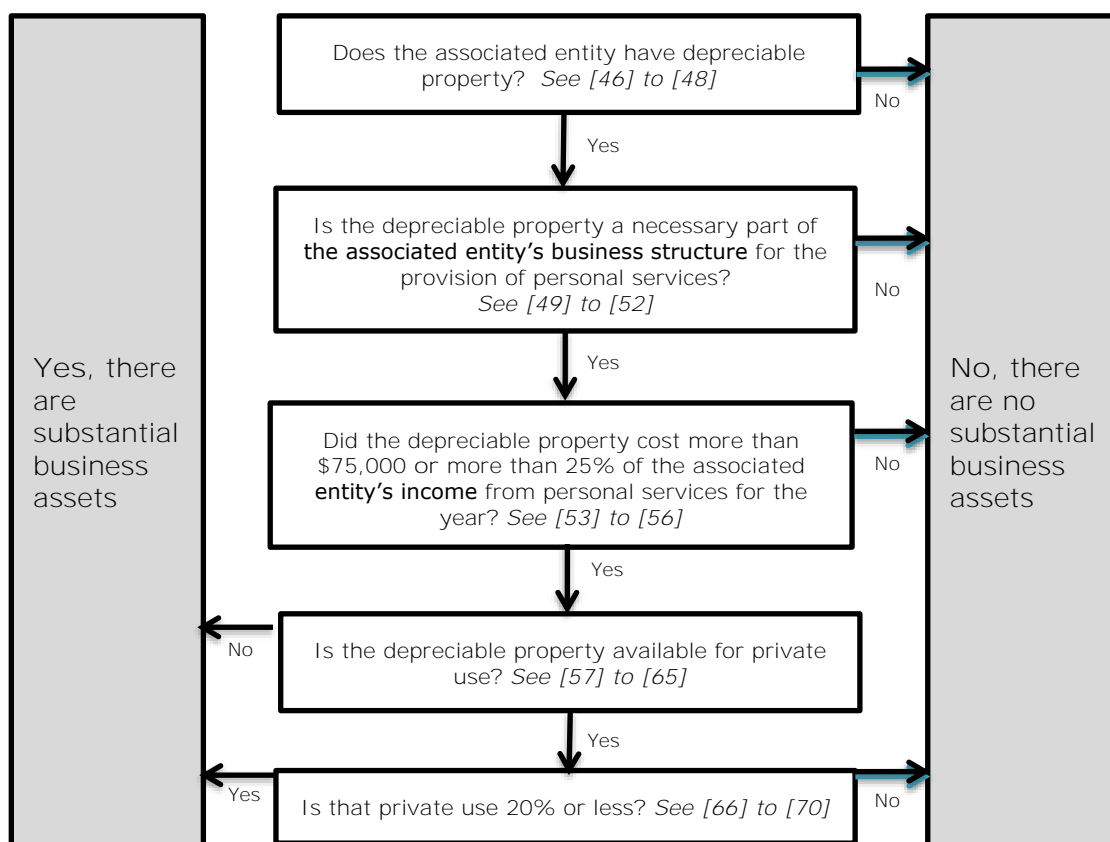
Yes, Dawn and her relatives are providing more than 80% of their services to a buyer. More than 80% (in this case 100%) of the services provided by D&Dco will be provided by a combination of the working person (Dawn) and the relatives of Dawn (Richard, Diana or David).

Are there substantial business assets?

40. The income attribution rules will not apply if the associated entity:
- has “substantial business assets”; and
 - those assets are a necessary part of the business structure that is used to **derive the associated entity’s income** from the provision of personal services to the buyer.
41. If the associated entity does not have substantial business assets, or those assets are not a necessary part of the business structure that is used to derive gross income from the provision of personal services, then income attribution may be required (subject to the application of the other thresholds and exemptions discussed in this Interpretation Statement) (s GB 27(2)(d)).
42. The substantial business assets test is designed to recognise that when substantial business assets are used **in the associated entity’s business** of providing personal services there should also be a return on that capital. For example, the owner-driver of a petrol tanker should receive a return based on both the asset employed and the labour provided.
43. The expression “**substantial business assets**” is defined in s GB 28(6) as depreciable property that:
- has a total cost of more than:
 - o \$75,000; or
 - o 25% or more of the associated entity’s total income from services for the income year; and
 - **is not for “private use”**, which will not apply where the private use of the depreciable property is 20% or less of its total use (s GB 28(8)).
44. “**Substantial business assets**” can comprise a single asset or multiple assets.
45. The questions that need to be considered to determine whether an associated entity has substantial business assets are summarised in Flowchart 2.

46. The text following the flowchart to [85] considers each question in the order that it appears in the flowchart.

Flowchart 2: Are there substantial business assets?



Does the associated entity have depreciable property?

47. As stated above, to have a "substantial business asset", an associated entity must have property that is "depreciable property".
48. "Depreciable property" is, generally, defined as being property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use in deriving assessable income, or in carrying on a business for the purpose of deriving assessable income (s EE 6). Depreciable property includes items that are "depreciable intangible property" (listed in sch 14). These items include property such as a patent or the right to use a patent, and the right to use a copyright. However, "depreciable property" does not include items of property that are listed in s EE 7, such as land, trading stock, and financial arrangements.
49. To be depreciable property, the substantial business assets must be used, or available for use, to derive the **associated entity's** assessable income from the provision of personal services. Not all property will automatically satisfy this requirement. Property that is used for private use is unlikely to satisfy this test. This is consistent with the definition of "substantial business assets".

Is the depreciable property a necessary part of the **associated entity's business** structure for the provision of personal services?

50. As discussed above, it is a requirement that the depreciable property be a **necessary part of the associated entity's business structure** that is used to provide personal services to the buyer. The first step is to identify the business that the associated entity is undertaking and then the structure that is being used. In most cases the business being undertaken by the associated entity will be self-evident. It can then be considered whether the particular assets being considered (to be substantial business assets) are a necessary part of the business structure.
51. An **associated entity's "business structure"** is the structure or organisation that has been established to carry out **the associated entity's contractual obligations to the buyer of the working person's services** (*CIR v Trustpower Ltd* (2016) 27 NZTC 22-010 (CA); *Sun Newspapers Ltd v FCT* (1938) 5 ATD 87 (HCA)).
52. The dictionary definitions of "necessary" indicate that the depreciable property must be essential, vital, indispensable or imperative to the success of the activity being performed. Case law indicates that the word "necessary" can have a narrow or a wide interpretation depending on the statutory context. In the context of the income attribution rule, which is a specific anti-avoidance rule, the **Commissioner's view is that** the word "necessary" should be narrowly interpreted (*Pabari v Secretary of State for Work and Pensions* [2005] 1 All ER 287).
53. Therefore, it is **the Commissioner's view that** business assets must be indispensable or essential to the provision of the particular services provided by the working person to the buyer of those services. Tools and equipment that are only infrequently (if at all) used by a working person to perform the personal services provided to a buyer of the personal services may not satisfy the narrow test of indispensability.

Example 14. Necessary business tools

Wendy the plumber is the working person. She is a very experienced plumber and is employed by her associated entity. **The associated entity's business is providing** plumbing services. The associated entity owns all of the plumbing equipment that Wendy needs to carry out her work and a van to carry that equipment. The buyer is constructing a large commercial building that will take at least three years to build.

Question

Are the plumbing equipment and van a necessary part of the business structure?

Answer

Yes the plumbing equipment and the van owned by the associated entity are a **necessary part of the associated entity's business structure**.

Example 15. Necessary business tools

Barry the builder is the working person. Barry is employed by his associated entity which runs a business providing building services. All of the income of the associated entity is from a single buyer. The buyer owns all of the building equipment that Barry **needs to carry out the buyer's** building contract. The buyer also provides a vehicle to transport Barry **from the buyer's premises to** the construction site.

The associated entity owns some equipment that is not used for building and it is stored at Barry's private residence. Barry uses a motor vehicle owned by the associated entity to drive from his **private residence to the buyer's premises**. Barry then uses the buyers building equipment and motor vehicle to travel to the construction site.

Question

Are the **associated entity's** equipment and motor vehicle a necessary part of the business structure?

Answer

No, based on the facts provided the **associated entity's equipment and** motor vehicle are not necessary parts of the business structure (while the motor vehicle may be a necessary part of the business structure more information would be needed before this could be decided). The equipment owned by the associated entity is not a necessary part of the business structure because it does not relate to the business of the associated entity and the buyer provides Barry with all of the building equipment necessary.

Did the depreciable property cost more than \$75,000 or more than 25% of the **associated entity's income** from personal services for the year?

54. **Depreciable property will only be a "substantial business asset" if** it has a total cost of more than (s GB 28(6)(a)):
- \$75,000; or
 - 25% or more of the associated entity's total income from personal services for the income year.
55. These are alternative tests, either of which must be satisfied.
56. This test requires the taxpayer to correctly ascertain the relationship between the cost of their depreciable property and the two statutory thresholds. It is **"cost" and not market value that is relevant. The "cost" will** be the same as the cost the associated entity uses for depreciation purposes.
57. The most common categories of business assets owned by associated entities include motor vehicles, tools and equipment, computers and communication equipment.

Example 16. Substantial business assets – monetary thresholds

Cost of depreciable property	\$40,000
Total income from services	\$120,000
25% of total income from services	\$30,000
Statutory amount	\$75,000

Question

Does the asset meet the monetary threshold?

Answer

Yes, the asset meets the monetary threshold. The cost of the depreciable property is \$40,000 which is less than the statutory amount of \$75,000. The first limb of the test is not satisfied. However, the cost of \$40,000 is more than 25% of income from personal services which is \$30,000. The second limb of the test is satisfied.

Example 17. Substantial business assets – monetary thresholds

Cost of depreciable property	\$50,000
Total income from services	\$240,000
25% of total income from services	\$60,000
Statutory amount	\$75,000

Question

Does the asset meet the monetary threshold?

Answer

No, the asset does not meet the monetary threshold. The cost of the depreciable property is \$50,000 which is less than the statutory amount of \$75,000. The cost is also less than 25% of income from personal services which is \$60,000. The test has not been satisfied because the taxpayer has failed both of the alternative tests.

Example 18. Substantial business assets – monetary thresholds

Cost of depreciable property	\$80,000
Total income from services	\$280,000
25% of total income from services	\$70,000
Statutory amount	\$75,000

Question

Does the asset meet the monetary threshold?

Answer

Yes. The asset meets the monetary threshold. The cost of the depreciable property is \$80,000 which is more than the statutory amount of \$75,000. The cost is also more than 25% of income from personal services which is \$70,000. The test is satisfied because the taxpayer has satisfied both of the alternative tests (and only one test needs to be satisfied).

Example 19. Substantial business assets – monetary thresholds

Cost of depreciable property	\$80,000
Total income from services	\$360,000
25% of total income from services	\$90,000
Statutory amount	\$75,000

Question

Does the asset meet the monetary threshold?

Answer

Yes, the asset meets the monetary threshold. The cost of the depreciable property is \$80,000 which is more than the statutory amount of \$75,000. The first of the alternative tests has been satisfied. It does not matter that the cost of \$80,000 is less than 25% of income from personal services which is \$90,000. The test is satisfied because the taxpayer is required to satisfy only one of the alternative tests.

Is the depreciable property used for private use?

58. **Depreciable property may not be a "substantial business asset" if it is used for private use (subject to the 20% test discussed from [67]).**
59. **The Act does not contain a general definition of "private use". The dictionary definitions relevantly indicate that "private" refers to the part of a person's life that is concerned with situations or activities in a person's personal relationships and activities rather than with the person's work or business relationships (CIR v Haenga (1985) 7 NZTC 5, 198 (CA)).**
60. Many business assets, such as computers, printers, tablets, smart phones tools and equipment, are capable of being used for both business and non-business activities. In relation to the use of such assets, the Commissioner considers that any use that is not in the course of undertaking specific income earning activities should be classified as private use.

Private use of motor vehicles

61. The Act contains a **specific definition of "private use" for motor vehicles**. Under s CX 36, private use for a motor vehicle includes:

- **the employee's use of the vehicle for travel between home and work; and**
 - any other travel that confers a private benefit on the employee (for example, use after hours, during the weekend or when the working person is on leave).
62. Section GB 28(9), which sets out how to calculate the percentage of private use of a substantial business asset (discussed from [67]), refers to the number of days for which fringe benefit tax (FBT) is payable for the property. Because FBT is payable for motor vehicles depending on their private use, this definition is also relevant when determining the private use of a motor vehicle for the purposes of the substantial business asset test.
63. This Interpretation Statement briefly discusses where there will be private use of a motor vehicle. For more information on this topic see "Travel by Motor Vehicle Between Home and Work – Deductibility of Expenditure and FBT Implications" *Tax Information Bulletin* Vol 16, No 10 (November 2004): 31 (IS 3448), and IS 17/07 "Fringe Benefit Tax – Motor Vehicles" *Tax Information Bulletin* Vol 29, No 9 (October 2017): 12.

Travel between home and work

64. In most cases, the Commissioner considers that travel between home and work in a vehicle owned by an associated entity will confer a private advantage and be considered private use of that vehicle. However, where a home is also a workplace and an employee is required for sound business reasons to travel to perform employment duties partly at the home workplace and partly at another workplace, then no private benefit will be conferred by that travel (*CIR v Schick* (1998) 18 NZTC 13,738 (HC)).
65. **If the working person's home is also the associated entity's premises**, and sound business reasons exist for this arrangement, travel in a motor vehicle from the home **to the buyer's premises will be considered work-to-work** travel. This travel will not be considered private use for s GB 28(6)(b).
66. If the associated entity's premises are separate from the working person's home, the standard rules relating to FBT and motor vehicles as set out in IS 17/07 and IS3448 apply. It is likely that any travel between home and those premises in a motor vehicle will be considered private use under s GB 28(6)(b).

Is the private use 20% or less?

67. The phrase "**private use**" is limited for the purposes of the income attribution rule so that where the private use of the depreciable property is 20% or less of its total use it will not be considered private use (s GB 28(8)).
68. This limitation means depreciable property may satisfy the test for substantial business assets even if there is an element of private use or enjoyment, provided the level of private use is not more than 20% of the total use. Or, to put it another way, the classification of an asset as a substantial business asset will not change in cases where the business use of that asset is at least 80%.
69. Section GB 28(9) provides guidance on calculating the percentage of private use of a business asset.
70. In the case of property that is subject to the FBT rules, the percentage of private use must be calculated by comparing the number of days for which FBT is

payable with the total days in the tax year in which the property is owned or is subject to a specified lease, a finance lease or a hire purchase agreement.

71. In the case of all other property (including any property that is excluded from FBT under s CX 21), the percentage of private use must be calculated by comparing the expenditure relating to the property that is non-deductible as a result of the private use with the total expenditure relating to the property incurred in the tax year.

Are the services being provided essential support for a product?

72. The income attribution rule will not apply to the extent that the services provided by a working person are essential support for a product supplied by the working **person's** associated entity (s GB 27(3)(c)).
73. Various dictionary definitions suggest that **the word "product"**, when read in this context, describes the sale of something that has been produced or acquired by the associated entity that is sold to the buyer.

Example 20. Essential support for a product

Computer Comprehensive Service Ltd is the associated entity that has entered into a contract with its only customer, a government department (the buyer). The contract requires Computer Comprehensive Service Ltd to install a new computer system, provide software and **hardware support and provide "hands on" training to the buyer's staff. All of the staff training will be undertaken by the working person at the buyer's premises.**

Question:

Does the income attribution rule apply?

Answer:

No, the income attribution rule does not apply. Computer Comprehensive Service Ltd (the associated entity) has agreed to provide the government department (the buyer) with a computer system, software and hardware support, and comprehensive hands on training. The training services the working person provides are essential support for the hardware and software (the product) that Computer Comprehensive Service Ltd sold to the government department.

Is the amount being attributed less than \$5,000?

74. The income attribution rule will not apply where the total amount to be attributed to the working person by the associated entity is less than \$5,000. This means that if the amount attributed under s GB 29 is less than \$5,000, no attribution need be made (s GB 27(3)(d)).
75. However, if the working person has more than one associated entity, this exemption can apply only once (s GB 27(3)(d)(i)). This means the second entity must attribute income regardless of the level of that income.

Is the associated entity a controlled foreign company?

76. The \$5,000 exemption will not apply if the associated entity is a CFC. This is to ensure that all income from CFCs is returned regardless of the amount. A separate exemption that may apply for CFCs is discussed at [20] and [21].

References

Subject references

associated persons
attribution of income from personal services
controlled foreign companies
income tax

Legislative references

Income Tax Act 2007 – ss CQ 2, CX 21, CX 36, CX 38, DN 2, EE 6, EE 7, EX 1, GB 27 to GB 29, in s YA 1 (“associated persons”, “car”, “motor vehicle”, “relative”), subpart YB, ss YD 1, YD 2, sch 14

Land Transport Act 1998, s 2 (“motor vehicle”)

Case references

Case P26 (1992) 14 NZTC 4,196 (TRA)
Case R37 (1994) 16 NZTC 6,208 (TRA)
Case S26 (1994) 17 NZTC 7,182 (TRA)
Case T38 (1997) 18 NZTC 8,255 (TRA)
CIR v Haenga (1985) 7 NZTC 5,198 (CA)
CIR v Schick (1998) 18 NZTC 13,738 (HC)
CIR v Trustpower Ltd (2016) 27 NZTC 22-010 (CA)
Pabari v Secretary of State for Work and Pensions [2005] 1 All ER 287 (EWCA Civ)
Sun Newspapers Ltd v FCT (1938) 5 ATD 87 (HCA)

Other references

“Attribution of Income” Tax Information Bulletin Vol 12, No 12 (December 2000): 49
“IS 16/03: Tax Residence” Tax Information Bulletin Vol 28, No 10 (October 2016): 2
“IS 17/07: Fringe Benefit Tax – Motor Vehicles” Tax Information Bulletin Vol 29, No 9 (October 2017): 12
“New Definitions of ‘Associated Persons’” Tax Information Bulletin Vol 21, No 8 (October/November 2009): 75
“Travel by Motor Vehicle between Home and Work – Deductibility of Expenditure and FBT Implications” Tax Information Bulletin Vol 16, No 10 (November 2004): 31

Appendix – Legislation

Sections GB 27 to GB 29 provide:

GB 27 Attribution rule for income from personal services

Application of section GB 29

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

Threshold for application of attribution rule

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

Exemptions

- (3) The attribution does not occur—
 - (a) if both the associated entity and the working person are non-residents at all **times during the associated entity's income year**;
 - (b) if the associated entity is a natural person and is neither a partner of a partnership nor a trustee of a trust;
 - (c) to the extent to which the services personally performed by the working person are essential support for a product supplied by the associated entity;
 - (d) if the total amount to be attributed to the working person, for the associated entity and the income year, is less than \$5,000, unless—
 - (i) the application of this paragraph would prevent income being attributed to the working person for the income year in relation to another associated entity;
 - (ii) the associated entity is a CFC and a person who holds an attributing interest in the CFC files, after the date (the Royal assent date) on which the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 receives the Royal assent, a return of income in which the amount of income attributed to the working person is determined under this section;
 - (e) if the associated entity is a CFC and—
 - (i) the amount gives rise to attributed CFC income under section CQ 2(2B) (When attributed CFC income arises) or attributed CFC loss under

section DN 2(2) (When attributed CFC loss arises) for a person who holds an attributing interest in the CFC; and

- (ii) the person who holds the attributing interest in the CFC files, after the Royal assent date, a return of income in which the amount attributed to the working person is determined under section EX 20B (Attributable CFC amount).

Treatment of certain dividends

- (4) If a company that is required to attribute an amount to the working person under this section pays a dividend, sections HA 14 to HA 19 (which relate to qualifying companies) are treated as applying to the company and the dividend if the company—
 - (a) has no net income for the tax year in which it pays the dividend other than income attributed under this section, ignoring interest income that is incidental **to the company's business; and**
 - (b) is not a qualifying company; and
 - (c) chooses to have the dividend treated as if it were paid by a qualifying company.

Cancellation of notional imputation credits

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

GB 28 Interpretation of terms used in section GB 27

When this section applies

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

Associated persons

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

Non-associated buyers

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

Relatives

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

Fringe benefits included

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

Meaning of substantial business assets

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

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

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

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

Private use of assets

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

Calculation of private proportion of use

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

GB 29 Attribution rule: calculation

Amount attributed

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

Calculation for trustee or partnership

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

Salary paid or fringe benefits treated as deductions

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

Reduction of attributable income for distributions

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

Attribution reduced by market value of administrative services

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

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

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

Attribution to more than 1 working person

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