Tax Information Bulletin

Volume Three, No. 9 June 1992

Contents

1992 Average Market Values of Specified Livestock 2

Accrued Monetary Remuneration and Holiday Pay 5

Balance Date Policy 7

New Record Retention Period 9

Accrual Determinations Recently Signed by the Commissioner 9

Earner and Employer Premiums Introduced 10

Interest Deductibility 14

FBT - Prescribed Rate of Interest for Quarter commencing 1 April 1992 18

Due Dates Reminder 18

Correction - TIB Volume Three, No.8

In TIB Volume Three No.8 there was an article on a recent Disclosure Exemption issued by the Commissioner. Unfortunately, the last line of the article was missed off when it was printed.

The last paragraph should read:

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.

ISSN 0114-7161

1992 Average Market Values of Specified Livestock

Under the authority of section 86D of the Income Tax Act 1976 (the Act) the Governor-General, by Order in Council, has announced the average market values of specified livestock for the 1991-1992 income year.

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

Note: For the 1992 income year the standard values are set at the lesser of the values applying last year (the lesser of the 1990 and 1991 standard values) and the values calculated for the 1992 year. This further "capping" of the standard values was made possible by an amendment to section 86 of the Act, and was part of the interim measures recommended to Government by the Livestock Valuation Consultative Committee.

Type and class of Livestock	Standard value (see "Note" above) $ c	Herd Value (Average Market Values) $ c	Trigger price for High Priced Livestock $ c
SHEEP:			
Ewe hoggets	14.28	24.60	100
Ram and wether hoggets	14.28	24.60	100
Two-tooth ewes	19.51	34.30	137
Mixed age ewes (rising three and four year old ewes	11.88	21.20	100
Rising five year and older ewes	9.73	13.00	100
Mixed age wethers	11.50	14.60	100
Breeding rams	103.90	175.30	701

Type and class of Livestock	Standard value (see "Note" above) $ c	Herd Value (Average Market Values) $ c	Trigger price for High Priced Livestock $ c
BEEF CATTLE:			
Beef Breeds and Beef Crosses			
Rising one-year heifers	143.50	307.00	921
Rising two-year heifers	212.80	430.00	1,290
Mixed age cows	229.37	406.00	1,218
Rising one-year steers and bulls	193.67	389.00	1,167
Rising two-year steers and bulls	345.57	551.00	1,653
Rising three-year and older steers and bulls	419.53	748.00	2,244
Breeding bulls	844.33	1,927.00	5,781

Type and class of Livestock	Standard value (see "Note" above) $ c	Herd Value (Average Market Values) $ c	Trigger price for High Priced Livestock $ c
DAIRY CATTLE:			
Freisian and Related Breeds			
Rising one-year heifers	161.23	276.00	828
Rising two-year heifers	301.23	476.00	1,428
Mixed age cows	286.53	491.00	1,473
Rising one-year steers and bulls	145.83	327.00	981
Rising two-year steers and bulls	311.97	464.00	1,392
Rising three-year and older steers and bulls	419.53	748.00	2,244
Breeding bulls	575.17	1,053.00	3,159
Jersey and Other Dairy Breeds			
Rising one-year heifers	145.83	280.00	840
Rising two-year heifers	275.57	427.00	1,281
Mixed age cows	219.80	348.00	1,044
Rising one-year steers and bulls	119.70	353.00	1,059
Rising two-year steers and bulls	291.90	537.00	1,611
Breeding bulls	401.33	796.00	2,388

Type and class of Livestock	Standard value (see "Note" above) $ c	Herd Value (Average Market Values) $ c	Trigger price for High Priced Livestock $ c
DEER:			
Red Deer			
Rising one-year hinds	76.00	76.00	228
Rising two-year hinds	159.00	159.00	477
Mixed age hinds	136.00	136.00	408
Rising one-year stags	119.00	119.00	357
Rising two-year and older stags (non-breeding)	199.50	216.00	648
Breeding stags	495.00	1,402.00	4,206

Type and class of Livestock	Standard value (see "Note" above) $ c	Herd Value (Average Market Values) $ c	Trigger price for High Priced Livestock $ c
DEER:			
Wapiti, Elk and Related Crossbreeeds Rising one-year hinds	73.00	73.00	219
Rising two-year hinds	270.00	270.00	810
Mixed age hinds	297.50	305.00	915
Rising one-year stags	125.00	125.00	375
Rising two-year and older stags (non-breeding)	232.63	239.00	717
Breeding stags	860.00	1,529.00	4,587
Other Breeds (Fallow/Sika etc.): Rising one-year hinds	44.00	44.00	132
Rising two-year hinds	92.00	92.00	276
Mixed age hinds	94.00	94.00	282
Rising one-year stags	37.00	37.00	111
Rising two-year and older stags (non-breeding)	68.00	68.00	204
Breeding stags	251.30	350.00	1,050

Type and class of Livestock	Standard value (see "Note" above) $ c	Herd Value (Average Market Values) $ c	Trigger price for High Priced Livestock $ c
PIGS:			
Breeding sows less than one year of age	73.03	109.00	327
Breeding sows over one year of age	123.67	187.00	561
Breeding boars	165.90	252.00	756
Weaners less than 10 weeks of age (excluding sucklings)	26.60	39.00	117
Growing pigs 10 to 17 weeks of age (porkers/baconers)	71.87	106.00	318
Growing pigs over 17 weeks of age (baconers)	108.03	172.00	516

Type and class of Livestock	Standard value (see "Note" above) $ c	Herd Value (Average Market Values) $ c	Trigger price for High Priced Livestock $ c
Angora and Angora Crosses (Mohair Producing):			
Rising one-year does	8.63	12.00	100
Mixed age does	5.83	10.00	100
Rising one-year bucks (non-breeding)/wethers	4.67	5.00	100
Bucks (non-breeding)/ wethers over one year	7.00	7.00	100
Breeding bucks	48.00	100.00	100
Other Fibre and Meat Producing Goats (Cashmere and Cashgora Producing):			
Rising one-year does	6.07	8.00	100
Mixed age does	4.67	6.00	100
Rising one-year bucks (non-breeding)/wethers	2.33	3.00	100
Bucks (non-breeding)/ wethers over one year	4.90	7.00	100
Breeding bucks	25.00	25.00	100
Milking (Dairy) Goats:			
Rising one-year does	4.67	50.00	200
Does over one year	9.57	80.00	320
Breeding bucks	69.07	200.00	800
Other dairy goats	4.90	7.00	100

Accrued Monetary Remuneration and Holiday Pay

Introduction

Section 13 of the Income Tax Amendment Act (No 3) 1991 recently amended section 104A of the Income Tax Act 1976. Since then, Inland Revenue has received enquiries on what constitutes holiday pay, and how the new provisions apply in practice.

This item outlines the treatment of accrued monetary remuneration and our interpretation of holiday pay.

Background

The Income Tax Amendment Act (No. 3) 1991 changed the tax treatment of the accrual and payment of monetary remuneration. In reconciling the deductibility of monetary remuneration with the date the expense is actually incurred, the new provisions specify a set period after the end of the income year by when remuneration must be paid out if a deduction is to be allowed for that income year. This period is 63 days for employees, but remuneration for shareholder-employees must be paid out before the 31 March date that is the last possible date to which an extension of time for filing may be granted. This gives 6 to 18 months, depending on the company's balance date. Where the time limit is not met, the monetary remuneration is deductible in the year in which it is paid.

Where monetary remuneration is paid to shareholder-employees, section 75(3) deems them to have derived it in the same income year in which the company is allowed a deduction under the above rules.

These provisions take effect for the 1990/91 income year for monetary remuneration other than holiday pay payable to employees. For holiday pay payable to employees, the provisions take effect in the 1991/92 income year.

Interpretation of Holiday Pay

Inland Revenue interprets "holiday pay" as payment in relation to holidays as expressed as an employee's minimum entitlement under section 7A and section 11 of the Holidays Act 1981, and any payment for holidays provided for in an Employment Contract that are of a similar nature as those provided for in the Holidays Act.

Thus, holidays are of two kinds: statutory holidays and annual leave.

Section 7A of the Holidays Act covers statutory holidays. They are: Anniversary day, Christmas Day, Boxing Day, New Year's Day and the following day, Labour day, Waitangi Day, Good Friday and Easter Monday, Anzac Day, and Queen's Birthday Observance.

Section 11 of the Holidays Act provides for a minimum of 3 weeks' annual leave. Any other holiday leave provided for in an Employment Contract that is of the same nature as that provided for in section 11 of the Holidays Act is also included. This means any further annual leave over and above the 3 weeks' statutory minimum is included as holiday pay.

If an industry or company provides for a certain day of the year as a holiday, such as Accountant's holiday or Bank holiday or Company Anniversary, payment for this day is included as holiday pay.

Holiday pay does not include long service leave, retirement leave, sick leave, or any other accruing entitlements in respect to employee remuneration.

Calculating the Deductible Portion

With annual leave, the calculation is straightforward;

- For employees, the company can deduct any holiday pay incurred in the income year which has been taken and paid, or paid out in lieu of leave, in that year or within 63 days.
- For shareholder-employees, the company can deduct any holiday pay incurred in the income year which has been taken (paid out) in that income year or before the relevant 31 March.

The calculation for monetary remuneration in general is exactly the same.

With statutory holidays, the company can claim a deduction if:

- an employee or shareholder employee does not work on the statutory holiday and receives payment for that day; or
- an employee has worked on a statutory holiday and has been granted a holiday on another day in return, and this day is taken and paid out in the same income year, or within 63 days of the end of the income year (or, for shareholder-employees, by the relevant 31 March date).

Note that for factory workers, section 25 of the Holidays Act provides for payment for a statutory holiday to employees whose employment is terminated within the fortnight prior to that statutory holiday. Such payments are calculated in accordance with section 25 of the Holidays Act. They constitute holiday pay and are deductible if paid in the income year, or if the income year includes part of the fortnight prior to the statutory holiday and payment is made within 63 days.

Deductions where Conditions not met

Where the 63 days or the 31 March date conditions are not met, and holiday pay (or monetary remuneration in general) is paid out after the time limit, it is deductible in the next income year in which the conditions are met.

Ordering Requirements

There will already be substantial "stocks" of accrued holiday pay for which companies have previously been allowed a deduction. The legislation does not specify what ordering system should be used for accrued holiday pay. In accordance with the principle from *Clayton's Case; Devaynes v. Noble (1816) 35 ER 781,* the crediting of holidays taken against holiday leave entitlements will be deemed to be paid out on a first-in-first-out basis. An employer must use up the existing "stock" for an employee before they can credit leave against newly accruing leave entitlements.

The same first-in-first-out rules apply to all accruals of monetary remuneration.

Example 1:

X is an employee of QRS Company Ltd. QRS has a 31 March balance date. X is entitled to four weeks' annual leave each year. As at 1 April 1991, QRS Ltd has accrued holiday pay of two weeks for X. X takes three weeks annual holiday leave in January 1992 and a further two weeks annual holiday leave in May to coincide with the school holidays. X takes no further annual holiday leave that year.

Treatment:

By the start of the company's 1992 income year, holiday pay equivalent to two weeks' wages has already accrued for X. The first two weeks of holiday pay paid to X in January 1992 must be credited against the accrued holiday pay. The third week paid to X in January is deductible by QRS Ltd for the 1992 income year as it falls inside the income year for which the holiday pay entitlements have accrued. The two weeks paid out in May is also deductible for the income year as it is paid out within 63 days of the end of the income year.

This leaves X with one week's unused holiday entitlement which becomes deductible by QRS Ltd in the income year in which it is paid out.

Example 2:

IJK Company Ltd has a 30 September balance date. It accrues a shareholder-employee remuneration of $150,000 in its financial statements to 30 September 1991 (i.e., the 1991 income year). The shareholder-employee is credited with $110,000 on 28 February 1992, and the remaining $40,000 is credited on 30 April 1992.

Treatment:

In this case, the key date is 31 March 1992. That is the last date for payment of the shareholder-employee remuneration for the 1991 income year if a deduction is to be allowed for that year. Thus, IJK Ltd may deduct the $110,000 credited on 28 February in the 1991 income year, but the remaining $40,000 credited on 30 April 1992 must be deducted in the 1992 income year.

Under section 75(3), the shareholder-employee will be deemed to have derived the $110,000 in the same income year as IJK is allowed a deduction.The $110,000 must therefore be included in the shareholder's 1991 return.

Application Dates

The provisions for monetary remuneration other than holiday pay take effect from the 1990/91 income year. Those applying to holiday pay take effect from the 1991/92 income year.

Balance Date Policy

Introduction

This article sets out Inland Revenue's policy on balance dates for income tax purposes. Taxpayers may adopt a balance date other than 31 March (a "non-standard balance date") where:

- the nature of their business makes a 31 March balance date inappropriate; or
- a subsidiary wishes to align its balance date with its parent company; or
- an estate wishes to adopt the deceased's date of death; or
- a shareholder-employee wants the same balance date as the company.

This item sets out the criteria which we will follow when we receive a request for a non-standard balance date.

Current Practice

Section 2 of the Income Tax Act 1976 defines "income year" to mean the "year" in which the income is derived. This means a year commencing on 1 April and ending on the following 31 March. Returns of income must therefore cover the year ended 31 March.

However, section 15 allows a taxpayer (with the consent of the Commissioner) to elect to furnish a return of income for the year ending on the date of the annual balance of the accounts. In these cases the income derived during the accounting year is deemed to be derived for tax purposes during the income year ending on the 31 March nearest to the taxpayer's balance date.

All balance dates from 1 April to 30 September inclusive in the same calendar year relate to the

previous 31 March, and all balance dates from 1 October to 30 March inclusive relate to the following 31 March.

Examples:

Accounting Year	Corresponding Income Year
31 October 1991	31 March 1992
28 February 1992	31 March 1992
30 June 1992	31 March 1992
30 September 1992	31 March 1992

Currently, a small number of recognised industry non-standard balance dates are approved.

We have completed a review of our policy, and there are more circumstances in which we will approve a non-standard balance date. These are set out below.

The Circumstances

1. The nature of the business makes a 31 March balance date inappropriate.

   We will grant a non-standard balance date where it would help a business that is operating in an environment in which 31 March is not the most appropriate balance date.

   Some businesses have a "natural" end to their income year such as the end of a growing period, the end of a seasonally busy period, or the time in the annual business cycle in which the majority of income and their relevant costs can be brought to account. Examples of businesses which could have "natural" income years not ending on 31 March include manufacturers, retailers, wholesalers, professionals, the tourism industry, farmers, horticulturists, and service related industries.

   Without limiting the range of businesses that may have non-standard balance dates, these balance dates are commonly recognised:

Apiarists	- 30 Nov or 31 Dec
Education/Childcare related services	- 31 December
Farmers, cattle	- 31 May
dairy	- 31 May
sheep	- 30 June
Fishing Industries	- 30 September
Horse Breeders	- 31 July
Meat Processing and Export	- 31 August to 1 October
Orchardists, Pipfruit	- 31 March to 30 June
Kiwifruit	- 31 March to 30 June
Seed dressers	- 30 November
Tobacco growers	- 31 July

2. The date coincides with the balance date of a parent company, except where the change would result in a significant deferral of income.

3. For continuing estates, the date coincides with the date of death of the deceased taxpayer.

4. For shareholder employees, the date coincides with the balance date of the company in which they are major shareholders and from which they derive their main source of income.

   If they are major shareholders in more than one company, their balance date should be aligned to the balance date of the company which provides their main source of income. If no main source of income can be identified, the choice of which company's balance date to align with should be the taxpayer's.

Information We Need

An application for a non-standard balance date must be in writing, and must fully state the reasons for the application.

We need the following information ***before*** we can consider a request for a non-standard balance date:

1. Full name of the entity seeking the balance date
2. Name of the tax agent
3. Full details of the reasons why a non-standard balance date should be approved
4. If the request is because a 31 March balance date is inappropriate for the taxpayer's particular business, we will also need:
   - If the business is already in operation:
     - details of cash flows
     - details of stock patterns
     - details of customer demand
     - details of seasonal patterns
     - other evidence showing that financial information prepared to the proposed balance date will be more appropriate to the entity than information prepared to 31 March.
   - If the business is a new business we will need predictions of the factors set out above.

   If there is an industry balance date commonly recognised (as listed above), this will be strong evidence that a request for a similar balance date would be approved.

5. Whether the entity is associated with any other entities, and if so, the nature of the relationship and the balance dates of the other entities.

6. Any other reasons for requesting the balance date other than those already stated.

Unacceptable reasons for a Non-Standard Balance Date

The anniversary date of the commencement of the business is not a valid reason for a non-standard balance date.

We will not accept an application for a non-standard balance date if it is for reasons of tax deferral or tax avoidance, or to take undue advantage of any tax incentive or concession.

Reference: HO 10.B.2.1

New Record Retention Period

Introduction

In TIB Volume Three, No.6 of April 1992 and in a letter to practitioners, we stated that the new standard record retention period was now seven years. We also said that the Commissioner could extend this period by up to three years for taxpayers who are being or have been audited or investigated, or for taxpayers whom we are considering for an audit or an investigation.

We have been asked to clarify the position for back year records already being held, and for taxpayers whom we are considering for an audit or investigation.

Retention Period

As from 1 April 1992, taxpayers are not required to retain records for activities earlier than year ended 31 March 1985, i.e. the seven year period will apply immediately.

Non Standard Balance Dates

For non standard balance dates, the seven year period runs in line with the balance date.

For example:

A taxpayer has an early balance date, e.g. 30 November 1984. This relates to the period ended 31 March 1985 and the seven year period runs to 30 November 1991.

A taxpayer has a late balance date, e.g. 30 June 1985. This relates to the period ended 31 March 1985 and the seven year period runs until 30 June 1992.

Audit/Investigations

Where we are considering a taxpayer for an audit or investigation, we will administer the new legislation on the basis that if we have not advised a taxpayer in writing that records must be kept beyond the seven year period for an audit or investigation, then the records may be destroyed.

Accrual Determinations Recently Signed by the Commissioner

The Commissioner signed these two accrual determinations on 28 May 1992:

Determination G17B: Deferred Property Settlements Denominated in New Zealand Currency

This determination rescinds and replaces Determination G17A: *Discounted Value of Amounts Payable in Relation to Deferred Property Settlements Denominated in New Zealand Currency*, which the Commissioner signed on the 9th day of February 1990.

This determination differs from Determination G17A:

(a) by expanding the scope of the determination to ensure the acquisition price, for the purposes of the base price adjustment, must be determined in all circumstances;

(b) by making it clear that if all the amounts payable - and the dates on which those amounts are payable - are known at the first balance date after the transfer date, the yield to maturity method must be applied to calculate income derived or expenditure incurred during the term of the deferred property settlement;

(c) by providing a method of calculating income derived or expenditure incurred during the term of a deferred property settlement where the amounts payable or the dates on which those amounts are payable are not known with certainty at the first balance date after the transfer date; and

(d) In the use of the specified rate. This determination uses the method prescribed in Determination G23: *Specified Rate*. Determination G17A used the market yield ascertained in accordance with Determination G13: *Prices or Yields*.

This determination is made pursuant to sections 64E(1)(a), 64E(1)(f), and 64E(6) of the Income Tax Act 1976.

Determination G25: Variations in the Terms of a Financial Arrangement

This determination applies where a financial arrangement is subsequently varied, but not to the extent that the financial arrangement matures or is fully remitted.

The variation may have been contemplated or anticipated in the original financial arrangement, such as an exercisable option. The determination requires an adjustment to be made in the year of variation. This adjustment results in the total income or expenditure at the end of the year of variation to be equal to what it would have been had the timing and details of the variation(s) been known at the date of issue or acquisition.

The determination's methodology is similar to that used in:

i) section 64D(4) of the Act where a taxpayer ceases to be a non cash basis holder; or

ii) section 64C(2A) of the Act where a taxpayer may opt to calculate income or expenditure by straight line method.

This determination is made pursuant to section 64E(1) of the Income Tax Act 1976.

Both of these determinations are reproduced in Appendix A to this TIB.

Earner and Employer Premiums Introduced

Accident Rehabilitation and Compensation Insurance Act 1992

Introduction

The Accident Rehabilitation and Compensation Insurance Act (ARCI Act) 1992 was assented to on Wednesday 1 April 1992. It introduces a new premium on earners, and replaces both the old self-employed levy and the employer levy with an employer premium.

The earner premium applies from 1 April 1992. The employer premium comes into force on 1 July 1992 and applies for the 1992/93 income year.

Inland Revenue collects the premiums on behalf of ACC (AR & CI Corporation)

Earner Premium - Section 114, ARCI Act 1992

All employees, self employed taxpayers and people receiving withholding payments will pay the earner premium on their employment or self employed income, at the rate of 70 cents per $100 earned (0.7%).

The maximum income on which the ACC (AR & CI Corporation) will pay out compensation is 80 percent of $76,648. Therefore the maximum amount of earner premium that can be paid on the combined income is $536.53 (0.7% x $76,648).

This premium is levied on income received on or after 1 April 1992. It will fund the cost of non-work related accidents suffered on or after 1 July 1992.

Employees

- All employees pay the earner premium on all salary or wages and extra emoluments they receive, ***excluding:***
  - Income tested benefits, veterans' pension, national superannuation, or living alone payments;
  - Any student allowance as defined in section 303 of the Education Act 1989;
  - Any excessive salary assigned to a relative of a partner or shareholder under sections 97 or 190 of the Income Tax Act;
  - Any amount of excessive remuneration paid to a shareholder employee under regulation 10 of the Accident Rehabilitation and Compensation Insurance (Earnings Definitions) Regulations 1992.
  - Any amounts paid to a spouse of an employee under regulation 11 of the Accident Rehabilitation and Compensation Insurance (earnings definitions) Regulations 1992, where no deduction is allowed for the amounts paid under the Income Tax Act.

Employers will deduct the premium from employees' wages along with PAYE tax deductions. To reduce the impact on employers, the new premium has been included in the new PAYE tables. Employers will ***not*** have to separate out the earner premium each pay day.

As with income tax, the employer is acting as agent for the Inland Revenue Department (ultimately the ACC) in the collection of earner premium. This means the employer cannot claim a GST input tax credit for the earner premium deducted from employees.

At the end of the income year employers must show the amount of earner premium deducted on

their employees' IR 12 PAYE deduction certificates. This involves a simple calculation in the space provided on the certificate. The rules for paying and collecting earner premium are the same as those applying to tax deductions.

The IR 68 Employer PAYE Reconciliation Statement also requires employers to separate out the earner premium amount from the total deductions, so it can be transferred to the ACC.

Self Employed People

All self-employed taxpayers and people who receive withholding payments will be assessed for earner premium on their "earnings other than as an employee". This is defined as being their net assessable income, apart from employment income, that they derive from sources which:

- are dependent on their personal exertions; and
- would cease if they suffered an incapacity.

This condition ensures that passive income like interest and dividends are not subject to the premium, since they continue regardless of any incapacity the recipient may suffer.

These people will calculate their earner premium when they file their tax returns at the end of the income year. It will be due for payment on the same date as any income tax is due and payable. For taxpayers with a 31 March balance date, this will generally be 7 February of the following year.

Self-employed people and those receiving withholding payments who work for an average of 30 hours or more a week must also pay a minimum employer premium. For those who are 20 years of age or over and whose total liable earnings are less than $12,740 per annum, the minimum premium is $79.27 (GST exclusive), reduced by the earner premium payable on their earnings as employees;

For people under 20 years of age whose total liable earnings are less than $10,190, the minimum premium is $63.41 (GST exclusive), reduced by the amount of the premium they pay on their earnings as employees.

Employer Premium - Sections 101 to 104, ARCI Act 1992

The current self-employed levy and employer levy will be known as the employer premium. This premium is imposed to cover the cost of work related accidents. It will be experience rated to encourage employers to provide safe working conditions for their staff.

Employers will pay the employer premium on the total amount of salaries and wages they pay to their employees. Self-employed taxpayers and recipients of withholding payments will pay earner premium on the total amount of their "earnings other than as an employee" (defined above), after deducting their expenses.

For employers, the employer premium is assessed on the IR 68 Employer PAYE Reconciliation Statement, and payment is due on 31 May.

The premium is set at a basic rate to reflect the safety level of the particular industry involved. Later, employers will have their basic rate increased or decreased to reflect the number of claims for work accidents their employees make (experience rating). This will be handled by ACC separately from Inland Revenue systems.

For self-employed people, the current rules for minimum part time and full time levies will operate for the 1993 year. This means that there will be two different sets of rules and income levels for the earner premium and employer premium.

Taxation of Compensation - Sections 2 and 61, Income Tax Act 1976

Amendments to the Income Tax Act ensure the following forms of income provided under the ARCI Act are subject to income tax:

- compensation for loss of earnings under sections 38 and 39;
- increase in weekly earnings for earners in full time employment under section 43;
- vocational rehabilitation allowance under section 25;
- compensation for loss of potential earnings capacity under sections 45 and 46;
- weekly compensation payable to a dependent spouse under section 58;
- weekly compensation payable to dependent children under section 59;
- weekly compensation payable to other dependants under section 60.

(References are to sections of the ARCI Act 1992)

The new compensation payments which are taxable are also included in assessable income for Family Support and Guaranteed Minimum Family Income tax credit purposes.

References in the Income Tax Act to earnings related compensation payable under the Accident Compensation Act 1982 have been amended to incorporate references to compensation payable under the ARCI Act.

The provisions of the Income Tax Act relating to exempt income enable income expressly exempted from income tax under any other Act to be exempt from income tax in terms of the Income Tax Act (section 61(50) refers).

Section 76 of the ARCI Act exempts the following forms of income from income tax:

- any independence allowance payable under section 54;
- any survivor's grant payable under section 56;
- any funeral grant payable under section 55;
- any payment under the ARCI Act or regulations made under that Act to an injured person for rehabilitation.

Premiums Deemed to be Income Tax for Collection and Penalty Purposes

Section 115(2) of the ARCI Act provides that Part XI of the Income Tax Act shall apply with all necessary modifications to:

- earnings as an employee;
- earner premium payable as if the premium were tax deductions made on account of income tax;
- any employee under the ARCI Act as if such employee were an employee in terms of Part XI of the Income Tax Act;
- any employer under the ARCI Act as if such employer were an employer in terms of Part XI of the Income Tax Act.

Every employer and employee shall comply with Part XI to the extent to which Part XI applies to them by virtue of section 115(2) of the ARCI Act 1992

Penalties for Offences - Section 115(5) to (10), ARCI Act 1992

In relation to earner premium an offence is committed against the ARCI Act where:

- an employer fails to make a deduction of premium;
- an employer fails to make payment of the deduction;
- anyone gives false information or misleads the corporation;
- anyone causes any employer to refrain from making a deduction;
- anyone obtains or attempts to obtain a benefit from the amount of any premium deducted.

Anyone convicted of one of these offences will be liable for:

- a fine of up to $15,000 on the first occasion for each offence; and
- a fine of up to $25,000 on the second and subsequent occasions for each offence.

Anyone who knowingly permits the deducted earner premium to be used for a purpose other than payment to Inland Revenue as agent for the Corporation will be liable for:

- a prison term of up to 12 months or a fine of up to $15,000 on the first occasion for each offence ; and
- a prison term of up to 12 months or a fine of up to $25,000 on the second and subsequent occasion for each offence.

No-one will be convicted of an offence under section 115 of the ARCI Act where they have been convicted of an offence under section 368(1) of the Income Tax Act 1976, and if the premium was deemed to be a tax deduction, the premium would have come under the same offence.

Inland Revenue will impose and collect these penalties.

Penal Premium

Employee Earner Premium Deductions - Section 115(11) to (13) and section 119, ARCI Act 1992

Where employers:

- fail wholly or in part to make a deduction of earner premium; or
- knowingly apply or permit to be applied, the amount of any earner premium deduction to purpose other than the payment to Inland Revenue as agent for the Corporation,

they may be charged with penal premium of an amount up to treble the deficient premium. Inland Revenue will assess and collect the premium as if it were penal tax under sections 420-426 of the Income Tax Act 1976.

Employers will not be charged penal premium where they have deducted earner premium and have not paid it to Inland Revenue, but can show that this failure to pay was due to illness, accident or circumstances beyond their control.

Other Premiums - Section 119, ARCI Act 1992.

Anyone who evades, attempts to evade or does or omits to do anything with intent to evade the payment of employer premium may be charged penal premium.

Penalty for Non-Payment or Late Payment - Section 115(14) to (16) and 118, ARCI Act 1992

Employers who:

- fail to make a deduction of earner premium; or
- fail to pay the deduction to Inland Revenue as agent for the Corporation; or
- are liable to pay an amount to Inland Revenue as agent for the Corporation, but fail to do so,

may (without conviction) be charged a penalty of 10 percent on the amount of the earner premium that remains outstanding after the due date. Inland Revenue will impose and collect this penalty, which compounds at the rate of 10 percent at 6 monthly intervals. This penalty is in addition to any other penalty.

Late payment penalty will also be imposed on any outstanding employer premium and earner premium payable on earnings other than as an employee at the same rate.

Recovery of Earner Premium from Assets of Employer - Section 115(17), ARCI Act 1992

Where an employer makes an earner premium deduction and fails to pay the deduction to the Corporation or agent of the Corporation, the deduction shall rank equally with tax deductions as a charge against the employer's assets.

Private Domestic Workers - Section 115(18), ARCI Act 1992

Employers of private domestic workers do not have to deduct PAYE or earner premium deductions from payments to them. Instead, private domestic workers deduct their own PAYE and earner premium and pay the deductions to Inland Revenue on a monthly basis.

At the end of the income year Inland Revenue completes the IR 68 Employer PAYE Reconciliation Statement and gives a copy to the private domestic worker.

Private domestic workers calculate their employer premium in their IR 3 returns, and pay it with their end-of-year tax.

Deducting Premium from Payments due to Defaulters - Section 130, ARCI Act 1992

Where anyone has defaulted in paying any premium or penalty, the Corporation may issue any other person who owes money to the defaulter with a deduction notice. This notice will require the person making the payment to pay an amount specified in the notice to the Corporation rather than to the defaulter. The Corporation will also issue a copy of the notice to the defaulter.

If the Corporation issues a deduction notice to someone who owes money to the defaulter, the person receiving the notice commits an offence under the ARCI Act if they fail to pay the amount specified in the notice to the Corporation. Anyone convicted of this offence may be liable for a fine of up to $500.

ACC Access to Accounts and Books - Section 129, ARCI Act 1992

The Corporation shall have access to books and accounts of employers and earners who have earnings other than as employees, so it can ascertain the accuracy of their statements of earnings.

Small Balance Write-Off - Section 132, ARCI Act 1992

If the amount of the premium payable is $5 or less, earners and employers will not have to pay the premium and no penalty will be levied on this amount.

Child Rebate - Section 115(20), ARCI Act 1992

Where employers, acting in accordance with Inland Revenue rulings, have not made any tax deduction from salary or wages paid to a child because the child qualifies for the child rebate under section 50A of the Income Tax Act, they will not have to make an earner premium deduction.

Consequential Amendments to the Revenue Acts

Payment of Tax Deductions to the Commissioner - Section 353(1), Income Tax Act 1976

Amendments to this section require employers to show the amount of the total deductions (the combination of earner premium deductions and PAYE deductions) on the IR 12 deduction certificate and the IR 68 Employer PAYE Reconciliation Statement.

This section now includes definitions of “earner premium deductions” and “total deductions”.

Year in which Accident Compensation Levy, Earner Premium and Employer Premium are Deductible - Section 140A, Income Tax Act 1976

This section deals with the timing of the deduction allowed under section 104 for premiums paid by employers and self employed taxpayers. The employer premium and the premiums paid by self employed taxpayers are deductible in the year in which they become due and payable by the taxpayer.

Transitional Tax Allowance Rebate - Section 50C, Income Tax Act 1976

Anyone who would have been working if they had not suffered a personal injury (for which they are receiving earnings related compensation under the Accident Compensation Act 1982) may claim the transitional tax allowance rebate.

This section is amended so people can claim the rebate where they are receiving compensation under the ARCI Act.

Amendments to GST Act

There are two consequential amendments to the Goods and Services Tax Act 1985.

The definition of the term "supply" in section 5(13) of the GST Act is amended to ensure that indemnity payments for loss of earnings paid out under the ARCI Act are not subject to GST.

The input tax provisions of the GST Act (section 20(3)(v)) are also amended so that no input tax credit is allowed for indemnity for loss of earnings paid under the ARCI Act 1992.

Amendments to Inland Revenue Department Act

The Inland Revenue Department Act has been amended so that it refers to the new ARCI Act and Corporation, and to the new forms of taxable compensation provided by the ARCI Act.

Interest Deductibility

Section 106(1)(h)(i) and (ia), Income Tax Act 1976

Summary

This statement sets out the Commissioner's policy on interest deductibility under section 106(1)(h)(i) and (ia), and provides examples of its application. It also contains an analysis of the leading cases on interest deductibility underlying the policy.

The Commissioner will allow an interest deduction if the interest has sufficient nexus with the income earning process. This depends on whether the borrowed capital is used in gaining or producing assessable income in the period in which the deduction is claimed, or in the future.

The new policy broadens the scope of interest deductions available to taxpayers. The Commissioner will not deny an interest deduction simply because the taxpayer also makes a capital gain or loss in a given income year.

Introduction and Application

This statement outlines the Commissioner's interpretation of section 106(h)(1)(i) and (ia). It replaces the statement entitled "Deductibility of Interest" in Public Information Bulletin No. 163 of May 1987. That earlier statement dealt with section 106(1)(h)(i); the previous interest deductibility provision.

This new policy will apply to all cases from the date of release of this statement, including the cases presently under review.

The Commissioner's current policy on section 106(1)(h)(ii) is in PIB No. 178 (February 1989).

We will consider any request to reopen an assessment on this point in terms of the Commissioner's policy on reopening assessments (see PIB No. 123 of January 1984).

This statement contains -

- a brief history of the interest deductibility provision
- a statement of the Commissioner's current policy on the deductibility of interest
- examples of application of the policy
- a discussion on the case law underlying the policy statement

Background

Section 106(1)(h) sets out the three current tests for the deductibility of interest. It provides that no deduction shall be made for interest, except so far as the Commissioner is satisfied that -

(a) it is payable in gaining or producing the assessable income for any income year; or

(b) it is necessarily payable in carrying on a business for the purpose of gaining or producing the assessable income for any income year; or

(c) it is payable by one company in a group of companies on money borrowed to acquire shares in another company in that group of companies.

The present section is similar to section 104, and resulted from an amendment to the Act in 1987. The Commissioner views the treatment of interest deductions as unchanged despite the change in the language of the section.

The leading cases on the deductibility of interest on borrowed capital have all related to the previous form of section 106(1)(h). In particular, the decisions in *CIR* v *Brierley* (1990) 12 NZTC 7184, *Eggers* v *CIR* (1988) 10 NZTC 5153 and *Pacific Rendezvous* v *CIR* (1986) 8 NZTC 5146 applied the previous words of the section. *Public Trustee* v *C of T* [1938] NZLR 436 considered section 80(1)(h) of the Land and Income Tax Act 1923, an analogous earlier provision.

Policy

Section 106(1)(h)(i)

Section 106(1)(h)(i) allows an interest deduction in so far as the interest is payable in gaining or producing assessable income.

The Commissioner will consider the use of the capital for which the interest is paid to determine whether there is sufficient nexus between the interest and the gaining or producing of assessable income to meet the test for deductibility. The interest will be deductible where:

(i) the related capital is used in the period the deduction is claimed to produce assessable income in any income year; and

(ii) no identifiable part of that capital is used for the whole or part of that period in other ways (such as private or domestic use, or a use that produces exempt income).

The interest will not be fully deductible if part of the capital is used for a private or domestic use or a use that is incapable of producing assessable income in the period the deduction is claimed or in the future. In this case only the portion of the interest relating to the income producing use will be deductible. See the "Apportionment" section below for more information about this.

The onus is on the taxpayer to establish the degree to which the capital is used in the period in question in the production of assessable income. The taxpayer must show the factual basis of the claim. If that onus is discharged, the entire amount of interest is deductible. Whether the taxpayer’s evidence discharges that onus is a matter of degree and a question of fact.

Section 106(1)(h)(ia)

Section 106(1)(h)(ia) allows an interest deduction in so far as the interest expenditure is necessarily payable in carrying on a business for the purpose of gaining or producing assessable income.

This subsection only applies to taxpayers in business. They, as well as people who are not carrying on business, may also claim some deductions under section 106(1)(h)(i). The inclusion of the second subparagraph allows further deductions for taxpayers in business, since it covers expenditure that may not be demonstrable as gaining or producing assessable income.

Whether income must be produced in year interest deduction claimed

Income does not have to be produced in the same income year in which the deduction is claimed under section 106(1)(h)(i) or (ia). However, income must be expected. Whether the income is expected is a subjective assessment of the intention of the taxpayer based on the particular circumstances of each case.

Deductibility of interest incurred to retain assets producing assessable income

Interest is deductible if a taxpayer establishes that the capital was borrowed to meet involuntary expenditure to retain assets used in producing assessable income. However, if the capital was borrowed for purposes quite alien from the income producing asset (such as meeting personal obligations), the interest will not be deductible.

Where the interest expenditure is incurred to retain some assets which produce assessable income and some which do not, it will have to be apportioned.

The onus is on the taxpayer to establish that the interest is deductible, and what proportion of it is deductible.

Expenditure under the accrual rules

Expenditure under financial arrangements is deemed to be interest. However, certain financial arrangements which give rise to deemed interest expenditure do not have any underlying capital (e.g., interest rate swaps). In these situations use of borrowed capital cannot determine whether the interest is deductible.

Whether the interest is deductible in this situation is a matter of degree and a question of fact. The focus of the enquiry is on whether there is sufficient relationship between the expenditure and the income earning process of the taxpayer claiming the deduction (see *CIR* v *Banks* (1978) 3 NZTC 61236).

Apportionment

Section 106(1)(h) contemplates apportionment of interest where there are competing uses. The Commissioner bases his approach to apportionment of interest on judicially developed guidelines.

The circumstances of each case will determine how much of the interest expenditure is deductible. There is no precise judicial formula, but case law establishes that the apportionment method must be fair and not arbitrary (see *Banks* and *Buckley and Young Ltd* v *CIR* [1978] 2 NZLR 485; (1978) 3 NZTC 61271). For example, actual use of the item during the period the interest has been payable, or the availability of the item for business use could be the basis for apportionment.

In some cases the competing advantages from the interest expenditure are intangible, and cannot be easily measured. The taxpayer must provide sufficient evidence to establish how much of the total interest expenditure is deductible. If the taxpayer fails to discharge this onus, none of the expenditure will be deductible.

Examples

The following examples illustrate the application of this policy.

Example 1

An individual borrows $10,000 at 10% p.a. to finance a purchase of shares in a company. No dividend is paid in the 5 income years following the purchase of the shares. The taxpayer pays interest on the loan in each of the five income years. Is the interest deductible?

Application: The individual can deduct the interest in full in each of the 5 income years because the capital is used in each year in gaining or producing assessable income. Even though the company paid no dividends, the interest will be deductible provided the company has no restriction in its articles of association preventing the payment of dividends in the future.

The interest is deductible as long as the shares are expected to earn assessable income. There is no requirement that assessable income be produced in the year the interest deduction is claimed. The interest is deductible under section 106(1)(h)(i); it cannot be deducted under section 106(1)(h)(ia) as the taxpayer is not in business.

Example 2

A taxpayer borrows a substantial amount of money, and uses it to buy a house for investment as part of a retirement plan. The house is rented at a market rental, but the interest exceeds the rental income earned. Can the taxpayer deduct the interest?

Application: The interest is fully deductible under section 106(1)(h)(i) in every year the property is let or is available for letting. The taxpayer's possible intention to make a capital gain from the house does not affect the deductibility. The interest deduction is not limited to the amount of income earned.

Section 106(1)(h)(ia) cannot apply as the taxpayer is not in business.

Example 3

In a particular income year a self-employed taxpayer uses part of her home as an office in connection with her business. She has a mortgage on the house. Is the interest on the mortgage deductible in that income year?

Application: There are two competing uses present - a private use and an income-earning use. The interest is deductible to the extent it is payable in gaining or producing assessable income. There must therefore be an apportionment between the two uses. In this situation the Commissioner would generally accept the apportionment on a floor area basis.

The deduction is available under section 106(1)(h)(i) and 106(1)(h)(ia).

Example 4

A New Zealand importer of sport shoes buys US shoes to sell in New Zealand. The importer pays for the shoes in US$, and then hedges the obligation to pay US$ by a forward foreign exchange contract. This contract later results in a foreign exchange loss.

Application: The exchange loss is deemed to be interest. This expenditure is deductible under section 106(1)(h)(i) and section 106(1)(h)(ia) as it has sufficient nexus with the taxpayer's income earning process (i.e., the selling of shoes).

Example 5

Company A, which is in business, has insufficient funds to pay its tax. Rather than realize assets which produce assessable income, it borrows money to make the payment. Is the interest on the money borrowed to meet the company's tax obligations deductible?

Application: The interest is fully deductible since it is necessarily payable in carrying on a business for the purpose of gaining or producing assessable income. The interest is payable in preserving assets required for the business of the taxpayer. In terms of the principles in *Public Trustee* there is sufficient nexus with the income earning process to satisfy the test for deductibility under section 106(1)(h)(ia).

Example 6

(A) An individual who is not in business has an end of year tax liability. He borrows to pay the tax. His assets are a house and a car. Is the interest deductible?

Application: The interest is not deductible because there is no nexus with the gaining or producing of assessable income.

(B) The same taxpayer has investments in government stock. Rather than realize the investments he borrows to meet the tax expenditure. Is the interest deductible?

Application: The interest is deductible under section 106(1)(h)(i) to the extent that it is payable in meeting an involuntary tax expenditure and preserving income producing assets. To the extent that the interest is paid to preserve non-income producing assets it will not be deductible. Apportionment of the interest will depend on the facts of each case.

In this case the interest is not deductible under section 106(1)(h)(ia) because the taxpayer is not in business.

Example 7

A taxpayer decides to buy a house to live in. She could finance the purchase by realising her income producing investments, but instead she decides to borrow to finance the purchase. Is the interest on the borrowed money deductible?

Application: The interest is not deductible as it does not satisfy the test in section 106(1)(h)(i). The interest payable is not used in gaining or producing assessable income. The expenditure is of a private or domestic nature and prohibited from deduction under section 106(1)(j).

Example 8

A sole trader borrows to buy a luxury car for personal use rather than realize his business assets to meet the cost of the car. Is the interest deductible?

Application: The interest is not deductible as it does not satisfy the tests in section 106(1)(h)(i) or (ia). There is no nexus with the income earning process. The interest is not payable in gaining or producing assessable income, nor is it necessarily payable in carrying on a business for the purpose of gaining or producing assessable income. The expenditure is of a private or domestic nature and prohibited from deduction under section 106(1)(j).

Example 9

A partnership borrows money to purchase an existing partner's interest in the partnership. Is the interest deductible?

Application: The interest is deductible because the capital is borrowed to replace capital which is used in carrying on the partnership's business. The interest is necessarily payable in carrying on a business for the purpose of gaining or producing assessable income, and is therefore deductible under section 106(1)(h)(ia).

Example 10

A company which is in business borrows money to repay a loan from a shareholder. Is the interest deductible?

Application: If the loan is used to replace capital which was used in the company's assessable income earning activity, the interest will be deductible under section 106(1)(h)(ia). The test for deductibility is satisfied as the interest is necessarily payable in carrying on a business for the purpose of gaining or producing assessable income.

Scope of these Examples

A general similarity with the examples will not necessarily lead to the same tax result. Each individual case will depend on its own facts, and the Commissioner may challenge deductibility of interest in some cases. For example, interest borrowed to purchase shares in a company which is precluded by its articles of association from paying dividends will not be deductible. The capital in that situation cannot fairly be said to be used to produce assessable income.

The Commissioner will publish other examples on interest deductibility to supplement the guidelines in this statement.

Appendix

Appendix B to this TIB sets out in some detail the Commissioner's interpretation of several leading cases on interest deductibility on which this statement is based.

FBT - Prescribed Rate of Interest for Quarter commencing 1 April 1992

The prescribed rate of interest used to calculate the fringe benefit value of low interest loans has been lowered to **10.30** percent for the quarter which commenced on 1 April 1992. The rate for this quarter had previously been set at 10.50 percent, but there have been a small number of reductions in rate which have taken effect during this quarter. The new figure of 10.30 percent reflects the current average first mortgage interest rate from all major lenders.

The new rate will continue to apply for the quarter commencing 1 July 1992 and subsequent quarters until further amended. As usual, we will be reviewing the rate again in August to check whether it still reflects the market rates during that quarter. Recent announcements by some banks may mean a further reduction at that time.

The rate was changed by Amendment No. 13 to the Income Tax (Fringe Benefit Tax, Interest on Loans) Regulations 1985, which was made by Order in Council on 25 May 1992. We have again made use of the 1991 amendment which allows the prescribed rate to be reduced during the quarter.

Due Dates Reminder

June

20 PAYE deductions and IR 66ES for first 15 days of June 1992 due - "large" employers.
PAYE deductions and IR 66ES for May 1992 due - "small" employers.
Gaming Machine Duty return and payment for month ended 31 May 1992 due.
Payment of Imputation debit 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.

July

5 PAYE deductions and IR 66ES for last 15 days of June 1992 due - "large" employers.

7 First instalment of 1993 Provisional Tax due for taxpayers with March balance dates.
Second instalment of 1993 Provisional Tax due for taxpayers with November balance dates.
Third instalment of 1992 Provisional Tax due for taxpayers with July balance dates.
Tax returns for non-IR 5 taxpayers with balance dates from 1 October 1991 to 7 May 1992 due.

20 RWT on interest deducted during June 1992 due for monthly payers.
RWT on dividends deducted during June 1992 due.
Non-Resident Withholding Tax deducted during June 1992 due (or approved issuer levy).
PAYE deductions and IR 66ES for first 15 days of July 1992 due - "large" employers.
PAYE deductions and IR 66ES for June 1992 due - "small" employers.
FBT Return and payment for quarter ended 30 June 1992 due.
Gaming Machine Duty return and payment for month ended 30 June 1992 due.

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