Tax Information Bulletin

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Contents

Correction to Tax Information Bulletin Volume Three, No.7

There is an error on Page 15 of TIB Volume Three, No.7. The ninth paragraph in the top example box on page 15 should have the reference to section 394D(1)(va) deleted, so that it simply reads *"The recipient company also enters a credit for the resident withholding tax credit in its imputation credit account."*.

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Introduction

The previous Tax Information Bulletin (Volume 3 No.7) was a special corporate taxation issue devoted to the business tax changes introduced through the Income Tax Amendment Act (No.2) 1992.

This Bulletin deals with the remaining issues included in that Act, some of which were added via a Supplementary Order Paper. These issues are:

- the Interim Depreciation regime;
- the adoption of the Livestock Valuation Consultative Committee's interim report;
- An amendment to section 56A to provide for Cyclone Val donations;
- Minor changes to section 197C (energy trading operators), and to section 55 of the GST Act;
- Local Authority taxation changes.

A further amendment act, the Real Estate Agents Amendment Act 1992, has made major changes to the treatment of real estate salespersons. The tax consequences of this change are discussed in detail in this bulletin.

Depreciation Changes

Introduction

The Income Tax Amendment Act (No.2) 1992 introduces new provisions into the Income Tax Act to deal with changes to depreciation announced by the Government late last year.

Background

On 16 December 1991 the Government announced the application of a 25% loading to the current rates of depreciation allowed for:

- New depreciable assets (excluding buildings)
- Imported second hand assets (excluding motorcars) used in New Zealand for the first time
- Primary sector land improvements
- Bloodstock used for horsebreeding.

The 25% loading generally applies to these assets where they are acquired between 16 December 1991 and 31 March 1993 (inclusive), and first used on or before 31 March 1994.

The loading is designed to bring New Zealand depreciation rates more into line with rates available in other countries. From 1 April 1993 a new depreciation regime will be put in place once the review of Inland Revenue's current depreciation rates is completed.

On 16 December 1991 the Government also announced changes to the taxation treatment of fruit trees and vines. This will allow orchardists to write off the residual value of their trees when they are scrapped.

Part 1 : General Depreciable Assets

A new section 108A has been introduced into the Income Tax Act to provide for the 25% loading on ordinary depreciation rates for qualifying assets and qualifying capital improvements. The ordinary rates of depreciation are those allowed by the Commissioner under section 108 of the Act and include those rates allowed which are not contained in the published schedule. The loading also applies to rates of depreciation for plant and machinery, which include a supplementary shift allowance allowed under section 113A of the Act.

To qualify for the loading, assets have to meet the definition of “new asset” or “new New Zealand asset” and satisfy timing rules for the dates of acquisition and use.

To qualify for the loading, capital improvements to assets must meet the definition of “capital improvement” and satisfy the timing rules.

Calculation of the Loading

The loading amounts to 25% of the ordinary depreciation rate. Common rates will increase as follows:

Current Rate (%)	Loaded Rate (%) with 25% increase
3	3.8
5	6.3
6	7.5
10	12.5
12.5	15.6
15	18.8
20	25.0
25	31.3
33.3	41.7
50	62.5

Qualifying Assets

There are two types of asset which qualify for the 25% loading:

New Assets

These are assets which have never been used before, either in New Zealand or elsewhere. Assets which have been held as part of trading stock but which have not been used are considered new assets. Buildings have been specifically excluded from the definition of new assets and are not eligible for the loading.

New NZ Assets

These are assets which have never been used in New Zealand or which have never been used in the production of New Zealand assessable income. In most cases this will mean assets which have been imported into New Zealand for the first time. It will also mean that assets previously used by an overseas branch of a New Zealand resident company will not qualify for the loading. Buildings and motorcars have been specifically excluded from the definition of new New Zealand assets and are not eligible for the loading.

Qualifying Capital Improvements

In some cases depreciable assets will be subject to repairs or alterations which increase their capital value. Such capital expenditure is added to their written down tax book value and depreciated.

Capital improvements may qualify for the loading. Improvements to buildings will not qualify for the loading, but improvements to other depreciable assets, including motorcars, will qualify provided that the timing rules are satisfied.

Timing Rules

For a qualifying asset (a "new asset" or a "new New Zealand asset") to be eligible for the loading, its acquisition and use must satisfy the timing rules. Similar timing rules must be satisfied for qualifying capital improvements.

Qualifying Assets

Generally an asset must have been acquired between 16 December 1991 and 31 March 1993 (inclusive), and be used on or before 31 March 1994.

Where an asset was the subject of a binding contract for purchase before 16 December 1991, or was a new asset under construction before 16 December 1991, it will not qualify for the loading even though it may have been first used before 31 March 1994. Where an asset is subject to a binding contract on 31 March 1993 and has yet to be used it will generally qualify for the loading if it is used on or before 31 March 1994.

Where a new asset is under construction at 31 March 1993 it must be completed and used on or before 31 March 1994 to qualify for the loading.

Qualifying Capital Improvements

In general expenditure incurred in making a capital improvement to an asset will qualify for the loading where that expenditure was incurred between 16 December 1991 and 31 March 1993 (inclusive), provided that the improved asset is used on or before 31 March 1994.

If a capital improvement was the subject of a binding contract before 16 December 1991 or was under construction before 16 December 1991 it will not qualify for the loading.

Where a capital improvement is the subject of a binding contract on 31 March 1993 and the improved asset has yet to be used it will generally qualify for the loading if it is used on or before 31 March 1994.

Where a capital improvement is still being made at 31 March 1993 it must be completed and the improved asset used on or before 31 March 1994 to qualify for the loading.

Timing Rule Exceptions

There are two exceptions to the timing rules:

Transfers of assets from trading stock to capital stock

Where a firm had acquired or had begun to construct a new asset as trading stock prior to 16 December 1991 it will qualify for the loading if it is used by that firm as capital stock on or before 31 March 1994

Assets used by previously exempt persons

Where an income tax exempt entity acquired or constructed a qualifying asset or made a qualifying improvement and subsequently becomes taxable that entity may qualify for the loading. To do so it must have satisfied the timing rules. This will generally mean that the asset will have been acquired between 16 December 1991 and 31 March 1993 (inclusive) and have been used on or before 31 March 1994.

Ownership Rules

Where a qualifying asset or an asset which has a qualifying improvement is sold or transferred to another person the loading will generally be lost. The new owner will be limited to claiming the ordinary rates of depreciation. There is an exception to this rule where an asset is transferred under a matrimonial agreement. In this case the transferee can continue to claim the loading.

There is a further exemption for assets which are transferred between companies in the same wholly owned group. This covers companies which have 100% common voting interests at the time the asset was transferred.

In principle a partner owns a proportionate share of each partnership asset. Where a partnership dissolves or where there is a change in composition of a partnership of a proportion of the partnership assets. This will mean that new owners of the asset will not be eligible for the loading in respect of their shares.

Other Points

Section 108A(7) contains an anti-avoidance provision to deal with arrangements which attempt to obtain a loading where it was not intended that it be available.

Subject to the rules outlined above, the depreciation loading is treated in the same way as ordinary depreciation.

- Section 117 applies to the loading in the same way as ordinary depreciation.
- The Commissioner's rules relating to part year use of assets and balance date changes also apply to the loading.

Application Dates

The depreciation loading will generally apply to qualifying assets acquired between 16 December 1991 and 31 March 1993 (inclusive) and used on or before 31 March 1994.

Part 2: 25% Loading on Land used for Farming, Forestry or Aquaculture

Sections 18, 19 and 20 amend sections 128A, 128B and 128C of the Income Tax Act by providing that qualifying expenditure on items listed in the Thirteenth Schedule to the Act may be depreciated at the rate specified in the schedule, increased by the 25% loading.

To qualify for the 25% loading expenditure must be:

- Incurred by the taxpayer between 16 December 1991 and 31 March 1993 (inclusive) other than subject to a binding contract entered into before 16 December 1991 and first used in that period; or
- Incurred by the taxpayer between 1 April 1993 and 1 April 1994 pursuant to a binding contract entered into between 16 December 1991 and 31 March 1993 (inclusive).

This rule does not apply to existing improvements acquired when a taxpayer purchases land. However, there are two exceptions to this rule. The 25% loading will apply where the vendor would have been entitled to the loading and the assets where acquired:

- By a taxpayer in accordance with a matrimonial agreement; or
- By a company in a wholly owned group from another company in that wholly owned group and the land is acquired before 1 April 1993

then those land improvements continue to qualify for the 25% loading.

Sections 18, 19 and 20 apply to the tax on income derived in the 1991-92 income year and subsequent years.

Write-Off of Book Value of Trees and Vines

As well as providing for the 25% interim loading on items of expenditure listed in Part I of the Thirteenth Schedule, section 18 of the Amendment Act also introduces a new section 128A(4A). This subsection provides that trees or vines that are not planted primarily for timber production may have their book value written off where they have ceased to exist or have ceased to be used in the production of assessable income.

This section applies to the tax on income derived in the 1991-92 income year and subsequent income years. However, a proviso to subsection (4A) provides that trees or vines that ceased to be used in the production of assessable income before 16 December 1991 cannot have their residual book value written off under subsection (4A).

Note that the Government originally announced that the treatment of trees and vines would be consistent with the treatment of plant under section 108. The current treatment differs from that announcement because any gain on sale of trees or vines is not clawed back via section 117 of the Act.

Part 3: 25% Loading On Bloodstock

Section 14 of the Amendment Act provides that:

- Stallions and mares may qualify for the new interim depreciation regime; and
- Stallions may be depreciated on a diminishing value basis should the owner so wish.

Section 14(1) of the Amendment Act provides for a new definition of the term “specified write-down”. The specified write-down is the amount by which the value of a stallion or mare declines in an income year. The specified write-down is now-

- for a stallion to which subsection (1A) of section 86H applies, the specified write-down calculated in accordance with that subsection
- for any other stallion, an amount equal to 20% of the cost price of the stallion
- for any broodmare, an amount calculated in accordance with the following formula:

$$\frac{x \times y}{15 - z}$$

where:

x is either 1.25, for a broodmare to which paragraphs (a) and (b) of subsection (1A) of this section apply (see below), or for any other mare, 1; and

y is the cost price of the broodmare; and

z is 12 or the age in years of the mare when it first becomes eligible to be written down in value (being a number that is 11 or less).

Section (1) of the Amendment Act inserts a new section (1A) into section 86H of the principal Act. This new subsection provides that where any bloodstock is:

- First used for breeding purposes in New Zealand between 16 December 1991 and 31 March 1993 (inclusive); or
- First used for breeding purposes in New Zealand between 1 April 1993 and 1 April 1994 where the bloodstock was acquired between 16 December 1991 and 31 March 1993; or

- Between 1 April 1993 and 1 April 1994 where the bloodstock was acquired after 31 March 1993 but subject to a binding contract entered into between 16 December 1991 and 31 March 1993; and

The value of the bloodstock has not been taken into account by any other person at the end of any earlier income year, except:

- By a person from whom the taxpayer acquired the bloodstock in accordance with a matrimonial agreement; or
- By a company, in a wholly owned group of companies, from whom the taxpayer (also being a company in that wholly owned group of companies) acquired the bloodstock before 1 April 1993,

then the specified write-down in relation to a stallion shall be:

- 25 percent of the cost price of the stallion; or
- 37.5 percent of the diminished value of the stallion where the taxpayer elects this option in the return of income for the first income year in which the stallion is used for breeding purposes.

The 16 December 1991 announcement stated that stallions and mares not used for breeding purposes before 16 December 1991 would qualify for the interim loading. This legislation does not apply the 25% interim loading to bloodstock owned by one taxpayer but not used for breeding purposes by that taxpayer and sold, after 16 December 1991, to a person who then commences to use that bloodstock. Legislation will be included in a future Taxation Reform Bill to provide for the correct application of the policy announcement in this case.

Livestock Valuation

Sections 2, 85A and 86 and Twelfth Schedule

Introduction

Sections 11 to 13 of the Income Tax Amendment Act (No.2) 1992 give effect to the interim recommendations of the Livestock Valuation Consultative Committee.

Background

On 4 March 1992 the Livestock Valuation Consultative Committee reported to the Government recommending that legislation be introduced with effect from the income year commencing 1 April 1991 to provide:

- that farmers may move from the trading stock scheme to the cost / market / replacement option for the 1992 income year without prior notice to Inland Revenue;
- that farmers entering the herd scheme after 1 April 1991 should not be required to move all of a type of livestock into the herd scheme, but instead may choose to leave out immature and male livestock retained for meat production;
- that the classification of cattle as one type of livestock be amended to provide for two types of cattle livestock, namely dairy and beef.
- the option for the Governor-General, by Order in Council, to cap the current trading stock values at the lesser of the standard values applying for the 1991 income year or the standard values calculated for the 1992 income year. The merits of capping the values is currently being considered by the Committee and the Government.

The Government accepted their recommendations and legislation was introduced by Supplementary Order Paper to give effect to those listed above.

The Committee also considered that Inland Revenue should introduce some form of simplified self assessed cost regime to apply from the 1991-92 income year. They are currently determining the detail of such a regime.

Movement from Trading Stock Scheme

Section 12(4) of the Amendment Act (No.2) 1992 inserts a new subparagraph in section 85A(3)(d)(i) to provide unrestricted movement from the trading stock scheme to the cost / market / replacement option (as provided by section 86B of the Act). This option to move from the trading stock scheme to section 86B applies only to the 1991-92 income year. It does not apply to any subsequent income year.

Section 12(3) of the Amendment Act makes a number of minor consequential changes as a result of this amendment.

Inclusion of Livestock within Herd Scheme

Section 2 of the Amendment Act inserts a new definition of herd livestock. The definition provides that herd livestock is:

(a) any animal of the classes set out in column (3) to the Twelfth Schedule of the Act which is used by the taxpayer or any other person primarily for the purposes of the production of progeny or wool or velvet or fibre or primarily for any combination of those purposes; or

(b) an animal of any class of livestock that the taxpayer has elected, in accordance with section 85A(2C) of the Act to treat as herd livestock.

At the same time the Twelfth Schedule has been amended to remove immature classes of livestock from the third column (herd livestock classes). This means that herd livestock now comprises, at a minimum, the "core" herd, namely mature breeding animals. If the farmer wishes to include more classes of animals such as ewe hoggets then the farmer may elect to add that class of livestock within the definition.

Note that the Twelfth Schedule has been amended to remove immature classes of livestock from the Third column.

This amendment applies to the 1991-92 income year and subsequent income years.

Election to include Livestock within Herd Scheme

Section 12(2) of the Amendment Act inserts section 85A(2C) into the Income Tax Act. The subsection provides that a farmer may elect to include within the scheme any of those classes of livestock listed in column (2) of the Twelfth Schedule. Such an election must be made in writing and furnished with the return of income for the first income year to which the election is to apply. Where a return of income is being filed under E-file it is not possible for the notice to be filed at the same time as the electronic return, so the Commissioner will accept an election posted within a few days of the return being filed.

The election allows the farmer to include within the definition those animals which are of a core herd livestock class but which are not used for the production of progeny or wool and so forth. For example, rising 2 year heifers which were intended for breeding but did not mate are excluded by the second part of paragraph (a) of the definition. A farmer who wishes to include these heifers in the herd scheme can simply elect to do so at the end of the income year. This election is outlined in the new section 85A(2C), which is explained below.

The election ceases to apply where the type of livestock to which that class of livestock belongs leaves the herd scheme, for example, if a farmer elects to include ewe hoggets within the herd scheme and then subsequently removes sheep from the herd scheme. If the farmer should in the future wish to move sheep back into the herd scheme the herd livestock definition will have reverted back to the core classes, which do not include ewe hoggets. This means that a farmer is not bound by the earlier election to include ewe hoggets and in effect starts with a clean sheet. In this example the farmer decides to include ewe hoggets within the herd scheme so elects to do so.

As discussed below, sections 85A(2A) and (2B) have been repealed. However, to avoid confusion, the replacement provisions were enacted as section 85A(2C).

Section 12(1) of the Amendment Act is consequential to the new section 85A(2C). This subsection effectively amends section 86A(2)(b) to provide that where a farmer has a type of livestock in the herd scheme all classes of herd livestock of that type of livestock must be included in the herd scheme. This section provides the link between the farmer choosing which classes of animals are herd livestock, and that choice resulting in animals being valued in accordance with the herd scheme.

These amendments apply to the 1991-92 income year and subsequent income years.

Treatment of Existing Election Provisions - Section 85A(2A)

A consequence of this new definition is that the provisions relating to the inclusion of livestock within the herd scheme have been made more logical. Farmers now elect to *include* classes of livestock within the scheme rather than electing to *exclude* classes of livestock.

Section 12(2) of the Amendment Act repealed section 85A(2A), which provided that existing farmers with a type of livestock in the herd scheme could exclude immature classes of that type of livestock from the then definition of herd livestock. Section 12(2) of the Amendment Act then inserts a new section 85A(2D). This subsection deems a farmer to have elected to include an immature class of a type of livestock in the herd scheme, in accordance with the new section 86A(2C), where:

- The farmer elected pursuant to subsection 85A(2A), as formerly in force, not to include a class of immature livestock in the herd scheme; and
- The farmer has revoked that election; and
- Livestock of that type to which the class belongs are valued under the herd scheme in the 1991-92 income year.

Where a farmer originally chose to include immature classes of livestock within the herd scheme by simply not making an election under section 85A(2A) to exclude immature livestock, that farmer must now elect to include that immature livestock under the new section 85A(2C) if that stock is to continue to be valued under the herd scheme. An election to include that immature stock must be furnished:

- With the return of income for the 1991-92 income year; or
- Where a taxpayer's return has been furnished for the 1991-92 income year, at any time before 7 July 1992.

Those farmers who entered a type of livestock in the herd scheme in the 1989-90 income year or the 1990-91 income year did not have the option to exclude immature classes of livestock from the herd scheme.

In effect, they were given a different treatment from those farmers with stock already in the herd scheme. These farmers have been given the option to remove those immature classes of livestock from the herd scheme should they so wish. This effectively places them in the same position as existing farmers.

Where a farmer chose to include an immature class of livestock within the herd scheme by simply not making an election under section 85A(2A) to exclude immature livestock, that farmer must now elect to include that immature livestock under the new section 85A(2C) if that stock is to continue to be valued under the herd scheme. An election to include that immature stock must be furnished:

- With the return of income for the 1991-92 income year; or
- Where a taxpayer's return has been furnished for the 1991-92 income year before 7 July 1992, at any time before 7 July 1992.

Treatment of Existing Election Provisions - Section 85A(2B)

Section 12(2) also repeals section 85A(2B), which allowed farmers who had a type of livestock in the herd scheme to exclude classes of male non-breeding animals of that type from the scheme. As this repeal takes effect from 1 April 1991, the section is repealed without ever applying.

Any taxpayer who has furnished an election under section 85A(2B) must re-submit an election under section 85A. This further election must be furnished:

- With the return of income for the 1991-92 income year; or
- Where a taxpayer's return has been furnished for the 1991-92 income year before 7 July 1992, at any time before 7 July 1992.

Separation of Cattle into Two Separate Types

The Income Tax Act previously defined both dairy cattle and beef cattle as the same type of livestock, namely cattle. This treatment may be considered inappropriate because a dairy cattle operation can be a totally separate enterprise from a beef cattle operation, in terms of both its management and the reasons a farmer holds such cattle. Thus the Income Tax Act has been amended to treat cattle as two separate types. A farmer who has both dairy cattle and beef cattle will make separate elections and will not be compelled to value them under the same scheme. In summary, there is no longer a type of livestock known as cattle; it has been replaced by beef cattle and dairy cattle.

This change is simply achieved by amending the Twelfth Schedule to omit from column (1) the reference to cattle and insert references to beef cattle and dairy cattle.

However, giving effect to this change requires a number of minor consequential amendments. A new section 85A(2E) is inserted into the Act. This new section provides that farmers who elected to include cattle within the herd scheme are deemed to have elected to include dairy cattle and beef cattle in the herd scheme where appropriate.

Inclusion of Beef Cattle in Herd Scheme

Section 85A(2E)(a) provides that where a taxpayer elected that cattle be valued under the herd scheme in the 1990-91 income year or earlier, the taxpayer's beef cattle shall be deemed to be included in the herd scheme. This occurs where the taxpayer:

- At any time during the 1991-92 income year or any of the 2 immediately preceding income years derived income from beef cattle; and
- Has not since elected to value cattle under the trading stock scheme or the cost / market / replacement options, other than as a result of:
  - An election in the 1991-92 income year to value the cattle under another scheme; or
  - An election under sections 85A(2A) or (2B) to value cattle, which is herd livestock, under the trading stock scheme or the cost / market / replacement option. (The taxpayer exercised the option to exclude immature classes of livestock from the herd scheme).

This amendment applies to the 1991-92 income year and subsequent income years.

Inclusion of Dairy Cattle in Herd Scheme

Section 85A(2E)(b) is identical to section 85A(2E)(a) except that it applies to dairy cattle. It provides that where a taxpayer elected that cattle be valued under the herd scheme in the 1990-91 income year or earlier, the taxpayer's dairy cattle shall be deemed to be included in the herd scheme.

This amendment applies to the 1991-92 income year and subsequent income years.

Treatment of Taxpayers who elected to remove Cattle from the Herd Scheme and value them under another scheme in the 1991-92 Income Year

With the change from cattle to beef cattle and dairy cattle, any election to remove cattle from the herd scheme in the 1991-2 income year may no longer be appropriate. Taxpayers who made such an election have the option to move both beef and dairy cattle from the herd scheme, to move solely beef cattle from the scheme or solely dairy cattle from the scheme.

Section 85A(2E)(c) provides that a taxpayer who elected to value cattle (currently in the herd scheme) under the trading stock scheme or the cost / market / replacement option, may revoke that election so far as it relates to beef cattle, dairy cattle, and both beef and dairy cattle.

The notice of revocation must be furnished within the time allowed under the extension of time arrangements provided by section 17 of the Act. Note that this is a different furnishing requirement from that applying to taxpayers electing to include classes of livestock within the herd scheme. In the small number of cases where a taxpayer has already furnished a return a notice will be accepted up to 7 July 1992.

It is worth noting that a taxpayer who elected to move cattle to the trading stock scheme may choose which cattle type, if any, moves to the trading stock scheme but cannot change options and move cattle to the cost / market / replacement option.

Provision for Freezing of Trading Stock Values

The Committee recommended to Government that provision be made, for the 1992 income year only, for the Governor-General to have the authority by Order in Council to set the trading stock standard values on a type by type basis, at the lesser of the standard values applying to the 1991 income year and those calculated for the 1992 income year.

The recommendation to amend the legislation to provide this option was made because at the time the Committee made its report, insufficient information was available to assess whether an extension to the current cap on standard values was warranted. The Government therefore decided to put in place legislation to enable the values to be capped if necessary, rather than make an uninformed decision when the legislative opportunity existed.

Section 13 of the amendment Act inserts a new paragraph (d) into the definition of the term “standard value”. This new paragraph provides that the standard value applying to a class of livestock in the 1991-92 income year is:

- that calculated under the definition as normal; or
- the lesser of the “normal” value and the standard value applying in the 1990-91 income year, where the Governor-General issues an Order in Council before 17 May 1992.

Note that this is different from the Committee’s recommendation of providing authority to cap the values on a type by type basis. However, it is intended that any capping will be exercised for a type rather than an individual class.

The need for urgency in this area is recognised. It is currently intended that any announcement of the capping of the values will occur as soon as possible.

Note that this is different from the Committee’s recommendation of providing authority to cap the values on a type by type basis. However, it is intended that any capping will be exercised in relation to a type rather than an individual class of livestock.

Cyclone Val Donations recognised

Amendment to section 56A

Introduction

Section 8 of the Income Tax Amendment Act (No.2) 1992 amends section 56A of the Income Tax Act to provide that donations made to authorised Cyclone Val relief efforts will entitle donors to rebates (or deductions, if they are public companies).

Background

Two coordinated relief efforts were established in response to the devastation inflicted on Western Samoa by Cyclone Val in December 1991.

The first was operated by the Council for International Development. In conjunction with the ANZ Bank a system was established whereby donations could be made by making deposits into an account, known as the Cyclone Val Relief Fund, at any branch of the ANZ Bank.

The second relief effort was known as “Channel 2 Cyclone Aid for Samoa”. This was a telethon-type event where donations were made to an account administered by Television New Zealand, who transferred the funds to the Council for International Development.

Key Issues

The amendment to section 56A will entitle donors to tax rebates (or to deductions under section 147, if they are public companies).

To be eligible, donations must have been made to either the *Cyclone Val Relief Appeal Fund* or to *Channel 2 Cyclone Aid for Samoa.* The donation must be evidenced by a receipt. In the case of *Cyclone Val Relief Appeal Fund* that receipt will be in the form of an ANZ Bank deposit slip butt stamped with the name of the appeal. In the case of *Channel 2 Cyclone Aid for Samoa* conventional receipts were issued, marked "Channel 2 Aid for Samoa Appeal".

The rebate available is the lesser of 33 1/3 % of the donation or $500. The deduction available to public companies (for the gifts in an income year to any one donee) is limited to the greater of 1% of the company's assessable income, or $4,000. The total deduction for the year is limited to the greater of $1,000 or 5% of the company's assessable income.

Application Date

This amendment applies from 1 April 1991.

Energy Trading Operators

Section 197C

As described in TIB Vol 3 No 7, section 25 of the Income Tax Amendment Act (No.2) 1992 substituted new company grouping and loss offsetting provisions in the Income Tax Act.

Section 29 of the Amendment Act consequentially amends the group company references in section 197C of the Income Tax Act, which relates to energy trading operators, so these references conform with the new company grouping and loss offsetting provisions.

Goods and Services Tax Act

Section 55

As described in TIB Vol 3 No 7, section 25 of the Income Tax Amendment Act (No.2) 1992 substituted new company grouping and loss offsetting provisions in the Income Tax Act.

Section 65 of the Amendment Act consequentially amends the group of companies provision (section 55) in the Goods and Services Tax Act so it conforms with the new company grouping provisions in the Income Tax Act.

Local Authority Taxation

Introduction

Two anti-avoidance amendments relating to the taxation of local authorities have been implemented. Section 64 of the Income Tax Amendment Act (No.2) 1992 inserts a look-through provision in the local authority trading enterprise (LATE) definition contained in the Local Government Act 1974 (LGA). This will ensure that any entity under the control of a local authority is in fact covered by the LATE definition. Section 2(5) of the Amendment Act aligns the Income Tax Act definition of "local authority" with that contained in the LGA.

Background

From 1 November 1989, local authorities which were previously exempt from all income tax (other than on income received in trust), have had to pay tax on all income derived from LATEs. LATEs themselves are taxed depending on their nature, i.e., on the same basis as companies, trusts, etc.

The definition of a LATE is contained in section 594B of the LGA. One of the statutory purposes of local government is the "operation of trading undertakings on a competitively neutral basis".

Key Issues

The amendments will help to carry out the intention of the current local authority tax legislation. This intention is to make local authorities liable for tax on income from the trading activities of entities under their control, thereby ensuring that these activities operate on a competitively neutral basis.

The former LATE definition in the LGA contained a major loophole; subsidiaries of LATEs did not come within the LATE definition, even though they were still under the effective control of a local authority. The absence of a look-through provision in the LATE definition meant that any second tier or further tier company or organisation did not come within the LATE definition.

As local authorities are not liable for tax on income derived from non-LATE entities, a local authority could gain a tax advantage by structuring its affairs to circumvent the former LATE definition. For example, the local authority could interpose a holding company between itself and its trading enterprises. While a non-LATE entity is still taxed in its own right according to its nature, a local authority could effectively extract tax free income from a non-LATE entity by charging the non-LATE for high rentals, management fee charges and the like.

Although the cost of the high rentals and management fees was deductible to a non-LATE entity under the control of a local authority, the corresponding receipt derived by the local authority was not assessable because of the continued application of the local authority tax exemption for income from non-LATE sources. Local authorities could therefore previously maximise the tax free income they derived from non-LATE entities while at the same time minimising the taxable income of these entities.

The above tax avoidance avenue is not available for LATEs as section 61(2A) of the Income Tax Act makes local authorities liable for tax on all income (not just dividends) derived from LATEs.

Section 64 of the Amendment Act inserts a look-through provision in the LATE definition to ensure that second tier and further tier subsidiaries of first tier LATEs also come within the LATE definition. A local authority is therefore liable for tax on all income it derives from such second tier and further tier subsidiaries.

The previous definition of "local authority" in the Income Tax Act was very wide and gave rise to several tax avoidance opportunities. The LGA local authority definition, in contrast, is more specific and finite and would be unlikely in itself to give rise to any tax avoidance opportunities. Section 2(5) of the Amendment Act aligns the local authority definition in section 2 of the Income Tax Act with that contained in the LGA. A LATE itself is also now defined, by reference to the LGA definition, in section 2 of the Income Tax Act.

Application Date

These local authority taxation amendments apply from 1 April 1992.

Real Estate Salespersons now treated as Self-Employed

Introduction

The Real Estate Agents Amendment Act 1992 was assented to on 23 March 1992.

This legislation amends both the employment law and revenue law consequences of the July 1990 decision of the Court of Appeal in *Challenge Realty Limited and Ors.* v *C.I.R.*

This item is concerned solely with the principal revenue consequences of the Amendment Act.

Background

The effect of the decision in *Challenge Realty* was that real estate salespersons were required to be treated as employees for all purposes. For the purpose of the deduction of expenses under the Income Tax Act 1976, this change applied from 1 April 1989.

Section 105 (2) of that Act denies all deductions for expenses incurred in gaining or producing "income from employment". That term is defined as including income from "salary or wages". The term "salary or wages" is itself defined as including "commission, or other remuneration of any kind,".

The Court of Appeal decision applied the general law tests to determine the existence of an employer/employee relationship between real estate licensee and salesperson

Key Issues

The Real Estate Agents Amendment Act 1992 amends the Real Estate Agents Act 1976 to insert section 51A. The employment and revenue law provisions of this new section apply only if ***either***:

(a) before 20 March 1992 the parties had ***expressly or by implication*** agreed that the relationship between them should be that of employer and independent contractor; or,

(b) on or after 20 March 1992, the parties ***expressly agreed*** that the relationship between them shall be that of employer and independent contractor.

It is a question of fact in every case whether such an agreement exists. The employment and revenue provisions of the section are inapplicable unless such an agreement exists. While some licensees and their salespersons may have entered into written contracts before 20 March 1992, many may not have.

Where deductions for expenses are claimed, from 1 April 1992 the Commissioner will wish to see a written agreement expressly acknowledging the employer/independent contractor relationship.

Revenue Law Consequences

Where an employer/independent contractor relationship has been expressly acknowledged, there will be two revenue law consequences of the amendment.

- from 1 April 1991, salespersons will be recognised as independent contractors and thus permitted, under the Income Tax Act 1976, deductions for expenses incurred in deriving their income as real estate salespersons.
- from 1 April 1992, those salespersons who are either required to register for GST (i.e. who estimate their gross commissions will exceed $30,000 in the 12 months from that date) or who elect to register for GST will be permitted to do so.

Tax Invoices

Those salespersons who register for GST will be required to invoice all income due to them from their licensee and to retain and maintain the usual records of all expenses incurred in producing that income.

Because the Real Estate Agents Act permits a salesperson to work for one licensee only, and because commissions will continue to be received by the licensee prior to payment of the salesperson's portion; Inland Revenue anticipates that many licensees and their salespersons will prefer that tax invoices are issued by the licensee as recipient of the service rather than the salesperson as supplier of that service.

The attention of salespersons is accordingly drawn to section 24 (2) of the GST Act. That section permits tax invoices to be issued by the recipient (licensee) in respect of services supplied by the supplier (salesperson) subject to the following conditions:

- the Commissioner has granted prior approval for the issue of such documents,
- the tax invoice created must be provided to the salesperson and a copy retained by the licensee,
- the licensee and the salesperson must agree that the salesperson shall not issue a tax invoice for those services,
- the words "buyer created invoice- IRD approved" appear prominently on the document.

Currently, Inland Revenue is considering whether or not to grant a blanket approval for the issue of such tax invoices by licensees. We will announce a decision shortly.

In addition, all buyer created invoices must contain the same particulars as all other tax invoices, namely:

- the words "tax invoice" in a prominent place,
- the name and registration number of the salesperson,
- the name and address of the licensee,
- the date upon which the tax invoice is issued,
- a description of the services supplied,
- the value of the services supplied,
- ***either*** a statement of the GST charged, ***or*** a statement that the total amount charged includes GST.

Adjustments

The attention of salespersons and their tax advisors is also drawn to the provisions of section 21 (5) of the GST Act. That section provides that where goods acquired by a person (after 1 October 1986) other than for the purpose of making taxable supplies are subsequently applied in any taxable period for the purpose of making taxable supplies, a deduction from that person's output tax may be made of an amount equal to the tax fraction of that part of the lesser of-

(a) the cost of those goods and services, including any tax charged on them;

(b) the open market value of the supply of those goods and services.

The adjustment to be made is a "one off" adjustment. This means that in the taxable period in which the asset (car etc) is first applied by the salesperson for the purpose of the taxable activity, the salesperson may make a "one-off" adjustment based on the lesser of "cost" or "open market value". The salesperson then makes "on-going" adjustments under section 21(1) for private use.

Example 1

R.E. salesperson purchased a car in 1987 for $30,000 for use in the salesperson's business. The car is now valued at $12,000 and is still used in the business.

In the taxable period in which the salesperson registers for GST, there is a "one-off" deemed supply pursuant to section 21 (5). The value of that supply is $12,000. Therefore, the salesperson will receive an input tax credit of 1/9 of $12,000 ($1,333.33).

Three points however should be noted:

1. The "one-off" adjustment may be made by the salesperson only if the asset is used more than 50% in the taxable activity (as a real estate salesperson). If this test is not met, then period by period adjustments under section 21 (5) are required.
2. The asset is no longer a "private asset" as it has been introduced into the taxable activity. It is therefore an asset of the taxable activity and any subsequent disposal of the asset is "in the course or furtherance of a taxable activity" and is subject to GST.
3. Because the asset has become an asset of the "taxable activity" any non-taxable use of the asset (private or exempt) means that there is a deemed supply pursuant to section 21(1). Further adjustments under section 21(1) are required.

Those adjustments are made on a "period by period" basis and either the "depreciation rate" or "24% rule" (see para. 7.2.4 GST Guide) should be used to value the supply.

Example 2

R.E. salesperson with a 2 month taxable period. After claiming the one-off section 21(5) adjustment, uses the car 20% for private use. A section 21(1) adjustment for that taxable period should be made.

$$\frac{\$12{,}000 \times 13.33\% \times 20\%}{6}$$

= $53.32 (value of the deemed supply)

That amount is divided by 1/9 ($5.92) and $5.92 is entered in box 6 of the GST return as an output tax adjustment.

Depreciation

In the income year commencing 1 April 1991, depreciation will be calculated on the cost price of capital assets used in the salesperson's business as such. Because real estate salespersons are specifically exempted from the provisions of the GST Act until 1 April 1992, for the 1991 income year depreciation should be calculated on the GST inclusive price.

For income years commencing on or after 1 April 1992, those salespersons required, or electing, to register for GST should calculate depreciation on the GST exclusive cost of the asset where the asset is acquired for the principal purpose of making taxable supplies.

Where an asset used in the salesperson's business was acquired before 1 October 1986, the book value for depreciation purposes will be actual cost to the salesperson.

The book values at 1 April 1991 and 1 April 1992, for depreciation purposes, should be calculated as if the salesperson had been able to claim deductions for depreciation in each year since the date of purchase.

Example 3

R.E. salesperson purchased a motor vehicle for use in his employment as a real estate salesperson on 1 April 1990. The purchase price was $25,000, GST inclusive. The vehicle, which is used 100% in that activity, has an open market value of $16,000 at 1 April 1992.

To calculate book value at 1 April 1991 and the depreciation deductions for the 1992 and 1993 income years:

cost price at 1 April 1990	25,000
less 20% depreciation	5,000
book value at 1 April 1991	20,000
less 20% depreciation DV	4,000
	16,000

The book value at 1 April 1991 is $20,000 and the depreciation deduction, at 100% business use, for the 1992 income year is $4000.00

To calculate book value at 1 April 1992 and the depreciation deduction for the 1993 income year, assuming GST registration and open market value of $16,000 at 1 April 1992:

book value at 1 April 1992	16,000
less 1/9th GST input deduction	1,777
book value for dep'n purposes for GST registered salesperson at 1 April 1992	14,223
less 20% depreciation DV	2,844
book value at 1 April 1993	11,379

Book value at 1 April 1992 is $14,223 and the depreciation deduction for the 1993 year, assuming 100% business use and retention of vehicle for whole year, is $2,844.00.

Note: The basis of motor-vehicle depreciation approved by the Commissioner pursuant to section 108 is 20% of DV.

Record Keeping

The following points summarise record keeping obligations arising as a result of this amendment in the law:

- only expenses necessarily incurred in deriving a salesperson's income are deductible;
- documentary evidence, typically the originals of invoices, accounts and bank statements must be retained by the salesperson and held available for inspection (if requested) by Inland Revenue;
- both expenses deductions and GST "input expenses" may be disallowed if not supported by such documentary evidence.

These requirements apply for both expenses deductions under the Income Tax Act and GST returns under the GST Act.

Accident Rehabilitation Compensation and Insurance Act

Neither the levies payable pursuant to the Accident Compensation Act 1982 nor those payable pursuant to the Accident Rehabilitation and Compensation Act 1992 (its successor) in respect of real estate salespersons will be affected by the Real Estate Agents Amendment Act 1992.

Licensees are required to pay the employers premium on the salaries or wages of their office staff and those salespersons who do not contract as independent contractors; with those employees also paying the earners' premium.

Independent contractors will pay the employer premium in their capacity as self-employed, together with the earners' premium for non-work accidents. The earner premium and the employer premium will be calculated on assessable income (income after expenses) and both will be assessed and paid through the salesperson's annual tax return. The earner premium applies from 1 April 1992, and the employer premium comes into force on 1 July 1992, and applies to returns filed for the 1992/93 income year after this date.

Withholding Tax

Payments of commission to salespersons, irrespective of whether they are independent contractors or remain as employees paid on a commission-only basis, remain subject to the Income Tax (Withholding Payments) Regulations 1979. Under those regulations, licensees are required to deduct tax at a 20 percent rate when paying a commission to the salesperson. For a GST registered salesperson, this deduction is calculated on the GST exclusive amount of the commission.

Application Dates

Subject to the conditions outlined elsewhere in this item, deductions for expenses incurred in deriving income as a real estate salesperson may be claimed in income years commencing 1 April 1991, and thereafter.

Again, subject to the conditions outlined elsewhere in this item, real estate salespersons will be entitled or required, as the case may be, to register for GST from 1 April 1992. Those obliged to register have two months, rather than the usual 21 days, from that date in which to register before becoming subject to any penalties for that failure or for failing to file GST returns.

Recent Disclosure Exemption issued by the Commissioner - International Tax Regime

Introduction

Under the International Tax regime, taxpayers must disclose interests they held (e.g. by way of shares or units) at any time during an income year in a foreign company or foreign investment fund. This disclosure is required by section 245W and must be made by completing Part A of an IR 4G or IR 4H form, as appropriate.

A current disclosure exemption has recently been made under section 245W(2), resulting from recent legislative amendments outlined on page 10 of TIB Volume 3 No.6.

The exemption applies to the income year commencing 1 April 1991. It is reproduced at the end of this article.

Scope of Exemption

Broadly, the exemption removes the requirement to disclose the following categories of interests, for the 1992 income year:

1. an interest held in a foreign investment fund;
2. an interest held in a foreign company which is not an “income interest of 10% or greater”;
3. an interest held in a foreign company which is resident at all times, in a country or territory not listed in the schedule of Low Tax Jurisdictions contained in the Seventeenth Schedule to the Act, provided that;
   (i) an election has not been made under s.245Y(2); and
   (ii) an “income interest of 10% or greater” is not held in any underlying foreign company to which the exemption does not otherwise apply.

Explanation and Examples

Income Interest of 10% or Greater (Categories 2 & 3(ii))

When determining whether or not an interest in a foreign company is an “income interest of 10% or greater”, the following interests must be taken into account:

- income interests held directly in that foreign company and indirectly through any interposed foreign company.
- income interests held by associated persons (not being CFCs), as defined by s.245B.

Example

The disclosure exemption would not apply to an income interest held in a Cayman Islands company by a husband and wife (associated under s.245B(d)) of 5% each as:

(i) their combined income interest is 10%, being an “income interest of 10% or greater”; and

(ii) Cayman Islands is listed on the Seventeenth Schedule.

Example - Categories 1 and 2

Mr A held a nominal interest of 1% of the share capital in a Hong Kong public company in the year ended 31 March 1992.

This interest would not have to be disclosed as an interest in a foreign investment fund (on Part A of an IR 4H form), as category 1 (outlined above) applies.

This interest would also not have to be disclosed as an interest in a foreign company (on Part A of an IR 4G form), as category 2 (outlined above) applies.

Example - Category 3(i)

NZ Ltd held a 30% shareholding in K Ltd, a Dutch company. NZ Ltd also held a 15% shareholding in S Ltd, a Spanish CFC for which an election has been made under section 245Y(2) (to attribute foreign income or loss from 1 April 1988).

The interests held by NZ Ltd in both K Ltd and S Ltd are precluded from the scope of the disclosure exemptions by category 3(i) (outlined above). The interests in both companies must therefore be disclosed on Part A of separate IR 4G forms.

(Part B of the IR 4G form must also be completed by NZ Ltd in relation to the interest it held in S Ltd. This would also apply to NZ Ltd's interest in K Ltd if that company is a CFC, as NZ Ltd held an "income interest of 10% or greater".

Category 3(ii)

This category applies when there is a chain of foreign companies. It ensures that the disclosure exemption will not apply to an interest held in any foreign company interposed between the taxpayer and any underlying foreign company which is not exempted from the requirement to disclose.

Example - Category 3(ii)

NZ Ltd held at all times during the 1992 income year a 50% income interest in B Ltd, resident in Australia. B Ltd held at all times a 50% income interest in HK Ltd (resident in Hong Kong). NZ Ltd has not made an election under s.245Y(2).

The exemption does not apply to the interest held by NZ Ltd in HK Ltd, as:

(i) the interest is an income interest of 25% (50% x 50%), being an "income interest of 10% or greater"; and

(ii) Hong Kong is listed on the Seventeenth Schedule.

Therefore NZ Ltd would have to complete Part A of an IR 4G form in relation to its 50% control interest in HK Ltd. (NZ Ltd would also have to complete Part B of that form to attribute income from HK Ltd in relation to its 25% income interest, as that interest is an "income interest of 10% or greater".)

As the exemption does not apply to NZ Ltd's interest in the underlying company HK Ltd, the exemption does not preclude disclosure of NZ Ltd's interest in B Ltd.

Therefore, NZ Ltd would also have to complete Part A of a separate IR 4G form in relation to its 50% interest held in B Ltd.

Summary

For the 1992 income year, an interest held in a foreign investment fund will not have to be disclosed.

An interest held in a foreign company will not generally have to be disclosed for that year, where that interest is not an "income interest of 10% or greater", or where there is no requirement to attribute foreign income or loss under the CFC regime in relation to that company and any underlying foreign company.

Persons not required to comply with Section 245W of the Income Tax Act 1976

This Exemption may be cited as "International Tax Disclosure Exemption D3"

1. Reference

This exemption is made pursuant to section 245W(2) of the Income Tax Act 1976. It details interests in foreign companies and foreign investment funds in relation to which any person is not required to comply with section 245W of the Income Tax Act 1976 for the income year commencing 1 April 1991.

2. Interpretation

In this exemption, unless the context otherwise requires, expressions used have the same meaning as in section 2 or Part IVA of the Income Tax Act 1976.

3. Exemption

Any person who has an income interest or a control interest in a foreign company of a type specified below, or an interest in a foreign investment fund, in the income year commencing 1 April 1991, shall not be required to comply with section 245W(1) of the Income Tax Act 1976 in respect of that foreign company or foreign investment fund and that income year.

1. The foreign company is a foreign company in which the interest held by that person during any accounting period (the last day of which falls within that income year of the person), would not constitute an "income interest of 10% or greater", as defined by section 245A of the Income Tax Act 1976, as if the foreign company was a controlled foreign company.

2. The foreign company was at all times, during any accounting period (the last day of which falls within that income year of the person), resident in a country or territory that is not specified in the Seventeenth Schedule to the Income Tax Act 1976; and

(a) the person has not made an election in terms of section 245Y(2) of the Income Tax Act 1976; and

(b) the person did not hold at any time during that income year an interest in any underlying foreign company, which would constitute for that accounting period an "income interest of 10% or greater", as defined by section 245A of the Income Tax Act 1976, as if that underlying foreign company was a controlled foreign company to which Parts 2 and 2(a) of this exemption does not apply.

This exemption is made by me acting under delegated authority from the Commissioner of Inland Revenue pursuant to section 11 of the Inland Revenue Department Act 1974.

This Exemption is signed on the 5th day of April 1992.

Joy Hames
Director - Taxpayer Audit

Due Dates Reminder

April

30 GST return and payment for period ended 31 March 1992 due.

May

5 PAYE deductions and IR 66ES for last 15 days of April due - "large" employers only.

7 First instalment of 1993 provisional tax due for taxpayers with January balance dates.

Second instalment of 1992 provisional tax due for taxpayers with September balance dates.

Third instalment of 1992 provisional tax due for taxpayers with May balance dates.

14 RWT on interest deducted during April 1992 due for monthly payers.

RWT on dividends deducted during April 1992 due.

Non-Resident Withholding Tax deducted during April 1992 (or approved issuer levy) due.

20 PAYE deductions and IR 66ES for first 15 days of May due - "large" employers only.

PAYE deductions and IR 66ES for April due - "small" employers.

Gaming Machine Duty return and payment for month ended 30 April 1992 due

29 GST return and payment for period ended 30 April 1992 due.

31 Employer wage reconciliation statement (IR 68) and payment of Employer AC levy due

Specified Dividend Reconciliation (IR 17S or IR 17SA) for RWT on dividends due.

31 Annual reconciliation statement (IR 15S) due for RWT on interest.

June

5 PAYE deductions and IR 66ES for last 16 days of May due - "large" employers only.

7 First instalment of 1993 provisional tax due for taxpayers with February balance dates.

Second instalment of 1993 provisional tax due for taxpayers with October balance dates.

Third instalment of 1992 provisional tax due for taxpayers with June balance dates.

IR 5 Income Tax returns due to be filed.

14 RWT on interest deducted during May 1992 due for monthly payers.

RWT on dividends deducted during May 1992 due.

Non-Resident Withholding Tax deducted during May 1992 (or approved issuer levy) due.

20 PAYE deductions and IR 66ES for first 15 days of June due - "large" employers only.

PAYE deductions and IR 66ES for May due - "small" employers.

Gaming Machine Duty return and payment for month ended 31 May 1992 due

Payment of debit Imputation balances due

30 GST return and payment for period ended 31 May 1992 due.

Final day for "small employers" to elect to pay FBT annually.