Tax Treatment of Entertainment Expenditure

In its 1992 Budget, the Government announced planned changes to the tax treatment of entertainment expenditure. The Minister of Revenue made this press statement about the Budget announcement on 17 December 1992:

Further information on the Government's proposed new tax treatment of entertainment expenditure will be available from early next week at Inland Revenue Offices.

The proposed legislation enacting the changes is included in the Taxation Reform Bill (No 6) introduced to Parliament today.

"Public interest in the development of detailed policy on entertainment expenditure has been understandably high," the Minister of Revenue, Wyatt Creech, said today.

"Given the level of interest, and the regime's introduction to Parliament, the Inland Revenue Department is making available a publication on the operation and practical implications of the tax changes."

Under the proposed legislation fringe benefit tax will be imposed on 50% of entertainment expenditure, with the cost of the entertainment and the FBT liability fully deductible.

FBT will not, however, be imposed on non-employing taxpayers. Instead only 50% of the entertainment expenditure will be deductible.

"Submissions on the Bill will be heard by the Finance and Expenditure Select Committee," Mr Creech said. "The chairperson of the committee advises me that the likely closing date for submissions will be 12 February 1993. They can be lodged from now on."

The following articles reproduce the text of the information available from Inland Revenue.

The Proposed Tax Treatment of Entertainment Expenditure

This guide to the proposed tax treatment of entertainment expenditure is based on the legislation contained in the Taxation Reform Bill (No. 6) 1992 at time of its introduction into Parliament. It has been prepared to assist people to understand the detail of the proposed tax treatment. The legislation is to be referred to the Finance and Expenditure Select Committee. Submissions on the Bill will be heard by the Finance and Expenditure Select Committee. Because changes can occur as a result of the Select Committee process, this publication may not therefore reflect the final form of the legislation. It is expected that the closing date for submissions to the Select Committee will be 12 February 1993.

Background and Summary

Currently, businesses are able to fully deduct entertainment expenses for tax purposes. Entertainment expenditure often carries a significant portion of private benefit, as well as a business benefit. The private benefit should not be deductible. Because it is difficult to apportion the private component, the legislation sets a minimum of 50 percent of the total expenditure as the private element.

The tax treatment proposed in this legislation brings defined expenditure on entertainment into the Fringe Benefit Tax regime, and offers an alternative income tax treatment for non-employing taxpayers.

The Inland Revenue Department is committed to enforcing this legislation and plans to step up compliance activity in this area.

Any questions on the proposed entertainment regime may be directed to:

Legislative Affairs Directorate
Head Office
Inland Revenue Department
P O Box 2198
WELLINGTON

Phone: (04) 472-1032
Fax: (04) 499-1690

Wyatt Creech
Minister of Revenue

Information about the proposed new entertainment provisions continues on page 2

For Tax Purposes, What is Entertainment?

In the Bill as introduced, entertainment is defined as being the provision of:

(i) food;

(ii) beverages;

(iii) recreation;

Recreation is widely defined as being active or passive participation in sports, games, physical exercise, or artistic, cultural, social, or leisure pursuits or amusement whether or not provided in connection with an entertainment facility. An entertainment facility includes land, buildings, aircraft, yachts or other vessels or vehicles.

(iv) accommodation or travel provided in connection with entertainment in the form of (i), (ii) or (iii) above;

Where the accommodation or travel is connected with or undertaken for the purposes of facilitating entertainment as in (i), (ii) or (iii) above, it is subject to the same tax treatment as the entertainment itself. For example, a client of an advertising agency is taken to Club Med. The dominant purpose of the expenditure was entertainment or entertainment-related, the total expenditure, including accommodation and travel will be subject to the regime.

(v) money or money's worth for the provision of any of (i), (ii), (iii) or (iv) above.

This means that allowances paid to cover entertainment as defined will become fully subject to FBT. Reimbursing payments will be partially subject to FBT.

What Entertainment is Excluded?

The Bill excludes several types of entertainment from the proposed treatment:

- Goods and services which constitute entertainment but are provided at market value to paying customers in the ordinary course of a business, such as a restaurant selling food and drink to the public.

  Consequently, meals sold to the public will not be subject to tax. Expenditure incurred by a restaurateur to entertain suppliers, for instance, will, however, be subject to the regime.

  This exclusion prevents the business being charged FBT or denied a deduction for its inputs. Where a restaurant provides entertainment which is not in the course of the business, i.e. for no charge, it will become subject to the regime.

- Entertainment which is already assessable as income to the person to whom it is provided.

- Expenditure which is incurred in promoting or advertising goods and services to the general public or a broad sector of the general public. The invitation must be public and non-exclusive.

  Some examples of where this exclusion would apply are:

  - a movie theatre provides a free ticket to every 10th patron.
  - a trade association holds an exhibition publicly advertised to members of the construction industry.
  - a manufacturer publicly invites retailers to the launch of its new T.V. If the manufacturer invited retailers of that manufacturer's product only, the promotion would not meet the terms of the exclusion, not being to a broad sector of the public. The provision of morning and afternoon teas or similar light refreshments would be excluded even in this case under the general exclusion however.

- Expenditure incurred in the provision of entertainment for charitable purposes. For example, the sponsorship of a hospital children's Christmas party.

- The provision of morning and afternoon teas or similar light refreshments provided at any time during the day.

- Expenditure incurred in the provision of an in-house dining facility or cafeteria which is open to all employees.

  The provision of food and drink to employees and clients in in-house dining facilities on non-social occasions is exempted. Consequently, expenditure incurred in the provision of a staff cafeteria will be excluded from the regime.

  The exemption will not, however, apply to :

  - executive dining rooms not available to all employees;
  - alcohol consumed in an in-house dining facility; and
  - staff parties, such as a Christmas party.

- Entertainment enjoyed as an incidental part of employment on the premises of the employer, who in the ordinary course of business provides entertainment to the public.

  This provision would exempt, for instance, incidental food provided to a kitchen-hand by a restaurateur.

- Entertainment enjoyed by a reviewer or critic of entertainment. Consequently, expenditure incurred on entertainment by a film or food critic, for instance, would not be subject to the regime.

- Entertainment provided in conjunction with commercial travel by aircraft, train or bus, for example, in-flight meals.

- Entertainment provided by an after-dinner speaker.

What is the Proposed Tax Treatment?

The regime contains two alternative tax treatments:

- Entertainment expenditure of employers is subject to the FBT regime.
- Non-employing taxpayers may elect to have their entertainment expenditure subject to the FBT regime with an alternative of non-deductibility. This alternative recognises the fact that additional compliance costs would result from non-employing taxpayers joining the FBT regime.

Generally, 50 percent of entertainment expenditure will be subject to FBT.

Where the expenditure involves employees, and is at the employer's premises, 50 percent of the expenditure will be subject to FBT.

An in-house dining facility open to all employees is not subject to the regime.

Can Taxpayers Elect to Move Between Alternatives?

It will not be possible to move between the alternative treatments.

The entertainment expenditure of taxpayers already in the FBT regime will become subject to the FBT treatment.

Those taxpayers who are not employers may elect to make the expenditure non-deductible, or subject to FBT.

Where the entertainment regime applies to those not liable for income tax this will be by way of the FBT regime.

Why 50% of the Expenditure?

The 50% approach recognises that the benefits derived from entertainment expenditure include both business and private components. The Government accepts that any proportion chosen will necessarily only be an arbitrary approximation of the actual private benefits conferred in a particular situation, but 50% strikes a fair balance.

What Kind of Records will Taxpayers Need to Keep?

There should be no need to keep any additional records, apart from the normal ledgers, journals, invoices or receipts which clearly show what the actual expenditure is. These records are already required to substantiate any expense deduction.

More Detail on Other Areas of the Legislation

In-house Entertainment Facilities

Expenditure incurred in the provision of in-house entertainment will be subject to tax. Half of the expenditure will be subject to FBT or partial non-deductibility. Any expenditure incurred in the provision of an exempt in-house dining facility will fall outside the regime because of the specific exclusion relating to it. The provision of an in-house gymnasium, swimming pool, squash court, etc., will be subject to the regime.

The value of an in-house facility (not including an exempt in-house dining facility) will be based on:

- external market value of a similar facility, where it is presumed that that market value includes all relevant costs; or
- a combination of actual direct and indirect costs relevant to the facility.

The indirect costs that should be included are:

- utilities;
- repairs and maintenance of equipment;
- rent;
- depreciation.

The basis of apportionment of indirect costs should follow the rules used for trading stock purposes whereby a common measure such as floor area is used.

Corporate Boxes

Half of the cost of a corporate box will be subject to the regime.

The regime will apply to both temporary and permanent facilities.

Examples would include corporate boxes at sports grounds and hospitality tents at horse races.

Conferences, Seminars and Trade Displays

Entertainment provided at a conference, seminar or trade display will be subject to FBT or non-deductibility. Entertainment will not, however, include the provision of morning and afternoon teas or similar light refreshments.

Where the entertainment provided at a conference, seminar or trade display is specifically identified in the charge to a taxpayer, FBT or non-deductibility will be imposed on that person. Where, however, the value of the entertainment is not specifically identified, the liability will fall on the conference organiser. In relation to an overseas conference, it would be unreasonable to impose a New Zealand tax liability on a non-resident organiser. Accordingly, FBT or non-deductibility would apply to a "fair and reasonable portion" of the total charge to the taxpayer.

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Entertainment as defined includes travel or accommodation to facilitate the provision of food, drink or recreation. Consequently, the cost of travel or accommodation will be subject to tax where the predominant purpose of the expenditure is to facilitate entertainment, for example, where the presentation of conference material is merely incidental to sightseeing tours and social functions.

Jurisdictional Coverage

All entertainment provided by a New Zealand resident will be subject to the regime irrespective of where and to whom the entertainment is provided.

A person who is not resident in New Zealand, but has business income derived in New Zealand, will be subject to the regime for entertainment provided in New Zealand. If that person entertains offshore, the expenditure would not be subject to the regime unless a deduction was claimed for that expenditure against New Zealand sourced assessable income.

Controlled Foreign Companies and Foreign Investment Funds

Entertainment expenditure incurred by a CFC will be subject to the entertainment regime.

For the FIF regime, non-deductibility will be followed when branch equivalent income is calculated. However, use of either comparative value or deemed rate of return is based on the valuation of the investment in the FIF rather than the calculation of the entity's income, and non-deductibility would have no effect. Further, entertainment expenditure would not be identified using the accounting profits method.

Consequently, unless the branch equivalent method is followed to calculate FIF income, the regime on entertainment will not apply to the holder of a FIF.

Non-Taxable Bodies

Following the current operation of the FBT regime to non-taxable bodies 50 percent of the expenditure incurred in entertaining employees will be subject to FBT, where that entertainment occurs in the course of carrying on a business.

Government departments and local authorities will, however, be subject to FBT for entertainment provided to employees and clients or customers.

Goods and Services Tax

Amendments will be made to the Goods and Services Tax Act 1985 to ensure that where entertainment expenditure is incurred, an associated GST output tax liability will arise. This output tax liability will be based on the FBT value or the amount that is non-deductible entertainment expenditure for income tax purposes.

Shareholders

Following the current practice in relation to non-cash dividends provided to shareholders, entertainment provided to:

(i) shareholder-employees of any company will be subject to FBT, with the cost of the entertainment and the FBT liability fully deductible;

(ii) shareholders of qualifying companies will be exempt from tax and non-deductible;

(iii) shareholders of non-qualifying companies will be treated as a non-cash dividend, assessable to the shareholder and non-deductible to the company.

Changes to the Current FBT Regime

A number of exemptions to the current definition of fringe benefit will be removed. Consequently, the definition of fringe benefit will be extended to include:

- entertainment, not including an allowance, provided to an employee by his/her employer for the purpose of enabling the employee to entertain someone, including existing or prospective clients or customers of the employer. Fifty percent of the expenditure incurred in the provision of such benefits will be subject to FBT.
- a membership subscription which the employer of the employee has paid, and which entitles the employee to membership of a club of which members of the general public may become members. Consequently, subscriptions to a gym or tennis club, provided by an employer to employees will be subject to FBT.
- benefits enjoyed through the in-house provision of entertainment, but not including entertainment provided through an in-house dining facility. Fifty percent of such expenditure will be subject to FBT.

The exemption for small amounts (the de minimis) in the FBT regime will be "capped" at $75 per quarter per employee for the first three employees receiving fringe benefits and $225 per employer per quarter thereafter. If the value of fringe benefits exceeds this threshold, the full value of the benefits will be taxable. This de minimis will not, however, apply to the provision of entertainment.

Allowances and Reimbursing Payments

The definition of entertainment includes "money or money's worth..." This means that entertainment allowances paid to employees will be fully subject to FBT. Reimbursing payments will be partially subject to FBT.

Alphabetic List of Entertainment Types

Accommodation - deemed to be entertainment where incurred in connection with, or for the purposes of facilitating the provision of food, drink or recreation. The extent to which it is deemed to be entertainment will be determined on the facts of the case.

Annual General Meeting - the treatment accords with that for a conference or seminar. Any entertainment (as defined) provided at the meeting will be subject to the regime. Note that morning and afternoon teas provided at a conference or seminar are specifically excluded from the definition of entertainment.

Allowances - to the extent that an allowance is paid for the provision of entertainment that amount is subject to the full imposition of FBT. Apportionment is therefore required where an allowance is paid for entertainment as well as for other forms of expenditure.

Amusement - included in the definition of recreation, the provision of which is deemed to be entertainment.

Board Meeting Lunch - the provision of food or drink at a board meeting will be subject to FBT, not including that provided in a staff cafeteria.

Briefing for Product Launch - where the requirements contained in the advertising/promotional exemption (see "What Entertainment is Excluded"), are met the expenditure will fall outside the regime. In any case, morning and afternoon tea, or similar light refreshments, will be exempt.

Business Lunches at Restaurants - will be subject to the regime.

Business Travel - will not be affected, although any travel in connection with or for the purposes of facilitating the provision of entertainment will be subject to the regime. For instance, after a business conference a holiday is taken in Hawaii. The cost of the travel associated with that holiday will be subject to FBT or partial non-deductibility.

Business Training Sessions - any entertainment provided at such a session is subject to the regime. This excludes the provision of morning and afternoon tea.

Cafeteria- specifically excluded from the definition of entertainment.

Charity Shows - any entertainment expenditure incurred for charitable purposes is exempted from the changes. For example, a children's hospital Christmas party. Tickets to a charity ball, however, would not be deductible as the recipient of the entertainment - the employee - is not a "charity".

Christmas Party - provided to employees and/or clients is subject to tax.

Client Meals - any meal provided to any person is subject to the changes.

Club Fees/Subscriptions - will be subject to FBT.

Cocktail Parties - deemed to be the provision of entertainment therefore the cost is not fully deductible or will be subject to FBT.

Conferences - morning and afternoon tea provided at a conference is exempt - all other expenditure in respect of the provision of entertainment at a conference will be subject to FBT or partial non-deductibility.

Corporate Boxes - deemed to be an entertainment facility and 50 percent of the cost of the box is either non-deductible or subject to FBT.

Corporate Jets - deemed to be an entertainment facility on occasions where it is associated with entertainment.

Depreciation - any depreciation allowance claimed in respect of an entertainment facility will be subject to the regime.

Employee Meals - any meal provided to an employee, whether away from home on business, or working overtime is subject to FBT. If the meal is provided in an in-house dining facility, it will not be subject to the regime.

Exhibition - falls within the advertising/promotion exemption if exhibiting goods or services of a business of the taxpayer or another person to the general public.

Fashion Parade - any entertainment provided at a fashion parade is deductible if it is available to the general public.

Film Critic - expenditure incurred in critiquing movies, i.e., purchasing tickets, will not be subject to the regime.

Film Premiere - if open to the general public any associated entertainment is deductible.

Free Drinks, Free Movie Passes - fall within the advertising/promotion exemption if given to members of the general public. For example, via a radio give-away.

Games Room - if situated in an employer's premises for the benefit of employees half of the cost is subject to FBT.

Gifts - provided to employees or clients will be subject to the regime if the gift(s) are in the form of entertainment.

Gymnasium - same treatment as a games room, if the gymnasium is in the employer's premises for the benefit of employees.

Harbour Cruise - the provision of entertainment by recreation via an entertainment facility.

In-Flight Airline Meals - will not be subject to the regime in accordance with the exclusion for entertainment provided in conjunction with commercial travel by aircraft.

Lease Incentives - provided in the form of entertainment for example a holiday is subject to the regime.

Leisure-Time Pursuits - are recreational activities and are deemed to be entertainment.

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Meals -

- taken whilst working overtime
- taken whilst away from home on business
- in restaurants
- not including those in an exempt in-house dining facility

are subject to the regime.

Non-Employee Meals - 50 percent of the expenditure is subject to the regime. If the meal is provided in an in-house dining facility, it will not be subject to the regime.

Plant and Equipment - deductions for repairs, maintenance and depreciation allowances claimed on plant and equipment used for the provision of entertainment will be partially denied.

Promotional Give-Aways - fully deductible if made available to the general public.

Recreation - defined to be the provision of entertainment.

Samples - not subject to tax if they are made available to the general public.

Scenic Flights - deemed to be entertainment as they provide recreation in the form of amusement.

Seminars - any entertainment (excluding the provision of morning and afternoon teas) provided at a seminar will be subject to the regime if incurred by, for instance, a sole trader.

Shopping Centre Promotions - fully deductible if made available to the general public.

Sightseeing Tours - deemed to be entertainment via the provision of recreation.

Tickets - to a sporting event or the theatre for instance will be subject to FBT or partial denial of deductibility.

Travel - deemed to be entertainment if predominantly in connection with the provision of food or drink or recreation.

Wine Tasting - falls within the promotion/advertising exemption if open to the general public.

Yachts and Boats - deemed to be an entertainment facility.

Entertainment Checklist

The following is only a general guide. It should be noted that in some situations the treatment may differ.

Item	Subject to the Regime
Accommodation	Yes
AGM	Yes
Allowances	Yes
Amusement	Yes
Board meeting lunch	Yes
Briefing for product launch	No
Business lunch	Yes
Business travel	No
Business training sessions	Yes
Cafeteria	No
Charity shows	Yes
Christmas Party	Yes
Club fees/subscriptions	Yes
Client meals	Yes
Cocktail parties	Yes
Conferences (except morning/afternoon teas & light refreshments)	Yes
Corporate Boxes	Yes
Employee meals (except in an in-house cafeteria)	Yes
Exhibition	No
Fashion Parade	No
Film premiere	No
Free: drinks	
movie passes	No

Item	Subject to the Regime
Games room	Yes
Gifts	Yes
Gymnasium	Yes
Harbour Cruise	Yes
In-house dining facility	No
In-house recreational facility	Yes
Joy flights	Yes
Lease incentives	Yes
Leisure time pursuits	Yes
Meals: in-house dining facility	No
working overtime	Yes
away from home on business	Yes
restaurants	Yes
Non-employee meals	Yes
Plant and equipment	Yes
Promotional give-aways	No
Recreation	Yes
Samples	No
Seminars (same as conferences)	Yes
Shopping centre promotions	No
Sightseeing tours	Yes
Tickets	Yes
Travel	Yes
Wine tasting	No
Yacht	Yes

Energy Companies

Introduction

This article explains the tax implications of the Energy Companies Act 1992. Under this Act the energy undertakings of Electric Power Boards and territorial local authorities (these local authority undertakings are sometimes called "MEDs" in this article) are transferred to new energy companies. The income tax treatment of these undertakings is currently governed by section 197C of the Income Tax Act 1976.

Energy companies will essentially be taxed like any other company under the general provisions of the Income Tax Act. The taxation provisions in the Energy Companies Act are of a transitional nature, and provide for the tax positions of Boards and MEDs to be transferred to their successor energy companies. The original tax provisions were replaced by the Energy Companies Amendment Act 1992 which was enacted on 17 December 1992.

Corporatisation Process

Before discussing the tax implications of the Energy Companies Act ("the Act") it is first necessary to give an overview of the process by which Electric Power Boards ("Boards") and MEDs are corporatised under the Act. The Act itself is an outcome of the Energy Sector Reform Bill which was introduced in the House on 4 December 1991. It was enacted on 25 June 1992 and its general commencement date is 1 July 1992.

The corporatisation of a Board or MED consists of the following stages:

- preparing an establishment plan;
- forming an energy company; and
- transferring the Board's or local authority's energy undertaking to an energy company.

Establishment Plan

All Boards and territorial local authorities ("local authorities") must prepare establishment plans for transferring their energy undertakings to energy companies. They must submit these plans to the Minister of Energy ("the Minister") by 31 December 1992, for the Minister's approval. There is provision in the Act for this submission date to be extended to 31 March 1993 with the Minister's consent.

Each establishment plan for an energy company must contain the following main items:

- a share allocation plan;
- a valuation of the energy undertaking to be transferred;
- an indication of any non-voting equity securities to be issued by the energy company to any person;
- an indication of any debt securities to be issued by the energy company to any person; and
- a draft memorandum of association, articles of association and statement of corporate intent.

The share allocation plan is to contain the Board's or local authority's recommendations as to the persons or classes of persons to whom the voting equity securities in the related energy company should be allocated once the energy undertaking is transferred to an energy company. The plan will also contain recommendations as to what the terms of those shares should be.

An establishment plan is not effective until the Minister has approved it. The Minister must approve local authority establishment plans, and may not amend them. It is likely (though not mandatory) that all the equity securities in MED successor energy companies will be allocated to the relevant local authorities.

The Minister may decline to approve a Board's establishment plan. He may also (after allowing an opportunity for the Board to submit a revised plan) amend a Board's establishment plan and approve the plan in its amended form. The major exception to this ministerial power of amendment is in relation to a Board's share allocation plan. The Minister may not approve a Board's establishment plan unless the share allocation plan has been endorsed by the Board's interim trustees (defined in section 4 of the Act). Where a Board's share allocation plan has not been so endorsed the voting equity securities in the successor energy company must, by default, be allocated on a pro rata basis to the constituent local authorities in the Board's area.

Two or more Boards or local authorities (including any combination of Boards or local authorities) may prepare and submit to the Minister a joint establishment plan which provides for only one successor energy company to the two or more Boards or MEDs.

A local authority may also prepare an establishment plan that provides for its energy undertaking to be transferred to two or more energy companies.

Formation of Energy Companies

Once the Minister has approved an establishment plan, a Board or local authority must form an energy company to which their energy undertaking can be transferred. This company must be formed and registered under the Companies Act by 1 April 1993 (or such later date as the Minister may allow). The sole subscriber for the shares in an energy company on its incorporation shall be respectively a Board or local authority. These shares will be deemed to have been allotted as fully paid up to the subscribing Board or local authority.

Where the Minister has approved a joint establishment plan the relevant Boards or local authorities will have to jointly form and register an energy company in which they are the subscribers.

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Transferring Energy Undertakings to Energy Companies

Transferring Boards' Energy Undertakings

A Board's energy undertaking will be transferred to its successor energy company on a date appointed by Order in Council. The transfer will be by way of vesting rather than sale, so no consideration is payable to the Board by the successor energy company.

The Board itself will be dissolved on the same date that its energy undertaking is vested in the successor energy company.

Each Order in Council made for a Board and its successor energy company must give effect to the relevant approved establishment plan (including its share allocation plan), and the energy company shall issue shares to the persons, or classes of persons, specified in the Order accordingly. Any shares in the successor energy company that the Board subscribes for shall vest in the persons specified in the Order.

The shares that the successor energy company issues will be deemed to be fully paid up, and shall be issued on such terms as are specified in the relevant Order in Council. The successor energy company will also assume any of the Board's liabilities.

Transferring Local Authorities' Energy Undertakings

Each local authority must transfer its energy undertaking to one or more energy companies by 1 April 1993 (or such later date as the Minister may allow). This transfer must take place in accordance with an approved establishment plan.

Unless a creditor consents to an energy company assuming a liability of its predecessor MED, the liability will remain the local authority's. The MED successor energy company must issue sufficient debt securities to the relevant local authority to enable the local authority to meet its former MED-related liabilities.

Tax Implications

The original tax provisions in the Act - sections 54 and 62 - have been replaced by new sections which apply from 1 July 1992, the same date as the Act's general commencement. This substitution was made by the Energy Companies Amendment Act 1992, which was enacted on 17 December 1992.

Tax Treatment of Share Allocations under the Act

This part of this article deals only with the tax treatment of the initial allocation of energy company shares to those identified in approved establishment plans as persons to whom the shares should be issued ("allottees"), and to the on-sale of those shares by allottees. The ordinary tax rules governing share transfers will apply to any subsequent transfers of energy company shares.

Gift Duty

Section 54(3) of the Act provides that any vesting or issue under the Act of shares in a Board's successor energy company will not constitute a dutiable gift. There will be no gift duty consequences on the transfer of assets from a Board or MED to an energy company because the Act deems a Board or MED and its successor energy company to be the same person for all tax purposes.

Income Tax

An allottee will not be liable for income tax on any energy company shares that s/he receives under an approved establishment plan. The only exception would be where a person receives shares in the capacity of an energy company employee pursuant to an employee share scheme (section 69, Income Tax Act).

Whether allottees will be liable for income tax if they on-sell their energy company shares at a profit will depend on whether the relevant charging provision - section 65(2)(e) - applies. Section 65(2)(e) provides that any profits or gains from selling or disposing of any personal property are taxable in certain situations, including when the property is acquired for the purpose of selling or otherwise disposing of it. Because the receipt of energy company shares by allottees arises through operation of statute, section 65(2)(e) would not apply to an allottee's subsequent disposition of the shares.

Section 65(2)(e) can also apply when a taxpayer's business comprises dealing in the property disposed of. Since an allottee who is a share trader will typically receive any energy company shares in his/her capacity as a consumer rather than in a share trading capacity, section 65(2)(e) will also not apply in this situation.

Generally, all allottees (except people who receive shares in their capacity as energy company employees) will hold their energy company shares on capital account.

Tax Treatment of Debt Securities - Accruals Regime

Inland Revenue will apply section 64J of the Income Tax Act in respect of the debt securities issued by energy companies under section 48(3)(b) of the Act, so that these securities are deemed to have been issued at market value. This will ensure that the entire amount of a debt security is neither assessable to the holder of the security nor deductible to the issuing energy company.

Tax Treatment of Energy Companies

An energy company will be taxed like any other company, and will be subject to the general provisions of the Income Tax Act. Section 197C of the Income Tax Act, which relates to the taxation of energy trading operators (i.e., Boards and MEDs), will not apply to energy companies.

Expenditure incurred by Boards, MEDs and energy companies relating to the corporatisation process (for example, the cost of preparing an establishment plan) will typically be capital in nature and therefore non-deductible. Boards, MEDs and energy companies may claim GST input tax credits on this expenditure, except where it relates to the making of exempt supplies.

General Rule

Section 54(1) of the Act deems an energy company to be the same person as its predecessor Board for the purposes of the Inland Revenue Acts. Similarly, an energy company and its predecessor MED are deemed to be the same person for the purposes of the Inland Revenue Acts (section 62(1)). (Although an MED is only a branch of a local authority at general law, it is deemed under section 197C to be a separate person for Income Tax Act purposes.)

Implications

The present tax positions of Boards and MEDs will be transferred intact to their successor energy companies. For example, an energy company will have the same balance date and IRD and GST number as its predecessor Board or MED, tax losses will be carried over, approved Globo Asset accounts will be unaffected, and the tax values of depreciable assets and trading stock will remain the same.

Energy companies will be required to maintain imputation credit accounts from their formation. Section 394D(1)(a)(iv) of the Income Tax Act will prevent any credits arising in an energy company's imputation credit account where the company pays any income tax on income derived by its Board or MED predecessor. Section 394E(1)(b)(iii) will prevent any debits arising in an energy company's imputation credit account when the company receives a refund of income tax which was paid on income derived by its Board or MED predecessor.

The application of the imputation regime to Boards and MEDs is discussed below.

Any energy company restructuring occurring after the initial transfer of undertakings under the Act will be subject to the ordinary tax rules.

Shareholder Continuity

Sections 54(2) and 62(2) of the Act ensure that energy companies do not breach shareholder continuity requirements for the purpose of inheriting any losses incurred by their Board or MED predecessors. This is achieved by deeming the initial shareholders in the energy companies to be the same persons as those persons deemed to be the shareholders in the relevant predecessor Board or MED.

Transfer of MED to Two or More Energy Companies

Section 62(3) of the Act prevents, in the case of a local authority energy undertaking being transferred to two or more energy companies, the double counting of any losses. If any loss of the MED has been taken into account in the accounts of one of its successor energy companies that loss may not be taken into account in the accounts of any other energy company.

Merger of Two or More Energy Undertakings into One Energy Company

Two or more Boards or local authorities are permitted under the Act to transfer their energy undertakings to one energy company. There is no specific tax legislation relating to such mergers. The application of the general tax provisions in sections 54 and 62 of the Act in such cases would result in the tax position of each Board and MED prior to corporatisation being combined in the one successor energy company's tax position.

Tax Treatment Where MEDs Corporatised Ahead of Act

A number of local authorities, probably in contravention of section 594ZO of the Local Government Act 1974, corporatised their MEDs before the Energy Companies Act came into force. The companies to which local authorities transferred their energy undertakings ahead of the Act are deemed from 1 July 1992 to be energy companies for the purposes of certain provisions (principally accountability-type provisions) of the Act (section 81(1)).

Section 82 of the Act specifically validates the early corporatisation of the energy undertakings of the Dunedin City Council, Palmerston North City Council and Invercargill City Council.

Section 81(3) effectively prevents a company, to which a local authority transferred its energy undertaking in advance of the Act, from accessing the loss grouping provisions of the Income Tax Act before 1 July 1992 (being the commencement date of the Energy Companies Act). Section 197C(8) of the Income Tax Act places restrictions on an MED using the loss grouping provisions in the Income Tax Act. Section 81(3) deems a company to which a local authority transferred its energy undertaking ahead of the Act to be an energy trading operator for the purposes of section 197C(8) up to 1 July 1992.

Section 62(4) provides that the taxation provisions in section 62 apply to the companies to which local authorities transferred their energy undertakings ahead of the Act as if those companies were energy companies. These companies are therefore treated as being the same persons as their predecessor MEDs for tax purposes.

Application of Local Authority Trading Enterprise Definition to Energy Companies

Under section 61(2A) of the Income Tax Act local authorities are liable for tax on any income they derive from local authority trading enterprises (LATEs). The LATE definition is contained in section 594B of the Local Government Act 1974.

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Companies to which local authorities transferred their energy undertakings ahead of the Energy Companies Act came within the LATE definition (by virtue of being companies in which local authorities held a majority of shares) up until 1 July 1992. Energy companies were excluded from the LATE definition in the Local Government Act from 1 July 1992 by an amendment to that definition (section 594B(1)(b)(iia)) made by Section 10 of the Energy Companies Amendment Act 1992. The reason for this exclusion is to prevent energy companies in which local authorities hold a majority interest from being subject to the regulatory regime in Part XXXIVA of the Local Government Act in addition to the regulatory regime in the Energy Companies Act.

An amendment in the Taxation Reform Bill (No.6) - introduced in Parliament on 17 December 1992 - will bring an energy company which is under the control of a local authority back into the LATE definition for income tax purposes only with effect from 1 July 1992. Those companies to which local authorities transferred their energy undertakings ahead of the Energy Companies Act will therefore always have remained in the LATE definition for Income Tax Act purposes.

Application of Imputation Regime to Boards and MEDs

Inland Revenue has considered the application of the imputation regime to Boards and MEDs, and has decided that section 394B(2)(c) does not permit them to maintain imputation credit accounts. This means that there will be no imputation credits available from Boards and MEDs to be inherited by the successor energy companies.

Section 394B(2)(c) prevents a company whose constitution prohibits all of its income or property from being distributed to any proprietor, member or shareholder from establishing and maintaining an imputation credit account. Members of a Board or local authority cannot receive in a proprietary capacity any distribution of income or property. They are only entitled to be remunerated for their services in accordance with Part IVC of the Local Government Act 1974.

This decision that Boards and MEDs have not been entitled to maintain imputation credit accounts since the inception of the imputation regime is consistent with the policy underlying section 394B(2)(c) and the imputation regime generally.

The main policy rationale for the imputation regime was to provide relief to shareholders from the double taxation inherent under a classical taxation system (rather than to give any taxation benefit to the company itself paying tax from which imputation credits arise). If, however, a company has no shareholders who are entitled to receive dividends to which imputation credits may be attached, that company should not be permitted to establish an imputation credit account. This policy is reflected in section 394B(2)(c) and clearly applies in the case of Boards and MEDs who have never had any shareholders entitled to receive dividends.

The issue of the inability of Boards and MEDs to maintain imputation credit accounts is quite separate from the corporatisation process and would have arisen regardless of this process.

Non-Standard Balance Dates and Business Income

Introduction

This item deals with taxpayers with balance dates other than 31 March. They are required to return business income to their respective balance dates.

Background

Section 15 of the Income Tax Act 1976 (the Act) allows taxpayers with a balance date other than 31 March to return income to that balance date. This concession is subject to taxpayers obtaining the Commissioner’s consent, except where they adopt an industry standard balance date (see TIB Volume 3 No.9 of June 1992 for more information).

It was held in Taxation Review Authority case *K41* (1988) 10 NZTC 348 that taxpayers must return income that is not associated with their business to 31 March each year. Those taxpayers with a non-standard balance date must return business income to a non-standard balance date.

Inland Revenue's Position

The Commissioner believes that the decision in case *K41* applies to all taxpayers and partnerships with non-standard balance dates. This means such taxpayers must return all business income to that non-standard balance date. Business income includes all income associated with the taxpayer’s business. In practice this will include virtually all income to a non-individual taxpayer. The Commissioner believes that this includes business interest and dividend income.

Where taxpayers' business income includes resident withholding income, they will need to apportion the resident withholding income between their income years. Please note that resident withholding tax credits are not to be apportioned, but apply to the income year in which the deductions are made.

Generally, companies within the same group of companies will have a common balance date. Thus where one company pays interest to another company within the same group and those companies have a common balance date, they will deduct and return the interest to that common balance date.

Examples

Example A

Z is an individual in paid employment who also has a part-time business. The business has an approved non-standard balance date of 31 October.

Z will return his income from employment and interest from personal bank accounts each 31 March. He will return the business income, including interest from any business bank accounts, to each 31 October.

Under section 15 of the Act, income returned to a 31 October balance date is deemed to have been derived in the year to the succeeding 31 March. Z will therefore make one return of income as at 31 March, which will include his business income to the non-standard balance date of 31 October.

For his 31 October 1992 balance date, Z will return his business income as at 31 March 1993. At that date Z will also return his employment income and non-business interest derived to 31 March 1993.

Example B

Y is an individual who operates a dairy farm. Y adopted the industry standard balance date of 31 May. Y also has a part-time job driving a school bus.

Y returns all income related to the farm operations to 31 May each year. This includes interest on business accounts and interest from the dairy company account. Y returns the wages and any interest from personal accounts to 31 March.

Y makes one return of income. In 1993 this will be as at 31 May. That return will comprise non-business interest and employment income to 31 March 1993, and business income for the twelve months to 31 May 1993.

Example C

X is an employee of Xtra Ltd, and its primary shareholder. Xtra Ltd has an approved non-standard balance date of 30 June. The bulk of X's income arises from her shareholding in Xtra Ltd.

This is a sufficient reason for X to apply to adopt Xtra's balance date. Once this has been approved X will return her salary, company current account interest, and dividends sourced from Xtra to 30 June. She will return non-business income such as interest on personal bank accounts to 31 March.

X will file one return of income as at 30 June. Under section 15 of the Act the business income is deemed to have been derived in the year ending 31 March. Therefore in 1993, X will return her non-business interest income for the 12 months ended 31 March 1993 and all of her business income for the 12 months ended 30 June 1993 as at 30 June.

Inland Revenue considers that where a shareholder-employee earns a salary that relates to his/her shareholding, then that salary is derived from the business (company). It is business income.

Example D

W Ltd is a company. It is a member of the Alphabet group of companies. The Alphabet group has an approved non-standard balance date of 30 November. W Ltd loaned money to another company within the group, V Ltd.

Interest earned on this loan is business income and should be returned to W Ltd's adopted balance date. This ensures consistency as V Ltd will be deducting the interest to the group's balance date.

Where money is borrowed to acquire another company, the "acquired" company must be included within the "group of companies" as at 31 March in the relevant income year.

Application

The above comments do not represent a change in the Commissioner's policy. Rather they are meant as a restatement of existing policy.

References HO 10.B.2.1
Technical Rulings 76.4.1.3

Child Support Annual Assessments

The Child Support Agency is currently issuing assessments to all liable parents for the 1993-94 year. These assessments are based on parents' 1992 taxable income, and they will apply from 1 April 1993 to 31 March 1994.

Liable parents can estimate their income for 1993-94 if they believe it will be less than 85% of their 1992 income. Parents who do this will need to provide documentation to the Child Support Agency to support their estimates. Some liable parents may ask their tax practitioners to provide this information.

Employers and tax practitioners who are deducting Child Support from wages and salaries can shortly expect to receive amended deduction notices resulting from this annual assessment action.

GST and Bloodstock destined for Export to Asia - Definition of "Consumption"

This policy statement amends Inland Revenue's policy contained in Tax Information Bulletin Vol 2, No.7. and Vol 3, No.3.

Background

Under section 11(1C) of the Goods and Services Tax Act ("the Act"), the Commissioner may extend the period of time that goods intended for export may remain in New Zealand.

In TIB Vol 2, No.7 and Vol 3, No.3, we ruled that where it was not possible for bloodstock to be exported within 28 days of the time of supply due to the nature of the contract, zero rating of the supply would still apply providing the bloodstock was exported within 183 days (six months) of the date of supply.

Discussion

The New Zealand Thoroughbred Breeders' Association has asked Inland Revenue to review its policy under section 11(1C) of the Act. We have therefore extended the period of time that bloodstock sold at the annual yearling sales and destined for export to Asia may stay in New Zealand. We accept that the tropical conditions, lack of space in the importing countries, and immaturity of the bloodstock warrant a further extension of time up to 10 months from the date of supply (i.e., the sale).

Inland Revenue has also agreed to amend the definition of "consumption" contained in TIB Vol 2, No 7. and TIB Vol 3, No.3. In the previous TIBs "consumption" was defined as "breeding, racing, or entry into show in New Zealand". We have agreed that given the purpose for which thoroughbred bloodstock is purchased, a replacement definition of the "consumption" principle is appropriate. Our view is that "consumption" of a thoroughbred yearling occurs when the horse contests a race for prize money according to the New Zealand Rules of Racing.

Policy

With written application, bloodstock sold at the annual yearling sales which is intended for export *to Asia* may remain in New Zealand for up to 10 months from the date of sale. (Inland Revenue's policy on bloodstock destined for export to countries outside Asia remains unchanged. With written application, bloodstock destined for countries outside Asia may remain in New Zealand for up to six months from the date of supply.)

No change is made to the requirements that;

(i) Any request for an extension of time beyond the 28 day rule must be in writing, and be accompanied by a copy of the contract of supply, and

(ii) The animal must not be used in New Zealand under the "consumption" principle. "Consumption" as applied to a thoroughbred yearling should be defined as occurring when the horse contests a race for prize money under the New Zealand Rules of Racing.

If the animal has not been "consumed" as defined above and is still in New Zealand at the expiration of the six month or ten month period, GST becomes payable whether the animal is subsequently exported or not.

If the animal has not been "consumed" as defined above and is still in New Zealand at the expiration of the six month or ten month period, the vendor must account for GST on the sale. When the animal is subsequently exported the vendor can recover the GST.

References: TIB Vol 2 No 7
TIB Vol 3 No 3
Tech Rulings 107.14.2

No Back Taxes for Courier Drivers

Inland Revenue will not seek back taxes from owner-driver couriers or their companies, despite a recent Employment Court decision that a driver was an employee, and not self-employed.

The tax consequences of this decision could be significant. There are expenses which self-employed people can claim, but which are not deductible for employees. There are also consequences for GST, PAYE deductions, Earner and Employer Premiums and Fringe Benefit Tax.

Inland Revenue is considering the implications of this court decision, and we will publish a detailed policy statement in an upcoming TIB unless there is an appeal to the Court of Appeal.

However, Inland Revenue will not seek back taxes if we have accepted in the past that an owner-driver is self-employed.

Companies assessed for an extra $332 Million

Inland Revenue investigations revealed that companies owed an extra $332 million of tax in the past year.

More than half of this tax arose from audits of big businesses. Investigations of companies with a turnover of more than $50 million a year revealed an extra $179 million owing in income tax and GST. Investigations of smaller companies with a turnover between $3 and $50 million resulted in assessment of an extra $126 million of income tax and GST.

Inland Revenue's investigations are proving very cost-effective, since every direct dollar devoted to company investigations last year returned an extra $22.26 in extra tax assessed.

Tax evasion is rare amongst companies, but there is plenty of room to differ on what constitutes legitimate tax minimisation through measures such as write-offs and deductions. Companies spend a lot of money trying to reduce the tax they have to pay; this is a fact of business. In return, Inland Revenue specialist investigators regularly audit companies to see that they are paying the amount of tax required under the law. It is part of Inland Revenue's job to make certain that all taxpayers pay their correct share of taxes.

Inland Revenue is constantly seeking to improve our technology and approach to company tax investigations. By June 1993 we will have a special computerised system completed, which will help us to pinpoint the most likely areas of company tax avoidance, based on past trends.

Reminder - Club and Society Tax Returns

Inland Revenue sent letters to more than 26,000 clubs and societies in December 1992, to remind them to put in their tax returns. All clubs and societies must file a tax return each year, unless they are tax exempt.

Organisations which meet certain criteria are exempt from income tax. Inland Revenue's "Clubs and Societies" booklet (IR 254) gives detailed information about this. You can get a copy from your local Inland Revenue office, or ask there if you need more information about the tax obligations for a club of society.

Student Loan Scheme Act 1992

Introduction

The Student Loan Scheme Act 1992 received royal assent on 21 December 1992. It provides for the collection of loans made to students at tertiary institutions under the Government's Student Loan Scheme from 1 January 1992. Collection will be made through the tax system from the 1992/93 income year.

Outline of Scheme

Most loans are made to students between 1 January and 31 December each year. They will be transferred from the loan manager (Student Loans Management Ltd) to Inland Revenue for collection as at 28 February of the following year.

Borrowers will be given the opportunity to object to any amount that is to be transferred to Inland Revenue for collection. Where a borrower has objected, no amount will be transferred until an objection has been resolved. It is expected that objections will mainly relate to possible clerical errors. The Ministry of Education will be responsible for loans prior to transfer.

Following transfer the Commissioner will issue borrowers with a notice showing the amount of principal transferred and the interest payable as at the date of the transfer.

The Ministry of Education will deal with entitlement to loans and the amounts that may be borrowed. The *Student Loan Scheme* booklet explains this part of the scheme.

Students who wish to borrow must apply for a loan each year. Thus a borrower may have a current loan with the loan manager, with any previous years' loan(s) transferred to Inland Revenue for collection.

Repayment for New Zealand Residents

Repayment of a loan will be solely dependent on the level of borrowers' assessable income for tax purposes. Once this exceeds the repayment threshold ($12,670 for the 1992-93 income year and $13,104 for the 1993/94 income year) borrowers will have to repay 10 cents for each dollar of their income over the repayment threshold. Repayment will be required regardless of whether or not borrowers continue to borrow to finance their studies.

Example

Assessable income for the year ending 31 March 1993	20,000
Less repayment threshold	12,670
Repayment obligation	$7,330
@ 10 c in $ =	$733

Pay-Period Taxpayers

Borrowers who have had their loan transferred (i.e. the Commissioner holds a loan balance for collection) have been excluded from the definition of a pay-period taxpayer in section 356 of the Income Tax Act 1976. This means they must file tax returns. Inland Revenue will assess any student loan repayment obligation at the same time as their income tax liability is established.

Interest

Money advanced under the loans is subject to interest. The total interest rate (8.2% for the 1992/93 income year) has two components:

- The base interest rate - which represents the cost to Government of the money advanced (this has been set at 6% for the 1992/93 income year), and
- The interest adjustment rate - which represents the rate of inflation (this has been set at 2.2% for the 1992/93 income year).

When calculating interest, any payments made during the year reduce the loan balance.

Example

Loan balance on 1 April is $5,000 and the borrower makes two payments during the year, $1,000 on 1 May and $500 on 1 June.

Interest Calculation

$5,000 x 30/365 x 8.2%	33.69
$4,000 x 31/365 x 8.2%	27.85
$3,500 x 304/365 x 8.2%	239.03
	$300.57

At the end of the year the borrower must file a tax return. Inland Revenue will then establish the borrower's repayment obligation when we assess his/her return. Any payments that s/he makes will be offset against this repayment obligation. The repayment obligation will be credited first to the base interest charge, secondly to the interest adjustment charge and finally to the principal owing.

Example

Repayment Obligation Calculation

Assessable income	$27,000
Repayment threshold	$12,670
	$14,330
@ 10 c in $ =	$1,433

Application of Repayment Obligation

Base interest (first)	$ 219.93
Interest adjustment (second)	$ 80.64
	300.57
Reduction of principal (third)	$1,132.43
	$1,433.00

Note: In the previous example the borrower would have the choice of having the overpayment of $67 ($1,500 - $1,433) refunded or applied in a further reduction of the loan balance (or applied to any other revenue).

Interest Write-Off

Borrowers who are New Zealand residents for income tax purposes may be entitled to have all or part of the base interest written off in any year that their repayment obligation is less than their base interest charge. This means that for such residents, the loan balance will never increase by more than the rate of inflation.

The interest write-off will only be available to people who have **not** borrowed during the loan year in which the start of that income year falls. For example, a person who borrows in the 1992, 1993 and 1994 loan years (1 January to 31 December in each year) would not be entitled to any interest write-off until the 1995/96 income year, as the start of the 1994/95 income year (1 April 1994) falls in the loan year 1 January 1994 to 31 December 1994.

There is a special provision on the grounds of hardship for writing off of the base interest of a non-resident engaged in full time study overseas. This is discussed below.

Examples

Each of the following examples assumes that the person has ceased borrowing and is a New Zealand resident for income tax purposes.

1 Loan balance of $5,000 with no payments made during the year.

Base interest	$300
Interest adjustment	$110
Repayment obligation	Nil
Write-off	$300
Added to loan balance	$110

2 Loan balance of $5,000 with no payments made during the year.

Base interest	$300
Interest adjustment	$110
Repayment obligation	$100
Write-off	$200
Added to loan balance	$110

3 Loan balance of $5,000 with no payments made during the year.

Base interest	$300
Interest adjustment	$110
Repayment obligation	$350
Write-off	Nil
Added to loan balance	$ 60

Income Tax Implications of Interest Write-Off

Any interest write-off will not be subject to income tax. Section 64F(7C) of the Income Tax Act 1976 excludes the forgiveness of the debt from the accruals regime.

Repayment Deductions

From 1 April 1993 employers must deduct instalments of their employees' repayment obligations, in the same manner as they make PAYE deductions. Borrowers who expect their primary income to exceed the repayment threshold ($13,104) must advise their employer that loan repayment deductions are to be made, by adding "ED" to the "G" or "SEC" tax codes when completing their IR 12s.

The PAYE tables will contain two new codes: "G ED" and "SEC ED". Employees who expect their primary income to be higher than the repayment threshold will use "G ED" to ensure that 10 cents in the dollar is deducted from any income over $252 per week ($13,104 x 1/52). Employees with primary income over the threshold will also give a "SEC ED" code to any other employer, which will ensure that 10 cents in the dollar is deducted from their total secondary income. As the repayment threshold is built into the deductions made from primary income, 10 cents in the dollar is deducted from all secondary income.

Example

Weekly primary income	$500.00
Weekly repayment threshold	$252.00
	$248.00
Deduction	$ 24.80
Secondary income	$120.00
Deduction	$ 12.00

These deductions from salary and wages are known as repayment deductions.

Special Deduction Rates

Borrowers whose primary income is less than the repayment threshold but who have other income that raises their total income above the threshold will not use the "G ED" code. They may, however, apply for a special deduction rate instead of paying in a lump sum on assessment.

Example

Primary income 1994	$10,000
Interest	$ 6,104
Total income	$16,104
Repayment obligation	$ 300

This borrower may apply for a special deduction rate of 3 cents in the dollar to be deducted from the primary income (in addition to the normal tax deductions).

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Borrowers will also be able to apply for a special deduction rate in any situation in which the "G ED" or "SEC ED" deductions will not represent that year's liability. For example, if a borrower earns a high amount over part of the year, the deductions may be in excess of the annual liability.

Crediting of Repayment Deductions

For the purpose of calculating interest, any repayment deduction made from employees will be credited to their loan account on the 15th of the month in which the deduction was made.

Example

Deductions made on pay days as follows:

6 May 1993	$ 30
13 May 1993	$ 30
20 May 1993	$ 30
27 May 1993	$ 30
	$120

Paid to Inland Revenue 20 June 1993

Credited to account 15 May 1993 $120

Employers' Obligations

The rules for collecting and paying PAYE deductions also apply to collecting repayment deductions. In addition, when they pay the deductions to Inland Revenue, employers must give us a schedule showing employees from whom repayment deductions have been made and the amount of those deductions.

Interim Repayments (Periodic Payers)

A borrower whose end of year liability is more than $1,000 after taking into account any repayment deductions (this is the residual repayment obligation) must pay interim repayments by instalments for the following year. The amount of these instalments will be calculated in a similar manner to provisional tax. This regime will apply to:

- Borrowers who have income other than from salary or wages (from which repayment deductions have been made) in excess of $10,000; or
- Borrowers who have income that exceeds the repayment threshold by $10,000 or more, if repayment deductions are not made from any salary or wages.

Examples

1

Salary (subject to repayment deductions) $15,000
Business income $ 5,000

Person is **not** a periodic payer

2

Salary (subject to repayment deductions) $20,000
Business income $15,000

Person **is** a periodic payer

3

Salary (not subject to repayment deductions) $10,000
Business income $20,000

Person **is** a periodic payer

Calculating Interim Repayments

Borrowers will have the option of basing their liability on the previous year's residual repayment obligation, plus a 5% increase, or of estimating their liability. An estimate may be made at any time up to the third instalment date.

Example

Assessable income 1993/94

Salary	13,934
Business Income	12,170
	26,104
Repayment threshold	13,104
	$13,000
Repayment obligation	$ 1,300
Repayment deductions	$ 83
Residual repayment obligation 1993/94	$ 1,217
Interim repayment 1994/95	$ 1,277 *

Payable (March balance date)

7 July 1994	$ 425
7 November 1994	$ 425
7 March 1995	$ 427

* $1,217 x 105%

Interim Payments when Return not Furnished

If a borrower hasn't filed the previous year's return by the time the first or second instalment is due, if s/he does not wish to estimate, s/he may use the residual repayment obligation for the second preceding year, increased by 10 percent. If a borrower still hasn't filed the previous year's return by the third instalment date, s/he must make an estimate. If s/he doesn't make an estimate, the amount of any payments s/he made will be deemed to be the estimate.

Voluntary Payments

Borrowers can make voluntary payments to Inland Revenue at any time after 1 March 1993.

Where a borrower makes any payment in excess of that year's terminal repayment obligation, s/he will be given the choice (on the return form) of having the excess payment refunded or applied in reduction of the loan balance (or applied to another revenue). An election to have the excess payment applied in reduction of the loan balance will be irrevocable.

Non-Residents

In April each year, Inland Revenue will send a non-resident assessment to any borrower who has left New Zealand and ceased to be a resident.

The amount payable will be $1,000 per annum (or 1/15 of the loan balance at date of departure if this was $15,000 or over) plus the estimated interest for the year. The interest will be estimated taking into account the payments that are due during the year. The total will then be averaged over four payments, which will be due on 30 June, 30 September, 31 December and 31 March.

If paying the full amount of the non-resident repayment obligation would cause financial hardship, borrowers may negotiate a lesser payment with Inland Revenue. Unlike income tax, the Student Loan Scheme Act does not grant the Commissioner the power to remit any liability, other than the special hardship provision discussed below. In any case where the Commissioner is satisfied that hardship would be caused by full payment, the uncollected amount will be "added back" to the loan balance. Any request for relief from payment on hardship grounds must be made annually.

A special hardship provision exists for non-residents who are engaged in full time study overseas. In this case the Commissioner may fully or partly remit the base interest for the period the student was engaged in full time study, if he is satisfied that payment would cause serious hardship.

Non-residents who return to New Zealand and regain residency status must advise Inland Revenue of their return.

Residents Leaving New Zealand

Notification requirements

Borrowers who go overseas for more than three months must advise Inland Revenue of their departure, unless they will continue to repay their loans through repayment deductions or instalments of their interim repayment obligation while away.

Repayment Obligation

In the year a borrower leaves New Zealand, and ceases to be resident, the repayment obligation will be assessed on the assessable income to date of departure, and a proportion of the non-resident repayment obligation for the balance of the income year to 31 March. The repayment threshold will be also apportioned according to the number of days the borrower was resident in New Zealand.

Example

Date of departure 30 June 1993

Resident Assessment

Income to 30 June 1993	$5,000	
$13,104 x 91/365	$3,267	
	$1,733	
@ 10 c in $ =		173.30
"G ED" Deductions		160.00
Payable 7/2/94		$13.30

Non-Resident Assessment

$1,000 x 274/365	$750.68	
Estimated Interest	$203.32	
	$954.00	
Payable 30/9/93, 30/12/93 & 31/3/94		$318.00

The reverse of the above will occur if a borrower who has become a non-resident returns to New Zealand and regains residency status.

Interest write-off

In the year in which a resident leaves New Zealand any interest write-off will be limited to the interest chargeable to the date of departure.

Example

Date of departure:	30 June
Interest 1/4/93 to 30/6/93:	$300 (base)
	$110 (interest adjustment)
Interest 1/7/93 to 31/3/94:	$825 (base)
	$302 (interest adjustment)
Resident repayment obligation:	$250
Write-off:	$ 50 ($300 - $250)

The reverse of the above will occur if a borrower who has become a non-resident returns to New Zealand and regains residency status.

Returns and Assessments

As mentioned above, all borrowers have been excluded from the pay-period taxpayer definition, so they must file tax returns. There is a separate form (SL9) for working out their student loan repayment obligation, which they should fill in and attach to their income tax returns.

Inland Revenue will make loan repayment assessments in the same manner as we make income tax assessments, and the same standard procedures (e.g., objection procedures and limitations on re-opening assessments) will apply to them.

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Payment and Recovery

Any terminal repayment obligation (the net amount after deducting from the repayment obligation any payments made) is due for payment at the same time as a borrower's terminal income tax is due.

If a borrower does not make a payment by the due date s/he will be charged a late payment charge. In most cases this will be a compounding charge of 2 percent per month.

In addition to the standard recovery powers that the Commissioner has for arrears, he will also be able to call up the total loan balance in any case where a borrower has not paid any repayment obligation assessed, or has not furnished any return or information, within two years of when it was due.

Refunds, Relief and Write-Off on Death

Inland Revenue will refund any overpayment unless a borrower asks us to credit it to the loan balance.

If paying the full amount of a repayment obligation (or a non-resident repayment obligation) would cause serious financial hardship, a borrower may negotiate a lesser payment with the Commissioner. Unlike income tax, the Commissioner may not remit any Student Loan liability, other than as set out under the special hardship provision for non-residents who are engaged in full time study overseas discussed above. In any case where the Commissioner is satisfied that hardship would be caused by payment in full, the amount that the Commissioner refrains from collecting is "added back" to the loan balance. Any relief from payment on hardship grounds must be requested annually.

As well as the standard provisions covering refunds, remission of late payment charges and special provisions for a borrower experiencing hardship, any amount owing on the death of a borrower will be written off.

Offences and Penalties

As well as the standard provisions that apply for income tax in relation to offences, penalties and penal charges, it will be an offence for an employer to discriminate against a person because that person has a student loan.

Changes in Balance Date

Where a borrower has a change in balance date for income tax purposes, in the assessment of the repayment obligation, the repayment threshold will be adjusted on a daily basis to reflect the more or less than 12 months' income. The repayment obligation thus established will be apportioned to determine whether the borrower is entitled to an interest write-off.

Example

1 9 Months' Income

Assessable income for the period 1 April to 31 December	$15,000
$13,104 x 275/365	$ 9,872
	$ 5,128
Repayment Obligation	$ 512.80
Base interest	$ 800.00
$512.80 x 365/275	$ 680.62
Interest Write-off	$ 119.38

2 15 Months' Income

Assessable income for the period 1 April to 30 June	$25,000
$13,104 x 456/365	$16,371
	$ 8,629
Repayment Obligation	$ 862.90
Base interest	$ 700.00
$862.90 x 365/456	$ 690.69
Interest Write-off	$ 9.31

Further Information

If you need to know more about how the Student Loan Scheme Act 1992 applies to you, see Inland Revenue's publications *Student Loan Repayments* and *Student Loans - An Employer's Guide*. You can get copies of these from your local Inland Revenue office.

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

Income Under $9,880 Rebate

Section 50C - Transitional Tax Allowance: A student asked why s/he had not been allowed the income under $9,880 rebate in full. S/he received income from a student allowance and from a vacation job. The vacation job involved 30 hours of work a week over a period of 11 weeks.

Section 50C entitles certain low-income "full-time earners" to receive a tax rebate. In this case, the student was not was not a "full-time earner" while s/he was studying, so the rebate was calculated on the basis of the 11 weeks of paid employment.

To qualify for the rebate, the student must also be over 15 years old.

Reference: HO.TPA035

Bursaries for Employees

Section 61 - Incomes Wholly Exempt from Tax: A taxpayer asked whether the bursary s/he received from an employer was assessable income. The taxpayer attended university full-time whilst remaining in the employment of the firm. The bursary was based on the salary the taxpayer would have received if s/he had been working full-time.

Section 61(37) of the Act exempts scholarships and bursaries from income tax. This exemption does not apply where the main purpose for the payment of a bursary is not the provision of education.

In *CIR* v *Drew* (1988) 10 NZTC 5060, it was found that an employee/employer relationship existed. In this case, the main purpose of the bursary was to secure the employment of the recipient of the bursary and the provision of educational assistance was merely incidental.

A payment of this type is not exempt under section 61(37). It is assessable for income tax under section 65 as employment income or income according to ordinary concepts.

Reference: HO.TPA044

Charitable Donations made by Companies

Section 147 - Gifts of Money by Public Companies: A public company asked what deductions it could claim for one donation of $6,000 paid to a charitable organisation. The donation was the only one the company made for the income year. The company's assessable income for that year was $100,000.

Section 147 of the Act sets out the tax deductibility of gifts of money made by public companies to charitable organisations. In this case, section 147 limits the maximum deduction allowable for any gift of money made to *any one donee* by the company to $4,000, being the greater of 1% of the company's assessable income or $4,000.

Section 147 also limits the total deduction for all charitable cash donations that a public company makes to the greater of $1,000 or 5% of the company's assessable income.

Reference: HO.TPA060

Tax Treatment of Premiums Paid to an Overseas Insurance Company

Section 209 - Insurance effected with Persons not carrying on Business in New Zealand: A New Zealand company asked whether tax was payable on a premium for a fire risk policy paid to an overseas insurance company. The overseas company does not carry on any business in New Zealand.

Section 209 of the Act imposes liability for tax on premiums (except for life insurance or reinsurance premiums) that a New Zealand resident pays to an overseas insurer who is not carrying on business in New Zealand. The overseas insurer's taxable income is deemed to be 10% of the premium paid. The tax is payable at the rate of 38%, and is due by the New Zealand resident's terminal tax due date.

The New Zealand company or the person who pays the premium to the overseas insurer is deemed to be the insurer's agent. As agent, s/he must furnish a tax return to Inland Revenue's Special Companies section, and pay the income

tax due on behalf of the insurer. In this case, the New Zealand company, as agent for the insurer, is required to furnish a tax return for the premium paid.

Reference: HO.TPA063

Tax Treatment of a Lump Sum Payment from Registered Superannuation Fund to a Beneficiary

Section 227 - Income Assessable to Beneficiaries: A superannuitant taxpayer asked whether a lump sum payment from a registered medical superannuation fund was assessable income. The taxpayer also asked whether the payment constituted "other income" for the purposes of the National Superannuitant Surcharge.

From 1 April 1990 all payments made by a registered superannuation scheme to members, whether from a pension or lump sum scheme, are not assessable for income tax pursuant to section 227(6) of the Act.

In terms of section 336D(1) of the Act, the lump sum payments to fund members will not constitute "other income" for National Superannuitant Surcharge purposes.

Reference: HO.TPP076

Filing Annual Nil FBT Returns

Section 336T - Payments of Fringe Benefit Tax on Annual Basis in Respect of Employers other than Shareholders: An employer asked whether s/he could file fringe benefit tax returns on an annual basis. The employer had not provided any fringe benefits since commencing employing staff 18 months ago and did not expect to provide any in the future.

Fringe Benefit Tax is generally payable on a quarterly basis, but Inland Revenue may allow an employer to furnish an annual "nil" return. To do this, the employer must complete an IR 419 to declare that s/he has not provided any fringe benefits for a 12 month period. S/he must also have filed "nil" FBT returns for four consecutive quarters, or satisfy Inland Revenue that s/he will not be providing fringe benefits.

The employer must immediately notify Inland Revenue if s/he begins to provide fringe benefits. S/he must then furnish returns quarterly.

Reference: HO.TPA065

Completion of IR 66ES Form for Newspaper Delivery Persons

Section 432 - Employers to make returns as to employees: A newspaper firm asked whether it was required to furnish commencement and cessation schedules (IR 66ES) for school children or other students employed to deliver newspapers.

Section 432 of the Act requires employers to furnish commencement and cessation schedules to Inland Revenue for all employees starting or finishing employment. The newspaper firm must complete an IR 66ES with the relevant details for ***all*** employees starting or finishing employment after 1 April 1992.

Reference: HO.TPA032

Goods and Services Tax Act 1985

Purchase of Property by Foreign Consulate

Section 8 - Imposition of Goods and Services Tax on Supply: A foreign consulate asked whether it was liable to pay GST on the purchase of land for the purposes of establishing a consular building in New Zealand. The land had been purchased from a person who was registered for GST purposes.

Section 8 imposes GST on all supplies of goods and services (except exempt supplies) by a registered person in the course or furtherance of a taxable activity that s/he carries on. Consulates are not exempt from GST. In this case, the consulate is liable to pay the GST charged on the purchase price. If the consulate is registered for GST, it will be entitled to claim input tax credits where appropriate.

Reference: HO.TPAO55

GST Payable on School Holiday Programme

Section 8 - Imposition of Goods and Services Tax on Supply: A GST registered business ran a school holiday programme for its employees' children over the Christmas break. The employees paid a daily fee for each child to attend to cover the costs of running the programme. The business requested confirmation that GST would not be charged on the fees paid by the parents.

Section 8 of the Act charges GST on the supply of goods and services by a registered person in the course or furtherance of a taxable activity. In this case, the programme is being run by the business as part of its taxable activity and GST is payable on the school holiday programme fees. The business is entitled to claim input tax credits for GST charged on supplies of goods or services incurred in running the programme.

Reference: HO.TPA068

Sale of Commercial Property Between Two Registered Persons

Section 11 - Zero-Rating: A tax practitioner asked why the sale of a commercial rental building between two registered persons was subject to GST. Only 10% of the property was tenanted at the time of the sale.

Section 11(1)(c) of the Act zero-rates the supply to a registered person of a taxable activity as a going concern. In the case of the supply of a commercial building, the Commissioner suggests as an administrative guideline that if the building is 50% or more tenanted at the time of supply, then the supply will be treated as the supply of a taxable activity as a going concern (see TIB Volume Three, No.5 - page 4).

In this case, as only 10% of the property was tenanted, the supply does not qualify for zero-rating and is subject to GST.

Reference: HO.TPP007

Sale of a Motor Vehicle to an Employee of a Business

Section 8 - Imposition of Goods and Services Tax on Supply: An employer purchased a new motor vehicle and provided it to his manager as part of the manager's remuneration package. The employment contract provided that the vehicle remain the property of the employer for the period of the contract. Upon termination of the employment contract, the manager exercised his contractual right to purchase the motor vehicle. The employer was registered for GST but the manager was not. The manager asked about the GST implications of the transaction.

GST is charged on the supply of goods and services made by a registered person in the course or furtherance of a taxable activity. In this case, the motor vehicle was an asset of the employer's business. As the employer was registered for GST and the vehicle sold was used in the course of a taxable activity, the sale of the vehicle is subject to GST.

Selling a car to an employee is no different to any other supply that the employer may make in the course of conducting a taxable activity.

Reference: HO.TPP063

Stamp and Cheque Duties Act 1971

Liability for Stamp Duty for Redetermination of Rent

Section 8 - Meaning of the Term "Lease", and Section 29 - Duty on Instruments Increasing Rent or Other Consideration under Lease: A solicitor asked whether a liability for stamp duty arose due to the redetermination of rent where this change was not evidenced in writing.

For the purposes of this Act, an instrument increasing rent under a lease falls within the section 8 definition of a "lease". Section 29 of the Act treats an instrument increasing rent as a new lease for consideration equal to the increase in rent. Additional duty is payable upon this amount.

There is no provision in the Act for the re-presentation of a lease for stamping with further duty if there has been an increase in rent. However, if a new lease is prepared it should be presented for stamping in the usual way.

Reference: HO.TPP065

Stamp Duty on Amalgamation of a Regional Council and a Local Authority

Section 13 - No Stamp Duty Payable on Instruments of Conveyance to Certain Persons: A local authority asked whether stamp duty is payable on the transfer of assets arising from an amalgamation from a regional council to a local authority.

Section 13 of the Act contains a number of specific exemptions from stamp duty on conveyances made to certain people. Section 13(1)(k) provides an exemption from duty on any instrument of conveyance to any local authority from another local authority if the instrument is required to implement a scheme within the meaning of the Local Government Act 1974, or for the purposes of a corresponding scheme implemented pursuant to any former Act.

In this case, the transfer of the assets will be exempt from stamp duty provided the amalgamation of the authority falls within a scheme specified by section 13(1)(k).

Reference: HO.TPP061

Legal Decisions - Case Notes

Welcome to the first issue of this column. From this Tax Information Bulletin onwards, we will be publishing brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, the Court of Appeal and the Privy Council. From time to time, we will review other cases which have tax implications. In subsequent issues we will also print an update of pending appeals, Taxation Review Authority fixtures and other useful information.

We've given each case a rating as a guide to its potential importance for readers:

• • • • •	Crucial
• • • •	Important
• • •	Interesting
• •	Routine
•	Limited Interest
-	Reported for Completeness

We've shown full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue, and short case summaries and keywords deliver the bare essentials for busy readers. These case notes also outline the principal facts and grounds for the decision. Where possible, we have given indications of forthcoming appeals.

These case reviews do not set out Inland Revenue policy; we have published them for the general interest of our readers.

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Income Tax Act 1976

Case: Commissioner of Inland Revenue v Inglis
(1992) 14 NZTC 9,180 (CA)

Rating: • • • • •

Act: Income Tax Act 1976: sections 65(2)(a), 65(2)(e), 101, 104 and 106(1)(a)

Keywords: *"fixed capital", "circulating capital", "deductions", "losses on share sales", "purpose of resale"*

Summary: A taxpayer successfully claimed losses on the sale of shares acquired for the purpose of resale.

Facts: The taxpayer sold properties and invested the proceeds in the share market 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 was not in the business of dealing in shares. The fact that he bought the shares to sell them when he and his wife decided to buy a house indicated he had bought the shares with the clear and dominant purpose of reselling them. The Commissioner disallowed the losses. The case was referred to the TRA who held that the losses were deductible. The Commissioner appealed the matter to the Court of Appeal.

Decision: The Court of Appeal dismissed the appeal and held that the losses were deductible. The Act allows deductions for expenditure or loss in gaining or producing assessable income (section 104), but section 106 (1)(a) prevents any such deduction for capital losses. The Court considered that this prohibition only applies to losses of fixed capital and not to losses of circulating capital (that is, "the cost of trade"). The Court went on to state that because the second limb of section 65(2)(e) makes the share transactions assessable, this had the effect that the shares were held on revenue and not on capital account. If the taxpayer 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), second limb). By making the profits on shares assessable the statute artificially changed their character from fixed to circulating capital. Therefore, the prohibition in section 106(1)(a) would not apply and any losses from the transaction would be deductible.

Comments: The Commissioner is not appealing this case.

References: Inland Revenue's policy on losses on share transactions is set out in Tax Information Bulletin (Volume Four, No. 5, December 1992).

Case: Commissioner of Inland Revenue v Stockwell
(1992) 14 NZTC 9190 (CA)

Rating: • • • •

Act: Income Tax Act 1976: sections 65(2)(a), 65(2)(e), 101, 104 and 106(1)(a)

Keywords: *"business of buying and selling shares", "deductions", "losses on share sales"*

Summary: The taxpayer in this case successfully claimed losses on the sale of shares. He was found to be in the business of dealing in shares and had acquired the shares for the purpose of resale. This case was heard at the same time as *Commissioner of Inland Revenue* v *Inglis* (1992) 14 NZTC 9180, and the judgments in the two cases should be read together.

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Facts: The taxpayer was a structural engineer who invested money from an inheritance in the share market. He held the shares for a period of two to eight months. His intention was to make a short term gain on the sale of shares in order to set up a property development business. He made losses on the sale of the shares and claimed them as a deduction. The Commissioner disallowed the losses and a case was stated to the TRA. The TRA allowed the taxpayer's losses on the basis that the taxpayer was in the business of share dealing. The TRA also concluded that the taxpayer had acquired the shares with the dominant purpose of resale. The Commissioner appealed the decision. The Commissioner did not challenge the finding that the shares were acquired for the dominant purpose of resale but sought guidance on what constitutes a business of share dealing.

Decision: The Court of Appeal dismissed the appeal. The shares were bought with the dominant purpose of resale, and therefore any profit would be assessable under the second limb of section 65(2)(e). Any corresponding loss from the transaction would be deductible as a loss of circulating capital.

The Court held on the facts that the presumption should be against finding that a business existed. However, as the TRA had not erred in law and had accepted the taxpayer's evidence, the finding that the taxpayer was in business could not be disturbed.

The Court also stated that where a taxpayer has a full time occupation and devotes some of his time to speculation on the stock exchange, it would be unlikely that the taxpayer has embarked on a business. The same should apply to a retired or unemployed person who engages in a modest amount of buying and selling shares.

The Court also noted that the nature of income producing activities varies, and that it is not desirable to formulate hard and fast rules. The Court added that whether a particular activity amounts to a business is a matter of fact and degree, but recognised that the continuity and extent of the activity was an important consideration, if not the dominant consideration. It was stated that the activity need not be the taxpayer's sole or principal activity to constitute a business. It was further noted that the buying and selling of shares merely to supplement an adequate income from other sources or to provide interest or excitement is unlikely to be a business. In order for a person to be regarded as dealing in shares, the Court would expect to find both a considerable number of purchases and sales over an appreciable period of time, and a substantial capital investment.

Comment: The Commissioner is not appealing this case.

References: Inland Revenue's policy on losses on share transactions is set out in Tax Information Bulletin (Volume Four, No. 5, December 1992).

Case: TRA No. 88/92

Rating: • • • •

Act: Income Tax Act 1976: sections 64B, 64C and 64F

Keywords: *"accrual regime", "financial arrangement", "foreign exchange gains and losses", "hedging"*

Summary: Contracts for forward sales of a commodity, denominated in a foreign currency, entered into by a commodity exporter are not financial arrangements and are not subject to the accrual regime.

Gains and losses on foreign exchange hedging contracts entered into by the same exporter, which span a balance date, are to be recognised on realisation. This finding applies only in the absence of a specific accrual determination to the contrary.

Facts: The objector was a commodity exporter which sold a commodity to overseas buyers. The contracts for sale were denominated in foreign currencies.

At balance date the objector was party to a number of commodity contracts under which delivery of the commodity and payment (in the foreign currency) took place at different times after that balance date. At the same time the objector was party to a number of foreign exchange contracts which hedged the objector's risk that the value of the foreign currency would reduce between the date the commodity contract was entered into and the date on which payment, in the foreign currency, was made.

At balance date the objector had accrued "losses" of approximately $500,000 under the commodity contracts and accrued gains of approximately $500,000 under the foreign exchange contract.

The Commissioner and the objector agreed that the commodity contracts and the foreign exchange hedging contracts were separate financial arrangements and were both subject to the accrual regime.

Decision: The TRA held that the commodity contracts were not financial arrangements and were not subject to the accrual regime. This finding made it unnecessary for the Authority to consider the parties' arguments whether the accrual regime measured the gain or loss between the date the contract was entered into and payment, or between the date of delivery and payment.

The TRA also held that, in the absence of any relevant accrual determination at the time, the objector was not required to recognise the accrued gain under the foreign exchange contracts at balance dates. Any gain or loss under those contracts was to be recognised on realisation.

Comment: The Commissioner is appealing this case.

References: Technical Rulings Ch 14.2.16

Case: TRA No. 82/92 Case P82 (1992) 14 NZTC 4,546

Rating: • • • •

Act: Income Tax Act 1976: sections 337 and 338

Keywords: *"tax deductions", PAYE", "travel agents", "employees or independent contractors"*

Summary: A group of travel agents who operated their own businesses under the mantle of an objector company were not employees of that company, so it did not have to deduct PAYE.

Facts: The objector company provided certain facilities, and was accredited to IATA, which is necessary to carry on the business of a travel agency. The "partners" provided some equipment and inputs; chose their hours and where they worked; arranged their own locum if necessary; were not supervised or controlled by the objector; were paid in accordance with their sales; bore any loss due to their own mistakes; shared overheads; used the company name for some communications; and their individual names for others.

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Decision: Judge Barber decided that the objector was not liable to deduct PAYE. He considered that the agents were running a type of partnership under the mantle of the company. Each agent operated her or his own personal business enterprise, in reliance on the accreditation of the objector company. This was despite the interlinking of their activities.

Comment: The Commissioner is not appealing this case.

References: Technical Rulings Ch 12.6.3, Ch 56.4 and 56.4.6

Case: TRA No. 92/19

Rating: • • •

Act: Income Tax Act 1976: sections 65(2)(a) and (e), 104 and 106(1)(a)

Keywords: *"losses of circulating capital", "tainted by illegality", "business activity", "stolen moneys"*

Summary: The taxpayer made substantial losses from trading on the futures market using money stolen from his employer. The losses were deductible. The stolen money, which had not been repaid, was regarded as capital and so was non-assessable.

Facts: The taxpayer stole large sums from his employer to trade on the futures market. Whilst some trading resulted in gains, overall the taxpayer made considerable losses.

The taxpayer's intention was to repay the money from the expected profits from futures trading. Only some of the money was repaid. When detection became inevitable, the taxpayer fled to Australia.

Decision: Judge Willy decided that any profit from futures trading was assessable under section 65(2)(a). It was found that there was a sufficient nexus between the losses and the gaining or producing of assessable income. The losses were accordingly deductible under section 104.

The prohibition against deductions for loss of capital under section 106(1)(a) did not apply. The losses were of circulating capital. (This point was recently confirmed in *CIR v Inglis* and *CIR v Stockwell*. Both cases are noted in this column.) The taxpayer was in the business of futures trading.

The taxpayer's activities were sourced by stolen money, and "tainted by illegality". This had no bearing on whether the activities could be regarded as a business.

The remaining issue was whether the unpaid balance of the stolen money was assessable to the taxpayer. Judge Willy agreed with counsel for the taxpayer that the relevant question was the character of the money at the time of receipt. The action of stealing the funds did not produce income according to ordinary concepts, rather it was a transfer of capital.

The taxpayer is obliged to repay the stolen money. The fact that a considerable amount is still outstanding does not, of itself, make it income.

Comment: The Commissioner is appealing this case.

References: Technical Rulings Ch 20.3

Case: James Bull Ltd v CIR
HC M.No.52/89

Rating: • • •

Act: Income Tax Act 1976: section 122

Keywords: *"use", "performing services", "directly", "statutory interpretation"*

Summary: The hiring out by a taxpayer of plant or machinery for use by another person in a farming or agricultural business does not qualify the taxpayer for an investment allowance under section 122 of the Income Tax Act 1976.

Facts: The taxpayer is a company carrying on the business of hiring plant, machinery and vehicles to a crop farmer. These assets were put to use by the farmer in developing a block of land he owned. The taxpayer claimed a farming investment allowance under section 122 in respect of the new farming assets it had purchased. The Commissioner disallowed the claim and the matter proceeded by way of case stated to the High Court.

Decision: The Commissioner argued that the taxpayer, having hired the assets out to another person, did not itself use these assets for farming or agricultural purposes, and did not qualify for the incentive.

The taxpayer submitted that regard should be had to the intent of the legislation which was to encourage increased farm production. Also, the business of hiring plant to those involved in the actual farming should properly be regarded as a farming or agricultural business. This would satisfy the provisions of section 122(1)(a). The taxpayer also argued that it was "performing services" under section 122(1)(b) by the hiring out of plant and machinery for farming or agricultural use.

The Court found that as section 122(1)(a) provides that the plant and machinery is to be used "by the taxpayer primarily and principally and directly ..... on any land in New Zealand", the obvious intention of the provision is that it should apply only to those who farm the land.

In respect of section 122(1)(b), the Court considered that the act of "performing services .... on any land" includes more than the mere hiring out of plant or machinery.

Comment: We do not know whether the taxpayer will seek to appeal this case.

References: Technical Rulings Ch 23.3.5

Case: TRA No.92/49, 92/50, Case P85 (1992) 14 NZTC 4,564

Rating: • • •

Act: Income Tax Act 1976: section 65

Keywords: Assessable income, Loss of profits insurance, Timing of derivation

Summary: A payment received under a loss of profits insurance policy is included in assessable income in the income year during which the amount of the payment is settled.

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Facts: A taxpayer company suffered loss due to two successive fires on its business premises. The company claimed under a loss of profits insurance policy. The policy allowed the insurer an indemnity period of 15 months to make an assessment of the actual loss suffered by the taxpayer. Agreement on the final amount of insurance payable was reached at a settlement conference held almost three years after the first fire.

Decision: The Commissioner contended that the insurance proceeds should be spread over the 15 month indemnity period. The Authority rejected this argument.

Judge Willy held that the insurance payments under the loss of profits policy flowed from the settlement of the insurance claim. At this time, the payments were derived by the taxpayer, and therefore should be included as assessable business profits in the income year during which settlement was reached. Before settlement, the taxpayer was unable to make a reasonably accurate estimate of the amount of the insurance receipt and the insurance company was under no absolute obligation to make any payment.

Comment: The Commissioner is appealing this case.

References: Technical Rulings Ch 12.2.2 and Ch 20.43.3

Case: TRA No.92/94; 92/95; 92/96

Rating: • •

Act: Income Tax Act 1976: sections 4 and 4A

Keywords: *"deemed dividends", "suppressed moneys", "imputation"*

Summary: Moneys taken by husband and wife co-shareholders from a private company, in order to lessen the company's tax liability, constituted a dividend in the hands of the shareholders.

Facts: The co-shareholders took money from the till of the company during the years 1987 to 1989 and used it for personal expenditure. Following an Inland Revenue investigation, the company and the shareholders were reassessed. The company paid all income tax and GST owing and did not pursue its objection. The Commissioner deemed the money received by the shareholders to be deemed dividends under section 4 and 4A.

Decision: Judge Willy rejected the contention that the shareholders were merely reducing their current accounts with the company. Evidence of this from the records of the company was not provided, and those current accounts actually increased during the years concerned.

The moneys received by the shareholders were properly classed as dividends under s4(1)(a).

The shareholders were not entitled to a credit for the GST subsequently paid by the company in respect of the "suppressed moneys". The GST was a liability of the company, irrelevant to the amount received by the shareholders.

As to whether the shareholders were entitled to a credit for the income tax paid by the company, Willy J noted that the imputation provisions came into effect in the 1989 year, and postponed making a final determination on the matter in case the shareholders could still bring themselves within those provisions for the 1989 year.

Comment: We do not know yet whether the taxpayer is appealing this case.

References: Technical Rulings Ch12.14.1

Case: TRA No.92/77, Case P86 (1992) 14 NZTC 4,575

Rating: • •

Act: Income Tax Act 1976: sections 416, 420 and 423
Inland Revenue Department Act 1974: section 36

Keywords: *"penal tax", "onus of proof", "mitigating circumstances"*

Summary: A taxpayer had attempted to evade paying tax on the receipt of interest income. He had his penal tax reduced from 150% to 100% because of mitigating circumstances.

Facts: The taxpayer objected to the Commissioner's assessment of penal tax of 150%.

Decision: Judge Willy was satisfied that the Commissioner had correctly concluded that the taxpayer had evaded his taxation obligations. The Commissioner had also satisfied the onus of proof obligations required by the legislation

In his consideration of the proper amount of penal tax to be charged, Judge Willy took into account the taxpayer's longstanding health problems. The objector had virtually a lifetime of prescription drug taking, which had affected his faculties. Judge Willy decided that the amount of penal tax assessed to the objector was excessive in this case and that it should be amended to 100% of the tax evaded.

Comment: The Commissioner is not appealing this case.

Case: CIR v Watson
HC M70/91

Rating: •

Act: Income Tax Act 1976: sections 104 and 106(1)(a)

Keywords: *"commencement of business", "start-up expenditure", "business test", "findings of fact"*

Summary: The High Court dismissed the Commissioner's appeal against a decision of the Taxation Review Authority. The TRA ruled that a full-time employee was entitled to claim expenses relating to part-time consultancy activities because a "business" had commenced.

Facts: Until March 1989 the taxpayer was employed full-time by a large timber merchant as an export sales executive. In his 1988 return the taxpayer claimed travel, accommodation, meals, entertainment and other expenses in respect of a part-time export consultancy venture.

The venture involved market research and feasibility studies, and taking leave during trips overseas for his employer and making trips on his own behalf, to investigate export opportunities for other New Zealand companies. The venture was conducted with the employer's consent. Expenses for that portion of trips spent on his employer's business were met by the employer. The taxpayer received no income from his consultancy activities until March 1989.

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At the TRA hearing the Commissioner argued that the taxpayer had not commenced "business" by 31 March 1988. Therefore, the expenditure claimed by the taxpayer was "preliminary to business" and thus capital and non-deductible pursuant to s.106(1)(a) of the Income Tax Act 1976.

The TRA found in favour of the taxpayer and ruled that the expenditure was deductible. (Case M92 (1990) 12 NZTC 2,565)

Decision: In the appeal the Commissioner argued that the Authority had erred in holding that the taxpayer's business activities had commenced prior to 31 March 1988.

Ellis J. held that the TRA's decision was based essentially on findings of fact drawn from evidence presented at the TRA hearing. This included in particular the evidence arising from the oral testimony and cross examination of the taxpayer, which the appellate Court had not had the opportunity of hearing. The Judge commented that the Authority put a great deal of weight on his assessment of the taxpayer as a witness and the Judge was not prepared to interfere with that assessment. The Commissioner's appeal was dismissed.

Comment: The Commissioner has not yet decided whether to appeal this case.

References: Technical Rulings Ch 20.3

Goods and Services Tax Act 1985

Case: Turakina Maori Girls College and Others ("Integrated Schools")
CA 35/92

Rating: • • • •

Act: Goods and Services Tax Act 1985: sections 2, 3(1)(ka), 6, 8 and 14

Keywords: *"attendance dues", "integrated schools", "consideration", "services", "financial services"*

Summary: "Attendance dues" paid to proprietors of assets used by integrated schools are paid as consideration for a service. The supply is not an exempt supply and is subject to GST.

Facts: This was a "test case" for proprietors of assets used by schools integrated under the Private Schools Conditional Integration Act 1975. That Act enabled private schools originally established to provide education with a special character to be brought within the State system.

The controlling authority of an integrated school is the board of trustees, and it is responsible for the provision of free education to pupils. "Proprietors" of integrated schools determine and supervise the maintenance of the special character of the school, are the owners or trustees of the land and buildings, and enter into contracts with the parent or guardian entitling the pupil to attend the school.

"Attendance dues" may be charged to fund the obligations of the proprietors for payment of debt, for capital works and improvements, and other charges associated with the land and buildings such as insurance. The operation of the schools, including teachers salaries and educational materials, is funded by the State.

Decision: The Court of Appeal confirmed the High Court decision. The attendance dues are paid as consideration for a "service", and the supply is not exempt.

The provision of the land and buildings, entitlement to enrol, and assurance of the special character, in respect of which the attendance dues were paid, were clearly "services" as defined in the Act.

The Court noted that the supply need not be to the person who pays the consideration. The consideration is "in respect of, in response to, or for the inducement of the supply".

The Court rejected the argument that any service provided was the collection and application of the attendance dues, which is mostly a financial service. The payments were not of "interest, principal, dividend or other amount whatever in respect of any debt security". The debts, if any, are those of the proprietors, not the parents or guardians.

Comment: The appellants have not sought to appeal the decision to the Privy Council.

References: Technical Rulings Ch 108.7.5.2.1

Case: TRA No. 92/44 Case P83 (1992) 14 NZTC 4,553

Rating: • • •

Act: Goods and Services Tax Act 1985: sections 2, 6, 8 and 51
Income Tax Act 1976: section 241

Keywords: *"taxable activity", "deemed registration", "subdivision", "residence"*

Summary: Although now an Australian tax resident, the taxpayer was required to register for GST in New Zealand on the subdivision and sale of his farm. The subdivision and sale of the farm was held to be a taxable activity for GST purposes.

Facts: The taxpayer owned and farmed a property in New Zealand. He decided to live permanently overseas, and began the subdivision of the farm. Three years later, the subdivision was completed. The taxpayer was no longer a New Zealand tax resident. The Authority was asked to determine whether the proceeds of the sale should be subject to GST.

Decision: The taxpayer argued that he was not required to register for GST in New Zealand since he was not a New Zealand tax resident and his New Zealand income was below the threshold figure. The Authority rejected this argument and held that he was required to register under the statute.

The taxpayer argued that the subdivision was a one-off property development and fell outside the definition of taxable activity. After a thorough consideration of the case law, the Authority held that the definition consisted of two alternatives; a continuous activity, or a regular activity. The subdivision was held to amount to a continuous activity.

The Authority commented that it would be rare that a subdivision of land would not be a taxable activity for the purposes of the Act.

Comment: The Commissioner is not appealing this case.

References: Technical Rulings Ch 106.3

Case: TRA No 91/159 Case P84 (1992) 14 NZTC 4,561

Rating: • • •

Act: Goods and Services Tax Act 1985: sections 2 and 11(1)(c)

Keywords: *"going concern", "taxable activity"*

Summary: The son bought premises previously leased by a partnership consisting of his father and himself. This was not a supply of a going concern, despite the fact that the son had previously taken over liability for the lease without any formal assignment.

Facts: The objectors were a father and son partnership which carried on a photography business from leased premises. The father retired from the business. The son took over liability of the lease. There was no formal assignment of the lease from the partnership. The son later decided to buy the building to save paying rent. The son claimed a deduction of input tax in respect of the sale which Inland Revenue originally allowed. As a result of an audit of the son's GST affairs the Commissioner advised that the supply of the building should have been zero rated under section 11(1)(c).

Decision: The Commissioner argued that as there had been no formal assignment of the lease to the son, the partnership remained the tenant. Thus the sale was subject to the lease which therefore constituted the sale of a going concern. Judge Willy held that notwithstanding the lack of formal assignment, the father held his part of the lease interest in trust for his son (until the date of the purchase of the freehold). The former lease merged on settlement of the freehold. There was no activity capable of "going".

Comment: The Commissioner is not appealing this case.

References: Technical Rulings Ch 107.9.2

Case: TRA No.92/93

Rating: • •

Act: Goods and Services Tax Act 1985: section 5(12)

Keywords: *"going concern"*

Summary: The sale and purchase of a charter yacht did not amount to the supply of a taxable activity as a going concern.

Facts: The objectors were a yacht chartering partnership. The partnership sold its yacht to a firm of yacht charterers and purchased a replacement yacht with commercial berth from them. The partnership did not market or initiate any charter business in respect of the new yacht prior to its purchase. No goodwill passed with the sale. There were no advance bookings nor was there an introductory period to get to know the vendor's clients. There was no restraint of trade agreement. The basic criteria indicating the sale and purchase of a business as a going concern were not present.

Decision: The Commissioner argued that the transfer of the berth indicated that the purchasers were buying more than a bare yacht. Judge Willy was satisfied that

although the assets purchased were capable of forming the basis of a yacht chartering business, no such business passed from the vendor to the purchaser.

Comment: The Commissioner is not appealing this case.

References: Technical Rulings Ch 107.9.2

Case: TRA 91/184

Rating: •

Act: Goods and Services Tax Act 1985: section 4

Keywords: *"open market value"*

Summary: This case had earlier been heard in part and adjourned pending the agreement of the parties to the valuation of a property. A figure was agreed and the Authority amended the assessment accordingly and ordered the objector to refund an overpayment of GST.

Case: No. 92/119

Rating: •

Act: Goods and Services Tax Act 1985: section 24

Keywords: *"tax invoice", "compliance with legislation"*

Summary: Solicitors provided a settlement statement for the vendors on purchase of land from a partnership. It did not comply with the requirements of the Act for invoices, and Inland Revenue disallowed the claim for input tax credit. The matter was settled by consent.

Facts: The invoice and its subsequent amendments were defective. At various points the defects included the fact that the parties were incorrectly identified and the GST registration number which was supplied was incorrect.

Inland Revenue disallowed the invoice on the basis that it did not comply with section 24 of the Act, which sets out requirements for the correct form.

Attempts to amend the invoice did not resolve the situation and a case was stated.

Decision: The Authority recognised that the defects in the invoice were technical, and facilitated an agreement between the parties which led to a consent order based on the submission of an amended invoice.

References: Technical Rulings Ch 109.19.2

Inland Revenue Department Act 1974

Case: TRA No. 91/70

Rating: • •

Act: Inland Revenue Department Act 1974: section 39A(1)

Keywords: *"consent order", "costs"*

Summary: The objection was withdrawn by consent. The Commissioner requested that an order for costs be made against the objector, claiming that insufficient notice was given of the withdrawal. On the facts of this situation, no order for costs was made.

Facts: The objector was a company in receivership. The first debenture had been paid and the receivership was terminated. The receiver of the second debenture holder then took over management eleven days before the fixture. He was not aware of the objection before that time. Three working days later, he advised Inland Revenue that he wished to abandon the objection.

Decision: Costs were not awarded since the Authority considered it unreasonable in the circumstances. It was noted that the bulk of the preparatory expenditure had been incurred before the date of change in management, and that no delay was made by the new management in advising the withdrawal of the objection. It was noted that the power to award costs does not relate to expenditure incurred by the Commissioner.

A warning was made to taxpayers, that in general the delay of notifying withdrawal or abandonment would result in a award of substantial costs.

Case: TRA No. 92/88

Rating: -

Act: Inland Revenue Department Act 1974: section 38

Keywords: *"non-appearance", "dismissal of objection"*

Summary: The objection was dismissed when neither the objector nor his agent appeared within 35 minutes of the allocated time for the fixture.

Case: TRA 92/87

Rating: -

Keywords: *"consent order"*

Summary: This case was withdrawn by consent, without any order for costs being made.

Due Dates Reminder

February

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.

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

March

5 PAYE deductions and IR 66ES for last 13 days of February due - “large” employers only.

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

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

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

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

20 RWT on Interest deducted during February due for monthly payers.

RWT on Dividends deducted during February due.

NRWT (or Approved Issuer Levy) deducted during February due.

PAYE deductions and IR 66ES for first 15 days of March due - “large” employers only.

PAYE deductions and IR 66ES for February 1993 due - “small” employers.

Gaming Machine Duty return and payment for month ended 28 February 1993 due.

31 GST return and payment for period ended 28 February due.

* This was shown as 20 February in error in last month's TIB.

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