Section 33 - Repeal of Exemptions from Income Tax

This section repeals sections 61(6), (7), and (8) of the Income Tax Act 1976. The effect is the withdrawal of income tax exemptions relating to income derived by:

- Primary producer and marketing boards,
- Certain milk treatment companies,
- Milk treatment corporations established under regulations made pursuant to the Marketing Act 1936 and the Agriculture (Emergency Powers) Act 1934.

The withdrawal of the exemption applies from the income year which commenced on 1 April 1988. The amendment results from an announcement made in the Government Economic Statement of 17 December 1987.

For details of the tax treatment of these organisations see the commentary on section 39 of the Amendment Act.

Section 39 - Taxation of Primary Producer Boards and Co-operative Companies

Introduction

In line with Government policy outlined in the Government Economic Statement of 17 December 1987, a number of exemptions and concessions have been removed from the Tax Act. This Appendix specifically deals with:

- The exemption from tax of income derived by primary producer and marketing boards, and certain milk treatment companies and corporations. (See section 33 of the Amendment Act (No 5)).
- Deductions for "qualifying expenditure" incurred by primary producer co-operative companies. (See section 41 of the Amendment Act (No 5)).
- The exemption from tax of certain income derived by co-operative dairy companies, co-operative milk marketing companies and co-operative pig marketing companies. (See section 41 of the Amendment Act (No 5)).

Section 39 introduces four new sections to the Income Tax Act - Sections 197E to 197H. These new sections relate to:

Section 197E Statutory Producer Boards

Section 197F Milk Treatment Companies and Corporations

Section 197G Primary Producer Co-operative Companies

Section 197H Co-operative Dairy Companies
Co-operative Milk Marketing Companies
Co-operative Pig Marketing Companies.

Statutory Producer Boards

The income tax records for these organisations will be held in Special Files Section, Wellington District Office. The definition of a statutory producer board refers to:

(a) Any board listed in the Eighteenth Schedule to the Act, and

(b) Any marketing authority established under regulations pursuant to the Primary Products Marketing Act 1953, and

(c) Any other primary producer or marketing board, other than an exempt body or a State Owned Enterprise.

Statutory producer boards listed in the Eighteenth Schedule to the Act are:

New Zealand Apple and Pear Marketing Board
New Zealand Dairy Board
New Zealand Fishing Industry Board
New Zealand Horticulture Export Authority
New Zealand Meat Producers Board
New Zealand Pork Industry Board
New Zealand Wool Board

Marketing authorities within the meaning of the Primary Products Marketing Board Act 1953 are:

Berryfruit Marketing Licensing Authority
Game Industry Board
New Zealand Kiwifruit Authority
Raspberry Marketing Council

All of the above derive income from members by way of levies. The income is used to provide certain promotional activities for their members.

In addition the Apple and Pear Marketing Board and the Dairy Board purchase all export goods produced by their members, process those goods and sell them overseas. The Boards pay for goods supplied by their members according to prices determined from time to time.

The Wool Board purchases some wool from members but only when guaranteed prices cannot be gained elsewhere.

Where goods are purchased from members the boards operate in a similar way to co-operatives. Section 199 of the Tax Act (Profits of mutual associations in respect of transactions with members) allows mutual associations to claim a deduction (within certain limits) for rebates paid to members. Statutory producer boards are also able to claim a deduction for amounts paid for produce supplied by members. Full details of the treatment of produce payments are described in the commentary relating to changes to section 199 of the Tax Act. See section 40 of the Amendment Act.

A flow chart on page 10 of this Appendix shows how the New Zealand Dairy Board operates, and the effect of the rules relating to the imputation system apply.

Statutory producer boards are deemed to be companies and their activities are deemed to constitute the carrying on of a business (section 197E(2)(a) and (b)).

Many boards are able to charge levies for capital development. These levies are to be treated as non-taxable income in the boards' hands and they will be non-deductible to the member in terms of section 106(1)(a) of the Tax Act. All other levies are assessable income to the board and deductible expenditure to the member. (Section 197E(2)(c)).

Section 104 of the Tax Act provides that expenditure is deductible if it is incurred in gaining or producing assessable income, or in carrying on a business for the purpose of gaining or producing assessable income. Some statutory producer boards have a statutory right to charge levies, and do not actually incur any expenditure in gaining or producing that type of income. Expenditure is incurred after the income is derived in relation to services provided for members.

For this reason section 197E(2)(d) provides that expenditure, other than capital expenditure, incurred in satisfying the producer boards' statutory functions will be deductible for income tax purposes.

Stabilisation Accounts

Most producer boards retain income resulting from the sale of goods supplied by members in prosperous periods so that greater payments can be made to members in those times when prices for their produce are . Many of the boards have made representations that income retained in this way should not be subject to tax until such time as the income is paid to members. The Government has rejected these submissions. The Tax Act does not allow deductions for provisions which are set aside to cover future expenditure unless a liability actually exists to pay the debt. To allow producer boards to claim a deduction in respect of these retentions would place boards in a more advantageous position than any other sector of the economy.

Transitional Measures

Basis for Depreciation

Sections 197E(3), (4), and (5) prescribe the method of determining the value, for the purposes of calculating depreciation, of assets which have been used by a board while the activities of the board were exempt from tax. For assets which are depreciated on a diminishing value basis, the cost will be deemed to be the actual cost price reduced by the amount of depreciation which would have been allowed as a deduction if the asset had been used in a taxable activity.

Buildings will be depreciated on the basis of their cost price.

Any questions as to the original cost price of an asset, or the date on which it was acquired is to be decided:

• By agreement between the Commissioner and the board, or

• Where agreement cannot be reached, by the Commissioner.

<u>Value of Stock on Hand as at 31 March 1988</u> (or equivalent balance date)

Sections 197E(6) and (7) provide that opening stock on hand at the date when the income of producer boards commences to be taxable must be valued at the <u>lesser</u> of the:

• Cost price,

• Market selling price, or

• Price at which it cam be replaced.

An auditor's statement to this effect is required before a deduction can be allowed.

The rationale behind these provisions is that if producer boards were allowed to claim a deduction in respect of opening trading stock valued at any of the options available under section 85, the board would be able to select the highest option for the initial deduction, but subsequently write down trading stock to one of the lower valuation options, in this way gaining an unwarranted tax advantage.

Subsection (9) provides that producer boards are not required to deduct and any withholding tax from dividends received from overseas and derived during the 1989 income year.

Milk Treatment Companies and Corporations.

Since the Milk Board was abolished rnany of the companies and corporations which were previously exempt under sections 61(7) and (8) have been wound up and new business structures arranged to carry on the businesses. Those new structures will be subject to tax under the Tax Act in accordance with the provisions relating to the type of business structure which has been adopted. E.g. Company, partnership or co-operative.

The purpose of section 197F is to provide transitional measures relating to:

• The values of fixed assets for the purposes of calculating depreciation, and

• The valuation of opening trading stock

for organisations which previously derived income which was exempt from tax in terms of sections 61(7) or (8), or for organisations which have taken over the business of such an organisation.

Transitional Provisions

The transitional provisions are the same as those applying to statutory producer boards: i.e.,

Basis for Depreciation

Sections 197F(2), (3) and (4) prescribe the method of determining the value, for the purposes of calculating depreciation of assets which have been used by a milk treatment station while the activities of the organisation were exempt from tax. For assets which are depreciated on a diminishing value basis, the cost will be deemed to be the actual cost price reduced by the amount of depreciation which would have been allowed as a deduction if the asset had been used in a taxable activity.

Buildings will be depreciated on the basis of their cost price.

Any questions as to the original cost price of an asset or the date on which it was acquired is to be decided:

• By agreement between the Commissioner and the milk treatment station, or

• Where agreement cannot be reached, by the Commissioner.

<u>Value of Stock on Hand as at 31 March 1988</u> (or equivalent balance date)

Sections 197F(5) and (6) provide that opening stock on hand at the date when the income of milk treatment stations commences to be taxable must be valued at the lesser of the:

• Cost price,

• Market selling price, or

• Price at which it cam be replaced.

An auditors' statement to this effect is required before a deduction cam be allowed.

The rationale behind these provisions is that if milk treatment stations were allowed to claim a deduction in respect of opening trading stock valued at any of the options available under section 85, the treatment station would be able to select the highest option for the initial deduction, but subsequently write down trading stock to one of the lower valuation options, in this way gaining an unwarranted tax advantage.

Primary Producer Co-operative Companies

Under section 200 of the Tax Act primary producer co-operative companies were able to claim a deduction in respect of profits which were reinvested in qualifying primary produce activities. This concession is repealed in section 41 of the Income Tax Amendment Act (No 5) 1988.

Transitional Measures

Section 197G provides a number of transitional measures applying to taxpayers who were eligible for the concession. The measures relate to:

• The valuation of opening trading stock,

• The sale of any asset the cost of which had previously been taken into account in calculating a deduction allowable in terms of section 200, and

• The surrender of a shareholder's shares, or the winding up of a primary producer co-operative company.

Value of Stock 1 Hand us at 31 March 1988 (or equivalent balance date)

This provision is essentially the same as the measures relating to statutory producer boards and milk treatment stations.

Sections 197G(2) and (3) provide that opening stock on hand at the commencement of the 1989 income year must be valued at the lesser of the:

- Cost price,
- Market selling price, or
- Price at which it can be replaced.

An auditor's statement to this effect is required before a deduction e can be allowed.

The rationale behind these provisions is that if the primary producer co-operative company was eligible for a deduction in terms of section 200 when the trading stock was purchased. It was considered appropriate, therefore, for the deduction to be limited to the amount calculated in relation to the lowest valuation option available in terms of section 85 of the Tax Act.

Sale of Assets

Section 197G(4) repeats a previous provision (section 200(6)).

Where a company sells an asset, other than trading stock, and the cost of the asset was allowed as a deduction under section 200, the proceeds from the sale are deemed to be assessable income in the year of sale.

Surrender of shares

Section 197G(5) repeats the repealed section 200(8) of the Tax Act.

Where hsareholders surrender shares, or on the winding up of the company, receive in excess of the paid up value of their shares, the Commissioner is authorised to treat any such excess as assessable income to the extent that the amount of the excess represents an amount allowed as a deduction in any earlier year.

Note 1) The provisions of section 200(7) of the Tax Act are discontinued. That section provided that in the event of winding up or being taken over by non-co-operative shareholders an adjustment could be made, in the year of takeover or winding up, in respect of past deductions allowed under section 200.

These provisions were repealed as it was considered that the policy would deler primary producer co-operatives from diversifying.

2) Transitional provisions relating to asset values are not necessary in relation to primary producer co-operative companies. The written down value of assets will be available from the tax records and depreciation will be calculated according to normal tax rules.

Co-operative Dairy, Milk Marketing and Pig Marketing Companies.

Prior to the passingof the Income Tax Amendment Act (No 5) 1988, sections 201, 202, and 203 of the Tax Act provided that all income in relation to:

- The collection, handling, manufacture, treatment, sale, and distribution of butter, cheese, casein, dried milk, or any other dairy produce (section 201)
- The collection, handling, manufacture, treatment or marketing of milk or cream or any product of milk or cream which the Commissioner determined was dairy produce (section 202)
- The collection, handling or slaughtering of pigs, bobby calves, or cull cattle, or from the treatment or marketing of any product thereof which the Commissioner determined was the product of such stock (section 203)
- Rent obtained from employees engaged in the activities mentioned above (section 201 202 and 203)
- Payments received as a shareholder or supplier of a company which was exempt under section 61(7) of the Tax Act (sections 201 and 202)

was exempt from tax as long as that income was not applied to activities not covered by the exemption.

Sections 201 to 203 are repealed by section 41 of the Income Tax Amendment Act (No 5) 1988. The new section 197H introduces transitional provisions similar to those applying, to statutory producer boards and milk treatment stations. That is:

Transitional Provisions

Basis for Depreciation

Sections 197H(2), (3) and (4) prescribe the method of determining the value, for the purposes of calculating depreciation, of assets which have been used by the co-operative marketing company while the activities of the organisation were exempt from tax. For assets which are depreciated on a diminishing value basis, the cost will be deemed to be the actual cost price reduced by the amount of deprecation which would have been allowed as a deduction if the asset had been used in a taxable activity.

Buildings will be depreciated on the basis of their cost price.

Any questions as to the original cost price of am asset, or the date on which it was acquired is to be decided:

- By agreement between the Commissioner amd the co-operative marketing company, or
- Where agreement cannot be reached, by the Commissioner.

<u>Value of Stock on Hand as at 31 March 1988</u> (or equivalent balance date)

Sections 197F(5) and (6) provide that opening stock on hand at the date when the income of co-operative marketing companies commences to be taxable must be valued at the lesser of the:

- Cost price,
- Market selling price, or
- Price at which it can be replaced.

An auditor's statement to this effect is required before a deduction can be allowed.

The rationale behind these provisions is that if co-operative marketing companies were allowed to claim a deduction in respect of opening trading stock valued at any of the options available under section 85, the co-operative would be able to select the highest option for the initial deduction, but subsequently write down trading stock to one of the lower valuation options, in this way gaming an unwarranted tax advantage.

Subsection (7) provides that regulations may be made under section 433 of the Tax Act for a number of purposes. The purposes specified are those which were previously provided under sections 201(2), 202(3) and 203(3). Regulations made under those provisions are:

Co-operative Dairy Companies 'Income Tax Regulations 1955

Co-operative Milk Marketing Companies Income Tax Regulations 1960

Co-operative Pig Marketing Companies Income Tax Regulations 1964

Prior to the passing of the Income Tax Amendment Act (No 5) 1988 these regulations provided that income derived by the co-operative company which was not invested in qualifying activities was to be deemed to be assessable income.

Section 41 of the Income Tax Amendment Act (No 5) 1988 repeals the operative clauses of these regulations.

Note however that the other clauses remain in force, particularly provisions relating to the surrender of shares, or winding up of the co-operative.

Where shareholders surrender shares, or on the winding up of the company, receive in excess of the paid up value of their shares, the Commissioner is authorised to treat any such excess as assessable income to the extent that the amount of the excess represents an amount allowed as a deduction in any earlier year.

Section 40 - Profits of Mutual Associations in respect of Transactions with Members

Section 199 of the Tax Act provides that where a mutual association enters into transactions with members, profits arising from those transactions are assessable income, but, within certain limits, deductions may he claimed in respect of rebates paid to members. Deductions for rebates are restricted to the amount of profit relating to member transactions.

Section 199(6) of the Tax Act provides that rebates are assessable income to members only if the rebate relates to a business transaction.

Section 40 of the Income Tax Amendment Act (No 5) 1988 makes a number of amendments which modifies the operation of section 199:

- As it relates to statutory producer boards, and
- In relation to the introduction of a full imputation system.

The definition of "association" remains unchanged.

"Member" is defined in relation to statutory producer boards. A member of a board is any person who:

(a) Is liable to pay a levy to a statutory producer board, or

(b) Supplies produce or goods to the board in terms of its statutory functions.

The definition of "rebate" is virtually the same except that it excludes any:

- "Cash distribution" to which a board elects to allocate an imputation credit in terms of section 394R(1)(a),
- "Cash distribution" to which a co-operative elects to allocate an imputation credit in terms of section 394X(1)(a),

(These distributions are treated as dividends and, accordingly, are not deductible for tax purposes)

- Distributions which relate to retained funds which have previously been the source of a "notional dividend" as described in section 394R(1)(b) or section 394X(1)(b), or

- Distributions by a producer board, from capital levies received, on the occasion of a winding up.

  These distributions are deemed not to be dividends. They are therefore not assessable in the recipient's hands, and as capital payments are non-deductible to the board or co-operative).

Subsection (2) amends section 199(3) by making it subject to a new section 199(3A). The new subsection (introduced by section 41(4)) provides that:

(a) Statutory producer boards may claim a deduction for all rebates or produce payments made to members, and that restrictions on deductions for rebates applying to other co-operatives do not apply.

The reason for relaxing the rules relating to the deduction for rebates is that rebates, including produce payments, paid by boards to members are in respect of business transactions and will accordingly be subject to tax in the members' hands.

(b) The producer board may elect whether a rebate is deductible in the year it is paid, or in certain circumstances the previous income year. (A rebate can include an amount paid not later than 6 months after the end of the trading year of the producer board).

(c) Where a producer board pays a rebate to a member which is itself a mutual association, the amount of the rebate is deemed to be assessable income in the year in which the board claims the deduction.

Section 40(3) amends section 199(3)(b) which limits the deduction for rebates paid by mutual associations, other than producer boards, to the amount of the profit applicable to member transactions. The effect of the amendment is that where a deduction for rebates paid by a co-operative company is limited to the amount of profit applicable to member transactions, in calculating the amount of that profit, the co-operative will deduct the amount of any "cash distribution" (as described in section 394X(1)(a)). The reference to section 394R(1)(a) in this section is unnecessary and is to be removed.)

Section 40(5) repeals section 199(7) consequent to the repeal of sections 201 to 203 of the Tax Act.

Section 199(10) lists transactions which are regarded as transactions with members. Section 40(6) introduces two new types of transaction to the list. They are:

- Transactions between a producer board and member involving the acceptance by the board of produce or goods in terms of the board's statutory functions, and

- Payment of levies to a producer board by a member.

Section 41 - Exemptions and Deductions relating to Primary Producer and Other Co-operative Companies No Longer to Apply.

This sections repeals a number of concessions, the announcement of which was made in the Government Economic Statement of 17 December 1987. Some consequential amendments are also made.
These are:

- Section 200 of the Tax Act is repealed. Deductions for profits derived by primary producer co-operative companies, and reinvested in "qualifying activities" are withdrawn. See commentary on section 197G for details of transitional provisions.

- Section 201 of the Tax Act is repealed. Exemption for income derived by co-operative dairy companies is withdrawn. See commentary on section 197H for transitional measures.

- Section 202 of the Tax Act is repealed. Exemption in respect of income derived by co-operative milk marketing companies is withdrawn. See commentary on section 197G for transitional measures.

- Section 203 of the Tax Act is repealed. Exemption in respect of income derived by co-operative pig marketing companies is withdrawn. See commentary on section 197H for transitional measures.

- Regulation 5 of the:
  - Co-operative Dairy Companies Income Tax Regulations 1955
  - Co-operative Milk Marketing Companies Income Tax Regulations 1960
  - Co-operative Pig Marketing Companies Income Tax Regulations 1964

These regulations provided that income which was exempt under sections 201 to 203 could be clawed back if profit were not reinvested in qualifying activities. They are no longer necessary. For details of provisions which remain see commentary on section 197H.

IMPUTATION

Statutory Producer Boards and Co-operative Companies

This Appendix deals only with special provisions relating to producer boards and co-operatives, and should be read in conjunction with the Appendix to TIB No. 1, July 1989 which deals with imputation in general.

General - Statutory Producer Boards - Section 394Q

Statutory producer boards are liable for income tax on income derived after the commencement of the 1989 income year, and dividend withholding payment on foreign source dividends derived in the 1990 and subsequent income years.

As statutory producer boards do not have conventional shareholding structures, special provision must be made for them to impute to their members credits for tax (and dividend withholding payment) paid by them.

Statutory producer board is defined in section 394Q and basically means any primary producer or marketing board established by an Act.

A member of a board is any resident who, during a year in question, carries on any farming or agricultural or other business and who is liable to pay a levy to the board, or who supplies produce to the board, during the year.

A statutory producer board is deemed to be a company for the purposes of the Act and is therefore required to operate an ICA for each imputation year. Credits and debits arise to the account as they do for other companies under sections 394D amd 394E of the Act. That is:

Credits

- Income tax paid
- Excess retention tax paid
- Imputation credits attached to dividends received
- Dividend withholding payment credits attached to dividends received
- Dividend withholding payments made
- Any end of year balance in a dividend withholding payment account
- Any end of year balance in a branch equivalent tax account
- Any reduction in dividend withholding payments payable
- Any credit to offset previous debit relating to an arrangement to obtain a tax advantage

Debits

- Imputation credits attached to dividends paid
- Any refund of income tax paid
- Any refund of excess retention tax
- Allocation debits (occurs where a company is in breach of the allocation rules)
- Any refund of dividend withholding payments
- Any credit of tax to a branch equivalent tax account
- Loss of commonality of shareholding
- A reversal of tax payable due to an arrangement to obtain a tax advantage being overturned
- Company ceases to be an ICA company

For full information about how the debits and credits arise see Appendix to TIB No.1, July 1989.

Special provisions relating to Statutory Producer Boards and Co-operative Companies

Statutory Producer Boards - Sections 394Q to 394V

Co-operative Companies - Sections 394W to 394ZB

A statutory producer board or co-operative company can distribute credits to members in one of two ways - by means of

1. a notional dividend

2. a cash distribufion

A determination to do so must be made within 6 months after the year of determination in respect of which the determination is made (section 394R(3) and section 394X(3))

1. Notional dividend

This mechanism may be used by a statutory producer board or co-operative where the board or co-operative is required to pay tax on retained income. Notional dividends allows the board or co-operative to allocate imputation credits in much the same way as a company would allocate credits to a bonus share issue. The benefit of the use of notional dividends is that a member with a marginal tax rate lower than the company rate would be able to offset excess imputation credits against tax payable on other income.

The producer board or co-operative may allocate imputation credits to members on the basis of:

(a) the proportion of produce transactions of the member to all produce transactions during the year of determination, or

(b) the proportion of levies which a member paid to the amount of levies paid by all members , or

(c) a combination of (a) and (b), or

(d) any other method approved by the Commissioner. The Commissioner has power to determine the extent to which a board or co-operative should have made the calculation on another basis.

Example

Allocation on Basis of Produce Transactions

Assume a producer board has two members:

A - $1,000 of produce transactions during year ending 30 June 1990

B - $2,000 of produce transactions during year ending 30 June l990

Credits amounting to $1,500 are available in the producer board's ICA to be allocated to members.

The formula in section 394T(2) (394Z for co-operatives) provides for the allocation of imputation credits to members:

$$\frac{a}{b} \times c$$

a = amount paid to or by the member for produce transactions during the year

b = amount paid to or by all members for produce transactions during the year

c = all imputation credits which the producer board has determined to attach to the notional distribution.

The producer board calculates the amount of credit to be given to each as follows:

A $\frac{1{,}000}{3{,}000} \times 1{,}500 = 500$

B $\frac{2{,}000}{3{,}000} \times 1{,}500 = 1{,}000$

The producer board is deemed to have paid a (notional) dividend to each member of the following amount:

$$\frac{a}{b}$$

where a = the amount of imputation credit attached

b = the resident companies' tax rate (for the income year in which the determination is made)

So, in the example above, on the basis of a company tax rate of 28%, the notional dividend paid to member A would be:

$\frac{500}{.28} = \$1{,}785.71$

Note: When the No. 5 Bill was passed the company tax rate was 28 cents in the dollar. This has now been increased to 33 cents.

Member A will therefore receive a "notional" dividend of $1,785.71 with a credit of $500 attached - this is a dividend carrying the maximum imputation ratio. (As all notional dividends will be fully credited the allocation rules in section 394G do not apply to producer boards.)

Member A will receive no cash (hence the term "notional" dividend), merely a shareholder dividend statement. The dividend is derived on the date of the determination by the producer board and must be included by the member in his/her assessable income for that year.

Note: In all circumstances other than the receipt of a notional dividend, a non-corporate shareholder returns as assessable income the dividend received plus the imputation credit attached. The amount of the notional dividend already includes the credit. Imputation credits attached to notional dividends are therefore not added to the notional dividend paid in returning assessable income. Member A will return $1,785.71 as income and claim a credit of $500.

As noted earlier, the allocation of notional dividends is a means of allowing imputation credits for tax paid by the producer board or co-operative to flow through to the member. If member A is on a tax rate which is higher than the company tax rate he/she will receive no cash and will be required to pay additional tax on that notional dividend. For those on the company tax rate there will be no additional liability. Those on a tax rate lower than the company rate will be able to offset excessive tax credits against tax relating to other income derived.

When the cash which was represented by that notional dividend is subsequently distributed it is distributed tax-free to members (section 4A(1)(j) or (k)) - this is because tax has already been assessed to a member on that amount. However the amount which is paid to the member cannot be an amount which is deductible to the producer board or co-operative - section 4A(5) deems such a distribution to be a return of capital for the purposes of section 106(1)(a) which prohibits a deduction for capital. Producer boards and co-operatives are required to keep sufficient records to enable the Commissioner to determine whether an amount which is distributed is an amount which was included in a notional distribution.

Producer boards are not required to file company dividend statements but section 394U(3) requires that they furnish with the annual return particulars of the dividend deemed to have been paid. Section 394ZA(3) similarly provides that co-operatives are required to furnish an annual return showing details of dividends paid.

2. Cash Distributions

The second method which the producer board or co-operative may adopt for passing on imputation or dividend withholding payment credits to members is to attach the credits to a cash distribution to members which would have been deductible to the board but which the board has elected to treat as non-deductible. (To allow a company to attach imputation credits to an amount which is deductible is effectively to allow credit for tax not paid.)

Cash distributions will be particularly attractive where a producer board or co-operative is in a loss position but has received a dividend with imputation credits attached. The mechanism was designed to allow members or shareholders to utilise the credits attached to the dividend.

The amount of the distribution which the producer board or co-operative elects to treat as non-deductible is deemed for the purposes of the Act to be a dividend. It will be derived by the member when it is received.

A co-operative may elect to make a cash distribution to all who were shareholders at any time during year X based on the proponion of a shareholder’s produce transactions with the co-operative to the total produce transactions. A producer board may also allocate cash distributions on the basis of produce transaction, but has two further options on which to allocate such distributions:

(i) the proportion that levies payable by each member bear to the total levies payable by all members of the board, or

(ii) any other method approved by the Commissioner.

The formula for calculating the amount of imputation credits which may be attached to a cash distribution is set out in section 394S for producer boards and section 394Y for co-operatives:

$$a \times \frac{b}{1 - b}$$

where a = the amount of the cash distribution

b = the resident companies’ tax rate (for the year in which the determination is made)

Example

Assume a producer board makes a total produce payment for the year ended 30 June 1989 of $3,000.

Member A in that year was paid $2.000 in produce transactions

Member B in that year was paid $1.000 in produce transactions

In July 1989 a producer board wishes to allocate credits to a total cash distribution of $900 made to members of the producer board during the year ended 30 June 1989. The cash distribution would have been deductible under the Income Tax Act but the producer Board elects to treat this amount as non-deductible in determining its assessable income.

The amount of credits which may be attached to the distribution in terms ot section 394S (section 394Y for co-operatives) - on the basis of a company tax rate of 28% - is

$$\frac{90.0 \times .28}{.72} = 350$$

Member A is to receive $600 (Allocated on the basis of produce transactions)
Member B is to receive $300

The amount of credit to be allocated to each member is calculated according to the formula in section 394S(2) (section 394Y(2) for co-operatives:

$$\frac{c}{d} \times e$$

where c = the member's share of the cash distribution

d = the total amount of the cash distribution

e = the amount of imputation credits attached in respect of the cash distribution

Member A therefore receives $\frac{600}{900} \times 350 = 233.33$

Member A receives a \$600 cash distribution with 233.33 credits attached S/he will return \$833.33 (distribution plus credits) as assessable income and claim \$233.33 credit of tax.

Member B receives $\frac{300}{900} \times 350 = 116.66$

Member B receives a \$300 cash distribution with \$116.66 credits attached. S/he will return as income \$416.66 and claim a credit of \$116.66.

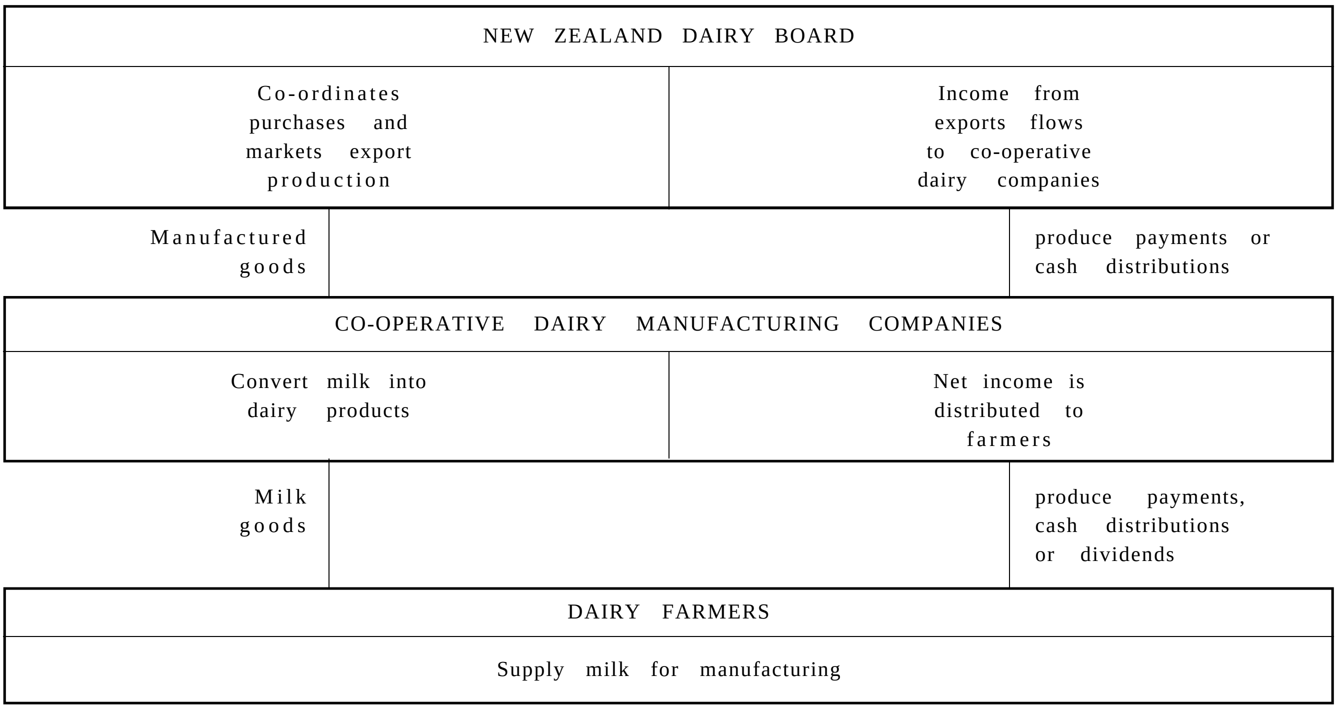
Timing of Cash and Notional Distributions

Co-operative companies are entitled only once in respect of each year of determination to attach a credit to a notional distribution and/or a cash distribution. Producer Boards may do so as many times in a year of determination as they consider appropriate.

Co-operative companies

In addition to being able to allocate credits to members by attaching them to notional distributions and cash distributions, co-operative companies which are imputation credit account companies and dividend withholding payment account companies may pay dividends and attach credits thereto in the normal way.

In relation to allocation rules, these apply only to attachment of credits to those dividends which are not notional distributions or cash distributions. Notional and cash distributions are fully credited.



Notes

- Produce payments are made according to prices set from time to time. A catch-up payment may be made after the end of the income year. They are deductible to the producer board or co-operative company that pays them, umless the board or co-operative elects to treat them as cash distributions. (See below) The payments are income in the recipient's hands.

- Cash distributions are non deductible to the board or co-operative. They are treated as a dividend in the recipient’s hands. An imputation credit is attached.

- Normal dividends can be paid by co-operatives but not by producer boards. Normal imputation rules apply. An imputation credit may or may not be allocated.

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APPENDIX B TO TIB NO. 2, AUGUST 1989

EXPLANATION OF THE INCOME TAX AMENDMENT ACT (NO 5) 1988 - PART II

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