Releasing Official Information about Taxpayers

The Chief Ombudsman recently reviewed Inland Revenue's policy on releasing factual information from our tax audit and investigations reports, and on releasing details of anonymous information that we receive.

Audit and Investigation Reports

Following the Ombudsman's review, we have defined more clearly our rules for releasing material from these reports.

We will release factual material from these reports, with certain exceptions. The exceptions are material which discloses our procedures and material where release would constitute premature disclosure of evidence. Further, we will not release comments, judgements or opinions contained in these reports.

When Inland Revenue releases an edited report to a taxpayer, we have to show where information has been withheld, and the reason why we are withholding it (e.g., disclosure of Inland Revenue procedures, premature disclosure of evidence, or comments, judgements and opinions).

Anonymous Information

Anonymous information may be one factor we take into account when we start an investigation into a particular taxpayer's taxation affairs. However, we don't rely on such information to substantiate a discrepancy, either when making a reassessment after an investigation or in any consequent judicial proceedings. If we do use anonymous information, it is as a "pointer" only; any taxpayer's actual taxation liability must be established by our own investigations.

We will not divulge the existence of anonymous information. If we receive a request for details of anonymous information, we will decline it under section 13 of the Inland Revenue Department Act 1974.

The Ombudsman's Office has dealt with numerous complaints from people seeking the identity of informants who have provided information about them to Inland Revenue. We have consulted with the Ombudsman, and between us we've agreed that it is vital that Inland Revenue does not release information we receive in confidence, for the following reasons:

(a) Confidentiality - informants must know that their identities will remain confidential.

(b) Defamation - some anonymous letters and telephone calls we receive clearly contravene the laws of defamation. Any litigation that resulted from Inland Revenue releasing details of anonymous information received could be prejudicial to our ability to administer the Inland Revenue Acts.

(c) Illegal Activities - we collect revenue from all types and classes of taxpayer. Inland Revenue does not discriminate between legal or illegal activity, moral or immoral activity. Anonymous information can relate to taxpayers operating illegally.

Taxpayers who engage in illegal activities must have the assurance that information we obtain on their activities is used solely for the purpose of the Inland Revenue Acts. Not even the Police can access this information.

(d) Safety - the safety of informants is of major concern. If we gave details of anonymous information to the taxpayer concerned, it could prejudice the physical safety of the informant or some other person. It could be possible for a taxpayer to incorrectly/correctly work out the identity of an informant, and cause injury to that person.

Official Information copy available

There is a copy of Inland Revenue's Technical Rulings Chapter 8; "Official Information" available for viewing at the counter section of your local District Office. Anyone may read this on request.

Exemption D4: Exemption from the Requirements of Section 64H(1) of the Income Tax Act 1976

Section 64H(1) of the Act requires anyone who is a party to an interrelated financial arrangement to notify the Commissioner of it. Section 64H(2) permits the Commissioner to exempt certain transactions. The existing Exemption D3 exempts all interrelated financial arrangements from the disclosure provisions, except for those financial arrangements specified in the Schedule to the exemption.

The only difference between Exemption D4 and the previous Exemption D3 is the application date. Exemption D4 applies to the income year commencing 1 April 1993.

The full exemption is printed in Appendix A to this Tax Information Bulletin.

1993 Disclosure Exemption - International Tax Regime

Introduction

Under the International Tax regime, taxpayers must disclose interests that they hold in a foreign company or a foreign investment fund (FIF) at any time during an income year. These interests include shares in a foreign company or anything deemed to be a company (e.g. a unit trust), and any entitlement to benefit under a foreign superannuation scheme or a foreign life insurance policy, provided the interest is not excluded from the FIF rules.

Section 245W of the Income Tax Act requires taxpayers to disclose these interests. They must do so by completing an IR 4G form or an IR 4H form, as appropriate.

A 1993 disclosure exemption has been made under section 245W(2). This reflects changes introduced by the Income Tax Amendment Act (No.2) 1993 (covered in TIB Volume 4, No.9).

The exemption applies for the income year ending 31 March 1993 (including any non-standard 1993 balance date). The text of it appears in Appendix B to this TIB.

1993 disclosure requirements

The effect of the exemption is that the only types of interests that taxpayers must disclose for the 1993 income year are:

1. Interests in a FIF (use the IR 4H form):
   (i) acquired (or reacquired) at any time between 2 July 1992 and 31 March 1993 (both days inclusive); or
   (ii) where a taxpayer has calculated a 1993 FIF loss, and made an election under section 245Y(10) in relation to that loss.
2. Control and income interests in a foreign company where the income interest is an "income interest of 10% or greater", regardless of the country of residence of the foreign company (use the IR 4G form).

Scope of exemption

The scope of the 1993 disclosure exemption is not as wide as previous income years' exemptions. The main differences are:

1. An interest in a FIF did not have to be disclosed in earlier years, because of the non-application of the FIF regime to those years.
2. An "income interest of 10% or greater" held in a foreign company resident in a country not listed in the Seventeenth Schedule to the Act (containing low tax jurisdictions), did not generally have to be disclosed in earlier years.

   The 1993 disclosure exemption does not provide a similar concession. This means the disclosure obligation applies equally to a foreign company resident in any country, including the previously exempted Fifteenth Schedule (grey list) countries.

Interests in a FIF

FIF interests acquired before 2 July 1992 and still held on 1 April 1993

The FIF regime does not apply to these interests until 1 April 1993. This means the regime won't apply until the 1994 income year, except for taxpayers whose 1993 balance date falls after 31 March 1993. For these taxpayers, any 1993 FIF income or loss arising from 1 April 1993 to the 1993 balance date is deemed to be derived or incurred in the 1994 income year. This means they won't have to calculate it or include it in a tax return until the 1994 income year

The effect of the 1993 disclosure exemption is that FIF interests acquired before 2 July 1992 and still held on 1 April 1993 won't have to be disclosed in the 1993 income year.

FIF interests acquired before 2 July 1992 and not held on 1 April 1993

The FIF regime does not apply to these interests, so they won't have to be disclosed.

FIF interests acquired between 2 July 1992 and 31 March 1993

The FIF regime applies to these interests from their date of acquisition. This falls in:

- the 1992 income year for any taxpayer who has a late non-standard 1992 balance date, which falls after the date of acquisition;
- the 1994 income year for any taxpayer who has an early non-standard 1994 balance date, and a 1994 income year starting before the date of acquisition (no 1993 disclosure is required in this case);
- the 1993 income year in other cases.

Although the disclosure exemption effectively means that taxpayers must disclose FIF interests acquired between 2 July 1992 and 31 March 1993, the resulting FIF income or loss is deemed to be derived or incurred in the 1994 income year - and must therefore be calculated and declared in the taxpayer's 1994 tax return. This means that for 1993 only disclosure is required on the 1993 IR 4H form.

The main reason for requiring disclosure in the 1993 income year is so Inland Revenue can ensure that 1994 tax returns include any FIF income or loss arising during the 2 July 1992 to 31 March 1993 period.

FIF interests acquired after 31 March 1993

Income or losses from FIF interests acquired after 31 March 1993 are deemed to be derived or incurred in the 1994 income year. Taxpayers must include them in their 1994 tax returns, regardless of their 1993 balance date.

These interests don't have to be disclosed in the 1993 income year, and any resulting FIF income or loss doesn't have to be calculated until the 1994 income year.

FIF interests and election under section 245Y(10)

In limited cases, a taxpayer can utilise a 1993 FIF loss in the 1993 income year, instead of deferring it until the 1994 income year. Such cases include taxpayers:

- who acquired the FIF interest as part of a business transaction trading in such interests (e.g. share traders);
- who have calculated the FIF loss under the Branch Equivalent method and wish to offset that loss against 1993 attributed foreign income from a controlled foreign company (CFC) in the same jurisdiction as the FIF.

To utilise a 1993 FIF loss in the above manner, a taxpayer must make an election under s245Y(10). To do this, the taxpayer must file a 1993 tax return which includes the FIF loss calculated using the 1993 FIF income/loss worksheet, and make disclosure of the FIF interest on a 1993 IR 4H form,

You can get a 1993 FIF income/loss calculation worksheet by writing to:

International Tax Central Unit
Inland Revenue Department
P.O. Box 895
WELLINGTON

De minimus rule for natural persons

Where the total cost of all a natural person's FIF interests does not exceed $20,000 at all times during an income year, the interests held are deemed not to be FIF interests. This means s/he doesn't have to disclose them under the FIF rules. Note that any income derived under the other income tax provisions (e.g. dividends), must be included in his/her tax return as usual.

Once a natural person's interests exceed the $20,000 de minimus threshold at any point in time during the income year, the FIF disclosure and income or loss calculation rules apply to the full amount (and the entire income year), not just the amount exceeding $20,000.

De minimus rule and interests acquired between 2 July 1992 and 31 March 1993

In determining whether the $20,000 threshold has been exceeded, for an interest acquired between 2 July 1992 and 31 March 1993, the cost of interests acquired before 2 July 1992 (and still held on the date the post-2 July 1992 interest was acquired) must also be included, for this purpose only.

Where a natural person's interests exceed the aggregate $20,000 threshold , s/he must only make a disclosure in the 1993 income year of the FIF interests acquired between 2 July 1992 and 31 March 1993 (both days inclusive).

Example

Mr. A purchased 1,000 shares in a Hong Kong publicly listed company for $18,000 on 4 May 1992. On 23 August 1992, he purchased 750 units in a Jersey unit trust for $3,000.

The total cost of interests held on 23 August 1992 of $21,000 exceeded the $20,000 de minimus threshold, so they both constitute FIF interests.

However, only the 750 units costing $3,000 in the Jersey unit trust must be disclosed as an interest in a FIF for the 1993 income year. This is because that interest was acquired between 2 July 1992 and 31 March 1993.

Note that:

- The full $3,000 FIF interest must be disclosed even though the $20,000 de minimus threshold was exceeded by only $1,000.
- The FIF income or loss resulting from the $3,000 FIF interest, although generally derived or incurred in the 1993 income year, doesn't have to be calculated or included in a tax return until the 1994 income year.
- There is no requirement to disclose or calculate any FIF income or loss resulting from the $18,000 interest for the 1993 income year. The requirement to disclose or calculate any FIF income or loss on this interest in the 1994 income year will depend on whether Mr A still held this interest on 1 April 1993.

Interests in a foreign company

The legislative requirement to disclose an interest in a foreign company applies regardless of the company's country of residence. The 1993 disclosure exemption also makes no distinction.

Therefore for the 1993 income year, the obligation to disclose an interest in a foreign company resident in Australia (a country listed in the Fifteenth Schedule to the Act), is the same as that which applies to a foreign company resident in Hong Kong (a country listed in the Seventeenth Schedule to the Act).

The change requiring disclosure for previously exempted Fifteenth Schedule countries is partly due to the new Attributed Repatriation rules. These rules apply to an income interest of 10% or greater held in a control-

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led foreign company (CFC), for the CFC's accounting periods ending on or after 2 July 1992. The Attributed Repatriation rules apply regardless of the CFC's country of residence, and generally have effect for the 1993 income year.

In addition, disclosure of Fifteenth Schedule interests is required to monitor the use of the Sixteenth Schedule tax preferences and to help identify any tax preferences to be added to Part A of that Schedule (for the CFC regime). It also helps to identify any additions required to Part C of the Sixteenth Schedule (for the FIF regime).

Income interest of 10% or greater

In determining whether or not an interest in a foreign company is an "income interest of 10% or greater", the following interests must be included:

- income interests held directly in that foreign company and indirectly through any interposed foreign company;
- income interests held by associated persons (not being CFCs), as defined by s.245B.

Example

The disclosure exemption would not apply to an income interest held in a Cayman Islands company by a husband and wife (associated under s.245B(d)) of 5% each. This is because under the associated persons rule, they are each deemed to hold the interest of the other person and would both have an "income interest of 10% or greater" requiring disclosure.

Overlap of interests between the IR 4H and IR 4G forms

There may be instances where an income interest of 10% or greater held in a foreign company is also an interest in a FIF. This means an overlap in completing the disclosure forms may occur, since separate forms apply (an IR 4H for an interest in a FIF, and an IR 4G for an interest in a foreign company). In such cases, disclosure should be made on whichever form is the most appropriate. Specifically;

Use the IR 4H form to disclose:

- An interest in a foreign company which is a FIF (not a CFC) regardless of the level of interest held.

Use the IR 4G form to disclose:

- An interest of 10% or greater in a foreign company which is not a FIF or a CFC (e.g. a 20% interest in an Australian company which is not a CFC).
- An interest of 10% or greater in a foreign company which is a CFC (e.g. a 20% interest in an Australian company which is a CFC).

Note that

- An interest of 10% or greater in a CFC is not an interest in a FIF.
- An interest of less than 10% in a foreign company which is not a FIF (e.g. excluded under the Fifteenth Schedule exemption) doesn't have to be disclosed on either the IR 4G or IR 4H form, even though the foreign company may be a CFC.

Summary

For the 1993 income year, an interest held in a FIF does not have to be disclosed, unless the interest was acquired between 2 July 1992 and 31 March 1993 (both days inclusive), or in the limited circumstances when a 1993 FIF loss is able to be utilised in the 1993 income year.

An interest held in a foreign company does not have to be disclosed unless the income interest in the company is an income interest of 10% or greater. There is no differential treatment for the country of residence of the foreign company.

Depreciation Amendments

In April 1993 we sent out the Appendix to Tax Information Bulletin Volume Four, No.9. That appendix dealt with depreciation. Since we published it, we've learned that it contained a number of errors. We apologise for this, and we've included some amendment pages as Appendix C to this bulletin.

Interest Calculation Method for FBT Determined

Income Tax (Calculation of Interest on FBT) Regulations 1993

Introduction

Regulations setting the rate and method used to calculate interest on FBT came into force on 28 May 1993. Employers who elect to pay FBT on an annual or income year basis must pay interest on their Fringe Benefit Tax.

Background

From 1 April 1992, smaller employers have had the option of furnishing an annual Fringe Benefit Tax (FBT) return instead of quarterly returns. The Income Tax Act allows for the furnishing of annual returns where an employer's total tax deductions (gross tax deductions and specified superannuation contribution withholding tax) do not exceed $100,000 in an income year.

Employers who elect to pay FBT annually will pay an additional amount in the nature of interest. This interest compensates the Government for the deferred payment of tax because of the movement from quarterly payments to an annual payment. Section 336TC(3) of the Income Tax Act states that interest on FBT is to be calculated in accordance with regulations made by the Governor-General by Order in Council. These regulations are called the Income Tax (Calculation of Interest on Fringe Benefit Tax) Regulations 1993 (“the regulations”).

The regulations

The regulations determine the base rate of interest used to calculate interest when FBT is paid annually. The base rate has been set at 9% and can be amended by further Order in Council. As with the prescribed rate for low interest loans, the base interest rate will reflect market rates prevailing at any time.

The regulations also specify a formula which is used in conjunction with the base rate of interest to calculate interest on FBT. The formula compares the previous due date of each quarterly FBT payment with the new due date of the annual FBT payment or actual payment (whichever is earlier), to determine the amount of time the average quarterly FBT payment has been deferred.

For the purposes of the calculation the formula deems balance dates that do not fall on the last day of the month to be the last day of the month on which the balance date falls.

Employer requirements

In practice an employer need not apply the formula contained in the regulations. The base rate has been applied to the formula using an employer’s old and new FBT payment due dates to calculate a pre-determined rate. To calculate interest on FBT, the employer simply multiplies the pre-determined rate (which will be printed on the employer’s FBT return) by the total annual FBT liability.

The pre-determined rate

The pre-determined rate for employers who have elected to pay FBT annually in relation to employees other than shareholder/employees in terms of section 336TA is 4.37%. This rate was printed on the annual FBT return which was due on 31 May 93, and related to benefits provided for the year ended 31 March 93.

The pre-determined rates for employers who elect to pay FBT annually in relation to shareholder/employees in terms of section 336TB are as follows;

Month of Balance Date	Pre-determined Rate %
January	10.56
February	10.57
March	10.59
April	9.84
May	9.09
June	8.34
July	7.59
August	6.84
September	6.09
October	10.57
November	10.56
December	10.57

The applicable rate will be printed on the employer’s FBT return which is due on the employer’s terminal tax due date and relates to benefits provided during the employer’s income year.

Refunds

The pre-determined rate is calculated assuming payment of interest is made on due date. If payment is made before due date, interest will effectively have been overpaid. In these cases interest will be recalculated and the resulting credit refunded.

Income tax

Interest on FBT is fully deductible for income tax purposes as provided for by section 336TC(2)(c) of the Income Tax Act. Interest on FBT is deductible in the same year or years and to the same extent that the FBT to which that interest relates is deductible under section 140AA(1) of the Income Tax Act.

Application date

The regulations came into force on 28 May 1993.

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

Deduction for Loss from Misappropriation of Property

Section 164 - Misappropriation by employees and other persons engaged for purposes of business of taxpayer: A taxpayer whose employee had stolen petty cash and items of stock over two years asked if he could deduct the loss incurred for tax purposes.

Under section 164, a taxpayer can deduct any loss that s/he incurs while carrying on a business, if the loss -

- results from misappropriation of any property by an employee, and
- has not been taken into account already.

In this case, the taxpayer could only claim a deduction for the petty cash taken in the current year (to the extent that it isn't also included in the amount deducted as petty cash expenses in the profit and loss account).

The taxpayer had already claimed a deduction for the petty cash taken in the previous year, as it became part of the petty cash expenses in his profit and loss account. The stock taken in both the previous and current years was part of the "cost of goods sold" figure. The taxpayer could deduct the cost of it in each of these years as a purchase of stock. He could not claim a deduction for it under section 164 unless he had adjusted the "cost of goods sold" figure to exclude the value of the stolen stock.

Section 164(2) specifies circumstances which would deny a deduction, but none of these existed in this case.

Deduction of Rental Losses incurred while Taxpayer was Non-Resident

Section 188(3) - Carry-forward and set-off (of losses): A taxpayer returned to live permanently in New Zealand, after spending several years in Australia. He asked if he could carry forward the rental loss he incurred on a New Zealand rental property while he was a non-resident, and offset it against his income from employment since returning.

Under section 188(3), a taxpayer can carry forward a loss and offset it against income in a succeeding income year, as long as the loss would have been subject to New Zealand income tax if it had it been a profit instead (section 188(5)). Nothing in section 188 prevents a non-resident from carrying forward a loss once s/he becomes a resident.

As this taxpayer would have been liable for New Zealand income tax on any rental income, he can carry the loss forward and offset it against his employment income.

Deducting the Costs of an Energy Audit

Section 104 - Expenditure or loss incurred in production of assessable income: An energy consultant asked us if his clients could deduct for tax purposes the fees he charged them for advising where their businesses could save on energy consumption.

Under section 104, expenditure incurred in producing assessable income, or in carrying on a business for the purpose of producing assessable income, is tax deductible. Consequently, if the cost of the energy audit is incurred in the course of producing assessable income it will be tax deductible.

In general terms, energy audits commissioned by persons in business will be tax deductible, but those for private individuals will not be deductible.

Trusts must file Tax Returns

Section 9 - Annual returns by taxpayers: An executor of a trust asked if Inland Revenue could exempt the trust from filing tax returns because of its special circumstances.

Section 9 of the Income Tax Act requires every taxpayer (including a trust) to file an annual tax return in the prescribed form. A trust is a taxpayer for the purposes of this section. The only exemption from filing tax returns is in section 357(2); for "pay period taxpayers". A trust does not meet the definition of a pay period taxpayer, so it cannot be exempt under that section.

Inland Revenue has no authority to exempt a trust from filing returns, even in special circumstances.

Exemption from Resident Withholding Tax - Non-Profit Bodies

Section 327M(1) - Application for certificate of exemption: A non-profit body earned over $1,000 (but less than $2,000) in interest income in the previous income year.

Its registrar asked if the body was entitled to a certificate of exemption from resident withholding tax (“RWT”), since it expected its interest income to be less than $1,000 in the current income year.

Under section 327M(1)(i) a non-profit body may apply for a certificate of exemption if its income is both exempted under section 61(34) and has not exceeded $1,000 in the its most recently completed accounting year. Inland Revenue has no discretion to issue a RWT exemption certificate where a non-profit body has exceeded the $1,000 income exemption, but expects to earn less than $1,000 in the current year.

If the non-profit body’s income is assessed at less than $1,000 at the end of the current income year, any overpaid RWT will be refunded. The body could then apply for a RWT exemption certificate for the next income year.

The non-profit body could also apply for a RWT exemption certificate under section 327M(12) if, for example, it is likely to incur a loss.

NZ Superannuation paid to Overseas Resident

A taxpayer who lives in (and is a national of) the Netherlands asked whether his status as a non-resident for New Zealand income tax purposes would be affected if he had his New Zealand national superannuation paid into a New Zealand bank account.

The taxpayer will remain a non-resident for New Zealand tax purposes. Any interest he earns on money held in the New Zealand bank account will be subject to non-resident withholding tax at the rate of 10%.

Under Article 19, clause 2, of the Netherlands Double Tax Agreement*, any social security pension that is paid to a resident and national of the Netherlands is not taxable in New Zealand. As this taxpayer is both a resident and national of the Netherlands, his New Zealand sourced pension should not have tax deducted from it in New Zealand.

* Convention Between the Government of New Zealand and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income

Tax on Rounded Amounts

Section 343 - Amounts of tax deductions: A company’s computer payroll tax system was programmed to round the employees' gross taxable pay. The system rounded down to the nearest dollar for amounts less than 50 cents, and rounded up to the nearest dollar amounts greater than 50 cents. It then calculated tax on the rounded amount, and added to that tax the rounded down cents or subtracted the rounded up cents.

The company wanted to know whether this was allowable under the Income Tax Act.

Section 343 deals with the amounts of tax deductions. It states that tax must be deducted according to the Annual Taxing Act. If there isn't an Annual Taxing Act for any year, tax must be deducted according to the second schedule of the Income Tax Act. Effectively, employers must deduct tax at the rates shown in the tax deduction tables that Inland Revenue issues (these are based on the figures in the Income Tax Act).

There is no specific legislation that states that the nearest lower figure is to be used where the exact amount of earnings is not shown in the appropriate table. However, for both administrative purposes and the fact that tax is not payable on amounts of less than $1, it is generally more appropriate to use the nearest lower whole dollar value.

The method that the employer is using in this case is acceptable to Inland Revenue.

Deduction for Unpaid Wages Provision

Section 104 - Expenditure or loss incurred in production of assessable income: A company had a provision for wages payable on its 31 March 1993 balance date for work already carried out by its employees. It asked whether the provision was a tax-deductible expense for the 1993 year. The wages were paid on the first Wednesday in April 1993.

Section 104 allows a deduction for any expenditure incurred in gaining or producing assessable income, or necessarily incurred in carrying on a business for that purpose. Wages payable for work already performed constitute expenditure which has been incurred.

Under section 104A(2A)(a)(ii), monetary remuneration paid to an employee within 63 days of the taxpayer’s balance date is not part of any “unexpired portion” of accrual expenditure (under section 104A(2)), so it will not be added back to the taxpayer's assessable income under section 104A(4).

Accordingly, a deduction for wages payable is permitted under section 104. In this case, the wages were paid to the employees within 63 days of balance date, so section 104A(2A) deems the wages to have been paid in the income year ending 31 March 1993. The employer could claim a deduction for the provision.

Income Equalisation Minimum and Maximum Deposit Amounts

Sections 175 and 176 - Income Equalisation: A fruit farmer asked what were the minimum and maximum amounts that could be deposited in the Income Equalisation scheme for any accounting year.

The minimum amount that can be deposited is $200 (under section 176(3)), and the maximum amount (under section 175 and 176(2)) is limited to the taxpayer’s assessable income from the business of farming.

Loss Limitations

Section 188A - Losses Incurred in Specified Activities: A kiwifruit farmer asked what the implications of Section 188A were.

Ten classes of “specified activities” were covered by the loss offset rules of Section 188A of the Act. The legislation was intended to discourage the use of farming activities as tax shelters. Effectively, the limitation on a “specified activity” meant that losses incurred from an activity which was not a taxpayer's main business activity were subject to a maximum tax deductible loss of $10,000 in each income year.

For specified farming activity losses, this applied up to and including the year ended 31 March 1990. For losses incurred before the 1990 income year, any unabsorbed balance of such losses must be carried forward and offset, initially against any profit arising from the specified activity in the 1991 income year. Any balance remaining is then offset against income from other sources up to a maximum of $10,000. This process is repeated in 1992 and subsequent income years until the loss is extinguished.

Requirement to file a Tax Return when Incorrect Tax Code used

Section 344 - Application of Tax Codes Specified in the Tax Code Declarations or Tax Code Certificates: The taxpayer was asked to furnish a tax return for 1992 on the income from the unemployment benefit and a part time job. Both sources of income had tax deducted at the G tax code, and the taxpayer's total income for the year was less than $20,000.

Where an employee is receiving an income-tested benefit and other source deduction payments, s/he must use a “SEC” tax code for the other source deduction payments (section 344(1)). In this case, no exemption from filing a return can be given under Section 356(2). Because the income from the part time job did not have tax deducted at the correct rate, the taxpayer would not be deemed to be a pay-period taxpayer under Section 356(2).

Capital Cost of devising an Invention

Section 143 - Patent Expenses: A taxpayer asked if he could claim a deduction for expenditure incurred in obtaining a patent.

Section 143(1) gives Inland Revenue the discretion to allow a deduction for expenditure incurred during the year in connection with the grant, maintenance, or extension of a patent. The deduction can be made from assessable income in the same year the expenditure was incurred, if the taxpayer has used the patent to produce assessable income for that year.

Ordinarily the capital cost of devising an invention would not be allowable as a deduction. However, Section 143(2) provides that where a patent has been granted, Inland Revenue may allow such deduction as it thinks fit for any expenditure that the taxpayer incurs in devising the invention, if s/he has used the patent to produce assessable income for that year.

IRD Numbers on Estate Returns

Section 10 - Returns by Partners, Co-Trustees, and Joint Venturers: A solicitor asked what information Inland Revenue requires about the trustees of an estate.

The trustees are personally liable (to the extent of the estate's assets) for any tax that the estate owes, and for the filing any tax returns required under sections 10 and 11 of the Income Tax Act. Because of this, Inland Revenue requires each trustee’s name and IRD number to be shown in the trust/estate return of income.

Goods and Services Tax Act 1985

Gaming Duty and GST

A taxpayer asked how GST is calculated in relation to gaming machines.

GST is calculated on the difference between the coins paid into the machine and those paid out (i.e., the “banking” from the machine). Each machine has a cash box in which coins are held for payouts, and this box must be cleared out at the end of the month and added into the banking, so GST is not calculated on an artificially low figure.

Accident Rehabilitation and Compensation Insurance Act 1992

ACC Earner Premium on Mayoral Honorarium

Section 114 - ACC Earner Premium: A Mayor whose only source of income was from the Mayoral Honorarium wanted the ACC earner premium deducted fortnightly from that Honorarium.

All employees, self employed taxpayers and people receiving withholding payments must pay the earner premium (80 cents per $100 earned) on their employment or self employment income. The Mayor's Honorarium is a withholding payment, so the earner premium cannot be deducted along with the withholding tax. The premium will be calculated at the end of the income year when the Mayor files a tax return.

Child Support Act 1991

Shared Custody Provisions

A liable parent enquired as to when the shared custody provisions of the Child Support Act 1991 applied.

The shared custody provisions do not come into effect unless the liable parent has custody of the child(ren) for at least 40% of the nights in the child support year. The reason for this is that the custodial parent still incurs the costs of maintaining a home for the child even though the child is with the other parent.

Miscellaneous

Identification Required When obtaining IRD Number

A taxpayer asked why he had to produce his birth certificate when applying for an IRD number for himself.

At Inland Revenue, we need to have a system of allocating IRD numbers that maintains confidentiality, security and accuracy. Our present system relies on taxpayers being accurately identified before they get an IRD number.

We recognise that this system may involve a cost for the taxpayer in obtaining a birth certificate, but it is the most effective way of ensuring that IRD numbers are not issued in false names.

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.10

TRA 91/190:	The taxpayer is not appealing this decision
TRA 92/27	Inland Revenue is not appealing this decision
TRA 92/139	Inland Revenue is not appealing this decision

Overseas Company included in Group of Companies

Rating: • • • •

Case: Alcan New Zealand Ltd v Commissioner of Inland Revenue

Act: Income Tax Act 1976; sections 2, 85 and 191

Keywords: *"group of companies"*

Summary: The Australian parent of a company incorporated in New Zealand was included within "a group of companies" for the purposes of valuing trading stock.

Facts: Alcan New Zealand Ltd (Alcan NZ) is incorporated in New Zealand. The parent company, Alcan Australia Ltd (Alacan Australia) held 73.26% of the shares and 98% of the voting rights in Alcan NZ. It was entitled to 98% of Alcan NZ's dividends. Alcan Australia does not derive business profits in New Zealand.

Alcan NZ bought aluminium ingots and billets from Alcan Australia for processing into semi- fabricated aluminium products in New Zealand. In arriving at the closing value of trading stock for the 1988 and 1989 income years, Alcan NZ valued the aluminium on hand at cost to the group. That is, it regarded Alcan Australia as part of "a group of companies" for the purposes of section 85(4). This allowed the group to use the cost price to Alcan Australia rather than the cost price to Alcan New Zealand.

The issue is one of timing, as eventually all the stock will be sold or otherwise disposed of.

Inland Revenue's argument was that Alcan Australia could not be included within the meaning of the expression "group of companies" for the purposes of that definition in sections 2 and 191(3) and used in section 85(4). This is because Alcan Australia is not resident in New Zealand and doesn't derive assessable income in New Zealand.

The objector's argument was that Alcan NZ and Alcan Australia are a "group of companies" as defined in section 191(3). The various tests contained in the subsection were satisfied. Therefore, they were entitled to value their trading stock on a cost to group basis as provided in section 85(4).

Decision: The Court held that the words of section 191(3) of the Act are clear and should be given their literal meaning. Therefore "a group of companies" may include a company incorporated in New Zealand or elsewhere.

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

FBT and use of Work-Related Vehicle

Rating: • •

Case: TRA No. 92/180

Act: Income Tax Act 1976; section 336N(1)

Keywords: *"Fringe benefit", "conferring of a benefit of a private or domestic nature", "work related vehicle", "motor vehicle"*

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Summary: A garment manufacturing company whose husband and wife shareholders used the company car to transport stock from various outworkers to the shareholder's home was not liable for fringe Benefit Tax ("FBT") on the shareholders' use of the car because it was a "work related vehicle".

Decision: Judge Willy accepted the shareholders' evidence that they used their house for the purpose of making, storing and repairing garments made in the objector's business, and that the vehicle was not kept at the objector's factory work place because security there was inadequate.

Judge Willy was satisfied that there was no element of private use and enjoyment of the vehicle for the purposes of section 336N(1). The vehicle was used for the purpose of, and in the course of, carrying on the business. The vehicle was a "work related vehicle" for the purposes of 336N(1).

Comment: Inland Revenue is appealing this decision.

Interest Deductibility - Loan from Shareholder to Company

Rating: • •

Case: TRA No: 91/161

Act: Income Tax Act; section 106(1)(h)

Keywords: *"interest deductibility"*

Summary: The taxpayer successfully claimed a deduction for interest on money that he borrowed and lent to the company of which he was a shareholder. There was an expectation that the taxpayer would derive assessable income from the borrowed funds.

Facts: The taxpayer borrowed money to purchase shares in a company and also made a current account loan to the company.

Inland Revenue disallowed the interest deductions in both situations. Inland Revenue then conceded that the interest on money borrowed to acquire shares was deductible. The issue before the TRA was whether the taxpayer could deduct the interest on the money borrowed that he lent to the company.

Decision: The TRA held that providing that there is the necessary nexus between the capital advanced and the gaining and producing of assessable income in any income year, the interest on the money borrowed is deductible. The TRA did not accept Inland Revenue's submission that there was no possibility or expectation of any assessable income from the loan investment. It was found that the investor envisaged that interest would be paid and interest in fact was paid to the taxpayer. The taxpayer was entitled to deduct the interest on the money he borrowed to lend to the company.

Comment: Inland Revenue is not appealing this decision.

Tax treatment of Redundancy Payment from Third Party

Rating: • •

Case: TRA No. 92/114

Act: Income Tax Act 1976; section 68

Keywords: *"Redundancy payment"*

Summary: A payment made by a third party to buy industrial peace where there was no legal or moral obligation on the third party to do so was not a "redundancy payment" for the purposes of section 68 of the Income Tax Act 1976.

Facts: The taxpayer's employer company went into receivership and the taxpayer was made redundant. A redundancy agreement entitled the taxpayer and other employees to redundancy payments. The company could not afford to pay the employees. The employees took industrial action resulting in a third party, not associated with the employer, agreeing to pay the redundancy payments. Inland Revenue, once aware of the full facts of the case, assessed the payments in full to the employees.

The objector argued that the payments were "redundancy payments" and were entitled to concessionary tax treatment under section 68. The taxpayer argued that section 68 did not require the redundancy payment to be made by the employer. Alternatively, the taxpayer argued that the third party was an agent for the employer, or stood in the shoes of the employer.

Decision: Judge Willy found that the payments in question were not within the definition of redundancy payments for the purposes of the Income Tax Act 1976. There was no legal or moral obligation on the third party to make the payments. The third party made the payments to stop the redundant employees from picketing. The Judge did not agree with the objector that the third party was acting as an agent for the employer.

Comment: The taxpayer is not appealing this decision.

Penal Tax - Proof of Intent to Evade

Rating: •

Case: TRA No: 91/175

Act: Income Tax Act 1976; sections 416 and 420

Keywords: *"Penal tax", "intent to evade"*

Summary: The Taxation Review Authority held that Inland Revenue had not proved the taxpayer had intended to evade tax and therefore penal tax was not chargeable.

Facts: The taxpayer (a farm-worker) failed over a period of five years to return interest received from a number of banks and from savings stock. Most of the interest was from a six month renewable term deposit at one of the banks, where accruing interest was added to and reinvested with the original deposit. The taxpayer did not draw any money from the term deposit bank account during the five year period. The deficient tax totalled $6,034 and Inland Revenue had imposed penal tax of $6,030.

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The taxpayer's evidence was that he was under the impression that he did not have to include the interest in his returns at the time it was credited to his account. He thought tax was payable on the interest when he drew the money out.

Decision: Judge Barber assessed the taxpayer to be an "honest and truthful" witness and held that he did not intend to evade income tax by not declaring the interest. It follows that having failed to establish "intent to evade", Inland Revenue could not charge penal tax.

Comment: Inland Revenue is not appealing the decision.

Taxpayer's Onus of Proof - Asset Accretion Test

Rating: •

Case: TRA No. 92/161

Act: Income Tax Act 1976; section 65. Inland Revenue Department Act 1974; section 36

Keywords: *"Asset accretion test", "onus of proof"*

Summary: The taxpayer earned money through buying and selling motor vehicles. He did not return this income, or some rental income, in the 1989 or 1990 income years. The dispute centred around the amount of undeclared income which should be attributed to the taxpayer in those income years.

Facts: The onus of proof was on the objector to prove that the amount of income that Inland Revenue assessed was incorrect, and he had to provide evidence of the correct amount. Inland Revenue calculated the objector's income for the two years using asset accretion schedules which showed a significant increase in the objector's assets. The objector endeavoured to explain the cash deposits into his bank account as cash advances drawn on various credit cards.

Decision: Judge Willy found that the objector had failed to discharge the onus of proof that his income was a lower figure than that assessed by Inland Revenue. Lack of sufficient records, and any evidentiary basis for his explanations, led Judge Willy to find that the objector had failed to discharge the onus of proof. Inland Revenue's assessments were confirmed.

Comment: The taxpayer is not appealing this decision.

Liability to be registered for GST

Rating: • •

Case: TRA Case Q26 (1993) 15 NZTC 5,127 TRA No.92/170

Act: Goods and Services Tax Act 1985; sections 6(1), 33 and 51

Keywords: Liable to be registered, taxable activity

Summary: The taxpayers were liable for GST on the sale of a factory and the land on which it stands.

Facts: The objector partnership decided to subdivide land that they owned. They sold part of the property and decided to build a factory on the remainder of the land. The factory was intended to be leased to two companies of which the taxpayers were the principal shareholders.

The partnership borrowed money to finance the building of the factory and on-lent those funds to the companies. The companies built the factory and claimed a GST refund for the costs incurred in purchasing materials used for the building.

The companies got into financial difficulties. A bank-appointed receiver sold the companies' assets to discharge the debts owed to the bank. The factory and land was sold by the objector partnership. The partnership was not registered for GST. Inland Revenue assessed the objectors for GST on the sale of the land and factory.

The partnership's first letter of objection stated it was not liable to be registered for GST because it was not carrying on a taxable activity as the value of its taxable supplies did not exceed $24,000. The partnership sent in a further letter of objection, which was out of time, alleging that even if the objectors were liable to be registered then the registration could only relate to the land as the factory had been constructed by and paid for by the companies. Inland Revenue argued that the partnership was limited to the grounds of their first objection.

Decision: Judge Willy held that the TRA has all the powers vested in the Commissioner of Inland Revenue and that it could extend the time for the lodging of an objection. He accepted the late objection and considered the issues raised. He found that the taxpayers were carrying on the taxable activity of leasing commercial premises. The partnership and the companies were associated persons. The open market value of the lease was not less than $57,670. The taxpayers were liable to be registered for GST.

Comment: The taxpayer is not appealing this decision.

Grounds for Re-opening GST Assessment

Rating: •

Case: TRA No 92/178

Act: Goods and Services Tax Act 1985; sections 6, 31(1) and 31(2)

Keywords: *"Taxable activity", "re-open assessment", "knowingly", "fraudulently"*

Summary: This case reviews the conditions necessary for Inland Revenue to re-open an assessment once four years have expired from the date after which those assessments were made.

Facts: The objector company commenced a small family manufacturing business. The shareholders comprised the father, two sons and a daughter. The shareholders also operated a separate partnership trading venture. The partnership acquired an old residential villa in a run down condition. Ownership of the property was taken in the name of four family trusts, the intention being that the property would be leased to the partnership. The objector company undertook the work required to upgrade the residential property and charged the partnership for that work on a proper commercial basis.

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There were three issues in this case. The first two related to whether the objector could claim input tax credits for work done on the property and work-related telephone calls made by the principal of the company. The third issue related to incorrectly completed GST returns.

Decision: Judge Willy held that the objector was entitled to deduct input tax for work done on the property and for telephone calls made in the course of the objector's work.

An employee of the objector's accountant made a number of errors in calculating input and output tax for the objector's first taxable period October to December 1986. Judge Willy held that Inland Revenue produced no evidence to support a finding of fraud against the objector company or any of its servants or agents. Inland Revenue failed to discharge the onus of proof. There were no grounds for invoking the provisions of section 31(2), so the objector was protected by the four year limitation period.

Comment: Inland Revenue is not appealing this decision.

Due Dates Reminder

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.

August

5 PAYE deductions and deduction schedules for last 16 days of July 1993 due - "large" employers only.

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

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

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

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

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

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

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

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

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

RWT on Dividends deducted during July 1993 due.

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

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

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