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National Superannuation

Income Tax Amendment Act (No.6) 1991

Introduction

Parliament has recently passed changes to the guaranteed retirement income earners' surcharge regime. These changes put into effect the Government's announcement of 7 November 1991 that:

- The Budget night proposal to abate National Superannuation through an income-tested scheme administered by the Department of Social Welfare is not to proceed; and
- The surcharge administered by the Inland Revenue Department is to continue.

Key Issues

The Income Tax Amendment Act (No.6) 1991 inserts a new Part XA into the Income Tax Act. The new Part, which is very similar to the present one,

- changes the rate of the surcharge from 20 to 25 percent, and
- lowers the surcharge threshold from $7,202 to $4,160 for single superannuitants and from $12,012 to $6,240 for a married couple. The surcharge will thus apply to a greater number of superannuitants.

Other changes to Part XA are of a purely technical nature:

- References to guaranteed retirement income and related terms have been replaced with appropriate references to national superannuation;
- Living alone payments to national superannuitants are now included within the definition of "national superannuation";
- The sections have been renumbered and reordered.

Superannuitants who are already liable to pay the surcharge may have made elections under the old legislation. These are deemed to continue to apply. New elections may be made at any time.

For the purposes of calculating Provisional Tax, the GRI surcharge will be included in 1991 or 1992 residual income tax.

Application Date

Income year commencing 1 April 1992 (or alternative balance date).

GST Treatment of Allowances Paid to Employees

Introduction

This item clarifies the GST treatment of input credits in respect of allowances paid to employees.

Background

On page 5 of TIB Volume 2 No.3 we explained the rules relating to claiming GST input credits where employers reimburse employees for work related expenditure. We have been asked to clarify the statement in the item that GST input credits are not allowed where an allowance is paid. This ruling is in variance to a paragraph (Chapter 3.5.6.) of the GST Technical Rulings prior to the recent reprint.

The GST Technical Rulings paragraph intimates that a GST input credit will be allowed where a shareholder/employee is reimbursed for the use of a private motor car on work related travel. The example in the paragraph shows the GST input credit calculated on the basis of reimbursement using the Public Service Mileage Rates (PSMRs). For the reasons explained in TIB Vol.2 No.3, this ruling is incorrect. There is no GST incurred by the employer and there is insufficient connection between the payment made by the employer and the expenditure incurred by the shareholder/employee.

Ruling

The ruling at Chapter 3.5.6 of GST Technical Rulings only applied to shareholder/employees. As from the date of the publication of this TIB employers will no longer be entitled to any further GST input credits where the PSMRs have been used to reimburse shareholder/employees for work related travel. This ruling will not affect employer costs of ordinary employees' reimbursement. It was never Inland Revenue policy that employers could claim an input tax credit in respect of ordinary employees where an allowance was paid or travel was reimbursed by way of the PSMRs.

The ruling given in TIB Volume 2 No.3 is confirmed. Employers cannot claim GST input tax credits on allowances paid, or travel reimbursed using the PSMRs, in respect of ordinary employees. The same ruling will apply to employers of shareholder/employees as from the date of this TIB.

Reference: H.O. 10.A.8.4
GST A.5.1.

Correction - Tax Simplification Dates

There was an error in the table of Tax Simplification Recommendations on page 6 of Tax Information Bulletin Vol.3 No.3.

The new due date for payment of end-of-year tax for Provisional Taxpayers whose Residual Income Tax in the previous year was more than $2,500 is the 7th day of the month contained in the Eighth Schedule to the Income Tax Act 1976.

The new due date for Provisional Taxpayers who are natural persons, and whose Residual Income Tax in the previous year was $2,500 or less, is the 20th day of the 8th month after balance date. For all other Provisional Taxpayers, end-of-year tax is due on the 7th day of the month contained in the Eighth Schedule.

We wish to thank Mr Jim Gordon, the New Zealand Society of Accountants' Taxation Director, for bringing this error to our attention.

Accrual Determinations Recently Signed by the Commissioner

The following two accrual determinations have been signed recently.

Determination G5A: Mandatory Conversion Convertible Notes

Determination G5A differs from determination G5 in that it allows an initial or final coupon payment to be ignored for the purpose of determining whether the coupon interest payments under the note are payable at regular intervals and are of equal amounts.

The determination is reproduced in Appendix A to this TIB.

Accrual Disclosure Exemption - D3

Exemption D3 is a general exemption from the requirements to disclose details of interrelated arrangements to the Commissioner. D3 exempts from disclosure all interrelated arrangements (the making of which is a generally accepted commercial practice) except for those interrelated arrangements that are referred to in the schedule to the exemption.

A more detailed discussion of the exemption together with a copy of the determinations is contained in Appendix B to this TIB.

Goods and Services Tax on Fringe Benefits

Introduction

This item corrects an error in the Fringe Benefit Tax Guide - IR 409 (April 1989) and an omission in the GST Guide - GST 600 (September 1991).

Fringe Benefit Tax Guide - IR 409 (April 1989)

On page 57 of the FBT Guide, under the paragraph relating to "GST on Fringe Benefit", a list of the types of fringe benefits not included for GST purposes is set out. This list includes "employer contributions to employee superannuation, sickness, accident, death benefit funds and life insurance policies".

Upon review of the list it became apparent that employer contributions to employee sickness, accident, and death benefit funds do not fall within the exclusion list set out in s21(3A) of the Goods and Services Tax Act 1985, and are therefore subject to GST.

Thus, fringe benefits in the form of employers' contributions to employee sickness, accident and death benefit funds should not be excluded when working out the GST on fringe benefits.

Goods and Services Tax Guide - GST 600 (September 1991)

There has been some confusion as to whether categories "D" or "E" of the fringe benefit categories are to be included in the calculation of GST on fringe benefits.

Some employers have maintained that as the procedure provided on page 91 of the GST Guide only refers to categories "A" and "C", categories "D" and "E" are to be excluded in the calculation of GST on fringe benefits.

The "procedure" provided on page 91 of the GST Guide was merely meant to be an example of the calculation method. Unfortunately, the term "procedure" rather than "example" was used, resulting in some confusion as to whether categories "D" and "E" are to be included in the calculation.

Categories "D" and "E" should be included in the calculation of GST on fringe benefits where appropriate.

Deduction of Provision for Long Service Leave

Taxation Review Authority Decision - Case M123 (1990) 12 NZTC 2,788

Introduction

This item sets out Inland Revenue's policy on the application of the above decision to other cases involving a deduction claimed for provision for long service leave.

Background

The taxpayer concerned was a company whose employees' entitlement to long service leave was governed by a number of industrial awards. The taxpayer claimed a deduction for an amount in respect of long service leave which its employees had become entitled to but did not take during the year.

The Commissioner disallowed the amount claimed on the grounds that it was not deductible until the year the leave was actually taken and payment made.

The TRA, in deciding for the taxpayer, held that the liability for the expenditure had been "incurred" in the year the employees became entitled to the long service leave. In its decision the TRA elected to follow the decision of the Privy Council in the Hong Kong case of *C of IR* v *Lo & Lo* [1984] BTC 281 in preference to a number of other cases, notably the judgment of the High Court of Australia in *Nilsen Development Laboratories Pty Ltd* v *FC of T* 81 ATC 4031.

Comment

Recent amendments have been made to section 104A to deal with the deductibility of monetary remuneration. One result of these changes is that the deduction of a provision made for long service leave, as claimed in the above case, is largely prevented. The changes affecting such deductions apply from the income year commencing 1 April 1990. An explanation of the amendments is on page 21 of TIB Volume Three No.1.

The TRA's decision in Case M123 was not appealed by the Department for administrative reasons. However, we still consider the unanimous judgment of seven Australian High Court judges in *Nilsen* to be the more appropriate authority governing treatment of deductions of this nature. Another case involving a deduction claimed in respect of a provision made for long service leave is currently awaiting hearing by the High Court. Until this case is decided any deductions for provisions made for long service leave, claimed in income years prior to 1991, will continue to be disallowed. This is in line with the Department's long-standing policy as set out in Technical Rulings paragraph 20.50.4.

Reference: 10.H.3.1

Employment Status of Owner/Driver Carriers

Inland Revenue made this Press Release on 30 November 1991:

"Owner/Driver Carriers Reassured

Owner/driver carriers have been reassured that Inland Revenue will not be pursuing back taxes as a result of the recent Employment Tribunal decision indicating some may be employees.

The Tribunal last week found that an owner/driver courier whose contract had been terminated was an employee and not self-employed.

Commissioner of Inland Revenue David Henry said today that the tax consequences of that decision for those involved could be significant.

"Among other things, expenses that were deductible to the self-employed would not be deductible to employees. Also, there would be changes for the treatment of GST, PAYE deductions, Accident Compensation levies and Fringe Benefit Tax."

However Mr Henry reassured owner/driver carriers that there would be no immediate tax changes.

"We understand that the decision is to be appealed. When we have considered the outcome of the appeal we will let owner/drivers know what the tax consequences are. No matter what we do we will not seek any back taxes from these people if the appeal indicates that they are employees and we have accepted in the past that they are self-employed." "

Harbour Boards / Port Companies - Depreciation on Tugboats

Background

Harbour Boards were brought into the Income Tax system from 1 April 1987 by section 197D of the Income Tax Act 1976. Port Companies incorporated pursuant to the Port Companies Act 1988 are also liable to income tax. As these taxpayers have only recently been brought into the tax system, tugboats have not appeared in the Department's schedule of approved depreciation rates.

Ruling

Tugboats may be depreciated at the rate of 10% diminishing value as from 1 April 1987. This includes the deck equipment and main engines on the vessel.

Reference: H.O. 10.D.3.6F

Accrual Regime - Contingent and Non-Contingent Payments Relating to Financial Arrangements

Summary

This item deals with the accrual regime treatment of fees paid in relation to financial arrangements (sections 64B to 64M of the Income Tax Act 1976). It discusses sections 64C, 64BA(2) and 64BA(3) of the Act.

Background

The accrual regime is intended to spread all costs of a financial arrangement over the term of that arrangement.

This intention is achieved by -

(a) Section 64C(1); and

(b) The definition of acquisition price in section 64BA and its use in the base price adjustment or cash base price adjustment.

Section 64C(1) determines the cash flows to be used for calculating income or expenditure over the term of an arrangement, using an accrual method (usually the yield to maturity method). The acquisition price of a financial arrangement is a component of the base price adjustment. The base price adjustment is calculated when a financial arrangement matures, is sold or transferred.

Costs associated with financial arrangements include amounts which are contingent on the implementation of the financial arrangement (e.g., brokerage fees).

In addition, non-contingent payments that exceed 2% of a financial arrangement's core acquisition price must also be spread. The core acquisition price is defined in section 64BA. Examples of non-contingent payments are legal fees which are payable whether or not the transaction proceeds, and non-refundable bank fees.

Ruling

Section 64C(1) of the Act determines the cash flows used to calculate income derived or expenditure incurred. All consideration provided to or by the person in relation to a financial arrangement must be included in those calculations. Consideration includes payments made between the holder and the issuer (e.g., interest, bank fees) or between the holder or issuer and a third party (e.g., brokerage fees).

The only exception to this rule is payments that do not depend on the financial arrangement going ahead. As long as these payments do not exceed 2% of the core acquisition price, they are excluded from accrual calculations. Non-contingent payments are those that must be paid *regardless* of whether the financial arrangement proceeds. Non-contingent payments may be deductible under section 136 or section 104 of the Act.

Treatment of fees paid to third parties

Fees relating to financial arrangements that are paid to a third party must be included in accrual calculations. They are part of the consideration paid in relation to the financial arrangement. For example, if an amount is paid to an issuer's sharebroker for submitting applications for an issue of debenture stock, is it subject to the accruals regime?

The answer is yes. As such payments relate to the financial arrangement and are contingent on its implementation, they must be accrued over the term of the arrangement in accordance with section 64C. This means that issuers can deduct the brokerage fees they have paid over the term of a financial arrangement if the total amount of expenditure incurred in any income year satisfies the deductibility criteria of section 106(1)(h).

The recipient of the brokerage fees in this case is not a party to the financial arrangement. The fees will therefore be assessable in the income year in which they are derived.

Holders can also deduct brokerage or other contingent fees paid over the term of a financial arrangement using the yield to maturity (or an alternative) method.

Discussion

Section 64C of the Act gives taxpayers a way of calculating income or expenditure from financial arrangements during the term of the arrangement. The principal method of accrual is the yield to maturity method. To apply the yield to maturity method the cash flows from the financial arrangement must be identified.

Section 64C(1)

Section 64C(1) identifies the relevant cash flows. It says that:

> ".. regard shall be had to the amount of all consideration provided to the person and by the person in relation to the financial arrangement.."

Consideration is not defined in the Act. For the purposes of the accrual regime consideration means all benefits that are received or provided in relation to the financial arrangement. Consideration includes all amounts paid to or by a holder or issuer (e.g., interest, principal and fees). The deductibility or otherwise of the various amounts outside sections 64B to 64M of the Act is irrelevant. It is the net effect

(as reflected under section 64C or section 64F) of the benefits given and received that constitutes expenditure incurred or income derived. All such benefits provided or received must therefore be included in accrual calculations.

The phrase "in relation to" covers payments between the parties to the financial arrangement or those made to third parties.

The general rule is that all benefits provided or received in relation to financial arrangements are accrued. The one exception is stated in section 64C(1), which excludes from the accruals calculation:

> "..the amount of item z in section 64BA(2) and (3) of this Act.."

Item z is defined in section 64BA as the smaller of:

(i) The amount of all consideration provided in relation to the financial arrangement by the issuer or holder, as the case may be, that is not contingent on the implementation of the financial arrangement:

(ii) An amount equal to 2 per cent of the core acquisition price of the financial arrangement.

Fees not contingent on the implementation of the financial arrangement are those fees payable regardless of whether or not the arrangement proceeds. Non-contingent fees could include such things as legal fees, non-refundable application fees and valuation fees. These expenses may be deductible upfront under sections other than 64B to 64M, e.g., section 136 or section 104.

Accrual Methods

Sections 64BA and 64C(1) of the Act provide the framework for determining cash flows to be used for accrual calculations. Section 64C(2), (3), and (4) and determinations detail the accrual methods of accounting for income or expenditure for tax purposes. The primary method of accrual is the yield to maturity method.

However, taxpayers may use alternative calculation methods. An alternative method must have regard to the principles of accrual accounting, conform with commercially acceptable practice, be consistently applied for financial reporting purposes and produce a result that is not materially different from that obtained using the method set by determination.

Inland Revenue stated in Public Information Bulletin 167, December 1987, that:

> "..Any fee contingent upon the implementation of the financial arrangement must be included in the amortization calculation, except that where the result of dealing with it separately would not be materially different from including it, it is acceptable to deal with it separately.."

Inland Revenue published its policy on materiality in Tax Information Bulletin Volume Three, No.1 of July 1991.

Examples

(1) A (the issuer) borrows 100 from B (the holder). The loan is repayable in instalments which total 100 plus interest. A pays an arrangement fee of 5 to C. C is in the business of introducing borrowers and lenders. This fee is payable if the loan proceeds, and is therefore contingent on the implementation of the financial arrangement. A, B and C are New Zealand taxpayers.

   (i) A's total expenditure is the interest on the loan plus the arrangement fee of 5. This total expenditure is spread over the term of the loan using the yield to maturity method or an alternative.

   (ii) B's total income derived is the interest received from A. This interest amount is spread over the term of the loan using the yield to maturity method or an alternative.

   (iii) C's income is the arrangement fee of 5 which is assessable in the income year that it is derived.

(2) A (the issuer) borrows 100 from B (the holder). The loan is repayable in instalments which total 100 plus interest. A pays an uplifting fee of 5 to B on the day the loan is advanced. A and B are New Zealand taxpayers.

   (i) A's total expenditure is the interest on the loan plus the fee of 5. The amount is spread over the term of the loan using the yield to maturity method or an alternative.

   (ii) B's total income is the interest on the loan plus the fee of 5 received from A. The amount is spread over the term of the loan using the yield to maturity method or an alternative.

Reference: H.O. Accrual T:145

Fringe Benefit Tax - Prescribed Rate of Interest

The prescribed rate of interest used to calculate the fringe benefit value of low-interest loans has been reduced to 11.3 percent for the quarter commencing 1 October 1991.

The rate for this quarter was previously 12.4 percent, but it has been reduced because of the fall in commercial interest rates.

This new rate will also apply for the quarter commencing 1 January 1992 and following quarters, unless it is subsequently reviewed.

Due Dates Reminder

December 1991

20 PAYE Tax Deductions for first 15 days of December 1991 due - "Large" employers only.

PAYE Tax Deductions for November 1991 due - "Small" employers.

January 1992

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

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

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

Third instalment of 1992 Provisional Tax due for taxpayers with January balance dates.

1991 end-of-year tax due for taxpayers with February balance dates.

14 Interest PAYE deducted during December 1991 due for monthly payers.

Dividend PAYE deducted during December 1991 due.

Non-Resident Withholding Tax deducted during December 1991 due.

15 GST return and payment for period ended 30 November 1991 due.

20 PAYE Tax Deductions for first 15 days of January 1992 due - "Large" employers only.

PAYE Tax Deductions for December 1991 due - "Small" employers.

FBT return and payment for quarter ended 31 December 1991 due.

31 GST return and payment for period ended 31 December 1991 due.