# What we learned from the Readers' Survey

This is the first Tax Information Bulletin since we've received the final results of the recent Readers' Survey. The key outcomes from the survey results are:

- The main reason why most people receive the TIB is to find out about new or changed Inland Revenue policies. The second most important reason is to get Inland Revenue's interpretation of new tax laws.
- 90% of readers thought that the level of language in the TIB is just right.
- Almost 80% of readers want to receive the TIB monthly.
- 83% of readers refer back to most issues of the TIB two or more times.

As a result of specific requests from readers, we've made these changes:

## Table of Contents

We've moved the table of contents to the front cover, and broken it into sections. This will make it easier to find specific articles when searching through back issues.

## Due Dates Reminder

This section received the highest rating for the "least needed" section in the TIB, partly because some of the dates had already passed by the time some readers see the TIB. In future the reminder will cover approximately two months following the TIB release date, so it should be more useful. This means the reminders in successive TIBs will overlap, so you should have plenty of warning for any upcoming due dates.

The dates in this reminder come from Inland Revenue's *IRD Calendar* (IR 24), which covers the period from 1 April 1992 to 31 March 1993 (updated annually). You can get a copy of this calendar from any Inland Revenue office.

## Two-Column Layout

Readers' opinions were divided on this subject. Some thought that having two columns made speed-reading easier, while others found it difficult to follow articles that run from one page to another.

To suit as many readers as possible, we will keep the two-column layout, but break as few articles as possible over two or more pages. Where we do have to break an article, we'll include a "to page..." and "from page..." to make it easier to follow.

## Typeface (Font)

Several readers commented that they had trouble with the typeface (font) in the TIB. We've changed this to a slightly narrower typeface for most of the TIB, so there is less hyphenation, and more words per line. The word and letter spacing is also more consistent.

We haven't used the narrower typeface for the "Questions We've Been Asked" section, because the column width there suits the present typeface.

## Space between Articles

A number of readers found the TIB too cramped, and wanted more space between articles. We will leave more space where possible, which will also reduce the number of articles that are printed across two pages.

## Quality of Paper

Several readers found the shiny paper very hard to read under artificial light, and others thought that the paper was of too high a quality (and cost) for the TIB.

We are looking into changing the paper in the TIB, and we'll let you know the results as soon as possible. However, since readers use the TIB as a reference document the paper needs to be reasonably durable.

## Index Frequency

Most readers want the index updated every six months. From now on we will close off the index at 30 June and 31 December each year, and issue a new one each January and July.

## Upcoming Legislation

There is some reader demand for articles about upcoming legislation. We will include these, but make sure they are kept separate from the legislation that has been passed.

## Binders or Labels

Several people asked for ring binders or labels to make filed TIBs easier to find. We don't have the facilities to produce or distribute binders as cheaply as you could obtain them, but we will include cut-out-and-stick-on labels in the TIB periodically, probably at the same time as the index.

## Examples

One of the most popular demands was for practical examples to show the effect of new legislation or policy. Wherever appropriate, we will include these from now on.

## Summary

Overall, most readers who took part in the survey were happy with the Tax Information Bulletin (although there was one respondent who used it as a soporific). We hope that you will find the above changes useful, and that the TIB will continue to meet your needs.

Thank you to all our readers who took part in the survey.

# New Tax Legislation

## Income Tax Amendment Act (No.5) 1992, Gaming Duties Amendment Act (No.2) 1992, Stamp and Cheque Duties Amendment Act (No.4) 1992, Estate and Gift Duties Amendment Act (No.2) 1992

The above Acts were enacted on 14 December 1992. They resulted from the Taxation Reform Bill (No.5) 1992, which was introduced into Parliament in July. Many of the bill's proposed amendments dealt with:

- The introduction of a new regime that allows wholly-owned companies to elect to form a consolidated group, which can be treated as a single entity for tax purposes
- Fine-tuning of the Qualifying Company regime and other matters introduced in the Income Tax Amendment Act (No.2) 1992
- A rewrite of the petroleum mining provisions, to incorporate new treatment of exploration and development expenditure, and of farm-out arrangements
- The introduction of a new depreciation regime.

Parliament subsequently placed the proposed depreciation legislation into a separate bill, the Income Tax Amendment Bill (No.11) 1992. This bill is still with the Finance and Expenditure Select Committee, awaiting Government decisions on international comparability.

The section references in the headings of the following articles refer to the principal Acts. The table of contents below gives the section numbers from the amendment Acts.

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# Consolidated Groups

## Sections 191BA - 191VC, Income Tax Act 1976

### Introduction

A new consolidation regime for wholly owned groups of companies has been introduced. This regime applies from 1 April 1993, so standard and late balance date groups can consolidate for the 1993-94 income year. Early balance date groups will be able to consolidate for the 1994-95 income year.

Under consolidation, wholly owned groups of companies are able to:

- transfer assets within the consolidated group, with deferred income tax and stamp duty consequences and no gift duty consequences;
- claim deductions for administration and other costs of holding companies which may not be deductible to the company that incurred the expenditure;
- utilise losses incurred by group members, by referring to shareholder continuity of the group, not of the individual member;
- offset imputation credits within the group, even though ordinary imputation credit rules do not permit grouping of imputation credits.

The provisions in sections 191C - 191WC are designed to co-ordinate the operation of the regime with the remainder of the Act, as well as to prevent the regime from being abused.

### Background

The Government announced the consolidation regime in its 1991 Budget. In essence, consolidation treats a group of companies owned by the same shareholders as one economic entity. In effect, the regime implements the Valabh Consultative Committee's preliminary recommendation that intra-group asset transfers should be tax-free.

An original objective of consolidation as it was first proposed was to reduce the disadvantage to wholly-owned groups caused by the removal of the inter-corporate dividend exemption. However the Government has decided to retain the inter-corporate dividend exemption for wholly-owned groups.

### IRD Administrative Practices

#### Depreciable assets

Currently Inland Revenue allows depreciable assets to be transferred within 100 percent commonly owned groups without tax consequences. The legislative basis for this administrative discretion is contained in sections 108 and 117 of the Act.

The Income Tax Amendment Bill (No.11) 1992 proposes amendments to these sections, which could apply as early as 1 October 1992 for early balance date companies. The consolidation tax treatment of depreciable assets is likely to replace this administrative practice from 1 April 1993.

#### Gift Duty

Currently, asset transfers between 100 percent commonly-owned companies are treated as not liable for gift duty. Public Information Bulletin No.96 of October 1978 explains this treatment.

The consolidation provisions specifically exempt from gift duty any asset transfers in circumstances which constitute gifts, if these occur within 100 percent commonly-owned groups.

Inland Revenue will review the policy statement in PIB 96 in light of the amendments contained in this Act. Until the outcome of that review, asset transfers between 100 percent commonly-owned companies which are not part of the same consolidated group will remain unaffected by these amendments.

### Which companies can consolidate

- Consolidation is restricted to "eligible companies" (explained below).
- It is only available to New Zealand resident companies that are 100 percent commonly owned. (General provisions on measurement of voting and market value interests apply when working out 100 percent common ownership.)
- Parent/subsidiary companies or sister/brother companies that are 100 percent commonly owned may elect to form a consolidated group.
- All the companies in a consolidated group must have the same tax balance date.

#### Eligible companies

Consolidation is restricted to companies that are taxed under consistent rules for any particular activity. Accordingly, consolidation is restricted to an "eligible company" defined in section 191D as one which is all of the following:

- resident in New Zealand;
- not treated as non-resident under a Double Taxation Treaty Agreement;
- not exempt from income tax;
- not a loss attributing qualifying company under the qualifying company regime.

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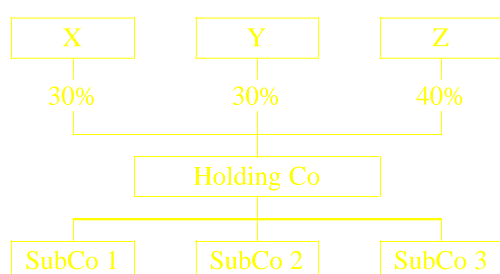
A loss attributing qualifying company may not consolidate because it may only have one class of share and, by definition, a group consisting of two companies has at least two classes of shares.

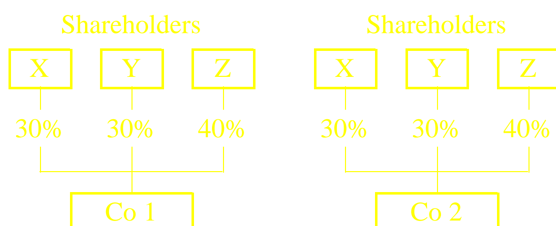
### 100 percent common ownership

100 percent common ownership is determined in the way set out in sections 8A to 8D of the Act (provisions for measuring a person's interest in a company using voting interest, and market value interest where appropriate). At any one time a group of people must own between them 100 percent of the interests in every company in the group. In addition, they must own the interests in the same proportions for each company (section 191E).

Example 1: Group made up of a holding company and its subsidiaries




Example 2: Group of commonly-owned related companies




***Less than 100 percent common shareholding***

Companies that are less than 100 percent commonly owned may be permitted to consolidate in limited circumstances (governed by section 191E and section 191(4). These circumstances are:

- If they have not more than 1 percent variation in common shareholding due to nominal shareholding required to be held under company law;
- If they have not more than 3 percent variation in common shareholding due to shares held by employee share purchase schemes approved under section 166 of the Income Tax Act.

### Parent/subsidiary or brother/sister groups

Unlike consolidation regimes in Germany and the United States, there is no requirement to include the parent company in the regime. This means a consolidated group may comprise associated subsidiaries that are wholly owned.

### One balance date

A group of companies cannot consolidate unless they all have one common balance date. This makes sure that the group's income for any income year relates to the same period, not an amalgam of different periods.

Where a group has several tax balance dates, they must decide on one tax balance date.

## Formation Rules

A group of companies that wishes to consolidate must give Inland Revenue written notice of their election to form a consolidated group (Section 191F). That notice must also contain:

- an undertaking by each company to be jointly and severally liable for the group's income tax liabilities (see "Joint and Several Liability" on page 5);
- nomination of an agent or "nominated company" of the group (see "Nominated Company" on page 5).

## Commencement Dates

Generally, a company will commence being treated as a member of a consolidated group:

- from the start of the income year in which it notifies Inland Revenue, if it gives this notice within 63 days of the start of that income year (section 191F(3));
- in any other case from the start of the following income year (section 191F(3)).

There is special provision for a group of newly-incorporated companies to be treated as a consolidated group from the beginning of the income year of incorporation and formation, provided they notify Inland Revenue within 63 days of the latest of those incorporations (Section 191F(4)).

There is also a special provision which allows a group of companies that have become entitled to form a consolidated group during an income year to be treated as a consolidated group from the day of first entitlement, provided they notify Inland Revenue within 63 days of the first entitlement (Section 191F(5)).

There is an anti-avoidance provision to prevent groups consolidating during an income year instead of at the start of the year, where there is an arrangement to abuse the regime (section 191F(8)).

Companies that form a consolidated group during an income year rather than from the start of an income year must furnish a set of part year accounts in the return for that year (see "Part Year Accounts" on page 6).

Example 3

Tom Co Ltd and Dick Co Ltd become wholly owned on 30 June 1993. The group has a 31 March balance date. The group elects to be a consolidated group within 63 days of first becoming commonly owned. Consolidation commences on 30 June 1993. Part year accounts are required for the period before consolidation.

### Extension of time for furnishing notices

Inland Revenue may accept notification given outside the 63 day period if the Commissioner is satisfied that the notice of election could not reasonably have been furnished earlier (Section 191F(6)).

## Entering an Existing Group

The rules for entering an existing consolidated group are similar to those for forming a consolidated group. A company electing to join an existing consolidated group must give the Commissioner a written election notice which contains an agreement to be jointly and severally liable for the group's income tax (section 191I(2)).

### Commencement dates

A company that joins an existing consolidated group will generally commence being treated as a member of the group:

- from the start of the income year in which it notifies Inland Revenue, if it gives this notice within 63 days of the start of the income year (Section 191I(3));
- in any other case, from the start of the following income year.

A newly-incorporated company can join an existing group from the beginning of the income year of incorporation provided it notifies Inland Revenue within 63 days of incorporation (section 191I(4)).

A newly acquired company can also join an existing consolidated group from the day it becomes entitled to become a member, provided it notifies Inland Revenue within 63 days of entitlement (section 191I(5)).

There is an anti-avoidance provision to prevent companies joining a consolidated group part-way through an income year rather than from the start of the year, where there is an arrangement to abuse the regime (Section 191I(8)).

Companies that join a consolidated group during an income year must furnish a set of part year accounts in the return for that income year (section 191I(5)).

### Extension of time for furnishing notices

Inland Revenue may accept notification given outside the 63 day period if the Commissioner is satisfied that the notice of election could not reasonably have been furnished earlier. (section 191I(6)).

## Joint and Several Liability

A company forming or joining a consolidated group must give an undertaking to be jointly and severally liable for the group's income tax including provisional tax, PAYE, RWT, SSCWT, and FBT (sections 191F(2), 191I(2), 191Q and 191R). There are limited provisions for relaxation of the joint and several liability.

First, the requirement for joint and several liability may be limited to one or more companies of the group, when the group makes its election. In this case the Commissioner must be satisfied that the company/companies bearing liability for the group tax have sufficient assets to meet the group's tax liability. The reason for this provision is so that groups of companies that have financial arrangements subject to negative pledge clauses can still consolidate (section 191L(3) and (4)).

If the companies liable for the group tax default in paying it, the Commissioner may raise separate assessments on the companies excluded from joint and several liability for the amount of the group tax liability attributable to them. The excluded companies would thus be liable for their share of the group tax in the event of a default (Section 191L(5)).

Second, joint and several liability may be removed from a company that leaves a consolidated group if the Commissioner is satisfied that removing such liability would not significantly prejudice the collection of income tax ( section 191L(2)).

## Nominated Company

The nominated company must be a member of the consolidated group. The group can change which company is the nominated company by sending written notice to Inland Revenue (Section 191H).

Where there are changes to the group, the role of the nominated company may be significant. For example, if two members in a consolidated group of four companies become wholly owned by new owners, it is possible for both groups to claim continued consolidated group status. To overcome this potential problem, section 191J(4) ensures the group of which the nominated company is a member continues as the consolidated group. Tax consequences are therefore not triggered for that group. (See "Exit Rules" below for consequences of a consolidated group not having a nominated company)

## Member of One Group Only

Where a company is a member of more than one consolidated group at any time, it will be treated as a member only of the first consolidated group it joined, as long as it still meets the requirements for being treated as a member of that group (Section 191G).

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## Exit Rules

A company may leave a consolidated group voluntarily by sending to Inland Revenue a written election to cease to be treated as a member. The company's membership will cease from the beginning of the income year after the year Inland Revenue receives the notice, if so requested in writing. Otherwise, the company will be treated as a non-member from the beginning of the income year in which Inland Revenue receives the notice (section 191J(1) and (2).

There are also provisions which deem a company in certain circumstances to have ceased being a member. These circumstances are when:

1. the company ceases to be an "eligible company" as defined;
2. the company ceases to be entitled to be a member of the same consolidated group as the nominated company;
3. the consolidated group to which a company belongs ceases to have a nominated company. (However, if the nominated company of the group is wound up and Inland Revenue receives notice within 20 days of the wind-up that another company is to be the new nominated company, the company will not cease to be a member. The Commissioner has discretion to accept a notice after the 20 day period.)

In the first two of these situations, the company is treated as a non-member from the beginning of the income year in which the deemed cessation occurs, or from the date of deemed cessation if the company specifically requests this in writing (section 191J(6)). However, Inland Revenue will deny this request where there is a finding of a tax avoidance arrangement (section 191J(7)).

In the third situation above, the company is treated as having ceased to be a member from the beginning of the income year in which the deemed cessation occurs if there is no new nominated company within the 20 day period.

Where a cessation date occurs part way through an income year, the company leaving the group must furnish part year accounts for that income year (see "Part Year Accounts" below).

A company that ceases to be a member of a consolidated group through being wound up is treated as having ceased to be a member from the date of wind-up. This is not conditional upon adequate accounts being furnished to the Commissioner (section 191J(8)).

## Part Year Accounts

A company that enters or exits an existing consolidated group part way through an income year must furnish part year accounts (Section 191K). These are necessary as the company becomes a different tax entity, and is subject to different tax rules in the income year of entry or exit.

The company should include these part year accounts in its tax return for that year, and file it by the usual due date. (For example, if a company with a 31 March balance date joins a consolidated group three months into its income year, it must furnish a set of part year accounts with its return for that income year.) The part year accounts replace the normal full year accounts that would otherwise have been furnished.

The company's assessable income is determined (to the extent fair and reasonable and with any necessary modifications) by treating the part year as a complete income year. Where accounts cover six months, they should include only half the normal deductions permitted for items such as depreciation or amortisation. As the part year is treated as a complete income year, the income/loss of the separate part year periods are not netted off. This is relevant in determining part year losses and profits for carry forward and offset under sections 188 and 191.

Example 4

ABC group is a consolidated group which DCo joins on 30 September 1995. Both ABC group and DCo have 31 March balance dates. On an individual taxpayer basis, DCo determines its assessable income to 30 September 1995 and includes it in its own return for the income year ended 31 March 1996. DCo 's pre- and post- consolidation results are not offset against each other. If the pre-consolidation result was a loss of $100 and the post-consolidation result attributable to DCo is a profit of $90, DCo is allowed a pre-consolidation loss of $100; it would not be limited to $10.

## Returns, Assessments and Liability of Consolidated Group

Generally, a consolidated group files one tax return, receives one tax assessment and consequently has only one tax liability for any income year.

### One tax return

A consolidated group files one tax return, which includes the income derived by all companies in the group (Section 191L(1)(a)). The group will file that return under an IRD number that is separate from the individual companies' IRD numbers.

The member companies will not have to file separate returns unless these are needed because of part year consolidations.

The Commissioner can grant an extension of time for filing the consolidated group's tax return under section 17(5), provided the consolidated group is made up of ten or more companies.

## Consolidated accounts

The Commissioner has discretion to determine what information (in addition to the consolidated tax accounts) Inland Revenue needs to enforce the consolidation regime and the Income Tax Act generally. The Commissioner will specify if individual accounts are required (Section 191L(1)(b)).

## One tax assessment

The group will receive only one income tax assessment, based on the tax return it files. There will not be separate assessments unless they are required by part year consolidations (Section 191L(1)(d)).

## Availability of tax credits on single company group basis

Subject to the usual quarantining rules, total group income is calculated before taking into account available credits (foreign tax credits and controlled foreign company or "CFC" credits). This means the credits belonging to individual companies that don't have any New Zealand taxable income can be offset against the income of other companies in the group. In this way, the group can use credits that are otherwise non-utilisable (Section 191L(1)(c) and section 191D(2)(b)).

On the other hand, where the credits are attributed to individual group members that have taxable income, but the group is in overall tax loss, the credits will be lost. This is because the availability of the credits is determined after calculating total group loss.

> Example 5
>
> SubCo 1 and SubCo 2 are a members of a consolidated group. SubCo 1 has tax credits of $100 from tax it has paid overseas. SubCo 1 has taxable income of $1,000. SubCo 2 makes a loss of $1,800, so on a group basis, there is a net loss of $800. The $100 tax credits are not available for offset to the group.

# Calculating Group Assessable Income

Put simply, the group assessable income is the sum of the member companies' assessable incomes, with some special rules applying for the following:

- intra-group items of income/expenditure;
- treatment of the consolidated group as a single company;
- the determination of thresholds on a group level.

(Section 191L)

## Assessable/deductible items

Assessable/deductible items arising from intra-group transactions are not included in the determination of group income, except for transactions involving the disposition of trading stock (section 191M(1)(a) and (b)). This treatment of intra-group income and expenditure items results in intra-group transactions being treated as transactions between branches of the same company, so that there are no taxation consequences.

Under section 191M(1)(a), only income items that would not be assessable income if the group were a single company are not taken into account. This ensures that income arising from transactions with a third party outside the consolidated group, but as part of an intra-group arrangement, remain assessable to the group.

Under section 191M(1)(b), only those expenses that would not be deductible if the group were a single company are not taken into account. This ensures that intra-group expenses (including reimbursement between group members for fringe benefits provided) are not deductible. In the case of outlays to a third party (such as fringe benefit tax paid), the expenses are deductible.

> Example 6
>
> ParentCo engages a third party to provide management consultant services. ParentCo on-charges the fees to SubCo. SubCo is a land-holding company deriving no income. ParentCo is not allowed a deduction for the management fees paid to the third party.

## Administration expenses of holding company deductible

Section 191M(1)(c) allows deductions for administration and other expenses of a holding company regardless of whether the holding company itself derives any assessable income. This is because those expenses would be deductible to that consolidated group if treated as if a single company. One qualification is that a nexus must exist between that expenditure item and the assessable income or business activity of any other member of that consolidated group. This prevents deductions to a non-operating group.

## Expenses not deductible if group is a single company

Consistent with the treatment of a consolidated group as a single company, section 191M(1)(d) denies deductions for expenses which would be deductible to the member but not to the group. Interest deductible under section 106(1)(h)(ii) is excepted. This permits deductions for interest on money that one member borrowed from outside the group so another group member could purchase at least 66 percent shareholding of a third group company. The group must demonstrate a clear and direct link between the borrowing and the intra-group loan used to purchase equity in a manner that meets the requirements of section 106(1)(h)(ii).

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> Example 7
>
> ABC consolidated group purchases land. The land is legally held by subsidiary C as a revenue asset. Parent A uses the land for its head office. Subsidiary C is not allowed a deduction for expenses incurred in acquiring the land.

## Income assessable if group is a single company

Section 191M(1)(e) includes in the group income any profit or gain that would not be assessable when derived by a member but which would be assessable if derived by the consolidated group as a single company. This provision is intended to prevent intra-group arrangements to transfer assets and re-characterise them to avoid tax. This provision is similar to the provision in section 191(6) aimed at preventing group structuring to avoid tax from certain activities.

## Capitalisation of group costs of improvements to fixed assets

Section 191M(2) permits capitalisation of non-deductible expenditure that a group member incurs in relation to an asset held by another group member.

> Example 8
>
> In consolidated group ABC, ACo owns a building. BCo makes some capital improvements to the building. The cost of those capital improvements can be added to the costs incurred by the owner, ACo.

## Threshold levels determined on group basis

Where a provision of the Act specifies a threshold, the position of the group is to be determined as if the consolidated group were one entity (Section 191M(1)(f)).

> Example 9
>
> Consolidated group ABC wants to know under what circumstances it may invoke section 64C(2A) and use the straight line method of calculating income or expenditure. Section 64C(2A) permits a straight line method of calculation if the total value of all financial arrangements held or issued is less than $1 million.
>
> Assume each member in ABC group has less than $1 million of financial arrangements but the group as a single company has financial arrangements with a combined value of over $1 million. ABC group may not invoke section 64C(2A) as the group exceeds the minimum threshold value of financial arrangements.

# Special Provisions on Dispositions of Property

A comprehensive set of asset transfer rules applies to intra-group transfers of assets. Generally, no tax is payable on the intra-group transfers of assets other than trading stock.

## Transferee rule

Tax becomes payable in relation to the intra-group transfers when the transferred asset is sold out of the group. Consistent with the treatment of the consolidated group as one entity with separate branches, selling shares of a company in the group that holds the transferred asset constitutes a sale of the asset out of the group (section 191N(6)). This treatment is necessary to prevent consolidation from being abused.

> Example 10
>
> In FGH Group, FCo shares are sold to a third party. At the time of sale FCo is holding land assessable under section 65(2)(f) which was transferred to it by GCo. The difference between the transferred asset's market value at the time of the share sale and the deemed transfer value is included in the return of income by the group.

These are the rules applying to various types of assets:

## Financial arrangements

Generally, section 64F of the accrual rules requires a base price calculation for any transferred asset, in order to allocate income or expenditure from the transferred financial arrangement between the transferrer and the transferee in the year of transfer. An intra-group transfer of a financial arrangement would require a base price adjustment.

Section 191N(4) specifies the deemed consideration for the transfer, so that it does not result in any allocation of income or expenditure between the transferrer and transferee for the year of transfer. To qualify, both parties must use the same method of allocating income or expenditure (e.g., yield to maturity basis) and meet certain conditions. These conditions are:

- election of a nil allocation by the nominated company; and
- the transferrer and transferee are members of the same consolidated group for the whole income year of transfer; and
- neither party is entitled to carry forward pre-consolidation losses, unless the group’s assessable income is sufficient to absorb all such losses.

These conditions are designed to prevent income being allocated so as to give undue tax advantage.

Where the group does not meet these conditions but there is no change in the method of calculation, it must make a fair and reasonable allocation for the year of

transfer. Where there is a change in the calculation method, the transferrer is deemed to have transferred the financial arrangement at market value. The following example illustrates the allocation required in all three situations.

*Note: The Taxation Reform Bill (No.6) 1992 contains a minor amendment to section 191N(3).*

Example 11

In XYZ Group, a company (transferor) transfers debenture stock on 1/12/94 to a member of the group (transferee). The base price adjustment required under section 191N(4) is as follows:

**Debenture stock details**

| | |
|---|---|
| Face value | $250,000 |
| Coupon rate (payable quarterly) | 10% |
| Issue date | 1/3/92 |
| Maturity date | 1/3/97 |
| Purchase date | 1/9/93 |
| Purchase cost | $235,880 |
| Purchase yield to maturity | 12% |
| Assessable income to 31/3/94 | $16,502 |

**Transfer date base price adjustment**

| | Same method (i) | Same method (ii) | Different method |
|---|---|---|---|
| Item a for the base price adjustment formula to equal nil | $221,132 | | |
| Item a for the base price adjustment formula using the purchase constant annual rate of 12% | | $240,267 | |
| Item a for the base price adjustment formula using market value based on a market yield of 9.5% | | | $252,506 |

**Transferor income allocation from 1/4/94 to 1/12/94**

| | Same method (i) | Same method (ii) | Different method |
|---|---|---|---|
| a = value at transfer date | + $221,132 | + $240,267 | + $252,506 |
| cash coupons plus (5 x $6,250) | + $31,250 | + $31,250 | + $31,250 |
| | + $252,382 | + $271,517 | + $ 283,756 |
| b = acquisition price | - $235,880 | - $235,880 | - $235,880 |
| c = assessable income to 31/3/94 | - $16,502 | - $16,502 | - $16,502 |
| Base price adjustment | + $0 | + $19,135 | + $31,374 |

**Total accrual income 1/9/93 to 1/12/94**

| | | | |
|---|---|---|---|
| Accrual income | + $16,502 | + $35,637 | + $47,876 |

**Transferee income allocation from 1/12/94 to 1/3/97**

| | Same method (i) | Same method (ii) | Different method |
|---|---|---|---|
| a = Face value | + $250,000 | + $250,000 | + $250,000 |
| b = Value at transfer date | - $221,132 | - $240,267 | - $ 252,506 |
| Cash coupons (9 x $6,250) | + $56,250 | + $56,250 | + $56,250 |
| Accrual income allocated using appropriate method | + $85,118 | + $65,983 | + $53,744 |

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## Trading stock

Consolidation replicates the tax treatment provided previously by the proviso to section 85(4).

Unlike the tax treatment on intra-group transfers of other assets, intra-group transfers of trading stock are generally not ignored for tax purposes. Instead, such transfers are deemed to occur at the transferrer's tax carry over value, or at cost for new purchases. However, the nominated company may elect to have transfers ignored according to the general asset transfer rules for all or certain lines of trading stock, provided the Commissioner is satisfied that the trading stock in question and its ownership can be specifically traced (Section 191N(5)).

## Depreciable assets

Section 191N(1) provides for depreciation clawbacks or further deductions under the Act, to be determined generally based on the tax book value plus subsequent capitalised costs.

Example 12: transfer of depreciable asset

Assume a transfer of an ice-cream plant within FGH group. A tax event occurs on the sale of the ice-cream plant out of the group. The details are as follows:

| | | |
|---|---|---|
| Purchase date | 1/4/94 | |
| Purchase cost | | $10,000 |
| Transfer date | 31/3/95 | |
| Tax book value on transfer date | | $8,000 |
| Consideration for transfer | | $8,500 |
| Tax event | 1/4/96 | |
| Market value at tax event date | | $7,000 |
| Tax book value at tax event date | | $6,400 |
| Depreciation recovered | | $600 |

(The consideration passing between the companies for the transfer is irrelevant. Depreciation is calculated on the tax book value on transfer).

## Other assets

Any other assets such as land and revenue assets are deemed to be transferred intra-group at cost to the transferrer, including expenditure incurred in purchasing or improving the assets and legal costs in improving legal rights in relation to that asset (Section 191N(1)).

## Value of absorbed asset

Where an asset is transferred intra-group as part of another asset rather than in its original form, and its market value cannot be determined, there is provision for its market value as at the time prior to absorption to be taken into account (Section 191N(7)).

## Adjustment on sale of shares on revenue account

Where a parent company has consolidated with a subsidiary and the shares in the subsidiary are held on revenue account, any gain or loss on the sale of the subsidiary shares would be assessable or deductible under normal income tax rules. Section 191N(8) provides for a necessary adjustment on the sale price to take account of any exempt intra-group transaction. Without the adjustment a deduction for "losses" on sale of the shares would be "incurred" and deductible.

Example 13

ParentCo and SubCo are members of a consolidated group. ParentCo's shares in SubCo are held on revenue account. The purchase price of the shares was $2.00 a share. While a consolidated member, SubCo transfers most of its assets to ParentCo. This results in a lower share market price of $1.00 per share. ParentCo sells its shares in SubCo to a third party. Section 191N(8) applies to adjust the sale price to $2.00, so no loss is available to the group.

## Anti-avoidance provision

Section 191N(9) is aimed at consolidated groups which consolidate for a brief period solely to obtain the benefit of tax-free asset transfers. In that instance, the transfers will be recognised and included in the group's income.

# Stamp Duty on Intra-Group Conveyances

Section 13 of the Stamp and Cheque Duties Act 1971 contains new provisions covering the imposition of stamp duty on transfers within a consolidated group. Generally, the stamp duty treatment is similar to the income tax treatment of asset transfers. Stamp duty is not payable on intra-group transactions at the time of transfer, but it may become payable if the asset is transferred out of the group, including by way of sale of the shares of the recipient company holding the asset.

Stamp duty will be imposed on the market value of the asset at the time of transfer out of the group, not on its market value at the time of initial transfer within the group. This will minimise compliance costs because it requires assets to be valued only if they eventually leave the group. If the tax were based on the value of transferred assets at the time of initial transfer, consolidated groups would effectively be required to value any asset subject to intra-group transfers at the time of transfer, because of the difficulties they would have in attempting to determine that value at a later time.

## Income Tax and Stamp Duty Consequences on Wind-up

When the transferee company holding an asset which was transferred intra-group ceases to be a member of the group through being wound up, income tax is not payable (section 191N(6). However, stamp duty becomes payable (Section 13(4) of the Stamp and Cheque Duties Act 1971).

## Gift Duty

Section 74A of the Estate and Gift Duties Act 1968 has been amended so that no gift duty will be payable on asset transfers within a consolidated group. Unlike the treatment for income tax and stamp duty, gift duty does not become payable at a later date when the asset is transferred out of the group.

Another provision prevents gift duty becoming payable on transactions between companies, if these transactions constitute dividends.

## Loss Carry-Forward and Grouping

The loss carry forward provisions in section 188 (general provisions), 188AA (transitional provisions) and 188C (mining losses) apply with modifications to a consolidated group as if it were one tax entity. The grouping provisions in section 191 and 191A are also modified to apply to the group as one tax entity. Any loss the consolidated group incurs is treated as a group loss (section 191O(2)).

Any loss that a company incurs before it becomes a member of a consolidated group remains that of the member (section 191O(3)). The member's pre-consolidation losses are offset against group assessable income. There are limits to the offset (sections 191O(5) and (6)). These limits are discussed below and in examples 15 and 16.

The member's pre-consolidation losses not offset against group assessable income may be either:

- carried forward for offset against future income derived when it leaves the group; or
- offset to a company 66 percent commonly owned with it, including another consolidated group.

The consolidated group losses and pre-consolidation losses carried forward are offset on a “ first in - first out” basis. Where these losses are incurred in the same income year, the losses are pro-rated (section 191O(4)).

Example 14

Assume SubCo 1, SubCo 2 and ParentCo are the members of a consolidated group. SubCo 1 and SubCo 2 have pre-consolidation losses incurred in the 1993 income year of $100 and $200 respectively. The group has assessable income of $200 in the 1994 income year. The losses offset against group income are pro-rated one-third from SubCo 1 and two-thirds from SubCo 2

### Limited loss offset where members are not a group at all times

Under ordinary loss offset rules a loss may be offset provided the group existed from the year the loss was incurred through to the income year of offset. In a consolidated group of members which was not a 66 percent commonly owned group at all times, section 191O(5) restricts the loss to the aggregate of:

- the amounts that the company incurring the pre-consolidation loss (“loss company”) is permitted to carry forward, and
- the amount permitted to be offset against income of those members that formed a 66 percent commonly owned group with the loss company at all relevant times.

The incomes of the loss company and the other group members (66 percent commonly owned) in the year of consolidation are calculated in accordance with section 191M on a single company basis.

Example 15

ACo has pre-consolidation losses of $1,000 (incurred in the 1991 income year). The consolidated group comprises ACo, BCo and CCo. CCo was not 66 percent commonly owned with ACo during the 1991, 1992 and 1993 income years. BCo was 66 percent commonly owned with ACo at all times. In the 1994 income year (first year of consolidation), the consolidated group has assessable income of $1,200 comprising $300, $300 and $600 derived by ACo, BCo and CCo respectively. The amount of loss that may be deducted is determined as follows:

| | |
|---|---|
| ACo’s assessable income in 1994 (available for carry forward under s188) | $300 |
| BCo's assessable income in 1994 (available under s191A) | $300 |
| Total deduction against consolidated group income | $600 |

### Limited loss offset on part year consolidation

Where a company with pre-consolidation losses is a member for only part of the consolidated group’s income year, the amount of loss offset against the consolidated group’s income is also restricted, taking into account any income derived in the part period before consolidation. Section 191O(6) takes into account the possibility that the loss company may have been a member of another consolidated group in the part period before consolidation.

Accordingly, the amount of loss offset is restricted under section 191O(6) to the lesser of:

A. the amount of pre-consolidation loss to be carried forward against group income, less any assessable

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income derived by the company or by another consolidated group of which the loss company was a member during the part year period before consolidation;

B. the part year assessable income of the consolidated group.

Example 16

Assume ACo in ABC group left XYZ group to join ABC Group midway through the income year. The incomes derived during the relevant periods are:

| | |
|---|---|
| ACo (loss carried forward) | $1000 |
| ACo (income) | Nil |
| XYZ Group (income) | $400 |
| ABC Group (income) | $500 |

Lesser of $1000 - (0 + 400) = $600 or $500. Only $500 may be carried forward under section 191O(6).

## Group income deemed company income for purposes of section 188(9)

Where pre-consolidation losses are carried forward against future consolidation assessable income, for the purposes of section 188(9) the income the consolidated group derives is treated as if it was derived by the loss company (section 191O(7)).

## Attributed Foreign Income and Foreign Investment Fund Income of Consolidated Group Members

Only New Zealand resident companies are eligible to consolidate. Members of a consolidated group with interests in controlled foreign companies (CFCs) and foreign investment funds (FIFs) must include in the consolidated group's income any attributed foreign income and FIF income. For this purpose, section 191P generally provides for Part IVA (relating to CFCs and FIFs) to apply as if the consolidated group were one company.

Any tax credit becoming available or any attributed foreign loss and FIF loss incurred are treated as becoming available to or incurred by the consolidated group (section 191P(2)).

A member's pre-consolidation tax credits, attributed foreign loss and FIF loss remain in the ownership of the member company, but they may be carried forward and offset against the consolidated group income subject to the normal quarantining rules. The order of offset is similar to that applicable in section 191O. Section 191P(3) provides for a member's pre-consolidation tax credit, attributed foreign loss and FIF loss to be utilised as follows:

- to be offset against the group's income tax or attributed foreign income or FIF income, subject to the quarantining rules;
- to be credited or deducted or set off against future income tax payable or income derived by the member when it leaves the consolidated group or joins another group;
- to be carried forward by the member company to future income years;
- to be offset against income tax payable by or income of any other company (other than the consolidated group) as permitted under the Act.

Like losses under section 191O, the group's tax credits and attributed losses and FIF losses are offset on a "first in- first out basis". Where the losses are incurred in the same income year, the losses are pro-rated (section 191P(4)).

Example 17

Assume ACo, BCo and CCo are the members of consolidated group ABC. ACo and BCo have pre-consolidation attributed foreign losses of $100 and $200 respectively, carried forward from the 1993 income year in respect of their Hong Kong companies. The consolidated group has attributed foreign income from Hong Kong in the 1994 income year of $200. The losses are pro-rated one-third from ACo and two-thirds from BCo.

## Limited credit and loss offset where members are not a 66 percent commonly owned group

Like losses under section 191O, some restrictions to offsets of credits and losses are necessary where the members of the consolidated group were not members of a 66 percent commonly owned group as required under the Act. Accordingly, section 191P restricts the amount that may be offset to the aggregate of the following amounts:

- the amount of the tax credit or loss permitted to be carried forward by the company to a subsequent year, and
- the amount permitted to be offset against tax payable or income of other member companies that were at all relevant times members of a 66 percent commonly owned group.

The income tax payable and the income of the companies in the year of consolidation is determined by applying section 191M of the Act (i.e., on a single company basis).

## Limited offsets on part year consolidation

Where a company is a member of a consolidated group for only part of an income year, the amount of tax

credits or losses that may be offset are restricted to take into account the company's income tax payable or income derived in the part period before it joined the group. Accordingly, the amount of offset is restricted under section 191P(6) to the lesser of:

A. the amount of pre-consolidation tax credits to be credited against the group's income tax payable (or loss to be deducted against the group's income),
*less*
any income tax payable (or income derived) by the member (or by another consolidated group of which it was a member) during the part period before it joined the group;

B. the amount of income tax payable (or income derived) by the consolidated group that can be reasonably and fairly attributed to the part of the income year during which the newly-joined company was a member of the consolidated group.

The income tax payable or income derived is calculated by applying the provisions in section 191K in relation to part year accounts.

## Consolidated Group Members' Provisional Tax

A consolidated group's provisional tax payable is determined by applying the provisions in Part XII of the Act as if the consolidated group were a single company.

### Joint and several liability

Companies forming or joining a consolidated group must give an undertaking to be jointly and severally liable for the consolidated group's income tax. This extends to provisional tax. However, where a group has approval for joint and several liability to be limited under section 191L to one or more of its companies, the provisional tax liability is also so modified (Section 191Q(1)(a)).

### Calculating provisional tax payable based on fraction of RIT incurred in a preceding income year

In the first year of consolidation or in any income year in which there are new members, calculating the group's provisional tax relies on the Residual Income Tax (RIT) that each member incurred in a preceding income year before becoming a consolidated group member. Section 191Q(1)(b) requires the consolidated group to include in its RIT for the preceding year the proportion of the individual company 's income for the preceding year which reflects the proportion of the provisional tax year in which the company was a member of the consolidated group.

Example 18

XCo joins XYZ consolidated group on 1 April 1994. The group has a 31 March balance date. XCo was a member for 12 months during the 1995 income year. XYZ group must include 12 months of RIT derived by XCo in the 1994 income year (plus 5 percent uplift) in its provisional tax payments for the 1995 provisional tax year. XCo makes no payment of provisional tax individually.

Example 19

YCo joins consolidated XXX Group on 8 July 1995. XXX Group has a 31 March Balance date. YCo and the group made their first instalments of provisional tax separately. When YCo joins the group, XXX Group must recalculate the preceding year's RIT for its subsequent instalments of provisional tax. YCo's provisional tax liability for part of the year is squared up at year end and it doesn't have to pay any further provisional tax.

### Calculating provisional tax for company leaving a consolidated group

Where a company was a member of a consolidated group for all or part of a year and ceases to be a member for all or part of a succeeding year, it must estimate its provisional tax, with associated penalties for under-estimation. The consolidated group may estimate down its provisional tax payment (Section 191Q(2)).

## Withholding Tax Obligations of Consolidated Group Members

Joint and several liability for the consolidated group's income tax extends to resident withholding tax (RWT), fringe benefit tax (FBT), specified superannuation contributions withholding tax (SSCWT) and tax deductions under Part XI, including PAYE deductions (Section 191R). However, the members are individually responsible for complying with their respective obligations, such as filing individual returns..

## Imputation Credits

The consolidated group must maintain its own separate imputation credit account (ICA) covering the group's activities (section 191S(1)). The opening balance of a newly formed Group ICA is nil. An existing consolidated group's opening balance is equal to the closing balance of the preceding imputation year (section 191S(2)).

The ICA of each member in the group is maintained separately from the group ICA, in accordance with Part XIIA of the Act. The individual ICAs will generally record the balance to the date of consolidation.

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## Credits and debits arising to group's ICA

Sections 191SA and 191SB generally replicate the provisions in sections 394D and 394E, but by treating the consolidated group as if it were a single company.

## Debiting and crediting between consolidated group and individual companies

Post-consolidation credits and debits arising to the group ICA do not arise to the individual ICAs (section 191SC(1)).

Section 191SC(2) provides the mechanism for transferring credits from the individual ICAs to the group ICA. A transfer is made when a debit arises to the group ICA and that debit is not offset by any group credit that arose earlier or on the same date as the credit in the individual ICA. The ordering procedure in section 394E(4) applies to the group credits. When a credit transfer occurs, a corresponding debit arises under section 394E to the individual ICA (section 191SC(3)).

The ordering procedure in section 394E(4) also applies to the individual credits in the individual ICAs that are transferred under section 191SC(2). The "first in - first out" rule applies. If two or more credits arose at the same time, the consolidated group may elect which credit to offset. Where no election is made, the credits are offset on a pro-rata basis (section 191SC(4)).

Example 20

ACo and BCo are members of ABC Group. Both companies have pre-consolidation credit balances and, in particular, credits of $100 and $200 which arose at the same time (5/7/92). On 10/10/95 a debit of $100 arises to the group ICA which is not offset by any group credit. Assume no election is made. The credits from ACo and BCo are offset proportionately, that is, one-third from ACo and two-thirds from BCo .

If a debit were to arise to the individual ICA account and cause or increase a debit balance, section 191SC(5) provides for that debit not to arise to the company's ICA but to be debited to the Group ICA. In this way the individual member does not have to pay further income tax.

Section 191SC(6) provides for a debit arising from a refundable excess under the export market development provisions to be treated as a refundable excess to the consolidated group. This is achieved by debiting the group ICA with an amount equal to the amount of refundable excess calculated under section 394L(4A). A corresponding credit arises to the individual ICA to reflect the transfer (section 191SC(7)).

Section 191SC(8) provides for the equivalent of the provision in section 394L(5), so that the amount of further income tax that a consolidated group member pays may be credited against the group's income tax payable. To the extent that it is so credited, the credit is not available under section 394L(5) to the individual member (section 191SC(8)).

## Application of specific imputation provisions to consolidated groups

Section 191SD(1)(a) provides for a consolidated group that maintains a policyholder credit account ("PCA") to be able to make transfers of the credit balance in the group ICA to the group PCA. This provision is the equivalent of section 394FA(1).

Where the consolidated group has a non-standard balance date, section 191SD(1)(b) provides for section 394FA(3) and (4) to apply with any necessary modifications to the consolidated group as if it were the company referred to in those subsections. This means that certain deemed transfers from the group ICA to the group PCA will occur on the last day of the imputation year.

Section 191SD(2) provides for section 394G to apply to a consolidated group as if it were a single company, and for intra-group dividends not to be taken into account for purposes of section 394G(2) to (4). This means that the imputation ratio and benchmark dividend rules apply to all dividends except intra-group dividends paid by each member in the group. The attachment of imputation credits to intra-group dividends will be optional.

Section 191SD(3) imposes on a consolidated group's nominated company the responsibility for ensuring that the group complies with sections 394J (the requirement to furnish annual imputation returns) and 394K (the requirement to furnish an imputation return as requested by the Commissioner or as otherwise required under that section).

The provisions in section 191SD(4) and (5) generally provide for sections 394L, 394N, 394O, 394P and 394M relating to further tax payable and imputation penalty tax to apply to the group as if it were a single company and for references to a company to apply as references to a consolidated group.

Section 191SD(6) provides for section 394ZF(2) to apply where dividends are deemed under section 394ZF(1) to be paid by a member of the group.

Section 191SD(7) provides for section 394ZG and 394ZH to apply to the consolidated group as if it were a single company and for the references to provisions of the Act to be references to the equivalent consolidation provisions.

## Dividend withholding payments

An equivalent provision to section 394ZM(2) applies to a consolidated group whose member is paid a foreign withholding payment dividend. The amount of the dividend withholding payment (DWP) to be deducted

can be reduced by the amount of the credit balance in the group's branch equivalent tax account (BETA) pursuant to the election of the nominated company of the group under section 191VC(2) - (section 191T(1)).

Joint and several liability for the consolidated group's income tax extends to DWP (section 191T(2)).

Section 191T(3) provides in a separate provision from section 394ZN(2), so the group can elect to have its losses which are available for carry forward and offset under sections 188 and 191N reduced in satisfaction of a DWP liability.

Section 191T(4) provides that when a company becomes entitled to a refund of DWP the amount of the refund available will be determined by the credit balance in the group's DWP or ICA at the end of the most recent imputation year. The credit balance is reduced by any earlier refund paid during the imputation year to the company or any other group member (section 191T(5)). These provisions are equivalent to section 394ZO(2) and (3).

Section 191T(6) provides that where a company that is a member of a group has paid DWP during an income year, it is entitled to a refund if the group incurred a loss in that year. The section sets a limit on the amount able to be refunded that mirrors the restrictions in section 394ZO(4).

Where a company makes a payment of DWP when it is not a member of a group, and is subsequently entitled to a refund after it has joined a group, section 191T(4) in effect governs the limit on refund (section 191T(7)).

Subsection (8) provides that the Commissioner can disallow a shareholder's claim for a tax credit arising from a DWP credit attached to a dividend received if there has been no DWP paid to support that credit by any member of the consolidated group. This is a modification to section 394ZP(4).

## Dividend Withholding Payment Accounts

A consolidated group must maintain a group DWP account if any member of the group maintains a DWP account. The group's account is maintained separately from the individual DWP account (section 191U(1)(a)).

The group may also elect at any time to maintain a group DWP account. The nominated company must notify the Commissioner of the election to maintain a group DWP within 21 days of the date of election (section 191U(1)(b) and (2)).

The opening balance of the group DWP will be nil in the first year, and after that equal to the closing balance of the preceding imputation year (section 191U(3)).

A Group that has voluntarily maintained a group DWP account may elect to cease maintaining it subject to the conditions set out in section 191U(4) and (5).

### Credits and debits arising to group DWP account

Sections 191UA and 191UB generally replicate the provisions in sections 394ZV and 394ZW, but by treating the consolidated group as if it were a single company.

### Debiting and crediting between group and individual DWP accounts

Post-consolidation credits and debits arising to the group DWP account do not arise to any individual DWP accounts. (section 191UC(1)).

Section 191UC(2) provides the mechanism for transferring credits from any individual DWP accounts to the group DWP account. A transfer is made when a debit arises to the group DWP and that debit is not offset by any group credit that arose earlier or on the same date as the credit in the individual DWP. The ordering procedure in section 394ZW(4)(c) applies to the group credits. When a credit transfer occurs, a corresponding debit arises under section 394ZW to the individual DWP account (section 191UC(3)).

The ordering procedure under section 394ZW(4)(c) also applies to credits in two or more individual DWP accounts that are transferred under section 191UC(2). The "first in - first out" rule applies. If two or more credits arose at the same time, the consolidated group may elect which credit to offset. Where no election is made, the credits are offset on a pro-rata basis (section 191UC(4)).

If a debit were to arise to a company's DWP that would cause or increase a debit balance, section 191UC(5) provides for the debit not to arise in the company's DWP account but to be debited to the group DWP account. In this way the individual company does not have to pay further DWP.

Section 191UC(6) provides for the equivalent of the provision in section 394ZZF(5), so that the amount of further DWP a group member pays may be credited against DWP payable by any member of the group at a later date. To the extent that it is so credited, the credit is not available under section 394ZZF(5) to the individual member. This provision is targeted at companies which maintain a DWP account before consolidation.

### Application of specific DWP provisions to consolidated groups

Section 191UD(1) provides for a company that is a member of a group that operates a DWP account to attach DWP credits to a dividend that it pays. The amount attached is debited to the group DWP account.

Section 191UD(2) provides for a consolidated group that maintains a Policyholder Credit Account (PCA) to be able to make transfers of the credit balance in a group DWP to the group PCA. This provision is the equivalent of section 394ZXA(1).

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Where the consolidated group has a non-standard balance date, section 191UD(2)(b) provides for sections 394ZXA(3) and (4) to apply with any necessary modifications to the consolidated group as if it were the company referred to in those subsections.

Section 191UD(3) provides for section 394ZY(1) to (4) to apply to a consolidated group as if it were a single company, and for intra-group dividends not to be taken into account for purposes of subsections (2) to (4). This means the DWP benchmark provisions apply to all dividends except intra-group dividends paid by each member in the group. The attachment of DWP credits to intra-group dividends will be optional.

Section 191UD(4) provides for sections 394ZY(4A), (4B) and (4C) (relating to the calculations of the allocation deficit debit, the DWP payment credit transfer fraction and the imputation credit transfer fraction) to apply to a consolidated group that maintains a PCA as if references to a company and provisions of the Act were references to a consolidated group, and to equivalent consolidation provisions respectively. Dividends paid intra-group are not taken into account for purposes of these provisions.

The obligations to provide information under sections 394ZZA and 394ZZB fall on the company in the consolidated group that pays a dividend with a DWP credit attached, as section 191UD(5) provides for these provisions to apply as if references to a DWP account company were references to a company in a group that maintains a DWP account.

The nominated company is responsible for furnishing the annual DWP account return under sections 394ZZC and 394ZZD. Section 191UD(6) requires these provisions to apply as if the consolidated group were a single company and each reference to a provision of the Act were a reference to the equivalent consolidation provision.

If it makes an election in accordance with section 394ZZE(2), a group may transfer any year end credit balances in its DWP account to the group's ICA (section 191UD(7)).

The provisions relating to further DWP payable and DWP penalty tax in sections 394ZZF, 394ZZG, 394ZZH, and 394ZZI, and to the power of determination in section 394ZZJ, are to apply as if the consolidated group were a single company. The members of a group are jointly and severally liable for any further DWP, or DWP penalty tax or additional tax that becomes payable by the group.

## Branch Equivalent Tax Accounts

A consolidated group must maintain a group branch equivalent tax account (BETA) if any member of the group maintains a BETA. The group's account is to be maintained separately from the individual BETA (section 191V(1)).

The group may also elect at any time to maintain a group BETA. The nominated company must notify the Commissioner of the election to maintain a group BETA within 21 days of the date of election (section 191V(2)).

A group that voluntarily maintains a group BETA may elect to cease maintaining a group BETA subject to certain conditions applying in section 191V(3) and (4).

## Debits and credits arising to group BETA

The opening balance of the group BETA will be nil in the first year of operation, and thereafter equal to the closing balance of a preceding imputation year.

The credits that may arise in the group BETA are:

(a) credits for tax paid on attributed foreign income that the consolidated group derives in any year. This amount is calculated using the formula in section 191VA(2)(a);

(b) credits for the amount of "tax paid" through the reduction of a company or group loss of an amount calculated using the formula in section 191VA(2)(b);

(c) credits transferred from individual BETAs under section 191VB(2).

The credits in (a) and (b) above arise on the date the consolidated group's tax return is filed. The credits in (c) above arise on the date immediately before the relevant debit arose in the individual company's BETA (section 191VA(3)).

Section 191UA(4) and (5) provide for these debits to arise in the Group BETA:

(a) The amount of credits in the BETA used to reduce a DWP liability (The debit arises on the due date for paying the DWP.);

(b) The amount of BETA credit balance elected to be transferred to the Group ICA (The debit arises on the date the Group elects to credit the Group ICA.);

(c) The amount of any refund of income tax paid on attributed foreign income derived by the consolidated group (The debit arises on the date the refund is paid.);

(d) The amount of debit that would arise under section 394ZZP(3) on a breach in shareholder continuity of the consolidated group (The debit arises at the specified time the debit arises under section 394ZZP(3).);

(e) The amount of the credit balance in the BETA where the Group ceases to maintain a Group BETA (The debit arises immediately before the Group ceases to maintain a BETA.);

(f) the debit arising under section 191VB(5): this is a debit that would have arisen to the individual company's ICA had there been sufficient credits in that ICA. (The debit arises at the time first referred to in that section.)

Section 191VA(6) provides an ordering rule for the reduction of the credit balance in the BETA under section 191VA(4)(a).

### Debiting and crediting between group and individual BETAs

Post-consolidation credits and debits arising to the group BETA do not arise to the individual BETA accounts, if any (section 191VB(1)).

Section 191VB(2) provides the mechanism for transferring credits from the individual BETAs, if any, to the group BETA. A transfer is made when a debit arises to the group BETA and that debit is not offset by any group credit that arose earlier or on the same date as the credit in the individual BETA. The ordering procedure in section 394ZZP(6)(c) applies to the group credits. When a credit transfer occurs, a corresponding debit arises under section 394ZZP to the individual BETA (section 191VB(3)).

The ordering procedure in section 394ZZP(6)(c) also applies to credits in two or more individual BETAs that are transferred under section 191VB(2). The "first in - first out" rule applies. If two or more credits arose at the same time, the consolidated group may elect which credit to offset. Where no election is made, the credits are offset on a pro-rata basis (section 191VB(4)).

If a debit would arise to the BETA of a company that would result in a debit balance, section 191VB(5) provides for the debit not to arise in the company's BETA but to be debited to the group BETA.

### Application of BETA provisions to consolidated groups

Section 191VC(1) provides for a consolidated group that maintains a group BETA to elect in accordance with section 394ZZQ(2) to make transfers of the credit balance in the group BETA to the group's ICA.

The group's nominated company may also elect in accordance with section 394ZZQ(4) to use the credit balance in the group BETA for the purpose of reducing the DWP liability of any group member (section 191VC(2)).

Section 191VC(3) provides for section 394ZZR, relating to determinations by the Commissioner as to BETA credits and debits, to apply to the group BETA as if the consolidated group were a single company.

A group BETA, like a company BETA, will never have a debit balance. A refund of income tax paid on attributed foreign income and due to the group will be retained by the Commissioner where it would result in a debit balance in the BETA (section 191VC(4).

Where a company pays tax on attributed foreign income then joins a group, a refund can be obtained if the group BETA has sufficient credits (section 191VC(4)).

## Policyholder Credit Accounts

A consolidated group must maintain a group policyholder account (PCA) if any member of the group is carrying on a business of providing life insurance to which sections 204 to 205F of the Act apply. The group's account is maintained separately from the individual PCA account (section 191W).

### Credits and debits arising to group PCA

The opening balance of a newly formed consolidated group's PCA is nil. An existing group's opening balance is equal to the closing balance of the preceding imputation year (section 191WA(1)).

Sections 191WA(2) and (3) provide for the following to arise as credits in the group's PCA :

(a) The amount of the credit balance in the group ICA that the group elected in accordance with section 191SD(1)(a) to be transferred to the group PCA (The credit item arises on the date the amount of the credit arises as a debit to the group's ICA.);

(b) The amount of the credit balance in the group DWP that the group elected in accordance with section 191UD(2) to be transferred to the group PCA (The credit item arises on the date the amount of the credit arises as a debit to the group's DWP account.);

(c) The amount of any credit arising to the group PCA under section 191WB(1) (The credit item arises at the time first referred to in section 191WB(1).)

Section 191WA(4) and (5) provide for the following to arise as debits in the group PCA:

(a) The amount of any credit balance in the group PCA elected by the group to be used as a credit against income tax payable on policyholder income the group derives (The debit item arises on the last day of the relevant income year.);

(b) The amount of any credit balance in the group PCA that the group elects to transfer to the group ICA (The debit item arises on the date the election is made.)

### Debiting and crediting between group and individual PCAs

Section 191WB(1) provides the mechanism for transferring credits from the individual PCAs to the group PCA. A transfer is made when a debit arises to the group PCA and that debit is not offset by any group credit that arose earlier or on the same date as the credit in the individual PCA. The ordering procedure in section 394E(4)(c) applies to the group credits. When a credit transfer occurs, a corresponding debit arises under section 394ZZZB to the individual PCA (section 191WB(2)).

The ordering procedure in section 394E(4)(c) also applies to credits in two or more individual PCAs that

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are transferred under section 191WB(1). The “first in - first out” rule applies. If two or more credits arose at the same time, the consolidated group may elect which credit to offset. Where no election is made, the credits are offset on a pro-rata basis (section 191WB(3)).

### Application of PCA provisions to consolidated groups

Section 191WC(1) provides for a consolidated group to elect to credit any credit balance in the group PCA in payment of income tax payable on policyholder income the group derives. The election is made by recording the amount of the credit as a debit to the group’s PCA (section 191WC(2)).

The group may also elect in accordance with section 394ZZZC(4) to transfer the credit balance in the group PCA to the group ICA (section 191WC(3).

Section 191WC(4) provides for sections 394ZZZC(5) and (6) and 394ZZZD (relating to elections to use credit balance to reduce income tax and determinations by the Commissioner on PCA debits and credits) to apply as if references to a PCA company and the PCA provisions were references to a consolidated group and to equivalent consolidation provisions.

# Groups of Companies

## Sections 85(4), 191(1), 191(3)(b), 191(4) and 191(7), Income Tax Act 1976

### Group Transfers of Trading Stock

The proviso to section 85(4) which permitted trading stock to be transferred within a group without tax consequence is repealed. The repeal is consistent with a recommendation in the Valabh Committee's interim report, *Tax Accounting Issues*, released in February 1991. The Government has decided to restrict the tax treatment previously allowed under that proviso to certain wholly-owned groups and to consolidated groups.

From 1 April 1993 the tax-free transfer of trading stock is limited to 100 percent commonly owned groups that meet certain conditions. These conditions are that the transferrer and transferee companies :

- are resident in New Zealand; and
- share a common tax balance date.

The Commissioner may waive the requirement for a common tax balance date, where he determines that the difference in balance dates is necessary to avoid a material distortion of either company's income by causing income and expense for a single business cycle to be reported in different income years. The Commissioner will only use this discretion if either of the companies apply for it.

> Example
>
> Company A and Company B are 100 percent commonly owned. Company A has a 30 June balance date, Company B has a 31 March balance date. Company A may transfer trading stock tax-free to Company B if either company can satisfy the Commissioner that it would cause a material distortion in either company to have a common balance date.

Deferred tax on the trading stock transferred intra-group becomes payable when the asset is sold out of the group. To prevent the provision being abused, the sale of shares of the transferee company holding the trading stock constitutes a sale out of the group.

> Example
>
> Company A transfers trading stock to Company B. Some shares in Company A change hands so that Company A is no longer 100 percent commonly-owned with Company B. Gains or losses on the transferred trading stock become assessable/ deductible as there is a deemed disposal and reacquisition at market value, by the original transferrer of that asset.

For companies with standard or late balance dates, the repeal applies from the first day of the company’s 1993-94 income year. For companies with early balance dates, it is effective from the first day of the 1994-95 income year. The effective dates coincide with the earliest possible dates a company may commence being treated as a member of a consolidated group.

### Companies included in a Group of Companies

The provisions in sections 191(1) and 191(3)(b) are amended to clarify that a “group of companies” is one in which a group of persons hold 66 percent commonly in each company. For loss offsets, the group must exist at all relevant times. This does not mean that the same group of persons must hold 66 percent in each company at all times. The amendments clarify that the composition of that group of persons may change, provided there is at all relevant times a group of persons holding 66 percent in common in each company. The amendment takes effect from the 1992-93 income year.

### Definition of Wholly Owned Group of Companies

The definition of a "wholly owned group of companies" in section 191(4) is amended. It now refers to a group of companies that is 100 percent commonly owned. Small variations in common shareholding due to company law requirements and holdings of employee share purchase schemes approved under section 166 (up to 3 percent) are permitted. The definition applies for purposes of the new provisions on the inter-corporate dividend exemption under section 63(2K) and consolidation under sections 191BC-191WC. It also applies for purposes of existing provisions including sections 108A on additional depreciation and 86H on bloodstock valuation. The amendment applies from the 1992-93 income year.

### Joint Assessments Provision repealed

Section 191(7), which provided for joint assessments of groups of companies, is repealed. The Government has decided to replace joint assessments with single assessments on consolidated groups. For companies with standard or late balance dates, the repeal becomes effective from the first day of the 1993-94 income year. For companies with early balance dates, it takes effect from the first day of the 1994-95 income year. The effective dates coincide with the earliest possible dates those companies may commence being treated as members of a consolidated group.

# Miscellaneous Dividend Amendments

## Sections 4,63,313 and 327ZA, Income Tax Act 1976

### Treatment of Section 192 and 195 Debentures

There are two minor amendments to section 4 of the Act. Section 192 and 195 debentures are now included in the definition of "share", so interest paid on them is a distribution to a shareholder under section 4(1)((a). Paragraph (h) of section 4(1) is therefore redundant and has been removed.

It is also now clear that the amount for which a section 192 or 195 debenture is issued can be returned to the debenture-holder tax-free under section 4A(1)(c).

The amendments apply from the date such debentures were included in the definition of "share" - generally 31 July 1991.

### Grandfathering of dividends on fixed rate shares issued before 31 July 1991

The provision relating to grandfathering of dividends paid on pre-1991 Budget redeemable preference shares (section 63(2E)(h)) has been amended. Dividends are tax-free where they are payable at a rate which is a specific fixed percentage of the amount subscribed, or is a percentage of the amount subscribed determined by a fixed relationship to a commercial interest rate. Paragraph (h) has been expanded to include dividends that are determined by a combination of those two factors.

The amendment is backdated to 1 April 1992.

### Exemption for dividends paid within wholly owned groups

Section 63(2K) has been inserted into the Act so that dividends paid between members of a 100% commonly owned group are exempt from tax if the recipient and the payer of the dividend have the same balance date.

However, where they have different balance dates, in certain circumstances the dividend may be tax-free. This will apply where the Commissioner determines, on the application of either the recipient or the payer, that the difference in balance dates is necessary to avoid a material distortion of either company's income by causing income and expense for a single business cycle to be reported in different income years.

For example, where a company with a June balance date wishes to pay a dividend to its parent with a March balance date, the Commissioner would have to be satisfied that it would cause a material distortion in the June balance date company to move to a March balance date, and it would also be distortionary for the March balance date company to take a June balance date.

Once the Commissioner has determined that the different balance dates of payer and recipient are necessary, dividends passing between those companies will be exempt. However, section 63(2L) gives the Commissioner power to revoke a determination he has made if he considers that the different balance dates are no longer necessary or if they are part of a tax avoidance arrangement.

Certain dividends are excluded from the exemption (section 63(2K)(e)). This retains the previous position in that the general intercorporate dividend exemption in place before 1 April 1992, and the interim regime effective until 1 April 1993, did not apply to these dividends.

The amendment applies from 1 April 1993.

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### Non-resident withholding tax

This section corrects a minor defect in the formula for calculating non-resident withholding tax on taxable bonus issues (section 313). The amendment is back-dated to 1 April 1992.

### Resident withholding tax

Section 327ZA(b) has been amended so that it applies to all dividends and not just specified dividends. The effect is that a credit may arise to a company's imputation credit account under section 394D(1)(k) for the amount of resident withholding tax that has been deducted from a dividend the company derived.

The amendment applies from 1 April 1992, when dividends paid to companies became subject to resident withholding tax.

# Qualifying Company Regime Amendments

## Part XIIAA, Income Tax Act 1976

There are several amendments to the qualifying company provisions. They all apply from the commencement of the regime.

### Shareholder's effective interest in Qualifying Company

This section makes a minor amendment to section 393A(2)(a), which provides that a shareholder's voting and market value interest in a qualifying company is determined under sections 8A to 8E. Section 8E relates only to measurement of an interest for the purposes of the loss and credit continuity provisions. The reference to that section has been removed, since it is irrelevant for the purposes of the qualifying company regime.

### Revocation of Qualifying Company election

Section 393E(2) has been amended to clarify that a shareholder election is deemed to be revoked upon the sale of ***all*** of a shareholder's shares to a ***new*** shareholder. Where a shareholder disposes of only some shares in the qualifying company, his/her shareholder election is still valid.

### Qualifying Company elections

This provision amends section 393F(3) to extend the 63 day period of grace for making shareholder elections to two situations:

- where a shareholder becomes sui juris;
- where a shareholder has purchased shares from a vendor who retains a shareholding in the company. (This is necessary because the vendor's election is not revoked and therefore section 393F(2)(b) does not apply.)

### Shareholder's liability for Qualifying Company 's tax

Section 393H has been amended to clarify that a qualifying company is primarily responsible for its own tax.

### Deduction of Interest paid on Money borrowed to buy shares in Qualifying Company

Section 393I(3) has been replaced with subsections (3) and (3A).

Subsection (3) clarifies that a shareholder in a qualifying company may not deduct interest paid on money borrowed to acquire shares in the company to the extent of non-cash dividends s/he received in a year.

Subsection (3A) provides that, for the purpose of determining whether a deduction for interest is available where a shareholder has borrowed to invest in a qualifying company, distributions from the company are not exempt and are deemed not to be dividends.

This means that the rules for determining deductibility match those applying to a partner investing in a partnership. Before this amendment, some apportionment may have been required where shareholders received exempt dividends arising from items such as a capital gain derived and distributed by a qualifying company.

### Taxation of Qualifying Companies

Section 393J(a)(i) is amended to remove some circularity caused by the reference to section 394ZL.

### Qualifying Company Election Tax

The formulae for calculating standard qualifying company election tax (QCET) and QCET for the 1992-93 income year have been amended. The previous formulae incorrectly calculated the amount of QCET in two ways:

- The first part of the formula should have calculated the gross dividends distributed. The credits (item c) are therefore added to item a of the formula.
- The credits in the imputation and dividend withholding payment accounts took no account of tax paid after the end of, but in relation to, the 1991-92 income year. In addition, where a refund was owing but not yet paid, the balance overstated the credit in the account.

The amendments remedy these problems.

An amendment is also made to item e of the formula for QCET calculated at the concessional rate. Item e in effect calculates the net dividends received and retained by a company between 30 November 1990 and the date of entry to the qualifying company regime. Tax is paid on such dividends at the company rate.

Because there was often no reason to calculate or keep a record of non-cash dividends that a company received before the removal of the intercorporate dividend exemption, it is now sometimes difficult or impossible to accurately state the amount of non-cash dividends it received. Non-cash dividends have therefore been omitted from the calculation.

However, this enables companies associated with a company entering the regime in the 1992-93 income year to pay non-cash dividends to that company in order to take advantage of the concessional rate. A new subsection (4) has therefore been included in section 393T. It provides that, in effect, non-cash dividends are included if that would significantly increase the amount of QCET payable.

Finally, the formula for calculating concessional QCET has been amended so that item e does not include dividends derived from a company that becomes a qualifying company for the 1992-93 income year.

Item e was inserted in the formula to prevent a company paying dividends to a related company that becomes a qualifying company for the 1992-93 income year for the purpose of having such dividend income taxed at the concessional rate. Where the payer itself becomes a qualifying company for the 1992-93 income year, there is no benefit to be gained by passing dividends to a related company in this way. Such dividends should therefore not be included in item e.

## Due date for paying QCET, and use of money interest

New section 393U of the Act sets out the due date for paying QCET for companies entering the regime in the 1992-93 income year. The tax is due on the terminal tax date for the 1992-93 income year. (For other income years, QCET is due on the terminal tax due date for the year ***before*** the year in which the company becomes a qualifying company.)

However, companies will have to pay use of money interest on their QCET if it isn't paid by the third provisional tax instalment date for the 1992-93 income year. For standard balance date companies, this is 7 March 1993.

The amount of interest payable is calculated under the formula in section 393U(2). The formula calculates a daily rate payable for each day on which the tax is unpaid from the day after the third provisional tax date to the terminal tax date for the 1992-93 income year.

The applicable rate is the general use of money interest rate (currently 6%).

The interest is payable on the terminal tax date for the 1992-93 income year.

Example

Company A, with a standard balance date, becomes a qualifying company for the 1992-93 income year. It pays QCET of $1,000 on its terminal tax date for the 1992-93 income year - 7 February 1994.

The amount of interest also payable on 7 February 1994 is:

$$\frac{\$1{,}000 \times 6\%}{365} \times 336 = \$55.23$$

The tax is outstanding for 336 days (8/3/93 - 6/2/94 inclusive).

New subsections (6) and (7) have been inserted into section 393L to extend those provisions to the use of money interest imposed by new section 393U.

As a result, no deduction is allowed for such use of money interest (section 106(1)(f)).

Subsection (7) applies the Act to the interest as if the interest were income tax.

## Information to be given to shareholder

Section 393M(5) of the Act has been amended to provide that where a shareholder asks a qualifying company for a statement of the amount of non-cash dividends s/he received in a year, the company must include this information in the shareholder dividend statement.

Shareholders who have borrowed to invest in a qualifying company may not deduct interest on that borrowing to the extent of any non-cash dividends received during an income year. They therefore need to know the amount of non-cash dividends they have received during the year.

## Loss Attribution Elections

Section 393O has been amended to provide in effect that minority shareholders can no longer revoke loss attribution elections. Taxpayers considering entering the loss attribution regime have expressed concern about the effect of a revocation of a loss attribution election and the power this gives to disgruntled minority shareholders.

Loss attribution elections can only be revoked by resolution of the board of directors, or by sui juris shareholders with 50% or more of the shareholding of

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the company. Where the sui juris shareholders hold less than 50%, all sui juris shareholders can revoke the election.

Section 393O(2) has been amended so that the death of a director of a qualifying company no longer causes revocation of a loss attribution election.

# Imputation

## Sections 394E, 394ZW, 394ZZP, Income Tax Act 1976

A minor defect in the new credit continuity provisions has been corrected.

Under legislation in place before 1 April 1992, credits to the imputation, dividend withholding payment and branch equivalent tax accounts arising on or before 16 December 1988 were not subject to the imputation credit continuity rules.

The new rules provided that in effect the continuity provisions did not apply to credits arising before that date.

This amendment restores the previous position.

### Foreign Dividend Withholding Payments

Where a company in loss, or anticipating a current year loss, receives a foreign dividend, the loss may be reduced in satisfaction of a foreign dividend withholding payment (FDWP) liability.

Section 394ZN now also provides that where the recipient of a dividend is in profit but is in a group with a company in (or anticipating a) loss, that company's loss may be reduced in satisfaction of a FDWP liability.

The provision will only apply if that company's loss may be offset against the first company's profit.

Subsection (3), which gives the Commissioner power to disallow the election where the loss company does not in fact incur a sufficient loss, has been extended to apply in the above circumstances. The Commissioner is also empowered to disallow the election in part where the companies are in the same group for part only of an income year.

The amendment is backdated to 1 April 1992.

# Petroleum Mining Regime Amended

## Sections 214D - N, Income Tax Act 1976

### Introduction

Major amendments have been made to the petroleum mining regime. From 16 December 1991 petroleum exploration expenditure, development expenditure and farm-out arrangements will be taxed in a new manner. There are also new anti-avoidance provisions.

### Background

On 16 December 1991 the Government announced its intention to introduce new tax legislation affecting the petroleum mining sector. The new legislation was intended "to achieve broad international comparability of tax treatment of petroleum exploration and development expenditure, both onshore and offshore." The measures contained in the new legislation were to be effective from that date.

### Key Issues

#### Exploration Expenditures

The term exploration expenditures has been defined as exploratory well expenditures, prospecting expenditures and expenditures incurred in acquiring a prospecting licence, prospecting permit or an exploration permit. The term does not include any residual expenditure (section 214D).

Exploration expenditures are now deductible in the year incurred (section 214F(2)(a)).

#### Development Expenditure

Development expenditures have been defined as those incurred for the purpose of planning, constructing, or acquiring petroleum mining assets (petroleum mining assets include petroleum permits or permit specific assets). Permit specific assets which are necessary for carrying on development operations have an estimated useful life which is dependent on the remaining life of the permit. Development expenditures exclude exploration and residual expenditures (section 214D).

Development expenditures are now capitalised and deductible over seven years. Deductions begin in the first year of commercial production for onshore projects and from the year incurred for offshore developments (section 214F(2)(b)).

#### Farm-out arrangements

A farm-out arrangement is defined as one where a farm-in party agrees with a petroleum miner (farm-out party)

to incur expenditure for work in a permit area either by undertaking or paying for that work. In return for incurring this expenditure the farm-in party acquires a right or option to any future revenue from petroleum that arises from that permit or subsequent permit (section 214D).

The expenditure incurred as part of a farm-out is no longer assessable income in the hands of the farm-out party. Expenditure incurred on the part of the farm-in party is either exploration or development expenditure, depending on whether an exploration permit or a development permit is involved (section 214I(1) section 214I(2)).

## Other Issues

### Definition of Offshore Development

Offshore developments are defined as those in which the major part of the facilities required for the extraction, production, treatment, processing, and separation of petroleum are required to be situated in a marine environment below the high tide mark (section 214D).

### Access to deferred deductions when related parties disassociate

Previously, when a petroleum miner sold a petroleum mining asset to an associated party the miner was only entitled to any deferred deductions up to the level of assessable income received. The legislation has been amended to allow a miner access to any remaining deferred deductions should the miner and buyer become disassociated.

However, the Commissioner has the power to determine whether the disassociation was undertaken for the purpose of accessing those deductions, in which case he will continue to treat the two as associated parties for tax purposes (section 214F(7)).

### Exploration expenditure deemed to be development

Where a party buys or farms in to an exploration permit, the expenditure will be deemed development expenditure if, at that time, there is either:

- an application for a mining permit for the area (or part of the area) enclosed by the exploration permit; or
- petroleum is being produced in commercial quantities on a continuing basis (section 214F(8)).

### Clawback Provision

A clawback provision has been introduced. Where an exploration well is drilled and expenditure is deducted and then the well is later used for the commercial production of petroleum, that previously deducted expenditure can now be clawed back, without interest, and treated as development expenditure.

The burden of the clawback will fall on the current owners of the permit, at the time of the clawback, in proportion to their equity in the permit (section 214F(9)).

### Transitional Provisions for Farm-out Arrangements

Where farm-out arrangements negotiated before 16 December 1991 have led to expenditures after that time, such expenditure is subject to a transitional provision. The new regime deals specifically with expenditure incurred by the farm-in party. The treatment of the farm-out party combines aspects of the 1990 regime and the new regime. Income is not assessable in the hands of the farm-out party. The farm-out party's deferred deductions incurred with respect to that permit must be reduced but not deducted. The means of determining the amount of reduction is specified in section 214I(2) of the 1990 regime.

### Sale or Disposal of a Permit

When selling or disposing of a permit or permit specific asset, the seller receives consideration which it may use in any way it chooses (section 214D). Therefore, a sale differs from a farm-out arrangement as any money received by the farm-out party must be spent on exploration or development in the specific permit to which the farm-out relates.

The income from a sale or disposal is assessable income in the hands of the seller (section 214H). Any deferred deductions attributable to that petroleum asset are deductible in the year that the consideration is received (section 214F(5)).

### Joint Ventures are not Partnerships

Joint ventures are no longer defined as partnerships, so they do not qualify as associated parties (section 214D).

### Objecting to a Determination

Procedures by which a petroleum miner can object to a determination made by the Commissioner have been introduced under section 214L(1)).

### Anti-avoidance Provisions

A new anti-avoidance section has been included in the legislation. The first part is a general anti-avoidance provision which makes it explicit that section 99 of the Income Tax Act applies to the petroleum regime (section 214MA(1)).

The second part is more specific. It states that certain types of arrangements described in the legislation are deemed to be arrangements designed to avoid or alter the incidence of tax (section 214MA(2)).

## Application Date

Changes to the treatment of exploration expenditures, development expenditures and farm-outs came into effect on 16 December 1991. All other changes, such as the anti-avoidance provisions and subsequent amendments to section 214N, apply from 1 July 1992.

# Crown Research Institutes subject to Income Tax

## Sections 8B, 61(2), 197I and 394B, Income Tax Act 1976

### Introduction

There have been several amendments relating to Crown Research Institutes (CRIs). They involve the definition of the assessable income of CRIs, their exclusion from certain income tax exemptions, prohibiting CRIs from maintaining imputation credit accounts, and ensuring that CRIs can utilise the loss carry forward and grouping provisions.

### Background

Established pursuant to the Crown Research Institutes Act 1992, CRIs commenced operation on 1 July 1992. The Government had previously decided that CRIs should be subject to income tax. These amendments are consequential to that decision.

### Key Issues

CRIs have been included in the Income Tax Act's "special corporate entity" definition. This allows them to be treated in the same way as state-owned enterprises and statutory producer boards for the purposes of measuring voting and market value interest provisions (sections 8A - 8F of the Income Tax Act). The special corporate entity status is designed to cater for companies with no ultimate natural person shareholders. Including CRIs in the special corporate entity definition is to their benefit as it will enable them to utilise the loss carry forward and grouping provisions in the Income Tax Act. It will also prevent CRIs from grouping their losses with other CRIs or any other Crown-owned entities. A CRI will only be able to group for loss purposes with its own subsidiaries

CRIs will not be permitted to maintain imputation credit accounts (section 38). This can be justified on tax policy grounds as the Crown is the sole shareholder in CRIs, and it obviously cannot utilise any imputation credits arising from the payment of income tax by CRIs.

To ensure that the Government decision that CRIs be subject to income tax is upheld, CRIs are expressly excluded from the income tax exemptions applying to public authorities and scientific or industrial research promoters.

It is expressly provided that all payments that a CRI receives for the purpose of producing public good science outputs are deemed to be assessable income (section 20(2)). A substantial part of the business of CRIs will be the supply of public good science outputs. Funding received for this purpose by CRIs from the Foundation for Research, Science and Technology should be treated as assessable income according to ordinary concepts. It is arguable, however, in the absence of an express legislative direction, that non-specific output funding received by CRIs from the Foundation for Research, Science and Technology could be described as having a capital rather than revenue character. (Non-specific output funding is untagged, so CRIs have a complete discretion as to which particular public good science output they use these funds for.) Accordingly, to put the matter beyond doubt, all public good science output funding received by a CRI is deemed to be assessable income.

### Application Date

These amendments apply from 15 June 1992, being the commencement date of the Crown Research Institutes Act 1992 under which CRIs are formed and registered.

# Forestry Amendments

## Section 74(5), Income Tax Act 1976

An amendment treats standing timber as separate from the land it is growing on if that land is sold and the timber is subject to a cutting right. Previously the standing timber was deemed to be sold along with the land, even if cutting rights had been granted to a third party.

When standing timber is subject to a forestry right registered under the Land Transfer Act 1952 or a *profit à prendre* granted before 1 January 1984, the deeming provision of Section 74(5) does not apply on the sale of land on which the standing timber occupies.

This amendment applies to sales of land occurring on or after the commencement of the 1992-93 income year.

# Bloodstock Depreciation

## Section 86H(1A)(b), Income Tax Act 1976

An amendment ensures that bloodstock not previously used for breeding receive the interim 25% depreciation loading. The previous section 86H(1A)(b) excluded some bloodstock not previously used for breeding from this loading.

The amendment allows for the application of the 25% loading if the bloodstock has not actually been used for breeding purposes by any other person before a taxpayer acquires it, whether or not a previous owner has taken the bloodstock's value into account under the section or claimed a deduction for it.

The interim loading will continue to apply when bloodstock is transferred under a matrimonial agreement and between companies in a wholly-owned group as provided for previously.

The amendment applies for the 1991-92 income year and subsequent years.

# Provision Denying Employment-Related Expenditure Clarified

## Section 105(2), Income Tax Act 1976

Section 105(2) of the Income Tax Act has been amended to remove a reference to other provisions of the Act relating to deductions of employment-related expenditure or loss.

The legislation previously provided that taxpayers were not able to deduct expenses incurred in gaining or producing income from employment, except where a deduction was expressly provided for in the Income Tax Act.

The legislation intended that employees should not be able to deduct any employment-related expenditure or loss. However, section 105(2) allowed for deductions which were specifically provided for in the rest of the Act.

The amendment clarifies the subsection by removing the reference to other express provisions of the Act. This makes it clear that no employment-related deductions are allowed at all, and over-rides other provisions of the Act which could be interpreted as allowing employment-related deductions.

The amendment applies from the 1992-93 income year onwards.

# Refunds where Excess RWT deducted in error

## Section 327F, Income Tax Act 1976

An amendment extends the time in which payers of resident withholding income can make refunds to investors when they have deducted too much tax as a result of a payer error.

When the Resident Withholding Tax (RWT) regime was introduced it allowed payers to refund any excess tax which they had deducted as a result of a payer error, as long as they made the refund before the date by which RWT deductions for the relevant period were due to be paid to Inland Revenue. They then had to issue an amended RWT deduction certificate or shareholder dividend statement.

The NZ Bankers' Association highlighted problems which arise where errors are not identified until after the relevant deductions have been paid to Inland Revenue.

Where errors were discovered too late for a refund to be made the only way in which depositors could get any excess deduction refunded was to wait until the end of the income year and claim a refund through the tax system. This adversely affected customer relationships and was considered a significant administrative problem.

The Tax Simplification Consultative Committee also identified this problem, and recommended the amendment.

The amendment to section 327F will allow payers to refund amounts deducted in error at any time up to 31 March in the year in which the error was made.

If the person receiving the interest or dividends has received an RWT deduction certificate or shareholder dividend statement, s/he must return it to the payer for cancellation. The payer will then issue an amended certificate or statement.

The amendment will apply from 14 December 1992.

# PAYE Bonds for Non-Resident Employees

## Section 350A, Income Tax Act 1976

### Introduction

The new section 350A enables the Commissioner to accept from an employer a bond or other form of security to defer the obligation to deduct PAYE from non-resident employees in situations where their liability to tax in New Zealand is uncertain.

### Background

The taxation of non-resident employees is dependent on whether:

- they qualify for the “92 day exemption” contained in s61(19) of the Income Tax Act 1976;
- they qualify for the “182 day exemption” under a Double Taxation Agreement;
- or their non-resident employer has a permanent establishment in New Zealand.

As all of these are dependent on future events, there is often uncertainty at the outset whether a tax liability will arise.

Except for the most straightforward cases it is not possible to determine in advance whether an exemption will apply. Consequently, Inland Revenue requires PAYE to be deducted until such time as the employee’s right to the exemption has been established, at which time a refund is made. This is at the end of the employee’s visit. This policy is necessary in view of the “flight risk” that non-resident employers and employees present. This policy is stated in PIB 97.

As foreign tax jurisdictions may also require PAYE to be deducted until the exemption is established, the employers are often forced to either make double deductions of PAYE or pay the PAYE themselves. This unnecessarily adds to the cost of doing business in New Zealand and encourages non-residents to ensure their employees remain exempt from tax in New Zealand (through tax planning) or to flout their PAYE obligations.

### Issues

To protect tax revenue and reduce employers' compliance costs and current administrative burdens, section 350A provides that the Commissioner is now able to accept a bond or other form of security, at his discretion, to cover the PAYE on non-resident employees in situations where their tax liability is uncertain.

Where such a bond or other security is provided, the employer need not make PAYE deductions from the non-resident employee unless and until the employee clearly becomes liable to tax in New Zealand, or the Commissioner specifies to the employer a date after which tax deductions are to be made.

Where an employee is liable to tax from a certain point in time (for instance, the start of an income year), PAYE must be paid from that date onwards. This obligation to deduct PAYE from future source deduction payments would arise where, for instance:

- the bond becomes inadequate to cover further source deductions; or
- it become apparent that the exemption will not be available.

In the latter case an obligation to deduct PAYE from past source deduction payments will arise. One IR 12 will be completed for the period in which the employee is liable to tax. Where that period covers two income years it will be necessary to apportion the source deductions made to each income year to ensure the employee is credited with the tax attributable to source deduction payments made in the previous income year.

Where it becomes certain that the employee is not liable to tax in New Zealand the bond will be returned to the employer.

It is envisaged that the bond will be of a similar form to that currently accepted for Non-Resident Contractor’s Withholding tax.

The Non-Resident Contractors’ Unit of Special Companies Section in Inland Revenue’s Wellington District Office will handle applications.

### Application Date

The provisions of section 350A apply from 14 December 1992.

# Provisional Tax Use of Money Interest Rate Clarified

## Section 398A and 413A, Income Tax Act 1976

There have been minor clarifying amendments to sections 398A and 413A of the Income Tax Act, which cover the use of money interest rate for provisional tax under- and overpayments. The amendments make it clear that each day's interest is to be calculated having regard to the prevailing specified rate of interest applicable to that particular day. The amendments do not represent a change in the policy of the legislation.

These amendments apply from 1 July 1992.

# GST - Supply of Games in Casino Premises

## Section 5(11B), 5(11C) and 10(15A), Goods and Services Tax Act 1985

### Introduction

The amendments to sections 5(11B), 5(11C) and 10(15A) provide for the fact that the supplier of services for GST purposes may be the holder of the casino operator's licence or the holder of the premises licence, depending upon the management structure. The amendments also amend the calculation of that supply to take into account redemptions of chips.

### Background

The original provision provided that money paid to play games on casino premises was deemed to be for a supply of services by the holder of the casino operator's licence. This provision presupposed a lease-type arrangement would exist between the holder of the casino premises licence and the casino operator, in which case the casino operator would be the supplier. However, there may be instances when the supplier is in fact the holder of the premises licence. A specific example is where the casino operator merely operates the casino under management contract, with income accruing to the holder of the casino premises licence.

In addition, by deeming a supply to be made where money is paid to participate in authorised games, games where money bet does not always give rise to casino income were included. An example is baccarat, where the casino takes a commission only from certain winning hands.

Further, the previous calculation of supply omitted reference to redemptions of chips.

### Key Issues

The amended section 5(11B) focuses on money paid to a casino in deeming a supply to be made, rather than money paid to the casino operator or by players on the premises. The supplier could be either the holder of the premises licence or the casino operator, depending on the nature of their agreement.

The amendment ensures that commissions paid for games such as baccarat are consideration for supply.

The definition of casino operator's licence has been replaced with a definition of casino operator.

The calculation of the value of the supply in section 10(15A) now takes into account redemptions of chips.

### Application Date

The amendment applies from 14 December 1992.

# Zero-Rating of Goods situated outside NZ at Time of Supply

## Section 11(1)(b), Goods and Services Tax Act 1985

Section 11(1)(b) of the GST Act has been repealed and replaced. Goods situated outside New Zealand at the time of supply will now be zero-rated, regardless of whether they are imported into New Zealand.

Under the previous wording of the section, goods which were sold overseas and were to be imported into New Zealand for home consumption were subject to GST at the time of supply, and also at the time they were imported into New Zealand.

The amended section zero-rates the supply of goods not situated in New Zealand at the time of supply. Such goods only become subject to GST if and when they are actually imported into New Zealand.

The amendment applies from 14 December 1992.

# GST on Fringe Benefits

## Section 21(4), Goods and Services Tax Act 1985

An amendment to Section 21(4) of the GST Act corrects a reference to the Fringe Benefit Tax provisions in the Income Tax Act. This was necessary following amendments to the FBT provisions in the Income Tax Act.

The GST Act contains special time of supply rules for fringe benefits. It refers to the provisions in the Income Tax Act which govern quarterly payment of FBT.

However, the Income Tax Amendment Act 1991 amended the FBT provisions so FBT could be paid quarterly or on an annual (income year) basis.

The amendment provides for a time of supply for fringe benefits where FBT is paid on an annual (income year) basis.

The amendment applies from 14 December 1992.

# Commissioner able to make GST Assessments in all Cases

## Section 27, Goods and Services Tax Act 1985

Section 27 of the GST Act, which deals with GST assessments, has been amended. The amendment clarifies the circumstances in which the Commissioner is able to make an assessment.

Previously, the Commissioner could make an assessment only in certain defined situations, such as where a person failed to file a return, or the Commissioner was not satisfied with a return as filed.

The amendment enables the Commissioner to make an assessment of GST payable by any person. Where the Commissioner has not made an assessment, a person can request that an assessment be made.

The amendment applies to returns due to be made on and after 14 December 1992.

# Time Limit for GST Objections extended

## Sections 32(3) and 33(1), Goods and Services Tax Act 1985

Sections 32(3) and 33(1) of the GST Act set out the time limits in which certain objections can be made. These sections have been amended, and the time limit has been extended to two months.

Under the previous legislation, a person could object to a decision or an assessment made by the Commissioner within 28 days of the notification of that decision or assessment, subject to the Commissioner's discretion to extend the time limit.

The amendment extends the time limit for objections to two months.

The amendment applies to decisions notified on or after 1 December 1992 and to assessments for which notices of assessment are given on or after 1 December 1992.

# GST Refunds

## Section 45, Goods and Services Tax Act 1985

Section 45 of the GST Act, which sets out the time in which refunds of excess tax can be made, has been amended to bring it into line with the amended section 27.

The amendment replaces references to tax properly payable with references to tax assessed under section 27 of the Act. The effect of the amendment is to provide that refunds will be made, within eight years of the end of the relevant period, where the amount of GST paid is greater than the amount assessed.

The amendment applies to tax payable with respect to returns due to be made on and after 14 December 1992.

# Companies may Group for GST Purposes

## Section 55(1), Goods and Services Tax Act 1985

An amendment to section 55(1) of the GST Act corrects a previous amendment to the section, and allows companies the option to group for GST purposes.

The Income Tax Amendment Act (No.2) 1992 (the No.2 Act) set out new company grouping and loss offset provisions in the Income Tax Act. It also amended the company grouping provision in the GST Act to conform with the new company grouping provisions in the Income Tax Act (see TIB Vol 3 No 8, page 10).

The No. 2 Act mistakenly provided that all companies who were able to group for loss offset purposes under the Income Tax Act were groups for GST purposes, thereby removing their ability to elect to group for GST purposes.

This amendment rectifies the mistake and provides that companies who are a group for loss offset purposes may elect to group for GST purposes.

The amendment applies with respect to supplies made on or after 1 April 1992 (the date the amendment to the GST Act made in the No.2 Act came into effect).

# GST Liability of Personal Representatives, Liquidators and Receivers

## Section 58, Goods and Services Tax Act 1985

### Introduction

An amendment has been made to section 58, which sets out the GST obligations of personal representatives, liquidators and receivers. The amendment clarifies that these people have a personal liability for the GST obligations incurred in their capacity as personal representative, liquidator or receiver.

### Background

This amendment clarifies the intention of the legislation and makes it clear that personal representatives, liquidators and receivers are, and always have been, liable for GST.

### Key Issues

The amendment deems personal representatives, liquidators and receivers to be registered persons. In effect, this imposes a personal liability for GST on people who carry on a taxable activity in their capacity as personal representative, liquidator or receiver. The GST due for each taxable period must be returned to the Commissioner with priority over creditors.

The main changes to the previous legislation are as follows:

- It is recognised that receivers and the like are usually appointed as agents of the company in receivership. It is the company which carries on the taxable activity and not the receiver. The amendment deems personal representatives, liquidators and receivers to be registered persons carrying on the taxable activity of the “incapacitated person” (i.e., a registered person who has died, gone into liquidation or receivership or become bankrupt or incapacitated).
- The amendment makes it clear that there are not concurrent liabilities for GST in the period of incapacity. Personal representatives, liquidators and receivers are registered persons with respect to the taxable activity and the company is no longer the registered person for that time.
- The Commissioner no longer has the discretion to deem personal representatives, liquidators and receivers to be registered persons; the liability is imposed automatically.

The amendment does not alter the current practice for people in receivership-type situations. Before this amendment personal representatives, liquidators and receivers were liable for GST incurred in the period in which they were carrying on a taxable activity in their capacity as personal representative, liquidator or receiver . The amendment merely clarifies the legislation.

### Application Date

The amendment applies from 14 December 1992.

# Amendment to Estate and Gift Duties Act 1968

## Introduction

Section 74A of the Estate and Gift Duties Act is inserted to expressly exempt from gift duty gifts within a consolidated group, and Section 74B is added to remove possible double taxation implications of a gift that is also a dividend.

## Background

Before this amendment, Inland Revenue's interpretation was that the transfer of assets "between companies in a group, i.e., wholly-owned subsidiaries or companies with common shareholdings" were not gifts and therefore not subject to gift duty (see PIB 96). The term "group" in PIB 96 means a 100% commonly owned group. We are currently reviewing this policy.

## Key Issues

Section 74A only exempts from gift duty gifts between consolidated group members. This means that gifts between companies that are 100 percent commonly owned will not qualify for the exemption unless those companies are members of the same consolidated group. Unlike the income tax and stamp duty treatment, gift duty does not become payable at a later date when the donee company holding the gift leaves the consolidated group.

There is a possibility of transactions between non-consolidated members constituting dividends as well as gifts. To overcome a possible double taxation problem, section 74B provides that gift duty is not payable on gifts that constitute dividends (whether assessable or exempt).

Currently, transfers of assets which occur between 100% commonly owned companies are treated as not liable to gift duty. This treatment is explained in Public Information Bulletin No.96 (October 1978).

Inland Revenue will review the policy statement in PIB 96 in light of the amendments contained in this Act. Until the outcome of that review, asset transfers between 100% commonly owned companies which are not part of the same consolidated group will remain unaffected by these amendments. Any consequence of this review will apply from a specified date (which could be earlier than 1 April 1993).

## Application date

The amendment to section 74A that relates to gifts within consolidated groups applies from 1 April 1993. The Commissioner's administrative practice will be withdrawn from 1 April 1993. The amendment removing double taxation implications of a gift that is also a dividend applies from 14 December 1992.

# Stamp Duty on Conveyances within a Consolidated Group

## Stamp and Cheque Duties Act 1971

Section 13 of the Stamp and Cheque Duties Act 1971 is amended so the stamp duty payable on conveyances between companies that are members of the same consolidated group can be deferred.

Before this amendment, stamp duty was payable on conveyances of property, even between companies that are 100 percent commonly owned. The consolidation regime permits deferral of income tax on intra-group asset transfers, and also allows similar treatment of stamp duty.

Stamp duty will not be payable on conveyances between companies that are members of the same consolidated group. The stamp duty is deferred and becomes payable only if the asset conveyed leaves the group. This includes a situation where the company that acquired the property intra-group leaves the consolidated group or is wound up.

The amendment applies from 1 April 1993, when consolidation generally becomes effective.

# Gaming Duty Amendments

## Gaming Duties Act 1971

### Filing Returns

An amendment to section 12D of the Gaming Duties Act 1971 removes the requirement for a gaming machine operator to file an early GMD return where his/her gaming machine operator's licence is cancelled, or an application for its renewal is refused.

It also allows the Commissioner to authorise the making of returns for a return period that ends within seven days either side of the last day of a calendar month.

Before this amendment, if a gaming machine operator's licence was cancelled or an application for its renewal refused, the operator had seven days in which to deliver

a final return. The possibility of compliance difficulties made this short a period impractical.

Where a gaming machine operator's licence is cancelled or an application for renewal is refused, the return and payment date that applies will be the same as normal; the 20th of the following month.

The original gaming machine duty legislation had no flexibility with regard to the return period, which was set at one calendar month.

Gaming machine operators may now apply to the Commissioner for a return period that ends within seven days either side of the last day of a calendar month. This added flexibility will permit larger operators to account for the duty at the same time as they complete internal returns. The payment date for tax remains the same.

This amendment applies from 14 December 1992.

## Amounts under $5.00

For most revenues that Inland Revenue collects, the Commissioner is able to write off debits under $5.00. The original gaming machine duty legislation did not provide for this.

Section 12FA of the Gaming Machine Duty Act 1971 has been amended so that the Commissioner may write off amounts of gaming machine duty payable that are less than $5.00. This applies to debit balances only; Inland Revenue will pay out any refunds regardless of the amount.

The amendment applies from 14 December 1992.

## Liability on Casino Licence Holders

The original casino duty legislation made the holder of the casino operator's licence liable for casino duty. This has been amended to take into account the possibility that either the holder of the premises licence or the holder of the operator's licence may be liable for casino duty.

As with the GST legislation, the original casino duties legislation presupposed a lease-type arrangement would exist between the holder of the casino premises licence and the casino operator. In this case the casino operator would be the supplier, and be liable for the casino duty.

However, there are instances when the supplier may in fact be the holder of the premises licence. Specifically, where the casino operator merely operates the casino under management contract, with profits going to the holder of the casino premises licence.

The amendment inserts a new definition of "casino operator", which means the holder of either a casino premises licence or a casino operator's licence or a temporary authority, who is entitled to the gaming income of a casino.

This makes sure that the person entitled to a casino's gaming income is liable for casino duty, and must file the appropriate returns.

The amendments apply from 14 December 1992.

## Calculating Casino Win

An error in section 12M of the original legislation which took into account the value of unredeemed chips twice has been corrected.

Casino duty is calculated on a casino operator's "casino win". The casino win is basically all sales of chips plus any money paid to play games, less chips redeemed and any money paid out as prizes.

The original legislation made an adjustment for unredeemed chips so that the duty applied to any unredeemed chips. However, this is already implicit in the calculation of casino win.

The adjustment for unredeemed chips has been removed, so casino operators will not be double-taxed on the value of chips not redeemed. The legislation now levies the duty as originally intended.

The amendment applies from 14 December 1992.

## Definition of a Gaming Machine

An amendment substitutes a new definition of "gaming machine" in section 2 of the Gaming and Lotteries Act 1977. This definition is used in levying gaming machine duty in the Gaming Duties Act 1971.

The previous definition referred to machines used in games of chance. It was not always clear whether this definition included machines used merely to dispense tickets or cards in games, rather than to actually determine the outcome.

The new definition refers to devices as well as machines, to take into account technological advances in the workings of gaming machines.

It specifically excludes machines or devices used only to distribute tickets in sequence, where the machine or device itself does not determine or manifest the outcome of the game. For example a device that dispenses "Avago" cards is not a gaming machine.

The amendment applies from 14 December 1992.

# Taxpayers' Rights and Obligations

In each of our offices we have recently displayed a charter which spells out people's rights and obligations in dealing with Inland Revenue. This charter tells people what service they should expect from us, and what obligations they have in their dealings with us.

These include the right to prompt, courteous and efficient service from Inland Revenue, and the right to individual attention. The charter also tells people of their right to question Inland Revenue's decisions, and to be informed of their rights and obligations before an audit begins.

Also included is people's obligation to act honestly when dealing with their tax affairs.

All of our offices have reviewed their performance to make sure we are providing our customers with the service outlined in the charter. They also have suggestion forms so customers can provide comments on our service, and suggestions on how we can improve it. We want feedback from our customers, and if there are cases where we are not fulfilling our promises we want to know, so we can do something about it.

# Share Losses - Deductions

## Court of Appeal Decisions

### Introduction

In two recent test cases Inland Revenue asked the Court of Appeal to clarify when taxpayers may deduct losses incurred on the sale of shares. The Court said that those losses are deductible if the taxpayers would have been taxed on any profit from the sale of those shares.

In the light of these decisions, this article outlines when profits from share transactions will be assessable and when losses from share transactions will be deductible. It also sets out how Inland Revenue will apply these Court decisions to taxpayers who claim deductions for losses on share sales.

The test case results will also be relevant to the taxation of transactions in other types of personal property and to land sales (under section 67(4)(a) of the Income Tax Act 1976). However, this article covers only the tax treatment of share transactions.

### Background

The Court of Appeal decisions in *C of IR* v *Stockwell* (CA 119/92) and *C of IR* v *Inglis* (CA 116/92) were delivered on 19 November 1992. These will both have important implications for some taxpayers. They decided that if taxpayers buy shares and would have been liable for tax on any profits or gains from selling the shares, then any losses they incur on that sale are deductible.

The decisions apply only to people who trade in shares (or other property) as a business, or who buy shares for the purpose of reselling them. The Court drew a clear distinction between these people and others who typically invest spare money from time to time, hoping for dividends and some capital growth. Proceeds from these casual transactions would be neither taxable nor deductible.

## Taxation of Share Sales

Profits or gains from the sale or other disposition of company shares are assessable for income tax if:

(a) The profits are business profits (section 65(2)(a) of the Income Tax Act 1976); or

(b) The taxpayer is in the business of dealing in shares (section 65(2)(e), 1st limb); or

(c) The taxpayer acquires the shares with the purpose of selling or otherwise disposing of them (section 65(2)(e), 2nd limb); or

(d) The profits come from any undertaking entered into or devised for a profit making purpose (section 65(2), 3rd limb).

### "Acquired for the purpose of selling"

Profits from selling shares are taxable if the taxpayer acquired the shares with the purpose of selling or otherwise disposing of them. However, sometimes taxpayers buy shares for more than one purpose, and may be uncertain about the tax treatment of those share transactions. In these situations the dominant purpose at the time of buying the shares is the relevant one.

Often ordinary investors acquire shares to make capital gains from their growth in value, as well as to earn income from dividends. In this situation there is no clear purpose of resale when the shares are bought, so any profit on sale would not be taxable. Neither would any losses be deductible.

To work out whether the profit (or loss) from a taxpayer's share sales are assessable (or deductible), it is necessary to look at each individual parcel of shares that the taxpayer sells during the year, and the purpose for which s/he acquired those shares.

## What the Cases said

This article concentrates on the *Inglis* case, which is the main judgment about taxing share sales. The *Stockwell* case agreed with the decision in *Inglis,* and also considered the sort of behaviour that would show that a taxpayer was in the business of dealing in shares (section 65(2)(e), 1st limb).

In the *Inglis* decision the taxpayer had sold properties and invested the proceeds in the sharemarket until he and his wife were ready to purchase a larger house. The share market crash meant that he made substantial losses on those share investments. He wasn't in the business of dealing in shares, but the fact that he bought the shares to sell them when he and his wife decided to buy a house proved that he had bought the shares with the clear and dominant purpose of reselling them. If he had sold any of the shares at a profit, that profit would have been taxable as profits from property acquired for the purpose of resale (section 65(2(e), 2nd limb).

The Court of Appeal reasoned that the Act allows deductions for expenditure or loss in gaining or producing assessable income (section 104), but section 106 (1)(a) prevents any such deductions for capital losses. However the Court considered that this prohibition only applies to losses of fixed capital and that money used for share trading effectively changes to circulating capital (i.e., "the cost of trade"). Thus, in substance, the shares became stock in trade, were held on revenue account and any trading loss on them would be deductible under section 104.

This means that a taxpayer who is in the business of dealing in shares or who buys shares with the dominant purpose of reselling them can claim a deduction for any loss realised on the resale of those shares.

The practical effect of these decisions is that where a taxpayer acquires shares with the dominant purpose of reselling them, then in the year of sale:

(a) the taxpayer will be assessable on any profit from the sale (i.e., the amount by which the sale price (less any brokerage) exceeds the cost price (plus any brokerage));

(b) the taxpayer may claim a deduction for any loss on the sale (i.e., the amount by which the sale price (less any brokerage) is exceeded by the cost (plus any brokerage))

(c) expenditure incurred to acquire shares will be deductible and the amount of any difference *on resale* will be taxable or deductible, as the case may be.

Taxpayers who seek to deduct share sale losses (where profits would have been assessed under the 2nd limb of section 65(2)(e)) have the onus of showing that when they bought the shares they had a clear and dominant purpose of reselling them. The requirement for taxpayers to show their clear and dominant purpose in acquiring shares was established in *C of IR* v *National Distributors* (1989) 11 NZTC 6,346. In that case, the court envisaged that taxpayers would point to the following types of activities in order to give an objective indication of their purpose in acquiring shares

- regular and systematic reviewing of their share portfolio
- whether they adopted a coherent pattern of sales and purchases;
- if they had sold shares for no other apparent purpose than for trading;
- whether the shares were held for a relatively short period;
- the taxpayer's vocation; and
- any other relevant circumstances about their acquisition and use of the shares.

*continued on page 4*

*from page 3*

We suggest that taxpayers use the format on page 35 as a convenient way of showing all the necessary information.

## Example

Chris is not a professional gambler, but likes to go on tours to big overseas racing carnivals two or three times a year. She funds each trip by investing on the sharemarket (she finds the returns are better than the TAB) and realising the investments when she makes her travel arrangements. She invested $8,000 to provide for her Melbourne Cup trip (the total cost was $8250, once brokerage was included). However, when she sold the shares she only got $3,880 ($4,000 less brokerage of $120). Chris spent that November at home but got some consolation by working out that she could deduct $4,370 (i.e. $3,880 minus $8,250) from her assessable income for that year.

## Inland Revenue's Policy on applying the Decisions

### Current Claims/Objections

Inland Revenue will apply the decisions to current claims and current objections to assessments. We will contact the taxpayers who have such claims or objections.

### Reopening of Past Assessments

In addition, some taxpayers may be able to have past assessments reopened.

Generally, if Inland Revenue has issued an assessment and the taxpayer hasn't objected within the time limit, the assessment becomes final and the taxpayer can't have it amended unless s/he makes a late objection. It is then up to the Commissioner to decide whether to allow the objection and amend the assessment (sections 27 and 30(2)).

However, the Commissioner will consider the particular circumstances of each objection to see if he will accept a late objection and reopen a taxpayer's assessment. In making this decision, the Commissioner will take account of factors including:

(a) whether the objector has consistently asserted that s/he was entitled to a deduction (in contrast to a taxpayer who never sought a deduction in the past, but who becomes aware of a decision affecting another taxpayer and tries to take advantage of it); or

(b) whether the objector has been associated with a claim or action against Inland Revenue on an issue relevant to the objection (even if not formally involved in the actual proceedings); or

(c) Inland Revenue has told the objector that the outcome of a group claim would be applied to that objector.

(See the article on *Gisborne Mills Ltd & Ors* v *C of IR* (1989) 11 NZTC 6,194 in TIB Vol.1, No.5 for Inland Revenue's policy on reopening assessments.)

## Applications for re-opening Past Assessments: Procedure.

Taxpayers who think they can claim a deduction for share sale losses they incurred in previous years can object to their assessments for the relevant income years. Inland Revenue will consider any such objections as late objections under section 30(2) of the Act.

If you want to make such an objection, you should send it in writing to your local Inland Revenue office. Please include these details for each share sale:

- name of company
- number of shares sold
- date of purchase, and cost price of shares (including brokerage)
- date of sale, and sale price of shares (net, after brokerage)
- other associated expenses (e.g. interest)
- amount of profit or loss
- the purpose for buying the shares (and evidence to establish that purpose - such as an outline of other share transactions over a period that includes the income year of the assessment. Inland Revenue would expect any taxpayers claiming a deduction for a loss to declare any profits from similar transactions).

You may use the format on page 35 as a convenient way of showing all this information:

## Summary

The Court of Appeal decisions in *C of IR* v *Stockwell* and *C of IR* v *Inglis* allow taxpayers who trade in shares (and other property) as a business, or who buy for the purpose of reselling (and would therefore be taxable on any profits from those transactions) to deduct any losses they incur on those transactions.

Inland Revenue will apply the decisions to current claims and objections. We will also consider reopening past assessments where taxpayers can show that the decisions should apply to their assessments, given their particular circumstances.

**References:** HO.10.S.2.1
Tech Rulings 12.9.5; 12.9.5.1;
12.9.5.3; 12.9.6.

**Please provide this information if you intend claiming losses on share transactions**
**(You can also use this format if you want a past assessment reopened)**

Name: ______________________

Occupation: ______________________

IRD Number: ______________________

Show details for all shares acquired for the purpose of resale.[1]

| Name of company | Purchases | | | Sales | | | Profit or loss ($) |
|---|---|---|---|---|---|---|---|
| | No. of shares bought | Date of purchase | Cost[2] ($) | No. of shares sold | Date of sale | Proceeds[3] from sale ($) | |
| | | | | | | | |

[1] Include all shares acquired for resale, even if they have not been sold

[2] Cost = price of the shares plus any brokerage paid

[3] Proceeds from sale = the amount received, less brokerage paid

**Other Information**

1. Please include any factual evidence of the purpose why you acquired the shares in question, including any documentary evidence. Relevant items of evidence are:
   - system for reviewing your share portfolio
   - the pattern of share sales and purchases
   - purpose of selling shares
   - the length of time you held shares before sale
   - any other circumstances which give an objective indication of why you acquired the shares
2. Please provide details of any expenses (e.g., interest) if there were any associated with the share transactions.
3. Please provide details of any previous share sales on which you have declared profits in your tax return. Include information shown in the above table where appropriate.

# Hire Purchase Agreements - when to return Income

## Summary

This item sets out Inland Revenue's new policy on when income from a hire purchase (HP) agreement should be returned. This policy will apply to HP agreements from 1 April 1993.

The retail profit element of a HP agreement must be returned in the income year the HP agreement is entered into, and the interest element must be returned on an accrual or "Rule of 78" basis (Tech Rulings Ch.12, para 12.42.3.3 explains this formula).

The Government intends to amend section 76 of the Income Tax Act so that the existing retail profit reserve on any HP agreement entered into on or before 31 March 1993 can be spread over the lesser of the remaining years of the agreement, or that year and the next three years. It also intends to enact a new finance lease regime which will apply to HP agreements entered into from 1 April 1993 onwards.

## Existing Policy

The existing policy allows taxpayers to offset a reserve against income derived from HP agreements. Inland Revenue allows the reserve because it represents an allowance for:

- the retail profit content, and
- the interest content

of any instalments that are unpaid at balance date. This is based on the assumption that the interest and profit content of the HP agreement is spread equally over all instalments.

NOTE: The Hire Purchase Act 1971 defines "Hire Purchase Agreement" as either a customary Hire Purchase Agreement or a Conditional Sale Agreement. Inland Revenue adopts this definition for the purposes of the Income Tax Act.

"Retail Profit" is the profit that the seller would have made if the goods in question were sold for cash.

## New Policy

The new policy will apply to HP agreements from 1 April 1993. The timing of the change is consistent with our usual practice of applying policy changes from a future date.

Inland Revenue reviewed its policy in the light of:

(a) Sections 222A to 222E of the Income Tax Act;

(b) Case M13 (1990) 12 NZTC 2092 and Case M94 (1990) 12 NZTC 2578; and

(c) Current accounting practice (see SSAP 18).

Following the review, HP agreements should clearly follow the specified lease regime in sections 222A to 222E of the Income Tax Act. This policy amends the previous policy on HP agreements and the specified lease regime, which was set out in Public Information Bulletin No.120/1, of August 1983.

A HP agreement is a "specified lease" for the purposes of sections 222A-222E. "Lease" is defined in section 222A(1) to include any hire or bailment and includes both a true hire purchase agreement (that is a bailment with an option to purchase) and a conditional sale agreement.

Sections 222A to 222E of the Income Tax Act provide a code for financial leases (called "specified leases" in the provisions). In particular these sections specify how the income from the "financial" portion of the specified lease should be returned.

Section 222C deems income derived from a specified lease to be interest. In a HP agreement that income is any amount above the "cost price" of the asset. "Cost Price" of an asset is the normal selling price at which the retailer would have sold it.

Section 222C also gives methods to calculate the amount of interest for any particular income year. There are two prescribed methods; one approximates the yield to maturity (YTM) method, the other is any method that has the Commissioner's approval (The only other method to date which has the Commissioner's approval is the "Rule of 78" method). The retailer can use the Rule of 78 method if the HP agreement meets these criteria:

(a) the term of the agreement is 5 years or less; and

(b) all instalments are of an equal amount other than the final instalment, which must be within five percent of other instalments; and

(c) all instalments are payable regularly, e.g., weekly, monthly, six monthly.

As noted above, section 222C deals only with the interest income, that is, the amount above the cost price. The retail profit should be returned in the income year the HP agreement is entered into.

The purchaser does not have to deduct interest in the same manner as the retailer returns it (see Tech Rulings Ch.12, Para 12.42.4). Section 222D governs the amount of interest which the purchaser can deduct in any income year, providing the interest meets the deductibility test in the Act.

The Government has indicated that it will introduce a new finance lease regime which will apply to HP agreements entered into from 1 April 1993. This regime will bring both specified leases and HP agreements into the accrual regime. The principal change will be that the interest element of these transactions will generally be returned on a YTM basis (or in some circumstances straight line or another method which conforms with commercially acceptable practice and gives materially the same result as YTM). The retail profit element will continue to be returned as income in the income year the HP agreement is entered into. The proposed new regime will apply to transactions entered into on or after 1 April 1993.

## Proposed Transitional Measures

The Government has indicated that it will amend section 76 of the Income Tax Act, which allows income to be spread where there has been a change in accounting practice. It is proposed that taxpayers who have entered into HP agreements on or before 31 March 1993 will be able to spread the existing retail profit reserve over the lesser of the remaining life of the agreement or over the year of adjustment and the three succeeding years. This means taxpayers should have sufficient time to adjust to the change in Inland Revenue's policy.

We will publish a detailed statement on the transitional measures and finance lease regime as soon as the legislation is passed. This statement will include practical examples to demonstrate the effect of the legislation.

**Reference:** HO.10.R.9.1.
Tech Rulings 12.42.8 and 20.50.2

# Objecting to Assessments

Part two of Inland Revenue's Objection Procedures booklet (IR 266) states that taxpayers can make an objection only to a notice of assessment.

Following legal advice, we have determined that in reality a taxpayer objects to an assessment; not the actual printed notice which conveys the assessment. Consequently, a taxpayer may object to an assessment of tax shown on a notice of adjustment that s/he receives before receiving the actual notice of assessment. The time limit for lodging an objection remains two months from the date on the notice of assessment.

In the case *R* v *DFCT ex parte Hooper* Cook J said when referring to an assessment:

> "An 'assessment' is not a piece of paper: it is an official act or operation; it is the Commissioner's ascertainment, on consideration of all relevant circumstances, including sometimes his own opinion, of the amount of tax chargeable to a given taxpayer. When he has completed his ascertainment of the amount, he sends by post a notification thereof called 'a notice of assessment' ... But neither the paper sent nor the notification it gives is the 'assessment'. This is and remains the act or operation of the Commissioner."

This issue arose when Inland Revenue disallowed an assessment because we had not yet issued a notice of assessment.

Similar objection rights exist in relation to determinations that the Commissioner makes about such things as:

- a loss, or a loss carried forward
- Foreign Investment Funds
- imputation
- source deduction payments.

In the case *Lloyds Bank Export Finance* v *C of IR* (1991) 13 NZTC 8134 PC, Inland Revenue argued before the Privy Council that an assessment must result in tax to pay, and that a taxpayer could not object to an assessment in nil tax to pay or loss situations. The Privy Council did not support this view and confirmed that a taxpayer can object to any assessment of his/her liability, regardless of whether it has a positive, negative, or neutral (nil) result.

# Taxpayer Audit Programme - Lines of Authority

## Introduction

We previously published this item in TIB Volume One, No. 7 of January 1990. Since then, the New Zealand Society of Accountants has asked us to provide an update on the structure and operations of Inland Revenue's Taxpayer Audit Programme.

Taxpayer Audit is currently carrying out a programme evaluation, which may affect the current structure.

## Background

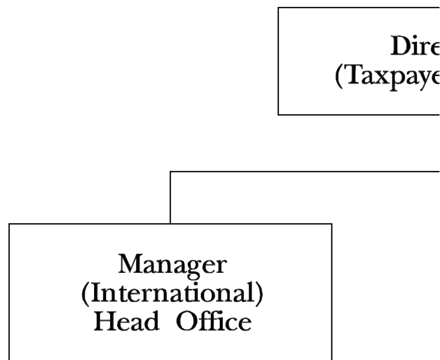
Inland Revenue's field audit/investigations activity is grouped under the Taxpayer Audit Programme - consisting of Payroll Inspectors, GST Audit, Income Tax Audit, Investigations Unit and Specialist Units.

## Structure

The Taxpayer Audit programme has three main levels:

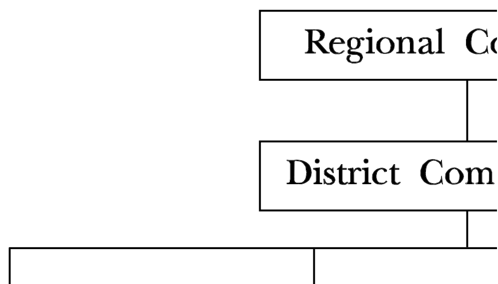
### 1. Head Office

Taxpayer Audit in Head Office is headed by the Director (Taxpayer Audit) and is concerned with policy matters. There are two specialist units set up in Head Office - a small team of Specialist Inspectors and a recent policy initiative has seen the establishment of the Special Audit Unit.




### 2. District Office

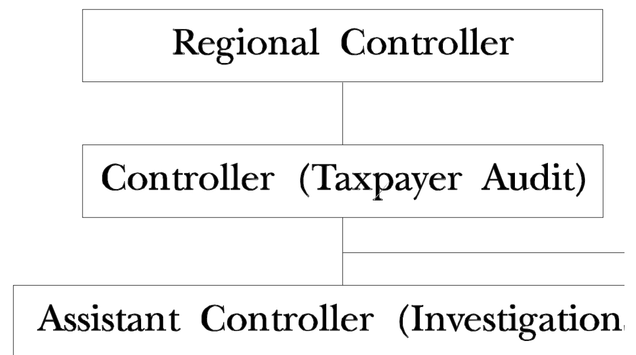
In our district offices, Payroll Inspectors, GST Auditors and Income Tax Audit staff all have Supervisors to whom they report directly. The Manager (Taxpayer Audit) has overall responsibility for the Payroll, GST Audit and Income Tax Audit programmes, and reports to the local District Commissioner



### 3. Investigations Unit

The Investigations Unit is structured on a regional basis. In each region (Northern, Waikato, Central and Southern) there is a Controller (Taxpayer Audit), who is situated at the Inland Revenue Regional Office in Auckland, Hamilton, Wellington or Christchurch. There are Senior Investigating Accountants, Investigating Accountants and Investigations Officers in most of our district offices, and Assistant Controllers (Investigations) in Auckland, Otahuhu, Takapuna, Hamilton, Napier, New Plymouth, Palmerston North, Wellington, Lower Hutt, Christchurch, Dunedin and Invercargill.

The Senior Investigating Accountants work on the more complex large audits.




## What to do if you are concerned about an Audit or Investigation

If you disagree with any of the findings of an audit or investigation, or if you are unhappy about the way an audit or investigation is being conducted, you should initially raise the matter with the officer concerned and/ or that officer's immediate superior. If the problem is not resolved, your next point of contact will depend on the type of audit or investigation.

- For Payroll Inspectors, GST and Income Tax Auditors, contact the relevant Supervisor at your local IRD office. If the matter cannot be resolved at this level, ask for the local Manager (Taxpayer Audit). If the s/he is unable to help, then the next step is the District Commissioner and ultimately the Regional Controller.
- For cases involving the Special Audit Unit, you should contact the Manager (Special Audit). If s/he cannot resolve the matter, ask for the Director (Taxpayer Audit).
- For cases involving Specialist Inspectors, you will need to contact the Manager (International Audit). If s/he cannot resolve the matter, ask for the Director (Taxpayer Audit).

- Sometimes an Investigating Accountant or Investigations Officer from one District /Region investigates a file in another District/Region. The lines of control of these investigations remain at "home base". In these investigations, issues may arise which need to be discussed. Where the parties involved are not at the same location, discussions will be held by mutual arranged place. In this situation IRD staff are happy to travel to other centres. If discussions with the Controller (Taxpayer Audit) do not resolve the matter, you may wish to contact the local Regional Controller where the file is held. A formal request for case stated would be dealt with by this Regional Controller.

# Interest on Qualifying Tax in Dispute

## Introduction

Inland Revenue must pay interest when refunding qualifying tax in dispute. Our Objection Procedures booklet (IR 266) states that this interest is only payable on the non-deferrable portion of tax in dispute. However, this is incorrect; we must pay interest on all qualifying tax in dispute that we refund.

## Background

When a taxpayer makes a “competent” objection (explained in our Objection Procedures book), s/he may put off paying up to half of the tax in dispute until the objection is decided. The half that s/he can put off paying is called deferrable tax in dispute, and the half that s/he must pay by the normal due date is called non-deferrable tax in dispute.

## Interest Payable

If an objection is fully or partly allowed, Inland Revenue must refund any consequential overpayment, and pay interest on the qualifying tax in dispute. This is so whether the Commissioner concedes an objection, or if the Courts or Taxation Review Authority decide in the taxpayer's favour.

Inland Revenue must pay interest on any qualifying tax in dispute that the taxpayer pays before the objection is decided, and which must subsequently be refunded. If the taxpayer chooses to pay an more of the tax in dispute than the minimum non-deferrable part (50%), then Inland Revenue must pay interest on this total amount.

The prescribed formula for calculating the interest is:

$$\frac{X \times Y}{365} \times Z$$

X = the number of days for which interest is payable

Y = the amount of qualifying tax in dispute that Inland Revenue is to refund

Z = the specified interest rate (13.5% up to 31/3/1992; 10% from 1/4/92)

## Examples

### Example 1

Inland Revenue issues an income tax notice of assessment on 25 May 1992, which shows residual income tax (RIT) of $3,500 due by 7 February 1993. The taxpayer makes a competent objection to the assessment on 18 June 1992. S/he considers that the RIT should have been $1,000.

The Commissioner declines the objection on 2 July 1992, and on 15 July 1992 the taxpayer requests that a case be stated to the High Court. The qualifying tax in dispute is $2,500. On 8 February 1993 (the 7th is a Sunday), the taxpayer pays the $1,000 that is not in dispute, and half of the tax in dispute ($1,250).

On 3 May 1993 the High Court decides in the taxpayer's favour, confirming that the assessment should have been $1,000. On 12 May 1993 Inland Revenue refunds the overpaid tax of $1,250 and interest of $32.20.

That interest was calculated using the prescribed formula:

$$\frac{94 \times \$1{,}250}{365} \times 10\% = \$32.50$$

### Example 2

If the taxpayer in Example 1 had chosen to pay all the tax in dispute, (even though by law s/he only had to pay half of it), the qualifying tax in dispute on which interest is to be calculated would be $2,500. The interest payable would then be $64.39.

$$\frac{94 \times \$2{,}50}{365} \times 10\% = \$64.39$$

**Reference:** HO.10.T.2.3.

# Depreciation on Second-Hand Assets

## Introduction

This article sets out the circumstances in which a taxpayer can claim depreciation based on the actual price paid for a previously depreciated asset that s/he acquires from another person.

## Section 111(1)

Section 111(1) of the Income Tax Act 1976 limits the depreciation that may be claimed on assets acquired from another person. The new owner may only claim as much depreciation as the previous owner could have claimed if s/he had retained the asset. However, the new owner can claim depreciation based on the actual price paid for the asset where the Commissioner is of the opinion under section 111(2) of the Act that

> *"the circumstances are such that a deduction in respect of the depreciation of the property based on the actual price or other consideration given for the property should be allowed."*

In these circumstances the purchaser can depreciate the asset based on the amount s/he paid for it, regardless of its depreciated value in the hands of the vendor.

## Application of Section 111(2)

Section 111(1) will not apply if the Commissioner is satisfied that the purchaser should be able to claim depreciation based on the actual price paid for the property.

The Commissioner will normally exercise this discretion if there is an arm's length sale where:

(i) the sale is bona fide; and

(ii) the purchase price is a fair market value for the asset; and

(iii) the purchaser buys the asset for use in income producing activities, and the vendor no longer uses it for producing activities.

In *CIR* v *Lys and Others* (1988) 10 NZTC 5,107 there was a transfer to a family trust. The High Court stated that this transfer should be considered in relation to normal commercial and conveyancing practices. If the transaction was in accordance with these practices then section 111(2) should apply even though the parties were related.

## Summary

Where there is a transfer in accordance with normal commercial practice for arm's length sales, the new owner can claim depreciation based on the amount s/he pays for the property. The fact that the parties are related does not in itself prevent the Commissioner from exercising his discretion under section 111(2).

**Reference:** HO.10.D.3.6
Tech Rulings (Old Series) Ch 7 Para 5
(Amendment No 407, October 1988)

# GST and Suspensory Loans

## Introduction

All suspensory loans and advances made on behalf of the Crown or by any public authority before 1 January 1993 will not be subject to GST when they are converted to a grant or subsidy, unless the loan or advance is expressly stated to include GST.

## Background

The Goods and Services Tax Amendment Act (No.3) 1991 clarified Government policy by confirming that grants and subsidies made by the Crown and public authorities are subject to GST when made to a registered person for his/her taxable activity. Suspensory loans and advances are "grants or subsidies" when the loan or advance becomes non-repayable because the conditions for non-repayment are satisfied.

Suspensory loans and advances have been made with no provision for GST payable. Recipients of suspensory loans and advances would therefore be out of pocket if required to return GST on those loans and advances which did not include provision for GST.

## Key Issues

To prevent recipients of suspensory loans and advances from being out of pocket, the Government has decided that any loans or advances made before 1 January 1993 will not be subject to GST when converted to a grant or subsidy. However, loans and advances which were explicitly stated to include GST will still be taxable upon conversion.

A registered person can claim a GST refund if s/he paid GST on a suspensory loan or advance which made no provision for the GST liability.

This measure was brought into effect by the Goods and Services Tax (Grants and Subsidies) Order 1992.

Recipients of loans and advances made after 1 January 1993 must return GST on any loan or advance which is converted to a grant or subsidy.

# Companies in Receivership or Liquidation - RWT Exemption Certificates

## Introduction

This item sets out details of what Inland Revenue will accept as budgeted accounts where a company that is in receivership or liquidation applies for a certificate of exemption from resident withholding tax (RWT).

## Background

Section 327M(12) of the Income Tax Act 1976 allows the Commissioner to issue certificates of exemption from resident withholding tax.

There are two situations where the Commissioner can issue such a certificate. One of these is where a taxpayer will or is likely to incur a loss, or has losses to carry forward that are greater than that year's assessable income (paragraph (a) in section 327M(12)).

To meet this criterion, section 327M(12)(d) requires the taxpayer to supply budgeted accounts that confirm the losses (or projected losses) to Inland Revenue.

Companies in receivership or liquidation often have current or prior year losses. However, some of these companies cannot produce budgeted accounts to confirm their losses to Inland Revenue. We currently accept accounting statements prepared for the liquidator or receiver, but in some cases these accounting statements have not been prepared when a liquidation or receivership begins.

In these cases, we will apply the following policy.

## Ruling

This ruling applies to companies in receivership or liquidation that wish to apply for a certificate of exemption from RWT under subsection 327M(12). Where statements were not prepared for the receiver or liquidator, or there are insufficient records to produce detailed budgeted accounts, we will accept pro forma accounts that show:

a) the amount of losses to be carried forward; and

b) the amount of expected income or loss for the year; and

c) that the losses in a) will be sufficient to fully offset any income in b).

This is provided:

- the company has filed tax returns which confirm the losses; or
- there are other reasonable grounds for concluding that the company will meet the requirements of paragraph (a) or paragraph (b) of section 327M(12), and these grounds are provided to Inland Revenue in writing.

## Application Date

The policy applies from 1 January 1993. It may not be applied retrospectively.

**Reference:** HO.10.I.6.9
Tech Rulings 58.15.6.5 and 58.15.6.6

# Questions We've Been Asked

This section of the Tax Information Bulletin sets out the answers to some day-to-day questions that we've received. We've published these as they may be of general interest to readers.

These items are based on letters we've received. A general similarity to items in this package will not necessarily lead to the same tax result. Each case will depend on its own facts.

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# Income Tax Act 1976

## Cash Gifts Received by Voluntary Workers

**Section 65 - Items Included in Assessable Income:** A voluntary worker for a church organisation asked whether cash gifts and donations received from friends and family were liable for income tax. The payments were made to help the worker with the services provided on behalf of the organisation.

The payments made to the volunteer from family and friends are not of an income nature as they are not paid or received as reward for services. Nor were the payments expected or relied on for the volunteer's support. The gifts were marks of affection, esteem or respect for the volunteer. The payments did not therefore have the character of income, so they were not assessable for income tax purposes.

**Reference:** HO.TPA041

## Assessability of Insurance Commission

**Section 65 - Items Included in Assessable Income:** An insurance agent asked whether commission derived from selling policies to himself and his immediate family should be treated as assessable income.

All commissions paid on policies that an insurance agent sells are assessable income under section 65 of the Act. This is regardless of whether or not the policy was sold to family.

**Reference:** HO.TPP069

## Assessability of Gratuity to Retiring Employee

**Section 68 - Retiring Allowances Paid to Employees:** When s/he ceased employment, a taxpayer received a gratuity payment for long service leave entitlement. S/he asked whether this payment was assessable for income tax purposes. The taxpayer's employment agreement stated that the employer would grant on retirement or resignation a gratuity payment to employees who had 10 or more years service. The payment was to be calculated at the rate of one week's salary for each year of service less any paid leave taken under a long service leave entitlement.

If a payment made to an employee is calculated according to any right or entitlement which is not dependent on the employee's retirement or redundancy, the payment is fully assessable for income tax purposes. In this case, as long service leave could be taken instead of a gratuity payment, and the payment was not dependent on the taxpayer's retirement or redundancy, it was fully assessable.

**Reference:** HO.TPA048

## Deduction for Outward Bound Course Fees

**Section 104 - Expenditure or Loss Incurred in Production of Assessable Income:** An employer asked whether s/he could claim a deduction for fees paid to enable an employee to attend an Outward Bound course.

Expenditure incurred in producing assessable income, or in carrying on a business for that purpose, is deductible under section 104 of the Act. In this case the employer was allowed a deduction because the Outward Bound course was regarded as training given to the employee.

**Reference:** HO.TPA045

## Profit on Sale of Leased Asset

**Section 107 - Revised Assessments Where Assets Purchased and Resold After Deduction of Payments Under Lease:** A taxpayer in business leased a motor vehicle, and subsequently purchased it after a year. The purchase was a condition of the lease, but the lease was not a "specified lease" as defined in section 222A. The taxpayer then sold the motor vehicle 6 months later for more than the purchase price.

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Under section 107, the lesser of these amounts is assessable in the year of sale:

- the excess of sale over purchase price, or
- the deductions allowed under the lease

This applies whether or not the purchase was a condition of the lease.

**Reference:** HO.TPP032

## Interest Income Derived by Deceased Estate

**Section 232 - Income Derived by Trustee after Death of Deceased Person:** The trustee of an estate asked about the tax treatment of the deceased person's interest income which had accrued to the date of death. The deceased was a cash basis holder. The interest had been received by the trustee after date of death.

Interest which is not paid out to the person or dealt with until after the date of death is deemed under section 232 of the Act to have been derived by the trustee. The income should therefore be included in the estate's return of income.

**Reference:** HO.TPA005

## Income of New Zealand Resident Working Overseas

**Section 242 - Liability of Income Derived from New Zealand and Abroad:** A New Zealand resident asked why income received while working overseas would be liable for New Zealand income tax. The person had left New Zealand to work overseas for 4 months and subsequently returned.

The taxpayer was deemed to be a New Zealand resident for income tax purposes. Income that s/he received in New Zealand was liable for income tax in New Zealand under section 242 of the Act. This applied to all income that the taxpayer received, whether it was from within or outside New Zealand.

A person who is not a New Zealand resident for tax purposes is only liable for income tax on income with a New Zealand source.

**Reference:** HO.TPA016

## Interest Derived by Overseas Exchange Teacher

**Section 243 - Classes of Income Deemed to be Derived from New Zealand:** A French exchange teacher working in New Zealand derived interest income from a bank deposit in New Zealand. The teacher was a deemed resident under section 241, so the bank deducted resident withholding tax from the interest. The teacher questioned whether this deduction was correct.

Section 243 of the Act deems the interest to be derived from New Zealand, because it has a source in New Zealand. Article 21 of New Zealand's Double Tax Agreement with France contains an exemption which applies to income received from teaching activities in New Zealand for up to two years. The exemption does not apply to income from activities other than teaching. The bank had therefore correctly deducted withholding tax from the interest.

If the teacher had not been a deemed resident, non-resident withholding tax would have applied.

**Reference:** HO.TPA012

### Exemption from Resident Withholding Tax for Non-Profit Bodies

**Section 327M - Certificates of Exemption:** A non-profit body asked if it was possible to be exempted from the deduction of resident withholding tax from interest on an investment. The non-profit body received total income of less than $1,000 in its most recently completed accounting year.

A non-profit body which is exempt from income tax, or which has a total income of less than $1,000 may apply for a certificate of exemption from resident withholding tax under section 327M of the Act. If the body's income exceeds $1,000, resident withholding tax must be deducted from any interest or dividends they receive.

**Reference:** HO.TPA015

# Goods and Services Tax Act 1985

### GST on Food Parcels sent Overseas

**Section 11 - Zero-Rating:** A food retailer asked whether food parcels sent overseas on behalf of persons living in New Zealand are zero-rated for GST purposes. A person in New Zealand purchased the food parcels, and as part of the sale the retailer was to send the parcels to a person overseas.

A supply of goods and services entered for export to a place outside New Zealand will be zero-rated under section 11 of the Act. In this case the goods would be treated as a zero-rated supply by the food retailer.

**Reference:** HO.TPA049

### GST and Domestic Rental Properties

**Section 14 - Exempt Supplies:** The taxpayer asked whether s/he could claim GST on the purchase price of a dwelling used for rental purposes.

The supply of rental accommodation is an exempt supply under section 14(c) of the Act. In this case no GST can be claimed on any expenditure, including the purchase price of the rental property.

**Reference:** HO.TPA029

# Due Dates Reminder

## January 1993

5 PAYE deductions and IR 66ES for last 16 days of December 1992 due - "large" employers only.

7 First instalment of 1993 Provisional Tax due for taxpayers with September balance dates.

Second instalment of 1993 Provisional Tax due for taxpayers with May balance dates.

Third instalment of 1993 Provisional Tax due for taxpayers with January balance dates.

1992 End-of-Year tax due for taxpayers with February balance dates.

Annual income tax returns due for non-IR 5 taxpayers with balance dates from 1 to 30 September 1992.

15 GST return and payment due for period ended 30 November 1992.

20 RWT on Interest deducted during December 1992 due for monthly payers.

RWT on Dividends deducted during December 1992 due.

NRWT (or Approved Issuer Levy) deducted during December 1992 due.

PAYE deductions and IR 66ES for first 15 days of January 1993 due - "large" employers only.

PAYE deductions and IR 66ES for December 1992 due - "small" employers.

FBT return and payment for quarter ended 31 December 1992 due.

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

GST return and payment for period ended 31 December 1992 due.

## February 1993

5 PAYE deductions and IR 66ES for last 16 days of January 1993 due - "large" employers only.

7 First instalment of 1994 Provisional Tax due for taxpayers with October balance dates.

Second instalment of 1993 Provisional Tax due for taxpayers with June balance dates.

Third instalment of 1993 Provisional Tax due for taxpayers with February balance dates.

1992 End-of-Year tax due for taxpayers with balance dates from March to September (inclusive).

Annual income tax returns due for non-IR 5 taxpayers with balance dates from 1 to 31 October 1992.

Earner Premium payment due for self-employed people.

20 RWT on Interest deducted during January 1993 due for monthly payers.

RWT on Dividends deducted during January 1993 due.

NRWT (or Approved Issuer Levy) deducted during January 1993 due.

PAYE deductions and IR 66ES for first 15 days of February 1993 due - "large" employers only.

PAYE deductions and IR 66ES for January 1993 due - "small" employers.

Gaming Machine Duty return and payment for month ended 31 January 1993 due.

GST return and payment for period ended 31 January 1993 due.

Volume Four, No.5 December 1992

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