ⓘ This is a reissue of BR Pub 09/09. For more information about the background to this Public Ruling see the Commentary to this Ruling.

DEDUCTIBILITY OF BREAK FEE PAID BY A LANDLORD TO EXIT EARLY FROM A FIXED INTEREST RATE LOAN

PUBLIC RULING – BR PUB 12/01

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of sections DA 1, DB 6, DB 7, and EW 31 and the definition of "interest" in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is where a person has entered into a fixed interest rate loan and the money has been used to acquire a property from which rental income is derived or to refinance another loan used for that purpose. The person subsequently pays a break fee to the lender to repay in full and terminate that loan earlier than its agreed repayment date. It does not matter whether the loan is replaced by further borrowing from either the same or a different lender.

This Ruling will not apply where the loan is not used solely for the deriving of rental income, or where the loan is part of or connected with one or more other financial arrangements between the lender and the borrower.

This Ruling will also not apply if the taxpayer has adopted the IFRS financial reporting method in section EW 15D or section EW 15G.

How the Taxation Law apply to the Arrangement

The Taxation Laws apply to the arrangement as follows:

- A base price adjustment will be required.
- The amount of any break fee will be included in the "consideration" element of the base price adjustment formula for a borrower and will increase the overall negative figure that the base price adjustment provides.
- The negative amount under the base price adjustment will be expenditure incurred under the financial arrangements rules and will be interest.
- A company (other than a qualifying company or a look through company) is entitled to a deduction for the negative base price adjustment amount as interest under section DB 7.
- Other taxpayers, including qualifying companies and look through companies, are entitled to a deduction under section DB 6 and the general permission in section DA 1.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2012/13 income year.

This ruling is signed by me on the 10th day of April 2012.

Susan Price
Director, Public Rulings

ⓘ This is a reissue of BR Pub 09/10. For more information about the background to this Public Ruling see the Commentary to this Ruling.

DEDUCTIBILITY OF BREAK FEE PAID BY A LANDLORD TO VARY THE INTEREST RATE OF AN EXISTING FIXED INTEREST RATE LOAN

PUBLIC RULING – BR PUB 12/02

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

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

This ruling applies in respect of sections DA 1, DB 6, DB 7, and EW 31 and the definition of "interest" in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is where a person has entered into a fixed interest rate loan and the money has been used to acquire a property from which rental income is derived or to refinance another loan used for that purpose. The person then subsequently pays a break fee to the lender for a variation of that loan to adjust the interest rate.

This Ruling will not apply where the loan is not used solely for the deriving of rental income, or where the loan is part of or connected with one or more other financial arrangements between the lender and the borrower.

This Ruling will also not apply if the taxpayer has adopted the IFRS financial reporting method in section EW 15D or section EW 15G.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the arrangement as follows:

- No base price adjustment will be required.
- Taxpayers who are not cash basis persons, and cash basis persons who have chosen to adopt a spreading method, will be required to apply Determination G25 in relation to the variation to the terms of the loan. The amount of the break fee will be included in the calculation under the determination. This means an adjustment will be made in the year of variation and the deduction of the break fee will effectively be spread over the term of the loan.
- Cash basis persons will be able to deduct the amount of the break fee when it is incurred under the general permission in section DA 1.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2012/13 income year.

This ruling is signed by me on the 10th day of April 2012.

Susan Price
Director, Public Rulings

ⓘ This is a reissue of BR Pub 10/20. For more information about the background to this Public Ruling see the Commentary to this Ruling.

DEDUCTIBILITY OF BREAK FEE PAID BY A LANDLORD TO EXIT EARLY FROM A FIXED INTEREST RATE LOAN ON SALE OF RENTAL PROPERTY

PUBLIC RULING - BR Pub 12/03

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of sections DA 1, DB 6, DB 7, and EW 31 and the definition of "interest" in section YA 1.

The Arrangement to which this Ruling applies

The Arrangement is where a person has entered into a fixed interest rate loan and the money has been used to acquire a property from which rental income is derived or to refinance another loan used for that purpose. The person subsequently pays a break fee to the lender to repay in full and terminate that loan earlier than its agreed repayment date in order to sell the rental property. Therefore, the person ceases to derive rental income from the property.

This Ruling will not apply when the loan is not used solely for the deriving of rental income or where the loan is part of or connected with one or more other financial arrangements between the lender and the borrower.

This Ruling will also not apply if the taxpayer has adopted the IFRS financial reporting method in section EW 15D or EW 15G.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- A base price adjustment is required in the income year the loan is repaid.
- The amount of any break fee is included in the "consideration" element of the base price adjustment formula and will increase the overall negative figure that the base price adjustment provides.
- The negative amount under the base price adjustment is expenditure incurred under the financial arrangements rules and constitutes interest.
- A company (other than a qualifying company or a look through company) is entitled to a deduction for the negative base price adjustment amount as interest under section DB 7.
- Other taxpayers, including qualifying companies and look through companies, are entitled to a deduction under section DB 6 and the general permission in section DA 1.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on the first day of the 2012/13 income year.

This ruling is signed by me on the 10th day of April 2012.

Susan Price
Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 12/01, BR PUB 12/02 AND BR PUB 12/03

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 12/01, Public Ruling BR Pub 12/02 and Public Ruling BR Pub 12/03 ("the Rulings").

Legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

Background

1. The Rulings deal with the deductibility of fees charged by banks to permit landlords to repay a fixed interest rate loan early or to vary the existing terms of such a loan. These fees are variously referred to by terms such as "early repayment fees", "early repayment adjustment charge", "early exit fees" or "mortgage break fees". In these Rulings, the term "break fee" is used to refer to all such charges.

2. The amount of the fee and the circumstances that trigger the charging of the fee vary from lender to lender. The fee is generally seen as compensation for the loss the lender may have suffered if their current interest rate for a similar loan for a fixed interest rate period closest to the borrower's unexpired fixed interest period is lower than the fixed interest rate applying to the borrower's loan.

3. A break fee is charged in two primary scenarios:
   - the loan is repaid early (whether replaced by further borrowing from the same or another financial institution or not);
   - the interest rate of the loan is simply renegotiated during the term of the loan and the existing loan continues.

4. It may be that the loan is repaid early because the rental property is sold and the landlord ceases to derive assessable income from the property.

5. BR Pub 12/01, BR Pub 12/02 and BR Pub 12/03 are re-issues of BR Pub 09/09, BR Pub 09/10 and BR Pub 10/20 respectively, which expired on the last day of the 2011/12 income year. The Rulings are consistent with the conclusions reached in BR Pub 09/09, BR Pub 09/10 and BR Pub 10/20. The Rulings and the commentary required minor adjustments for consistency of wording and were also updated due to legislative amendments. Those amendments do not affect the conclusions.

Application of the Legislation

6. The application of the legislation depends on whether the loan is repaid in full and terminated, or the loan remains in existence and there is simply a variation of the interest rate.

Loan repaid in full

7. A fixed interest rate loan is a financial arrangement pursuant to section EW 3. The financial arrangements rules ("FA rules") will therefore apply. When a loan is repaid in full, a base price adjustment ("BPA") is required under section EW 29.

8. Although many landlords are likely to be cash basis persons under the FA rules and not required to use a spreading method, they are still subject to the FA rules and will be required to do a BPA if the loan is repaid in full.

9. The formula for calculating a BPA is in section EW 31(5). The formula for a borrower is:

   consideration − income + expenditure + amount remitted

10. A break fee charged by a bank in respect of the early repayment of the loan will fall within the definition of "consideration" in section EW 31(7) as "consideration that has been paid … by the person for or under the financial arrangement". The break fee will not be ignored as a "non-contingent fee" because the fee is not "for services provided for the taxpayer **becoming a party** to the financial arrangement and payable whether or not the financial arrangement proceeds". The fee is payable to allow the taxpayer to cease being a party to the financial arrangement. As the scope of these rulings excludes landlords who have adopted the International Financial Reporting Standard ("IFRS") financial reporting method under section EW 15D or section EW 15G, it is unnecessary to consider whether the break fee constitutes a non-integral fee.

11. As part of the consideration paid by a borrower, the amount of the break fee will increase the overall negative figure that the BPA provides in this scenario (see Example 1 below).

12. A negative BPA is expenditure incurred under the FA rules pursuant to section EW 31(4) and, in accordance with that section, is deductible pursuant to section DB 6 or DB 7.

13. Negative BPA expenditure is "interest" for the purposes of sections DB 6 and DB 7 (see the definition of "interest" in section YA 1). A non-corporate taxpayer or qualifying company or look-through company will be able to deduct the amount of the negative BPA as interest under section DB 6, provided the general permission in section DA 1 is satisfied and none of the general limitations (excluding the capital limitation) apply. Section DB 6 specifically provides that the capital limitation will not apply, so it is unnecessary to consider whether the amount is of a capital or revenue nature.

14. Where the borrowed money was used to purchase property from which rental income is derived, the Commissioner's view is that the general permission will be satisfied and the amount of the negative BPA will be deductible under section DB 6.

15. In the case of a company (other than a qualifying company), the amount of the negative BPA will be deductible under section DB 7 without any requirement to consider the general permission. It is noted that a

"company" as defined in section YA 1 does not include a look-through company for these purposes.

16. The Commissioner notes that some commentators have suggested section DB 5 may have application when the loan amount is refinanced. Section DB 5 provides a deduction for expenditure incurred in borrowing money used as capital in deriving income. The Commissioner's view is that section DB 5 has no application where the FA rules apply. The amount of the break fee is dealt with under the BPA on repayment of the original loan, as set out above. This will be the case whether or not the amount of the loan is refinanced.

Interest rate varied

17. Instead of repaying a loan in full and then refinancing with a new loan, a borrower may negotiate with their lender to vary the rate of interest on an existing loan. This is sometimes referred to as an "interest rate switch". A break fee will often be charged in these circumstances.

18. Where the renegotiation of the interest rate is simply a variation of the loan and that same loan continues in existence, a BPA is not required. In these circumstances, the deductibility of the break fee depends on whether or not the taxpayer is a cash basis person. Note that if the change in the interest rate is effected by way of the existing loan being discharged and a new loan agreement being entered into, a BPA will be required as discussed above.

19. A taxpayer who is not a cash basis person will have been required to adopt a spreading method in relation to the loan under the FA rules. As the loan is a fixed interest rate loan at the time of the variation, it will not be a variable rate financial arrangement (as defined in Determination G25: Variations in the terms of a financial arrangement). Therefore, the taxpayer will need to apply Determination G25 when the loan is varied, rather than Determination G26: Variable rate financial arrangements. The break fee will be brought into the Determination G25 calculation. This means an adjustment is made in the year of variation and the deduction of the break fee is effectively spread over the term of the loan (see Example 2 below).

20. A cash basis person is not required to adopt a spreading method, although they may choose to do so. A person will be a cash basis person if:

- the income and expenditure under all the person's financial arrangements for the income year does not exceed $100,000, or
- the value of all the person's financial arrangements on every day of the income year does not exceed $1 million.

21. In addition, the difference between the accrual treatment and the cash treatment of all the person's financial arrangements cannot exceed $40,000 for the income year. Where a significant break fee is paid, it is possible that these thresholds may be breached and a person may cease to be a cash basis person. In those circumstances the treatment of the break fee set out above for a non-cash basis person will apply.

22. Note that as a result of the changes made by the Taxation (Business Tax Measures) Act 2009 with effect from the 2009/10 income year a non-natural person may be a cash basis person.

23. Where a cash basis person does not adopt a spreading method, the deductibility of the break fee is determined outside the FA rules.

24. The break fee will be incurred whether it is actually paid or simply added to the balance of the loan: *King v CIR* (1973) 1 NZTC 61,107.

25. The break fee will be deductible if it satisfies the general permission and none of the general limitations apply. Where the borrowed money was used to purchase property from which rental income is derived, the Commissioner's view is that the general permission will be satisfied. Note that if the borrowing was used for a private or domestic purpose, a deduction would be denied under the private limitation in section DA 2(2).

26. Note that section DB 5 will also have no application in these circumstances. Where all that occurs is a variation of the interest rate applicable to a loan, the break fee cannot be said to have been incurred in borrowing money.

Rental property sold

27. The Commissioner's view is the same analysis applies when the loan is repaid in full and terminated regardless of whether the rental property is sold and the landlord ceases to derive assessable income from the property.

28. The BPA is carried out at the time the rental property is sold and the deriving of rental income ceases. The negative BPA amount is deductible as interest as it has a sufficient relationship with the derivation of rental income.

Alternative view – general permission not satisfied

29. The Commissioner notes that some commentators have suggested that because the break fee is paid to allow the taxpayer to dispose of the property, and therefore to cease deriving assessable rental income, the break fee does not have a sufficient relationship with the derivation of assessable income and the general permission is not satisfied to the extent of the amount of the break fee. The Commissioner's view is that the break fee amount is an indivisible part of the negative BPA amount produced by the application of the BPA formula. The BPA provides a net figure at the end of the financial arrangement. This net figure is treated as interest, and it is the deductibility of that interest net figure that must be considered. The individual amounts that go into the BPA formula are not considered separately to determine assessability or deductibility.

Relevance of post-cessation business cases

30. It has also been suggested that relevant here is the line of reasoning in the post-cessation of business cases, such as *Amalgamated Zinc (de Bavay's) Ltd v FCT* (1935) 54 CLR 295, *Case U29* (2000) 19 NZTC 9,273 and *Inglis v CIR* (2001) 20 NZTC 17,379.

31. The post-cessation cases look at the deductibility of expenditure incurred after a business has ceased. These cases are concerned with how long after

a business has ceased that expenditure may be claimed. However, under the present arrangement, the BPA is being performed at the same time as the rental property is sold and the deriving of rental income from it ceases. Therefore, the post-cessation cases are not relevant.

Examples

32. The following examples are included to assist in explaining the application of the law.

Example 1 – Loan repaid in full

33. At the beginning of year 1, B borrows $200,000 at a flat 10% per annum fixed interest rate to purchase a rental property from which rental income is derived. The loan is interest only. At the end of year 2, B breaks the loan in order to refinance at a lower interest rate with another bank. B repays the loan and pays an additional $10,000 break fee.

34. B will have to calculate a BPA in relation to the loan as follows:

- consideration – income + expenditure + amount remitted

35. The consideration received by B is the original loan amount of $200,000. The consideration paid by B is the return of the principal, two instalments of interest at $20,000 each, and the break fee of $10,000, or $250,000:

- ($200,000 + $20,000 + $20,000 + $10,000).

36. There is no income amount or amount remitted. The expenditure amount is the $20,000 interest incurred under the loan in year 1.

37. The BPA is thus:

- ($200,000 – $250,000) – $0 + $20,000 + $0

  = –$50,000 + $20,000

  = –$30,000

38. The negative BPA amount of $30,000 represents the $20,000 interest expense for year 2 and the amount of the break fee.

39. The negative BPA amount is expenditure incurred under the FA rules and is deemed to be interest. It will be deductible to B in the year in which it is incurred under section DB 7 (if B is a company) or section DB 6 and the general permission (if B is a non-corporate or qualifying company).

Example 2 – Interest rate varied

40. A and B are the shareholders in S Ltd. S Ltd owns two residential rental properties. S Ltd borrows $100,000 for three years. Interest is fixed at 10% payable annually in arrears. S Ltd is not a cash basis person. Assuming a straight-line spreading method, the total annual expenditure incurred under the FA rules would be:

- ($100,000 + $30,000 – $100,000)/3 = $30,000/3 = $10,000 per annum

41. In year 2 the loan is renegotiated to an 8% interest rate. A break fee of $2,500 is charged. The revised annual finance charges are:

- ($100,000 + $26,000 + $2,500 – $100,000)/3 = $28,500/3 = $9,500 pa

42. Determination G25 will apply. The formula is:

- a – b – c + d

where

- a is the sum of all amounts that would have been income derived by the person in respect of the financial arrangement from the date it was acquired or issued to the end of the income year, if the changes had been known as at the date the financial arrangement was acquired or issued;
- b is the sum of all amounts that would have been expenditure incurred by the person in respect of the financial arrangement from the date it was acquired or issued to the end of the income year, if the changes had been known as at the date the financial arrangement was acquired or issued;
- c is the sum of all amounts treated as income derived of the person in respect of the financial arrangement since it was acquired or issued to the end of the previous income year; and
- d is the sum of all amounts treated as expenditure incurred of the person in respect of the financial arrangement since it was acquired or issued to the end of the previous income year.

43. Applying the Determination G25 formula, the adjustment in year 2 is:

- $0 – $19,000 – $0 + $10,000 = –$9,000

44. This gives total expenditure for years 1 and 2 of $19,000 ($10,000 + $9,000), the equivalent position by the end of year 2 had the revised annual expenditure of $9,500 been claimed from the outset of the financial arrangement. This means the deduction for the break fee is effectively spread over the term of the loan.

Example 3 – Rental property sold

45. At the beginning of year 1, B borrows $200,000 at a flat 10% per year fixed interest rate to purchase a rental property from which rental income is derived. The loan is interest only. At the end of year 2, B breaks the loan in order to sell the property. B repays the loan and pays an additional $10,000 break fee.

46. B must calculate a BPA in relation to the loan as follows:

    - consideration – income + expenditure + amount remitted

47. The consideration received by B is the original loan amount of $200,000. The consideration paid by B is the return of the principal, two instalments of interest at $20,000 each, and the break fee of $10,000:

    - ($200,000 + $20,000 + $20,000 + $10,000) = $250,000.

48. There is no income or amount remitted. The expenditure is the $20,000 interest incurred under the loan in year 1.

49. Therefore, the BPA is:

    - ($200,000 – $250,000) – $0 + $20,000 + $0

      = −$50,000 + $20,000

      = −$30,000

50. The negative BPA amount of $30,000 effectively represents the $20,000 interest expense for year 2 and the amount of the break fee.

51. The negative BPA amount is expenditure incurred under the FA rules and is deemed to be interest. If B is a company (other than a qualifying company or a look through company), B will obtain a deduction for the $30,000 in the year in which it is incurred under section DB 7. If B is a non-corporate, a qualifying company or a look through company, the $30,000 will be deductible under section DB 6 and the general permission. The general permission is satisfied because the borrowed money was used to purchase the rental property from which assessable income was derived.

References

Expired Ruling(s)
BR Pub 09/09
BR Pub 09/10
BR Pub 10/20

Subject references
Deductibility
Mortgage break fees paid by landlords

Legislative references
Income Tax Act 2007
DA 1, DB 6, DB 7, EW 31 and the definition of "interest" in section YA 1

Case references
King v CIR (1973) 1 NZTC 61,107
Amalgamated Zinc (de Bavay's) Ltd v FCT (1935)54 CLR 295
Case *U29* (2000) 19 NZTC 9,273
Inglis v CIR (2001) 20 NZTC 17,379

Appendix – Legislation

Section DA 1(1) and (2) provides:

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**.

Section DA 2(1) and (2) 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**.

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**.

Section DB 6(1) and (4) provides:

DB 6 Interest: Not capital expenditure

Deduction

(1) A person is allowed a deduction for interest incurred.

...

Link with subpart DA

(4) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

Section DB 7(1), (2) and (8) provides:

DB 7 Interest: Most companies need no nexus with income

Deduction

(1) A company is allowed a deduction for interest incurred.

Exclusion: Qualifying company

(2) Subsection (1) does not apply to a qualifying company.

...

Link with subpart DA

(8) This section supplements the general permission and overrides the capital limitation, the exempt income limitation, and the withholding tax limitation. The other general limitations still apply.

Section EW 3(2) and (3) provides:

EW 3 What is a financial arrangement?

Money received for money provided

(2) A financial arrangement is an arrangement under which a person receives money in consideration for that person, or another person, providing money to any person—

(a) at a future time; or

(b) on the occurrence or non-occurrence of a future event, whether or not the event occurs because notice is given or not given.

Examples of money received for money provided

(3) Without limiting subsection (2), each of the following is a financial arrangement—

(a) a debt, including a debt that arises by law:

(b) a debt instrument:

(c) the deferral of the payment of some or all of the consideration for an absolute assignment of some or all of a person's rights under another financial arrangement or under an excepted financial arrangement:

(d) the deferral of the payment of some or all of the consideration for a legal defeasance releasing a person from some or all of their obligations under another financial arrangement or under an excepted financial arrangement.

Section EW 29(3) provides:

EW 29 When calculation of base price adjustment required

Maturity

(3) A party to a financial arrangement must calculate a base price adjustment as at the date on which the arrangement matures.

Section EW 31 provides:

EW 31 Base price adjustment formula

Calculation of base price adjustment

(1) A person calculates a base price adjustment using the formula in subsection (5).

When formula applies

(2) The person calculates the base price adjustment for the income year in which section EW 29 applies to them.

Positive base price adjustment

(3) A base price adjustment, if positive, is income, under section CC 3 (Financial arrangements), derived by the person in the income year for which the calculation is made. However, it is not income to the extent to which it arises from expenditure incurred by the person under the financial arrangement in earlier income years and for which a deduction was denied in those income years.

Negative base price adjustment

(4) A base price adjustment, if negative, is expenditure incurred by the person in the income year for which the calculation is made. The person is allowed a deduction for the expenditure under sections DB 6 to DB 8 (which relate to deductions for interest) or, if none of those sections applies, under section DB 11 (Negative base price adjustment).

Formula

(5) The formula is—

consideration − income + expenditure + amount remitted

Definition of items in formula

(6) The items in the formula are defined in subsections (7) to (11).

Consideration

(7) **Consideration** is all consideration that has been paid, and all consideration that is or will be payable, to the person for or under the financial arrangement, ignoring non-contingent fees, minus all consideration that has been paid, and all consideration that is or will be payable, by the person for or under the financial arrangement. For the purposes of this subsection, the following are ignored:

(a) non-contingent fees, if the relevant method is not the IFRS financial reporting method in section EW 15D:

(b) non-integral fees, if the relevant method is the IFRS financial reporting method in section EW 15D.

Consideration in particular cases

(8) If any of sections EW 32 to EW 48, or EZ 52D applies, the consideration referred to in subsection (7) is adjusted under the relevant section.

Income

(9) **Income** is—

(a) income derived by the person under the financial arrangement in earlier income years; and

(b) dividends derived by the person from the release of the obligation to repay the amount lent; and

(c) income derived under section CF 2(2) and (3) (Remission of specified suspensory loans).

Expenditure

(10) **Expenditure** is expenditure incurred by the person under the financial arrangement in earlier income years.

Amount remitted

(11) **Amount remitted** is an amount that is not included in the consideration paid or payable to the person because it has been remitted—

(a) by the person; or

(b) by law.

Section EW 54 provides:

EW 54 Meaning of cash basis person

Who is cash basis person

(1) A person is a ***cash basis person*** for an income year if—

(a) 1 of the following applies in the person's case for the income year:

(i) section EW 57(1); or

(ii) section EW 57(2); and

(b) section EW 57(3) applies in the person's case for the income year.

Persons excluded by Commissioner

(2) A person may be excluded under section EW 59 from being a cash basis person for a class of financial arrangements.

Section EW 55 provides:

EW 55 Effect of being cash basis person

Use of spreading method

(1) A cash basis person is not required to apply any of the spreading methods to any of their financial arrangements, but may choose to do so under section EW 61.

Calculation of base price adjustment

(2) The fact that a cash basis person does not use any of the spreading methods for the financial arrangement does not excuse them from the requirement to calculate a base price adjustment when any of section EW 29(1) to (12) applies to them.

Section EW 57(1)–(9) provides:

EW 57 Thresholds

Income and expenditure threshold

(1) For the purposes of section EW 54(1)(a)(i), this subsection applies if the absolute value of the person's income and expenditure in the income year under all financial arrangements to which the person is a party is $100,000 or less.

Absolute value threshold

(2) For the purposes of section EW 54(1)(a)(ii), this subsection applies if, on every day in the income year, the absolute value of all financial arrangements to which the person is a party added together is $1,000,000 or less. The value of each arrangement is,—

(a) for a fixed principal financial arrangement, its face value:

(b) for a variable principal debt instrument, the amount owing by or to the person under the financial arrangement:

(c) for a financial arrangement to which the old financial arrangements rules apply, the value determined under those rules.

Deferral threshold

(3) For the purposes of section EW 54(1)(b), this subsection applies if the result of applying the formula in subsection (4) to each financial arrangement to which the person is a party at the end of the income year and adding the outcomes together is $40,000 or less.

Formula

(4) The formula is—

(accrual income − cash basis income) + (cash basis expenditure − accrual expenditure)

Definition of items in formula

(5) The items in the formula are defined in subsections (6) to (9).

Accrual income

(6) **Accrual income** is the amount that would have been income derived by the person under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made. It is calculated using 1 of the following methods, as chosen by the person:

(a) the yield to maturity method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(b) the straight-line method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(c) an alternative method approved by the Commissioner.

Cash basis income

(7) **Cash basis income** is the amount that would have been income derived by the person under the financial arrangement if the person had been a cash basis person in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made.

Cash basis expenditure

(8) **Cash basis expenditure** is the amount that would have been expenditure incurred by the person under the financial arrangement if the person had been a cash basis person in the period starting on the date on which they became a

party to the arrangement and ending on the last day of the income year for which the calculation is made.

Accrual expenditure

(9) **Accrual expenditure** is the amount that would have been expenditure incurred under the financial arrangement if the person had been required to use a spreading method in the period starting on the date on which they became a party to the arrangement and ending on the last day of the income year for which the calculation is made. It is calculated using 1 of the following methods, as chosen by the person:

(a) the yield to maturity method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(b) the straight-line method, whether or not the person may use it, or has chosen to use it, for their financial arrangement; or

(c) an alternative method approved by the Commissioner.

Increase in specified sums

(10) The Governor-General may make an Order in Council increasing a sum specified in any of subsections (1) to (3).

In section YA 1, the definitions of "company", "IFRS", "interest", "maturity", "non-contingent fee", and "non-integral fee" provide as follows:

YA 1 Definitions

Company,-

(a) means a body corporate or other entity that has a legal existence separate from that of its members, whether it is incorporated or created in New Zealand or elsewhere:

(ab) does not include a partnership:

(abb) does not include a look-through company, except in the PAYE rules, the FBT rules, the NRWT rules, the RWT rules, the ESCT rules, the RSCT rules, and for the purposes of subpart FO (Amalgamation of companies):

(ac) includes a listed limited partnership:

(ad) includes a foreign corporate limited partnership:

(b) includes a unit trust:

(c) includes a group investment fund that is not a designated group investment fund, but only to the extent to which the fund results from investments made into it that are—

(i) not from a designated source, as defined in section HR 3(5) (Definitions for section HR 2: group investment funds); and

(ii) not made before 23 June 1983, including an amount treated as invested at that date under the definition of **pre-1983 investment** in section HR 3(8):

(d) includes an airport operator:

(e) includes a statutory producer board:

(f) includes a society registered under the Incorporated Societies Act 1908:

(g) includes a society registered under the Industrial and Provident Societies Act 1908:

(h) includes a friendly society:

(i) includes a building society:

(j) is further defined in section EX 30(7) (Direct income interests in FIFs) for the purposes of that section

IFRS, -

means a New Zealand Equivalent to International Financial Reporting Standard, approved or issued under the Financial Reporting Act 1993, and as amended from time to time or an equivalent standard issued in its place

interest,—

...

(c) in sections DB 6 (Interest: not capital expenditure), DB 7 (Interest: most companies need no nexus with income), and DB 8 (Interest: money borrowed to acquire shares in group companies),—

(i) includes expenditure incurred under the financial arrangements rules or the old financial arrangements rules

...

maturity,—

(a) in the financial arrangements rules, means,—

(i) for an agreement for the sale and purchase of property or services or an option, the date on which the agreement or option ends:

(ii) for any other financial arrangement, the date on which the last payment contingent on the financial arrangement is made:

...

non-contingent fee means a fee that—

(a) is for services provided for a person becoming a party to a financial arrangement; and

(b) is payable whether or not the financial arrangement proceeds

non-integral fee means a fee or transaction cost that, for the purposes of financial reporting under IFRSs, is not an integral part of the effective interest rate of a financial arrangement

In Determination G25: Variations in the Terms of a Financial Arrangement, the definition of "Variable Rate Financial Arrangement" reads as follows:

Variable Rate Financial Arrangement means a financial arrangement under which:

(a) the interest rate is determined by a fixed relationship to economic, commodity, industrial or financial indices or prices, or banking or general commercial rates; or

(b) the interest rate is set periodically by reference to market interest rates.