Tax Treatment of Computer Software

The appendix to this TIB sets out Inland Revenue's policy on the tax treatment of computer software. This policy applies to expenditure incurred on or after 1 July 1993. Software expenditure incurred before 31 July 1993 was fully deductible as an expense for tax purposes; the new policy does not alter that treatment.

New Publications from Inland Revenue

Inland Revenue has recently released these new publications:

National Superannuitant Surcharge

We've updated this booklet to explain the benefits of using a special tax code to pay surcharge.

We recently sent letters to 50,000 superannuitants who were previously liable for surcharge, to explain how they could avoid a large tax bill at the end of the year by using a special tax code during the year.

This booklet also explains who has to pay surcharge and how to calculate the amount payable.

Self-Employed or an Employee?

This leaflet explains how to tell if a worker is an employee or a self-employed contractor. A person's employment status affects the expenses s/he can claim, and who is liable for some ACC premiums. Also, there can be penalties if someone knowingly tries to avoid their tax obligations in this area.

If you are unsure whether you (or someone who works for you) is self-employed or not, this leaflet will help you to work out the answer.

Retiring Allowances and Redundancy Payments

This leaflet explains the new tax treatment of retiring allowances and redundancy payments. These apply to redundancy payments paid from 30 November 1992, and to retiring allowances paid from 1 January 1994. The leaflet also explains the conditions for an amount to be treated as one of these types of payments.

Objection Procedures

This booklet explains what taxpayers should do if they disagree with an assessment that Inland Revenue issues. At Inland Revenue we make every effort to apply the tax laws fairly and correctly, but there may come a time when people disagree with our assessments. This book explains the options available to resolve any such disagreements.

You can get a copy of any of these publications from your nearest Inland Revenue office.

Inland Revenue Reduces Amount of Tax Outstanding

Inland Revenue has reduced the amount of outstanding tax by nearly $100 million in the last 12 months. The level of collectible debt now stands at $969 million, compared with $1,068 million at the same time last year.

Our new debt collection systems have made a big contribution towards this reduction. Staff are freed up to pursue reluctant payers while the system automatically identifies debt and issues reminder notices.

Debt collection staff collected $42 in outstanding tax for every dollar spent to recover the money in the past nine months. The amount of overdue cash revenue recovered during this period exceeded $825 million.

If people owe tax but can't afford to pay it, they should get in touch with Inland Revenue as soon as possible, rather than leaving it until we contact them.

Accident Compensation Changes

Accident Rehabilitation and Compensation Insurance (Earnings Definitions) Regulations 1992, Amendment No.2

There have been a number of amendments to the interpretation regulation of the Accident Rehabilitation and Compensation Insurance (Earnings Definitions) Regulations 1992. This article sets out the effects of these amendments.

Retiring and redundancy allowances

The definition of *earnings as an employee* has been amended to exclude redundancy payments and retiring allowances. This means earner premium and employer premium will *not* be payable on these forms of income.

All redundancy payments made on or after 1 July 1992 are excluded from the definition of earnings as an employee. Any retiring allowances paid on or after 1 January 1994 are also excluded from this definition.

Losses attributed by qualifying companies

If a qualifying company attributes any loss to one of its shareholders, the shareholder cannot offset that loss against any other earnings for the purposes of calculating the premium on other earnings.

This amendment applies from 1 April 1993, and applies to losses attributed in the 1993/94 income year.

Shareholder Employee salaries

These salaries will not be liable to earner premium but will be included as earnings as an employee for the purposes of calculating the employer premium where:

- a shareholder employee receives a payment of salary or wages to which section 6(2) or section 6(3) of the Income Tax Act applies (that is, no source deduction payments have been made); and
- the salary or wage is included in the shareholder's income for the 1991/92 income year; and
- the amount of the payment has been determined between 1 June 1992 and 31 March 1993;

The employer premium on these payments is due and payable on 31 May 1993. There is provision in the IR 68A form for calculating employer premium on these salaries.

This amendment ensures that shareholder employee salaries:

- where no PAYE has been deducted;
- which are determined between 1 June 1992 and 31 March 1993; and
- which are included as income for the 1992 year

are treated the same as other 1992 salary or wages, so they are not liable for earner premium.

ACC premiums on shareholder employees' salaries determined at the end of the income year

This amendment removes an anomaly which caused the current year's ACC premium rates to be generally imposed on the previous year's shareholder employees' no-deduction salaries.

Shareholder employees have earner premium deducted by the company from no-deduction salaries (where no PAYE is deducted) when the salary is determined.

Previously ACC premiums on shareholder employees' earnings were accounted for in the annual reconciliation statement (IR 68) which is due on 31 May. Where shareholder employees' no-deduction salaries for the previous income year ending on 31 March are determined after 31 May, the remuneration was returned in the following year's IR 68P and employer and earner premium would have been accounted for at that point.

To reduce compliance costs faced by employers, an amendment has been made to shift the accounting for ACC premiums from the IR 68 to the company tax return (IR 4).

The due date for employer and earner premiums on shareholder employees' no-deduction salaries has been changed to coincide with the company's terminal tax due date.

The 1993 IR 4 company tax return incorporates panels to enable the calculation of the employer and earner premiums on shareholder employee remuneration.

Any company that has furnished its 1993 IR 4 company tax return before 31 March 1993 must account for both the employer and earner premiums on shareholder employees' no-deduction salaries on the 1993 annual reconciliation statement (IR 68). A dummy IR 12 for the shareholder employees' no-deduction salaries will be required to reconcile the statement.

Failure to furnish

A new regulation is inserted to provide that a person who intentionally fails to furnish statements, documents, or other information under these regulations commits an offence. This amendment reflects the failure-to-furnish provision under the Income Tax Act.

The regulation ensures that a person who fails to furnish a statement for both income tax and premium purposes commits an offence under the Income tax Act 1976 (for the income tax component) and the Accident Rehabilitation and Compensation Insurance Act 1992 (for the premium component).

This amendment applies from 1 April 1993.

Accident Rehabilitation and Compensation Insurance (Employer premium) (No.2) 1992, Amendment No.1

The Accident Rehabilitation and Compensation Insurance (Employment Premiums) Regulations (No.2) 1992 have been amended to make it clear that those regulations apply to employer premiums which become payable after 1 April 1993.

The Accident Compensation Employers and Self-Employed Persons Levies Order 1991 is revoked.

Employer Premium and Earner Premium Regulations

Definition of full time self-employed

Under the Accident Compensation (Prescribed Amounts for Calculation and Payment of Levies) Order 1985, full-time self-employment was limited to the average hours worked in *self-employment*. The new definition in the Accident Rehabilitation and Compensation Insurance (Earnings Definitions) Regulations 1992 and the Accident Rehabilitation and Compensation Insurance (Employment Premiums) Regulations 1992 require that *all employment* be taken into account to establish whether a person is in full-time employment

Accordingly, where a person has employment that on average is 30 hours or more per week from any combination of employment, s/he will be classed as in full-time employment. Note that the regulations further provide that full-time employment can be less than 30 hours if the employment contract defines lesser hours as full-time.

For example, a person who works 25 hours per week as an employee and 5 hours as a self-employed person will be classed as in full time employment (that is, 25 hours as an employee plus 5 hours self-employment).

Minimum employer premium payable by self-employed persons

Under the Accident Compensation Act 1982, the rules for applying the minimum AC levy on self-employment were:

full-time	Minimum Leviable Earnings	$10,400
part-time	Minimum Leviable Earnings	$2,600

The new minimum rules set out in the Accident Rehabilitation and Compensation Insurance (Employment Premiums) Regulations (No.2) 1992 have:

1. Split the category of full-time into those who are over twenty years of age at *any* time during the year and those earners under twenty at *all* times during the year.

   Full-time employment
   (20 years of age or over) ..... Minimum $12,740
   Full-time employment
   (under 20 years of age) ..... Minimum $10190
   All other earners ..... No Minimum

2. Removed the minimum part-time premium so that these earners will pay the premiums based on their actual liable earnings.

3. Lowered the minimum liable earnings for any earnings received as an employee, thereby reducing the amount of earner and employer premium payable.

Example

A full time self-employed person over 20 years of age has the following income and liable earnings:

Business loss	($5,000)
Salary	$9,000
Assessable income for tax purposes	$4,000
Prescribed Minimum liable earnings	$12,740
Less employment earnings	$9,000
Total liable earnings	$3,740

(Business losses cannot be offset against earnings as an employee for the purposes of calculating the ACC premiums.)

The employer premium and earner premium are calculated on liable earnings of $3740, *not* $4,000.

The earner qualifies for earnings-related compensation based on 80 percent of the *prescribed minimum liable earnings*. Because the earner premium and employer premium will have already been paid on the $9,000 salary, the earner premium and employer premium liability on the self-employed earnings are calculated on the balance to bring the "compensation cover" up to the *prescribed minimum liable earnings*.

If the business in the above example had made a profit of $5,000 instead of a loss, the minimum rules would not apply because the sum of the business income and the salary exceeds the prescribed minimum of $12,740. Employer and earner premiums would be calculated on the actual business profit ($5,000).

A person under twenty at all times during the year with a $12,000 salary and a business loss would not pay any further premiums because the minimum liable earnings (of $10,190) have been exceeded and there is no other income to pay the premiums on.

Where a person has a business loss the earnings-related compensation will be paid out based on 80 percent of the income, i.e. 80 percent of the salary.

Property Valuations - Acceptance by Inland Revenue

We have been asked to confirm who Inland Revenue will accept property valuations from.

In recent months there has been some confusion between solicitors, real estate agents and Inland Revenue as to who we will accept property valuations from when submitting items for stamp duty assessment, or in answer to an audit enquiry.

Inland Revenue will accept valuations from a registered valuer, Valuation New Zealand or an associate member of the Real Estate Institute of New Zealand. This does not include those Real Estate Agents who are salespersons only.

Commissions on Life Insurance sold to Agent's Family

Summary

This article confirms that an insurance agent who sells a policy to a member of his or her immediate family is not assessable on the commission received for that sale. The item corrects a statement published on page 43 of TIB Volume 4, No 5 (December 1992) that such commissions were assessable.

This article also sets out the Fringe Benefit Tax ("FBT") implications of the provision, for the insurance agent's employer, of discounted life insurance policies to the agent or his/her immediate family.

Inland Revenue's policy

Commissions received by agents or employees of Life Insurance Offices who take out life insurance policies on their own lives or on the lives of their immediate family members should be regarded as reductions or discounts from the premiums payable under the policies, and not as assessable income. In this context "immediate family" means the agent's or employee's spouse and dependent children. The provision of such benefits by the employer will be subject to FBT, unless excluded from the definition of Fringe Benefit by section 336N(1)(j)(ii)(B) of the Income Tax Act 1976 ("the Act").

Discounted premium

A discount is not regarded as income. Since income is what comes in, not what is saved from going out, the receipt of something which saves a taxpayer from incurring expenditure is not income - (*FC of T* v *Cooke & Sheridan* 80 ATC 4140).

Fringe benefit

Where a salesperson is an employee and his/her employer provides an insurance policy to the salesperson (or to someone associated with him/her) as a consequence of the employment relationship, Inland Revenue regards this as the provision of a benefit for the employee's private use or enjoyment (i.e., a fringe benefit). The employer will be liable to FBT on the amount:

(a) by which the commission reduces or discounts the price of the policy (i.e., the premiums) if it had been sold on the open market to a buyer who is independent of the seller (section 336O(5)(a)); or

(b) by which the commission reduces or discounts the price of the policy (i.e., the premiums) to the employer, if bought from an independent third party (section 336O(5)(b); or

(c) if neither (a) nor (b) applies, the amount the Commissioner is satisfied the person who provides or performs those services to or for the employee, would have charged a member of the public (who is independent of the provider/performer) for such services on the open market in New Zealand (section 336O(5)(c)); or

(d) if the Commissioner is satisfied that neither (a) (b) nor (c) can be used to determine that value of the fringe benefit,

- the amount the Commissioner determines would normally be paid for such services by a member of the public in a transaction freely entered into on ordinary trade terms between buyers and sellers (who are independent of each other) on the open market in New Zealand; or
- if that amount cannot be determined, such amount as the Commissioner determines (section 336(O)(6)).

(e) if the policy is a specified insurance policy (as defined in section 336N(1)), the amount of the commission to the extent that it represents the amount of the premium "paid" by the employer.

Exception to FBT treatment

This policy on FBT liability will not apply to an employer's expenditure on premiums for the following types of life insurance policy, because these policies do not constitute "fringe benefits" (section 336N(1)(j)(ii)(B) and definition of "expenditure on account of an employee", section 2):

- A policy that is or is part of a specified fund under section 59(1); or
- A policy held by or on behalf of trustees of any superannuation category 3 scheme;
- A policy in respect of which no premium is refundable, or convertible to cash by the employee or any associated person of the employer and benefits from which are only payable or distributable:
  - on the death, accident or sickness of, and for the benefit of, that employee or their spouse or child; except
  - where the employer is a proprietary company and the expenditure is deemed a dividend under section 4(1)k.

Conclusion

Commissions received by agents or employees of Life Insurance Offices for life insurance policies effected on their own lives or on the lives of members of their immediate family are not assessable income of the agent. The provision of such benefits by the employer will be subject to FBT, unless excluded from being "fringe benefits" by section 336N (1)(j)(ii)(B).

Consolidation - Election Form Available

Under the Consolidation regime, groups of companies can elect to be treated as a single entity for tax purposes, as long as they meet certain conditions. This regime is explained fully in TIB Volume Four, No.5 (December 1992), and in our "Consolidation" leaflet. You can get a copy of either of these from any Inland Revenue office.

Companies have 63 working days from the start of the income year in which to elect to become a consolidated group. This means companies with a 31 March balance date must elect by 29 June 1993. Companies with non-standard balance dates will have 63 working days from the start of their accounting year to elect.

Groups of companies that wish to consolidate can now get the necessary election form (IR 4EF) from their local Inland Revenue office. This form contains an undertaking from each member company to be "jointly and severally liable" for the consolidated group's income tax - including Provisional Tax, PAYE, RWT, SSCWT, and FBT. It also provides for the group to elect a "nominated company" to act as agent for the group and its members.

A further election form (IR 4EG) covers elections to join or leave an existing consolidated group, elections to maintain a trading stock concession, changing a group's nominated company, and applying to limit joint and several liability. This form is also available from any Inland Revenue office. Each consolidated group will be allocated a new IRD Number, which it should use for all future tax returns, payments and enquiries for the group. Member companies will not receive separate tax returns each year, unless they are consolidated for only part of the year.

Companies wishing to consolidate should send their completed election forms to:

Inland Revenue Department
P O Box 895
WELLINGTON

Questions We've Been Asked

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

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

Income Tax Act 1976

Industry Balance Dates

Section 15 - Returns to Annual Balance Date: A pipfruit orchardist asked whether Inland Revenue has recognised an industry balance date for pipfruit orchardists, and if so, if a pipfruit orchardist could adopt this balance date without prior approval from Inland Revenue.

Inland Revenue does not allow taxpayers to adopt balance dates other than 31 March as of right. However, we will normally consent to the adoption of a non-standard balance date where the change is to a recognised industry balance date. For pipfruit orchardists the recognised industry balance dates fall between 31 March and 30 June.

Where there is a recognised industry balance date, a taxpayer in that industry cannot adopt it automatically. Inland Revenue considers each approval for a change of balance date individually, and any taxpayer must apply in writing before we will allow a new balance date. The information we need is outlined in Tax Information Bulletin, Volume Three, No. 9 of June 1992.

Farm Ownership Rebate

Section 49 - Rebate for Savings in Special Farm, Fishing Vessel, and Home Ownership Accounts: A taxpayer opened a farm ownership account, but for various reasons it was not possible for him to purchase a farm and the money was transferred to a home ownership account. The farm account was thus closed. As a consequence, the taxpayer had to repay some of the rebate received from operating the farm account. The taxpayer and his wife then purchased a home.

Subsequently, the couple decided to save for a farm. They reopened the farm account and wished to obtain the previous tax benefit, which had been repaid.

Although the taxpayer was able to re-establish the farm account, there is no provision in the Act to allow the taxpayer's request to reinstate the balance of the original rebate.

Tax Treatment of Foreign Teacher's Salary

Section 61 - Incomes Wholly Exempt from Tax: A teacher from Japan came to New Zealand to teach Japanese at a secondary school under a government-approved scheme. The question was asked whether the salary that was paid from Japan was exempt from New Zealand tax.

Japanese resident teachers coming to New Zealand to teach Japanese are exempt from paying tax in New Zealand under section 61(38), where the programme has the approval of the Ministry of Education.

Tax Exemption - Sporting Bodies and Other Non-Profit Groups

Section 61 - Exempt Income: An arts group considered that it was unfair that sports bodies were able to get a full tax exemption whereas they could not.

Section 61(30) specifically exempts from income tax the income derived by an *"amateur sports promoter established substantially or primarily for the purpose of promoting any amateur game or sport... for the recreation of the general public..."*. The section also requires that the income cannot be used for any member's private pecuniary profit.

This subsection exempts amateur sports bodies. Arts groups are not amateur sports promoters, so the section cannot apply to them. However, an arts group may be able to gain tax exemption as either a "charity" or a "non-profit body" under other provisions within section 61.

To be exempted as a charity, under section 61(25) income must be derived for charitable purposes. Charitable purposes include "*... any other matter beneficial to the community*". That subsection also requires that the income cannot be derived for any individual's private pecuniary benefit.

Section 61(34) exempts from income tax the first $1,000 of income that a non-profit body derives, again provided no individual person derives a private pecuniary benefit.

Company Making a Donation to a Club

Sections 61(30) and 65 - Items Included in Assessable Income: A company wanted to make a donation to a sports club (a recognised non-profit body) on the condition that the cash donation was used to purchase sports equipment. The company wanted to know if the gift would create tax implications for the club.

The first point to address is whether the club is exempt from tax. As the above item notes an amateur sports promoter is exempt from tax. Thus, if the sports club satisfies the requirements of section 61(30) it is exempt from tax on its income. Failing that, the next consideration is whether the gift has the character of income.

Inland Revenue considered that this type of donation would effectively be an unconditional gift. The payment would be voluntary and all parties involved would receive no identifiable direct valuable benefit from the purchase of the sports gear. Accordingly the gift would not have the character of income. It would not be assessable income to the club even if the club could not satisfy the requirements of section 61(30).

The company itself may have a gift duty exposure depending on the amount of this and other gifts made. Gifts totalling over $27,000 in a twelve month period are liable for gift duty.

Subdivision of Orchard into Lifestyle Units

Section 67 - Profits or Gains from Land Transactions: A taxpayer who owned and operated a vineyard for the past five years decided to remove the vines and subdivide his property into lifestyle units. He wanted to know whether any profits from the sale of the units were taxable.

Under section 67(4) there are established categories under which any profits or gains derived from the sale or other disposition of land are to be included within a taxpayer's assessable income. The categories of section 67(4) are as follows:

- land acquired with the purpose or intention of sale
- sales by land dealers
- sales by a developer or subdivider
- sales by a builder
- profits arising from rezoning of the land
- development or subdivision schemes entered into within 10 years of acquisition
- significant development or subdivision schemes not caught by any other categories.

Any profit from the sale of the lifestyle units will be assessable under section 67(4)(e). This is because the development constitutes a subdivision entered into within 10 years of acquisition. When calculating the profit, the value of the land at the date of beginning the undertaking or scheme (in this case the start of any activity to allow the subdivision of the land into lifestyle units) may be used.

Forestry Company - Deductible Expenses

Section 74 - Income Derived From Use or Occupation of Land: A company considering establishing a forestry business wanted to know what expenses were deductible against its forestry income.

In addition to the general deduction provisions of the Act, section 74 provides specific rules for income from using or occupying land.

Indirect and administrative costs together with depreciation on forestry plant and machinery are deductible under section 74 on a current year basis. This basis of deductibility is available to any person (including a company) who carries on a forestry business on land in New Zealand. The range of expenses that are deductible in the income year in which they are incurred covers the following:

- rent, rates, land tax, insurance premiums, administrative overheads, and other like expenses
- weed control (excluding releasing), pest control, disease control, or fertiliser application undertaken after planting the forest
- interest on money borrowed and used as capital in the forestry business
- repairs and maintenance of plant, machinery, or equipment used primarily and principally in
  - planting or maintaining trees on land on which the taxpayer carries on the forestry business; or
  - preparing or otherwise developing the land for forestry operations of the taxpayer
- repairs and maintenance of land improvements (excluding trees) effected on the land used for the forestry business (such as roads, fences, and dams).

Costs of constructing temporary access tracks are fully deductible to a forestry business in the income year in which they are incurred, provided certain conditions are met.

Income Equalisation Scheme and Kiwifruit Growers

Section 179 - Hardship as Grounds for Refund from Income Equalisation Reserve Accounts: Several kiwifruit growers requested a blanket ruling for growers affected by the reduced export returns for kiwifruit. They wanted to use the income equalisation scheme to defer the recognition of income in 1992, and to offset that income into either the 1993 or 1994 income years. The growers also asked about the possibility of making the deposit for a nominal period only (to satisfy the requirements of the Act) and if this was possible, how short this period could be where the hardship claim is self-evident.

The income equalisation scheme allows taxpayers engaged in farming, agriculture, fishing, or forestry to even out fluctuations in income from year to year. Where a taxpayer in one of these industries makes a payment to Inland Revenue within a specified period, s/he can deduct the amount of it from a nominated year's income (being either the year in which the payment was made, or the preceding year). Generally refunds from the scheme are assessable in the income year in which the taxpayer applies to Inland Revenue for a refund.

Except in specified circumstances, a payment cannot be refunded within 12 months of when it was made. Where the Commissioner is satisfied that a refund is necessary to avoid a taxpayer suffering serious hardship, a refund may be made within 12 months of a deposit being made.

In this case the Commissioner did not consider it appropriate to issue a blanket approval for refunding deposits made by these kiwifruit growers. Inland Revenue will consider each application on its own merits.

Rate of PAYE Deductions for Domestic Purposes Beneficiary

Section 343 - Amounts of Tax Deductions: A taxpayer receiving the domestic purposes benefit also worked 20 hours a week. This part-time job reduced the benefit to under $100 per week; an amount less than her part-time earnings. The taxpayer wanted to know why she paid primary tax on her benefit, and secondary tax on her wages, which were the larger part of her income.

Under section 343(1) an income tested benefit is deemed to be a person's primary income. Any additional earnings from employment are therefore "secondary income" and taxable at 28 cents in the dollar. PAYE deductions are merely an interim payment towards the actual annual liability - which is based on the total income that a person receives for the year.

Inland Revenue accepts that the secondary rate will be inappropriate in some cases. Where only a small proportion of the income is over $9,500, the secondary tax rate may result in too much tax being deducted. In these cases, Inland Revenue will refund the overpayment when we issue an assessment after the taxpayer has filed a return. If the taxpayer wished to have the correct amount of tax deducted at the time, she could apply to Inland Revenue for a special tax code. In this case a special tax code would reduce the PAYE deducted from the wages.

Pay-Period Taxpayer - Definition

Section 356 - Interpretation Pay-Period Taxpayer: A taxpayer asked for an interpretation of the term "pay-period taxpayer". The significance of the term is that a pay-period taxpayer's liability is determined exclusively by tax deducted at source. (A "pay-period" taxpayer may still file a return if s/he wishes.)

Section 356(2) defines a pay-period taxpayer as a natural person whose only income for a particular income year was from employment and/or interest and dividends, and whose total income derived either:

- was not more than $9,500; or
- was not more than $20,000 and did not include any income from employment; or
- was not more than $20,000 and included $1,500 or less in interest income.

In addition, the salary and wages must have been subject to the full and correct amount of PAYE deduction, and the correct amount of resident withholding tax must have been deducted from any interest and dividends.

Taxpayers who receive national superannuation cannot be "pay-period taxpayers" if their total other income exceeds $3,120.

Some taxpayers cannot be "pay-period taxpayers". Examples of these are shearers, or people who had to make financial support under the Child Support Act 1991.

Generally, pay-period taxpayers have their tax liability determined primarily by the PAYE amount deducted from their pay during the year. Rebate entitlement may also be taken into account in the rates under different deduction codes.

Guaranteed Minimum Family Income for Person Receiving Withholding Income

Section 374E - Guaranteed Minimum Family Income Credit of Tax: A taxpayer who had a family and whose income was below the Guaranteed Minimum Family Income (GMFI) threshold, asked whether he was entitled to receive GMFI.

To qualify for GMFI a taxpayer must be in employment and be receiving a "source deduction payment", as defined in section 6. The taxpayer in this case was a casual agricultural worker. Payment for this type of service comes within the definition of withholding payment income. The definition of source deduction payments includes withholding payments, so this taxpayer would be eligible to receive GMFI

Goods and Services Tax Act 1985

Advertising Prices as GST Inclusive or Exclusive

A taxpayer asked whether the GST Act required registered persons to advertise their goods on a GST inclusive or exclusive basis.

There is nothing in the Act that requires traders to advertise their goods on either a GST inclusive or exclusive basis. The only requirement is that tax invoices must state clearly either the amount of tax charged or that the total price charged includes tax.

However, the advertiser may need to comply with the provisions of the Fair Trading Act 1986.

GST Consequences of Estate Distribution

Section 5 - Meaning of Term Supply: A farming estate was registered for GST. Following a deed of family arrangement the estate was wound up. This resulted in the distribution of the farm and livestock to one beneficiary and a vehicle and some cash to another. The trustees and beneficiaries wanted to know the GST consequences of the distributions.

The estate (the registered person) is ceasing its taxable activities. Section 5(3) requires the estate to account for GST on assets that it holds. If the beneficiaries are registered for GST, they will be able to claim a GST input tax credit on the assets they receive that are to be used in a taxable activity.

The exception to section 5(3) is where goods and services are supplied as a going concern. In this particular case the land and livestock were capable of being a "going concern". Therefore, this was considered to be a going concern and the supply was zero-rated.

GST Charged on Local Authority Rates

Section 6 - Meaning of Term "Taxable Activity": A ratepayer expressed concern that GST was charged on local authority rates and considered that this was a tax on a tax.

Section 8 provides that GST is to be charged on all supplies of goods or services as part of a taxable activity. All activities carried on by a local authority are deemed to be taxable activities. The local authority is deemed to make a supply of goods and services under section 5(7)(a) when an amount of rates is payable to it, so GST is payable on that supply.

Registration Applies to All Taxable Activity

Section 8 - Imposition of GST on Supply: A farmer who was registered for GST was intending to sell a block of bare land on which there was a residential dwelling. The farm land was valued at $150,000 and the dwelling is valued at $90,000. The farmer wanted to know whether GST should be charged on the transaction.

The supply of farmland by a registered person falls within the terms of section 8. When farmland and a residential dwelling are sold in one transaction, we consider that the single transaction can be "apportioned" or "divided" into two separate supplies for GST purposes. The first is the supply of land, and the second is the supply of the residential dwelling. In the above case the supply of the farm land is a taxable supply and GST would be charged on the value of the farm land ($150,000). The supply of the residential dwelling is a private sale and no GST is charged.

See Tax Information Bulletin, Volume 3, Number 5 of March 1992 for a more detailed commentary.

Non-Resident Company Providing Services in New Zealand

Section 8 - Imposition of GST on Supply: A non-resident company considering doing work for a New Zealand company wanted to know of any GST implications.

Section 8(2)(b) provides that any services supplied by a non-resident to a GST registered person in New Zealand will not attract GST if those services are for the purpose of the registered person's taxable activity. The services are deemed to be supplied outside New Zealand, and GST is not charged unless both the supplier and recipient agree that it should be.

Charging GST when not Registered

Section 8 - Imposition of GST on Supply: A question was asked whether taxi licensees who aren't registered for GST purposes have to return GST when charging their fares on a GST inclusive basis.

Taxi licensees who aren't registered for GST, and whose annual turnover is $30,000 or less, should be charging on a GST exclusive basis. An unregistered taxi licensee cannot charge GST, and consequently, cannot claim that a fare is GST inclusive.

If an unregistered person charges GST then that person is required to account for the GST so charged.

If the licensee's turnover is less than $30,000 but the taxi company requires him / her to charge a GST inclusive fare, then s / he should register for GST.

GST Payable on Sale of a Business Asset

Section 11 - Zero-Rating: A taxpayer asked whether GST would be zero-rated on the sale of a business workshop. The vendor retained the remaining assets.

For zero-rating to apply under section 11(1)(c), the sale must be of a taxable activity as a going concern to another registered person. Essentially, this means that the purchaser must be registered for GST, and s / he must be capable of carrying on the activity as purchased.

In this case, the taxpayer was not selling the business, only an asset of the business. The issue is whether the workshop was capable of operation as a separate business to qualify as a "going concern". In this case Inland Revenue did not consider that the workshop could be operated on its own. Because of this the taxpayer would not be able to zero-rate the sale of the workshop as a going concern, so GST would be chargeable at the standard rate.

Supply Made to Agent

Section 11 - Zero-Rating: Company A made repairs to containers used for international transport by an International Shipping Company - Company B.

(i) Repairs to the containers were carried out by contractors contracted to Company A.

(ii) The contractors' invoices were a charge to Company A.

(iii) Company A invoices Company B with the contractors' charges without any further fees being added.

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Company A asked what the correct GST treatment would be.

Under section 11(2)(c)(ii), the services provided directly in connection with the containers would be zero-rated.

In addition, under section 6O(2), where a supply is made to an agent, (Company A), on behalf of another person who is a principal, (Company B), the supply is deemed to be made to the principal.

Business Sold as Going Concern, but Major Assets Leased

Section 11 - Zero-Rating: A taxpayer who was selling his business asked whether the sale was one of a going concern (and therefore, zero-rated). The taxpayer was selling all the assets of the business to a single purchaser, but retaining the land used in the business. The sale and purchase agreement for the assets provided that the vendor would lease the land to the purchaser so s/he could continue to operate the business in the same manner as the vendor. Both parties were registered for GST.

The sale of the business assets in conjunction with the lease of the land enables the continuity of the business. Therefore, the sale was considered to be one of a going concern.

Self Billing - Licensed Motor Vehicle Dealers

Section 24(2) Licensed Motor Vehicle Dealer - Invoice Self-Billing: A licensed motor vehicle dealer asked Inland Revenue about the invoice requirements for licensed motor vehicle dealers generating GST tax invoices on a self billing basis.

Inland Revenue has given a class approval to members of the New Zealand Motor Vehicle Dealer's Institute to use self-billing tax invoices.

Applications for approval on a class basis must be made to the Taxpayer Services Directorate at Inland Revenue's Head Office, PO Box 2198, Wellington.

Child Support Act 1991

Secrecy Provisions

A liable parent asked Inland Revenue for a copy of the estranged partner's application to the Child Support Agency.

We refused to release this information under Section 18(a) of the Official Information Act 1982 and section 13 of the Inland Revenue Department Act 1974. We must withhold this information to protect individual privacy; to release it would be a breach of that privacy. We give the same level of protection to the information that we receive from liable parents.

Under section 28(3) of the Official Information Act 1982, the Ombudsman can investigate and review a refusal to release information, and make it available under section 12 of that Act.

Liable Parent - Increase in Income

Section 29 - Basic Amount of Child Support Payable: A liable parent was about to start work in a job that was paying approximately $29,000 gross per annum. This meant that his liable parent contribution would increase from $10 per week to $36 per week. He also had custody of another child, and he considered that the increase was unfair.

In such situations a liable parent has the option to apply to the courts for a variation to his/her liable parent contribution.

To determine the amount of child support that a liable parent must pay, there is a formula assessment that includes a living allowance component to take into account the liable parent's living arrangements. The living allowance is based on certain social security rates, and also takes into account how many dependants live with the liable parent.

Non-Taxable Lump Sum - Effect on Child Support Liability

Section 29 - Basic Amount of Child Support Payable: A taxpayer asked whether receiving a tax free lump sum payment affected his child support liability.

The lump sum payment from the insurance company was not taxable. Since child support is based on taxable income, the payment is not included when calculating the child support liability.

However, if special circumstances exist, a custodial parent may apply to the Family Court for a departure order on the grounds that the formula assessment produces an unfair result because of the income, earning capacity, property, and financial resources of either the other parent or the child.

Liable Parent Departure Order - Court Procedures

Section 104 - Application for Departure From Formula Assessment in Special Circumstances: A liable parent asked about the respective parties' representation procedures at departure order proceedings.

Under section 104(3), the parties to a departure order hearing are the custodial parent and the liable parent. This is regardless of whether the custodian is a beneficiary or not. The rationale for this is that the custodian is the other party directly involved and has a real interest in the outcome of the court case. Accordingly, the custodial parent is served with all the court papers, as the respondent in the case.

Under section 125 Inland Revenue's Child Support Agency can intervene in the proceedings if they wish. The appearance of the Agency is discretionary and not mandatory. If they decide to intervene, the Agency have the same rights as a party to the proceedings.

If the Agency intervenes this will not prevent the custodial parent from being represented in his/her own right. It is up to the custodian to decide whether to be represented in court.

The Child Support Agency is intervening in most departure order cases, to make sure that the court is presented with information about the objects of the Act.

Miscellaneous

Forestry Partnership - Limit on Number of Partners

Section 456 of the Companies Act 1955 - Prohibition of Partnership with more than 25 Members: A partner in forestry partnership asked why the maximum number of persons in the partnership was limited to 25.

Section 456 limits the number of people that may form a partnership to 25. There is an exemption to this limitation for those professions or callings that the Governor General declares by Order in Council are not customarily carried on by a body corporate (such as accountants and solicitors). These professions are allowed up to 50 partners.

Note: Inland Revenue does not administer the Companies Act 1955.

Legal Decisions - Case Notes

This section of the Tax Information Bulletin sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, the Court of Appeal and the Privy Council.

We have given each case a rating as a reader guide to its potential importance.

- ••••• Important Decision
- •••• Interesting Issues Considered
- ••• Application Of Existing Law
- •• Routine
- • Limited Interest

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

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

Contents

Previously Published Cases - Appeal Notes

TIB Volume Four, No.6

James Bull Ltd v CIR - HC M 52/89: The taxpayer is appealing this decision to the Court of Appeal.

TRA 92/94, 92/95 and 92/96: The taxpayer is not appealing these decisions.

CIR v Watson - HC M 70/91: Inland Revenue is not appealing this decision.

TIB Volume Four, No.7

TRA 92/103 and 92/106 (Listed in TIB as TRA 94/92 - this was actually the Decision Number): Inland Revenue is not appealing this decision.

TRA 91/140: The taxpayer is not appealing this decision.

Estate of R E Turner v CIR - HC M 43/92: Inland Revenue is not appealing this decision.

TIB Volume Four, No.8

TRA 91/160: The taxpayer is not appealing this decision.

TRA 92/40: The taxpayer is not appealing this decision.

L R McLean and Company and Others v CIR (1993) 15 NZTC 10,100: The taxpayer is appealing this decision.

Deduction for University Fees

Rating: ••

Case: TRA No. 91/190

Act: Income Tax Act 1976, section 104, 105 and 106(a).

Keywords: *"Expenditure incurred prior to commencing business", "non-deductible employee expense"*

Summary: This case concerns the deductibility of University fees that a taxpayer incurred before he went into business.

Facts: In the 1989 calendar year the objector successfully undertook a Diploma of Business course at University. He was employed as an architect until 18 November 1989, at which time he started business as a self-employed architect. The fees were payable in February 1989, but 2/3 of them were not paid until December 1989. The objector sought to deduct the costs of the University course from his business income, but the Commissioner disallowed them.

Decision: Judge Barber found that the Commissioner acted correctly in disallowing the deduction.

Expenditure of this type has been non-deductible to employees since 1 April 1988. To get a deduction, the objector therefore needed to show that the course expenses were necessarily incurred in the course of his architectural business. However it was found that the expenditure was incurred before the establishment of the objector's business, i.e., before the start of any income earning process to which the expenditure could be related. The objector got no assistance from the fact that he paid most of the course fees in December 1989, after he became self employed, because the relevant time to consider deductibility is when the expenditure is incurred (i.e., became due - February 1989 in this case), not when it is actually made. The objector incurred the expenditure in preparing to set up in business as an architect, not in the course of that business. It was therefore capital rather than revenue in nature and not deductible.

Comments: We do not know if the taxpayer will be appealing this decision.

Undisclosed Income

Rating: •

Case: TRA No. 92/27

Keywords: "Wilfully or negligently", "with intent to evade"

Summary: This is an objection against the Commissioner's decision to impose penal tax (at 100% of the deficient tax) on income undisclosed over a period of four years. The Taxation Review Authority concluded that the Commissioner had not proved that the taxpayer had the necessary intent to evade tax.

Facts: The taxpayer company was a funeral director. From 1986 to 1989, it paid its employees in cash. Some of those employees rented accommodation in the funeral parlours from the taxpayer. They paid their rent in cash when they

received their salaries. Generally, the rent payments equalled about 80% of the living expenses of the taxpayer's working director. He would draw those from the company in cash when the salaries were paid. The taxpayer's accounting system at that time did not record the rental income in its accounts. Consequently, the taxpayer did not return that income in its income tax returns. The failure was discovered in 1989 when a new person was employed to manage the taxpayer's accounts. The taxpayer filed amended returns when its director learned that Inland Revenue was investigating the taxpayer's rental activities.

The working director's evidence was that he had intended neither to fail to return the rental income nor to avoid the tax on it. He had believed that the cash withdrawals had been "sorted out for Accounts". He attributed the failure to return the rental income to the inadequate accounting system in place during that period. Counsel for the taxpayer submitted that this was a credible explanation for the failure to return the income and raised a reasonable doubt that there was any intent to evade.

The Commissioner claimed that the director's experience and seniority in the company would have made him aware of these discrepancies. Therefore, the taxpayer had wilfully or negligently made a false return with intent to evade the tax.

Decision: Judge Barber assessed the working director to be a credible and honest witness, and accepted that he had no actual intent to evade tax. Neither did the director's conduct involve the necessary degree of recklessness for a criminal intent to evade tax. The Judge concluded that, having failed to establish, to the criminal standard of proof, that the taxpayer intended to evade tax, the Commissioner could not charge penal tax on the deficient tax.

Comments: Inland Revenue has not yet decided whether to appeal this decision.

Interest on Tax in Dispute

Rating: • • •

Case: Commercial Union General Insurance Company Limited v Commissioner of Inland Revenue

Act: Income Tax Act 1976, sections 34 & 34A

Keywords: *"Tax in dispute", "refund", "properly payable", "effective refund"*

Summary: This was an expedited test case on a "short point of statutory interpretation". The test case replaced an original case stated on trading stock losses, which was resolved when the Commissioner subsequently allowed deductions for most of the losses.

After the objection was resolved, there was $285,171.63 of refundable tax. (This was how much the company had paid on top of the amount that turned out to be "properly payable" once the objection was settled.) The test case considered how much interest the Commissioner was liable to pay on that amount.

Facts: In the 1986 income year the taxpayer claimed a deduction for unrealised losses on shares held, on the basis that they were trading stock. The Commissioner disallowed this claim and the taxpayer objected, but paid the full tax in dispute without prejudice. In the 1987 year, the taxpayer claimed those 1986 losses

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(which were by then realised), consistent with the Commissioner's 1986 assessment. Since the 1986 objection was subsequently allowed, this effectively amounted to a "double deduction" - the same losses having been claimed in 1986 and 1987.

After the Commissioner disallowed the losses in the 1986 year, the taxpayer paid the tax shortfall for that year and claimed the loss in the 1987 year. The Commissioner did not challenge this action. The taxpayer claimed interest on the $285,171.63 for the period form 7 March 1988 to 16 March 1993 (when the case stated was settled). However, the economic substance was that the taxpayer was "out of pocket" for the 1986 year only, as it had claimed the losses in the 1987 year. The Commissioner's primary argument was that the tax had been effectively refunded in the 1987 year when the losses were allowed so the taxpayer received a benefit equating the refund due on 7 March 1988.

Decision: The language of sections 34 and 34A is clear and does not permit the type of equitable adjustment of accounts argued for by the Commissioner. The tax that had been overpaid for the 1986 year was qualifying tax in dispute for the purposes of section 34A. If a taxpayer succeeds in an objection, interest is payable on the amount of tax required to be refunded - from the date the excess was paid until the date it is refunded. The account adjustment or "effective refund" by the Commissioner was not a "refund" for the purposes of section 34A. The taxpayer was entitled to a refund of tax overpaid for the 1986 year, with interest as claimed.

Comment: The Commissioner will not be appealing the decision.

Reference: Technical Rulings Chapter 78

Assessability of Aeroplane Game Winnings

Rating: • •

Case: TRA 92 / 139

Act: Income Tax Act, sections 65(2)(e), 4(1)(a)

Keywords: *"Aeroplane game", "assessable income", "windfall capital gain", "deemed dividend"*

Summary: Profits that the objector made by participating in an "aeroplane" game were assessable income under the third limb of section 65(2)(e). In addition, the Judge found that Inland Revenue's assessment of dividends made on the basis of an assets accretion method was incorrect.

Facts: The objector began playing the "aeroplane game" in 1987. The game has a pyramid structure - the "pilot" sells rights to enter the game as "seats" on the aeroplane - the seats cost $750 each. The pilot runs the game and has to attract two co-pilots and eight passengers. The objector received $6,000 for his flight as pilot. The Commissioner assessed this amount under section 65(2)(e) as income for the year ended 31 March 1988. The objector argued that it was a windfall capital gain.

The Commissioner also assessed the objector for an amount of $9,147.66 for deemed dividends in the 1989 financial year, on the basis of an asset accretion review which indicated suppressed sales of that amount from the objector's engineering business.

Decision: Judge Barber held that the dominant purpose of the aeroplane game was to make a profit. The activity that the objector engaged in had the hallmarks of a small business venture. Judge Barber held that the elements of the third limb of section 65(2)(e) had been met, i.e., a profit had been derived from carrying on an undertaking or scheme for the purpose of making a profit.

Judge Barber held that the cash which the Commissioner had deemed a dividend arose from the sale of capital items, the profit the objector had made from the aeroplane game and the saving in rent and living expenses the objector obtained from living with his girlfriend's father. Accordingly, the Judge held that the Commissioner had acted incorrectly by including the $9,142.66 in the objector's assessable income for 1989.

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

Reference: Technical Rulings Chapter 12.9.4

Clarification of Earlier Case Note

We have been asked to clarify the note in the case note on the Privy Council decision in *Hadlee and Sydney Bridge Nominees Ltd* v *CIR* (1993) 15 NZTC 10 106 published in Tax Information Bulletin Volume Four, No.8 of April 1993.

The note relates to their Lordships consideration of the decision in *FCT* v *Everett* 80 ATC 4 076. Their Lordships considered the decision in *Everett* where the High Court of Australia found that there was a valid assignment of a partner's interest in a professional partnership as that interest constituted a transfer of a proprietary interest. Their Lordships, however, concluded that the principle in *Everett* would not normally be applicable to the position of partners in New Zealand.

Because their Lordships found that there was no valid assignment, they did not find it necessary to consider the additional grounds under sections 10 and 99 for the Court of Appeal's judgment. The Court of Appeal's reasoning on those additional grounds stands and will be applied to appropriate cases.

Due Dates Reminder

June

5 PAYE deductions and deduction schedules 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 deduction schedules for first 15 days of June 1993 due - "large" employers

PAYE deductions and deduction 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.

July

5 PAYE deductions and deduction schedules for last 15 days of June 1993 due - "large" employers only.

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

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

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

First instalment of 1994 student loan interim repayment due for taxpayers with March balance dates.

Second instalment of 1994 student loan interim repayment due for taxpayers with November balance dates.

Annual income tax return due for non-IR 5 taxpayers with balance dates from 1 October 1992 to 7 May 1993

20 PAYE deductions and deduction schedules for first 15 days of July 1993 due - "large" employers

PAYE deductions and deduction schedules for June 1993 due - "small" employers.

Gaming Machine Duty return and payment for month ended 30 June 1993 due.

RWT on Interest deducted during June 1993 due for monthly payers.

RWT on Dividends deducted during June 1993 due.

Non-Resident Withholding Tax (or Approved Issuer Levy) deducted during June 1993 due.

FBT return and payment for period ended 30 June 1993 due.

31 GST return and payment for period ended 30 June 1993 due.

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