

DECEMBER 1990

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From The Commissioner...

Dear Subscriber,

This is the last Tax Information Bulletin for 1990. We hope the new format has found favour with you. We intend to go on improving it, and look forward to any suggestions you may have.

With best wishes for Christmas and 1991.

Yours sincerely

David Henry
Commissioner of Inland Revenue

Do You Have Any Ideas For Accrual Determinations?

Background

Section 64E of the Income Tax Act 1976 gives the Commissioner power to issue binding determinations for the purposes of sections 64B to 64M of the Act (usually referred to as the accrual regime). Broadly speaking, these determinations set out the methods for accounting for income and expenditure arising from various types of financial arrangement.

One of the recommendations in the Tax Simplification Committee report was that the Commissioner "should call for submissions which would identify types of financial arrangements requiring determinations, and suggested ways these should be dealt with". In

response to that recommendation, we would like to hear your ideas on the subject.

Please remember that the Commissioner only has power to issue determinations in accordance with the provisions of the Act; he can't approve a method of accounting for a class of financial arrangements which conflicts with the provisions of sections 64B to 64M. For example, the provisions of sections 64B to 64M require that financial arrangements be accounted for separately, so the Commissioner can't issue a determination which allows income and expenditure from several arrangements to be netted off against each other.

Suggestions

If you have any suggestions at all about -

- a) Determinations already issued,
- b) General Determinations that could be issued,
- c) Specific determinations that could be issued to cover matters of concern to you,

then we would like to hear them. Please complete the form on page 9. (This form is purely for your convenience; you do not have to use it.)

Please forward your suggestions to:

Manager (Technical Policy)
Head Office
Inland Revenue Department
PO Box 2198
WELLINGTON

Specific Determinations

As well as making determinations of general application, as has been the case to date, the Commissioner has power to issue determinations relating to specific financial arrangements in response to applications from taxpayers. The procedure for applying for such determinations is set out in The Income Tax Act (Determinations) Regulations 1987.

The attached form gives the opportunity to suggest to the Commissioner the type of determination taxpayers require without having to comply with the details of the Regulations.

Determinations as at 1 November 1990

These are the determinations which have been made up to the present time.

Some of these determinations apply to a wide range of arrangements. For example Determination G3 provides a Yield to Maturity Method to be used for calculating the income and expenditure of any financial arrangement where the cash flows are known in advance (eg Government Stock). Other determinations apply only to one type of financial arrangement. For example Determination G14 deals only with forward contracts for foreign exchange and commodities.

- G1A Apportionment of Income and Expenditure on a Daily Basis
- G2 Requirement as to Precision
- G3 Yield to Maturity Method

- G4 Unit Trusts with Repurchase Obligations
- G5 Mandatory Conversion Convertible Notes
- G6C Foreign Currency Rates
- G7B New Zealand Futures and Options Markets
- G9A Financial Arrangements that are Denominated in a Currency or Commodity other than New Zealand Dollars
- G10B Present Value Calculations
- G11A Accrual Income and Expenditure using Present Value Based Yield to Maturity Method
- G12 Accounting for a Financial Arrangements in the Absence of a Determination
- G13A Prices or Yields
- G14 Forward Contracts for Foreign Exchange and Commodities
- G15 Exemption from Section 64C for Small Debtors
- G16A Discounted Value of Amounts payable in Relation to Trade Credits Denominated in New Zealand Currency
- G17A Discounted Value of Amounts Payable in Relation to Deferred Property Settlements Denominated in New Zealand Currency
- G18 International Futures and Options Markets
- G19 Exchange Traded Option Contracts
- G20 Discounted Value of Amounts Payable in Relation to Trade Credits Denominated in a Foreign Currency
- G21 Discounted Value of Amounts Payable in Relation to Deferred Property Settlements Denominated in a Foreign Currency
- G22 Optional Conversion Convertible Notes Denominated in New Zealand Dollars Convertible at the Option of the Holder
- G23 Specified Rate

NB Determinations containing a letter in their title (eg Determination G1A) have rescinded earlier determinations which covered broadly the same subject matter. Similarly Determination G8 is not shown in the list above as it was rescinded by Determination G9.

Determination E6: Persons Not Required To Comply With Section 104A of the Income Tax Act 1976

Determination E6 determines the extent to which people are not required to comply with section 104A of the Income Tax Act 1976, for the income year commencing 1 April 1990. It differs from Determination E5 only in the size of the thresholds which determine whether compliance with section 104A of the act is required for various categories of expenditure. Those thresholds have

been adjusted upwards to account for the effects of inflation since Determination E5 was signed.

The determination was made pursuant to section 104A(5) of the Act. The Commissioner signed it on the 14 November 1990. The full determination is printed in the appendix to this Tax Information Bulletin.

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Loss of Earnings or Profits Insurance

This item explains the difference for tax purposes between a sickness/accident insurance policy and a loss of earnings or profits insurance policy.

Background

Inland Revenue has been asked to rule on the deductibility of premiums and assessability of benefits of certain sickness or accident policies.

Comment

In general terms benefits paid pursuant to an insurance policy will be assessable income when they are paid in an income form i.e., periodic payments.

However, Section 61(40) exempts payments from being assessable if three criteria are met. The benefit must:-

- a) be in respect of incapacity for work;
- b) be under a policy of personal sickness or accident insurance;
- c) not be calculated according to loss of earnings or profits

A policy of personal sickness or accident insurance is not defined for the purposes of section 61, but is regarded as being a policy of insurance under the terms of which the benefits payable are in respect of personal accident disease or sickness.

Therefore, if a payment is made pursuant to a personal sickness or accident policy in respect of incapacity for work, that payment will not be assessable for income tax purposes. The exception to this is if the benefit is calculated according to loss of earnings or profits.

For a policy to be regarded as a loss of earnings or profits policy, the benefit payable under the policy must be solely related to the taxpayer's prior income and must not be limited in other terms. For example, a policy which provided for a benefit of the lesser of the insured's prior income or \$500 per week would not be regarded as a loss of earnings or profits policy.

There will usually be strong indications as to whether a policy is a loss of earnings or profits policy or not. One example would be whether the policy requires that the insured supply evidence of loss of earnings, in addition to evidence of disablement or incapacity.

An insurance contract does not need to restore the total loss of earnings or profits suffered for the benefits to be taxable. What must be determined is whether or not the benefit is calculated according to the actual loss. For example, benefits under a policy providing for payment of 80% of lost earnings would be taxable.

Having decided on whether the benefits are assessable, the question of whether the premium payments are deductible is easily answered. If the benefits are assessable then the premiums are deductible. This is so whether the taxpayer is an employee or self employed.

Foreign Investment Fund Regime

Recent Determinations made by the Commissioner

Introduction

The Commissioner made four determinations on 6 November 1990 and six determinations on 15 November 1990 under the Foreign Investment Fund (FIF) regime, pursuant to section 245S(1) of the Income Tax Act 1976.

The determinations are outlined below, together with the rights and obligations of affected taxpayers. The determinations are reproduced in full in the New Zealand Gazette publications of 15th and 22nd November 1990.

A brief explanation of the FIF regime is contained in TIB Volume Two, No.4, released in November 1990. More detailed information is provided in the IR 275 booklet entitled "International Tax Guide".

The FIF regime is part of the International Tax legislation effective from 1 April 1988.

Outline of Determinations made

- FIF5: Bermuda International Bond Fund Limited
- FIF6: Guinness Flight International Fund Limited
- FIF7: RBC International Bond Fund Limited
- FIF8: Vanbrugh Currency Fund Limited
- FIF9: Guinness Flight Global Strategy Fund Limited
- FIF10: Barclays Australian Mineral Fund
- FIF11: Barclays Australian Equity Fund
- FIF12: The M & G Island Fund
- FIF13: MIM Britannia Pioneer Markets Fund Limited
- FIF14: Wardley Private Capital Trust

Determinations FIF5, FIF6, FIF7, FIF8, FIF9 and FIF10

These determine that as the distributions exception criteria in the FIF regime are met, rights held in the respective foreign entity (e.g. by way

of shares or units), *do not* constitute an interest in a Foreign Investment Fund in relation to the foreign entity's accounting year specified in the table below. For the purposes of this item, these foreign entities are referred to as "Non-FIFs".

Determinations FIF11, FIF12, FIF13 and FIF 14

These determine that as none of the exception criteria in the FIF regime are met, rights held in the respective foreign entity (e.g. by way of shares or units), *do* constitute an interest in a Foreign Investment Fund in relation to the foreign entity's accounting year specified in the table below. For the purposes of this item, these foreign entities are referred to as "FIFs".

Effect of Determinations

● Non-FIF's

These determinations confirm that New Zealand resident investors in these foreign entities are not liable under the FIF regime, for income tax on the change in value of any shares or units held over their 1989 and/or 1990 income year.

However, New Zealand investors will continue as normal to be liable for income tax on any distributions received from the respective foreign entity.

● FIF's

These determinations confirm that under the FIF regime, New Zealand resident investors in these foreign entities are liable for income tax on the change in value of any shares or units held over their 1989 and/or 1990 income year. This is in addition to any distributions received.

Which income year is affected by these determinations will depend on the balance date of the taxpayer. This is outlined in the table on page 6.

Determination		Date Published in Gazette	For. Entity Accounting Year ended	Taxpayer's Income Year ending on or between and		Taxpayer's Income Year Affected
Number	Status					
FIF5	Non-FIF	15 Nov 1990	30 June 1988	30 June 1988 1 Oct 1988	30 Sept 1988 29 June 1989	1988 1989
FIF6	Non-FIF	15 Nov 1990	31 Mar 1989	31 Mar 1989 1 Oct 1989	30 Sept 1989 30 Mar 1990	1989 1990
FIF7	Non-FIF	15 Nov 1990	1 Nov 1988	1 Nov 1988 1 Oct 1989	30 Sept 1989 31 Oct 1989	1989 1990
FIF8	Non-FIF	15 Nov 1990	24 Apr 1988	24 Apr 1988 1 Oct 1988	30 Sept 1988 23 Apr 1989	1988 1989
FIF9	Non-FIF	22 Nov 1990	31 Dec 1988	31 Dec 1988 1 Oct 1989	30 Sept 1989 30 Dec 1989	1989 1990
FIF10	Non-FIF	22 Nov 1990	31 Oct 1988	31 Oct 1988 1 Oct 1989	30 Sept 1989 30 Oct 1989	1989 1990
FIF11	FIF	22 Nov 1990	30 June 1988	30 June 1988 1 Oct 1988	30 Sept 1988 29 June 1989	1989* 1989
FIF12	FIF	22 Nov 1990	29 Sept 1988	29 Sept 1988 1 Oct 1988	30 Sept 1988 28 Sept 1989	1989* 1989
FIF13	FIF	22 Nov 1990	31 Mar 1989	31 Mar 1989 1 Oct 1989	30 Sept 1989 30 Mar 1990	1989 1990
FIF14	FIF	22 Nov 1990	31 Jan 1989	31 Jan 1989 1 Oct 1989	30 Sept 1989 30 Jan 1990	1989 1990

* The transitional provision contained at section 245Y(4) of the Act deems any FIF income that would otherwise be required to be included in the 1988 income year to be derived in the 1989 income year.

Example

Assume a New Zealand investor in Barclays Australian Mineral Fund (FIF10) has a balance date of 30 June 1989. In this example, the investor's balance date falls between 31 October 1988 and 30 September 1989. Accordingly the "Non-FIF" determination applies to that investor's 1989 income year.

For the majority of investors, i.e. those with a 31 March balance date, only their 1989 income year is affected by the determinations.

Note that for all other income years, the FIF regime will apply to these ten foreign entities, as it does for any foreign entity generally, i.e. rights in the foreign entity will constitute an interest in a FIF, unless any of the exception criteria from the FIF regime are met in those years.

Amended Assessments Required

If you have already sent your 1989 and/or 1990 Tax Return to the Department without including your FIF income, you should:

- complete Parts A and B of the IR 4H form, "Interest in a Foreign Investment Fund - Disclosure Schedule & Worksheet." and;
- send the completed IR 4H form(s) to your local Inland Revenue Office with a letter attached requesting your 1989 and/or 1990 return to be reassessed.

When we get the completed IR 4H form and letter, we will prepare and issue an amended 1989 and/or 1990 assessment for any further income tax payable.

Please note that if you have calculated 1990 FIF income and had previously opted to estimate your 1991 provisional tax, you may need to re-estimate your 1991 provisional tax liability.

Interests held in other Foreign Entities

You should follow the procedures outlined in this item where your obligations relating to interests held in other FIF's have not been fulfilled.

Rights of Affected Taxpayers

Any person holding rights in any of the ten foreign entities referred to in this item (or the

foreign entity itself), may formally object to the relevant determination. Any objection must be in writing, stating the grounds of objection. It must be delivered to the Commissioner within one month from the date the relevant determination was published in the Gazette.

Any such objection should be directed to the following address:

International Tax Central Unit
Inland Revenue Department
P. O. Box 895
Wellington

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GST Treatment of Interest Charged on Overdue Accounts

This item deals with the GST treatment of interest charged by a supplier on overdue accounts.

Background

Frequently, a supplier of goods or services charges interest on amounts not paid by a particular date.

Whether this interest is subject to GST depends on whether the contract which the goods and services are supplied under qualifies as a credit contract. If it does qualify as such then the provision of credit is deemed to be a financial service, and the interest charged is not subject to GST by virtue of Section 3(1)(f) of the Goods and Services Tax Act 1985. Section 3(3)(b)(ii) of the Credit Contracts Act 1981 specifically excludes "any reasonable amount payable as a result of a default under the contract" when determining whether there is the provision of credit under a credit contract.

Comment

The question of whether a contract which imposes interest where payment is not made by a prescribed date is a credit contract has been considered by the High Court in two cases. These are *Wrightson NMA Limited v Mead* (1984)

1 NZBLC and *Patrikios Holdings Limited v United Fisheries Limited* 1986 1 NZBLC.

These cases found that where there is an agreement to pay interest rather than pay cash by a prescribed date, that amount of interest is not an amount payable as a result of default for the purposes of Section 3(3)(b)(ii) of the Credit Contracts Act. In the *Wrightson NMA* case the agreement to pay interest was reached after there had been default in payment while in the *Patrikios Holdings* case it was a condition of the contract of supply that interest would be payable if the amount owing was not paid within seven days.

Ruling

When there is an agreement that allows a purchaser to pay interest on an amount rather than pay that amount by a prescribed date then a credit contract will exist and no GST will be payable on the interest charged.

This is to be contrasted with the situation where an amount is charged by way of penalty where payment is not made by a prescribed date. In this case a credit contract will not be in existence and GST will be payable on any amount charged by way of penalty.

Due Dates Reminder

December 1990

- 7 First instalment of 1991 Provisional Tax due for taxpayers with August balance dates.

Second instalment of 1991 Provisional Tax due for taxpayers with April balance dates.

Third instalment of 1991 Provisional Tax due for taxpayers with December balance dates.

1989 Terminal Tax due for taxpayers with January balance dates.
- 14 Dividend PAYE deducted during November 1990 due.

Interest PAYE deducted during November due for monthly payers.

Non-Resident Withholding Tax deducted during November 1990 due.
- 20 PAYE deductions for the first 15 days of December 1990 due - "Large" employers.

Tax deductions for November 1990 due - "Small" employers.
- 7 First instalment of 1991 Provisional Tax due for taxpayers with September balance dates.

Second instalment of 1991 Provisional Tax due for taxpayers with May balance dates.

Third instalment of 1991 Provisional Tax due for taxpayers with January balance dates.

1989 Terminal Tax due for taxpayers with February balance dates.
- 14 Dividend PAYE deducted during December 1990 due.

Interest PAYE deducted during December due for monthly payers.

Non-Resident Withholding Tax deducted during December 1990 due.
- 15 GST Return and payment for period ended 30 November 1990 due.
- 20 PAYE deductions for the first 15 days of January 1991 due - "Large" employers.

PAYE deductions for December 1990 due - "Small" employers.
- 5 PAYE deductions for last 16 days of December 1990 due - "Large" employers.
- FBT Return and payment for quarter ended 31 December 1990 due.

January 1991

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SUBMISSION ON ACCRUAL DETERMINATIONS

1. Financial Arrangements which require Determinations

Type of Arrangement	Suggested Treatment
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

2. Problems with existing Determinations

Determination	Problem and suggested solution
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

Your name and address (This is optional, but is requested in case we need to discuss your suggestion with you or seek further details of proposed method etc.)

*TAX INFORMATION
BULLETIN*



THIS IS AN INLAND REVENUE DEPARTMENT SERVICE
TO PEOPLE WITH AN INTEREST IN NEW ZEALAND TAXATION.