New Tax Legislation

Several Revenue Acts were enacted on 1 April 1993.

The Income Tax Amendment Act 1993 amends the Income Tax Act 1976. It results from the passing of the Income Tax Amendment Bill (No 11), which contained the new depreciation regime.

The remaining six Acts resulted from the Taxation Reform Bill (No 6) which was introduced into Parliament in December 1992 :

The Income Tax Amendment Act (No 2) 1993 amends the Income Tax Act 1976. Among the more significant reforms contained within it are:

- new rules governing the deductibility of business entertainment expenditure
- a new regime for the valuation of livestock for tax purposes
- changes to the existing regime for the taxation of international income
- better structured and simplified legislation for the calculation of provisional tax
- taxation of lump sum retiring allowances as income
- a new tax treatment of the profit and interest elements of hire purchase agreements
- amendments to the dividend definition
- a number of other remedial issues

The Estate Duty Abolition Act 1993 amends the Estate and Gift Duties Act 1968 by abolishing Estate Duty on the estates of people dying on or after 17 December 1992

The Goods and Services Tax Amendment Act 1993 amends the Goods and Services Tax Act 1985

The Inland Revenue Department Amendment Act 1993 amends the Inland Revenue Department Act 1974

The Student Loan Scheme Amendment Act 1993 amends the Student Loan Scheme Act 1992

The Child Support Amendment Act 1993 amends the Child Support Act 1991

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Estate Duty Abolished

Estate Duty Abolition Act 1993

Estate duty has been abolished on the estates of people dying on or after 17 December 1992.

On 17 December 1992 the Government announced that estate duty would be abolished from that date, and that amending legislation would be included in the next taxation reform bill. This legislation has been passed, so no Estate Duty is payable on the estate of anyone who dies on or after 17 December 1992.

There will therefore no longer be a requirement for grants of administration to be sent to Inland Revenue, or for administrators to file statements with the Department.

In the interim, Inland Revenue has been releasing grants of administration on the basis of an undertaking by the administrator that sufficient funds will be withheld from any distribution to beneficiaries to enable the payment of estate duty if the legislation was not enacted. These arrangements will obviously no longer apply, and Inland Revenue will not be enforcing any of the undertakings provided.

Application Date

The legislation generally applies from 17 December 1992. The amendment which removes the obligation on Registrars of the Court to send grants of administration to Inland Revenue applies from 1 April 1993.

Depreciation

Sections 107A - 108O, 111 and 117, Income Tax Act 1976

Introduction

The new depreciation regime is based on the Valabh Committee’s recommendations, and achieves a number of important goals.

First, it strengthens the taxpayers' rights by introducing a clear statutory base for the regime. Deductions are now a statutory entitlement; they are no longer at the Commissioner's discretion. For the first time, the criteria under which rates are set and the right of taxpayers to apply for a different rate are set down in statute.

Secondly, the regime includes a number of new features to reduce the compliance costs that taxpayers face.

For most assets, taxpayers will be able to choose between diminishing value and straight line methods of depreciation.

Another new feature of this regime is the pool method of depreciation, under which a taxpayer can depreciate a number of low value assets collectively rather than individually.

The facility to write off asset purchases of less than $200 is included, and taxpayers may also apply to write off the remaining value of assets which can no longer be used.

Thirdly, certain intangible assets and land improvements have been brought into the depreciation regime.

A permanent 20% loading is available for new assets purchased after the start of the 1995-96 income year. A transitional regime applies before then, under which assets purchased between 1 April 1993 and the end of the 1994-95 income year can be depreciated at either the new economic rate or the rate set under the previous regime. If the asset is new, the rate under the old regime will include the 25% interim loading.

Application dates

Because the new depreciation regime achieves a number of different objectives, there are several application dates.

For standard balance date taxpayers, all sections of the new regime come into force on 1 April 1993. All aspects of the regime are therefore available to these taxpayers except section 108F, which requires assets acquired in the 1995-96 and subsequent years to be depreciated at the economic rate, with a 20% loading for eligible assets.

For intangible assets, all aspects of the new regime come into force on 1 April 1993, regardless of a taxpayer's balance date.

Early balance date taxpayers can apply all aspects of the regime from the start of their 1993-94 income year, except those sections which relate to the application of the economic rate. Those sections come into force on a strictly 1 April 1993 basis for all taxpayers.

The consequence of this is that early balance date taxpayers will be depreciating all assets under the provisions of the new regime from the start of their 1993-94 income year, but must depreciate at the rates which the Commissioner currently allows. The exception to this rule is assets acquired after 1 April 1993, which may be depreciated at the new economic rate.

Late balance date taxpayers

There are special provisions so that late balance date taxpayers are not disadvantaged. These taxpayers may choose to depreciate assets acquired after 1 April 1993 at the economic rate. However, the other provisions of the regime are not available to these taxpayers until the start of their 1993-94 income year.

Statutory entitlement for depreciation - section 108

The core provision of this regime provides that any *depreciable property* shall be depreciated in accordance with the provisions of the Act.

Depreciable property is property which, if used to produce assessable income, can be depreciated. It is defined in detail in section 107A. Generally speaking, depreciable property is all the property which the Commissioner has previously allowed to be depreciated under the Act. It is property which declines in value, but does not include land or property for which a deduction is otherwise available under the Act. Certain intangible assets can now be depreciated (see discussion elsewhere) as can certain land improvements. Depreciable land improvements are listed in the 21st Schedule and depreciable intangible assets in the 22nd Schedule.

No depreciation deduction may be made in the year property is sold. This is because for most types of assets, a final adjustment must be made under section 117 in the year of sale. There is an exception to this rule for assets for which no final adjustment is made under section 117 - buildings and schedule depreciable property (see discussion elsewhere).

The depreciation deduction is now mandatory - taxpayers cannot defer it or claim only part of it. The section applies regardless of section 106(1)(a), which disallows any deduction for loss of capital.

Calculating the deduction - section 108A

A number of formulae are used for calculating deductions for depreciation in different circumstances. The basic formula is:

$$a \times b \times \frac{c}{12}$$

where

a is the depreciation rate

b is the adjusted tax value (if using the diminishing value method) or cost (if using the straight line method)

c is the number of months in the income year during which the taxpayer held the property. This increases or reduces the deduction both when the asset was only owned for part of the year, and when the taxpayer's income year was shorter or longer than 12 months.

Adjusted tax value is a fundamental concept in the new depreciation regime. In section 107A, adjusted tax value is defined as base price minus aggregate deductions.

For assets owned at the end of the 1992-93 income year, base price will generally be the tax book value at the end of that year.

For assets acquired after the beginning of the 1993-94 income year, base price will generally be cost.

In some cases, base price will be market value. This happens if the asset was not depreciable when the taxpayer first owned it, but becomes depreciable some time after the beginning of the 1993-94 income year. This rule does not apply to buildings or schedule depreciable property.

Example 1

Tracey Paku bought a car in 1991 for $10,000. In July 1993 she leaves her job as an accountant and sets up in business as a driving instructor. She intends to use her car in the business.

The base price of the car is its market value in July 1993 - $8,500.

To calculate adjusted tax value, deduct the aggregate deductions from the base value. Aggregate deductions are all those depreciation deductions that would have been taken if the property had been used wholly for deriving assessable income from the time which base value was determined.

- For property used in a business at the end of the 1992-93 income year, this calculation begins to run from the start of the 1993-94 income year.
- For property bought after the end of the 1992-93 income year, the calculation runs from the date on which the property was bought.
- For property originally not depreciable but brought into a business in New Zealand after the start of the 1993-94 income year, the calculation runs from the beginning of the month in which the property became depreciable.

Example 2

Andrew Marks Movers own a bulldozer which at the end of the 1992-93 income year had a tax book value of $80, 000. The rate is 25% diminishing value, and the bulldozer was owned for the entire 1993-94 income year. The calculation is therefore:

$$25\% \times \$80,000 \times \frac{12}{12} = \$20,000$$

AMM will therefore claim a deduction of $20 000 on account of the bulldozer. At the beginning of the 1994-95 income year, the new adjusted tax value will be

$80 000 - $20 000 = $60 000.

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Example 3

Andrew Marks Movers purchase a new bulldozer on 16 September 1993 for $200 000. Assuming AMM elect to use the interim rate (see discussion below) the applicable depreciation rate is 25%. If AMM is a standard balance date company, the bulldozer was owned for 7 months of that income year - September through to March. No apportionment is required for the ownership for only a part of September. The calculation is:

$$25\% \times \$200{,}000 \times \frac{7}{12} = \$29{,}167$$

The depreciation claim is therefore $29,167. The new adjusted tax value at the start of the 1994-95 income year is $200 000 - $29 167 = $170,833.

The adjusted tax value of the property may itself be the deduction if this value is so low that applying the formula would result in a deduction greater than the adjusted tax value.

There is special provision for depreciable property that is a motor vehicle to which sections 106B to 106E apply. These are motor vehicles owned by self-employed people or partnerships who must keep a logbook to establish the proportion of business to private use. These taxpayers are required to apply the formula:

$$d \times e$$

where

d is the amount of deduction calculated using the a x b x c/12 formula

e is the proportion of business to private use calculated in accordance with sections 106B to 106E.

Example 4

Ms MacReal is a self-employed salesperson. She has calculated under sections 106B to 106E that her car is 85% used for business purposes. The car's opening tax book value is $18,000, and she owns it for the entire 1993-94 income year. She bought the car second-hand in 1992, so the applicable depreciation rate is 20%.

First, applying the formula a x b x c/12:

$18,000 x 20% x 12/12 = $3,600.

Second, applying the formula d x e:

$3,600 x 0.85 = $3,060.

The deduction for depreciation is therefore $3,060. However, the adjusted tax value of the car reduces by the full $3,600 to $14,400.

There is also an apportionment calculation for other mixed-use property. Note, however, that this does not include use for which fringe benefit tax is payable. Fringe benefit tax is itself an apportionment mechanism, and if all non-business use of property is subject to fringe benefit tax then no further apportionment is required for depreciation purposes.

The formula for this property is

$$d \times \frac{f}{g}$$

where:

d is the amount of deduction calculated using the formula a x b x c/12

f represents the total of units for which the property was used for business use, (and where appropriate, the number of units the property was not actually used but was available for business use)

g represents the total units for which the property was either actually used or was available to be used.

This formula requires an apportionment to be made between business and other use. Any units of measurement which seem appropriate can be used, such as days, months, or kilometres. However, the units chosen must be units which measure the different uses accurately.

Example 5

Mr O'Deals is a self-employed car dealer. He owns a caravan and in 1993 he used it as a sales office for 8 months while a new office was being built. His family took the caravan on holiday for one month in the summer. For the rest of the year the caravan wasn't used at all. At the start of the income year the caravan had a written-down value of $3,500, and because it was bought before 16 December 1991 the appropriate diminishing value rate is 20%.

First, applying the formula a x b x c/12

$3500 x 20% x 12/12 = $700.

Second, applying the formula d x f/g

Item f is: 8 months as sales office;
3 months not used but available for the business;
11 months total

Applying the formula d x f/g

$700 x 11/12 = $642

The deduction for depreciation is therefore $642.

Note that this section does not apply to property being depreciated under the pool regime, which has its own set of rules.

Depreciation methods - section 108B

This deals with the application of the three different depreciation methods. All tangible property may be depreciated using either the straight line or the diminishing value method. This includes property which was originally depreciated under the legislation in force before the start of the 1993-94 income year. Depreciable intangible property can also be depreciated using either method provided it is not fixed life intangible property, which can only be depreciated using the straight line method.

The following chart shows equivalent straight line and diminishing value rates. For some assets, the precise rate used will not appear on the chart. Where this occurs, round the actual rate to the nearest rate in the relevant column. The appropriate equivalent is the rate directly opposite.

Conversions for diminishing value and straight line rates - assets owned before 1 April 1993

DV %	SL %	DV %	SL %	DV %	SL %	DV %	SL %
1	1	17.5	12	32.5	23	48	36.5
2	1.5	18	12.5	33	24	48.5	37
2.5	2	19	13	34	24.5	49	39
3	2.5	20	13.5	34.5	25	50	40
4	3	20.5	14	35	25.5	50.5	41
5	3.5	21	14.5	36	26	51	42
6	4	21.5	15	37	27	52	43.5
7	5	22	15.5	38	27.5	53	44
7.5	5.5	23	16	39	28	54	45
8	6	24	16.5	39.5	29	55	45.5
9.5	6.5	24.5	17	40	30	56	46
10	7	25	17.5	41	31	57	47
11	7.5	26	18	42	32	58	47.5
12	8	27	18.5	43	32.5	60	48
13	8.5	27.5	19	44	33	61	49
13.5	9	28	19.5	45	33.5	62	50
14	9.5	28.5	20	45.5	34	63	51
15	10	29	20.5	46	34.5	63.5	63.5
16	10.5	30	21	46.5	35	64	64
16.5	11	31	22	47	35.5	DV = SL	
17	11.5	32	22.5	47.5	36	to 100%	

Example 6

Under the previous regime non-refrigerated containers have a diminishing value rate of 15%. A container bought between 16 December 1991 and 31 March 1993 will also be eligible for the interim loading of 25%. This brings the diminishing value rate to 18.75%. To find the alternative straight line depreciation rate:

1. find the nearest rate to 18.75% in the diminishing value rate column of the chart above - which is 19%
2. ascertain the equivalent straight line rate - which is 12.5%.

A taxpayer who elects to use the straight line or diminishing value method in any particular year may not change methods after filing that year's tax return, but can make a different election in a subsequent year. If a taxpayer elects to pool property, that property must be pooled for as long as that taxpayer owns it, so an election to pool is effectively permanent.

If a taxpayer switches any property from the diminishing value method to the straight line method, it must be depreciated under the straight line method by writing off in equal annual instalments the adjusted tax value at the time of switching to the straight line method. Taxpayers in this situation must use adjusted tax value instead of cost as the base for the straight line method so they don't get an unfair advantage by switching methods partway through an asset's life.

Example 7

A taxpayer bought a jet boat at the beginning of the 1990-91 income year for $20,000. At the end of the 1992-93 income year, it had been depreciated down to $10,240, and the taxpayer decided to switch to the straight line method.

The equivalent straight line rate to 20% DV is 13.5%. Applying the straight line method requires 13.5% of $10,240 to be deducted in each year the taxpayer continues to use the straight line method.

A taxpayer may also elect to depreciate property using the pool depreciation method. This method is discussed later in this article.

A taxpayer elects which depreciation method to use simply by applying it in that year's tax return.

Rates of depreciation - sections 108C, 108D, 108E, 108F, 108G, 108H

The rates of depreciation available to an asset owner depend on both the type of asset and the time at which it was bought. The date on which a binding contract to buy the asset was entered into may also be relevant. The chart on the next page sets out the relevant rate regime:

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Date of contract to buy asset	Date asset delivered	Type of asset	Rate available
Before 16 December 1991	regardless	all assets	pre-interim
16 December 1991 to 31 March 1993	if used before 31/3/93	NZ new asset	interim
		used asset	pre-interim
	1/4/93 to end of 94/95 year	NZ new asset	interim or economic
		used asset	pre-interim or economic
	95/96 year onwards	NZ new asset	economic + loading
		used asset	economic
1 April 1993 to end of 1994/95 year	1/4/93 to end of 94/95 year	NZ new asset	interim or economic
		used asset	pre-interim or economic
	95/96 year onwards	NZ new asset	economic + loading
		used asset	economic
1995/96 year onwards	regardless	NZ new asset	economic + loading
		used asset	economic

Pre-interim rate is the rate the Commissioner allowed under the regime in force before 1 April 1993. It does not include the 25% interim loading.

Interim rate is the rate the Commissioner allowed under the regime in force before 1 April 1993, and includes the 25% interim loading which applied to eligible New Zealand new assets acquired after 16 December 1991.

Both the pre-interim and interim rates include the additional allowance for assets used in multiple-shift applications.

Economic rate is the rate set by the Commissioner under section 108C of the new legislation. These rates have been specified by the Commissioner by determination. These determinations will be similar in legal effect (although not similar in form) to the determinations issued by the Commissioner for the purposes of the Accruals Rules.

The rate the Commissioner initially calculates is a diminishing value rate, which is rounded to the nearest banded rate. Banded rates are set out in Appendix B. The formula for calculating rates is:

$$1 - \frac{\text{residual value}}{\text{cost}}^{\frac{1}{n}}$$

where "n" in the exponent is the estimated useful life in years.

Residual value is the greater of estimated residual value and 13.5% of cost. Estimated residual market value is defined as the market value of the property at the end of its useful life, based on an assumption of normal and reasonable maintenance.

Estimated useful life is defined as the time over which property might be expected to be useful in earning income, having regard to wear and tear and obsolescence.

Example 8

The Commissioner ascertains that, on average, motor vehicles which carry up to 12 passengers:

- are typically used in businesses for 5 years; and
- are typically sold at the end of that five years for an amount equal to 25% of original cost

So, a motor vehicle bought for $30,000 will be sold at the end of five years and can be expected to be sold on average for $7,500.

applying the formula:

$$1 - \frac{7{,}500}{30{,}000}^{\frac{1}{5}}$$

gives a diminishing value rate of 24.2%.

In accordance with section 108C, this rate will be rounded to the nearest band as set out in the Schedule. In this case, the closest rate is 26%.

The Commissioner may set a single depreciation rate for a number of similar types of depreciable property where it appears appropriate, having regard to the individual rates for those different types of property and the reduction in compliance costs that will be achieved.

For example, the Commissioner may have calculated that the appropriate depreciation rate for passenger motor vehicles under 2000cm^3 was 26%, and the appropriate rate for passenger motor vehicles over 2000cm^3 was 24%. Instead of requiring a distinction to be drawn between these two types of motor vehicles, the Commissioner may choose to set a single rate of 26%.

The Commissioner may issue a determination which changes the economic rate for an asset at any time. However, where the rate being used is that set under a general determination, the legislation prevents the Commissioner from reducing the rate for assets which are already owned.

The economic rate may also be a special rate set on request from a taxpayer. This procedure is discussed elsewhere in this TIB.

Economic rate plus loading is simply the economic rate discussed above with the addition of the 20% permanent loading. This loading is calculated by multiplying the economic rate by 1.2, so the 10% straight line rate becomes 12% when the loading is added.

Section 108E sets a special depreciation rate for international passenger jet aircraft.

Special and provisional economic rates of depreciation - section 108I

There are two situations where the Commissioner will issue economic rates at a taxpayer's request. When issued, those rates may be specific to a taxpayer or expressed to apply more widely.

Special economic rates will be issued to a taxpayer who can show the Commissioner that an asset the taxpayer owns depreciates at a rate which is greater or less than the general economic rate.

When setting a special rate, the Commissioner applies the same diminishing value formula set out above. However, the Commissioner will use figures supplied by the taxpayer for cost, life, and residual value if the Commissioner is satisfied that they are accurate. Note that under the formula the residual value will always be a minimum of 13.5%.

The Commissioner will not issue a special rate if:

- insufficient information has been provided to enable him to calculate a special rate; or
- the general economic rate is currently being reviewed, and a new rate which is at least equal to the rate in the special rate application will be issued within the next six months; or
- the rate calculated does not differ from the banded rate by at least half the difference between the already applicable general rate and the next highest or lowest band. For example, the general rate set for an asset might be 18% DV. The next highest DV band is 22%. A special rate application will therefore have to produce a rate of at least 20% before the special rate will be issued.

Where a special rate has been issued and the circumstances which applied when the rate was issued subsequently change, the Commissioner may revoke the special rate determination and either issue a new determination at a different rate or issue no new determination, which will require the asset to be depreciated at the general rate.

Provisional economic rates are available for assets for which no general rate has been set. These are likely to be assets which are newly-invented or which have not before been used by New Zealand businesses, and which are sufficiently different from assets for which rates have already been set that those rates or asset descriptions do not seem appropriate. Generally, a provisional rate will lapse when the Commissioner issues an applicable general rate.

The approach to setting provisional rates is similar to that for special rates. The Commissioner will take the data supplied by the taxpayer to the extent that it is accurate, and apply the diminishing value formula. The Commissioner will decline to issue a provisional rate if:

- insufficient information has been provided to enable him to calculate a rate; or
- a general rate already exists; or
- a general rate is in the process of being determined and will be set within the next six months.

Pool method of depreciation - section 108J

The pool method of depreciation is aimed at reducing compliance costs, by allowing taxpayers to depreciate low value assets collectively rather than individually as under the other provisions. Where appropriate, this section acts in substitution for some of the other depreciation provisions.

Only *poolable property* can be depreciated under this regime. *Poolable property* is property with a value less than the maximum pooling value, whether by costing less than the *maximum pooling value* or by having been depreciated individually to an adjusted tax value which is less than the maximum pooling value. *Maximum pooling value* will generally be $2,000, but taxpayers may apply for a higher maximum pooling value for specific assets.

Because there are no apportionment provisions in the pooling regime, poolable property must also be property which is used wholly in the business or is subject to fringe benefit tax.

The globo accounting method is no longer available under the new regime. Any property that was accounted for under the previous regime using the globo accounting method should be pooled, along with all other items in that globo account.

Formula for Deductions

The formula for calculating depreciation under the pool method is:

$$a \times \frac{b + c}{2} \times \frac{d}{12}$$

where:

a is the diminishing value rate of depreciation applicable to all items included in the pool in the income year (if items with different rates were included in the pool at any time during that period, this is the lowest of those diminishing value rates);

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b is the pool's adjusted tax value at the beginning of the income year, or nil if the pool did not exist at the beginning of the year;

c is the adjusted tax value of the pool at the end of the income year (before deducting depreciation for that year);

d is the number of whole or part calendar months in the taxpayer's income year.

This formula is built around the concept of calculating depreciation for the "average value" of the pool.

Acquisition and Disposal of Pool Assets

Where a taxpayer elects to include an item of poolable property in a pool, the adjusted tax value of the pool is increased by the cost of the property (if the item was included in the pool immediately upon acquisition) or by the adjusted tax value of the item (if the item was previously accounted for separately).

Where an asset is disposed of, the adjusted tax value of the pool is reduced by the consideration received. If no consideration is received - such as if the asset is dumped or lost - then no reduction is made. If the consideration received is greater than the value of the pool, then the adjusted tax value of the pool is reduced to nil and the excess is assessable income. Even if the pool still has assets in it, no further deduction can be claimed unless the pool has further assets added and therefore returns to a positive value.

Example 9

High and Steady Ltd are scaffolding contractors. At any time, they own roughly $100,000 worth of scaffolding. They buy new items regularly to replace items which are lost or wear out. The rate for scaffolding under the previous regime was 12.5% diminishing value including the 25% interim loading. The rate for scaffolding under the new regime is 12%. HSL decide to pool all scaffolding in one pool at the new rate.

At the end of the 1992-93 income year, the collective book value of all scaffolding is $87,000. The opening value of the pool is therefore $87,000.

In the 1993-94 income year, the following events take place:

May 1993	$10,000 spent on new scaffolding
August 1993	$4,000 received from insurance company for scaffolding stolen off site
January 1994	$8,000 spent on new scaffolding

closing value of the pool is therefore:	$ 87,000
add purchases	$ 18,000
	$105,000
deduct disposals	$ 4,000
closing balance	$101,000

The applicable depreciation rate is 12%, as the lowest rate applying to assets in the pool in the year.

applying the formula

$$\text{rate} \times \frac{\text{opening value + closing value}}{2} \times \frac{\text{months}}{12}$$

$$12\% \times \frac{\$87{,}000 + \$101{,}000}{2} \times \frac{12}{12}$$

= 12% x $94,000

= $11,280

So the depreciation deduction for the scaffolding pool is $11,280.

Different pools may be set up for the same type of assets. This may be useful where, for example, different rates apply because of different acquisition dates, or the assets are used in different locations and separate records are desired.

Note that the pooling regime does not allow the amount of any assessable income derived on disposal to be restricted to the amount of depreciation actually deducted. Taxpayers should therefore be wary of including in a pool any asset which is likely to ultimately be sold for more than its original cost.

There is also provision for the situation where all the assets in a pool have been disposed of but the pool still has a positive value. The remaining value of the pool is then deductible.

Write-off of depreciable property that can no longer be used - section 108K

There is a new provision which allows taxpayers to apply to the Commissioner for a determination stating that a deduction can be claimed for the remaining adjusted tax value of property (other than buildings) that can no longer be used.

Taxpayers must satisfy the Commissioner of certain criteria before he will issue the determination. These criteria are:

- that the property is no longer used by the taxpayer; and
- that the costs of disposing of the property are greater than any consideration that would be derived from disposing of it.

The Commissioner will also consider whether the property could be used by someone else in a business.

A write-off claimed under this section effectively becomes the depreciation deduction for the year, so no other depreciation deduction can be claimed.

If a taxpayer subsequently sells property that has been written off under a determination made under this section, section 117 will apply so that the proceeds of the sale up to cost will be assessable.

Deduction for low-value assets - section 108O

From the 1993-94 income year onwards, the statutory $200 deduction provided under the new regime replaces all taxpayer-specific concessions allowed by the Commissioner under the previous regime.

Taxpayers can claim a deduction for the cost of assets acquired for $200 or less provided that:

- they are not purchased from the same supplier at the same time as other assets to which the same depreciation rate applies, unless the consideration for the entire purchase is less than $200; and
- the assets will not become part of property that is depreciable - for example, expenditure on materials to build a new wall in the taxpayer's factory; and
- the cost of those assets is not deductible under another provision of the Act.

Where any property for which a deduction has been claimed under this provision is sold, the entire sale proceeds are assessable.

Assets accounted for using standard value and replacement value methods

These methods are not carried forward into the new regime. Assets held at the end of the 1992-93 income year which were depreciated using these methods must be dealt with under the new regime by depreciating the book value at the relevant new rate. These assets may also be pooled.

Intangible assets

Intangible assets are now included in the depreciation regime. This means the cost of some intangible assets can be capitalised and depreciated. Previously, some intangible assets such as patents and premiums paid for the lease of land had their own specialist sections of the Income Tax Act which allowed deductions. The cost of most other intangible assets was non-deductible.

The types of intangible assets which can be depreciated are limited to those listed in the new 22nd Schedule to the Income Tax Act. The 22nd Schedule can have extra asset types added if they meet these criteria:

- they have a finite useful life that can be estimated with a reasonable degree of certainty on their creation or acquisition; and
- they have a low risk of being used in tax avoidance arrangements once made depreciable.

The depreciation rules applying to intangible assets vary according to whether or not they are fixed life intangible property (FLIP). An intangible asset is a FLIP if, on its purchase or creation, it can reasonably be expected to have an economic life which is the same as its legal life.

The depreciation rate for FLIPs is self-assessed by the owner under section 108G. The formula to be used for the calculation is:

$$\frac{1}{\text{Legal Life}}$$

Legal life is a defined term which means the remaining life of the asset under the statute or contract which gives the asset its life. In determining the length of the legal life it must be assumed that any automatic rights of renewal are taken up, provided the only action needed is the payment of a pre-determined fee.

The formula gives a straight line depreciation rate and the straight line method is the only depreciation method that can be used for FLIPs. FLIPs will not be eligible for the 20 percent loading applying from the 1995/96 income year.

Example 10

A patent for a new type of electric motor is purchased on 1 May 1993 for $100,000. The patent was granted on 1 May 1991 for an initial period of 4 years, with automatic rights of renewal that will enable it to run to 1 May 2007 if it is renewed when required. As far as can be ascertained at the time of purchase, the patent will remain valuable until the end of its legal life. The depreciation rate to be used by the purchaser is:

$$\frac{1}{14} = .7 \text{ or } 7\%$$

A $7,000 deduction for depreciation can therefore be claimed each year. If the patent becomes obsolete before the end of its legal life, the owner can apply to write off the remaining book value under the provisions of section 108K.

Depreciable intangible assets which can be expected to have an economic life which is shorter than their legal life (economic life intangibles), such as software, are not FLIPs. The Commissioner determines their depreciation rate using the same method that is applied to all tangible depreciable assets.

Unlike FLIPs, economic life intangibles can be depreciated using a diminishing value or straight line depreciation rate They can also be pooled, and will be eligible for the 20 percent loading applying from the 1995/96 income year. Taxpayers can also apply for a special or provisional depreciation rate for economic life intangibles.

When a taxpayer develops an intangible asset rather than purchasing it, any scientific research costs remain

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deductible under section 144 (which has been amended to clarify this intent).

Since intangible assets are not disposed of in the same way as other assets, a special provision has been added to the definition of disposal in the new section 117(10). The provision (in 117(10)(a)(iv)) deems a disposal to include any event which has the effect of stopping the rights that make up an intangible asset from ever being able to be exercised.

Example 11

A taxpayer purchases for $1,000 a 5 year franchise which consists of the right to use a secret process and the right to use a trademark. The franchiser supplies the materials to use in the process. After 3 years the franchiser is declared bankrupt and no new materials can be purchased. The intangible asset is a FLIP and has a self assessed depreciation rate of 20%.

After 3 years, $600 worth of depreciation has been claimed so the adjusted tax value of the rights held by the franchisee is $400. Since the rights can never be used again, they are deemed to be disposed of and the $400 can be written off.

However, a disposal is also deemed (in 117(10)(b)) to not include the disposal of intangible property where it is part of an arrangement to replace it with property of the same type. This is to prevent taxpayers writing off the cost of software that is sent back to the seller in return for a heavily discounted price on a later version. In effect, the original software has just been upgraded. The cost of the upgrade can be added to the cost or book value (depending the depreciation method being used) of the original version.

Sections 83, 137, 139, 142 and 143 are existing tax provisions dealing with intangible assets which have had consequential amendments made to them. Deductions allowed under these sections for the purchase or creation of intangible assets ceased on 31 March 1993. Intangible assets created or purchased after 31 March 1993 (and for which a deduction is not otherwise available) can be depreciated under the new depreciation regime.

Gain or loss from disposition of depreciable property - section 117

As part of the depreciation reforms a new section 117 has been enacted, although the policy changes in this area are relatively minor.

Section 117 applies to the disposition of depreciable property and to software (sold to an associated person) for which a deduction has been claimed, but it does not apply to property depreciated using the pool depreciation method.

The major initiative in the new provision is the provision of a clear statutory basis for claiming of a loss on sale. The deductibility of the costs of disposal is also expressly provided for.

A formula is provided for apportioning the gain or loss on sale of any property that has been used partly for business use and partly for other use. This formula apportions the gain or loss in the same proportion as the depreciation deductions were apportioned.

One other new feature is the treatment of assets which become no longer depreciable. This will happen if, for example, a business asset becomes used entirely for non-business purposes. In the income year the asset leaves the business, an apportionment calculation will be carried out under the ordinary provisions. If, at the end of the following year, no depreciation is claimable for that year (because the asset was wholly outside the business), the asset will be deemed to have been disposed of for a consideration equal to market value on the first day of that year.

There are special provisions dealing with the disposal of intangible assets (see earlier commentary on intangible assets).

Schedule depreciable property

There is special provision for schedule depreciable property. Schedule depreciable property is petroleum drilling rigs, support vessels for offshore petroleum drilling rigs, and support vessels for offshore petroleum production platforms.

Because of the special nature of this property, the calculation under section 108A is done on a daily rather than a monthly basis. No adjustment is made on disposition or exit from the tax base under section 117 for schedule depreciable property.

Repairs and maintenance

Repairs and maintenance were previously deductible under section 108. The provision under which this deduction could be claimed has not been carried forward into the new regime.

Expenditure on repairs and maintenance is deductible from the 1993-94 income year onwards under the ordinary provisions of the Act. Expenditure will therefore have to satisfy the test under section 104, and is subject to the denial of a deduction for capital expenditure in section 106(1)(a).

The main consequence of this change is that alterations which do not increase the value of the asset must be capitalised and depreciated.

Expenditure on improvements

Taxpayers have two basic choices when dealing with the depreciation of capital expenditure on improvements to depreciable property. The expenditure can be either added to the cost of the depreciable property and depreciated as part of that property, or it can be separately capitalised and treated as a separate asset.

Expenditure on improvements can only be depreciated from the month in which the improvement was first used or became available to be used. Consequently, in the year in which expenditure on the improvement is made, the depreciation calculation for an improvement to an asset will be different from the depreciation calculation for the asset itself.

From the beginning of the following income year, taxpayers have two choices. If the straight line method is being used, the cost of the improvement should be added to the cost of the asset for depreciation purposes, and the adjusted tax value of the improvement should be added to the adjusted tax value of the asset. If the diminishing value method is being used, the adjusted tax value of the improvement should be added to the adjusted tax value of the asset. Alternatively, the improvement may continue to be depreciated as a separate asset. This approach will be useful if the rate applying to the improvement is different from the rate applying to the asset.

Sale of depreciable property between associated persons

Section 111 has been repealed and replaced with a new section which is restricted in its application to transactions between associated persons.

Section 111 in its original form was an anti-avoidance section under which the Commissioner could restrict the deduction that a transferee could claim to the amount of deduction which had been previously allowed to the transferor.

The latitude of discretion allowed the Commissioner was widely viewed as unsatisfactory, and it was not consistent with the new depreciation regime, which attempts to set out the rights and obligations of taxpayers in as transparent as possible a manner.

The new section 111 has the same effect as the previous section outlined above, except that it can only be applied to transactions between associated persons.

The new section 111 applies to transactions taking place from the start of the 1993-94 income year.

Transfers between commonly owned companies

Inland Revenue's administrative practice under the previous depreciation regime was to permit transfers between 100% commonly owned companies at tax book value. With the enactment of the new depreciation regime this practice needs to be reviewed. We are currently preparing a draft policy statement on this issue, which we will send to interested parties for consultation when it is completed. In the meantime, the existing administrative practice will continue.

Other minor issues covered in the Act

- a number of sections which set out special rules for depreciating certain assets are repealed. These sections were no longer of any legal effect, and in the main provided special incentives.
- the 20% permanent loading available from the 1995-96 income year is also available for expenditure on land improvements used for farming, agriculture, or forestry, and improvements in relation to aquaculture (amendments to sections 128A, 128B, and 128C).

Provisional Tax

Sections 375-391, 398A, 413A, Income Tax Act 1976

Introduction

A whole new Part XII of the Income Tax Act has been introduced, to apply from the 1994/95 income year. This new provisional tax regime is a combination of changes to the provisional tax interest regime - to reduce scope for tax deferral, and minor changes to address problems with the current regime. As well, the new Part XII simplifies the provisional tax legislation itself.

Summary of main changes

Use of money interest will apply from the first provisional tax instalment date for taxpayers with over $30,000 residual income tax (RIT). The $30,000 threshold recognises that deferral occurs mainly amongst large provisional taxpayers.

The rate of interest on overpayments will be different from that applying to underpayments. The Government has decided that as far as is feasible, provisional tax use of money interest will be aligned with market interest rates to reduce fiscal risk. Where one interest rate applies to both under- and overpayments of provisional tax some taxpayers have incentives to overpay their liability while others have incentives to underpay. The rates will be set by Order in Council.

Use of money interest paid to taxpayers will be assessable. Correspondingly, use of money interest charged to taxpayers will be deductible, subject to the normal deductibility provisions. Inland Revenue will deduct

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Resident Withholding Tax (RWT) from assessable interest in accordance with that regime.

The legislation increases the grounds for remission of underestimation penalty to include unforeseen fluctuations. The expanded part of the remission provision applies to compulsory estimators (taxpayers whose RIT exceeds $300,000) who have an unforeseen fluctuation of twenty percent or more in their tax liability for an income year, when the fluctuation occurs after the third instalment date for that year.

Summary of minor changes

The application of the requirement for taxpayers' estimates to be "fair and reasonable" has been strengthened. The Commissioner will have a new power to amend estimates retrospectively after the income tax liability is assessed. Taxpayers will now have a right to object to this and any estimates that the Commissioner makes during the income year.

The legislation provides for a fairer underestimation penalty. The current penalty is a two step process. The first step is to see if the taxpayer's estimate is less than 80 percent of RIT, and the second determines the amount of penalty. The penalty is capped by reference to last year's RIT where a taxpayer is a voluntary estimator.

The following changes to the penalty have been made:

- Determination of whether taxpayers have underestimated is based on the higher of what they paid and what they estimated. This prevents the penalty applying where taxpayers pay more but do not bother to update their estimate.
- Underestimation penalty will only apply to provisional taxpayers who had an obligation to pay provisional tax. It will not apply to those who estimate their liability when they were not required to do so.
- The penalty calculation will be based on the greater of what a taxpayer estimated or paid (rather than simply what was paid, which is the current position).

TSCC recommendations not implemented

A number of the recommendations of the Tax Simplification Consultative Committee (TSCC) have not been implemented. These not implemented are that:

- the provisional tax payment dates move to the 20th of the month
- the terminal tax date be moved for IR 3 and IR 5 taxpayers
- a seasonality provision be introduced
- non-individuals are always provisional taxpayers
- taxpayers can elect to be provisional taxpayers.

New regime in detail

The new provisional tax regime is described below in greater detail. We will publish a further TIB item explaining the application of the new regime section by section closer to the application date.

Structure of legislation

A new Part XII was inserted instead of amending the existing Part XII, to give the legislation a simpler and more coherent structure.

The structure of the legislation is embodied in sections 377 to 390. Section 377 sets the total amount of provisional tax payable. This total amount is calculated under section 377 where provisional taxpayers pay tax on an uplift basis. Where taxpayers estimate or the Commissioner makes a determination, the total provisional tax is still set under section 377. However, the total provisional tax payable is calculated under section 378 where taxpayers estimate or under section 379 where the Commissioner makes a determination.

Once the total amount of provisional tax payable is set, section 380 determines whether provisional tax is payable in one, two or three instalments. Provisional tax is payable in one, two or three instalments for new provisional taxpayers and in one instalment where provisional taxpayers with over $300,000 of RIT have less than $2,500 of RIT in the previous year.

Section 380 determines the amount of provisional tax payable on an instalment date. This is calculated using the total provisional tax payable under section 377 and the number of instalments determined under section 380. Section 381 provides that taxpayers can make further payments of provisional tax should they wish.

Sections 383 to 385 apply additional tax where taxpayers incorrectly pay an instalment or underestimate their residual income tax at the third instalment date.

Sections 386 to 390 contain other various offsetting provisions that allow taxpayers to credit provisional tax against their own income tax liability and the provisional tax liability of other taxpayers.

Provisional tax payments

Under the new provisional tax regime, any taxpayer with residual income tax greater than $2,500 is a provisional taxpayer. Provisional taxpayers must pay tax:

- in three instalments, if their RIT was greater than $2,500 in the previous income year. (Note that a targeted refund provision has been introduced to cover cases where last year's RIT is not known with certainty, causing taxpayers not to know they have an obligation to pay provisional tax for the current year); or
- in one instalment (the third instalment date), if a provisional taxpayer's RIT was less than $2,500 last year but more than $300,000 this year (and the taxpayer is not a new provisional taxpayer); or

- in either one, two, or three instalments, where the taxpayer is a new provisional taxpayer (*see New provisional taxpayer provision* below).

Where a taxpayer does not estimate, the amount of provisional tax payable on the first and second instalment dates is either:

- one third of 105 percent of last year's RIT; or
- one third of 110 percent of the RIT of the year before last, where the taxpayer has an extension of time arrangement and has not furnished last year's return by the instalment date.

At the third instalment date taxpayers who have not furnished the previous year's return must either estimate or guess at 105 percent of last year's RIT (because that tax return has not been filed).

Taxpayers have the right to estimate their liability at any time on or before the third instalment date for an income year. However, they must estimate by the third instalment date if their RIT for an income year exceeds $300,000.

The payment rules of the new regime are the same as those of the old system, except that a targeted refund provision and a new provisional taxpayer provision have been introduced.

Targeted refund provision

A provision has been introduced to provide specifically for a refund of provisional tax paid where provisional taxpayers turn out not to be required to pay provisional tax. This provision addresses the problem of uncertainty where provisional taxpayers have not furnished last year's tax return and so could not be certain last year's RIT exceeded $2,500 (and thus whether they have to pay provisional tax). They can pay provisional tax and get that tax back when they furnish the previous year's return. (Under current rules it is possible that money may not be refunded by the Commissioner until terminal tax date for that income year.) This provision applies from the 1992-93 income year.

New provisional taxpayer provisions

A new provisional taxpayer provision applies to non-natural persons who commence a taxable activity during an income year. It provides that new provisional taxpayers must pay provisional tax on those instalment dates which occur on or after 30 days after they commence their taxable activity. As they can choose to pay on the basis of last year's RIT plus 5%, payment will normally only occur where they have RIT over $300,000 (since these provisional taxpayers must estimate on or before the third instalment date). However, the interest regime can apply to new provisional taxpayers with over $30,000 RIT from the first instalment date occurring after the 30 day exemption has expired. So, in effect the provision is tied to the new interest regime rather than the provisional tax payment system.

Provisional tax interest regime

Non-natural persons will be subject to interest where RIT for the current year is greater than $2,500. Where their RIT is less than or equal to $30,000, two way interest will apply from the third instalment date. If their RIT is greater than $30,000, they will be subject to interest from the first instalment date (or possibly the second or third instalment dates if they are new provisional taxpayers - see below).

Natural persons will be subject to the new interest regime from the first instalment date where RIT for the income year is greater than $30,000. Where they have $30,000 or less RIT they will only be in the interest regime where they estimate, and then only from the third instalment date. Natural persons who are trustees will be subject to interest and qualify for interest on their trustee income as if they were not natural persons.

An adjustment has been made to the provision paying interest to taxpayers who paid provisional tax because they expected to be provisional taxpayers, but who turn out not to be. Taxpayers must now have:

- reasonably expected to be provisional taxpayers
- made an estimate of their RIT by the third instalment date
- paid an amount of not less than $2,500 as if it were provisional tax
- been able to be a provisional taxpayer had their RIT exceeded $2,500
- had RIT exceeding $2,500 last year.

Interest will be calculated as currently specified except that it will be assessable or deductible (as explained above), and Inland Revenue will deduct Resident Withholding Tax from interest on provisional tax overpaid. There is no requirement for taxpayers to deduct RWT from interest paid to Inland Revenue (this requirement has been applied retrospectively). A deduction for interest charged is claimable in the year the tax is assessed or reassessed.

Application date

The regime applies from the 1994/95 income year.

Tax Treatment of Business Entertainment Expenditure

Sections 106G, 336N, 336P, 336S, Income Tax Act 1976
Section 21, Goods and Services Tax Act 1985

Introduction

The Income Tax Amendment Act (No.2) 1993 and the Goods and Services Tax Amendment Act 1993 enact changes to the tax treatment of business entertainment expenditure. The new regime provides that the deductibility of business entertainment expenditure will be limited to 50 percent.

Background

The Government announced in the 1992 Budget its plans to make changes to the tax treatment of business entertainment expenditure. Such expenditure would still be deductible, but the private benefits - assumed to be 50 percent - would be subject to Fringe Benefit Tax (FBT). For those outside the FBT regime (sole traders, partnerships and trusts with no employees) 50 percent of business entertainment expenditure would be made non-deductible.

The legislation reflecting this decision was later introduced into Parliament. As a result of the many submissions received on the issue, changes were made to the proposed legislation in the select committee process. The main change was that instead of imposing FBT on the private benefits of business entertainment, the deductibility of business entertainment expenditure has been limited to 50 percent.

The legislation provides a broad definition of entertainment and several specific exclusions to the definition (see section 106G(1), (2) and (3)). The treatment of entertainment allowances and entertainment facilities is specified in subsections (4) and (5). Subsection (6) identifies a number of exemptions or partial exclusions to the definition. The Commissioner’s discretion is included in subsection (7). A number of amendments are made to section 336N, thereby modifying the FBT regime. Section 336P, which deals with the value of a fringe benefit arising from expenditure incurred on fares, accommodation and sustenance, will not include the provision of entertainment. Associated GST changes are included in the GST Amendment Act.

Inter-relationship between non-deductibility and FBT

FBT will apply where entertainment is provided to employees for their consumption or enjoyment at their discretion outside the course of their employment duties. Otherwise, the 50 percent deductibility rule will apply (except where the expenditure is specifically excluded from the regime).

Definition of entertainment

The new legislation defines entertainment as:

- food;
- beverages;
- recreation; and
- accommodation or travel for the purpose of providing any of these.

Recreation is widely defined as being active or passive participation in sports, games, physical exercise, or artistic, cultural, social, or leisure pursuits or amusement.

Where accommodation or travel is connected with or undertaken for the purposes of facilitating the provision of food, beverages or recreation, 50 percent of the deduction claimed pursuant to section 104 will be denied.

For example, a client is taken on a chartered fishing trip. It is considered that the dominant purpose of the expenditure is to provide recreation. The expenditure incurred in relation to the trip will therefore be subject to partial denial of deductibility.

Accommodation or travel associated with attendance at a business related conference will not be subject to the entertainment regime as the dominant purpose of the expenditure is business related.

Where the accommodation or travel expenditure has dual purposes (both for entertainment and business related purposes) the dominant purpose may be determined by considering the time devoted to each purpose. For instance, travel is undertaken to attend a two day event where business discussions occur over half a day and sightseeing and recreational activities occur over the remainder of the event. In this example the dominant purpose would be entertainment related.

The facts of each case will determine the dominant purpose of the expenditure.

Note that before expenditure can be considered as entertainment expenditure it must be deductible in terms of section 104. These entertainment expenditure provisions will not make non-deductible expenditure deductible.

Exclusions

The following are excluded from the definition of entertainment, and the expenditure incurred will be fully deductible.

Market value

Entertainment provided for market value in the ordinary course of a business which consists of the provision of entertainment is excluded.

This means that expenditure incurred by businesses providing entertainment in the ordinary course of its business to paying customers will continue to be fully deductible. For example, expenditure incurred by restaurants in providing meals to patrons will continue to be fully deductible.

Assessable income

Entertainment which is assessable income to the person to whom it is provided is excluded.

Taxable client entertainment allowances, for example, will continue to be taxable in the hands of the recipient and fully deductible to the provider. As well, food and beverages provided to employees that are currently taxable under section 72 will be fully deductible. For example, meals provided to a farm labourer as part of board and lodgings will be fully deductible.

Off-shore entertainment

Entertainment consumed or enjoyed outside New Zealand is excluded.

Under this exclusion, all expenditure which is incurred on entertainment which is consumed off-shore will be fully deductible.

Allowances paid to reimburse expenditure on off-shore entertainment will be fully deductible. Taxable allowances will still be fully assessable to the recipient

For income tax purposes, "New Zealand" includes the territorial waters (within the 12 mile limit), and the air space above, but not generally the waters of the Exclusive Economic Zone (within the 200 mile limit). Therefore, any entertainment which takes place outside the territorial waters will be fully deductible. Entertainment on a cruise ship from Auckland to Sydney, for example, will be consumed outside New Zealand and there will be no need to apportion entertainment between that enjoyed within New Zealand and that enjoyed outside.

Business entertainment enjoyed on pleasure craft which sail in New Zealand waters will usually be treated as being consumed in New Zealand, unless there is evidence to indicate that the entertainment was consumed outside territorial waters.

Promotional activities

Also excluded is entertainment which is provided as a merely incidental part of a function or activity which has as its dominant purpose the promotion or advertising to the public (or to any broad section of the public) of:

- a business, or
- goods or services provided in the course of carrying on a business.

The entertainment must be provided in circumstances where the public (or any broad section of the public) are invited or intended to use, consume or enjoy the entertainment and none of the following has a greater opportunity to use, consume or enjoy the entertainment than members of the public generally:

- clients, customers, or suppliers of the people providing the entertainment;
- employees of the people providing the entertainment (or of people associated with them);
- people associated with those providing the entertainment or with employees of either;
- any other special class of person as determined by the Commissioner.

The Commissioner will make rulings on a case by case basis. For example, motoring journalists invited to the product launch of a new car may be classified as a "special class of person". Similarly, dignitaries such as MPs and trade representatives from diplomatic missions invited to an exporting initiative may be representative of a special class of persons.

In determining whether a group of persons is a special group, the Commissioner will have regard to common characteristics of persons invited and the type of function or activity.

Expenditure on entertainment provided at a function or activity available to the public or any broad sector of the public will be fully deductible. For example, a barbecue at a hardware store or a fashion show in a shopping mall will be fully deductible.

A "broad section of the public" means a significant portion of the public; the entertainment must not be provided to an exclusive group. For example, where an *invitation* to a trade display is sent to all members of the construction industry the event would qualify for the exclusion, as the members of the construction industry qualify as a broad section of the public. However, an invitation to a group of joiners would not qualify.

If a publicly advertised event is directed at joiners, the event, because it is open to the public, is excluded.

If the entertainment provided at the function or activity is not available to the public or a broad section thereof, a special exemption applies (see the discussion on the promotion/advertising exemption where not to a broad sector of the public, below).

Samples

Samples of goods and services, being entertainment provided to clients or customers (not including employees, employees of associated persons or associated persons) in the course of a business for the purpose of promoting or advertising such goods and services, are excluded. In the case of goods, the samples must be either:

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- not consumed at the time provided (for example, a postal sample), whether provided at a function or elsewhere; or
- if consumed at the time provided, consumed in the course of a *function or activity* which has as its principal purpose the promotion or advertising of such goods (for example, wine at a wine tasting would be excluded).

An example of entertainment which is not deductible as a sample is when a publican informally provides a drink to a client.

Samples of services, such as free attendance at an aerobics class, are also fully deductible.

The sample must be a small part or quantity intended to show what the product is like.

The cost to a wine shop, for example, of holding wine tastings will be fully deductible, but if the wine shop were to provide a case of wine to a valued customer, this would not be considered a sample, but a gift. However, if the case of wine were provided to a wine merchant to distribute as samples then the exclusion would apply.

Any associated items, such as cheese provided at a wine tasting, would not be a sample of a wine maker's business. In most cases, however, wine and cheese would be provided in the course of a promotional activity, and could be fully deductible.

The eligibility of this exclusion will depend on the circumstances in which the sample is made available and the manner in which the sample is intended to be used. Accordingly, the exclusion will depend on the facts of each case.

Morning and afternoon teas

A reasonable amount of food and non-alcoholic beverages ordinarily and regularly provided as a morning or afternoon tea to employees or as a light refreshment (other than at a party, reception or other social function) of similar quantity and quality as morning or afternoon tea is excluded. Light refreshments would include food and beverages that could reasonably be expected to be provided as morning and afternoon tea. The food and beverages must be enjoyed on the employer's premises or at the employee's work place, or at a conference, seminar, convention, education course, or similar event attended as part of the recipient's employment or business.

This exclusion ensures that the costs (for items such as coffee, tea, milk, sugar and water coolers) of ordinary morning and afternoon teas are fully deductible. Further, so long as any facilities provided are used more than 50 percent for the provision of morning or afternoon tea, and/or any of the other exclusions, the regime will not apply to the costs of these facilities.

The exclusion covers all "morning and afternoon teas" which fall within the ordinary meaning of the term. For example, if a business usually provides coffee, tea, milk and sugar for employees, but also provides, say, biscuits at meetings and for clients, the cost of the biscuits will be fully deductible.

Morning and afternoon teas provided away from the employer's premises are also excluded if they are consumed by the employee in the course of employment or business. For example, morning and afternoon teas provided on a building site, to a consultant working in a client's office or at a conference are included in the exclusion.

Refreshments need not be served at mid morning or mid afternoon to qualify for this exclusion. For example, the cost of coffee and tea provided to nurses on a night shift is fully deductible.

Dining facilities

A reasonable amount of food and non-alcoholic beverages provided to or consumed by any person, including clients and suppliers (other than at a party, reception, or other social function), in a canteen, dining room or similar facility (whether temporary or permanent) is excluded. The facility must be on the premises or at a work place and operated wholly or principally for the purpose of providing food and non-alcoholic beverages on working days to employees. It must also be open to all employees working at the same location on an equal basis. The exclusion would also apply where, for example, an employer operates from two locations, and at one location a canteen is available for all staff from both locations.

This exclusion makes the costs of subsidised cafeterias fully deductible provided that they are open to all employees. It applies to both temporary and permanent facilities such as in-house cafeterias and cafeterias on building sites. Meals purchased from such facilities but consumed elsewhere are also excluded.

The exclusion does not apply to executive dining rooms, as they are not open to all employees.

Incidental entertainment

A reasonable amount of food, beverages or recreation provided or consumed where the ordinary business consists of the provision of such food, beverages or recreation for market value to the public is excluded. The food, beverages or recreation must be enjoyed on the premises as an incidental part of employment duties or business activities.

For example, light meals provided to a kitchen hand or the entertainment enjoyed by a security guard at a concert would be excluded from the entertainment definition.

What constitutes an incidental part of employment duties or business activities will depend upon the situation. Generally the exclusion will apply where a business provides entertainment as part of its business activities and employees consume an insignificant part of that entertainment, at negligible cost to the employer, in the course of performing their employment duties. The entertainment must be enjoyed on the premises. Light meals provided by a hotel to all staff, including desk staff, will, for example, fall within this exclusion, provided the criteria of the exclusion are met. In many cases the meal to hotel staff will fall within the dining facility exclusion.

Reviewers

A reasonable amount of food, beverages, recreation, or accommodation or transportation enjoyed by a person for the purpose of enabling the person to review the entertainment for a paper, magazine, book, or other medium for sale or distribution to the public is excluded.

For example, the cost of giving movie tickets to a movie reviewer and the costs incurred by a restaurant critic will be fully deductible.

The paper, magazine or book in which the review appears need not be for sale; it may be a free publication, but it must be produced for distribution to the public. For example, the costs incurred by a community newspaper's food critic will be fully deductible.

Travel

Food, beverages or recreation enjoyed merely as an incidental part of transportation on an aircraft, train, bus, or ship are excluded. The transportation must be open to members of the public.

Excluded, for example, are in-flight meals. Also excluded are food, beverages or recreation provided in waiting rooms and lounges such as the Koru and Golden Wing Clubs. Subscriptions to the Koru and Golden Wing Clubs will continue to be fully deductible and not subject to FBT as they are associated with employment duties.

Not excluded is transportation provided for the purpose of providing or enjoying food, beverages or recreation, such as the costs of taking clients on a fishing trip.

Charity entertainment

Entertainment provided to members of the public for the relief of poverty, illness, disability or other disadvantages is excluded.

For example, the cost to a supermarket of donating food to a food bank will be fully deductible, as will the cost of sponsoring a children's Christmas party at a hospital.

Charities are generally not subject to tax and therefore entertainment provided by charities generally will not be affected by the new regime.

If, for example, an employer pays for an employee to attend a charity ball, the expenditure is 50 percent non-deductible, since the entertainment is being provided to the employee, who is not a charity.

Speakers

Recreation in the form of a speaker at a conference, seminar, convention, educational course, or similar event, whether or not in conjunction with a meal, is excluded.

A speaker's fees are therefore excluded. Expenditure incurred in providing associated travel and accommodation for the speaker would also be excluded. If, however, the speech was incidental to recreational activity, for instance, the travel and accommodation would be considered to be predominantly associated with entertainment. Any entertainment provided to a speaker would be 50 percent non-deductible.

The exclusion would not apply to recreation provided by an after dinner speaker at a corporate golf tournament.

Employment duties

Recreation (or incidental accommodation or transportation) enjoyed where the recreation constitutes part of a person's employment duties or business activities (other than a merely incidental part) is excluded.

Under this exclusion, gym fees incurred by a professional sportsperson or a self employed aerobics instructor, for example, are fully deductible.

Although it could be argued that, say, an office worker is more efficient if fit and healthy, it is not part of an office worker's employment duties to attend a gym. To qualify for this exclusion, the recreation must be necessary to carry on the person's job. Such expenditure would be subject to FBT as it is outside the course of employment duties and would be enjoyed at an employee's discretion.

Waiting rooms

A reasonable amount of recreation provided in a waiting-room or reception area to occupy a person's time pending a consultation or meeting is excluded.

For example, the cost of providing magazines in a doctor's waiting room will be fully deductible.

Exemptions

Exemption for meals while travelling on business

There is a $25 per person per day exemption for food and beverages consumed while travelling in the course of deductible business travel. The $25 is GST exclusive where the taxpayer is GST registered and is entitled to claim full GST on inputs. The exemption applies to both expenditure incurred and allowances paid. If the $25 is exceeded, only 50 percent of the amount above $25 will be deductible.

For the exemption to apply, the person must be travelling or have travelled and received an allowance or a reimbursement of expenditure for any meals consumed. Further, the travel must not be for the purpose of enjoying or consuming entertainment i.e. travel to a business lunch.

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Where an employee entertains a client while travelling on business the $25 exemption will only apply to the meal consumed by the employee.

Where two employees are travelling on business and one employee pays for the meals consumed by both, the employer will be entitled to two $25 per person per day exemptions.

The exemption applies to employees and self employed persons while travelling on business.

For example, a travelling salesperson lives in Auckland and travels to Wellington on business for one day. While in Wellington the salesperson incurs meal expenses of $40. The deductible amount will be $32.50 (being $25 + 50% of the remaining $15).

Alternatively, a meal allowance might be paid to a Wellington based auditor while visiting a client in Lower Hutt, and the $25 exemption would apply.

This exemption would not apply to the provision of an overtime meal while not travelling.

Eligible conference exemption

The first $25 of expense per person per day of providing food or beverages at an "eligible" conference will be deductible to the recipient.

A conference is any conference, seminar, convention, educational course, or similar event. This would include a meeting and teleconference.

To qualify as "eligible" a conference must have a continuous duration of four hours or more (not including meals, recreation, and rest breaks such as morning and afternoon tea), and must not:

- be held principally for the purpose of promoting or advertising; or
- be held for the purpose of giving or receiving information about the business, or goods and services to customers or suppliers (A seminar to provide business information to employees would be eligible); or
- be held principally for the purpose of entertainment.

It is anticipated that conference organisers will detail the value which is fairly and reasonably attributable to entertainment at a conference. However, if this figure is not provided then the employer should base it on the value fairly and reasonably attributable to the entertainment, based on similar market values.

An example would be a business running a five-hour training seminar for its staff. Morning and afternoon teas and lunch are provided, occupying one hour. The cost of the food and beverages is $100, and 10 people attend. As the conference qualifies as eligible, the food and beverages provided will be fully deductible because the amount provided falls under the $25 per attendee threshold.

The $25 per person per day exemptions for meals while travelling on business and while attending an eligible conference apply for each calendar day. The exemptions can be aggregated to cover the period of absence. For example, a $250 exemption would apply to expenditure incurred on meals consumed while travelling on business for ten days. Daily calculations are not required to be made.

Promotion/advertising exemption where not to a broad sector of the public

Where a promotion is not made to the public it will still be deductible to the extent that it does not exceed the greater of $500 or $25 per attendee. Employees or associated people who have attended are not included in the number of attendees.

An example would be a product launch which is restricted to certain clients. Incidental food and beverages are provided to the 25 attendees to a value of $725. Five staff are also present at the promotion. The non-deductible portion of the promotion will be $50 calculated as follows:

Total cost of entertainment		$725
less exempted amount (being the greater of $500 or 25 X $25)		<u>$625</u>
		$100
Non deductible amount $100 x 50% =	$50	
deductible amount =	$675	

Multiple $25 exemptions

It will be possible for one employee to qualify for two $25 exemptions per person per day, as each of the $25 exemptions stands alone.

For example, an employee attends a one-day training seminar which qualifies as an eligible conference. The conference organiser provides lunch, which has a value of $10 per attendee. The employee also stays overnight and receives a $75 non-taxable allowance for meals. The employer will be able to claim the $25 exemption for the meal provided at the conference. Consequently, the $10 will be fully deductible.

A $25 exemption will also apply to meals consumed while travelling on business for both calendar days. Accordingly, the first $50 of the non-taxable meal allowance will be fully deductible. The remaining $25 of the allowance will be subject to the 50 percent non-deductibility rule.

Sponsorship

Expenditure incurred for the purpose of providing sponsorship is specifically excluded from the entertainment regime.

The expenditure must be incurred for the principal purpose of promoting or advertising the sponsor's business or goods and services provided by the sponsor's business to the public.

The extent to which the sponsorship provides entertainment benefits to a group of clients, customers, employees or associated persons will be subject to 50 percent deductibility. Consequently, where the organisers of a motor race, for instance, provide a corporate box available only to sponsors and their invited guests, in reciprocation for the sponsorship, the costs incurred in the provision of the corporate box will be only 50 percent deductible to the sponsor.

Expenditure incurred in the provision of sponsorship will, therefore, require apportionment where reciprocal entertainment benefits are provided. The costs incurred by the organiser, for instance, will determine the amount of the expenditure subject to 50 percent non-deductibility. If the costs are not easily identifiable, the market value of the benefits could be used as a proxy.

Where the organiser does not incur any costs in the provision of reciprocal entertainment benefits their value will be nil. For example, a theatre is unable to sell all tickets for a particular play and gives the unsold tickets to a sponsor.

However, if a sponsorship agreement requires a number of tickets to be given to the sponsor their market value will be 50 percent deductible. For example, an individual sponsors a particular tour by the local orchestra and ten tickets to a particular recital are required to be given to the sponsor. The sponsorship is $5,000 and the value of the tickets is $400, so 50 percent of the expenditure incurred in relation to entertainment ($400) is non-deductible. The remaining amount of the sponsorship is fully deductible. A deduction may, therefore, be claimed for $4,800.

Where, for instance, accounting services are provided gratuitously to the orchestra, unless reciprocal entertainment benefits are provided, the services are not subject to the entertainment regime.

Allowances

If a non-taxable entertainment allowance such as a meal allowance is paid, and is not specifically excluded from the regime, 50 percent of the allowance will not be deductible to the employer. Non-taxable entertainment allowances will be subject to the $25 exemptions.

Where a general non-taxable allowance comprising both entertainment and non-entertainment components is paid, 50 percent of the amount relating to the entertainment component will be non-deductible. The calculation of the amount attributable to entertainment will be made by the employer. This calculation is based on a reasonable apportionment with regard to the expenditure which is expected to be incurred on entertainment by the employee.

In determining the entertainment component of a general non-taxable allowance, taxpayers have to indicate how the breakdown has been arrived at. Such information will have been provided to the Commissioner when applying for a determination on the non-taxable status of the allowance. Accordingly, any entertainment element would be identifiable.

Entertainment facilities

Any deductible expenditure or loss incurred and any depreciation deduction claimed in relation to an entertainment facility will be subject to 50 percent non-deductibility. Consequently, rates, interest, cleaning costs and electricity, for example, may be 50 percent non-deductible.

Costs incurred in the provision of entertainment in an entertainment facility are not incurred in respect of the facility and, therefore, are not attributable to it. However, these costs are still subject to 50 percent deductibility. For example, the cost of meals provided on a yacht are independent of the costs of maintaining the yacht.

An entertainment facility is defined as any:

- permanent or temporary building or other structure; or
- boat and yacht; or
- aircraft;
- vehicle; or
- land;

used principally for the provision of entertainment, being food, beverages, or recreation. Consequently, 50 percent of the costs of a corporate box at Eden Park, for example, will be deductible.

In calculating the costs incurred and depreciation deducted in respect of an entertainment facility, any equipment associated with the facility should be included. For example, the costs incurred and depreciation deducted in respect of a kitchen would include the stove, dishwasher, fridge, and other equipment associated with a kitchen.

A facility that is used for other purposes (including excluded purposes) will not be considered an entertainment facility where entertainment is incidental to those other purposes. For instance, where monthly staff drinks are provided in a staff cafeteria used principally for the provision of food and beverages on working days to all employees (exempt entertainment), the staff drinks (entertainment) are incidental to that principal purpose. The cafeteria would not, therefore, be considered to be an entertainment facility and no attribution of deductible costs and depreciation is required.

Where, however, a room is principally used for social club activities, for instance, the room would be considered an entertainment facility.

Commissioner's discretion

The Commissioner has the discretion to determine, having regard to the market value of the entertainment, the extent to which any expenditure is incurred on entertainment. This discretion will be applied where the entertainment expenditure has not been reasonably and fairly calculated.

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For example, negotiations may be made with a motelier resulting in food and beverages provided without a specific charge in lieu of a higher room rate. In this case the entertainment expenditure has not been reasonably and fairly calculated having regard to the substance of the transaction and equivalent market values. Consequently the expenditure incurred on the accommodation will be reassessed by the Commissioner and the extent to which the expenditure is incurred in relation to entertainment determined.

Where, however, a complimentary meal is provided by a motelier, for instance, no expenditure is incurred by the recipient and the meal will not, therefore, be subject to the regime.

Fringe Benefit Tax

The changes to the tax treatment of entertainment expenditure have resulted in a number of changes to the FBT regime.

In most circumstances entertainment expenditure will be 50 percent non-deductible. However, any benefit that is considered to be entertainment (or would have been if not excluded) which employees may consume or enjoy it at a time which is at their discretion, and is not in the course of employment duties, will be subject to fringe benefit tax.

This accordingly brings the following examples into the FBT system:

- subscriptions to golf clubs;
- subsidised groceries sold to employees by supermarkets;
- gyms in workplaces (if access to the gym is limited to certain hours its use is still at the discretion of the employee);
- subsidised gym memberships.

Where expenditure is subject to fringe benefit tax, the expense will be fully deductible.

Some examples of areas that will not be subject to FBT but to the 50 percent non-deductibility rule are:

- staff Christmas parties (whether at work or not);
- subsidised drinks for staff at work,

because they are not enjoyed at a time which is at employees' discretion.

As a result of these changes, the following exemptions from FBT have been removed:

- membership subscriptions;
- in-house benefits (only those which are entertainment);
- benefits provided to an employee for the purpose of enabling the employee to entertain customers or clients, as this now falls within the 50 percent non-deductibility rule.

The value of a fringe benefit which arises from expenditure incurred by an employer on fares, accommodation or sustenance where an employee takes leave or a vacation while on business travel has been amended to exclude entertainment.

Any entertainment benefits which are treated as "other" benefits will be subject to the FBT exemption of $75 per quarter per employee, which has been capped at a maximum of $450 per quarter per employer.

Entertainment facilities liable for FBT

The entertainment regime will not apply where FBT is payable for an entertainment facility. The expenditure or loss on that facility will, therefore, continue to be fully deductible.

Situations may arise where an entertainment facility may be subject to non-deductibility and FBT. For example, a yacht may be available for use by employees at their discretion outside their employment duties and is also used to entertain clients. Based on the facts of the case, costs will need to be apportioned between FBT and non-deductibility.

Record keeping requirements

All forms of entertainment expenditure will need to be identified within accounts so that the new legislation can be complied with.

Inland Revenue recommends that businesses keep working papers which identify the following types of expenditure, to assist in complying with the new rules:

- details of food and beverages that have been provided other than in an in-house dining facility which is open to all employees;
- a breakdown of all costs associated with conferences and seminars, including food and beverages, accommodation and the facility hire where applicable. Other necessary details are the names of the persons who attended, the business they represent and the duration of the conference/seminar;
- the entertainment portion of non-taxable allowances;
- details of meal allowances paid to employees while travelling on business, showing who travelled, the purpose of the trip and the dates/times involved;
- where entertainment expenditure is incurred in promoting or advertising, records showing that the promotion was open to the general public;
- where a promotion is not open to the general public and exceeds $500 or $25 per attendee (whichever is the greater), the names of all persons who attended (for the exemption to apply).

Expenditure should be separately identified in relation to conferences/seminars, meal allowances while travelling on business and promotions and advertising. This will assist taxpayers in applying the appropriate exemptions.

Goods and Services Tax

The entertainment regime will also affect the treatment of GST.

Input tax credits for entertainment expenditure will continue to be claimed in each taxable period as usual. However, when entertainment expenditure is calculated for income tax purposes a deemed supply of entertainment will arise and GST output tax will be payable by a registered person on the non-deductible amount.

A deemed supply of entertainment will not apply to registered persons who are not subject to non-deductibility for income tax purposes.

A deemed supply will generally only arise where an expense is subject to 50 percent non-deductibility. The only exception is non-taxable allowances, as an input tax credit is not usually claimable for allowances.

The adjustment is based on the amount of non-deductible entertainment expenditure.

The deemed time of supply of entertainment will be the date on which the tax return is required to be filed pursuant to the Income Tax Act, therefore including any extension of time arrangements.

In calculating the assessable income of any registered person, no deduction shall be allowed for the GST output tax liability on this deemed supply of entertainment (see Section 140B).

Application date

The new entertainment regime will generally apply to expenditure incurred on or after 1 April 1993. The regime will affect 1993/94 income tax returns for businesses with early or standard balance dates. It will affect 1992/93 income tax returns for businesses with late balance dates.

The regime will apply from 17 December 1992 where expenditure is incurred on or after that date for the purposes of facilitating entertainment enjoyed on or after 1 April 1993. Any prepayment of entertainment expenditure will, therefore, be subject to the regime.

Examples

The following are illustrative examples of how various types of expenditure might be treated. Note that in each case it will be the factual situation that will be relevant.

Accommodation

Accommodation is deemed to be entertainment where incurred in connection with, or for the purposes of facilitating the provision of food or drink or recreation. For example, accommodation associated with taking a client on a fishing trip is considered entertainment. However, where the principal purpose of the travel is for business purposes the regime will not apply.

Allowances

To the extent that a non-taxable allowance is paid for the provision of entertainment that amount is subject to the regime. Apportionment is, therefore, required where an allowance is paid for entertainment and other forms of expenditure. The de minimis rules may apply.

Amusement

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

Board meeting lunches

The provision of food or drink at a board meeting will be subject to the regime unless it is taken or provided in a qualifying in-house dining facility. Where an employee or director is attending a board meeting while undertaking deductible business travel, the $25 exemption will apply. The eligible conference exemption may also apply.

Business lunches

Business lunches unless taken in a qualifying in-house dining facility are subject to the regime. See also *client meals*.

Business training sessions

Any entertainment provided at such a session is subject to the regime, excluding the provision of morning and afternoon tea, (and may be subject to the $25 exemption for an eligible conference).

Business travel

Business travel will not be subject to the regime unless the principal purpose of the travel is to facilitate entertainment.

Cafeterias or canteens

The provision of a cafeteria or canteen is specifically excluded from the definition of entertainment if it satisfies the criteria for an in-house dining facility.

Charity shows

Any entertainment expenditure incurred for the relief of poverty, illness, disability or other disadvantages is exempted from the changes. For example, expenditure on a children's hospital Christmas party is exempted. Tickets to a charity ball, however, are not exempt as the recipient of the entertainment - the employee - is not a "charity".

Christmas parties

Christmas parties provided to employees and/or clients are subject to the entertainment regime rather than the FBT regime.

Client meals

Client meals are subject to the regime unless taken in an in-house dining facility.

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Club fees/subscriptions

Fees or subscriptions paid in relation to the provision of entertainment, such as gymnasium fees, will be subject to FBT if they can be consumed or enjoyed at an employee's discretion and are provided outside employment duties.

Cocktail parties

Any expenditure incurred in the provision of a cocktail party is subject to the regime.

Conferences

Morning and afternoon tea or similar light refreshments provided at a conference are exempt. All other expenditure on the provision of entertainment at a conference will be subject to the regime (subject to the $25 exemption for eligible conferences).

Conferences would include, for example, directors' meetings, sales managers' meetings and educational conferences.

Corporate boxes

The costs of a corporate box at a recreational event and expenditure incurred in the provision of any food and beverages in the facility will be subject to the regime.

Employee meals

Any meal provided to an employee, or an allowance for such meals, whether travelling on business, or working overtime is subject to the regime. Meals consumed while travelling on business or at eligible conferences will, however, be subject to the $25 exemptions. Any meal consumed in an in-house dining facility will not be subject to the regime.

Exhibition costs

Any incidental entertainment provided at an exhibition will fall within the advertising/promotion exemption if the exhibition is open to a broad section of the public.

Fashion parades

Any incidental entertainment provided at a fashion parade is not subject to the regime if it is available to the general public. If it is not available to the general public the $500 exemption or the $25 exemption will apply.

Film premieres

Film premieres will receive the same treatment as fashion parades and exhibitions.

Free drinks, free movie passes

Such entertainment will fall within the advertising/promotion exemption if given to members of the general public, such as might occur via a radio give-away, for example.

Games rooms

A games room provided by an employer to his/her employees will be subject to FBT if the criteria are met (see *club fees*).

Gifts

Gifts that fall within the definition of entertainment will be subject to the regime unless they are provided to the public.

Gymnasiums (in-house)

Gymnasiums receive the same tax treatment as games rooms. The regime will not, however, apply to a gym for a professional sportsperson.

Harbour cruises

Harbour cruises, as a recreational activity, will be subject to the regime.

In-house dining facilities

A specific exclusion from the regime is included for a facility within an employer's premises that is available for use by all employees.

In-house recreational facilities

Any recreational facility provided to employees is subject to FBT (subject to the exclusion for recreation as a part of employment duties) if it can be used at an employee's discretion and the recreation falls outside his/her employment duties.

Joy flights

Joy flights receive the same tax treatment as harbour cruises.

Leisure-time pursuits

Leisure time pursuits are recreational activities and are deemed to be entertainment. If provided to employees, FBT may apply if they are consumed at employees' discretion and are outside their employment duties.

Meals

Any meals taken in an exempt in-house dining facility are not subject to the regime.

Meals whilst travelling on business will, however, be subject to the regime (subject to the $25 exemption).

Meals consumed in a restaurant if not travelling on business will be 50 percent non-deductible. Similarly, overtime meals will 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 are subject to the regime.

Product launches

Unless a launch is open to the general public any entertainment provided there is subject to the regime. However, either the $500 or the $25 per person exemption will apply to any promotional activity not open to the public or a broad section thereof.

Promotional give-aways

Such give-aways are not subject to tax if made available to the public or a broad sector thereof.

Recreation

Recreation is included in the definition of entertainment.

Samples

Samples of goods qualifying as entertainment that are provided and consumed at a function to promote the goods are exempt from the regime. Entertainment samples not consumed at the time provided are also exempt.

Seminars

Seminars receive the same tax treatment as conferences.

Shopping centre promotions

Shopping centre promotions receive the same tax treatment as a product launch.

Sightseeing tours

Sightseeing tours are deemed to be entertainment through the provision of recreation.

Tickets

If tickets are provided in relation to entertainment such as a sporting event or the theatre, the cost of the tickets will be subject to the regime.

Travel

Any travel conducted for the purposes of facilitating entertainment (such as a flight for a fishing trip) will be subject to the regime.

Wine tasting

If provided to the general public wine tasting falls within the promotion/advertising exemption. Samples of wine are also excluded (see samples).

Yachts

Yachts are an entertainment facility and the deductible costs incurred in relation to a yacht will be subject to the regime.

Questions and answers available soon

We have received several queries about details of the new entertainment regime. We will publish some of these (along with the answers) in a future TIB.

Foreign Investment Fund Regime

Sections 245R to 245RN, Income Tax Act 1976

Introduction

A new foreign investment fund (FIF) regime has been enacted. The new regime extends significantly the definition of an interest in a FIF and gives taxpayers four options for calculating a FIF income or loss. There are also rules for dealing with any change of method for calculating a FIF income or loss, and entry into or exit from the regime.

The principle objective of the FIF regime is to tax currently the income earned by FIFs to the extent of the interests held by New Zealand residents. In conjunction with the controlled foreign company (CFC) regime, the FIF regime ensures that foreign income earned by foreign entities on behalf of New Zealand residents is subject to New Zealand tax. The FIF regime manifests the Government's policy that New Zealand residents be taxed on their world-wide income.

The FIF and CFC regimes provide a mechanism for attributing the income of a foreign entity to a New Zealand resident who has an interest in that entity. The effect of the FIF and CFC regimes is that the same tax burden is borne by a New Zealand investor on income earned from investing in a foreign entity as on income from a New Zealand based investment.

The previous FIF regime was enacted by the Income Tax Amendment Act (No.5) 1988. This regime, which never permanently came into force, has now been repealed. Because the previous FIF interest definition was very complicated, with a resultant inability of many investors to determine whether their interest in a foreign entity constituted a FIF interest, the former FIF regime was continually deferred. The main difficulty with the old FIF interest definition was its incorporation of an active/passive income distinction. This distinction has not been maintained in the new, simplified and wider FIF interest definition.

The previous regime was also criticised because, by offering only the comparative value method to calculate a FIF income or loss, it assumed that the market value of FIF interests could be obtained by investors in all cases. This was not always possible. The new regime allows investors a choice of four methods to calculate their FIF income or loss.

The new FIF regime applies to all FIF interests held by New Zealand residents on or after 1 April 1993. The new regime also applies to FIF interests acquired after 2 July 1992.

Definition of an interest in a FIF - section 245RA(1)

The following types of interest held by a person in a foreign entity are treated as an interest in a FIF, unless one of the exemptions listed below applies:

- An interest in a foreign company (including a foreign unit trust).
- An entitlement to benefit as a beneficiary or member of a foreign superannuation scheme.

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- An interest in a foreign life insurance policy (this does not include a life insurance policy offered or entered into in New Zealand by a non-resident life insurer).

Exemptions - section 245RA(2)

An interest in a FIF does not include:

- A 10 percent or greater income interest in a CFC.
- An interest in a foreign entity that is:
  - resident and liable to income tax in a country that is specified in the Fifteenth Schedule to the Income Tax Act (i.e., a "grey list" country); and
  - not a foreign superannuation scheme or a foreign life insurance policy; and
  - not deemed to be a FIF by virtue of being specified in Part C of the Sixteenth Schedule.
- An interest in an employment-related foreign superannuation scheme (discussed further below).
- The aggregate interests in all FIFs held by a natural person with a cost of $20,000 or less (*de minimis* rule). Such small investors will not therefore be subject to the requirements of the FIF regime. This exemption applies to all FIF interests, including interests in foreign life insurance policies and foreign superannuation schemes.
- An interest held by a natural person in a foreign entity located in a country where exchange controls prevent the person from deriving any income in New Zealand currency or realising the interest for New Zealand currency (locked-in currency exemption). This exemption is limited to three circumstances:
  - Where the interest was acquired before 2 July 1992; or
  - Where the interest was acquired before the holder first became a New Zealand resident; or
  - Where the interest was acquired before the exchange controls were imposed by the country in which the foreign entity is located.
- Interests in foreign life insurance policies or foreign superannuation schemes acquired by natural persons before they become resident in New Zealand for the first time. This exemption is limited to a period of four income years. (This exemption is intended to apply to new migrants to New Zealand and, in particular, to employees who are on temporary secondment to New Zealand.)

Life insurance policy death benefits which a person was entitled to before 2 July 1992 or before becoming resident in New Zealand are also exempt from the FIF regime (section 245RB(7)).

Part C of the new Sixteenth Schedule to the Income Tax Act allows for the naming of foreign entities or classes of foreign entities which will be deemed to constitute interests in FIFs. Such entities, if they are resident in a grey list country, will not be covered by the grey list exemption from the FIF regime. (No foreign entities have been listed as at the date of enactment of the new Sixteenth Schedule.)

Interests in foreign superannuation schemes and foreign life insurance policies do not qualify for the grey list exemption because of the concessionary tax treatment for the superannuation and life insurance industries in all grey list countries. For example, superannuation schemes resident in Australia are taxed at 15 cents in the dollar.

The new definition of an interest in a FIF represents a substantial improvement from a simplification view over the previous definition, which required investors to have an intimate knowledge of a foreign entity in order to determine whether they had an interest in a FIF or not. The new FIF definition does not contain an active/passive distinction, which was also a feature of the former definition.

Employment-Related Foreign Superannuation Schemes - section 245R(1)

A person's interest in an employment-related foreign superannuation scheme is exempt from the FIF regime. An interest in an employment-related foreign superannuation scheme is defined as a natural person's entitlement to benefit from a foreign superannuation scheme to the extent to which the entitlement is attributable to services performed when the person was not resident in New Zealand, where:

- The entitlement to benefit arises through employment (including self-employment).
- The amount contributed to the scheme was calculated to:
  - have a fixed relationship (e.g., a percentage) to the person's employment or self-employment income; or
  - provide benefits that bear a fixed relationship to the person's employment or self-employment income (except to the extent the benefits are adjusted for inflation only).
- Contributions to the scheme were made only by or on behalf of the person, any employer or any former superannuation scheme of the person.
- The future benefits of the person under the scheme are not assignable (except under a matrimonial property arrangement) or able to be surrendered or charged against so as to forgo future benefits in exchange for current property (unless due to ill health or permanent incapacity).
- The person cannot withdraw from the scheme before retirement without a substantial loss of entitlement for doing so (unless due to ill health, permanent incapacity, a transfer to a similar superannuation scheme or a transfer under a matrimonial property arrangement).

Methods of calculating FIF income or loss - Sections 245RD - 245RG

In order to increase flexibility and simplify compliance, the new FIF regime contains four methods of calculating FIF income or loss:

- Comparative Value (CV) method
- Deemed Rate of Return (DRR) method
- Accounting Profits (AP) method
- Branch Equivalent (BE) method

The choice of four calculation methods under the new FIF regime is a substantial improvement over the previous FIF regime, which offered only the CV method of calculating FIF income or loss. By offering four different methods of calculating FIF income or loss the new regime takes account of the different types of FIF interests and investors.

Comparative Value Method - section 245RD

It is anticipated that this method will be the principal method used to calculate FIF income or loss. Briefly, the method taxes the increase or decrease in the value of a person's interest in a FIF over an income year, as a surrogate for the underlying income accumulated by the FIF.

Under the CV method, a person's FIF income or loss is calculated on the last day of the person's income year, using the formula:

$$(a + b) - (c + d)$$

where -

a is the market value of the person's FIF interest at the end of the income year.

b is the aggregate of all proceeds derived from the sale of a FIF interest and any distributions derived from the FIF interest.

c is the market value of the interest at the end of the preceding income year.

d is the aggregate of all expenditure incurred by the person in acquiring the FIF interest during the income year.

Where a person calculates FIF income or loss using the CV method, no dividend or assessable income is deemed to be derived under the other provisions of the Income Tax Act. However, this rule is subject to section 245RI under which aggregate dividends in excess of total FIF income may be assessable (discussed below in the transitional issues section). The acquisition cost of a FIF interest also cannot be claimed as a deduction outside the FIF regime, nor can the interest be treated as trading stock (section 245RB(6)). The treatment of FIF interest holding costs will be governed by the general provisions of the Income Tax Act.

Deemed Rate of Return Method - Section 245RE

The DRR method for calculating FIF income or loss involves applying a deemed rate of return to the book value of a person's FIF interest.

The DRR method will probably be used in those cases where the investor has insufficient information about the FIF to use any of the three other calculation methods. This is likely to be in cases of interests in foreign life insurance policies and foreign superannuation schemes.

The FIF income or loss of a person using the DRR method is calculated using the formula:

$$a \times b$$

where -

a is the book value of the interest at the end of the previous income year.

b is the rate of return prescribed by regulation.

The book value of a FIF interest at the end of an income year is calculated by the formula:

$$f + g - h + i + j$$

where -

f is the book value of the interest at the end of the previous income year if the DRR method was used (in any other case nil).

g is the aggregate of all expenditure incurred during the income year in acquiring the FIF interest.

h is the aggregate of all gains (including proceeds of sale) derived from the FIF interest during the income year.

i is the FIF income or loss in the income year calculated using the DRR method.

j is the aggregate of all amounts which are assessable income derived from the FIF interest in the income year under section 245RI (being the excess of any FIF distributions over the income calculated using the DRR method).

Where a FIF interest is disposed of, the difference between the book value of the interest and the sale proceeds must be recognised as FIF income or loss. Where the proceeds of sale reduce the book value to an amount less than nil (indicating that inadequate amounts of income had previously been returned) this amount is treated as FIF income. Conversely, where all interests in a FIF are disposed of and the proceeds of sale reduce the book value of the interest to an amount greater than nil (indicating that excessive amounts of income had previously been returned) a deduction is allowed for this amount.

This wash-up requirement is designed to ensure that persons using the DRR method are treated similarly to those persons who are required to use the CV method for calculating their FIF income or loss.

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This adjustment on sale does not apply to natural persons whose aggregate FIF interests have a book value of $100,000 or less, and where any gain on disposition would not have been assessable income for such persons outside the FIF regime.

In the case of an acquisition or disposition of a FIF interest during an income year, the income year is divided into two notional income years which are both subject to the DRR method. When the first notional year ends and the second notional year begins is determined by the date of acquisition or disposition of the FIF interest. The prescribed rate of return applying to each notional year is adjusted according to the number of days in each.

Where a person calculates FIF income or loss using the DRR method, no dividend or assessable income or acquisition deduction or trading stock treatment can arise under any other provisions of the Income Tax Act (section 245RB(6)). As noted above with the CV method, this rule is subject to section 245RI (under which aggregate dividends in excess of total FIF income may be assessable).

Accounting Profits Method - Section 245RF

Under the AP method, FIF income or loss is calculated by the formula:

$$a \times b$$

where -

a is the person's income interest percentage calculated as if the FIF was a CFC.

b is the net after-tax accounting profits of the FIF for the accounting period.

Under the AP method a taxpayer can elect to use a simplified measurement of income interest method, which involves measuring an income interest at 31 March only instead of at the end of each quarter (as required under the CFC regime). Any such election is binding for that FIF interest in subsequent years.

Where a person incurs a FIF loss in excess of the economic or financial loss suffered by the person, the amount of the FIF loss is limited to the amount of the actual economic or financial loss.

The branch equivalent tax account (BETA) regime has been extended to apply to FIF income calculated under the AP method (section 245RH). Credits arising under the FIF regime will be subject to the same jurisdictional ring-fencing as CFC credits. The BETA regime applies as if:

- the FIF income were attributed foreign income; and
- the FIF were a CFC; and
- the FIF interest of the holder were an income interest.

Branch Equivalent Method - section 245RG

FIF income or loss calculated under the BE method uses the same rules (with some modifications) as are employed to calculate branch equivalent income or loss under the CFC regime. The BE method is an exact determination of a FIF's income or loss under New Zealand tax rules. The other FIF income or loss calculation methods can therefore be viewed as proxies for the BE method, which represents the most accurate calculation of a FIF's income or loss. The BE method, however, requires the investor to have more information about a FIF than the other methods.

FIF income or loss is calculated under the BE method using the formula:

$$a \times b$$

where -

a is the income interest percentage of the FIF interest holder for the accounting period calculated under section 245D as if the FIF was a CFC.

b is the branch equivalent income or loss of the FIF for the accounting period calculated under section 245J as if the FIF was a CFC.

Where a person incurs a FIF loss in excess of the economic or financial loss suffered, the amount of FIF loss is limited to the amount of the actual economic or financial loss. The CFC regime foreign tax credit rules apply to FIF income calculated under the BE method. The BETA regime is also extended to FIF income calculated under the BE method (section 245RH).

Restrictions on choice of calculation method - section 245RC(1)-(7)

General rules

Subject to certain restrictions, anyone with FIF interests may elect to use any of the four methods of calculating FIF income or loss by furnishing their returns with the chosen method or methods. However, a taxpayer must have suitable information about a FIF interest in order to use a particular method.

A person who has interests in different FIFs may use different calculation methods for those interests.

Where a person has two or more interests in the same FIF, the person must use the same calculation method for that FIF. An exception to this rule is where a person's interests in the same FIF are of different classes and using the same calculation method for all classes of interest is not possible under the regime's provisions. In this case, calculation methods may differ between different classes of interest but not within the same class of interest.

Where a person with a FIF interest is not required to use one particular calculation method and does not elect to use any particular calculation method, the following default sequence takes place:

- AP method deemed to have been elected.
- If AP method not practicable, then CV method.
- If CV method not practicable, then DRR method.

The restrictions on the use of each calculation method are set out below.

CV Method

As with all other calculation methods, there must be suitable information available for a person to use the CV method. Principally, the market value of a FIF interest needs to be able to be ascertained at the end of each income year. It was mainly for the reason that this market value information could not always be obtained under the former FIF regime that the other calculation methods were developed.

DRR Method

The DRR method may only be used:

- where it is not reasonably practicable for the person to use the CV method (because the person cannot ascertain the market value of the FIF interest at the end of the income year) or the AP method; or
- by a natural person whose FIF interests do not have an aggregate market value of more than $100,000; or
- where a person has made no election and cannot use the AP or CV methods; or
- where the person used the DRR method previously, and is required to continue to use the method under section 245RC(8).

AP Method

The AP method may only be used where the following requirements are met:

- the FIF is a company listed on a recognised exchange or interests in it are offered widely to the public for subscription or purchase; and
- the net after-tax accounting profits of the FIF are calculated under generally accepted accounting principles of the country in which the FIF is resident; and
- the net after-tax accounting profits are detailed in financial statements which are:
    - sent or made available to shareholders in the company; and
    - readily available to interested members of the public; and
    - audited by a chartered accountant (or accountant of equivalent standard in the FIF's country of residence) who has given a standard audit opinion (without any qualifications) to the effect that the financial statements represent the income and financial position of the FIF and;
- the net after-tax accounting profits include any extraordinary items; and
- the person has no reason to believe that the net after-tax accounting profits of the FIF do not fairly represent the net after-tax profits for the accounting period; and
- the Commissioner has not concluded that the net after-tax accounting profits do not fairly represent the net after-tax profits of the FIF for the accounting period; and
- the FIF is not included in Part D of the Sixteenth Schedule of entities for which the AP method cannot be used.

BE Method

The BE method may only be used where the following requirements are met:

- the FIF is a company; and
- the person can provide to the Commissioner, if requested, sufficient information to allow the Commissioner to verify the FIF income or loss calculations using the BE method.

Change of calculation method - section 245RC(8)-(10)

In certain circumstances it is possible for a person to change the calculation method for a FIF interest in a succeeding period.

There are restrictions on changing methods in order to prevent persons from gaining a tax advantage by choosing the method that would produce the lowest FIF income or highest FIF loss in a particular income year or accounting period.

General Rule

A person must continue to use the same calculation method for a FIF interest in successive periods, except in certain cases:

- where it is mandatory to change to a new method in a succeeding period; or
- where a person is permitted to use a different calculation method in a succeeding period.

Mandatory Change of Method

Existing Method No Longer Practicable To Use

A person must change from the AP, BE or CV methods where it is no longer reasonably practicable for the person to use any of these methods in the succeeding period because it is not possible to:

- obtain information sufficient to continue to use the AP method or any of the AP method requirements (e.g., that net after-tax accounting profits are calculated under generally accepted accounting principles) are no longer satisfied.

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- obtain information sufficient to continue to use the BE method or to provide to the Commissioner (if requested) sufficient information to allow the Commissioner to verify the BE method calculations.
- ascertain the end-of-year market value of the FIF interest so as to be able to continue to use the CV method.

Change from DRR Method

A person must change from the DRR method where:

- the person was entitled to use the DRR method (under section 245RC(3)(b)) because that person is a natural person, whose aggregate market value of FIF interests did not exceed $100,000, and s/he ceases to be entitled to use the DRR method because his or her aggregate FIF interests exceed the $100,000 threshold; or
- the person had to use the DRR method under the default provision (section 245RC(7)) and the default provision ceases to apply because the person elects to use a different method or the AP or CV methods become practicable to use.

Voluntary Change of Method

Change to BE Method

A person may change to the BE method from another calculation method where:

- Notice is given to the Commissioner:
  - In such form as the Commissioner may allow;
  - Specifying the reasons for the change;
  - Before the beginning of the accounting period or income year in which the change will take effect (unless the Commissioner allows a different period of notice); and
- The person is electing to change to the BE method for the first time for that FIF interest (except where the Commissioner permits a change to the BE method for the FIF interest on more than one occasion because there is a change of circumstances (e.g., a significant shareholding change) and the Commissioner considers that altering the incidence of income tax was not the primary purpose or effect of the subsequent change).

Change from BE Method

A person may change from the BE method to another calculation method where:

- Notice is given to the Commissioner:
  - In such form as the Commissioner may allow;
  - Specifying the reasons for the change;
  - Before the beginning of the income year or accounting period in which the change will take effect (unless the Commissioner allows a different period of notice); and
- The person is changing back to the calculation method the person used for the FIF interest immediately before using the BE method; and
- The person has not previously elected to change from the BE method for that FIF interest, except where the Commissioner considers that:
  - the subsequent change is preceded by a change in factual circumstances (e.g. a significant shareholding change) which significantly alters the ability of the person to obtain information sufficient to use the BE method; and
  - altering the incidence of income tax was not the primary purpose or effect of the subsequent change.

Change by Natural Person

A natural person may change to any available calculation method where:

- S/he gives notice to the Commissioner:
  - In such form as the Commissioner may allow;
  - Specifying the reasons for the change;
  - Not later than the end of the income year (or end of the FIF accounting period) preceding the income year (or accounting period) at the end of which the change takes effect; and
- The aggregate market value of the person's FIF interests does not exceed $100,000 at the end of the income year (or end of the FIF accounting period) preceding the income year (or accounting period) at the end of which the change takes effect.

Consequences of change of calculation methods - section 245RM

Where a person changes the calculation method for a FIF interest from the:

- AP or BE methods to CV or DRR methods; or
- CV or DRR methods to AP or BE methods -

there is a deemed disposition and reacquisition of the interest at market value at the beginning of the FIF accounting period.

In the case of a person changing the calculation method for a FIF interest from the CV method to the DRR method there is a deemed disposition and reacquisition of the interest at market value at the beginning of the taxpayer's next income year.

In the case of a person changing the calculation method for a FIF interest from the DRR method to the CV method there is a deemed disposition and reacquisition of the interest at book value (calculated under section 245RE(5)) at the beginning of the taxpayer's next income year.

Entry into and exit from FIF regime - section 245RL

There are certain rules applying to a series of circumstances in which a person enters into or exits from the FIF regime. These circumstances are:

- Where a person becomes a New Zealand resident
- Where a person ceases to be a New Zealand resident
- Where a person dies
- On the disposition of a FIF interest for nil or inadequate consideration
- On the acquisition of a FIF interest for nil or inadequate consideration
- Property becoming a FIF interest because an exemption ceases to apply
- Property ceasing to be a FIF interest because an exemption begins to apply.

Here are the rules applying to these circumstances:

Person becoming a New Zealand resident

Where a person becomes a New Zealand resident and any property held by the person constitutes a FIF interest, there is a deemed acquisition at market value of the property at the time the person becomes a New Zealand resident, but only where the person uses the CV or DRR methods.

Person ceasing to be a New Zealand resident

A person with a FIF interest who ceases to be resident in New Zealand, and who uses the CV or DRR methods, is deemed to have disposed of the property constituting the FIF interest at market value at the time the person ceases to be a New Zealand resident.

Deemed disposition on death

Where a person with a FIF interest dies, there is a deemed disposition of the property constituting the FIF interest at market value at the time of death. This deemed disposition only applies where the deceased used the CV or DRR methods.

Inadequate consideration received on disposal of FIF interest

A FIF interest holder who disposes of any property which constituted the FIF interest for nil or inadequate (i.e. below market value) consideration, is deemed to have derived consideration equal to the market value of the property at the time of the disposition. This rule only applies where the person used the CV or DRR methods for the FIF interest disposed of.

Inadequate consideration paid on acquisition of FIF interest

A person who acquires any property which constitutes a FIF interest for nil or inadequate consideration (or on an *in specie* distribution from a company or trust) is deemed to have paid consideration equal to the market value of the property at the time of the acquisition. This rule only applies where the person acquiring the FIF interest applies the CV or DRR methods to that interest.

Property becoming a FIF interest

Where a person holds property which becomes a FIF interest as a result of any section 245RA(2) exemption ceasing to apply, the following treatment applies:

- If the person uses the CV or DRR methods in relation to the FIF interest, there is a deemed disposition and reacquisition at market value of the property at the time of its change in status; or
- If the person uses the AP or BE methods for the FIF interest and the change in status occurs during the FIF accounting period, the FIF income or loss will be apportioned according to the number of days in the accounting period in which the property is not a FIF interest.

Property ceasing to be a FIF interest

Where any property ceases to be a FIF interest as a result of any of the exemptions in section 245RA(2) commencing to apply, the following treatment applies:

- If the person used the CV or DRR methods when the property constituted a FIF interest, there is a deemed disposition and reacquisition at market value of the property at the time of its change in status; or
- If the person used the AP or BE methods when the property constituted a FIF interest, and the change in status of the property occurs during the FIF accounting period, the FIF income or loss is apportioned according to the number of days in the accounting period in which the property is not a FIF interest.

Calculating FIF income or loss - section 245RB

Certain general rules apply with regard to the amount and timing of FIF income or loss:

- A person's FIF income or loss calculated under the CV or DRR methods is treated as being derived or incurred in the income year for which it is calculated.
- A person's FIF income or loss calculated under the AP or BE methods is treated as being derived or incurred in the person's income year in which the accounting period of the FIF ends.
- No FIF income or loss can arise to the extent to which a person holds a FIF interest while not resident in New Zealand.
- Any amount of FIF income or loss calculated for a FIF interest that a person holds while resident in New Zealand is treated as income with a New Zealand source, regardless of any subsequent change of residence.

As already noted, where a person calculates a FIF income or loss under the CV or DRR methods (except to

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the extent that section 245RI applies):

- the person will not be treated as having derived any assessable income under any other provisions in the Income Tax Act; and
- the person will not be allowed a deduction under any other provision of the Income Tax Act for the acquisition cost of the FIF interest (e.g., no deduction allowed for interest on money borrowed to acquire a FIF interest); and
- the FIF interest cannot be treated as trading stock.

Change of Accounting Year - section 245RB(8)-(10)

A person whose FIF income or loss is calculated under the AP or BE methods may elect, with the Commissioner's approval, to base the calculation on a new accounting period of the FIF where that accounting year has changed. If the election is approved, the accounting period of the fund is deemed to commence on the day after the last day of the previous accounting year.

One of the factors which the Commissioner may consider when deciding whether to approve a change of accounting year election is whether the election (if approved) would result in a deferral of tax liability on FIF income.

Conversion into New Zealand currency - section 245RB(11) and (12)

If a person's FIF income or loss is calculated under the AP method, the net after-tax accounting profits are calculated in the currency in which the FIF prepares its financial accounts (or, if no such accounts are prepared, in the currency of the country in which the FIF is resident). These net after-tax accounting profits are converted into New Zealand currency at the average over the accounting period of the close of trading spot exchange rates for the fifteenth day of each complete month falling within the accounting period. A person may elect that this procedure shall not apply to that person in which case the person would be required to convert any receipts into New Zealand currency when they are derived.

Where a person's FIF income or loss is calculated under the CV or DRR methods, any gain or expenditure or loss is converted into New Zealand currency at the average over the income year of the close of trading spot exchange rates for the fifteenth day of each complete month falling within the person's income year. Again, a person may elect not to apply this procedure.

These currency conversion procedures are designed to reduce compliance costs.

Treatment of FIF losses - sections 245RJ and 245RK

General rules: Deductibility of FIF losses - section 245RJ

FIF losses calculated under the AP, CV or DRR methods incurred by a person in an income year or carried forward to that income year are aggregated and can be:

- set off against any FIF income (except FIF income calculated under the BE method) derived by that person in that income year; or
- where the Commissioner is satisfied that the balance of the FIF loss does not exceed the aggregate FIF income (excluding FIF income calculated under the BE method) derived in any previous income years, the person is entitled to offset that FIF loss against other assessable income. The aggregate prior year FIF income is reduced by the amount of that loss for the purposes of the subsequent operation of the provision.

Deductibility of BE method loss

FIF losses calculated under the BE method are subject to the CFC regime loss rules. Accordingly, any FIF loss of a person calculated under the BE method will be ring-fenced to the jurisdiction that the FIF is resident in and set off against FIF income (calculated under the BE method) derived by that person in that jurisdiction only. It will also be possible to set off such FIF losses against the attributed foreign income of a CFC resident in the same jurisdiction. Conversely, the attributed foreign loss of a person in relation to a CFC will be able to be set off against FIF income (calculated under the BE method) derived by that person in the same jurisdiction (section 245M(1)).

FIF loss carry forward rules

The rules applying to the carry forward of FIF losses are substantially similar to those contained in section 188:

- If a FIF loss cannot be set off in the year it is incurred it can be carried forward to the succeeding income year.
- Where FIF losses incurred in two or more income years are carried forward, those losses must be set off in the same order as they were incurred.
- If a company incurs any FIF loss, the requirements of section 188 must be satisfied (for example, those relating to shareholder continuity) in order for that loss to be carried forward by the company (the FIF loss is deemed to have been incurred on the last day of the income year).

Commissioner's determination of FIF loss

Where a person has furnished a return showing a loss that cannot be fully set off in that income year the

Commissioner shall make a determination of the person's FIF loss and the amount of any FIF loss that can be carried forward to a later income year.

The Commissioner shall give notice of a determination of a FIF loss or a FIF loss carried forward to the person. Such notice may be included in a notice of assessment made under section 29(1) or a notice of determination of loss made under section 29(2).

Exemption for dealers from FIF loss rules

Where a person in an income year has incurred a FIF loss from an interest calculated under the AP, CV or DRR methods, and the person acquired the FIF interest:

- As part of a business which comprises or includes dealing in such interests; or
- For the purpose of deriving a gain on disposal of the interest; or
- As part of an undertaking or scheme entered into or devised for the purpose of making a profit -

the loss is not subject to the FIF regime and instead is treated as if it were a loss incurred in gaining or producing assessable income.

Exemption from FIF loss rules for certain natural persons

A natural person who has carried forward a FIF loss to an income year, and whose foreign entity interests are not subject to the FIF regime in that income year because of the application of section 245RA(2)(d) ($20,000 *de minimis*), may set off that carried forward loss against the assessable income derived from those interests.

Company grouping loss rules - section 245RK

A company which has FIF losses (including carried forward losses) calculated under the AP, CV or DRR methods may offset them against any FIF income (except FIF income calculated under the BE method) derived by another company in the same wholly-owned group as the loss company. The general requirements of section 191A apply to any grouping of FIF losses with certain modifications (e.g., the non-application of the part-year loss grouping provisions).

A company's FIF loss calculated under the BE method is subject to the loss grouping rules (including ring-fencing) under the CFC regime. If the CFC requirements are met, the FIF loss may be offset against the attributed foreign income or FIF income (calculated under the BE method) derived in the same jurisdiction by another company in the same wholly-owned group as the loss company. Conversely, a company's attributed foreign loss will be able to be offset against FIF income (calculated under the BE method) derived in the same jurisdiction by another company in the same wholly-owned group (section 245N(1)).

Deferral of FIF tax liability - section 245RN

In certain circumstances some taxpayers will be able to elect to defer their FIF income tax liability until they have received income from their FIF interests in cash (including proceeds of sale). This concession will be subject to use of money interest being paid on the amount of deferred tax. The option is targeted at certain small investors and is designed to alleviate the cash flow difficulties such investors may experience from being taxed on an accrual basis. The requirements of this deferral option are:

- It is limited to a natural person who has a FIF tax liability in an income year from FIF interests acquired before 2 July 1992 or before the person first became a New Zealand resident.
- The person cannot realise the FIF interest, or would be subject to a significant economic loss if s/he did dispose of the interest.
- The person's assessable income for the income year (after deducting the aggregate of the total income tax payable by the person and the FIF income) must be less than $20,000.
- The person elects, by notice in writing to the Commissioner in such form as the Commissioner allows, to defer the payment of an amount of tax in the income year calculated by the formula:

  $$a \times \frac{b}{c}$$

  where -

  a is the person's total income tax payable in the income year.

  b is the person's FIF income in the income year.

  c is the person's total assessable income in the income year.
- The amount of tax deferred is subject to the use of money interest regime.
- The amount of any use of money interest imposed is itself deferred.
- Payment of the amount of tax (and use of money interest) deferred is suspended until the earliest of when:
  - the person disposes of the FIF interest; or
  - the FIF interest ceases to exist; or
  - the person is able to realise the FIF interest without significant economic loss.
- The amount of tax deferred is reduced by the amount of any cash distribution received by the person during the term of the investment.

Entertainment expenditure

Expenditure incurred by a FIF on entertainment consumed or enjoyed outside New Zealand will not be

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subject to the new restrictions (enacted by the Income Tax Amendment Act (No.2) 1993) on the deductibility of entertainment expenditure.

Disclosure - section 245W

Any person with a FIF interest must disclose to the Commissioner in the prescribed form and with the person's return of income for the income year:

- the existence and nature of the FIF interest; and
- any other information as may be required by the Commissioner in respect of that interest for the purposes of the administration of the Income Tax Act.

Application date and transitional treatment - sections 245RI, 245RL and 245Y

The new FIF regime applies to all FIF interests held by New Zealand residents on 1 April 1993. It also applies to FIF interests acquired after 2 July 1992 (1992 Budget night, when the new FIF regime was announced).

The new FIF regime will therefore apply, at the earliest, in the 1991/92 income year for taxpayers with a 1991/92 balance date ending after 2 July 1992, (i.e., between 3 July 1992 and 30 September 1992 inclusive) and who acquired a FIF interest after 2 July 1992.

Any FIF income or loss, or income or loss arising on the deemed reacquisition of property on 1 April 1993 pursuant to section 245RL(1)(d), which is derived or incurred in an income year ending on or before 31 March 1993, will be deemed to be derived or incurred in the 1993-94 income year. However, a FIF loss incurred in the 1992-93 income year from FIF interests acquired after 2 July 1992 will, where a person so elects, not be deemed to be incurred in the 1993-94 income year (section 245Y(10)).

Generally, FIF income or loss will only need to be taken into account for provisional tax purposes from the 1993-94 income year.

Transitional Rules for Interests Acquired before 2 July 1992

If a person acquired a FIF interest before 2 July 1992 and disposes of that interest before 1 April 1993, the person is deemed never to have held that interest (except to the extent that the property is reacquired) and accordingly no FIF income or loss will be derived or incurred in respect of that interest.

If a FIF interest acquired before 2 July 1992 is held on 1 April 1993, and the holder is using the CV or the DRR methods of calculating FIF income or loss, the holder is deemed to have disposed of the property constituting the FIF interest on 31 March 1993 and to have reacquired it on 1 April 1993 for a consideration equal to:

- the market value of the property on 31 March 1993; or
- where the holder so elects, the cost of the property.

Additionally, the interest holder is deemed never to have held the interest before 1 April 1993 for the purposes of calculating FIF income or loss.

Where a FIF interest acquired before 2 July 1992 is held on 1 April 1993, and the interest holder uses the AP or BE methods, then for the purposes of calculating FIF income or loss:

- the interest holder is deemed never to have held any interest in the FIF in any accounting period of the FIF that ended before 1 April 1993; and
- where any accounting period commences before and ends after 1 April 1993, the amount of FIF income or loss is reduced by an amount calculated by:

$$a \times \frac{b}{c}$$

where -

a is the FIF income or loss calculated under the AP or BE methods.

b is the number of days in the accounting period that occurred before 1 April 1993.

c is the number of days in the accounting period.

Any gain (other than from a disposition) which would have been assessable had the FIF regime not been enacted (i.e., without regard to section 245RB(6) under which a person using the CV or DRR methods is deemed to derive no assessable income (other than FIF income) from a FIF interest) is deemed to be a dividend where:

- the interest holder uses the DRR method; or
- the interest holder (using the DRR or CV methods) has elected under section 245RL(1)(d) to use cost as the initial value of the interest at 31 March 1993 (for an interest acquired before 2 July 1992) -

to the extent that the aggregate gains exceed the net FIF income derived.

Refund of tax paid under previous FIF regime

Section 52 of the Income Tax Amendment Act (No.2) 1993 provides that taxpayers who had actually paid income tax on FIF income before the retrospective deferral of the previous regime in 1991 will be refunded the tax, notwithstanding section 394M, which limits refunds of tax to the amount of the credit balance in a taxpayer’s imputation credit account.

Non-Dividend Repatriations

Section 245GA, Income Tax Act 1976

Introduction

Section 245GA subjects all non-dividend repatriations made after 2 July 1992 to Foreign Dividend Withholding Payments (FDWP) or income tax.

Background

Since 1 April 1988 New Zealand has subjected all foreign dividends received by a New Zealand resident company to a 33 percent withholding tax obligation called FDWP.

The amount of foreign dividend income received by New Zealand residents has declined since the introduction of FDWP. This is due in part to Controlled Foreign Companies (CFCs) repatriating profits to New Zealand in non-dividend forms to avoid incurring an FDWP liability.

For example, a CFC used to be able to repatriate its profits to New Zealand by:

- lending money to its parent or an associated company in New Zealand
- purchasing property in New Zealand
- injecting capital into or purchasing equity in an associated New Zealand company.

The Government announced in the 1992 budget that it would seek to impose FDWP on non-dividend transactions which may be in substitution for dividends.

Key issues

The regime will only apply to taxpayers who have an income interest of 10 percent or greater in a CFC for any accounting period. FDWP (for companies) or income tax (for individuals) will be payable on specified repatriations of the CFC. Specified repatriations are the lesser of:

- the CFC's increase in investment in New Zealand property; and
- the amount of unrepatriated income of the CFC.

The increase in investment in New Zealand property is the excess of the investment in New Zealand property as of the last day of the CFC's accounting period over the amount measured on the later of the end of the CFC's immediately preceding accounting period and 2 July 1992.

Unrepatriated income of the CFC basically consists of revenue and certain reserves that have not been returned to the shareholders.

New Zealand property

New Zealand property of a CFC is the aggregate of:

- tangible property (which includes real property) situated in New Zealand
- shares or options over shares in companies which are resident in New Zealand and are associated with the CFC
- the balances of any loans and other financial arrangements lent by the CFC to any person resident in New Zealand and associated with the CFC.

Exclusions from New Zealand property

Certain transactions are removed from the ambit of the regime. They are:

Tangible property

Tangible property will not include the following:

- property disposed of by the CFC by the later of 364 days after the date of acquisition, and nine months after the end of the accounting period of the CFC in which the acquisition occurred.
- property situated in New Zealand for less than 365 days in total.

The value of any tangible property will be reduced by the net principal balance of third-party indebtedness incurred to acquire or improve the property secured by a lien on the property.

Loans

New Zealand property will not include loans made by the CFC to associated persons resident in New Zealand where the loan is reasonably expected and does in fact mature within 365 days of when it is issued.

FDWP or income tax incurred on loans will be refunded if such loans are repaid within five years.

In calculating the balance of any loan outstanding, and where there are loans both from the CFC to the New Zealand parent and from the New Zealand parent to the CFC, the outstanding balances of the loans may be aggregated and netted off, so that FDWP is only payable on the net balance of the outstanding loans.

Where a loan is in a foreign currency, the loan should be converted to New Zealand dollars on the date which it was issued.

Pre-existing Business

New Zealand property will not include ownership of tangible property or a company if such property or company represents a component of a pre-existing operating business of the CFC and no associated person resident in New Zealand is engaged in the same line of business.

Anti-Avoidance Rules

Anti-avoidance rules have been introduced to address situations where taxpayers may try to structure transac-

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tions to defeat the purposes of the legislation. These include:

- Where a loan is made to an associated person and specifically guaranteed by the CFC, the loan shall be deemed to have been made by the CFC, regardless of whether such loan is made by a related person and regardless of whether such loan is made by a person resident in New Zealand.
- A loan made to an associated person resident in New Zealand and funded directly or indirectly through back-to-back loans (regardless of whether such back-to-back loans are routed through unrelated persons) from one or more associated persons with the CFC , shall be deemed made by the CFC.
- Rules have been inserted to treat rolled-over short-term loans as long-term loans.
- Short-term drops in outstanding loan balances are ignored around the last day of the CFC's income year if the circumstances indicate such fluctuation was incurred to avoid the effects of the legislation.
- Loans paid within five years but which are substituted in whole or part by another loan are treated as not maturing within five years.

Unrepatriated Income

FDWP (for companies) or income tax (for individuals) will be payable on the lesser of the CFC's increase in investment in New Zealand property and the amount of its unrepatriated income.

Unrepatriated income of a CFC is calculated using the following formula:

$$a - b - c$$

where

a is the aggregate shareholders' funds of the CFC at the end of the accounting period (measured under generally accepted accounting principles of New Zealand).

b is the aggregate, at the end of the accounting period of the CFC's

- paid-up capital; and
- share premium account,

excluding

- amounts resulting from bonus issues by the CFC except to the extent that such bonus issues were dividends derived by a person resident in New Zealand; or
- Reinvestment directly or indirectly of CFC distributions after 2 July 1992 except to the extent to which such distributions resulted in dividends derived by a person resident in New Zealand;

c is the aggregate of specified repatriations of the CFC for accounting periods preceding the accounting period in question ending after 2 July 1992 adjusted by any amended assessments made by the Commissioner.

Due date for paying FDWP

For companies, FDWP incurred on specified repatriations is due at the time FDWP would be due for a dividend the company received six months after the later of:

- the end of the accounting period of the CFC in which the attributed repatriation is calculated, or
- 1 April 1993.

For other taxpayers, the dividend will be deemed to be derived at the later of the end of the CFC's accounting period and 1 April 1993.

A taxpayer's domestic losses can be used to offset any FDWP or income tax payable.

We will publish a more detailed explanation of the non-dividend repatriation legislation in a future Tax Information Bulletin. This will explain the legislation for the underlying foreign tax credit regime (announced by the Government in December 1992) when it is enacted.

Application Date

The regime will apply to all non-dividend repatriations made after 2 July 1992.

Changes to the CFC Regime

Sections 245A-Q, Income Tax Act 1976

Introduction

The CFC regime has been amended. The changes include the removal of France from the grey list, the addition of some new concessions to the 16th Schedule, the introduction of a de facto control test, the deferral of full implementation of the CFC regime until 1 April 1993 and the setting of a new control interest level.

Background

The intent of the CFC regime is to subject foreign source income earned by New Zealand residents to the same level of New Zealand tax as income earned domestically. The Government has stated that it would review the regime to ensure that this policy intent is achieved. As a result the following amendments have been made.

Key Issues

The CFC regime will operate in all countries other than those on the "grey list" (the 15th Schedule) from 1 April 1993. The CFC regime has been operating with respect to CFCs resident in "black list" countries (the 17th Schedule), which are generally tax havens, since 1988. The 17th Schedule was designed as an interim measure.

The grey list has been amended to exclude France from 1 April 1993. Otherwise the grey list is confirmed as the current list of countries. The exemption from taxing earnings of companies resident in grey list countries (the 15th Schedule) applies to both the CFC and FIF regimes. The original grey list included Australia, Canada, France, Germany, Japan, the United Kingdom and the United States. The government has made a commitment to review the income tax laws of foreign countries at regular intervals based on the criteria announced in the 1992 Budget.

The following concessions have been specified in the 16th Schedule effective from 1 April 1993.

- In the case of Australia, any special allowances, reliefs or exemptions relating to offshore banking units.
- In the case of Canada, any special allowances, reliefs, or exemptions relating to international banking centres.
- In the case of the Federal Republic of Germany, any special allowances, reliefs, or exemptions relating to regional located investment in the former German Democratic Republic or in West Berlin.
- In the case of the United Kingdom of Great Britain and Northern Ireland, any special allowances, reliefs, or exemptions relating to activities carried on in enterprise zones.

Any person with an income interest in a CFC that has taken advantage of a listed (16th Schedule) concession in a grey list country must calculate attributed foreign income on its interest in the CFC.

The definition of a CFC has been changed from a foreign company in which five or fewer New Zealand residents own 50% or more, to a foreign company in which five or fewer New Zealand residents own more than 50%. The new control rule was introduced so that a 50/50 joint venture between New Zealand resident and non-resident partners would be excluded from the CFC regime.

A two tier de facto control test has been introduced so that where a foreign company is effectively controlled by five or fewer New Zealand residents, it will be a CFC.

The first part of the de facto test deems a foreign company to be a CFC if at any time during the accounting period a single New Zealand resident holds a control interest in the CFC equal to or greater than 40%. The exception to this is where another person that is not a New Zealand resident nor associated with the New Zealand resident that would otherwise be deemed to control the foreign company, has a control interest in the foreign company equal to or greater than the control interest of the New Zealand resident.

The second part of the de facto control rule states that a foreign company will be deemed to be a CFC if there is a group of five or fewer New Zealand residents who have the power to control the exercise of the shareholder decision making rights.

The purpose of the de facto control rules is to prevent New Zealand residents from decontrolling CFCs to avoid the requirements of calculating the income of the CFC under the branch equivalent method. It is also necessary to prevent abuse by taxpayers who do not have legal control of a CFC but exercise actual control.

Application Date

These amendments apply from 1 April 1993.

Western Samoan Tax Credit Scheme

Sections 245K, 293, 394ZM and Schedule 17A, Income Tax Act 1976

Taxpayers will not be able to claim foreign tax credits for taxes paid to Western Samoa on income derived on or after 9 March 1993, except for credits relating to wages and salaries.

On 2 March 1993 Western Samoa passed legislation which enables foreign companies to claim in their home jurisdictions a foreign tax credit for Samoan tax which, in substance, has not been paid.

Section 293 of the Income Tax Act allows New Zealand residents a credit for tax paid in a foreign jurisdiction on income that is taxable both in New Zealand and in the foreign jurisdiction.

On 9 March 1993 the Minister of Revenue announced the Government's intention to enact legislation to ensure that no one would be able to utilise the Western Samoan scheme at the expense of the New Zealand tax base.

Section 293 has been amended to disallow any foreign tax credit for income tax paid in a country specified in a new Schedule 17A to the extent that the income tax is paid on the types of income specified in the Schedule.

A new Schedule 17A has been inserted in the Income Tax Act. The only country that was specified in this Schedule on its enactment was Western Samoa. The non-recognition of Western Samoan tax credits applies to all Western Samoan income tax except income tax on salary or wages.

Similar amendments disallowing tax credits for income tax paid in countries specified in Schedule 17A have been made to the controlled foreign company and foreign dividend withholding payment regimes, as a credit for foreign tax paid is separately allowed for in those regimes.

These amendments apply from 9 March 1993.

Livestock Valuation

Sections 86-86L, 175, 185A-E, Income Tax Act 1976

Introduction

The Government reform of the way livestock are valued for tax purposes has been enacted. The trading stock scheme has been repealed and a national standard cost scheme introduced. The herd scheme has been made more flexible and a new adverse event income scheme has been introduced.

Background

A discussion paper on the valuation of specified livestock for taxation purposes was released in December 1991. The Ministers of Revenue, Finance and Agriculture then established a Livestock Valuation Consultative Committee to review the discussion paper. The Committee's key aims were to:

- examine the need to replace the trading stock scheme with a national standard cost scheme and the feasibility of doing so;
- consider the merits of introducing a method by which livestock owners can use their own costs to value livestock; and
- examine the herd scheme and the high priced stock scheme.

The Government released the Committee’s report on 2 September 1992. It contained Government decisions on the Committee’s recommendations. The legislation arising from those decisions was included in the Taxation Reform Bill (No.6) 1992.

The new regime applied from the 1992/93 income year, except in the case of the new adverse event income equalisation scheme, which applies from 1 April 1993.

Outline of new regime

Livestock valuation options

The trading stock scheme is repealed, as it is an inappropriate method of valuing livestock, and a national standard cost scheme has been introduced. National standard cost is based on national average cost of production rather than market values, the basis of the trading stock scheme.

Under the new national standard cost scheme, a farmer applies a national standard cost value to homebred stock, while purchased stock are valued at their purchase price. The average of these costs is applied to stock on hand at year’s end to derive a closing value. Broadly speaking this approach is used to determine to value of rising one year and rising two year immature stock (and rising three year in the case of male non-breeding cattle). Once livestock reach maturity the cost assigned to a particular animal is held until the animal is sold or dies.

Taxpayers will be able to move stock between national standard cost and the market value/replacement price options on a yearly basis for each inventory group (e.g., rising one year, rising two year, mature stock). National standard cost cannot be used in conjunction with the actual cost option, and movement between national standard cost and the cost option and vice versa will require two years’ notice.

The Government considers the herd scheme to be the most important valuation scheme and that its treatment of the herd as a capital asset is now well accepted. Thus much work was undertaken on improving the scheme. Until now the scheme required farmers to value their stock at 100 percent of the national average market values, which are set by Order in Council. The resultant increases in the value of the herd were tax free, while decreases were not deductible. This position has changed as the new legislation introduces herdstock ratios, to allow farmers to value their herd livestock in the range of 90 percent to 130 percent of the national average market values (depending on valuation) so as to take into account regional, breed and quality variations.

The herd scheme has been further amended to allow some stock to be valued under the herd scheme and some under an alternative valuation option, such as national standard cost. Where the herd scheme is being used a taxpayer will be allowed to value increases in stock numbers in any class under the herd scheme or some alternative valuation method or option. Animals in the alternative valuation option can be moved to the herd scheme on an animal by animal basis at the farmer’s discretion. However, the requirement that two years’ prior notice be given to exit from the Herd Scheme will continue.

Taxpayers will continue to be able to choose to use cost price, market value or replacement price to value their livestock.

The high priced livestock scheme has been amended by increasing the current minimum value of a high-priced animal from $100 to $500. The entry levels have also been raised to require that the purchase price be five times the higher of this year’s or last year’s national average market values. The rates of depreciation applying to high-priced livestock can now be set by the Commissioner in accordance with the principles which apply to depreciable assets generally. Taxpayers will be able to write stock down on a straight line or diminishing value basis but will not be able to switch between these two options.

Transitional provisions

A comprehensive transitional spread of income over five years has been introduced. This will cover income arising from the movement from the trading stock scheme, the cost/market value options to another scheme and the adoption of a herd value ratio.

Adverse event income equalisation scheme

An adverse event income equalisation scheme has been introduced which restricts deposits to income arising from an adverse event but allows easier withdrawal of deposits than the present income equalisation scheme.

Non-legislative changes to livestock valuation

The current method of calculating national average market values will be replaced. A trial comparing the accuracy of a survey of livestock valuers and a survey covering the main livestock sales periods will be undertaken to establish which system more accurately reflects market values. Values will not be released until June in any year.

The Commissioner has issued simplified self assessed cost guidelines, effective from the 1991/92 income year,

Detailed information to follow

We will publish a detailed discussion of the new livestock valuation regime in a future Tax Information Bulletin, together with information on the forthcoming national standard cost scheme determination. The new regime applies from the 1992/93 income year. The adverse event income equalisation scheme applies from 1 April 1993.

Retiring Allowances

Sections 2, 68, 336N Income Tax Act 1976

Introduction

All retiring allowances paid on or after 1 January 1994 will be fully taxable as income of the recipient. This new tax treatment will apply whether the payment is made in a single lump sum or in instalments.

Background

Retiring allowances are currently taxed inconsistently, dependent solely on the method of payment. Those payments made in a lump sum are taxed as fringe benefits and the retiring employee pays no tax. However, if the employee chooses to take the allowance in instalments as paid leave, this is taxed as income.

The change brings consistency to the taxation of similar kinds of payment made by employers to employees. The same policy was applied to redundancy payments last year.

During the Select Committee stages it was considered that the original period of notice to 1 April 1993 may not be sufficient. An amendment was made which put the proposed application date back to 1 January 1994 to allow people approaching retirement to make any necessary adjustment.

Key issues

Section 68 of the Income Tax Act will be repealed with effect from 1 January 1994. This will mean that all retirement payments paid by an employer to an employee will be taxable in full to the employee. This will be the case whether the payment is made in one lump sum or in instalments. Such payments are extra emoluments so they will be liable for an initial PAYE deduction of 28 cents in the dollar.

Fringe Benefit Tax

Lump sum retirement allowances have been removed from the definition of fringe benefit in the Income Tax Act. From 1 January 1994, employers will not have to pay Fringe Benefit Tax on any part of a retirement payment to an employee.

Earner Premium

Accident Compensation Earner and Employer Premium will not have to be deducted from retiring allowances. This will apply from 1 January 1994.

Payments before 1 January 1994

The existing tax treatment will continue to apply to all retiring allowances until 1 January 1994. Note that the provisions of section 68 only apply if the retiring payment is:

- made in a single lump sum payment; and
- made in respect of the employee's employment or service; and
- in the form of a bonus, gratuity or retiring allowance, other than a redundancy payment. If the payment falls within the definition of a redundancy payment in section 68 of the Income Tax Act (i.e. the position has become superfluous to the requirements of the employer) the payment must be taxed under the provisions for redundancy; and
- made on the termination of the employment or service being the occasion of the employee's retirement

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Social Security Act Amendments

Amendments have also been made to the Social Security Act as a result of the change to the taxation of retiring allowances. Retiring allowances are to be included in the definition of 'average income' for the purpose of calculating the high income earner standdown. People earning above the average wage who receive a retiring allowance will be required to look to savings before being granted income support benefits. However, retiring allowances will not be taken into account for the purpose of determining the rate of payment of any benefit.

Application Date

The measure applies to all retiring allowances paid on or after 1 January 1994.

Hire Purchase Agreements

Sections 64B, 64BA, 64E, 76A, 222A, 222F and 222G, Income Tax Act 1976

Introduction

From 1 April 1993 the tax treatment of hire purchase agreements will be similar to that of sales of goods financed by a loan from the seller. The gross retail profit on sale will be recognised in the year of sale and interest over the period will be recognised on an accruals basis. Transitional provisions have been made for agreements entered into before that date.

The new legislation replaces the policy statement published in TIB Volume Four, No.5 (December 1992) and gives effect to the Government's policy on hire purchase agreements consequent upon the Valabh Committee's report. It brings such agreements within the accrual rules in sections 64B to 64M of the Income Tax Act 1976.

Accordingly, hire purchase agreements fall into two categories:

- hire purchase agreements entered into before 1 April 1993; and
- hire purchase agreements entered into on or after 1 April 1993.

Hire purchase agreements entered into before 1 April 1993

Background

In the absence of transitional rules there would have been confusion about the appropriate treatment of pre-1 April 1993 hire purchase agreements.

Transitional provisions have been inserted into the Income Tax Act 1976 as a new section 76A. These will apply to all pre-1 April 1993 agreements which have not previously been terminated or expired. The implications of the new section 76A for hire purchase agreements entered into before 1 April 1993 are set out below.

Spreading provision

Section 76 provides for tax adjustments to be made following the discovery of specified incorrect accounting practices. It also allows taxpayers to spread any consequent increase in assessable income that exceeds $1,000 over the year of adjustment and three other income years.

The new section 76A makes similar provisions for previously unreturned retail profit on goods sold under a hire purchase agreement. This transitional rule only affects the vendor's treatment of the gross profit margin on goods sold under hire purchase agreements; it doesn't affect the purchaser's treatment of the notional interest content.

A vendor may elect to spread the remaining unreturned profit reserve from goods sold under pre-1 April 1993 hire purchase agreements over the lesser of the remaining life of the agreement or over the year of adjustment and the three succeeding years. The unreturned profit element is returned on a due and receivable basis over that time.

The section defines two terms:

- "**Full retail profit**" is the difference between the cash price as defined in section 2(1) of the Credit Contracts Act 1981 and cost price as defined in s222A(1); and
- "**Unreturned retail profit**" means any portion of full retail profit which has not been included in assessable income as at 1 April 1993.

There is a notional "year of adjustment" which is effectively the taxpayer's income year in which 1 April 1993 falls, and any unreturned retail profit on agreements entered into before 1 April 1993 shall be deemed to be income derived in that year of adjustment. Accordingly, for taxpayers with early or standard balance dates, the year of adjustment is their 1993/94 income year. For taxpayers with late balance dates the year of adjustment is the 1992/93 income year. (Section 76A(2))

Application of section 76A

Where a taxpayer's assessable income increases in the year of adjustment by $1,000 or more from the unreturned profit amount, the taxpayer must notify the Commissioner of that increase (Section 76A(3)).

Where a taxpayer has to notify the Commissioner of an increase of $1,000 or more in assessable income due to the recognition of unreturned profit, and is continuing to carry on business, that taxpayer may, by an irrevocable notice in writing, advise the Commissioner of an election to allocate that increase -

- on a due and receivable basis (as at present) to the year of adjustment and two immediately subsequent income years; and
- where at the end of that period there is any remaining outstanding balance due the whole of that outstanding balance will be assessable in the third immediately subsequent income year. This will apply to pre-April 1993 hire purchase agreements with a remaining term of more than 3 years (Section 76A(4)).

Amounts which have been allocated to income years in accordance with the above are deemed to be derived in those particular years, and not in the year of adjustment. However, the Commissioner may cancel any such allocation, in which case any unassessed amount will be assessable for income tax in the year in which the allocation was cancelled.

A taxpayer who is required to notify the Commissioner of the increase as described above must also notify the Commissioner in writing, with the income tax return for the year of adjustment, of -

- the aggregate amount of the unreturned retail profit required to be added in that year; and
- where the taxpayer elects to spread forward the unreturned profit, the further amounts which will be returned in the three immediately succeeding income years (Section 76A(5)).

If a taxpayer has adopted a non-standard accounting year, every reference to income year shall be a reference to the appropriate non-standard accounting year, with any necessary modification (Section 76A(6)).

Hire purchase agreements entered into on or after 1 April 1993

Background

Title to goods sold under a hire purchase agreement does not legally pass until the last payment under the agreement is made. However, most of the risks and rewards associated with ownership pass from the vendor to the purchaser on the date they enter into the hire purchase agreement.

The Valabh Committee recommended that a finance lease regime (which would incorporate hire purchase agreements) should replace the existing specified lease regime. It proposed a regime which recognised that the economic substance of finance leases (including hire purchase agreements) comprises both an asset sale and a money lending transaction.

However, at this stage, the new regime recently enacted is limited to hire purchase agreements and does not extend to the slightly wider class of finance leases dealt with by the Valabh Committee. Treatment under the new regime is in line with the existing treatment of specified leases which by definition effectively included hire purchase agreements. However, the spreading methods in the accrual regime are superior to those outlined in the specified lease regime.

The calculation of accrual income and expenditure in the accrual regime is generally on a yield to maturity basis, though under certain circumstances the straight line method may be used.

The asset sale and money lending aspects of a hire purchase agreement are dealt with respectively by amending the Income Tax Act 1976 to:

- exclude hire purchase agreements from the specified lease regime (by amending s222A) and insert new sections 222F and 222G that deal with the sale and purchase elements of hire purchase agreements when they are entered into and when they expire or are terminated; and
- amend sections 64B, 64BA and 64E to bring hire purchase agreements within the accrual rules and to integrate hire purchase agreements with the accruals regime.

These amendments are both explained below.

The deemed sale and purchase of assets under hire purchase agreements

Section 222F defines the various elements of a hire purchase agreement. Most of these terms have their ordinary meaning but several terms have been specifically defined for the new regime.

"Lessee", in relation to a hire purchase agreement means any person who obtains from a lessor (typically the lender who holds the hire purchase agreement) the use of or the right to use the hire purchase asset under the hire purchase agreement:

"Lessee's acquisition cost" in relation to a hire purchase asset, means the aggregate of:

- the acquisition price for the hire purchase agreement as determined under section 64BA(3), and
- the amount of any expenditure or loss incurred by the lessee in preparing and installing the hire purchase asset for use (unless the lessee can deduct such expenditure or loss under any provision other than section 108).

In most cases an asset's acquisition price will be its cash price plus any non-contingent fees (such as a non-refundable application fee) paid by the borrower under the agreement.

"Lessor" in relation to a hire purchase agreement means any person who grants to a lessee the use of or the right to use a hire purchase asset under the hire purchase agreement. In most cases, the lessor is likely to be the lender who holds the hire purchase agreement.

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"Lessor's disposition value" in relation to a hire purchase asset, means the acquisition price for the hire purchase agreement, determined under section 64BA(2).

For most assets, the acquisition price will be the cash price of the asset less any non-contingent fees paid to the lessor (such as a non-refundable application fee).

"Hire purchase agreement" has the meaning in section 2 of the Hire Purchase Act 1971, including any assignment of an agreement, except to the extent that the subject of the agreement is livestock or bloodstock.

Deeming provisions

Section 222G deems a lessor to have sold a hire purchase asset at the start of a hire purchase agreement for the lessor's disposition value (as described above), and deems the lessee to have purchased the asset at the lessee's acquisition cost (as described above). (Section 222G(1))

The lessee, not the lessor, is entitled to claim any allowable depreciation on the asset.

The tax treatment that would apply at the expiry or termination of a hire purchase agreement depends on whether title transfers to the lessee at that time.

The new section 222G deals with situations where ownership reverts to the lessor at the expiry or termination of a hire purchase agreement (a hire purchase agreement might be terminated early because of default by the lessee or the lessee buying out of the contract). It also deals with situations where title is acquired by the lessee at the termination or expiry of a hire purchase agreement.

In any case where a lessee (or associated person) does not acquire ownership of a hire purchase asset at the end of the agreement's term the lessor is deemed to have purchased the asset at the expiry of the hire purchase agreement.

Amendment of lessor's valuation

Where ownership reverts to the lessor who -

. disposes of the hire purchase asset or hires it to a different person under another hire purchase agreement; or

. where the hire purchase asset is subject to another hire purchase agreement, and the lessor surrenders the hire purchase asset, -

the amount of the consideration will be:

. reduced by the amount of any payment by the lessee (or any associated person) to the lessor as a consequence of such disposal, hire purchase agreement or surrender; or

. increased by the amount of any payment by the lessor (or any associated persons) to the lessee or the person associated with the lessee as a consequence of such disposal, hire purchase agreement or surrender (Section 222G(3)).

Transfer of ownership to lessee

A lessee may acquire ownership of a hire purchase asset at the end of the hire purchase period. Where the lessor was deemed to have sold the asset to the lessee at the start of the agreement, the transfer of ownership to the lessee at the termination or expiry of the hire purchase agreement will not constitute either a further disposition by the lessor or further acquisition by the lessee (Section 222G(4)).

Non-application: Section 107, which provides for certain expenditure to be added back on sale of a previously leased asset, does not apply to a lessee in a hire purchase agreement. (Section 222G(5))

Accrual Regime and Hire Purchase Agreements

The interpretation section of the accruals regime (Section 64B(1)) is amended initially by removing hire purchase agreements from the definition of an "Excepted Financial Arrangement". This amendment brings hire purchase agreements within the ambit of the accruals regime.

New definitions of "hire purchase agreement", "hire purchase asset" and "hire purchase payment" are cross-referenced to the definitions in the new section 222F.

The lessor in relation to a hire purchase agreement, (also defined in section 222F) is included in the definition of "holder".

Meaning of terms "core acquisition price" and "acquisition price"

To apply the accrual rules it is important to determine the "core acquisition price" and the "acquisition price" of a hire purchase agreement. To this end section 64BA(1) has a new paragraph (ca) which provides a method for determining "core acquisition price" for a hire purchase agreement in a similar manner to other financial arrangements. This will similarly allow determination of the "acquisition price".

Determinations

Section 64E(1) has been amended by inserting a new paragraph to permit the Commissioner to determine the method for determining the discounted value of the hire purchase payments.

Assignments of hire purchase agreements

While hire purchase agreements have been excluded from the accrual rules until now, assignments of income from hire purchase agreements are already subject to the accrual rules, through paragraph (c) of the definition of "financial arrangement" in section 64B(1).

An assignment gives rise to a new financial arrangement at the time it is entered into. This is similar to the treatment of assignments of trade credits (often referred to as factoring). Since a new financial arrangement is created by the assignment, there is no need to recompute the core acquisition price of the hire purchase agreement.

Instead, the person who holds the hire purchase agreement and who assigns the income stream from the agreement is deemed to issue a new financial arrangement to the assignee of the income from the hire purchase agreement (the person receiving the assignment is the holder of the new financial arrangement created by the assignment).

Both parties calculate a base price adjustment on the new financial arrangement to compute their accrual income when that arrangement matures or is otherwise sold.

The Valabh Committee has recommended modifications to clarify the application of accrual rules to assignments of income. The amendments proposed by the Committee are aimed at ensuring rules such as the base price adjustment work smoothly in relation to assignments. The Government is currently considering those proposals.

Application dates

The transitional arrangements in section 76A apply to any year of adjustment as defined and the three succeeding income years.

For taxpayers with standard and early balance dates the year of adjustment is the 1993/94 income year. For taxpayers with late balance dates it is the 1992/93 income year.

The accrual provisions in sections 64B, 64BA, and 64E, and the provisions of sections 222A, 222F and 222G apply to all hire purchase agreements entered into on or after 1 April 1993.

Examples of how the accrual rules apply to hire purchase agreements

Example 1

Assume the following facts for a hire purchase transaction:

Vendor's balance date: 31 March

Maximum face value of financial arrangements held by the vendor during the year: $1,000,000 (accordingly, interest income may be accrued on a straight line basis).

Date of Transaction: 5 September 1993

Cash Price of the property subject to the agreement: $1,000

Deposit paid by the purchaser: $ 100

Amount loaned by way of the hire purchase agreement: $ 900

Term of the hire purchase contract: 24 months

Interest rate on the loan: compound rate of 20% p.a. payable monthly in arrears

Hire purchase payments: $45.81

24 equal monthly payments of $45.81 representing payment of interest and principal computed on a declining balance basis.

Calculation of Income under the Agreement

The hire purchase contract spans three income years of the vendor. Assume that the vendor adopts a 365 day basis for allocating income from the agreement. The relevant details for each income year are:

Year Ending	Period of HP Contract	Days
31/3/94	5/9/93-31/3/94	207
31/3/95	1/4/94-31/3/95	365
31/3/96	1/4/95-5/9/95	158

Income from the agreement is spread on a straight line basis in accordance with accruals determinations G1A and G24 as follows:

Initial deposit	$ 100.00
24 payments of interest and principal of $45.81 per month	$1,099.44
Total consideration received	$1,199.44
Less acquisition price	$1,000.00
Net income from contract	$ 199.44

Interest to the holder under the agreement is allocated to income years as follows:

Year ending 31/3/94 (207 days)	$56.55
Year ending 31/3/95 (365 days)	$99.72

Base Price Adjustment (year ending 31/3/96)

The base price adjustment at the termination of the contract on 5/9/95 is calculated using the following formula:

$$a - b - c$$

where:

a is the amount of consideration received by the holder in respect of the contract ($1,199.44);

b is the acquisition price of the contract ($1,000); and

c is the net amount on which the holder has previously been subject to tax. The amount recognised in the previous two income years is $156.27 (being the sum of $56.55 and $99.72).

On this basis, a - b - c is $43.17. That amount is returned in the taxpayer's 1995/96 income year.

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Example 2

The facts in this example are the same as those in example 1 except that income from the hire purchase agreement is calculated on a yield to maturity basis. (The vendor holds financial arrangements in excess of $1 million).

Cash price of the property subject to the agreement:	$1,000
Amount "loaned" by way of hire purchase agreement	$ 900
Term of hire purchase agreement:	24 months
Interest payable on the loan: compound rate of 20% payable monthly in arrears.	

Based on this information, it is possible to construct a schedule spreading income to each income year calculated on a yield-to-maturity basis in accordance with accruals determination G3:

Year Ending	Income in Period
31/3/94	$92.01
31/3/95	$99.36

As before, income allocated to the year ending 31/3/96 (the year in which the arrangement matures) is calculated using the base price adjustment:

a - b - c

a is the amount of consideration received by the holder under the contract ($1,199.44);

b is the acquisition price of the contract ($1,000); and

c is the net amount on which the holder has previously been subject to tax. ($191.37 being the sum of $92.01 and $99.36).

On this basis, the income attributable to the 1995-96 income year under the base price adjustment is $8.07.

Dividend Definition

Section 4, Income Tax Act 1976

Introduction

Several changes have been made to the dividend definition, most of which relate to the transfer of benefits by a company to corporate associates of its shareholders.

Generally, under section 4(1)(l) a distribution is a dividend if

(a) it is made by a company to a person associated with a shareholder of the company; and

(b) it would have been a dividend if the distribution had been to a shareholder of the company.

The dividend is derived by the associate (by virtue of section 4(7)).

The Bill creates a category of transactions which are excluded from the operation of section 4(1)(l). It provides that where a benefit flows from a company to downstream companies (or to certain other associated corporates) no dividend arises provided several conditions are satisfied.

Although this is the major change to the associated person dividend rules, several other changes have been enacted and these are outlined below. All of the amendments take effect from 1 April 1993.

Removal of proprietary company restriction

The first amendment is that section 4(1)(l) is no longer restricted to *proprietary* companies. It applies to all companies.

De Minimis rule

New section 4(14) excludes the application of section 4(1)(l) where a company allows an associated company to use its property, provided that the amount of dividend that would otherwise have arisen from the use of such property does not exceed $10,000. This provision does not apply to concessional interest loans provided by a company to an associated corporate. Section 4(14) targets transactions which are not excluded by section 4(13) - which is discussed below.

No double taxation of dividend income

New section 4(15) prevents double taxation of dividend income except where this is expressly provided. Section 198 is one section under which double taxation may occur.

Benefits passing between certain associated corporates excluded from dividend definition

The most significant change is the introduction of new section 4(13).

Section 4(13) excludes from the scope of section 4(1)(l) benefits passing between certain associated corporates. The three examples below explain how the provision operates. Because new section 4(13) is complex and most easily understood through the use of examples, there are further examples in subsequent pages. In these examples, all companies are resident in New Zealand and have standard balance dates unless otherwise stated.

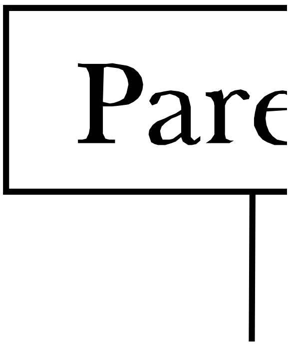
Downstream Transactions

The first and second examples illustrate the principle that where a benefit passes from a company to a downstream corporate associate no dividend arises except where a shareholder of the company owns more than 10% of the associate other than through the company.

In example 1, a benefit passing from Subsidiary 1 to Joint Venture Co. *does not* give rise to a dividend.

Example 1

Subsidiary 2 is a wholly owned subsidiary of Subsidiary 1 which is in turn wholly owned by Parent. Subsidiary 1 owns 50% of Joint Venture Co. (the other 50% is owned by an unrelated person). Subsidiary 1 passes a benefit to Joint Venture Co.



Section 4(1)(l) does not apply to the transaction in example 1 because the conditions in paragraphs (a) to (e) of section 4(13) are satisfied. Those conditions are discussed below, focusing on example 1.

(a) The recipient of the benefit must be a company - JV Co. satisfies this requirement.

(b) The provider of the benefit must either have

(i) a voting interest in the recipient, or

(ii) be associated with a company that has a voting interest in the recipient.

These voting interests can be direct or indirect. S1 has such an interest in JV Co.

(c) The recipient does not hold a voting interest in the provider of the benefit - JV Co. does not hold a voting interest in S1.

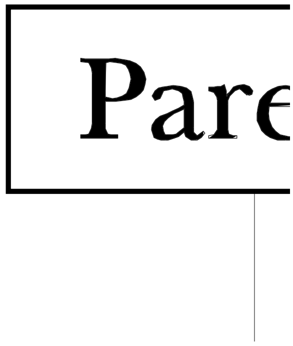
(d) This applies only where the provider of the benefit has no voting interest in the recipient, and therefore does not apply in this example. For a discussion of this provision see example 3 below.

(e) No person holds both an interest in the provider of the benefit and an interest of more than 10% in the recipient of the benefit. For the purposes of determining whether the 10% threshold is exceeded, interests held *by the provider* in the recipient are not traced through to the shareholder of the provider (see the words beginning "determined as if...." in (ii)(A) and (B) respectively). In the above example, therefore, interests held by S1 in JV Co. are not attributed to Parent (or shareholders of Parent) in calculating whether Parent (or its shareholders) owns more than 10% of JV Co.

A dividend *does* arise in example 2 when a benefit is passed from S1 to JV Co.

Example 2

Benefit passing from S1 to JV Co. does give rise to a dividend



Parent owns 100% of S1 which owns 100% of S2. S1 and Parent have a 50% interest each in JV Co. S1 passes a benefit to JV Co.

In example 2, paragraphs (a), (b)(i) and (c) are satisfied but (e) is not: Parent holds an interest in S1 and an interest of more than 10% in JV Co. (ignoring Parent's interest owned through S1.)

The concluding words in paragraph (e) - "determined as if sections ... related company)" are required to ensure that it is not necessary in applying (e) to trace through to the natural person shareholders of a company. The test in paragraph (e) can be applied at any level in a chain of companies - that is, in example 2, "no person" could refer to Parent itself or the shareholders of Parent Co. The words in brackets "(with the exception of the related company)" add a further complication and are discussed in relation to example 4a below.

The transaction in example 2 therefore gives rise to a dividend derived by JV Co. (which is exempt under section 63(2K) because JV Co. and S1 are in the same commonly owned group). Although the dividend is exempt, imputation credits are required to be attached at the benchmark rate.

Transactions between other associated corporates

One critical amendment to section 4(13) - the insertion of paragraphs (b)(ii) and (d) - was made at Select Committee stage. Where the company providing a benefit to a corporate associate has no voting interest in the associate, but is associated with a company that has such an interest (such associated company being "the related party"), no dividend arises provided that, if the benefit had passed instead to the related party, no New

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Zealand tax consequence would have arisen. This is illustrated in example 3 on the next page.

Example 3

A owns Parent which owns 100% of S1 and 90% of S2. L has a 10% shareholding in S2. S1 and Parent are a wholly owned group of companies. S1 makes a low interest loan to S2.

Because the loan could pass from S1 to Parent without triggering an assessable dividend or a FDWP liability (under section 63(2K), the dividend is not assessable income of Parent), no dividend arises in relation to the loan from S1 to S2.

The rationale for this principle is that, if a benefit could flow from S1 to Parent without a New Zealand tax consequence (because, for example, it is an exempt dividend) and from Parent to S2 without a tax consequence (because it is not a dividend), the benefit should be permitted to pass tax free directly from S1 to S2.

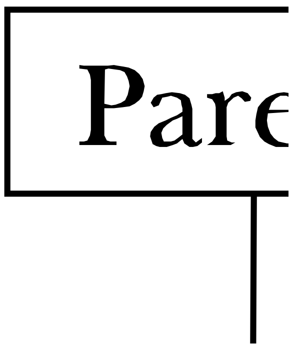
Associated party transactions - further examples

Exclusions from dividend definition

The transactions outlined in examples 4 to 6 do not give rise to a dividend.

(Note, however, that in relation to examples 4 and 5, even if the transaction had given rise to a dividend, it would have been exempt under section 63(2K), but subject to the imputation benchmark dividend rules.)

Example 4



Parent owns 100% of S1, which owns 100% of S2 and 50% of JV Co. The remaining 50% of JV Co is owned by an unrelated person.

a. S2 makes a low interest loan to JV Co.

Paragraphs (a), (b)(ii), (c), (d) and (e) are satisfied.

In terms of paragraph (e), S1 owns an interest in S2 and more than 10% of JV Co but if we choose S1 as "the related company" S1 is excluded from the operation of (e) . If S1 is "the related company" in this example, Parent (and the shareholders of Parent) do not fall foul of (e)(ii) because, under (ii)(A) and (B), interests in JV Co. are held by "the related company" (S1) and are not traced through to Parent.

In this example, Parent can also be "the related company" (the legislation permits any corporate associate of the provider to be "the related company" but once that company is chosen as the pivot, other contenders (such as S1) are not "the related company". (If Parent is chosen as the related company: Parent holds an interest in S2 and more than 10% of associate but is specifically excluded from the operation of (e)).

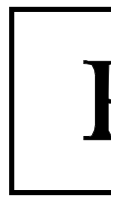
If P is "the related company", S1 does not breach (e)(i) and (ii), because S1's interests are attributed to the related company for the purposes of paragraph (e). This is achieved by the words in brackets at the end of paragraph (e).

b. Parent Co passes a benefit to JV Co.

Paragraphs (a), (b)(i), (c) and (e) are satisfied and the transaction is therefore excluded from the dividend definition.

In relation to (e), shareholders of Parent Co own an interest in Parent Co, but not in the associate JV Co (because the shareholders' interests in the associate that are held through Parent Co. are ignored - see subparagraphs (e)(ii)(A) and (B)).

Example 5



Parent Co. owns 100% of Subsidiary 1 which owns 100% of Subsidiary 2.

a. Subsidiary 1 makes an interest free loan to Subsidiary 2

Paragraphs (a), (b)(i), (c) and (e) are satisfied and therefore the transaction does not give rise to a dividend.

In relation to paragraph (e), Parent and its shareholders hold an interest in S1 but no interest in S2 as interests in S2 held by S1 are ignored for the purposes of determining whether Parent has a greater than 10% interest in S2 (see subparagraphs (e)(ii)(A) and (B)).

b. Parent makes an interest free loan to Subsidiary 2

Paragraphs (a), (b)(i), (c) and (e) are satisfied and therefore no dividend arises.

In terms of paragraph (b), Parent has a voting interest in S2 - this provision *includes* indirect voting interests.

As above, in relation to paragraph (e), Parent holds an interest in S1 but no interest in S2 as interests in S2 held by S1 are ignored in calculating P's interest in S2.

Cross border transactions

Example 6

US Co. owns 100% of both UK Co. and NZ Co. Only NZ Co. is resident in New Zealand.

a. US Co. makes an interest free loan to NZ Co.

As paragraphs (a), (b)(i), (c) and (e) are satisfied, the transaction does not give rise to a dividend.

In terms of paragraph (e), the shareholders of US Co. have an interest in US Co. but no interest in NZ Co. because the interests held by the provider of the benefit (US Co.) in the associate (NZ Co.) are not attributed to shareholders of US Co.

b. UK Co. passes a benefit to NZ Co.

Paragraphs (a), (b)(ii), (c), (d) and (e) are satisfied and therefore no dividend arises.

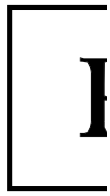
In relation to paragraph (d), concessional interest on a loan from UK to US Co. would not be a dividend which is assessable income of US Co. under New Zealand tax law (see section 242(c)).

In relation to paragraph (e), US Co. ("the related company") holds an interest in the provider (UK Co.) and more than 10% of the associate (NZ Co.) but is excluded from the operation of (e). Shareholders of US Co. hold an interest in UK Co. but no interest in NZ Co. as, under sub-paragraphs (e)(ii)(A) and (B), shares held by US Co. in NZ Co. are not held by shareholders of US Co.

Dividend provisions apply

The transactions outlined in examples 7 to 11 give rise to a dividend.

Example 7



Parent Co. owns 100% of Subsidiary 1, which owns 100% of Subsidiary 2, which in turn holds 100% of Subsidiary 3.

Subsidiary 3 makes an interest free loan to subsidiary 1.

Paragraphs (a), (b)(ii) and (d) are satisfied.

However, the transaction breaches paragraph (c) - the associate (S1) holds an interest in the company providing the benefit (S3).

A dividend therefore arises to S1 to the extent of the interest foregone on the loan (by virtue of the combined effect of sections 4(1)(e), 4(1)(l), 4(7), 4(10) and 4(11)).

The dividend is exempt to S1 under section 63(2K) but, under the general imputation provisions, credits are to be attached to the dividend at the benchmark rate.

Example 8

Individual A owns 100% of Company B and Company C.

Co. B disposes of property to Co. C for no consideration.

The transaction satisfies neither paragraph (b) nor paragraph (e). A dividend arises to Co. C through the interaction of sections 4(1)(c), 4(1)(l) and 4(7)).

As in example 7, the dividend is exempt under section 63(2K) but subject to the imputation benchmark rules.

Example 9

A owns 100% of Company B which owns 100% of Company D and 80% of Company C. T owns 20% of Company C.

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Co. C makes an interest free loan to Co. D.

The transaction breaches paragraph (d). Company B is the related company. If Co. C made an interest free loan to Co. B, Co. B would receive an assessable dividend equal to the interest that would have been payable on the loan had a market rate of interest been applied to the loan (section 4(1)(e) and 4(10) and 4(11)).

A dividend therefore arises to Co. D (by virtue of sections 4(1)(e), 4(1)(l), and 4(7)).

Cross border transactions

Example 10

NZ1 Co. owns 100% of UK Co. and NZ2 Co. Only NZ1 Co and NZ2 Co are resident in New Zealand.

UK Co. makes an interest free loan to NZ2 Co. for six months (the loan is therefore not an attributed repatriation).

NZ1 is "the related company" under paragraph (b)(ii).

The transaction breaches paragraph (d) - NZ1 would have a dividend withholding payment liability in relation to the interest shortfall if the loan was made by UK Co. to NZ1 Co.

The transaction therefore gives rise to a dividend, in respect of which NZ2 Co has a dividend withholding payment liability.

Consolidation

Section 191N, Income Tax Act 1976

Introduction

Several amendments have been made to the provisions in section 191N relating to dispositions of property within a consolidated group. They have been made because of the new depreciation regime and to correct a technical problem.

Background

Under the new depreciation regime, 1992-93 depreciation rates are grandfathered for depreciable property acquired under a binding contract entered into before 16 December 1991. A new concept of pooled property is also introduced for depreciation.

These amendments impact on the consolidation regime. Generally, a consolidated group is able to transfer depreciable property, together with other types of property, with deferred income tax consequences. A deferral is achieved through the deemed transfer price, which is generally the tax book value as opposed to market value at the time of transfer.

The amendments to the consolidation provisions incorporate the grandfathering treatment of certain depreciable property and provide for a deemed transfer price of pooled property transferred intra-group.

Key issues

New subparagraph (ca) of section 191N(1) has been inserted to ensure that where depreciable property acquired under a binding contract entered into before 16 December 1991 is transferred intra-group, the depreciation rates prevailing for the 1992-93 income year continue to apply.

The new depreciation regime permits depreciation of property on a pooled basis. Section 191N(1)(d) provides for the pool of property to be transferred at its adjusted tax value where the whole pool is transferred intra-group. Where only part of the pool of property is transferred, the lower of the market value of the part of the pool being transferred or the adjusted tax value of the whole pool is the deemed transfer price. Section 191N(2) is consequentially amended as a result of the amendments to subsection (1).

The provision in section 191N(4) allows a nil base price adjustment to be made on the transfer of financial arrangement within a consolidated group. The purpose of the nil base price adjustment is to allow the transferee to step into the shoes of the transferor. This purpose is frustrated where the taxation of coupon payments made to the transferor prior to the transfer is deferred to later income years. The amendment to section 191N(4) makes the necessary technical correction to ensure this deferral of income does not result.

Application dates

The amendments to section 191N(1), (2) and (4) take effect with the introduction of the consolidation regime from 1 April 1993, so for standard and late balance date groups, they will apply for the 1993-94 income year. For early balance date groups, they will apply for the 1994-95 income year.

FBT and Promissory Notes

Sections 336N and 336O, Income Tax Act 1976

Introduction

The FBT regime has been amended to widen its application to include loans made by the use of promissory notes and other similar financial arrangements.

Background

Some employers have been avoiding paying FBT on low interest loans by using promissory notes in lieu of such loans. Arguably, this type of financial arrangement did not fall under the old definition of loan used in the FBT provisions.

Key Issues

The definition of loan in section 336N(1) has been amended to include a payment given in return for a promissory note or any other capital amount advanced under a financial arrangement (not being an excepted financial arrangement).

A definition of owing has been added to section 336N(1) to ensure that the amounts advanced to employees by the use of promissory notes and other similar financial arrangements are deemed to be owed.

A definition of prescribed interest has also been added to clarify the calculation of FBT on low interest loans. In relation to a low interest loan, prescribed interest is the amount of interest that would have accrued on that loan during the quarter or income year (which depends on the time period used by the taxpayer for the calculation of FBT) had the interest been calculated on a daily basis using the relevant prescribed rate of interest (or non-concessionary rate of interest for loans made before 31 March 1985).

Subsection (2) of section 336O, which deals with the calculation of FBT payable on a low interest loan, has been amended to clarify its operation and to deal with other financial arrangements, including promissory notes. FBT is normally payable on the difference between the interest actually accrued by an employee under a loan and the prescribed interest.

In the case of financial arrangements with no interest payments, such as promissory notes, the interest accrued is substituted for the income, if any, that would have accrued to the employer using the yield to maturity method, as used in the accruals regime.

Example

An employee sells a promissory note, with a face value of $1,000 and a term of five years, to his/her employer for $800. Assume the prescribed rate of interest is 10 percent.

FBT is payable on the difference between $1,000 x 10% ($100) (if calculated on a yearly basis) and the income accruing to the employer using the yield to maturity method. The figures are as follows:

	Prescribed Interest	YTM Income	Difference
Year 1	$100	$36.51	$63.49
Year 2	$100	$38.18	$61.82
Year 3	$100	$39.92	$60.08
Year 4	$100	$41.74	$58.26
Year 5	$100	$43.65	$56.35

In many cases promissory notes are sold at face value so there is no income accruing to the employer and no yield to maturity calculation is required. FBT will be payable on the total amount of the prescribed interest in such cases.

Application Date

The change in the FBT regime applies from the quarter commencing 1 April 1993.

FBT and the $75 Exemption

Section 336S, Income Tax Act 1976

Introduction

Changes have been made to the $75 exemption for "other" fringe benefits, limiting the number of employees to whom it applies and the value of the exemption.

Background

The FBT regime previously allowed an exemption to all employees (including shareholder-employees) of the first $75 of "other" benefits provided in a quarter. "Other" fringe benefits are those other than motor vehicles; low interest loans; subsidised transportation; retirement allowances and contributions to superannuation funds; sickness, accident and death benefit funds; and insurance premiums. "Other" fringe benefits does not include sundry benefits provided at the workplace.

Key issues

The $75 exemption per employee per quarter for "other" fringe benefits (such as subsidised or free goods and services, entertainment benefits) have been changed as follows:

- The exemption has been capped at a maximum exemption of $450 per quarter. This means that an employer may claim $75 per employee per quarter up to $450 per quarter. For employers who filed an annualised or income year FBT return, the maximum exemption is $1,800.
- If the value of the "other" benefits provided or granted to an employee in a quarter exceeds the $75 exemption, then the exemption does not apply. For example, if the value of other benefits to an employee in a quarter is $110 then this value is subject to FBT. Previously, the value of $110 would have been reduced by the $75, its taxable value being $35.

  If the value of all "other" benefits to employees (including shareholder-employees) exceeds $450 per quarter then the full value is subject to FBT, notwithstanding that the value of "other" benefits to an employee may be less than $75 in the quarter.

Application date

These changes will apply from 1 April 1993 for those who file returns on an annual or quarterly basis. In the case of an employer who files on an income year basis this change will affect 1992-93 FBT returns in respect of benefits provided on or after 1 April 1993.

Overfunded Employer Superannuation Schemes Excluded from Life Insurance Taxation Regime

Sections 36 and 204Q, Income Tax Act 1976

Introduction

Sections 36 and 204Q of the Income Tax Act and section 23 of the Superannuation Schemes Act have been amended to clarify the tax status of overfunded employer-sponsored superannuation funds.

The existing subsection (4) of section 204Q excludes employer-funded superannuation schemes from the provisions of the life insurance taxation regime. Some employers have been able to suspend contributions to a scheme because the scheme has a large surplus. There has been some concern that such schemes would not be eligible for the relief provided by section 204Q.

Key issues

Employer-sponsored superannuation schemes will be excluded from the life insurance taxation regime even where they do not meet employer contribution requirements by reason of being overfunded. The Government Actuary retains the discretion to determine whether a fund qualifies for exclusion.

In addition, the objection procedure in situations where a superannuation fund objects to a decision by the Government Actuary as to whether or not it meets the criteria for exclusion from the life insurance regime has been clarified. Such an objection will be made under section 23 of the Superannuation Schemes Act, and not under the Income Tax Act. This provides for consistency of administration, as many other matters of concern to superannuation schemes are under the supervision of the Government Actuary.

Application date

The amendment regarding the tax status of over-funded employer-sponsored schemes will be effective from the start of the income year commencing 1 April 1991.

Pre-Accrual Financial Arrangements of Superannuation Funds and Life Insurance Companies

Sections 204C(1), 225A(3) and 232B, Income Tax Act 1976

These sections have been amended to clarify the treatment of pre-accrual financial arrangements. The amendments confirm the intent of the sections by making it explicit that the income calculations should take into account any repayments of principal. The amendments take effect from 17 December 1992 (the introduction date of the amending legislation).

Family Support Tax Credits

Sections 374A to 374N, Income tax Act 1976

Introduction

Amendments have been made to enable Inland Revenue to take over the payment of Family Support and Guaranteed Minimum Family Income (GMFI) for non-beneficiaries, with effect from 1 April 1993.

The Department of Social Welfare (DSW) will continue to pay Family Support to beneficiaries.

Previously Inland Revenue assessed Family Support and GMFI for non-beneficiaries, but DSW paid the credits to both beneficiaries and non-beneficiaries.

As a result of a governmental review of the Family Support system, Inland Revenue will now pay Family Support and GMFI to non-beneficiaries. The first payment will occur on 13 April.

Key issues

A number of amendments have been made to the Family Support and GMFI legislation.

The process whereby the Commissioner issues a certificate of entitlement has been altered. Previously the Commissioner determined entitlement and issued a certificate of entitlement to the recipient and to DSW.

Now the Commissioner will determine the Family Support and GMFI entitlement and issue a certificate of entitlement to the recipient. He will also retain a copy of the certificate of entitlement, in electronic form.

For shared custody cases, the minimum time for which a parent must have the care of a child in order to qualify for Family Support has changed from 4 weeks out of every 12, to one third of the time throughout the income year.

References in the legislation to the Social Security Commission have been replaced with references to the Director-General of Social Welfare.

The provisions in the legislation which provided for the Director-General to deliver Family Support to non-beneficiaries (sections 374G(11) and 374I(1)) have been repealed.

Where the Commissioner pays Family Support or Family Support and GMFI to non-beneficiaries, he will be required to issue by 20 April, following the end of the income year, a certificate stating the combined amount of Family Support and GMFI received during the previous income year.

The references to *pay day* in the legislation have been altered to ensure that the pay day is the day fixed by the Commissioner for the payment of Family Support and GMFI. The day was previously fixed by the Social Security Act. The Commissioner will pay Family Support and GMFI on a fortnightly basis.

Fortnightly payments of Family Support and GMFI will be paid directly into bank accounts. It is a requirement that applicants for Family Support and GMFI provide details of a bank account with one of the following financial institutions:

- any registered bank within the meaning of the term in section 2 of the Reserve Bank Act 1898;
- any private saving bank;
- any building society;
- Public Service Investment Society;
- any bank within the meaning of the Banking Act.

Losses from a qualifying company which are attributed to a shareholder of that company cannot be offset against assessable income for Family Support and GMFI purposes.

The definition of the term *full time earner* in section 374E(1) is amended to ensure that a person who is receiving continued compensation under section 138 of the Accident Rehabilitation and Compensation Insurance Act 1992 will still qualify as a full time earner for GMFI purposes.

References in the legislation to the Family Support *declaration* have been altered to refer to a Family Support *statement*. This change was necessary because the Family Support *declaration* was not a true declaration in terms of the Oaths and Declarations Act 1957 (a true declaration has to be witnessed).

Application date

These amendments apply with respect to the income year commencing on 1 April 1993 and subsequent income years.

Accident Compensation Levy, Earner Premium and Employer Premium - Year when Deductible

Section 140A, Income Tax Act 1976

There are two amendments to section 140A, which deals with how accident compensation levy, earner premium and employer premium should be accounted for. These amendments clarify who the section applies to and when a deduction can be claimed.

First, subsection (3) has been amended to make it clear that self-employed taxpayers can claim a deduction for earner premium from income other than salary and wages and to prevent private domestic workers from claiming a deduction. This amendment applies to premiums that become due and payable in the 1992-93 income year and any subsequent year.

Secondly, subsection (5) has been inserted to stop a double deduction for the payment of levies or premiums from being claimed, which can occur if they were originally accounted for on the wrong basis.

The amendment is necessary because some taxpayers are still incorrectly claiming a deduction for their levies or premiums in the year before they are payable, rather than the year they are payable. The effect of adjusting such claims has, in recent cases, been able to be negated because of the 4 year reassessment time limit. Effectively, a double deduction is allowed for the most recent year unable to be reassessed.

The amendment ensures that from 1 April 1993 a deduction for any premium or levy cannot be claimed a second time if it has already been (wrongly) claimed in a year that cannot be re-opened.

Local Authority Trading Enterprise Definition

Section 61(2A), Income Tax Act 1976

Introduction

Airport companies, port companies and energy companies are no longer excluded from the local authority trading enterprise (LATE) definition for the purposes of the local authority income tax exemption.

Background

Local authorities are liable for tax on all income derived from LATEs. The Income Tax Act uses the LATE definition contained in section 594B of the Local Government Act 1974. This definition, while generally including all companies under the control of a local authority, specifically excludes airport companies, port companies and energy companies.

Key issues

A new section 61(2A), relating to the local authority income tax exemption, has been enacted in the Income Tax Act. Several provisions in the former section 61(2A) have been omitted from the new provision as they are no longer necessary in light of the new local authority definition in section 2 of the Income Tax Act which was enacted in April 1992.

Local authorities are now liable for tax on any income they derive from airport companies, port companies or energy companies which are under their control. The reason these companies are excluded from the LATE definition in the Local Government Act is to prevent them being subject to the LATE regulatory regime in addition to their own sector-specific regulatory regimes. The exclusions were not designed for Income Tax Act purposes.

As long as any airport company, port company or energy company remains under the control of a local authority, it would be anomalous (in comparison to the tax treatment of income derived by local authorities from other companies under their control) to exempt local authorities from tax on income derived from these specific types of companies. Accordingly, the current exclusion of these types of companies from the LATE definition in the Local Government Act will not apply for the purposes of the income tax exemption for local authorities.

Application date

For income derived by local authorities from port companies or airport companies, the amendment applies from 1 April 1993.

For income derived from an energy company, the amendment applies from 1 July 1992. A number of former MEDs which were corporatised before the Energy Companies Act came into force on 1 July 1992 have been deemed by that Act to be energy companies since that date. These companies also used to come within the LATE definition until an amendment (enacted on 17 December 1992) retrospectively removed them from the LATE definition with effect from 1 July 1992. The reason for this amendment was that the relevant companies would otherwise have been subject to both the LATE regulatory regime and the Energy Companies Act regulatory regime. The application date for this Income Tax Act amendment brings former MEDs which were corporatised ahead of the Energy Companies Act back into the LATE definition for Income Tax Act purposes only, with effect from 1 July 1992. These companies will therefore always have remained in the LATE definition for income tax purposes.

Southland Electric Power Supply

Section 197C, Income Tax Act 1976

Introduction

An amendment restores the income tax liability of the Southland Electric Power Supply (SEPS) with effect from 1 November 1989. SEPS inadvertently fell out of the income tax net from 1 November 1989 as a result of amendments to non-tax legislation.

Background

SEPS comprises the undertaking of the former Southland Electric Power Board. Under the Southland Electric Power Supply Act 1936 the board's assets and liabilities were transferred to the Crown, which has up to the present time conducted the undertaking of the former board.

SEPS became liable to income tax from the 1987-88 income year along with Electric Power Boards and MEDs. In 1989 the local authority definition in the Local Government Act was amended as part of the then major reorganisation of local government. This affected the Income Tax Act because of the reference in that Act's local authority definition to the local authority definition in the Local Government Act. The amendment had the inadvertent effect of removing the liability of SEPS for income tax from 1 November 1989.

Key issues

Section 197C of the Income Tax Act, which relates to the taxation of energy trading operators (i.e., Electric Power Boards and MEDs), is amended so that it applies to the Crown acting in its capacity of carrying on the undertaking of the former Southland Electric Power Board. It is also expressly provided that the public authority income tax exemption will not apply to the Crown acting in its SEPS capacity. There is also a minor amendment providing that one of the deeming provisions applying to energy trading operators shall not apply to the Crown acting in its SEPS capacity.

No person other than the Crown will be affected by these amendments.

Application Date

The amendment restoring the income tax liability of SEPS applies from 1 November 1989 (being the date when SEPS inadvertently fell out of the income tax net). The other amendments apply from the 1987-88 income year, being the year when SEPS and other electrical supply authorities became liable for income tax.

Unit Trust and Group Investment Fund Redemptions

Section 63(2H), Income Tax Act 1976

The exemption for dividends paid on redemptions of units in a unit trust from the trust's fund manager and redemptions of interests in a Group Investment Fund (GIF) from the GIF's trustee or manager has been extended for one year. Dividends will now be exempt if they are paid before 1 April 1994.

The exemption applies to widely-held investment funds and will also apply to "second-tier" unit trusts and group investment funds that are vehicles for investment primarily by unit trusts, group investment funds or superannuation funds that are widely-held investment vehicles.

FBT Anti-Avoidance Provision

Section 336X, Income Tax Act 1976

The FBT anti-avoidance provision has been strengthened from 1 April 1993. When taxpayers are involved in an FBT avoidance arrangement, the Commissioner can now deem:

- one person involved in the arrangement to be the employer; and
- any other person involved to be the employee; and
- the benefit being passed from the deemed employer to the deemed employee (or what would have been the benefit had the arrangement not been entered into) to be provided by virtue of the employment of the deemed employee.

Section 336X has also been amended so that it is clear that it will apply when avoidance is only one of the purposes of an arrangement, so long as avoidance is not merely an incidental purpose.

Imputation Credits Attached to Notional Dividends

Sections 394U, 394ZA, 394ZC, 394ZE and 394ZP, Income Tax Act 1976

The legislation governing the imputation regime has been amended to ensure that the imputation credits attached to notional distributions made by statutory producer boards and co-operative companies can be used by the recipients of the distributions. A drafting error had created some uncertainty. Sections 394U, 394ZA, 394ZC, 394ZE and 394ZP have been amended with effect from 1 April 1993.

The formula for calculating a notional dividend used in sections 394U and 394ZA has been altered so that it does not include the amount of the credit attached to the dividend. Section 394ZC has been amended to make the imputation credits attached to notional dividends assessable. Sections 394ZE and 394ZP have been amended to make it clear that taxpayers receiving notional dividends are entitled to a tax credit when the credit attached to the dividend is not assessable because it was derived before 1 April 1993.

Rebate for Gifts of Money - Charitable Donee Status for five Organisations

Sections 56A and 147(2), Income Tax Act 1976

Five new organisations have been granted charitable donee status. The organisations are:

- Community Action Overseas (Oxfam NZ)
- The Winston Churchill Memorial Trust
- The Fred Hollows Foundation (NZ)
- Christian Blind Mission International (NZ)
- Four Sherpa Trust

Donations to these organisations will now be allowed as a rebate for individual taxpayers under section 56A, or as a deduction for public companies under section 147(2).

Donations to the first three organisations will qualify for the 1992-93 income year. Donations to the Christian Blind Mission International and the Four Sherpa trust will qualify for the 1993-94 income year.

Tax Status of New Zealand Conservation Corps and Access Training Allowances

Section 61(57), Income Tax Act 1976

Section 61(57) has been amended to provide a tax exemption for the training allowances paid to New Zealand Conservation Corps workers. The exemption takes effect from the inception of the Conservation Corps programme and is removed for training allowances derived after 30 June 1993. The tax exemption for Access training allowances is also removed for allowances derived after this date.

The removal of the tax exemption for the training allowances means that PAYE will have to be deducted from those payable after 30 June 1993.

Annual Confirmation of Rates

The rates of income tax for the 1992-93 income year have been confirmed. The rates are the same as those applying for the 1991-92 income year.

Minor Amendments

Definition of salary and wages - Section 2, Income Tax Act 1976

The definition of *salary and wages* is amended to include continued compensation provided under section 138 of the Accident Rehabilitation and Compensation Insurance Act 1992.

This amendment applies to income derived in the 1992/93 income year.

Private Domestic Worker - Section 17, Income Tax Act 1976

Section 17 of the Act is amended to require private domestic workers who account for their own tax deductions to file an IR 3 return, which has provision for the calculation of ACC earner and employer premiums. The amendment applies to 1992/93 returns.

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

The definition of *full time earner* in the transitional tax allowance has been amended to ensure that recipients of continued compensation under section 138 of the Accident Rehabilitation and Compensation Insurance Act 1992 can still qualify for the Transitional Tax Allowance. The amendment applies to tax on income derived in the 1992/93 income year.

Assessable income - Section 65(2)(ca), Income Tax Act 1976

Compensation payments which were payable under the Accident Compensation Act 1982 and which are continued under section 138 of the Accident Rehabilitation and Compensation Insurance Act 1992 are included in assessable income for income tax purposes.

The amendment applies to income derived in the 1992-93 income year.

GST on the Export of Secondhand Goods

Section 10(4) of the GST Act 1985

Introduction

An amendment provides that where goods are exported by a person who purchased them from an associated person, the consideration for the export sale will be deemed to be the purchase price of the goods to the associated person.

Background

The GST Act provides that in general exported goods are zero-rated. However, zero-rating does not apply where a secondhand goods input tax credit has been claimed by the person exporting those goods or by a person associated with the exporter.

Where goods are exported and the exporter has claimed a secondhand goods input tax credit, GST is payable on the supply by the exporter. The consideration for the supply is generally deemed to be the amount of the purchase price to the supplier. This effectively means that the secondhand goods input tax credit is clawed back.

Where the exporter has purchased the goods from an associated person, however, the consideration was previously deemed to be the greater of the purchase price to the exporter or the purchase price to the associated person.

Key issues

The provision has been amended so that the consideration is now deemed to be the purchase price to the associated person.

The provision is still an anti-avoidance mechanism but is now fairer, in that only the secondhand goods input tax credit is clawed back, and not any value added by the associated person.

Application date

The amendment applies from 1 April 1993.

Recovery of GST

Sections 1(3) and 42 of the GST Act 1985

The amendment ranks GST which is unpaid at the time of a bankruptcy, liquidation or receivership and due to the Comptroller of Customs with unpaid GST due to the Commissioner of Inland Revenue in such situations.

Section 42 of the GST Act provides for the ranking of GST due to the Commissioner of Inland Revenue in cases of bankruptcy, liquidation or receivership. GST ranks with unpaid PAYE.

The amendment provides that GST which is levied under sections 12 and 13 of the GST Act and due to the Comptroller of Customs ranks equally with that due to the Commissioner of Inland Revenue at the time of bankruptcy, receivership or liquidation.

An amendment to section 1(3) of the GST Act also provides that section 42 shall be deemed to be one of the Customs Acts in so far as it applies to the Comptroller of Customs.

The amendment applies to GST due and payable by persons who go into bankruptcy, receivership or liquidation on or after 1 April 1993.

GST-Zero-Rated Goods

Section 11, Goods and Services Tax Act 1985

Section 11 of the GST Act is amended to correct certain references.

When paragraphs (aa)-(af) were added to section 11(1), the proviso to section 11(1) was not amended accordingly.

This amendment rectifies this by including a reference to paragraphs (aa)-(af) in the proviso.

The amendment applies from 1 April 1993.

Road User Charges and GST

Section 5(6B) of the GST Act 1985

An amendment provides that the Ministry of Transport (MOT) will return the GST on road user charges.

GST on road user charges was returned to the Inland Revenue by New Zealand Post. As a result of the deregulation of the road user charges collection process, it is more administratively convenient for the MOT to return the GST on road user charges.

From 26 April 1993, New Zealand Post will no longer be the sole collection agency for road user charges. As a result of the change in collection mechanism, the MOT will be returning the GST on road user charges to Inland Revenue.

The amendment will apply from 26 April 1993.

Disclosure of Information to Social Welfare for Determining Entitlement to the Community Services Card

Section 13B, Inland Revenue Department Act 1974

The information disclosure provision has been extended to allow Inland Revenue to disclose additional information on Family Support recipients to the Department of Social Welfare (DSW).

The current disclosure provision allows information held by Inland Revenue on Family Support recipients to be disclosed to DSW to determine eligibility for the Community Services Card.

The supply of information enables the Community Services Card to be issued promptly to families who qualify. It also reduces the compliance costs associated with the card; information provided to Inland Revenue for Family Support purposes does not have to be supplied again to DSW.

The additional particulars to be transferred to DSW are:

- the family's estimated income at the beginning of an income year and its actual assessable income at the end of an income year;
- the family's estimated entitlement to Family Support and GMFI during the year and the actual entitlement at the end of the year;
- the birth dates of the children.

This information transfer conforms with the requirements of the Privacy Commissioner Act 1991.

The amendment applies from 1 April 1993, which is the date of assent of the Act.

Computer-Generated Assessments

Section 21D, Inland Revenue Department Act 1974

Section 21D has been added to the Inland Revenue Department Act. This section provides that, for the purposes of the Inland Revenue Acts, assessments and determinations made by a computer or other electronic means are to be treated as made by or under the properly delegated authority of the Commissioner.

This amendment clarifies the validity of assessments and determinations made under FIRST, IRD's computer system.

An amendment has also been made to section 21 of the Income Tax Act to clarify that default assessments made by FIRST are valid.

These amendments apply from 17 December 1992.

Student Loan Scheme Amendments

Sections 2,32,35,41,90 and 98, Student Loan Scheme Act 1992

The Student Loan Scheme Amendment Act 1993 made the following changes to the Student Loan Scheme Act:

Interest write-off

The interest write-off provisions have been changed to deny a write-off in any income year in which a loan is transferred to Inland Revenue for collection. This change was necessary because some loans will continue after 31 December, and thus fall into two "loan years".

Repayment deductions

The pay period from which employers must make repayment deductions has been changed from the first full pay period ending on or after 1 April 1993 to the pay period pay period ending on or after 1 April 1993. This change has been made to reduce compliance costs for employers by ensuring that the increased earner premium and any required repayment deductions both start in the same pay period.

Non-residents

The first year in which a borrower has to pay a non-resident repayment obligation has been changed from the year of departure to the income year following departure. A non-resident who returns to New Zealand (and regains residency status) will continue to pay a part-year non-resident repayment obligation, pro-rated to the number of days s/he was a non-resident.

A change has also been made to ensure that loans taken out by persons who are non-resident at the time of borrowing come within the non-resident regime.

Penal charge

A minor drafting error in the definition of "penal charge" has been corrected.

Insolvency Act 1967

Section 90 of the Student Loan Scheme Act 1992 inadvertently overrode a change made by the Accident Rehabilitation and Compensation Insurance Act 1992. This has been corrected.

Child Support: Transfer of Cases from Liable Parent Contribution Scheme

Sections 9 and 261, Child Support Act 1991

Introduction

An amendment corrects a drafting error in the Child Support Act 1991. Liable parents under the previous liable parent contribution scheme are required to pay child support, regardless of any remission allowed under the earlier scheme.

Background

The Child Support Act provides for the transfer of records from the previous liable parent contribution scheme. Where records were transferred in this way, custodians were deemed to have applied for child support.

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Owing to a drafting error, the relevant provision allowed records to be transferred only if the liable parent had been required to pay liable parent contributions.

Where the liable parent contribution had been reduced to zero, under the legislation as drafted the liable parent was not required to pay child support.

The child support scheme is a totally new scheme, and it was never intended that decisions under the previous scheme should apply to it. The amendment, therefore, reflects the Government's original intention.

Key issues

Section 261

Transfer of cases from the previous scheme, where liable parent contributions had been reduced to zero, is ratified. Liable parents who had claimed exemption under the previous provision are required to pay child support.

Section 9

Custodians who are social welfare beneficiaries are required to apply for child support. This ensures that the liable parent contributes to the cost of the benefit paid to support the family. Child support payments, up to the level of the benefit paid, are retained by the state, so that at least part of the costs of the benefit are recovered.

Where a child support application is required from a beneficiary custodian, this could be requested only at the time the benefit application was made.

A further amendment allows a child support application to be requested at any time.

Appeals against child support liabilities

Liable parents who are required to pay child support under the new provisions may consider the child support assessment is not appropriate in their particular circumstances. They can apply to the Family Court for a review.

Application date

These amendments apply from 18 December 1991, the date the Child Support Act was enacted. However, the amendments do not apply to any judgement given before the amendment was enacted, on 1 April 1993.

Due Dates Reminder

May

5 PAYE deductions and IR 66ES for last 15 days of April 1993 due - "large" employers only.

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

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

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

First instalment of 1994 student loan interim repayment due for taxpayers with January balance dates.

20 PAYE deductions and schedules for first 15 days of May 1993 due - "large" employers

PAYE deductions and schedules for April 1993 due - "small" employers.

Gaming Machine Duty return and payment for month ended 30 April 1993 due.

RWT on Interest deducted during April 1993 due for monthly payers.

RWT on Dividends deducted during April 1993 due.

Non-Resident Withholding Tax (or Approved Issuer Levy) deducted during April 1993 due.

31 Annual Liable FBT return (1 April 1992 to 31 March 1993) and payment due for employers who elected to pay FBT on an annual basis.

GST return and payment for period ended 30 April 1993 due.

Annual Wage Reconciliation and ACC Employer Premium Statement (IR 68A, IR 68P) due to be filed.

1993 Employer Premium due.

Specified Dividend reconciliation IR 17S or IR 17SA due.

Annual Interest Reconciliation Statement (IR 15S) due.

June

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

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

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

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

First instalment of 1994 student loan interim repayment due for taxpayers with February balance dates.

Second instalment of 1994 student loan interim repayment due for taxpayers with October balance dates.

Annual income tax return due for IR 5 taxpayers.

20 PAYE deductions and schedules for first 15 days of June 1993 due - "large" employers

PAYE deductions and schedules for May 1993 due - "small" employers.

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

RWT on Interest deducted during May 1993 due for monthly payers.

RWT on Dividends deducted during May 1993 due.

Non-Resident Withholding Tax (or Approved Issuer Levy) deducted during May 1993 due.

Payment of debit imputation balances due.

30 GST return and payment for period ended 31 May 1993 due.

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

First instalment of 1994 student loan non-resident assessment due.

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This Tax Information Bulletin deals with recent tax legislation. It covers these Acts:

• Income Tax Amendment Act 1993

• Income Tax Amendment Act (No.2) 1993

• Estate Duty Abolition Act 1993

• Goods and Services Tax Amendment Act 1993

• Inland Revenue Department Amendment Act 1993

• Student Loan Scheme Amendment Act 1993

• Child Support Amendment Act 1993

There is a full list on page 1 of the changes resulting from these Acts.

We haven't included "Questions we've been asked" or Legal case notes in this TIB because of time and space restrictions. These will return in future issues as usual.

Finally, there is an appendix to this TIB which deals with the practical application of the new depreciation regime. This was mailed out separately before this TIB, so you should have already received it. Extra copies are available from your local Inland Revenue office.