Tax Information Bulletin

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Contents

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New TIB Volume, and Updated Index

This is the first issue of Volume Three of the Tax Information Bulletin. Included with it is an index to all the articles in Volumes One and Two. Issue number 9 was the final issue of Volume Two.

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Tax Information Bulletin
Inland Revenue Department
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WELLINGTON

The following issues in Volume One are now out of stock, so we are unable to supply them. If you need a copy of a specific article from one of them, let us know and we'll photocopy it for you.

- Appendices to No 1
- No 2 (except Appendix B)
- Appendix A to No 3
- Appendix to No 5
- No 9 and Appendices

Inland Revenue Publications as at 1 July 1991

No.	Subject	Latest Print
FS 6	Family Support and Guaranteed Minimum Family Income	February 1991
GST 600	GST Guide	October 1990
IR 24	Tax Calendar	March 1991
IR 40C	Tax Facts for Income Tested Beneficiaries	February 1989
IR 184	PAYE Tax Guide for Employers	February 1991
IR 257	Running a Small Business?	June 1991
IR 259	Guaranteed Retirement Income Earners' Surcharge	March 1991
IR 260	Depreciation	May 1991
IR 266	Objection Procedures	June 1991
IR 274	Imputation	February 1990
IR 274B	Dividend Imputation	May 1989
IR 275	International Tax Guide	June 1989
IR 279	Interest PAYE	June 1990
IR 282	Putting your Tax Affairs Right	March 1990
IR 283	Interest PAYE Payers' Guide	June 1990
IR 284	Dividend PAYE	September 1989
IR 287	Problem Resolution Service	May 1989
IR 288	Taxation of Trusts	May 1989
IR 289	Provisional Tax	April 1991
IR 291	1991 Income Tax and Non-Resident Withholding Tax Guide for Non-Residents	April 1991
IR 292	New Zealand Tax Residence	April 1991
IR 409	Fringe Benefit Tax Guide	April 1989

We're currently updating these publications. We'll tell you as soon as they're available -

GS 605	Guide to Registration for GST
IR 665	Stamp Duty

Privy Council Decision
Collection of Information from Third Parties

This is the text of a press release made by the Commissioner of Inland Revenue recently:

The Commissioner of Inland Revenue, David Henry, has welcomed a Privy Council decision which confirms that Inland Revenue has been acting correctly in the collection of information from third party sources.

The case involved the New Zealand Stock Exchange and the National Bank challenging the Commissioner's right to information about unnamed taxpayers. The Court of Appeal had previously found in favour of the Commissioner, and the Privy Council has now upheld that decision.

Mr Henry said he welcomed the Privy Council's finding that "the whole rationale of taxation would break down" if the Commissioner did not have the right to collect information from third party sources.

The case arose from the Commissioner requiring some members of the Stock Exchange to produce a list of their largest clients and details of the purchase and sale of shares. He also required some banks, including the National Bank, to produce the names and details of bank customers trading in commercial bills.

In March last year, the High Court decided the Commissioner could only request information from a third party source when the request related to a specific named taxpayer. The Commissioner then appealed, and that decision was subsequently overturned by the Court of Appeal last July.

The National Bank and the Stock Exchange appealed that decision and that appeal was heard before the Privy Council last month.

In its written decision, the Privy Council said that "the whole rationale of taxation would break down and the whole burden of taxation would fall only on diligent and honest taxpayers if the Commissioner had no power to obtain confidential information about taxpayers who may be negligent or dishonest."

The Privy Council said that there were other provisions in the Inland Revenue Act that were designed to secure, and did secure, the secrecy of information obtained by the Commissioner about the affairs of every taxpayer.

"Every taxpayer is protected by the secrecy obligation imposed on the Commissioner."

The Council said that if the argument of the Stock Exchange and the National Bank was correct, confidentiality did not assist the taxpayer who made an honest return of their income or the dishonest taxpayer under investigation by the Commissioner.

Instead it "assists the dishonest taxpayer who conceals both his identity and his liability to tax from the Commissioner," the Council said.

The National Bank and the Stock Exchange also argued that the Commissioner's requirements made demands on sharebrokers and bankers that were onerous and expensive to obey. However, the Privy Council said there was "no doubt" that sharebrokers and bankers have or ought to have the information which the Commissioner has requested, and that the Commissioner had "demonstrated that he was prepared to modify his requirements to meet any genuine difficulty."

The Council said that every sharebroker or banker would resent the time and expense incurred in complying with the Commissioner's request for information.

"But the Commissioner must carry out his functions of ensuring that assessable income is assessed and that the relevant tax is paid."

Mr Henry said that Inland Revenue would continue to collect third party information as part of its audit activities.

"But these powers will continue to be used judiciously. There won't be any large increase in the amount of third party information we will be gathering."

He said that the Department was well aware that it could be time-consuming and costly for organisations to comply with its requests for information.

"Because we are aware of this, we will offer to extract the information ourselves, or provide assistance if requested."

In addition, where the relevant information is available publicly for a fee it was usual for the Department to go through the normal public channels and pay the charges, Mr Henry said.

Materiality and Precision - Accruals Income Tax Regime

Introduction

This item explains the meaning of the terms "materiality" and "precision" as they are used in the accruals regime, and discusses the materiality and precision requirements of the regime.

Precision is concerned with the accuracy of calculations made by taxpayers under determinations by the Commissioner pursuant to section 64E(1) of the Income Tax Act 1976. Materiality is a measurement of the difference between the amounts calculated under two separate accrual methods.

Precision

Precision requirements are outlined in Determination G2. It provides that calculations must be carried to a sufficient number of decimal places so that going to one further decimal place will not change the result by more than five dollars.

Precision is an accuracy criterion designed to ensure consistency in calculations made. It establishes a standard to be used in calculations arising from other determinations, and has no bearing on the question of materiality.

Determination G2 applies to all calculations required by the accruals regime. Accordingly, taxpayers are obliged to comply with G2 even if they are making calculations pursuant to another determination.

A precision test based on calculating to a fixed number of decimal places is considered not to be appropriate as it allows for inaccuracies in the final results when large dollar amounts are involved. This can happen even if the methods of calculation prescribed in other determinations are used.

For that reason it has been decided to keep to a precision measure based on a dollar figure. The current figure of five dollars has been reviewed and will be retained. It is considered to give a suitable level of accuracy, and not to result in an unacceptable level of compliance costs.

Materiality

In general, section 64C(2) of the Act requires use of the Yield to Maturity Method (YTM) to calculate income or expenditure in relation to a financial arrangement. The aim of this method is to allocate to each income year an amount that is fair and reasonable.

The Commissioner can make determinations setting out how this method is to be applied to particular types of financial arrangement. Alternatively, there are some financial arrangements for which it is not possible to carry out the calculation of income or expenditure using the YTM. In these cases the Commissioner may also make a determination setting out alternative methods of calculation to be used.

However, in either of the above situations the Commissioner is required to accept other methods of calculation used by taxpayers which meet certain criteria. One of these conditions is materiality. That is, the results of a calculation must not be "materially different" from those obtained using the prescribed method.

Statement of Standard Accounting Practice (SSAP) No.6, issued by the New Zealand Society of Accountants, establishes a materiality test for financial statements reporting purposes. SSAP-6 mentions that in deciding whether an item is material both the nature and amount of the item usually need to be taken into account. The Department endorses these comments.

However, as a practical guide to assist in determining when the materiality tests of the accruals income tax regime have been met, the Department has set guidelines using amount criteria only. These guidelines should be regarded solely as indicators and are not hard and fast rules. There may be instances where the circumstances of a particular case are such that the use of the guidelines is inappropriate. The question of materiality in those cases will need to be decided on the facts of the case.

Materiality Guidelines

In applying the materiality guidelines each type or class of financial arrangement should be considered separately.

The guidelines are applied to the amount of the difference between the income or expenditure from the financial arrangement calculated using -

i) either the YTM or other method as prescribed by determination of the Commissioner; AND

ii) the accounting method adopted by the taxpayer.

That difference will be regarded as materially different if it is equal to or greater than either -

(a) five per cent of the amount calculated according to the determination; or

(b) $500,000.

That difference will not be regarded as being materially different if it is less than both -

(a) five per cent of the amount calculated according to the determination; and

(b) $500,000.

Note: The dollar level referred to in the guideline should not be confused with recommendation 72 of the Consultative Committee on Tax Simplification. That recommendation favours the use of straight-line calculations for taxpayers with financial arrangements having a total face value of less than one million dollars.

The materiality provisions are designed to give taxpayers some degree of flexibility in their selection of calculation methods. Accordingly, taxpayers or their agents will not always have to apply the prescribed method of calculation in order to determine whether their alternate method is acceptable. They will need to do this only where they think that the materiality guidelines may be exceeded.

In practice the Department will only apply the prescribed method to test the accounting methods used by taxpayers. Amendments to income or expenditure figures resulting from such recalculations are not likely to be common occurrences.

In some cases the Commissioner may determine more than one method for calculating the income or expenditure from a class of financial arrangements. If the taxpayer has chosen an alternative method, the materiality requirement will need to be satisfied in relation to only one of those prescribed methods. Taxpayers should consistently use that same prescribed method as the measure for materiality over the life of the financial arrangement.

Other Requirements of Alternative Methods

Materiality is only one of four criteria that must be met in order for an alternative method of calculation to be acceptable in terms of section 64C.

The other three requirements are that:

the method conforms to the principles of accrual accounting

Although commonly used in accounting literature, the term "the principles of accrual accounting" is not defined in the Act or in a determination. It is a widely used, but largely unspecified concept.

There are a number of generally accepted "correct" ways in which a taxpayer might accrue income and expenditure. This is particularly so for more complex financial arrangements. The Department acknowledges this wide scope of choice, while stressing the need for taxpayers to adhere to the general tenor of the legislation when adopting an alternate method.

the method conforms with commercially acceptable practice

There is a relationship between the concepts "commercially acceptable practice" and "principles of accrual accounting". It has been suggested that if a method conforms to the principles of accrual accounting, then it is also likely to meet the "commercially acceptable practice" requirement.

In essence, the term "commercially acceptable practice" means the commercial application of accounting principles. These principles incorporate accrual accounting.

As with the term "principles of accrual accounting", "commercially acceptable practice" is imprecise and open to interpretation.

When considering computation issues, the courts have readily acknowledged the importance of established business conventions in the interpretation of tax laws. (See the comments of Richardson J. in Commissioner of Inland Revenue v. Farmers' Trading Co. Ltd. (1982) 5 NZTC 61,201 at pp 61,203-4.

the method be applied consistently

One of the reasons for granting the concession of allowing taxpayers to use an alternative method is that they are using or prefer to use that method for financial reporting. Consequently it is reasonable to require taxpayers to be consistent in their use of the alternative method.

This requirement is compatible with the trend of aligning accounting practices for financial and tax reporting purposes.

Reference: HO 10.A.2.1A

FBT - Prescribed Rate of Interest

The Minister of Revenue has advised that the prescribed rate of interest used to calculate the fringe benefit of low interest loans has been reduced to 13% for the quarter commencing 1 July 1991.

Approval of Overseas Tour and Conference Expenses

Summary

Any National organisation seeking prior approval for overseas tour and conference deductions should now apply to its local Inland Revenue office.

Background

For some time, Inland Revenue has accepted applications for prior approval to deduct the business-related cost of overseas tours and conferences by groups.

Until now, national organisations have submitted these applications to the Head Office of Inland Revenue. District and Regional offices have been handling applications for local groups.

Revised Policy

Both local and national groups seeking prior approval of tour and conference deductions should apply to their local district offices. They should send such applications to the office of the district in which the principal organiser of the tour is based.

Individual Claims

Inland Revenue considers individual claims when participants furnish their annual returns of income. Each claim is treated on its merits according to income tax law. Only those expenses that are necessarily incurred in producing a taxpayer's assessable income are allowable as a deduction. Irrespective of any prior approval set at a specified portion of expenses incurred, any taxpayer may be entitled to a deduction for more or less than that portion, depending on the circumstances of the case. Participants must retain receipts and full details of their expenditure.

Reference: HO 10.0.4.7
Technical Rulings: Chapter 20.

Retention of Business and Other Records

Summary

Inland Revenue has reviewed its policy on two aspects of record retention methods, as a result of Tax Simplification Consultative Committee recommendations.

Background

The requirements laid down in TIB No.6 (issued December 1989) are still largely valid, and should be adhered to. However, we have relaxed the requirements on two issues:

1. Microfilming
2. New Technology and Electronic Recording

We are also reviewing the retention period for business and other records. Currently, records must be kept for at least 10 years after the end of the income year (or taxable period) to which they relate, unless:

- The Commissioner has given notice in writing that retention of certain records is not required; or
- In the case of a company, the company has been wound up and finally dissolved.

New Policy

Microfilming

There are no changes to the current rules on microfilming financial records after 1 year. Here are the present rules:

Retain original of these records (before microfilming) for at least the last Financial Year for which an Income Tax Return has been filed:

- Financial transaction records such as:
  - expense vouchers, invoices, tax invoices, copies of taxinvoices, debit and credit notes
  - records of cash receipts, till tapes and receipt books
  - records and associated invoices of all goods purchased and sold, together with identification of buyers and sellers. (These requirements do not apply to cash retail sales, or to cash wholesale sales made in the same way as cash retail sales.)

- A record of all goods and services supplied by or to the registered person with identification of suppliers

- Accountant's Working papers including:
  - client questionnaires
  - stock sheets (and the records from which those statements are compiled)
  - depreciation schedules
  - debtors' and creditors' calculations

- Records and explanations of the accounting system, e.g., Chart of accounts, accounting manual. In a business with a computer based accounting system, the systems logic and full audit trail is required.

- Records of business assets and liabilities

- Internal business memoranda, including management reports and documents

- Written communications with other parties, including business letters, facsimile messages and telex messages

- Records relating to fringe benefits provided to employees, together with supporting documents

- Records relating to imputation credits, foreign payment withholding dividends, or branch equivalent tax accounts.

- Records relating to specified superannuation contributions to a superannuation fund.

The retention period before microfilming of books of account and other prime records has now been reduced to 3 years.

Retain original of these records (before microfilming) for at least 3 years:

- Books of account including cash books, journals and private ledgers.

- Business bank statements, cheque butts and deposit slips.

- Wage Records

- Minute books (shareholders and directors) and documents and papers submitted to meetings of shareholders and directors.

Electronic and other new technological methods of record retention

Because of new record storage facilities (eg, laser disks), and improved methods of referral and retrieval, Inland Revenue will allow different storage methods on the condition that the data can be restored to paper legibly in its original format.

Points to note on the use of Microfilming or any other New Technology

- Any records stored using new technology must be of good quality and must be easily readable
- The records, when reproduced in printed form, must be identical in format and all other respects to the original records
- There must be an adequate index to the stored material
- If some records are stored using a particular method, all records in that class must be stored using the same method. If some documents or files are vetted before being stored using a particular method, it is not acceptable for the vetted documents to be destroyed
- Viewing and printing facilities for stored records must be available free of charge to Inland Revenue officers
- If requested, persons must locate selected data which has been stored and print any items selected free of charge
- It may be necessary to establish the admissibility of records which have been stored using a particular method, in any proceedings

Approvals and Assistance

Providing you follow the above policy, you do not have to apply for prior approval to use new technology to maintain records in an electronic format.

Please remember that failure to adhere to the above policy will be a breach of Section 428 of the Income Tax Act 1976, and the penal provisions available to the Commissioner will be applied accordingly. Any taxpayers, accountants or other agents wishing to vary the above policy must get written approval to do so.

If you need any further information about the using new technology and electronic recording, any Inland Revenue Office will be able to help. Please direct any enquiries to the Verification Unit in your local Inland Revenue office.

Application for Destruction of Records

Inland Revenue is prepared to consider applications for the Destruction of Records after the expiration of 4 years from the end of the year in which a taxpayer was assessed. This applies to Private Companies, Self Employed Taxpayers, Partnerships and Trusts.

The Critical Factors that affect such applications are:

- Record of Compliance with Inland Revenue (furnishing of returns, payment of taxes, cooperation with enquiries, etc)
- Reputation of the taxpayer in general business
- Nature of taxpayer's business
- Accounting system

Books of Account must be Retained

You must still keep Books of Account (Journals, Ledgers, Cashbooks) for at least 10 years after the end of the income year (or taxable period) to which they relate.

Making an Application

Applications to destroy records should be made to the Manager (Taxpayer Audit) in the District Office where the file is held.

Reference: I.301

Average Market Values of Specified Livestock - 1991

Earlier this year the Governor-General, by Order in Council, announced the average market values of specified livestock for the income year commencing on 1 April 1990. This was in accordance with the provisions of section 86D of the Income Tax Act 1976.

Listed below, under the various classes of specified livestock, are the values to be used for the standard values scheme and the herd scheme for the income year, together with the trigger price for high price livestock.

Note: For the 1991 income year, farmers who have elected to use the standard values scheme for valuing livestock must use the lesser of the 1990 or the 1991 standard values. The definition of "standard value" in section 86 of the Income Tax Act 1976 was amended recently to reflect this change. The change is designed to minimise the tax effects that would have resulted from the rapid escalation in stock prices.

Type and class of Livestock	Standard Values (Use the lesser value as highlighted) 1990 $ c	1991 $ c	Herd Value (Average Market Value) $ c	Trigger Price for High Priced Livestock $ c
Sheep				
Ewe hoggets	**14.28**	16.43	28.40	113.60
Ram and wether hoggets	**14.28**	16.43	28.40	113.60
Two-tooth ewes	**19.51**	21.37	35.50	142.00
Mixed-aged ewes (rising three-year and four-year old ewes	**11.88**	13.07	22.50	100.00
Rising five-year and older ewes	**9.73**	9.87	14.10	100.00
Mixed-age wethers	11.67	**11.50**	14.70	100.00
Breeding rams	**103.90**	109.92	162.20	648.80
Cattle:				
Beef Breeds and Beef Crosses:				
Rising one-year heifers	**143.50**	169.40	302.00	906.00
Rising two-year heifers	**212.80**	250.60	437.00	1311.00
Mixed-aged cows	**229.37**	258.07	416.00	1248.00
Rising one-year steers and bulls	**193.67**	220.73	374.00	1122.00
Rising two-year steers and bulls	**345.57**	352.80	529.00	1587.00
Rising three-year and older steers and bulls	**419.53**	475.30	737.00	2211.00
Breeding bulls	**844.43**	1048.60	1598.00	4794.00

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Type and class of Livestock	Standard Values (Use the lesser value as highlighted) 1990 $ c	1991 $ c	Herd Value (Average Market Value) $ c	Trigger Price for High Priced Livestock $ c
Cattle (cont'd)				
Friesian and Related Breeds				
Rising one-year heifers	**161.23**	180.13	294.00	882.00
Rising two-year heifers	**301.23**	357.70	599.00	1797.00
Mixed-age cows	**286.53**	342.77	591.00	1773.00
Rising one-year steers and bulls	**145.83**	175.47	307.00	921.00
Rising two-year steers and bulls	332.97	**330.40**	487.00	1461.00
Rising three-year and older steers and bulls	**419.53**	475.30	737.00	2211.00
Breeding bulls	**575.17**	742.23	1186.00	3558.00
Jersey and other Dairy Breeds				
Rising one-year heifers	**145.83**	165.90	272.00	816.00
Rising two-year heifers	**275.57**	339.27	585.00	1755.00
Mixed-age cows	**219.80**	271.37	480.00	1440.00
Rising one-year steers and bulls	**119.70**	157.50	328.00	984.00
Rising two-year and older steers and bulls	**291.90**	327.13	518.00	1554.00
Breeding bulls	**401.33**	498.17	844.00	2532.00
Deer				
Red Deer				
Rising one-year hinds	302.00	**199.03**	201.00	603.00
Rising two-year hinds	364.93	**285.60**	389.00	1167.00
Mixed-age hinds	385.23	**262.73**	340.00	1020.00
Rising one-year stags	**140.47**	140.70	198.00	594.00
Rising two-year and older stags (non-breeding)	239.40	**224.70**	263.00	789.00
Breeding stags	767.90	**495.00**	495.00	1485.00
Wapiti, Elk, and Related Crossbreeds				
Rising one-year hinds	392.47	**265.00**	265.00	795.00
Rising two-year hinds	420.47	**332.27**	405.00	1215.00
Mixed-age hinds	479.03	**344.87**	354.00	1062.00
Rising one-year stags	**162.87**	166.83	244.00	732.00
Rising two-year and older stags (non-breeding)	280.00	**265.30**	318.00	954.00
Breeding stags	911.40	**860.00**	860.00	2580.00

Type and class of Livestock	Standard Values (Use the lesser value as highlighted) 1990 $ c	1991 $ c	Herd Value (Average Market Value) $ c	Trigger Price for High Priced Livestock $ c
Other Breeds (Fallow/Sika etc.)				
Rising one-year hinds	252.93	**123.00**	123.00	369.00
Rising two-year hinds	279.77	**160.00**	160.00	480.00
Mixed-age hinds	275.00	**136.00**	136.00	408.00
Rising one-year stags	108.03	**92.87**	109.00	327.00
Rising two-year and older stags (non-breeding)	87.03	**81.67**	111.00	333.00
Breeding stags	322.93	**255.73**	322.00	966.00
Goats:				
Angora and Angora Crosses (Mohair Producing)				
Rising one-year does	9.00	**8.63**	17.00	100.00
Mixed-age does	8.00	**7.00**	7.00	100.00
Rising one-year bucks (non-breeding) / wethers	6.00	**5.37**	9.00	100.00
Bucks (non-breeding) / wethers over one year	7.93	**7.70**	15.00	100.00
Breeding bucks	92.87	**48.00**	48.00	192.00
Other Fibre and Meat Producing Goats (Cashmere or Cashgora Producing)				
Rising one-year does	7.00	**6.07**	11.00	100.00
Mixed-age does	9.00	**4.90**	5.00	100.00
Rising one-year bucks (non-breeding) / wethers	3.27	**2.57**	3.00	100.00
Bucks(non-breeding) / wethers over one year	6.00	**5.13**	8.00	100.00
Breeding bucks	**50.40**	62.30	102.00	408.00
Milking (Dairy) Goats				
Rising one-year does	5.00	**4.67**	5.00	100.00
Does over one year	14.23	**9.57**	15.00	100.00
Breeding bucks	**69.07**	76.77	108.00	432.00
Other dairy goats	6.00	**5.13**	8.00	100.00
Pigs				
Breeding sows less than one year of age	**73.03**	75.83	122.00	366.00
Breeding sows over one year of age	**123.67**	129.03	207.00	621.00
Breeding boars	**165.90**	173.60	279.00	837.00
Weaners less than 10 weeks of age (excluding sucklings)	29.63	**26.60**	40.00	120.00
Growing pigs 10 to 17 weeks of age (porkers / baconers)	**71.87**	73.03	110.00	330.00
Growing pigs over 17 weeks of age (baconers)	**108.03**	111.30	173.00	519.00

Reference: H.O.10.O.3.2.

GST and Unconditional Gifts

Introduction

If a non-profit body (which is a registered person for GST purposes) receives an unconditional gift, it does not have to account for GST on that unconditional gift.

"Unconditional gift" has a special meaning for GST purposes. Section 2 of the Goods and Services Tax Act (1985) defines unconditional gift. Generally, a payment is an unconditional gift if a person makes a payment to a non-profit body, and that person (or an associated person) receives no "identifiable direct valuable benefit" as a result of that payment.

In Appendix B to TIB Vol.2, No.4 (November 1990), we explained the meaning of unconditional gift. This item continues that explanation of unconditional gift by considering:

(i) Does an acknowledgement that a distribution has been made amount to an "identifiable direct valuable benefit" in the form of a supply of goods and services; and

(ii) Can a distribution to a non-profit body with a condition attached still be an unconditional gift?

(1) PUBLIC ACKNOWLEDGEMENTS

Background

Since the November 1990 TIB, the question has arisen whether an "identifiable direct valuable benefit" accrues to the person making a distribution (the donor), when the recipient acknowledges that the donor made the distribution. For example, the name of the donor may be included on posters, reports, brochures, or programmes produced by the recipient of the distribution.

Does such acknowledgement amount to an "identifiable direct valuable benefit" in the form of the supply of goods and services, and thereby disqualify the distribution from being an unconditional gift?

Public Acknowledgements - Inland Revenue's View

Whether a donor receives an "identifiable direct valuable benefit" is a question of fact and must be determined on a case by case basis. The nature, extent, and circumstances surrounding the distribution must be considered.

The following factors are important in determining whether the recipient of a distribution is liable for GST on that distribution:

i. If the non-profit body receiving the distribution is not a registered person, and has no liability to register for GST, the distribution will not be subject to GST. This is because only a registered person charges GST on supplies it makes.

ii. Where there is no acknowledgement that the donor made the distribution (and no other benefit accrues to the donor), there is no "identifiable direct valuable benefit". The distribution will be an unconditional gift.

iii. There is a distinction between *advertising* and a *simple acknowledgement*:

(i) **Advertising** is clearly a service and gives rise to an "identifiable direct valuable benefit" to the person making the distribution, irrespective of whether that person profits because of the advertising. The distribution is subject to GST in the hands of the recipient.

(ii) **A simple acknowledgement**, however, does not give rise to an "identifiable direct valuable benefit". The distribution is not subject to GST in the hands of the recipient.

iv. Whether recognition amounts to advertising or a simple acknowledgement is a question of degree, and all circumstances surrounding the distribution must be considered. For example, 100 donors listed on a page in a programme are receiving a simple acknowledgement. However, if a non-profit body devotes a whole page of a programme to a particular donor, this amounts to advertising.

v. If a donor receives a GST tax invoice from a non-profit body in respect of any distribution, the parties are acknowledging that there has been a supply of goods and services. That distribution is subject to GST in the hands of the recipient. Further, the donor is entitled to claim an input tax credit where the donor acquired the supply for the principal purpose of making taxable supplies.

Where a donor does not receive a GST tax invoice, this may be evidence that the parties to the distribution consider that there has been no supply of goods and services. However, lack of a GST tax invoice cannot by itself determine the matter. This is because a supply of goods and services may still occur even though a non-profit body did not issue a GST tax invoice.

Where a donor does not receive a GST tax invoice for a distribution, the case must be considered objectively to decide whether the donor has received an "identifiable direct valuable benefit".

Examples

Example 1

ABC company makes a distribution of $1,000 to a local sporting club (a non-profit body). Equipment is purchased with the $1,000. The club is not registered for GST, nor does it have any liability to register.

The distribution cannot be subject to GST. The club is not a registered person for GST purposes. Therefore, it does not charge GST on supplies it makes.

Example 2

DEF company places an advertisement in a paper asking non-profit bodies to apply for funds. A local theatre group (a registered non-profit body) files an application and receives $500. At a performance, the theatre group produces a programme. The programme states that the performance is "with the assistance of" and then lists 30 organisations that have made donations to the group. The programme includes the name of DEF company.

Inland Revenue considers that DEF company has derived no "identifiable direct valuable benefit". The distribution is an unconditional gift for GST purposes, and has no GST implications.

Example 3

ABC trust makes a substantial distribution to a registered non-profit body. The non-profit body builds a hall with those funds and affixes a plaque which states that the hall was funded by the generous donation of ABC trust.

Inland Revenue considers that ABC trust has not derived an "identifiable direct valuable benefit". The distribution is an unconditional gift for GST purposes and has no GST implications.

Example 4

A bank makes a distribution to a registered non-profit body to allow the non-profit body to operate a helicopter. The helicopter has the bank's name and logo painted on it.

Inland Revenue considers that such a distribution is subject to GST. The bank receives an "identifiable direct valuable benefit" in the form of a supply of goods and services - that is, the bank is receiving advertising.

Example 5

An insurance company decides to sponsor a horse race. The racing club (a registered non-profit body) names the race after the insurance company.

Inland Revenue considers that such a distribution is subject to GST. The insurance company receives an "identifiable direct valuable benefit" in the form of a supply of goods and services - that is, the insurance company is receiving advertising.

(2) DISTRIBUTIONS MADE WITH CONDITIONS ATTACHED

The November 1990 TIB considered unconditional gifts from the viewpoint that there is not an unconditional gift where a donor makes a distribution, and any benefit is conditional on that distribution.

This article does not depart from that view. Rather, it approaches the problem from the perspective that a distribution is made with a condition attached. For example, a distribution of $3000 may be made to a registered non-profit body on the condition that a computer is purchased with the money. Does the "earmarking" of the distribution disqualify it from being an unconditional gift?

Inland Revenue considers that a donor can still make an unconditional gift even though the donor attaches a condition to that distribution. As long as the distribution is voluntary and for the purposes of the non-profit body, and the person making the distribution (or an associated person) does not receive an "identifiable direct valuable benefit", the distribution can still be an unconditional gift.

Example 6

A company makes a voluntary distribution of $500 to a football club (a registered non-profit body) on the condition that the football club purchases soccer balls with the money. Neither the company (nor an associated person) receives an "identifiable direct valuable benefit".

The distribution is an unconditional gift even though a condition is attached to the distribution. The payment is voluntary and for the purposes of the non-profit body, and neither the company nor an associated person receives an "identifiable direct valuable benefit".

Example 7

A company makes a distribution to a registered non-profit body to allow that body to stage a concert. It is a condition of the distribution that the company receives tickets to the concert without further payment.

Inland Revenue considers that such a distribution is subject to GST. The company receives an "identifiable direct valuable benefit" - that is, receipt of the tickets without further payment.

Application Date

This policy applies from 26 July 1991. Any live objections existing at that date will be considered in terms of this policy statement. Late objections will be considered in terms of the Department's policy on the acceptance of late objections. TIB No.5, November 1989 sets out this policy.

Reference: HO GST N.1.1
Technical Rulings 108.7

Objections to PAYE Deductions - Deferral of Disputed Tax

Inland Revenue has recently reviewed its policy on PAYE deductions and objections in terms of section 337(4).

Previously we did not allow the benefit of the section 34 deferral regime to employers who objected to PAYE determinations under section 337(4).

We have now reconsidered this position. Inland Revenue recognises that as the law currently stands "Notices of Deficient Tax Deduction" should be treated *as though they are* assessments for the purposes of the objection procedure.

Consequently, employers who are objecting to a PAYE determination and who have received a Notice of Deficient Tax Deduction may defer half of the amount stated as payable in that Notice.

Reference: Legal Services

Recent Legislative Changes

Introduction

The Acts covered in this TIB came from the Taxation Reform Bill (No.3). This Bill was formerly part of the Taxation Reform Bill which was introduced on 19 December 1990.

The Acts resulting from the Taxation Reform Bill (No.3) are the:

- Income Tax Amendment Act (No.3) 1991
- Goods and Services Tax Amendment Act (No.3) 1991

Another Legislative Affairs Production

TIB Video II

Following the success of the last TIB Video, we are pleased to offer a video covering the Income Tax Amendment Act (No. 3) 1991 and the Goods and Services Tax Amendment Act (No.3) 1991. It is professionally produced, and is 20 minutes long. The price of this video is $20 (GST inclusive), to cover the cost of producing it.

If you would like a copy, please fill in the coupon at the bottom of page 33, and send it to this address, with payment for $20.

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Contents

Income Tax Amendment Act (No. 3) 1991

Tax Exemption for Community Taskforce Allowance

Section 3

Introduction

This amendment exempts from income tax the allowance that the New Zealand Employment Service (Department of Labour) pays to participants of the Community Taskforce scheme.

Background

The Community Taskforce scheme will allow people who receive the unemployment benefit to undertake work with a sponsor. While on the scheme, the participant continues to receive the unemployment benefit from the Department of Social Welfare. The participant will also receive a $15 a week allowance to cover incidentals such as transport from home and work. The New Zealand Employment Service pays this amount to the sponsor, who in turn pays it to the participant if and when he or she turns up for work. Otherwise it is refunded.

Key Issues

The amendment inserts a new paragraph in section 61, which exempts income from tax. The amendment provides that this allowance is exempt from tax when derived by a participant.

As the sponsor is acting as agent on behalf of the New Zealand Employment Service in paying the allowance to the participant, the allowance is not subject to GST or income tax in the hands of the sponsor.

The Community Taskforce programme came into effect on 1 July 1991.

Accrual Regime Amendments

Sections 4, 5, 6, 18

Sections 4, 5, 6, and 18 implement some of the Tax Simplification Consultative Committee's recommendations on the accruals regime, specifically -

- To provide that taxpayers to whom the accruals rules apply, but who have financial arrangements of less than $1 million, may calculate their income on a straight line basis. (Recommendation 72)

- To raise the thresholds below which a taxpayer is classed as a cash basis holder. (Recommendation 74)

- To allow the calculation of deferred income (for determining whether or not a person qualifies as a cash basis holder) to be done on a straight line basis. (Recommendation 75)

- To allow a deceased person's estate to account as a cash basis holder (for up to five years after the death of that person) where the deceased was a cash basis holder. (Recommendation 80)

Section Analysis

Section 4: Accruals in relation to income and expenditure in respect of financial arrangements

Section 4 inserts sections 64C(2A) and (2B) into the principal Act. Specifically, section 64C(2A) provides that a person who holds or issues financial arrangements of $1,000,000 or less in any income year may calculate income or expenditure for that year on a straight line basis in respect of those arrangements. Any amount of income or expenditure calculated using the straight line method is deemed to be income derived or expenditure incurred in the relevant income year.

There are restrictions on the application of this provision in that:

(a) The amount allocated to any income year must be fair and reasonable;

(b) The straight line method must be applied to all financial arrangements to which it can be applied and to which that person is a holder or issuer during that year; and

(c) The person must continue to use the straight line method for financial arrangements to which it has been applied until they mature, are remitted, or are sold or otherwise transferred, even if the person exceeds the $1 million threshold.

Section 64C(2B) provides for the valuing of financial arrangements to be taken into account in determining whether the value of the financial arrangements issued and held by a person exceeds $1 million. It also provides for the calculation of income or expenditure for the first income year a person begins using the straight line basis for a financial arrangement.

Section 64C(2B)(a) provides that in the case of a fixed principal financial arrangement, the value of that arrangement is its nominal or face value. In the case of variable principal debt instruments, the value is the amount owing by or to the person on any day.

Section 64C(2B)(b) provides that in the first income year for which the straight line method is used and -

(i) The financial arrangement was acquired in a prior income year; and

(ii) The financial arrangement continues to be held or issued by the person at the end of the first income year in which the straight line method is used,

the income or expenditure in respect of that financial arrangement for that first income year (in which the straight line method is applied by the taxpayer) is calculated according to the following formula:

$$a - b - c - d$$

Where -

a is the sum of all amounts that would have been income had the straight line method applied from the date the financial arrangement was acquired or issued until the end of the first income year; and

b is the sum of all amounts which would have been expenditure had the straight line method applied from the date the financial arrangement was acquired or issued until the end of the first income year; and

c is the sum of all amounts of income deemed to have been derived by the person in respect of the financial arrangement before the commencement of the first income year; and

d is the sum of all amounts deemed to have been expenditure incurred by the person in respect of the financial arrangement before the commencement of the first income year.

Any positive amount arising from that formula is deemed to be income derived by the person in the first income year. A negative amount is deemed to be an expenditure incurred by the person.

Subsection (3) amends the provision which requires persons to use other methods of calculation (section 64C(3)) where it is not possible to use the yield to maturity method. The effect of the amendment is that where the yield to maturity method or the straight line method cannot be applied, the taxpayer may use another method which meets the other requirements of section 64C(3).

Subsection (4) consequentially amends section 64C(5) which provides that certain persons and financial arrangements do not have to be accounted for under the accruals provisions during the term of the arrangement. The list of which sections a person is not required to comply with is consequentially extended to include the new sections 64C(2A) and 64(2B).

Subsection (5) provides that this section applies to the income year commencing 1 April 1991 and every subsequent income year.

Section 5: Cash Basis Holder

Section 5(1) amends the cash-basis holder thresholds by:

- Raising the income the person can derive from financial arrangements before ceasing to be a cash basis holder from $50,000 to $70,000; and

- Raising the total value of financial arrangements a person can hold before ceasing to be a cash basis holder from $400,000 to $600,000.

- Raising the deferred income threshold to $20,000 from $15,000.

Subsection (2) amends the deferred income threshold twice. Firstly, the $15,000 deferred income threshold is raised to $20,000, or such greater amount the Commissioner may from time to time declare. Secondly, a person may calculate the cash basis holder threshold on the straight line basis or yield to maturity basis, or an alternative method approved by the Commissioner where it is not possible to use the first two methods. The straight line method can be applied whether or not the person is entitled to use it. In other words, a person with financial arrangements of over $1 million may still apply the straight line basis for the purpose of this calculation only.

Subsection (3) amends section 64D(6), which provides that no person who holds financial arrangements which produce trustee or beneficiary income can be a cash basis holder, to provide that this is subject to the amendment providing that a trustee of an estate may be a cash basis holder in certain cases.

Subsection (4) of this subsection inserts subsection 64D(7A) to provide that the trustee of a deceased person's estate is able to account for tax as a cash basis holder (for up to five years after the death of that person) where the deceased was a cash basis holder. In effect, the requirement that a cash basis holder be a natural person shall be waived for the year of death and four subsequent years. The estate shall become a cash basis holder only where all requirements of such, other than the natural person test, are met. Note that a base price adjustment is still required on the transfer of financial assets to the estate.

If, after having met all the tests of being a cash basis holder, the estate ceases to qualify as such, it is not possible to requalify at a later date under this subsection.

Subsection (5) provides that this section applies to the income year commencing on 1 April 1991 and every subsequent income year.

Section 6: Determinations

Section 6 provides the Commissioner with the power to issue a determination setting out how to apply the straight line method.

A determination will provide certainty as to how the straight line method is to be applied in more complex situations (e.g., a reducing principal loan). A determination will give taxpayers comfort that the method they have used will not be disputed by the Commissioner. The determination will be issued shortly.

Section 18: Trustee Income

Section 18 consequentially amends section 228(1)(c) of the principal Act. The amendment to trustee income provides that a natural person may be a cash basis holder where the requirements of section 64D(7A) are met.

Forestry Taxation

Sections 7 and 36

Sections 7 and 36 make a number of changes to the tax treatment of forestry. The major amendments introduce:

- an anti-avoidance provision to prevent the realisation of existing cost of bush accounts;
- deductibility of expenditure incurred on planting and maintaining trees;
- deductibility of expenditure incurred on creating access tracks, with an increased depreciation rate for "minor" roads.

Section Analysis

Section 7: Income Derived from the Use or Occupation of Land

Subsection (1) inserts a new section 74(2A), which is an anti-avoidance provision designed to prevent the realisation of existing cost of bush accounts by the sale of a forest to an associated person at less than that cost of bush. Where such a sale does occur the vendor may not deduct an amount which exceeds the existing cost of bush. The cost of timber to the associated person purchasing the forest is set at the purchase cost of the timber, and any amount not allowed as a deduction to the vendor.

Subsection (6) provides that subsection (1) applies only to timber sold on or after 1 April 1991.

Subsection (2) inserts a new section 74(3A). This subsection provides immediate deductibility for any expenditure incurred on the construction of access tracks for a specific operational purpose and which are not used for longer than 12 months after the completion of that construction. This amendment relates to the amendments made to the Thirteenth Schedule to the principal Act as outlined below.

Subsection (3) provides that any expenditure which was deductible under section 74(3A), and which is subsequently recouped by the taxpayer, is assessable income to the taxpayer in the year in which it is recouped.

Subsections (4) and (5) remove the cost of bush accounts in relation to expenditure on the planting and maintaining of trees. This provision makes expenditure incurred on planting and maintaining trees deductible where it is incurred during or after the income year commencing 1 April 1991.

Subsection (7) provides that subsections (2) to (5) of the Amendment Act apply to expenditure incurred in the income year commencing 1 April 1991.

Section 36: Thirteenth Schedule Amended

This section of the Amendment Act amends the Thirteenth Schedule to the principal Act to set new rates of depreciation on roads and access tracks.

A new paragraph (e) provides that a forester may depreciate expenditure on the construction of roads to or on the land, being roads which are formed and wholly or substantially metalled or sealed, and any culverts or bridges that are necessary for the purposes of that construction. The new rate of depreciation is 5% DV.

A new paragraph (ea) provides that a forester may depreciate at 20% DV, expenditure on the construction of roads to or on the land (and any culverts or bridges that are necessary for the purposes of that construction) where-

(i) Those roads are formed and partially metalled or sealed; or

(ii) Those roads are not metalled or sealed.

A provision is included to exclude access tracks to which section 74(3A) applies from paragraph (ea). This prevents a possible argument that access tracks to which section 74(ea) applies have to be depreciated as an unsealed road along with any other access tracks.

Subsection (2) provides that this section applies to the income year commencing on 1 April 1991 and every subsequent year.

Livestock Taxation

Sections 2, 9, 10, 11, 12 and 26

Sections 2, 9, 10, 11, 12 and 26 make a number of significant amendments to livestock taxation by:

- expanding the definition of herd livestock to include all specified livestock;
- providing that specified livestock may be excluded from the herd scheme should a farmer so wish;
- introducing a provision to spread income arising where a farmer moves livestock into the herd scheme or where the farmer is increasing herd livestock numbers;
- amending the high-priced scheme to ensure that non-breeding livestock are not included in the scheme when livestock values increase rapidly;
- freezing the standard values applying to the trading stock scheme at the lesser of the 1990 and the 1991 values.

Section Analysis

Section 2: Interpretation (Amends definition of Herd Livestock)

Section 2 (1) amends section 2 of the Income Tax Act 1976 by inserting a new definition of the term "herd livestock". The new definition provides that all specified livestock are now also herd livestock. In other words, trading stock animals can now be moved into the herd scheme should the livestock owner so wish. This subsection applies to the income commencing on 1 April 1991 and every subsequent income year.

Section 9: Livestock Valuation Elections

Section 9 replaces the existing section 85A (2)(b) and inserts a new section 85A (2B).

When introduced, section 85A (2) provided that when a livestock owner elected to include livestock in the herd scheme, all herd livestock of that type had to be included in the scheme. In other words, if a farmer elected to include deer in the herd scheme all classes of deer owned by the farmer which could be included in the herd scheme had to be included.

With effect from the income year commencing 1 April 1989, the definition of herd livestock was expanded to include further mature classes of livestock. Livestock owners already in the herd scheme were given an option to exclude those new classes should they wish. This provision is duplicated with the further expansion of the definition of herd livestock to include all classes of specified livestock. Specifically, livestock owners who have elected to use the herd scheme in respect of one or more types of livestock prior to the income year commencing 1 April 1991 are entitled to use this election.

In detail, section 85A (2)(b) is amended to provide that any election to include livestock in the herd scheme shall be on a type by type basis subject to sections 85A (2A) and 85A (2B).

Section 85A (2B) provides that where any taxpayer has elected to adopt the herd livestock scheme before the beginning of the income year commencing on the 1st day of April 1991, the taxpayer may further elect to exclude those classes of livestock now being added to the herd scheme in this Act.

Any election made may be revoked on a class by class basis by the taxpayer in any subsequent year. However, the election to exclude livestock classes, once revoked in relation to a class of livestock, cannot be reversed.

Section 10: Standard Value of Livestock

Section 86 is amended so that, in the case of the 1991 income year, the standard values applying to trading stock are frozen at the lesser of the 1990 and the 1991 standard values. This calculation is undertaken on a class by class basis and is compulsory, as the taxpayer must use the lower of the two values. This provision applies only to the 1991 income year and does not affect the herd scheme in any way. The amendment only applies for one income year and is to allow time for a livestock taxation review to take place.

Section 11: Valuation of High Priced Livestock

Section 11 amends the high-priced scheme to ensure a more effective targeting of the scheme when livestock values are increasing. The high-priced scheme ensures that the cost of a high-priced breeding animal is allocated over the breeding life of that animal.

Prior to the Amendment Act, the high-priced scheme was applied to an animal where that animal was purchased at a cost 3 times (or in the case of sheep and goats, 4 times) the previous year's average market value (NAMVs). The Amendment Act provides that the high-priced scheme applies only where the purchase cost of the animal exceeds by 3 times (or in the case of sheep and goats, 4 times) the higher of the previous year's or the current year's livestock values.

This introduces an element of uncertainty as, for most taxpayers, the current year NAMVs are not known until late or even after the end of their income year. However, the provision ensures that when values are increasing, entry levels will reflect that increase.

Where values are decreasing, an entry level based on the previous year's NAMV will apply, providing certainty when values are declining.

Some have suggested that the solution to the problem of non-breeding animals being included in the high-priced scheme was to increase the multipliers. However, where livestock values increase very rapidly, an increase in multipliers may not be sufficient to ensure that large numbers of livestock are not included in the high-priced scheme. Also, increasing multipliers would give farmers excessive write-downs where livestock values are not increasing. Finally, more livestock would be included in the determination of the value of the NAMVs. This would result in an increase in NAMVs.

Section 12: Spreading of Income Arising on entry into herd scheme and on increase in size of herd

Section 12 inserts a new section 86DA, which effectively spreads over 3 income years:

- 30% of the unrealised income from the retention of herd livestock. Unrealised income will also arise where livestock moves through the livestock classes. This income is defined as "homebred herdstock deferrable income"; and
- Income arising where specified livestock is moved into the herd scheme from another scheme. This income is defined as "new herdstock deferrable income".

"Homebred herdstock deferrable income" means an amount (not being less than nil) calculated in accordance with the following formula:

$$\frac{30 \times (a - b - c)}{100}$$

where -

a is the total herd value of all livestock which is female, more than 1 year of age at the end of the income year, and that class of livestock is valued in the herd scheme at the end of the year.

b is the cost of animals purchased or captured during the year where that livestock is female, more than 1 year of age at the end of the income year, and that class of livestock is valued in the herd scheme at the end of the year,

(Note: the unrealised income associated with animals purchased or captured and then retained is included in the formula by item (b) bringing animals purchased or captured into account at their purchase or capture cost and item (a) accounting for these animals at their herd value).

c is the total value of all herd livestock on hand at the beginning of the year where that livestock is female, of a class that is more than 1 year of age at the beginning of the income year, and is of a class valued at the end of the income year in accordance with section 86A of the Act.

"New herdstock deferrable herd income" means an amount (not being less than nil) calculated in accordance with the following formula:

$$d \times (e - f)$$

where -

d is in relation to any class of livestock being added to the herd scheme the lesser of:

(a) The number of that livestock of that class on hand at the beginning of the income year; and

(b) The number of that livestock of that class on hand at the end of the income year; and

e is the herd value declared for that year for that class of livestock; and

f is the average closing value of an animal of that class of livestock at the end of the immediately preceding income year. The average closing value is to be determined by dividing the total closing livestock value of that class of livestock by the number of animals that were on hand at the end of that immediately preceding income year.

The result of the above formulas comprises "deferrable herd income", which can be spread in accordance with subsections (2) to (5) of this section. For the 1990 income year deferrable herd income includes only the taxpayer's homebred herdstock deferrable income for that year. For the income year commencing 1 April 1991 and future income years, deferrable herd income comprises both new herdstock deferrable herd income and homebred herdstock deferrable income.

The application of the provision spreading income arising when livestock numbers increase through retaining animals is to help farmers restock after recent adverse events, particularly the East Coast droughts.

Subsections 86DA(2) to (5) provide the mechanics of the spread once the amount of income to be spread is calculated.

Subsection (2) provides that a taxpayer must elect to spread deferrable herd income in respect of an income year. The election is by notice in writing in the return of income for that income year. Subsection (2) also provides that the deferrable herd income is spread 1 / 3 to the current income year and 1 / 3 to each of the next 2 income years. This income is deemed to be income derived by the taxpayer in the income year to which it is allocated.

Subsection (3) provides that in a year where a farmer dies or ceases farming all the deferrable herd income becomes due in that year.

Subsection (4) provides that the Commissioner may cancel the spread. Any residual amount outstanding is due in the income year in respect of which the spread was cancelled.

Subsection (5) is the normal accounting year provision.

Section 26: Determination of Assessable Income

Section 26 amends section 374B(1) of the principal Act. Section 374B(1) provides for the calculation of income for the purposes of Family Support. This amendment provides that the 3-year spreading provision, provided in section 86DA (as inserted by section 11 of this Amendment Act), does not get taken into account when calculating Family Support.

In effect, the current position, that farmers with livestock included in the herd scheme have their Family Support calculated based on the basis of trading stock values, is continued.

Agricultural Development Expenditure

Sections 14 and 15

Sections 14 and 15 provide deductibility for certain types of expenditure which previously had to be capitalised and depreciated.

Section Analysis

Section 14: Certain expenditure on land used for farming or agricultural purposes

Section 14 amends section 127 of the principal Act by inserting a new subsection (A1). This new subsection provides that the following expenditure shall be deductible:

(a) The destruction of weeds or plants detrimental to the land;
(b) The destruction of animal pests detrimental to the land;
(c) The clearing, destruction, and removal of scrub, stumps and undergrowth;
(d) The repair of flood or erosion damage;
(e) The planting and maintaining of trees for the purpose of preventing or combating erosion;
(f) The planting and maintaining of trees for the purpose of shelter;
(g) The construction on the land of fences for agricultural purposes, including the purchase of wire or wire netting for the purpose of making new or existing fences rabbit- proof.

Subsection (2) provides that this section applies from the income year commencing 1 April 1991.

Section 15: Farmers' expenditure on tree planting

Section 15 of the Amendment Act amends section 134 of the principal Act to provide that the section no longer applies to trees for which a deduction can be claimed under section 127(A1). In effect this section now only applied to trees of an ornamental nature and trees planted by farmers not in the business of forestry.

While this section has no application subsection its effective application date is the income year commencing 1 April 1991.

Assessability and Deductibility of Monetary Remuneration

Sections 8 and 13

Introduction

The amendments remove the tax deferral opportunities arising from the timing mismatch between the time a deduction is claimed for monetary remuneration (i.e., salary, wages, and other remuneration) and the time that the remuneration is returned as income. The amendments also deny a deduction for balance day provisions such as holiday pay.

Background

The principles underlying the mismatch between the assessability and the Deductibility of monetary remuneration are:

- The employer is entitled to claim a deduction when the monetary remuneration is "incurred":
- The monetary remuneration is not assessable to

the employee or shareholder/employee until it "derived" (i.e., paid or credited).

The most common mismatch is the one year deferral of tax for shareholder/employees. For some time case law has allowed remuneration to be deducted by the company in the year in which it is incurred (the year in which the services are provided) but returned as income by the shareholder/employee in the following year when it is actually paid or credited. The recent Court of Appeal decision [*CIR* v *Glen Eden Metal Spinners Ltd* (1990) 12 NZTC] confirmed that, by committing itself in a resolution, a company can deduct the costs of directors' remuneration incurred, even though the amount deducted exceeds the amount actually paid to the directors in the following year.

The deferred payments bonus scheme is another version of this mismatch. This scheme is based on the advantage obtained by an employer deducting the cost of a bonus to an employee in an income year even though that bonus is not paid to the employee until years later. The bonus is not returned as income by the employee until the year in which it is paid.

Monetary remuneration includes any wage, salary, bonus, director fees, or payment made in respect of employment.

Key Issues

The provisions amend sections 75 and 104A of the Income Tax Act 1976, which deal the derivation of income and accrual expenditure respectively.

- **Derivation of income**

Section 8 amends section 75 of the Income Tax Act 1976 which determines when income is derived. The amendment requires a shareholder/employee of a company to return the monetary remuneration derived from that company in the same income year in which the company has claimed a deduction for that remuneration. The amount to be returned is the amount claimed as deduction under section 104A of the Act. For example, monetary remuneration claimed as a deduction by a company with a balance date of 30 September 1991 is returned by the shareholder/employee in the 1991 income year (i.e., ending 31 March 1991).

Where a company has incurred monetary remuneration in an income year and only part of that amount has been paid to the shareholder/employee, the balance is derived in the income year in which it is paid to the shareholder/employee.

- **Estimation of Provisional Tax**

The amendment will require a shareholder/employee with a 31 March balance date who derives remuneration from a company with a late balance date to pay provisional tax on income that has not been derived by the company and paid to the shareholder/employee. As a result, a shareholder/employee may find it difficult to estimate provisional tax.

- **Doubling up of income in the 1991 income year**

Where a shareholder/employee has been taking advantage of the timing mismatch, the amendment will result in a doubling-up of income in the 1991 income year. Taxpayers with a 31 July balance date who are affected by the doubling-up of income will be eligible in terms of the current provisional tax rules for a remission of underestimation additional tax and use-of-money interest on short-paid provisional tax for the 1991 income year if payment of the short-paid provisional tax is made by 7 February 1992. Under the existing provisional tax rules the Commissioner is required to remit such penalties and interest which result from a change in the law enacted subsequent to the beginning of the month prior to the due date for the payment of the third instalment of provisional tax. The amendments received the Governor-General's assent on 28 June 1991. Application for such a remission will need to be made to the Commissioner. Taxpayers with an August or September balance date who have estimated their 1991 provisional tax will need to make catchup payments on the date of their third provisional payment to avoid becoming liable for underestimation additional tax and/or use-of-money interest.

This relief from underestimation additional tax and use-of-money interest does not apply to 1992 provisional tax estimates.

- **Calculation of 1992 and 1993 Provisional Tax**

An adjustment must be made where a shareholder/employee has been affected by the doubling-up of income in the 1991 income year, and uses the 1991 residual income tax plus the uplift factors to determine 1992 provisional tax and the first and second instalments of 1993 provisional tax. The 1991 residual income tax is reduced by the tax payable on the remuneration returned through the operation of the amendment. The amount of the reduction is calculated by applying the average tax rate of the shareholder/employee to that remuneration returned.

- **Accrued expenditure**

Section 13 amends section 104A, which deals with accrued expenditure. Where an employer incurs expenditure by way of monetary remuneration in an income year which has not been paid in that income year or within the period allowed following the end of the income year, the amount not paid is treated as being the unexpired portion of accrual expenditure and is added back as assessable income. The amount added back is deductible in the income year in which it is paid. The test for determining when services for accrued monetary remuneration are performed is payment.

- **Period allowed for payment**

Where the employee is not a shareholder / employee, the remuneration must be paid in the income year in which it is incurred or within 63 days after the end of the income year. The amendment denies a deduction for holiday pay, long service leave and sick leave incurred in an income year unless payment has been made within the income year or the 63 day period.

Where the employee is a shareholder / employee of a company, the remuneration must be paid in the income year or within the time allowed for the furnishing of the return of income for that income year. This is the last day for furnishing a return under the extension of time arrangements.

- **Holiday pay**

The amendment allows holiday pay to be claimed as a deduction in the income year incurred under the existing rules for the 1991 income year. From the income year commencing 1 April 1991, holiday pay incurred will be treated like any other monetary remuneration incurred and only be deductible when it has been paid.

- **Shareholder/employee**

A shareholder / employee is a person who receives or is entitled to receive income which is not treated as a source deduction payment.

- **Paid**

The term "paid" is defined along the lines of section 75, which deals with derivation of income. "Paid" includes remuneration credited in account, reinvested, accumulated, or dealt with in the interest or on behalf of a person. The mere accruing of remuneration such as holiday pay and long service leave to a reserve does not constitute payment.

- **Application date**

Section 8 applies to monetary remuneration derived during or after the income year commencing 1 April 1990.

Section 13 applies (except for holiday pay) to monetary remuneration incurred on after 1 April 1990. The provision applies to holiday pay from 1 April 1991.

Any reserves created under the existing rules prior to the application of these amendments will not be treated as unexpired accrued expenditure and will not be added back as assessable income.

Loss Carry-Forward and Grouping Rules

Sections 16, 17, 29, 30 and 31

Carrying forward of Losses

Section 16 amends subsections (7) and (7A) of section 188 of the Income Tax Act 1976. Section 188(7) provides that a limited liability company can carry forward its losses only if there has been a 40 percent continuity of share ownership from the commencement of the income year in which a loss is incurred until the end of the income year in which a loss is offset. Prior to the Income Tax Amendment Act (No. 2) 1990 this shareholding continuity requirement was determined by "looking through" any corporate shareholders in the loss company to the ultimate natural person shareholders. The 1990 Amendment Act restricted this look through requirement to companies limited by shares only, to cater for the situations where there are no ultimate natural person shareholders, e.g., the subsidiaries of local authorities.

It was found that the 1990 amendment to section 188 was too wide in its effect and could facilitate the trafficking of losses. This is because there are several readily utilisable types of corporate entity (e.g., companies limited by guarantee) which effectively have natural person shareholders controlling them but which nevertheless are not caught by the 1990 amendment wording of the look through requirement in section 188(7).

Section 16 reinstates the previous requirement in section 188 which required one to look through any corporate shareholder in a loss company to the ultimate natural person shareholders to ascertain whether the shareholder continuity requirements had been satisfied. Specific provision, however, has been made for local authorities, statutory producer boards and statutory bodies established by specific Act of Parliament to ensure that the subsidiary companies of these entities are not prevented from carrying forward their losses by reason only of a lack of ultimate natural person shareholders. These parent entities are exempted from the corporate shareholder look-through requirement.

The term "special corporate entity", within the meaning of new section 191(1)(g), has been used in section 16 for reasons of drafting conciseness to refer to a local authority, statutory producer board or a statutory body established by specific Act of Parliament. A fuller description of this term is contained below in the TIB item on section 17.

In summary, section 16 tightens up section 188 to prevent manipulation for loss trafficking purposes while specifically providing for the bona fide loss carry-forward situations of the subsidiaries of local authorities, statutory producer boards and other statutory bodies.

Section 16 applies to the tax on income derived in the income years commencing on or after 1 April 1988.

Loss Carry - Forward Consequentials - Sections 29, 30 and 31

Sections 29, 30 and 31 make the equivalent amendments to section 15 of the Amendment Act in respect of the parts of the principal Act dealing with imputation (section 394E(4)), dividend withholding payments (section 394ZW(4)) and branch equivalent tax accounts (section 394ZZP(6)). Again use is made of the special corporate entity term which is defined in new paragraph (g) of section 191(1).

The parts of the Act referred to above contain shareholder continuity provisions (similar in concept to that found in section 188(7)) which, if not satisfied, operate to cancel any credits accumulated in an imputation credit, dividend withholding payment or branch equivalent tax account. These shareholder continuity provisions require one to look through all corporate shareholders to the ultimate natural person shareholders in determining whether the requisite shareholder continuity requirements have been satisfied.

Such shareholder continuity provisions, as was the case in section 188, are problematical for the subsidiaries of special corporate entities (within the meaning of new section 191(1)(g)) because their parent companies do not have any ultimate natural person shareholders as contemplated by the look-through provision. Sections 29 to 31 effectively exempt special corporate entities from the corporate shareholder look through requirement. Where shares are held by a special corporate entity, then for so long as they continue to be held by that entity, they shall be deemed to be held by the same person regardless of any change in the members or directors of a special corporate entity. The separate look-through provision in section 191(1)(b) is also stated not to apply to a special corporate entity in relation to the various continuity of shareholding provisions amended by sections 29 to 31.

The amendments made by sections 29, 30 and 31 apply from the income year commencing on or after 1 April 1988.

Group Loss Offsetting - Section 17

Section 17 amends section 191 of the Income Tax Act 1976, which sets out the requirements that must be satisfied for a number of companies to constitute a group and utilise the losses of other companies in the same group.

The amendments made by section 16 are principally intended to place corporate groups which include a local authority, statutory producer board or a statutory body established by specific Act of Parliament, on a level footing with other corporate groups in respect of the general ordinary and specified group provisions of section 191. While corporate groups including such entities were previously given limited access to the specified group provisions of section 191 (subsections (4), (4A) and (5)) by section 191(6)(b), they were not given access to the ordinary group provisions (subsections (3) and (7)). For example, the offsetting of losses was not possible within a corporate group which included a local authority, and which was at least two thirds but less than 100 percent commonly owned.

Section 17(1) makes the most substantive amendments by inserting new paragraphs (g) and (h) in section 191(1).

New paragraph (g) defines the term "special corporate entity" which, in turn, is used in new paragraph (h) and sections 188, 394E(4), 394ZW(4), and 394ZZP(6). The term is used for reasons of drafting conciseness and means:

(i) Any local authority as defined in section 2 of the Local Government Act 1974; or
(ii) Any statutory producer board as defined in section 197E(1) of the Income Tax Act 1976; or
(iii) Any statutory body established by Act of Parliament (whether in New Zealand or elsewhere), where the Commissioner, having regard to the terms of the statute by which the statutory body is established, is satisfied that it would be appropriate to treat the body as a special corporate entity.

While the local authority or statutory producer board references are self-explanatory, further background should be given to (iii). This provision refers to what are more commonly known as statutory corporations, which are established by specific Act of Parliament. While the provision extends to statutory bodies established by an Act of Parliament of a foreign jurisdiction, it should be noted that the scheme of section 191 permits only New Zealand sourced losses to be offset against New Zealand sourced income. The main criteria that the Commissioner would use in deciding whether it was appropriate, having regard to the terms of the statute by which a statutory body is established, to treat a statutory body as a special corporate entity is whether the body has any ultimate natural person shareholders with a beneficial interest; if it has, it is unlikely to be so appropriate. A statutory body will need to submit a copy of its parent statute to Inland Revenue to allow a decision to be made as to whether it is appropriate to treat that body as a special corporate entity.

It is necessary to make special provision in section 191 for a corporate group which includes a special corporate entity, as the general ordinary and specified group provisions mainly contemplate ordinary limited liability companies and are accordingly often couched in share capital language. Additionally, section 191(1)(b) requires one to look through all corporate shareholders to the ultimate natural person shareholders of the relevant companies. Such provisions pose problems for entities covered by the special corporate entity term which do not have share capital or natural person shareholders.

New paragraph (h) addresses these problems by expressly deeming a special corporate entity to have a paid-up capital and issued and allotted shares. The members or directors of such an entity, in their collective capacity as such, are deemed to be the shareholders of the entity and will be deemed to hold all of the paid-up capital, issued and allotted shares, entitlement to profits and voting power of the entity.

Paragraph (h) will give a corporate group which includes a special corporate entity access, in its own right, to the general ordinary and specified group provisions of section 191. The amendment will mean that a corporate group which includes, for example, a local authority will be able to offset tax losses by either subvention payment or election. Such a corporate group will no longer be dependent on section 191(6)(b) to gain limited access to the specified group offsetting provisions.

Subsections (2) and (3) of section 17 are directed at correcting a drafting oversight in section 191(6)(b). Section 191(6)(b) caters for companies without share capital whose capital is not capable, in terms of section 191(6)(a), of being deemed to be share capital, e.g., statutory producer boards and local authorities.

While it is certainly the intention of section 191(6)(b) to enable companies with no share capital to have access to the specified group offsetting provisions a drafting deficiency in the provision precluded such companies from, in fact, forming a specified group. Subsection (3) of section 17 is a remedial amendment to section 191(6)(b) and it gives effect to the provision's intention by expressly stating that companies to which section 191(6)(b) applies shall be deemed to be companies included in a "specified group".

Subsection (2) of section 17 amends section 191(3) by providing that a deemed specified group constituted under section 191(6)(b) also qualifies as a "group of companies" under section 191(3).

Subsection (4) inserts a new subsection (6A) in section 191 which effectively restates in a separate subsection the contents of former section 191(6)(c) which provided that the Commissioner was entitled to disregard a small amount of paid-up capital or nominal value of shares, or a small number of allotted shares.

The various amendments effected by section 17 apply from the income years commencing on or after 1 April 1988.

Excess Retention Tax Abolished

Section 19

Section 19, which repeals Part V of the Act, abolishes excess retention taxation, (ERT) on income derived in the 1991 and subsequent income years. Because ERT is assessed two years after the income is derived, ERT will still be assessed in the 1991 and 1992 income years in relation to income derived in the years ending 31 March 1989 and 31 March 1990.

The Valabh Committee in its report to the Government on the taxation of distributions from companies (November 1990) recommended the repeal of ERT. The reasons which the Committee advanced for the repeal of ERT are set out in Chapter 4.4 of its report, which has been released to the public.

Retirement Tax Repealed

Sections 2 and 20

Sections 2(2) and 20 of the Amendment Act repeal Retirement Tax.

Retirement tax was introduced in 1990 to allocate a specific part of income tax and Fringe Benefit Tax to the cost of Guaranteed Retirement Income. The rationale for introducing Retirement Tax was to identify the actual tax cost of Guaranteed Retirement Income.

These amendments repeal the definition of Retirement Tax, Part VA of the Income Tax Act 1976, the Twentieth Schedule, the various footnotes in the First Schedule, and clause 14 of part A of the First Schedule. It was considered that these provisions achieved little, if anything, in practice and unnecessarily increased compliance and administration costs. The repeal of Retirement Tax provisions will have no effect on the levels of tax revenue.

These amendments apply from the date on which the Act received the Royal assent.

Provisional Tax

Sections 22 and 32

When the interim provisional tax regime was implemented it was intended that use of money interest would be paid on the total amount of tax overpaid by the taxpayer and correspondingly interest charged on the total amount of tax underpaid by the provisional taxpayer.

The amendments in sections 22 and 32 confirm this policy in relation to under- or overpayments of Guaranteed Retirement Income Earner Surcharge and Family Support.

Section 22: Provisional Tax and Guaranteed Retirement Income Earner Surcharge

Section 22 amends the Guaranteed Retirement Income Earner Surcharge to confirm that the Use-of-Money Interest applies to under and overpayments

Section 32: Interest to be charged where Residual Income Tax exceeds Provisional Tax

Section 32(1) of the Amendment Act amends section 398A of the principal Act to insert a definition of the term "income tax payable" to include the correct amount of Family Support and Guaranteed Minimum Family Income in interest calculations.

Subsection (2) confirms the date on which interest charging commences where a taxpayer is liable for use of money interest. Previously the legislation was not clear that a taxpayer who was not required to make payments of provisional tax still had a third instalment date for the purposes of this section.

Subsection (3) provides that this section will apply to tax on income derived in the income year commencing 1 April 1991 and in every subsequent income year.

Fringe Benefit Tax

Sections 23, 24 and 35

Introduction

The Amendment Act amends the fringe benefit tax regime in five ways by:

- providing an exemption from fringe benefit tax for fringe benefits provided by charities to their employees;
- making a number of minor amendments to correct drafting oversights in relation to the imposition of fringe benefit tax on superannuation schemes;
- amending the calculation of the cost price of motor vehicles;
- allowing the prescribed rate of interest to be lowered during a quarter;
- imposing FBT on low interest loans made by a life insurer to its policyholders.

FBT and Charities

Section 23

Introduction

Section 23 provides that fringe benefits provided by charities to employees are not exempt from fringe benefit tax provided that they are not employed in a business carried on by the charity. Section 23 also makes a number of minor amendments to the fringe benefit tax regime as a consequence of the recent changes to the taxation of superannuation schemes.

Background

When introduced, the fringe benefit tax legislation provided that charities were exempt from fringe benefit tax in respect of fringe benefits provided to employees involved in their charitable activities. This exemption was removed with effect from 1 October 1990.

Key Issues

Subsection (1) inserts a definition of "charitable organisation" in section 336N which is any society, institution, association, organisation, trust or fund (not being a local authority, a public authority, or a university) to which, in the quarter, section 56A(2) of the principal Act applies. This differs slightly from the previous definition as universities are now specifically excluded from being a charity.

Subsection (4) inserts a new paragraph (h) into the definition of a fringe benefit to provide the necessary exemption.

This amendment takes effect from the quarter commencing 1 October 1991. This date ensures that charities have never been required to pay FBT on benefits provided to employees who work in non-business areas.

Other Amendments

Section 23 also makes a number of minor amendments to the definition of fringe benefit tax.

Subsection (2) amends the definition of fringe benefit tax to reinsert in paragraph (db) a reference to “any specified insurance premium”. These words were accidentally omitted when paragraph (db) was amended to remove a reference to contributions to non-designated funds.

The second amendment removes from the definition a reference to contributions to a designated fund or a non-designated fund. At the same time the amendment tidies up the definition slightly. These amendments are a consequence of the recent changes to the taxation of superannuation schemes.

These amendments take effect from 15 December 1989, the effective date of the original amendments.

FBT on Loans to Life Insurance Policyholders

Section 23

Introduction

Section 23 of the Amendment Act alters the provisions which impose FBT on low interest loans made by a life insurer to its policyholders. Previously, FBT was chargeable on all low interest loans to policyholders where the interest rate charged by the life insurer was less than the prevailing FBT prescribed rate of interest.

Background

The effect of the old provision was that life insurers could be liable for FBT on all loans to policyholders, including situations where the loan and the interest rate charged were arm’s length transactions.

The amendment alters the criteria for those loans which may be liable for FBT. Section 336N(9) of the principal Act has been repealed and replaced with another provision which ensures that a potential FBT liability is limited to situations where the loan is made available, or the interest rate charged on the loan is set, having regard to the status or capacity of the borrower as a policyholder.

Key Issues

The threshold at which a policyholder loan may be liable for FBT has been raised to ensure that the loan is granted or made available to the person, or the interest rate is set, having regard to the capacity or status of the borrower as a policyholder, before the loan can be liable for FBT under the new section 336N(8A) of the principal Act. This means that arm’s length loan transactions undertaken by insurers will not be subject to FBT merely because the borrower is a policyholder.

In addition, the new provisions make explicit reference to the situation where a loan has been provided to an associated person of a policyholder or by an associated person of the insurer. This provision merely confirms the position that, in determining the liability for FBT policyholder loans are subject to the same associated person considerations as employee loans.

Application Date

The amendments apply as from the FBT quarter commencing 1 October 1990, which was the application date for the original provisions.

FBT on Loans to Employees - Change to Method of Fixing Prescribed Rate of Interest

Section 24

Introduction

Section 24 of the Amendment Act makes a change to the times at which the prescribed rate of interest on employee loans can be changed for FBT purposes.

Background

Section 336W currently empowers the making of regulations declaring the rate of interest which is to apply to employment related loans. Such regulations must be made not less than one month before the start of a quarter and the interest rate fixed must apply for the whole of that quarter.

The requirement for the prescribed rate to be fixed at such an early point has meant that, at times, the FBT prescribed rate of interest for the quarter has been higher than the prevailing market rate of interest during much of the quarter. Where that is the case, employers must charge employees a higher rate of interest than they charge on arm's length loan transactions. The situation is particularly likely to occur during periods of declining interest rates.

Key Issues

The amendment is therefore the result of the need for more flexibility in setting the FBT interest rate.

The amendment provides that a new regulation may now be made up to one month before the end of a quarter and the new rate would apply for the whole of that quarter. A regulation can only be made during a quarter if it reduces the rate previously fixed for that quarter.

FBT and the Cost Price of Motor Vehicles

Section 35

Introduction

The basis for determining the fringe benefit value of cars provided to employees has been amended in a new Tenth Schedule to the Income Tax Act.

Background

The policy behind the Fringe Benefit Tax system has always been that the value of a benefit to be taxed is the amount that it would cost the employee to acquire that benefit personally from his or her tax paid income. That cost would include Goods and Services Tax. This amendment has been made to ensure that this policy is clearly reflected in the Income Tax legislation. In arriving at the fringe benefit value of a vehicle, employers must now include in the calculation any GST paid on purchase.

Key Issues

The method of determining the taxable value of a car for Fringe Benefit Tax purposes is unchanged apart from the requirement to incorporate GST in the calculation.

Employers now have two options for arriving at the fringe benefit value of any motorcar supplied to employees:

Option 1

Take the cost price of the vehicle to the employer, including the GST paid by the employer on acquisition, and apply the existing formula of 6 percent per quarter (24 percent per annum) to that inclusive cost price.

Option 2

Take the cost price of the vehicle to the employer, exclusive of any GST paid on acquisition; and apply to that cost price the alternative formula in the amended Tenth Schedule. At present this is 6.75 percent per quarter (27 percent per annum).

The alternative formula produces the same effect as under Option 1 using the GST rate prevailing at the time (i.e., GST of 12.5% is added to the formula rather than the cost price).

Option 2 has been added to allow for taxpayers who may have difficulty complying with the requirement to identify the GST element on all their vehicles. It is recognised that most businesses will have been recording vehicle assets on a GST exclusive basis.

The amendment applies to fringe benefits provided on or after 1st July 1991.

Offsetting of Tax Refunds

Sections 25, 27, 28, 33

Introduction

Legislative changes have been made to the Income Tax Act which will enable the Commissioner to offset tax refunds against outstanding tax liabilities of the person entitled to the refund.

Background

The Income Tax Act provides only very limited powers of offsetting tax refunds against other liabilities. The FIRST systems provide for an automatic offset of a tax refund to certain outstanding liabilities of the same taxpayer. Legislation is needed to provide for this automatic offsetting.

Key Issues

The amendment adds two subsections to section 409 of the Act. The first provides the Commissioner with the discretion to offset a tax refund against a person’s tax liabilities that have not been paid and are due and payable. It is important to note that whilst the offset will be done automatically by the computer, taxpayers will be able to request that a refund be used to offset an outstanding tax liability other than that selected by the automatic process.

The second subsection denies the Commissioner the authority to offset a tax refund where the refund arises from:

- an export tax credit;
- a family support credit of tax;
- a refund of excess resident withholding tax; or
- a refund of excess non-resident withholding tax.

There are consequential amendments:

- Section 374F(1) has been amended to make it clear that an allowance of credit of tax in the end of year assessment is to be refunded to the tax-payer and cannot be used to offset another outstanding tax liability.

- Section 362(2) has been amended to allow any refund arising in respect of overpaid PAYE deductions to be subject to the offsetting provisions. A similar provision has been made for overpaid provisional tax [S.389(1)].

The automatic offset will not be fully operational until all tax types are converted to the FIRST systems.

Relief in Cases of Serious Hardship

Section 34

Introduction

Two changes have been made to section 414 of the Income Tax Act 1976 (Relief in Cases of Serious Hardship):

- The Commissioner's Delegation has been increased from $5000.00 to $50,000.00.

- A new proviso has been inserted requiring the Commissioner to have regard to maximising the net present value of any recovery when exercising discretion under the delegation.

Background

The Commissioner's Delegation under section 414 was last increased in 1986. The level of $5000.00 for hardship cases is no longer adequate.

Key Issues

Many hardship claims on behalf of individual taxpayers now exceed the $5000.00 statutory limit. All cases which exceed the limit must be referred to the Minister of Finance for approval. To avoid delay in processing hardship claims, the Commissioner's delegation in section 414(5) has been significantly increased from $5000.00 to $50,000.00.

A new proviso has been added to section 414(2). This proviso requires the Commissioner to adopt a more "commercial" approach when considering whether to grant relief to taxpayers under section 414.

Officers exercising the Commissioner's delegation will look first to the hardship of the taxpayer. Once satisfied that action under section 414 is justified, it is then appropriate for them to look for ways to maximise the net present value of any potential recovery of tax owing. The principal consideration in making any decision under section should, however, remain the hardship that would be entailed for the taxpayer (or his / her estate).

Resident Withholding Tax - Technical Correction to Due Date Change

Section 21

Section 21 makes a minor amendment to the application date provisions of section 15(2) of the Income Tax Amendment Act 1991.

The amendment ensures that the change in the due date for the payment of resident withholding tax deductions from the 14th day of the month to the 20th day applies to all resident withholding tax deductions "payable" after 1 July 1992 not, as the section was previously worded, "made" after that date.

No-Declaration Rate of Resident Withholding Tax Deductions

Section 37

Introduction

A higher no-declaration rate of Interest PAYE deduction will apply from 1 April 1992 where a person receiving interest does not provide their IRD number to the payer of interest.

Background

Section 327ZD lists the items of information which payers of interest are to provide to the Commissioner, to be used, where required, to check that taxpayers are returning income correctly. One of those items is the tax file number of the recipient. There was, however, no incentive for anyone to supply an IRD number. The purpose of this amendment is to encourage taxpayers to supply that IRD number, by imposing a higher rate of deduction where the number is not supplied.

Key Issues

The amendment to the Nineteenth Schedule provides that the rate of deduction of Interest PAYE will be increased from 24c to 33c on payments made after 1 April 1992, where the recipient has not provided their IRD number to the payer of interest.

Where a deposit / account belongs to more than one person, only one IRD number is required to be recorded by payers.

Goods and Services Tax Amendment Act (No. 3) 1991

Application of GST to Government Grants and Subsidies

Section 2

Introduction

The amendment ensures that government grants and subsidies received by a registered person in the course or furtherance of a taxable activity are subject to GST.

Background

Since the introduction of GST, it has always been the Government's intention that GST was payable on government grants and subsidies received by a registered person in the course or furtherance of a taxable activity. However, a recent Taxation Review Authority (TRA) decision held that a wage subsidy paid by the Department of Labour to an employer was not subject to GST. The case concerned whether or not payments made by the Department of Labour to an employer under the Job Opportunity Scheme were consideration for a supply of services and therefore subject to GST.

While the TRA decision was based on the evidence before it and the circumstances of the particular case, it raised the issue of whether the GST Act should be amended to clarify the original intent. Prior to the amendment, it was considered that grants and subsidies were covered by general provisions of the Act i.e., consideration for a supply of goods and services in the course or furtherance of a taxable activity.

Key Issues

The amendment provides that where a payment in the nature of a grant or subsidy is made by the Crown or a public authority to:

- a person in respect of that person's taxable activity, or
- a person for the benefit and on behalf of another person in respect of that other person's taxable activity,

the payment will be treated as being consideration for a supply of goods and services in the course of the taxable activity. If the recipient of the payment is registered or liable to be registered that person will be required to account for GST on the payment.

- **Payment in the nature of a grant or subsidy**

The amendment does not define grant or subsidy per se. Butterworths' *Words and Phrases Legally Defined* states that "In the Shorter Oxford English Dictionary (3rd edn) 'grant' is defined as 'An authoritative bestowal or conferring of a right, etc.: a gift or assignment of money etc. out of a fund'". Further, "Again referring to the dictionary meanings of the words 'grant' and 'subsidy' there is one common thread throughout, that is a gift or assignment of money by government or public authority out of public funds to a private or individual or commercial enterprise deemed to be beneficial to the public interest. Subject to minor refinement the words 'grant' and 'subsidy' appear from their dictionary meanings to be almost synonymous." This definition was given in a Canadian case *GTE Sylvania Ltd* v *R* [1974] 1 FCR 726.

However, the provision does indicate what payments are treated as being or not being a payment in the nature of a grant or subsidy. A payment in the nature of a grant or subsidy includes:

- A suspensory loan or advance upon that loan or advance becoming non-repayable because the conditions for non-repayment are satisfied.

- Any payment of a kind declared by the Governor-General by Order in Council to be taxable grant or subsidy where that payment is excluded from being a payment in the nature of a grant or subsidy.

The following payments are excluded from the definition of a payment in the nature of a grant or subsidy:

- Any benefit paid under Part I of the Social Security Act 1964. Benefits covered by this exclusion include unemployment benefit, domestic purposes benefit and guaranteed retirement income.

- Any payment made to a person for the personal use and benefit of that person or a relative. This exclusion is intended to cover benefits similar to those covered by the above exclusion but are not paid under the Social Security Act such as family support tax credits.

- Any payment of a kind declared by the Governor-General by Order in Council not to be taxable grant or subsidy.

Application date

The amendment applies from the commencement of the GST regime on 1 October 1986 to ensure that the Government's original intention is reflected in the legislation. This also protects the revenue in relation to persons who have accounted for GST on grants and subsidies received in respect of their taxable activity. However, for persons who have not accounted for GST on such payments a liability is created for the payment of the GST component of the grant or subsidy. This liability existed under Inland Revenue's policy on the treatment of government grants and subsidies notwithstanding the TRA decision.

The Commissioner is prohibited from issuing an assessment or reassessment after the expiration of four years from the end of the taxable period to which the return relates or the assessment was made. However, this time limit is waived where the Commissioner is of the opinion that the person has knowingly or fraudulently failed to make a full and true disclosure of all material facts necessary to determine the tax payable for a taxable period.

Saving provision

A savings provision provides that the amendment shall not apply in respect of any completed court proceedings and for any objections lodged on or before 19 December 1990.

Zero-Rating of Intellectual Property Rights

Section 3

Introduction

This amendment clarifies the zero-rating provision to ensure that all services supplied in connection with intellectual property rights are zero-rated.

Background

The amendment contained in the Goods and Services Amendment Act (No. 2) 1991 ensured that certain services supplied for and to non-residents in respect of intellectual property rights were zero-rated. The services zero-rated were the filing, prosecution, granting, maintenance, transfer, assignment, licensing, or enforcement of intellectual property rights. However, that amendment did not cover the services of searching, advising in respect, opposing the grant or seeking the revocation of, or opposing steps taken to enforce intellectual property rights. By inference, it was arguable that these services were not zero-rated. This would have created a liability to pay GST on these services supplied since 1 October 1986. Such services were zero-rated in terms of the previous legislation that applied since 1 October 1986.

The provision, which allows for the zero-rating of services in connection with intellectual property rights for use outside New Zealand, was also deficient in that it was limited to the services first mentioned in the above paragraph. There is no reason why these additional services should not be zero-rated if they are provided in connection with intellectual property rights for use outside New Zealand.

Key issues

The amendment ensures that all services supplied in respect of intellectual property rights are zero-rated. This covers services supplied for and to non-residents who are outside New Zealand at the time the services are performed. It also covers services supplied to residents and non-residents in connection with intellectual property rights for use outside New Zealand.

The additional services zero-rated are searching, advising in respect, seeking revocation of or defending, or defence of enforcement of intellectual property rights.

- **Refund of GST paid**

Where a registered person has imposed GST on services supplied which are zero-rated in terms of this amendment, that person will be entitled to a refund of the GST paid. A credit note will have to be issued if a tax invoice has been issued to the recipient of the supply. The previously agreed consideration for the supply has been altered due to the impost of tax being zero-rated.

- **Validating provision**

An amendment is also made to the validating provision contained in the GST Amendment Act (No. 2) 1991. This is to ensure that the validating provision applies to this amendment.

Application date

This amendment applies to supplies made on or after 1 October 1986.

Tax Treatment of Real Estate Salespersons' Expenses

TIB Volume Two No.6 of February 1991 reported the announcement in Government's December Economic Statement that taxpayers in receipt of "commission-only income" were to be permitted to deduct telecommunications, advertising, and motor vehicle expenses incurred in deriving commission-only income, effective from 1 April 1991.

Details of the proposed amendment were reported on page 11 of that TIB. The Taxation Reform Bill (No.3) introduced section 105AA and amendments to sections 105 and 106B of the Income Tax Act 1976.

In reporting back that Bill, Parliament's Finance and Expenditure Select Committee recommended that these measures be withdrawn from the Bill and that the issue be dealt with by way of amendment to the Real Estate Agents Act 1982.

The Minister of Justice, the Hon. Doug Graham, has announced that the Government intends introducing an amendment to the Real Estate Agents Act to deem real estate salespersons to be self-employed for all purposes, including revenue, holidays, sick leave and personal grievances. It is expected that this amendment will be introduced shortly.

The current position remains that, until enactment of the announced amendment to the Real Estate Agents Act, real estate salespersons will not be entitled to deduct expenses incurred in deriving their income from that source.

Due Dates Reminder

July

31 GST Return and payment due for period ended 30 June 1991.

August

5 PAYE Deductions for last 16 days of July 1991 due - "Large" employers only.

7 First instalment of 1992 Provisional Tax due for taxpayers with April balance dates.

Second instalment of 1992 Provisional Tax due for taxpayers with December balance dates.

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

14 Interest PAYE deducted during July 1991 due - monthly payers.

Dividend PAYE deducted during July 1991 due.

Non-Resident Withholding Tax deducted during July 1991 due.

20 PAYE Deductions for first 15 days of August 1991 due - "Large" employers.

Tax Deductions for July 1991 due - "Small" employers.

Yes, I would like _____ (quantity) of the TIB Video, covering the Income Tax Amendment Act (No.3) 1991, and the Goods and Services Tax Amendment Act (No.3) 1991, at $20.

I have enclosed a cheque to the value of $_______

To: Neville Whitlock
Communications Unit, Taxpayer Services
Inland Revenue Head Office
P O Box 2198, WELLINGTON

Name:_______________________________________

Address:_____________________________________

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