

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA
TŪMATAITI

Receipt of funding

Decision date | Rā o te Whakatau: 27 November 2024

Issue date | Rā Tuku: 12 March 2025

TDS 25/06

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Subjects | Kaupapa

Income tax: income, capital/revenue, capital contribution property

Taxation laws | Ture tāke

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

Summary of facts | Whakarāpopoto o Meka

1. The Applicant of this ruling is a trust. Its purpose is to manage funding and to hold assets that generate income for the benefit of its beneficiaries. The Applicant received funding from the Crown under a Funding Agreement (the Funding). The Funding Agreement stipulated that the Funding is applied as follows:
 - acquisition of a list of specified assets (Specified Assets);
 - transaction costs relating to the acquisition; and
 - working capital.
2. Upon receiving the Funding, the Applicant passed the funds to its wholly owned subsidiary (the Subsidiary). In accordance with the Funding Agreement, the funds were used to acquire the Specified Assets (including transaction costs) and as working capital for the Subsidiary.

Issues | Take

3. The main issue considered in this ruling was whether the Funding was income to the Applicant under ss CA 1(2), CB 1, CG 4 and CG 8.

Decisions | Whakataurua

4. The Tax Counsel Office (TCO) concluded that the funding is not income to the Applicant under any of ss CA 1(2), CB 1, CG 4 or CG 8.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Income under subpart C

5. The issue is whether the receipt of the funding is income to the Applicant under subpart C. TCO reviewed the provisions in subpart C and concluded that ss CA 1(2), CB 1, CG 4 and CG 8 were most relevant to this ruling.

Section CA 1(2) – income under ordinary concepts

6. Section CA 1(2) provides that an amount is income of a person if it is their income under ordinary concepts.
7. To be “income under ordinary concepts”, the amount must be something that comes in to a person.¹ However, receipts that are on capital account are not income according to ordinary concepts.²
8. Therefore, to determine whether the Funding is income under s CA 1(2), TCO considered whether the receipt is capital or revenue in nature.
9. In the context of a receipt, particular regard is to be given to the character of the receipt in the hands of the recipient.³
10. Where a recipient carries on a business, the relevant factors for determining the character of receipts in the hands of the recipient include:⁴
 - the scope of the recipient’s business;
 - the periodicity, recurrence or regularity of the receipts;
 - the consideration provided for the receipts; and
 - the purpose and reason for which the money is received.
11. TCO considered each of these factors.

¹ See *Tennant v Smith* (1892) 3 TC 158 and *CIR v Grover* (1988) NZTC 5,012 (CA).

² *Reid v CIR* (1985) 7 NZTC 5,176 (CA); *Case S86* (1996) 17 NZTC 7,538.

³ See *GP International Pipecoaters Pty Ltd v FCT* 90 ATC 4,413 (HCA); *MIM Holdings Ltd v FCT* 97 ATC 4,420 (FFCA) and *CIR v City Motor Service Ltd* [1969] NZLR 1010.

⁴ *GP International Pipecoaters*

Scope of the recipient's business

12. Case law indicates that profit made in the course of carrying on the recipient's business will often, in itself, be a fact of telling significance. A transaction that is unusual or extraordinary, when judged against the transactions that the recipient usually engages in, in the course of carrying on the business, may indicate that the amount received from the transaction is capital and not income.⁵
13. Further, the sale of a capital asset used in carrying on a business will not be an ordinary incident of that business.⁶
14. TCO considered the Funding is the means by which the Applicant was able to establish its income earning structure, through the Subsidiary. Without the Funding, the acquisition of the Specified Assets, and the ability to generate revenue through those assets, would not have been possible. In contrast, the Funding is not a payment received that is used in the Applicant's ordinary business operations or the course of carrying on its business. Despite the fact the Funding enables the Applicant to carry on its business, it was not a receipt in the ordinary course of those business activities.
15. TCO noted that while the Funding was allocated to three things – acquisition of assets, transaction costs and working capital – the same characterisation applies to all aspects of the Funding.
16. TCO considered the Funding was not within the scope of the Applicant's ongoing business activities and concluded that the Funding is of a capital nature.

Consideration provided for the receipt

17. If consideration is provided in respect of an amount received, that consideration will ordinarily supply the touchstone for determining whether the receipt is capital or revenue in nature.⁷ For example, a receipt in exchange for the sale of a capital asset will ordinarily be capital in nature.⁸
18. TCO considered the fact that the Funding was not provided in exchange for any consideration, nor was the Applicant required to give anything to the Crown in return, strongly indicates that the receipt is capital in nature. The contractual arrangements in

⁵ *FCT v Myers Emporium* 87 ATC 4363 (HCA)

⁶ *CIR v Rangatira Ltd* (1995) 17 NZTC 12,182; *Californian Copper Syndicate Ltd v Harris* (1904) 5 TC 159, at 165.

⁷ *MIM Holdings; The Federal Coke Company Ltd v FCT* 77 ATC 4,255 (FCA), at 4,273.

⁸ See for example, *Birkdale Service Station Ltd v CIR* [2001] 1 NZLR 293 (CA) and *GP International Pipecoaters*.

the Funding Agreement only set out requirements on how to use the money, not on any obligation the Applicant has to the Crown for the Funding.

Periodicity, recurrence or regularity of the receipts

19. The qualities of periodicity, regularity, or recurrence of a receipt may stamp it with a revenue character. But that in itself is not enough, and consideration must be given to the relationship between payer and payee and to the purpose of the payment, in order to determine the quality of the payment in the hands of the payee.⁹
20. The Applicant received a single payment from the Crown. There may be other advances made to the Applicant but there is no indication of when that might occur. TCO considered this suggests the receipt is capital in nature, although did not regard this as determinative on its own and the other capital/revenue factors are more relevant in this case.

The purpose and reason for which the money is received

21. The character of the receipt in the hands of the recipient is not to be confused with how the recipient subsequently applies the receipt.¹⁰ And the presence or absence of a dedicated use to which a receipt must be put is not determinative of the character of the receipt.¹¹
22. The Funding was distributed by the Applicant to the Subsidiary to complete the purchase of the Specified Assets. However, this was not considered determinative and TCO placed no weight on this factor.

Overall conclusion on s CA 1(2)

23. The character of the Funding was best understood by considering the first two factors. These factors strongly indicate that the Funding was received outside the scope of the Applicant's ongoing business activities and was not made in exchange for any consideration. This suggests that the Funding is a capital receipt.
24. TCO also considered the other factors as well as the accounting treatment applied to the Funding. These factors did not change the conclusion that the Funding is a capital

⁹ *Reid v CIR* [1985] 7 NZTC 5,176 (CA), at 5,183

¹⁰ *GP International Pipecoaters* at 4,419

¹¹ *CIR v Wattie* (1998) 18 NZTC 13,991; *GP International Pipecoaters*.

receipt, being part of the Applicant's business structure rather than its ongoing business activities.

25. Given the above, TCO concluded the Funding is capital in nature and is, therefore, not income of the Applicant under s CA 1(2).

Section CB 1 – amounts derived from business

26. Section CB 1(1) provides that an amount derived from a business is income of a person. However, this does not apply to an amount that is of a capital nature (s CB 1(2)).
27. TCO concluded that the Funding is not from the Applicant's business activities. Rather, it is sourced from the Crown to acquire assets.
28. In any event, as TCO previously concluded that the Funding is a capital receipt, s CB 1(2) prevents it from being income under s CB 1(1).

Section CG 4 – receipts for expenditure or loss from insurance, indemnity or otherwise

29. Section CG 4 provides that when a person is allowed a deduction for expenditure or loss and derives an amount relating to the expenditure or loss, whether through insurance, indemnity or otherwise, the amount derived is income to the extent of the deduction.
30. The Funding in this ruling was used by the Applicant to fund the acquisition of the Specified Assets and added to its investment in its Subsidiary. Both have increased the Applicant's capital structure and therefore no deduction is allowable for that expenditure.
31. For s CG 4 to apply, funds are received in relation to an amount that has been deducted. Given the Applicant did not receive the Funding for an expenditure or loss that was deducted, TCO concluded that s GC 4 cannot apply because the first requirement under CG 4 is not met.

Section CG 8 – capital contributions

32. Capital contributions are income if s CG 8 applies. For s CG 8 to apply, an amount must be a capital contribution.
33. "Capital contribution", as defined in s YA 1, means an amount that:

- is paid by the payer to the recipient under an agreement between them;
- is paid by the payer other than in their capacity of settlor, partner, or shareholder of the recipient;
- is not income of the recipient (ignoring ss CC 1B and CG 8);
- is paid as a contribution for capital contribution property under the express terms and conditions of the agreement; and
- is paid in relation to an interruption or impairment of business activities, if the agreement is a contract of insurance, indemnity, or compensation.

34. TCO considered each of these requirements:

- The Funding was paid to the Applicant under an agreement between the parties – the Funding Agreement. Therefore, the first requirement is met.
- The second requirement is met because the Funding was not paid by the Crown in its capacity of settlor, partner, or shareholder of the recipient.
- The Funding is a capital receipt and not income of the Applicant. The third requirement is met.
- The fourth requirement is that the amount is paid as a contribution for capital contribution property under the express terms and conditions of the agreement. “Capital contribution property” is defined in s YA 1. For the purposes of this ruling, the first meaning in the definition is applicable. That is, for a recipient of an amount, depreciable property owned or to be acquired by the recipient. TCO concluded that this requirement is not met because the Funding Agreement did not expressly require the acquisition of depreciable property, only the acquisition of the Specified Assets (which are not depreciable property). The Funding does not meet the definition of capital contribution property.
- The Funding was not paid in relation to an interruption of business activities under a contract of insurance, indemnity or compensation and, therefore, the fifth requirement is not relevant.

35. Because the definition of “capital contribution” is cumulative, meaning that all requirements must be satisfied for the definition to apply, TCO concluded that the Funding is not a “capital contribution”. Therefore, s CG 8 cannot apply to treat the Funding as income to the Applicant.