Filing a special GST return when a creditor sells a debtor's goods in satisfaction of a debt

Introduction

This item states the Commissioner's current policy on furnishing a special GST return when a creditor sells a debtor's goods in satisfaction of a debt.

Background

When a debtor fails to pay a debt, a creditor will sometimes seize or repossess goods from the debtor, and sell them to recover the money owing. Section 17(1) of the Goods and Services Tax Act 1985 specifies when a special GST return must be filed in this situation.

Policy

When a creditor sells a debtor's goods in satisfaction of a debt, the creditor must charge and account for GST on the sale and file a special GST return (GST 121) unless either of these situations applies:

- the debtor advises the creditor in writing that the sale would not be taxable if the debtor had made it, and the reasons why a sale by the debtor would not be taxable
- the creditor holds enough reasonable information to conclude that a sale by the debtor would not have been taxable.

The creditor's obligation to file a special GST return is not affected by whether or not the he or she is registered for GST.

The special return must show all of these details:

- the creditor's name, address, and GST registration number (if registered)
- the debtor's name, address, and registration number (if registered)
- the date of sale
- the description and quantity of the goods sold
- the sale price and the amount of GST charged
- any other particulars that Inland Revenue requires.

The creditor must file this special return and account for the GST by the last working day of the month following the month of sale. The creditor must also supply the above details to the debtor by this date. The debtor is deemed to have sold the goods, and can claim any input tax credits still unclaimed.

Neither the creditor nor the debtor may include GST for that supply in any other return.

The tax charged by the creditor is recoverable as a debt due to the Crown.

Example

John is a plumber who is registered for GST. He borrows $5,000, using his work van as security. He claimed a GST input credit when he bought the van.

John defaults on the repayments so the loan company sells the van on 12 February. As John is registered for GST, the loan company must complete and file a GST 121 return, and account for GST on the sale of the van by the last working day of March. By this date, the company must also provide John with the information supplied on the return.

Neither John nor the loan company may include the GST on the supply of the van in any further GST returns.

Deducting withholding tax from hotel and tavern door charges

Introduction

This item states the Commissioner's current policy on deducting withholding tax from money collected as door charges at hotels and taverns, when this money is later handed to resident entertainers performing on the licensed premises.

Background

Entertainers in licensed premises are often paid out of takings from cover charges collected at the door of the bar in which they are performing.

Resident entertainers - definition

Under regulation 2 of the Income Tax (Withholding Payments) Regulations 1979 (the Regulations), a "resident entertainer" includes anyone deemed under Part IV of the Income Tax Act 1976 to be resident in New Zealand and who performs or engages in any activity which meets all of these conditions:

- The activity is in connection with any regular or casual performance by actors, entertainers, musicians, singers, dancers, comperes, or other artistes.
- The person performs the activity either alone or with any other person or persons in choirs, choruses,

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bands, orchestras, ballets, or other entertainment groups.

- The activity has a purpose of education, culture, religion, entertainment, or any other purpose.

Specified payments made to resident entertainers are subject to withholding tax at 20 cents in the dollar under clause 4(a) of Part B of the Schedule to the Regulations. In specific circumstances, if entertainers or bands receive a payment from the manager or licensee of a hotel or tavern, the manager or licensee must deduct withholding tax.

Policy

This policy concerning the responsibility for deducting withholding tax from hotel door charges applies to resident entertainers only.

Circumstances when a hotel must deduct withholding tax

Contract for services

If there is a contract for services (i.e. the entertainers or bands charge a fee for their services), the hotel must deduct and account for withholding tax.

Door charges collected by entertainers unaccompanied by hotel/tavern management

Under the Sale of Liquor Act 1989, the manager or licensee has the power to restrict entry into a licensed premises. A band member or entertainer acting alone who collects door charges and restricts entry to the premises is acting as an agent or delegate of the manager or licensee. The band member or entertainer is exercising the power to restrict entry on behalf of the manager or licensee, so he or she is collecting the charges on behalf of the management. The entertainers or bands are then paid for their performance from the door charges.

The charges handed over to the entertainers or bands are "specified payments" as defined in clause 4(a) of Part B of the schedule to the Regulations, so the licensee or manager must deduct and account for withholding tax on this payment at 20 cents in the dollar.

Withholding declaration form IR 13

If withholding tax must be deducted from the door charges, the entertainer must supply a withholding declaration form (IR 13) to the hotel. If no withholding declaration form is supplied to the hotel, under section 343A of the Income Tax Act 1976, the tax deduction is increased by an additional 15 cents for each dollar paid to the entertainer.

Circumstances when a hotel does not need to deduct withholding tax

Entertainers accompanied by management when collecting door charges

If a band member or entertainer collects door charges and is accompanied by an employee of the hotel who acts on behalf of the management by restricting entry to the hotel, there is no requirement for the hotel to deduct withholding tax from the door charges. The band member or entertainer is not collecting the door charges as an agent or delegate of management because he or she is not exercising the power to restrict entry. In this situation the door charges that are collected do not pass through management's hands.

The band or entertainer is responsible for accounting for any tax payable on the door charges.

Contract of employment

If an entertainer is working under a contract of employment, PAYE deductions are made by the hotel on the basis that the payments are salary and wages. Hotels do not have to deduct withholding tax because regulation 4(2)(a) excludes salary and wages from withholding tax.

Payment made to a company

If the payment is made to a company, regulation 4(2)(b) excludes any payments made to the company from withholding tax.

Exemption certificate

If the entertainer holds an exemption certificate (IR 118) the payments are exempt from withholding tax under regulation 4(2)(c). Under regulation 5, the Commissioner may issue a certificate of exemption to any person who is in business. The person will then become a provisional taxpayer.

Inland Revenue will only issue a certificate of exemption to taxpayers who have proven records of filing returns and paying tax by the due dates.

Lease duty on lease variations or renewals

Introduction

This item states the Commissioner's current policy on calculating lease duty when an increase in rental occurs on leases for commercial land and buildings.

Background

Section 26 of the Stamp and Cheque Duties Act 1971 (the Act), imposes stamp duty on leases of commercial land and buildings. Stamp duty is payable at the rate of 40c per $100 (or part thereof) of the maximum rent that

is payable or may become payable under the lease in any year. If the lease is for a term that is less than a year, the stamp duty is payable on the maximum rent that is payable or may become payable over the term of the lease.

There are two situations in which the rent payable may be increased:

- when a new lease agreement or a variation of the existing lease agreement is entered into, which results in an increase in the rent payable
- when the existing lease agreement provides for the rent to be re-determined based on the valuation of the property, inflation, or other factors.

(Note that under section 33 of the Act, if a lease has a fixed rent and the lease agreement provides for the rent to be re-determined by valuation or otherwise, the lease duty is calculated on the lease as if the highest amount of fixed rent for any one period was payable throughout the term of the lease.)

Policy

Under section 29 of the Stamp and Cheque Duties Act 1971, if the rent is increased during the term of the lease, the new agreement is treated as a new lease but duty is assessed only on the increase in rental. If the rental is increased by executing a new lease after the term of the original lease has expired, lease duty is assessed on the whole of the actual rental payable.

Example 1

Harold Bird leases a commercial building from UM Pire Ltd on 1 December 1983 for a term of 10 years at a rental of $50,000 per year. In June 1993 Harold exercises his right to renew the lease for a further 5 years and the rental is increased to $70,000 per year. Duty is calculated as follows:

Original rental (GST exclusive)	$50,000
Revised rental (GST exclusive)	$70,000
Increase in rental	$20,000
GST at 12.5%	$ 2,500
Amount on which duty is to be charged	$22,500
Duty payable	$90

This calculation method is used so that stamp duty is not charged retrospectively on the GST element of the original lease rental, as at the date of the original lease there may have been either no GST in existence, or GST at a different rate.

Example 2

Details as in Example 1, but Harold does not exercise his right of renewal until January 1994. In this situation section 29 does not apply, and duty is assessed on the total rental payable under the new lease.

Note: "Stamp duty", as defined in section 2 of the Stamp and Cheque Duties Act 1971, includes lease duty.

Misappropriation of property by partner in a partnership

Introduction

This item states the Commissioner's current policy in situations when there is a partnership liability to make good a loss resulting from the misappropriation of property by a partner.

Background

Section 163 of the Income Tax Act 1976 allows a deduction for payments made by a partner to make good a loss suffered by any person outside the partnership (other than the spouse of any partner) as a result of the misappropriation of property by another partner. Before section 163 was introduced, losses of this kind were not deductible because they were capital in nature.

The payment is deductible only if the partner is under a legal liability to make good the loss. It is not sufficient that the payment is made under a moral rather than a legal obligation.

Section 13 of the Partnership Act 1908 sets out the general principle by which partners are liable for any wrong committed by one of their partners. All partners are liable if a wrongful act or omission by any partner causes loss or injury to any person (except a partner in the firm) or incurs any penalty. The partners are only liable if the wrong is caused by a partner acting in one of these capacities:

- in the ordinary course of the business of the firm
- with the authority of his or her co-partners.

In addition to the general liability for wrongs imposed by section 13, section 14 of the Partnership Act 1908 also holds the partnership liable for a loss in these two specific situations:

- if a partner who is acting within the scope of his or her apparent authority receives a third person's money or property and misapplies it
- if the partnership receives a third person's money or property in the course of its business, and the money or property is misapplied by one or more of the partners while it is in the partnership's custody.

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Policy

Under section 163 of the Income Tax Act 1976, a taxpayer can claim a deduction for any amount paid to make good a loss that another person suffers because of the misappropriation of property, if these five conditions are met:

- the taxpayer carries on business in partnership
- the partnership or any of the partners receive property in the course of the partnership business
- the owner of the property is not a partner in the partnership, or the spouse of one of the partners
- Any partner except the taxpayer or his or her spouse misappropriates the property, causing a loss to the property owner
- The taxpayer is legally liable to make good the loss.

It is not necessary for the taxpayer to make the payment directly to the property owner. Any reimbursing payment made to an insurance office or indemnity fund that had previously made good the loss is deductible.

The deduction is allowable in the year of payment.

If the taxpayer later recoups all or part of the amount that was previously allowed as a deduction (for example, by way of insurance, indemnity, reimbursement, recovery or other means), the amount recouped is assessable income in the year the taxpayer receives it.

Example

John, Jane, and Jake carry on a car repair business in partnership. Susi brings her car in for repair. John sells the car (without the knowledge of Jane or Jake) and spends the proceeds at the race track. John, Jane, and Jake reimburse Susi for the loss of property.

All three of the partners are liable to make good the loss. However, only Jane and Jake can deduct their part of the amount paid under section 163, in the year they pay it.

Any amount that Jane and Jake later recover from John is assessable income in the year they receive it.

Dividend withholding payment accounts and consolidated groups of companies

Introduction

This item states the Commissioner's current policy on dividend withholding payment accounts ("DWPA") as they relate to consolidated group companies.

Background

Sections 191C to 191WC of the Income Tax Act 1976 set out the rules for consolidated groups of companies. Under these rules, two or more New Zealand resident companies can elect to be treated as a consolidated group of companies if they are wholly owned (that is, if they have 100% common shareholding at all times in the income year). Companies which elect to form a consolidated group will effectively be taxed as if they were a single company. An election to form a consolidated group will apply from one of these years:

- from the 1993/94 income year onwards, if the companies have a standard or late balance date for the 1993/94 year
- from the 1994/95 income year onwards, if the companies have an early balance date for the 1993/94 year.

Policy

If a member of the consolidated group is liable for a foreign dividend withholding payment (FDWP) on a foreign dividend that it derives, all member companies of the consolidated group are jointly and severally liable for that payment (section 191T(2)). The amount of the FDWP due can be satisfied by any of these methods:

- actual payment of the liability
- a debit to the credit balance of the group's branch equivalent tax account ("BETA") (section 191T(1))
- an offset against the group's tax losses (section 191T(3)).

A consolidated group must maintain a group DWPA if any member of that group maintains such an account. The group account must be maintained separately (section 191U(1)(a)). A group may also elect to maintain such an account even if no member operates one (section 191U(1)(b) & (2)). If a group elects to maintain an account, it may elect to cease maintaining it subject to certain conditions in sections 191U(4) & (5).

The effect of the group DWPA is that all credit and debits of group members move through the group account, reflective of the fact that consolidated groups of companies are treated as a single entity taxpayer.

DWP credits may only be transferred from a member company DWPA to the group account if both of these conditions are met:

- a debit arises in the group DWPA
- that debit is not offset by any group credit that arose earlier or on the same date as the credit in the individual DWPA (section 191UC(2)).

The offsetting of group credits against any debit takes precedence over the offset of any member credits.

When a credit transfer occurs, a corresponding debit arises in the member company's DWPA, unless such a debit would result in creating or increasing a debit balance in the member's account. In such a case the debit does not arise in the member's DWPA but is borne by the group account (section 191UC(5)).

When a group member pays any amount of further DWP payable on the end of year debit balance (through section 394ZZF), the amount paid is available for crediting against any other DWP payable by any member of the group at a later date. However, the amount is not available to be credited to an individual member (section 191UC(6)).

IRD Deputy Commissioners - changes in portfolios

The Commissioner, David Henry, has announced changes to the portfolios held by Inland Revenue's Deputy Commissioners. This interim arrangement will apply until the second level appointments are made as part of the progressive implementation of the Organisational Review of IRD.

The responsibilities held by each of the Deputies will be:

Deputy Commissioner	Output or Programme	Customer/Liaison
Bob Molony	• Revenue Assessment • Processing Centres • Information Technology (incl Output Centre) • Debt & Return Management • Crown Revenue • Student Loans • Supply of Information • Income Maintenance	• GCS/Unisys/Sun • NZSA (Public Practice) • DSW • Privacy Commissioner • Statistics Department • Ministry of Education
Peter Barrand	• Taxpayer Services (incl. Compliance Cost Unit) • Rulings • Legal Services • Taxpayer Audit (including Corporates)	• Customs Department • Crown Law Office • Tax Education Office • Big Business • Medium Business • Small Business • Employers' Federation • National Superannuitants
Graham Holland	• Policy Advice (including Revenue Forecasting) • Child Support Agency	• Treasury (Tax Policy) • Officials' Tax Committee • NZSA Tax Committee • NZ Law Society Committee • NZ Chamber of Commerce • International Fiscal Association
Maria McKinley	• Planning & Development • HRSS • Finance • EEO • Cultural Development • Quality Management	• SSC • Treasury (except Tax Policy) • Audit NZ • PSA/Joint Consultative Committee • Telecom

FBT - prescribed rate of interest increased

The prescribed rate of interest used to calculate the fringe benefit value of low interest employment-related loans has been increased to 7.9% for the quarter starting on 1 July 1994. This rate will also apply to all subsequent quarters unless it is later amended. It reflects increased market interest rates.

The prescribed rate was previously 7.7% for the quarters starting on 1 January 1994 and 1 April 1994.

GST - Supplies made to residents of commercial dwellings

Summary

This item states the Commissioner's current policy on the treatment of supplies made to residents in a commercial dwelling. There are special rules for calculating GST when commercial dwellings, such as motels, hotels, rest homes, or hospitals supply domestic goods and services to people who are, or will be, residing there for four or more weeks.

At the end of this item there are several examples and two flowcharts to show how registered persons are to calculate and account for GST in cases when they should apply the 60 percent rule in section 10(6) of the Goods and Services Tax Act 1985 (the GST Act).

Legislation

Under section 10(6) of the GST Act, if a person resides in a commercial dwelling for more than four weeks, the value attributable to the supply of domestic goods and services in the commercial dwelling is reduced to 60 percent after the end of the four weeks. Further, the 60 percent rate will apply from the start of the person's stay, if the commercial dwelling is also a residential establishment and the supplier and recipient have agreed that the total length of the stay will be four weeks or longer.

Section 2 of the GST Act defines the terms used in section 10(6).

The term "commercial dwelling" means:

(a) Any hotel, motel, inn, hostel, or boardinghouse; or

(b) Any camping ground; or

(c) Any convalescent home, nursing home, rest home, or hospice; or

(d) Any establishment similar to any of the kinds referred to in paragraphs (a) to (c) of this definition; -

but does not include -

(e) A hospital, except to the extent that that hospital is a residential establishment:

(f) A dwelling situated within a retirement village or within a rest home, where the consideration paid or payable for the supply of accommodation in that dwelling is for the right to occupy that dwelling:

The term "residential establishment" means:

> any commercial dwelling in which not less than 70 percent of the individuals to whom domestic goods and services are supplied reside, or are expected to reside, for a period of, or in excess of, four weeks; and also includes any hospital to the extent that it is used to provide domestic goods and services in a way similar to any such residential establishment.

The term "domestic goods and services" means:

> the right to occupy the whole or part of any commercial dwelling, including, where it is provided as part of the right to so occupy, the supply of -
>
> (a) Cleaning and maintenance:
>
> (b) Electricity, gas, air conditioning or heating:
>
> (c) Telephone, television, radio, or any other similar chattel:

Examples of goods and services that do not fall within the definition of domestic goods and services are meals, toll calls, medication and nursing. These must be taxed in full.

Section 10(6)

Section 10(6) ensures that long-term occupants of hotels, rest homes, hospitals, etc. are not disadvantaged in comparison with others who rent or lease their accommodation (which is exempt from GST). This section provides two different treatments for supplies in commercial dwellings, depending on whether the commercial dwelling is also a residential establishment.

Commercial dwelling - residential establishment

Under section 10(6), the supplier charges GST at 12.5% on 60 percent of the total value of domestic goods and services from the start of any contract or arrangement under which the recipient intends to reside for four weeks or more in a commercial dwelling that is a residential establishment. (This equates to charging GST at 7.5% of the total value of the domestic goods and services.) Those residents whose stays will be less than four weeks on any occasion, but whose stays will exceed four weeks in total over the course of the arrangement, will also qualify for the reduced rate.

Commercial dwelling - not a residential establishment

If a person intends to stay in a commercial dwelling, which is not a residential establishment, for periods in excess of four weeks, GST is chargeable on the reduced value of domestic goods and services only after four weeks. The reduced rate will apply only if the resident is charged for accommodation for seven days of the week. GST is charged at the standard rate on the full value of the supply for the first four weeks.

In all cases, GST is still chargeable at 12.5 percent on the full value attributable to any non-domestic goods and services supplied.

Rates for domestic and non-domestic goods and services

Only domestic goods and services supplied are subject to the lower GST rate under section 10(6), so the supplier must make an apportionment between domestic and non-domestic goods and services supplied.

The flowcharts at the end of this item illustrate how section 10(6) operates.

In 1986, Inland Revenue and the bodies that represent rest homes and private hospitals agreed to standard apportionment rates for the supply of domestic and non-domestic goods and services. These standard rates assist all parties to determine what will generally be acceptable to Inland Revenue. These rates also provide a degree of certainty within this industry group.

The rates are:

Rest homes	- 45% domestic goods and services. - 55% non-domestic goods and services.
Private hospitals	- 35% domestic goods and services. - 65% non-domestic goods and services.

Rest homes and private hospitals may use a factual basis for apportionment if they believe that the above rates are not consistent with the supplies they make. However, in this case they must maintain sufficient records to support the basis of their calculations, in the same way as other commercial dwellings.

In all other cases where a commercial dwelling, such as a motel or hotel, will be supplying domestic goods and services to residents for periods in excess of four weeks, an apportionment must be made on a factual basis. Sufficient records must be retained to support the basis of apportionment.

Claiming input tax

It has been suggested that input tax can only be claimed on 60 percent of the expenses of operating a commercial dwelling when section 10(6) applies.

Operating a commercial dwelling is a taxable activity. The supply of domestic goods and services in a commercial dwelling is a taxable supply and is chargeable with GST under section 8 of the GST Act. The different valuation of the supply under section 10(6) does not alter the fact that the supply is a taxable supply. Section 10(6) determines the value placed on the supply of domestic goods and services. It does not deem part of that supply to be non-taxable. As a result, the entire supply is taxable, although at a deemed reduced value.

This means that any expenses incurred in providing domestic goods and services in a commercial dwelling are incurred in the course of making taxable supplies. As a result, input tax can be claimed in full for expenses incurred in the course of operating a commercial dwelling.

Example 1

The Fireside Home is a rest home. More than 70 percent of its residents are there on a long term basis in excess of four weeks. This rest home is a commercial dwelling and is also a residential establishment within the meaning of the GST Act.

The Fireside Home applies the standard apportionment rates:

- 45% domestic goods and services (i.e. right to occupy, cleaning, maintenance, etc.);
- 55% non-domestic goods and services (i.e. meals, medication, etc.).

The Fireside Home charges the following amounts for accommodation, excluding GST:

Short stay residents *(under four weeks)*	$130.00/week
Day care residents	$ 30.00/day
Permanent residents	$120.00/week

For short stay and day care residents, GST is calculated in the normal way because the contracts are for less than four weeks' stay.

Short stay residents *(including 12.5% GST)*	$146.25/week (incl GST)
Day care residents *(including 12.5% GST)*	$ 33.75/day (incl GST)

However, the calculations for "permanent residents" are as follows.

Standard charge as stated above is $120.00

$120.00 x 45% = $54.00
(domestic goods and services)

$54.00 x 60% x 12.5% = **$ 4.05**
(GST on domestic goods and services)

$120.00 x 55% = $66.00
(non-domestic goods and services)

$66.00 x 12.5% = **$ 8.25**
(GST on non-domestic goods and services)

Total GST on charge: **$ 12.30**

Include basic pre-GST charge to client: **$120.00**

Total weekly charge to client incl. GST: **$132.30**

To simplify calculation:

This equates to a composite rate of 10.25% GST.

$120.00 x 10.25% = $12.30
\+ $120.00
$132.30

[45% x 60% x 12.5% = 0.03375
55% x 12.5% = 0.06875
0.03375 + 0.06875 = 0.1025 or 10.25%]

	Domestic expenses	Other expenses	Total expenses
Apportionment	45%	55%	100%
GST exclusive	$54.00	$66.00	$120.00
Value for GST			
Factor	60%	100%	
Value	$32.40	$66.00	$ 98.40
GST			
Rate	12.5%	12.5%	
Amount	$ 4.05	$ 8.25	$ 12.30
GST inclusive	$58.05	$74.25	$132.30

GST return - calculating the amount to show as GST charged on supplies to permanent residents

Assume the Fireside Home had 10 permanent residents who were charged $132.30 per week for a two month GST return period:

$132.30 x 8 weeks x 10 residents = $10,584.00
(total income from permanent residents for 2 months)

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Fireside Home must work out the GST content of this total and multiply it by 9 to obtain the GST inclusive figure to be shown on the GST return.

$10,584.00 x $^{10.25\%}/_{110.25\%}$ = $984.00 (GST)

$984.00 x 9 = $8,856.00
(GST inclusive total taxable supplies made - show this figure in GST return)

(Check: $12.30 x 8 x 10 = $984.00)

Note: The 10.25% used in this example is dependent on the apportionment being 45% and 55%. This percentage will alter if the apportionment is altered, as is the case in the following examples.

Example 2

The Ironside Hospital is a private hospital with a wing that caters for long term residents. It applies the standard apportionment rates for private hospitals, i.e. 35% domestic goods and services and 65% non-domestic goods and services.

The hospital has set a GST exclusive charge of $200.00 per week. There are 20 patients resident at the hospital. The hospital files returns on a monthly basis.

The following shows how much GST is to be charged to these patients.

$200.00 x 35% = $70.00
(domestic goods and services)

$70.00 x 60% x 12.5% = **$ 5.25**
(GST on domestic goods and services)

$200.00 x 65% = $130.00
(non-domestic goods and services)

$130.00 x 12.5% = $ **16.25**
(GST on non-domestic goods and services)

Total GST on charge $ **21.50**

Include basic pre-GST charge to client: **$200.00**

Total weekly charge to client incl. GST: **$221.50**

To simplify calculation:

This equates to a composite rate of 10.75% GST.

$200.00 x 10.75% = $ 21.50
+ $200.00
$221.50

[35% x 60% x 12.5 = 0.02625
65% x 12.5% = 0.08125
0.02625 + 0.08125 = 0.1075 or 10.75%]

	Domestic expenses	Other expenses	Total expenses
Apportionment	35%	65%	100%
GST exclusive	$ 70.00	$130.00	$200.00
Value for GST			
Factor	60%	100%	
Value	$ 42.00	$130.00	$172.00
GST			
Rate	12.5%	12.5%	
Amount	$ 5.25	$ 16.25	$ 21.50
GST inclusive	$75.25	$146.25	$221.50

GST return - calculating the amount to show as GST charged on supplies to permanent residents

20 residents are charged $221.50 per week for a one-month period.

$221.50 x 4 weeks x 20 residents = $17,720.00
(total monthly income from permanent residents)

Ironside Hospital must work out the GST content of this total and multiply it by 9 to obtain the GST inclusive figure to be shown on the GST return.

$17,720.00 x $^{10.75\%}/_{110.75\%}$ = $1,720.00 (GST)

$1,720.00 x 9 = $15,480.00
(GST inclusive total taxable supplies made - show this figure in GST return)

(Check: $21.50 x 4 x 20 = $1,720.00)

Example 3

The Sunnyday Motel entered into a contract to supply a resident who planned on staying at the motel for 10 weeks. The motel established that it had supplied:

25% domestic goods and services
75% non-domestic goods and services.

The GST exclusive charge to the resident is $400 per week.

The first four weeks' stay is charged at the full rate of 12.5% because the motel is not a residential establishment.

$400.00 x 12.5% = **$ 50.00**
$400.00
(GST inclusive charge per week for each of the first four weeks) **$450.00**

The charge for the following 6 weeks will be as follows:

$400.00 x 25% = $100.00
(domestic goods and services)

$100.00 x 60% x 12.5% = **$7.50**
(GST on domestic goods and services)

$400.00 x 75% = $300.00
(non-domestic goods and services)

$300.00 x 12.5% = **$37.50**
(GST on non-domestic goods and services)

Total GST on charge = **$45.00**

Total weekly charge to client incl. GST: **$445.00**

To simplify calculation:

The charge for the last 6 weeks equates to a composite rate of 11.25% GST.

$400.00 x 11.25% = $ 45.00
+ $400.00
$**445.00**

[25% x 60% x 12.5% = 0.01875
75% x 12.5% = 0.09375
0.01875 + 0.09375 = 0.1125 or 11.25%]

	Domestic expenses	Other expenses	Total expenses
Apportionment	25%	75%	100%
GST exclusive	$100.00	$300.00	$400.00
Value for GST			
Factor	60%	100%	
Value	$ 60.00	$300.00	$360.00
GST			
Rate	12.5%	12.5%	
Amount	$ 7.50	$ 37.50	$ 45.00
GST inclusive	$107.50	$337.50	$445.00

GST return - calculating the amount to show as GST charged on supplies to permanent residents

The motel received $3,500.00 for stays in excess of four weeks, which is subject to the reduced rate.

Sunnyday Motel must work out the GST content of this total and multiply it by 9 to obtain the GST inclusive figure to be shown on the GST return.

$3,500.00 x $^{11.25\%}/_{111.25\%}$ = $353.93 (GST)

$353.93 x 9 = $3,185.39

(GST inclusive total taxable supplies made - show this figure in GST return)

Example 4

The Sunnyday Motel received the following GST inclusive income from residents for the six-month period ending 30 June 1993. It was calculated that the apportionment between domestic and non-domestic goods and services is 25% domestic and 75% non-domestic.

Income from residents staying less than 4 weeks:	$100,000
Long term residents - first four weeks	$25,000
- fifth week plus	$250,000

Fully taxable amounts are:	**$100,000**
	$ 25,000
	$125,000

(divided by 9 = $13,888.89 GST)

Amounts taxable at the reduced rate are:

$250,000 x $^{11.25\%}/_{111.25\%}$ = $25,280.90 (GST)

$25,280.90 x 9 = **$227,528.09**

The total taxable supplies made (inclusive of GST) to be shown on the GST return are:

From residents staying under 4 weeks:	**$100,000.00**
1st 4 weeks for residents staying longer:	**$ 25,000.00**
Calculated at reduced rate above:	**$227,528.09**
Total taxable supplies made:	**$352,528.09**

(amount to be shown in GST return)

Chart 1: Determining whether section 10(6) applies

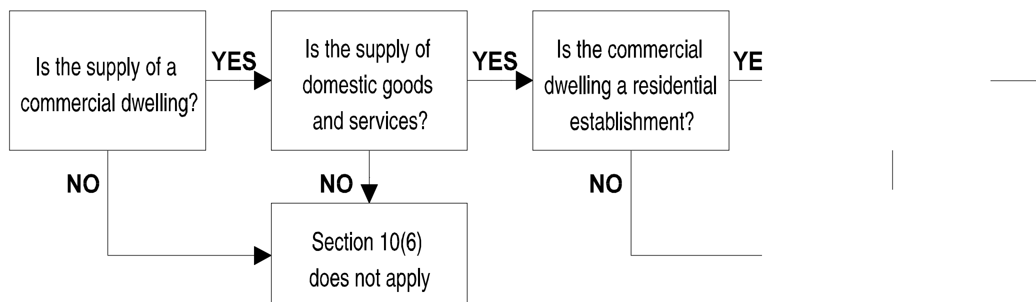
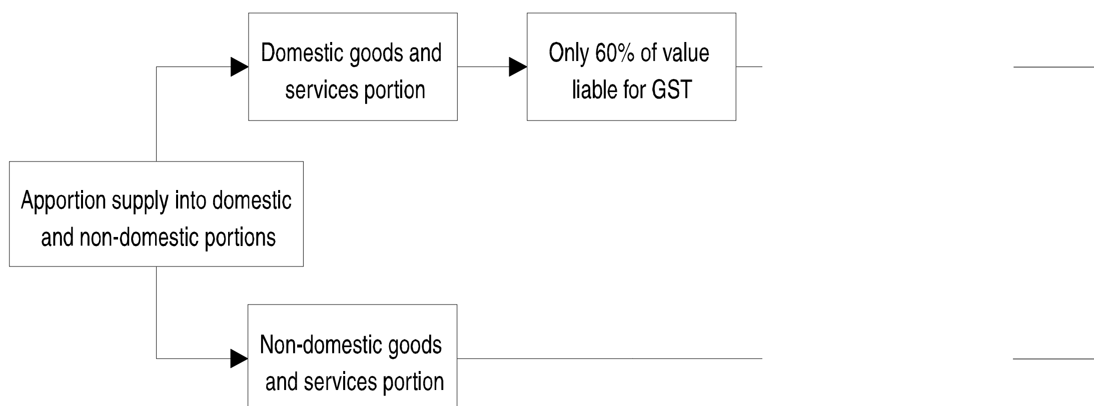


Chart 2: Calculating GST when section 10(6) applies



Child Support Amendment Act 1994

Introduction

The Child Support Amendment Act 1994 was recently passed by Parliament. It contains five changes to the Child Support scheme.

Three of the changes result from the 1993 Child Support Operations and Procedural Review. The other two changes are of an administrative nature.

At the end of this item there is a section-by-section analysis of the new Amendment Act.

Summary of changes

The five areas covered by the Amendment Act are:

- offsetting of Child Support liability when one party is a beneficiary
- actions to regularise an anomaly when a person receives an unsupported child benefit
- a process for administrative review of Child Support formula assessments
- corrections to difficulties surrounding the provisions relating to the Child Support Trust Bank Account
- a new method for setting the rate of interest in reconciliation of estimation cases.

Offsetting Child Support liability when one party is a beneficiary

Section 3 of the Amendment Act amends sections 34 and 35 of the principal Act, so that when one parent is a beneficiary, the other parent may elect that the offsetting provision be extended. The effect is that the amount to be deducted from the benefit will reduce the amount payable by the non-beneficiary. Amounts paid by the non-beneficiary will be passed on to the beneficiary only in the limited circumstances which are already in place, i.e., when the amount of Child Support collected exceeds the net amount of the benefit paid.

Previously under section 35, in shared and split custody cases, if both parents were liable to pay Child Support, offsetting of liabilities between the two parents was limited to situations in which neither parent was a beneficiary.

Unsupported child benefit anomaly

Sections 8 and 9 of the Amendment Act amend sections 142 and 143 of the principal Act. They provide that Child Support paid for a custodian's own children will no longer be used to pay for an unsupported child's benefit that is paid to the custodian for other children. Child Support received for an unsupported child will also no longer go towards offsetting a social security benefit paid for the custodian's own children.

From 1 July 1994 custodial parents who receive the unsupported child's benefit only have to apply for Child Support for the children for whom they are receiving a benefit; not for the unsupported child. The amendments to sections 142 and 143 will apply retrospectively from 1 July 1992.

The amendments to the Child Support Act ensure that custodians who have applied for Child Support for their own children will receive that Child Support (when paid by the liable parent). The Child Support received for their own children will not be used to offset the cost of the unsupported child's benefit.

Administrative review

Before 1 July 1994 the only available avenue for the variation of a Child Support formula assessment was to apply to the Family Court for an order to depart from the assessment.

Many people had complained that certain barriers existed to prevent parents from applying to the court, such as the cost (including the cost of legal representation), the delays, and the general difficulty with Court procedures as prescribed by the Child Support Act.

To overcome these barriers the Amendment Act provides for an administrative review procedure within Inland Revenue from 1 July 1994. The key features of the administrative review procedure are as follows:

- Review officers will use the departure order grounds contained in sections 105 and 106 of the Child Support Act, and will make determinations on the same basis as the court, in the form of a hearing.
- Either party to a Child Support formula assessment may apply for an administrative review.
- The other party to the Child Support assessment will be advised of the application for review of the assessment. The other party will have the right to reply, to confirm or contest details given by the applicant, and to attend the hearing.
- No legal representation will be allowed at the hearing. However, there is provision for representation or support in certain circumstances.
- The administrative review determinations will not affect the right of either party to apply to the Family Court for a departure order if they are not satisfied with the decision.
- There will be no fee for applying for an administrative review.

Applications

The administrative review process is available to either party to a Child Support formula assessment. The only formal requirements are that:

- the applications must be in writing
- the grounds on which the application is made must be stated
- the application must relate to an assessment for a Child Support year beginning no earlier than 1 April 1994.

Existing liability

An application for administrative review will not in itself suspend the obligation to pay the amount of Child Support assessed pending the outcome of the review. However, there is provision under section 96N of the Child Support Act for anyone applying for an administrative review to also apply for suspension of his or her assessed liability.

Attendance at hearings

Both parties to the application for an administrative review can attend the review hearing. However, neither party can be compelled to appear in the presence of the other, or to be allowed to have legal representation at the hearing. Under section 96J of the Child Support Act, approval can be given for either party to be represented at the hearing where special circumstances exist. A support person may also be allowed to attend the hearing. In either case, the representative or support person cannot be, or have been, a barrister or solicitor, or someone involved in advocacy work.

Child Support trust bank account

Before the Amendment Act when payments were received from parents it was not possible to distinguish between payments for Child Support and payments of tax. Section 140 of the principal Act has been amended by section 7 of the Amendment Act providing for all Child Support payments to be banked initially into the Crown Bank Account. Later, those amounts which are to be passed on to custodians, are paid into the trust bank account and payment is made from that account to the custodial parent.

Interest on underestimation of income

Section 40 of the principal Act provides that liable parents may elect to have their Child Support liabilities based on their estimated taxable income for the current year. They can only elect to use this provision where they estimate that their current income has decreased by 15% from their actual taxable income for the last relevant income year (the figure on which the formula assessment is based).

When a liable parent makes an election under section 40 and underestimates his or her current income, that parent is liable for interest on the amount of underpaid Child Support. Section 4 of the Amendment Act has amended section 46 of the principal Act and provided for the setting of the applicable interest rates by Order in Council. Section 12 of the Amendment Act amends section 235 of the principal Act and allows the Governor-General to make the Order in Council specifying the rate of interest.

Previously the interest rate for underestimations was linked to the interest rate for underpayments of provisional tax. It was necessary to separate the two rates of interest because of recent changes made to the provisional tax rules.

Application date

The provisions of the Child Support Amendment Act 1994 are to apply from 1 July 1994 unless expressly stated otherwise.

Child Support Amendment Act 1994 - Details of new legislation

Section 2

This section amends section 9 of the Child Support Act to provide that a custodian who is receiving an unsupported child's benefit but no other social security benefit does not have to apply for Child Support for other children for whom no benefit is paid.

Section 3

This section deals with the situation when two liable parents have split or shared custody of one or more children who qualify for Child Support, and neither parent is receiving a social security benefit, or only one parent is receiving a social security benefit. In this situation the amount of Child Support that is payable by one parent can be offset by the amount that the other parent is liable to pay.

If one parent is receiving a social security benefit, only the non-beneficiary parent can request that the offsetting provision be activated. In this case the amount to be deducted from the benefit will reduce the amount payable by the non-beneficiary.

Section 4

This section repeals the definition of "specified rate of interest" found in section 46 (1) of the principal Act and substitutes the following definition:

> *"'specified rate of interest' in relation to any day, means such rate percent per annum as may be specified by the Governor-General by Order in Council."*

When a liable person elects to estimate his or her income under section 40 of the principal Act, and underestimates his or her current income, that person is liable to pay interest on the amount of underpaid Child Support that has arisen as a result of the underestimation of income.

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Section 4 provides for the setting of the applicable interest rates by Order in Council, instead of having the rate linked to the interest rate applicable to underpayments of provisional tax as was previously the case.

Section 5

This section inserts into the principal Act a new part known as “Part VIA”. Part VIA contains the new administrative review procedures that have become available within the Inland Revenue Department from 1 July 1994.

Part VIA

Section 96A

This section empowers the Commissioner to make determinations to vary Child Support formula assessments.

Section 96B

This section provides that either a custodial parent or a liable parent can apply for a determination to be made by the Commissioner.

The application must be in writing and can only be made where there is a formula assessment already in force. An application may only be made in relation to Child Support payable in the Child Support year commencing on the 1st day of April 1994 or any later Child Support year.

Section 96C

This section provides that an application cannot proceed to determination unless the Commissioner is satisfied that one or more of the grounds specified in section 105 of the principal Act exist and that it would be just, equitable, and otherwise proper to make a determination.

Section 96D

This section empowers the Commissioner to make determinations in the same way as the Court makes departure order decisions under section 106 of the principal Act. The Commissioner is required to give both parties to the application, in writing, the reasons for making the determination.

Section 96E

This section sets out the formal requirements that are needed when making an application. An application that is made, under section 96B, must be in writing and must set out the grounds on which it is made. The grounds are those set out in section 105 of the principal Act.

Section 96F

This section provides that, after considering the application, if the Commissioner is satisfied that the issues raised in the application are too complex to be dealt with by the administrative review process then the Commissioner may refuse to make a determination. The Commissioner can recommend that an application is made to the Court for a departure order. The reasons for refusing to make a determination are required to be given, in writing, to the applicant.

Section 96G

Under this section if the Commissioner considers an application, and is satisfied that ***either*** there are no grounds for departing from the formula assessment ***or*** the formula assessment that is sought to be reduced is already set at the minimum liability then the Commissioner may refuse to make a determination. The reasons for refusing to make a determination must be given, in writing, to the applicant.

Section 96H

This section provides that when one party applies for a determination, the Commissioner will notify the other party of the application. The Commissioner will also send to the other party a summary of the grounds of the application, and inform the other party that he or she may request a copy of the application and make any representation if he or she so wishes.

A reply to an application must be in writing and filed with the Commissioner ***either*** within 14 days after the date on which the copy of the application and accompanying documentation is sent to the other party, ***or***, within 14 days of the date on which the notification was sent, if the other party does not request a copy of the application.

A copy of the other party’s reply and any accompanying documentation will be sent to the applicant.

If the Commissioner refuses to make a determination then this section does not apply.

Section 96I

This section provides that the Commissioner may act on the basis of the application and the reply (if any) and may, but is not required to, conduct an inquiry into the matter. The Commissioner is not bound by any rules of evidence.

The section also provides that the Commissioner must give an opportunity to both parties to appear before the Commissioner and be heard. Neither party can be compelled to appear in the presence of the other.

Section 96J

This section provides that approval for a party to the application to be represented can be given in cases where the Commissioner is satisfied that the person is unable to present his or her own case.

Subsection (4) provides that, if the Commissioner considers that it is proper, taking into account all the circumstances of the case, the Commissioner may approve a person nominated by a party to be present at

the hearing and to assist the party in the presentation of his or her case.

Subsection (6) provides that under no circumstances will legal representation be allowed at the hearing. This ban on legal representation extends to any person who is, or has been, enrolled as a barrister or solicitor, or who, in the opinion of the Commissioner, is or has been engaged in advocacy work before other tribunals.

Section 96K

A determination may not be made if, while the application is pending, the parties enter into a qualifying voluntary Child Support agreement, in relation to the Child Support assessment in question, and the agreement is accepted by the Commissioner.

Section 96L

This section provides that subsequent applications can be made after a determination has been issued if new matter has been submitted or the application covers a different ground from the previous application.

Section 96M

This section provides that the making of an application does not suspend or alter the amount of a formula assessment or the obligation to pay Child Support pending the issuing of a determination.

Section 96N

Under this section an application for a suspension order can be made to the Commissioner, and section 117 of the principal Act shall apply in the same way as it does when it is being used by the Courts.

However, a suspension order will not be made unless the Commissioner is satisfied that the making of a determination is likely to be unusually delayed and the time for filing a reply to the application has expired.

Section 96O

The Commissioner can make retrospective decisions using this section. The decision can only be made retrospectively to any day that the Commissioner considers appropriate but not being a day that precedes the later of the 1st day of April 1994 or the day on which the application for formula assessment to which the determination was made.

Section 96P

This section restricts the publication of reports by applying section 124 of the principal Act to Part VIA.

(End of Part VIA)

Section 6

This section provides for the consequential amendment of the principal Act in the manner indicated by the schedule to the Amendment Act.

The amendments provided for in the schedule apply from 1 July 1994.

Section 7

This section provides that all Child Support payments received by the Commissioner shall be paid into the Crown Bank Account.

From the Crown Bank Account there will be paid into the Child Support Trust Bank Account such amounts that are necessary to be passed onto custodians.

Section 8

This section deals with the payment of formula assessment Child Support to custodians who are social security beneficiaries.

The effect of this section is that Child Support paid for a custodian's own children will no longer be used to pay for an unsupported child's benefit which is paid to the custodian for other children. Neither will Child Support for an unsupported child go towards offsetting a social security benefit paid for the custodian's own children.

This section provides that if a beneficiary custodian is receiving an unsupported child's benefit and Child Support under a formula assessment then for each child for whom an unsupported child's benefit is being received, the Commissioner shall aggregate all payments of Child Support payable for each child and deduct an amount equal to the lesser of the net of tax amount of the unsupported child's benefit or the aggregate of all payments of Child Support received by the Commissioner in respect of that child or children. Any remaining amounts are to be paid to the custodian.

For any other child or children the Commissioner shall aggregate all Child Support payments received for those children and deduct an amount equal to the lesser of the net of tax amount of the social security benefit or the aggregate of all payments received by the Commissioner for those children. Any remaining amounts are to be paid to the custodian.

Section 9

This section deals with the payment of voluntary agreement Child Support to custodians who are social security beneficiaries.

The effect of this section is exactly the same as the effect of section 8. Both sections 8 and 9 ensure that custodians who have applied for Child Support for their own children will receive that Child Support. The Child Support received for their own children will not be used to offset the cost of the unsupported child's benefit.

The section provides that where a beneficiary custodial parent is receiving an unsupported child's benefit and Child Support under a voluntary agreement then the Commissioner shall pay to the custodian in respect of each child for whom money is paid under a voluntary agreement, the amount by which that money exceeds the payment that would have been made under a formula assessment.

In regards to each child for whom an unsupported child benefit is being paid the Commissioner shall aggregate all remaining payments of Child Support that are paid

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to the custodian for that child and deduct the lesser of the net of tax amount of the unsupported child's benefit or the aggregate of all payments of Child Support received by the Commissioner in respect of that child. Any remaining Child Support will be paid to the custodian.

In regards to any other child the Commissioner shall aggregate all remaining payments of Child Support and deduct an amount equal to whichever is the lesser of the net of tax amount of social security benefit other than the unsupported child's benefit or the aggregate of all payments of Child Support received by the Commissioner in respect of this child. Any remaining Child Support will be paid to the custodian.

Section 10

This section deals with unremitted deductions made by employers. It repeals section 147 of the principal Act by repealing the words "an amount equal to the amount of the deduction unpaid on or before that day shall be payable into the Child Support Trust Bank Account out of the Crown Bank Account without further appropriation than this section" and substituting the words "the amount of that deduction shall, for the purposes of this part of this Act, be deemed to have been received by the Commissioner on or before the 20th day of the following month".

These changes are consistent with the amendments made in section 7 of the Amendment Act.

Section 11

This section amends section 149(2) of the principal Act by omitting the words "in the Child Support Trust Bank Account."

Section 12

This section amends section 235 of the principal Act by inserting the following paragraph after paragraph (c):

> *"(ca) Specifying the rate percent per annum of interest that is to apply for the purposes of section 46 of this Act:"*

Subsection (2) provides that the first Order in Council made under section 235(ca) may have effect from the commencement of the Child Support year.

Section 13

This section deals with the transitional provisions relating to departure order applications pending as at 1 July 1994.

The section provides that if any application has been made to the Family Court under section 104 of the principal Act before 1 July 1994, but has not yet been heard by the Court, the applicant may elect to withdraw the application from the Family Court and to make an application under Part VIA of the principal Act.

However, there is no right of election if, ***either*** the custodian or the liable parent is a party to another application which is pending in a Family Court and the Court is satisfied that it would be more appropriate for the Court to consider the application at the same time as it hears the other application ***or*** the application relates either wholly or in part to a Child Support assessment payable in the 1994 Child Support year or any earlier Child Support year.

The election to withdraw the application from the Family Court is only available until 1 September 1994 or the date on which the Court commences hearing the application, whichever comes first.

GST - advertising for non-resident clients

Wilson & Horton decision

Summary

This item outlines the Commissioner's view of how section 11(2)(e) of the Goods and Services Tax Act 1985 (the GST Act) applies to the supply of advertising space and related services, in light of the High Court decision in *Wilson & Horton*. The High Court recently gave its judgment in *Wilson & Horton v CIR* (1994) 16 NZTC 11,221. This case dealt with the circumstances in which a newspaper publisher should account for GST on the service of placing advertisements for overseas clients.

We understand that there is some uncertainty about the correct GST treatment of the supply of advertising space and other related services to overseas clients.

The two main elements to the Commissioner's policy on the GST treatment of advertising services under section 11(2)(e) are:

- To qualify for zero-rating under section 11(2)(e), the services must be provided "contractually to" and "beneficially for" a non-resident person. If a New Zealand resident receives the benefit of the advertising services, the services are not zero-rated; and
- The provision of advertising space and related services are not supplied directly in connection with either moveable personal property or land (or improvements to the land).

The Commissioner will review this policy from time to time in light of any relevant Court decisions. Wilson and Horton are appealing the High Court's decision to the Court of Appeal.

This item replaces PIB 164, "GST on Advertising for Non-Resident Clients".

Effect of Section 11(2)(e)

Section 11(2)(e) zero-rates services supplied for and to a person who is not resident in New Zealand and who is outside New Zealand at the time the services are performed, not being services which are supplied directly in connection with:

(i) Land or any improvement thereto situated inside New Zealand, or

(ii) Moveable personal property (other than choses in action or goods to which section 11(2)(ca) applies) situated inside New Zealand at the time the services are performed.

A person is "resident" in New Zealand under section 2 of the GST Act if that person is a resident for income tax purposes under section 241 of the Income Tax Act 1976. The GST Act also deems a person to be resident for GST purposes if (and to the extent that) the person carries on a taxable activity or any other activity while having a fixed or permanent place of business in New Zealand relating to that activity.

Moveable personal property covers all types of goods other than land and improvements.

The Decision in Wilson & Horton

Facts

Wilson & Horton carries on the taxable activity of producing newspapers. Its main publication is *The New Zealand Herald*, in which many overseas parties place advertisements. The Commissioner argued that Wilson & Horton should charge GST at 12.5% on the publishing services provided to these overseas clients. Wilson and Horton contended the services were zero-rated.

Wilson & Horton and the Commissioner asked the High Court to rule on the GST treatment of five categories of advertisements:

- *Category 1*: Advertisements placed by overseas parties which refer to services offered by New Zealand residents.
- *Category 2*: Advertisements placed by overseas parties which refer to goods situated outside New Zealand which New Zealand residents offer for sale.
- *Category 3:* Advertisements placed by overseas parties which refer to goods situated in New Zealand which non-residents sell.
- *Category 4:* Advertisements placed by overseas parties which refer to goods situated in New Zealand which New Zealand residents offer for sale.
- *Category 5:* "Image" advertisements placed by overseas parties for the promotion of a brand name or product, when the goods or services referred to in the advertisement are sold in New Zealand.

Decision

The High Court discussed the interpretation of the phrases "directly in connection with" and "for and to" in section 11(2)(e) of the GST Act in deciding whether the advertising services were properly zero-rated. The High Court held that the services provided by Wilson & Horton are not supplied "directly in connection with" land or any moveable personal property in New Zealand.

Justice Hillyer's reasoning was that:

> "The supply of space and the services rendered by Wilson & Horton are directly connected with the advertising but not with the goods advertised. The goods are, as it were, at least one step removed from the services supplied by the newspaper proprietor" (1994) 16 NZTC 11,224.

The High Court also examined the meaning of "for and to" and agreed with the Commissioner that "for" means "beneficially for" and "to" means "contractually to". The Court illustrated this analysis with the example of a non-resident manufacturer who advertises goods in the New Zealand media so that New Zealand resident retailers can sell the goods. This supply of advertising is "for" the benefit of the manufacturer and the New Zealand retailers. The retailers enjoy the benefit of being able to sell the advertised goods to the New Zealand public. The advertising services would not be zero-rated because the supply is not made for and to the non-resident manufacturer.

Applying these principles, the High Court found that:

- Category 1 services are **standard rated** - the services are provided beneficially "for" the resident offering the services.
- Category 2 services are **standard rated** - the services are supplied beneficially "for" the residents who offer the goods for sale.
- Category 3 services are **zero-rated** - the services are provided "for and to" the non-resident selling the goods. The fact that the goods are located in New Zealand does not matter because the services are not supplied directly in connection with the advertised goods. An example is a New Zealand resident who went overseas, left household goods in New Zealand, and advertised from overseas to sell the goods.
- Category 4 services are **standard rated** - the services are beneficially "for" the resident offering the goods.
- The treatment of Category 5 services depends upon whether New Zealand residents sell the goods or services for sale in New Zealand. If residents do sell the goods, the supply is standard rated. Otherwise the services are zero-rated.

(The Court's analysis of the GST treatment of the five categories of advertisements is summarised in the table at the end of this item.)

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The High Court did not think that it would be unduly onerous for Wilson & Horton to determine whether any particular supply would be zero-rated or not using the Court's interpretation of the legislation.

Policy

The *Wilson & Horton* decision outlines how GST applies to the supply of advertising space and related services under section 11(2)(e) of the GST Act. The key features of section 11(2)(e) are the phrases "for and to" and "directly in connection with".

"For and to"

The determination of whether services are supplied "for and to" a non-resident is a question of fact depending upon the particular circumstances of any one supply. Appendix B to TIB No.9 (March 1990) provides some guidance on the meaning of "for and to" in section 11(2)(e). The TIB states that the word "for" suggests that goods or services must be supplied "for the benefit of" the recipient of the services.

The Commissioner considers that advertising services must be supplied for the benefit of a non-resident as well as contractually to the non-resident before the services can be zero-rated under section 11(2)(e). If a New Zealand resident enjoys the benefit of a supply of advertising services, the supply is "for" that resident. The "for and to" test in section 11(2)(e) is not satisfied and the supply is not zero-rated.

"Directly in connection with"

Appendix B to TIB No.9 (March 1990) sets out the Commissioner's interpretation of the meaning of "directly in connection with". This view is that:

(a) The meaning of this phrase depends upon the context in which it is used.

(b) The words "in connection with" require a relationship of more than remote degree.

(c) That relationship must be direct (i.e., in the case of services supplied in connection with goods, directly with the goods and not with some other person or thing).

(d) The following questions are useful in determining the matter in particular cases:

 (i) What is the service supplied in connection with, if anything?

 (ii) Is the connection direct - does anything interpose between service and object?

 (iii) Is the service merely incidental to the object?

Applying these tests, the Commissioner considers that the relationship between the supply of advertising space (and other related services) and any property to which the advertising relates is not "direct". The services cannot be denied zero-rating under section 11(2)(e) on the basis that they are supplied directly in connection with moveable personal property or land in New Zealand. As Justice Hillyer said in the *Wilson & Horton* case (at page 11,224), the services are "at least one step removed" from the subject matter of the advertisements.

Agency provisions

In the advertising context, the agency provisions in section 60 of the GST Act may need to be considered to determine whether a supply is zero-rated. Section 60(2) deems a taxable supply of goods and services made by a registered person to an agent who is acting on behalf of a principal to be a supply made to the principal.

The fact that a non-resident advertising agency arranges for the placement of advertisements does not necessarily mean that the supply of advertising services is made "to" that advertising agency. If the agency is acting as an agent on behalf of a principal, section 60(2) will deem the supply to be made to the principal and not to the agency. In this situation, the residence of the principal will determine whether there is a supply "to" a non-resident for the purposes of section 11(2)(e). The High Court in *Wilson & Horton* (at page 11,225) agreed with this approach.

Example 1

Gadget Co contacts a Wellington newspaper and books an advertisement for a newly developed product. Gadget Co is resident in the United Kingdom. It has a GST registered subsidiary in New Zealand that sells the advertised product. The subsidiary is resident in New Zealand because it is incorporated in New Zealand. The advertisements contain details of the address of the New Zealand subsidiary as distributor of the product. Are the services provided by the Wellington newspaper publisher zero-rated?

GST treatment

The services supplied by the publisher are subject to GST at 12.5%. They are not zero-rated under section 11(2)(e) because:

- The publisher supplies the services contractually "to" a non-resident, Gadget Co.
- However, the New Zealand resident subsidiary enjoys the benefits of the advertising. The supply is "for" a resident and so the "for and to" test in section 11(2)(e) is not met.

Example 2

Slick Co, an Australian resident advertising agency, places a series of advertisements with a New Zealand magazine. Slick Co has placed the advertisements as agent on behalf of the owner of a luxurious holiday resort in Australia. The ads relate to job vacancies at the resort. Are the services supplied by the New Zealand magazine zero-rated?

GST treatment

The services supplied by the magazine are zero-rated under section 11(2)(e) because:

- The magazine provides services contractually "to" a non-resident. Section 60(2) of the GST Act deems the supply to be made to the Australian resident resort owner, as principal. Slick Co simply acts as agent in receiving the supply.
- The supply is also "for" the benefit of the non-resident resort owner. No New Zealand resident person benefits from the advertising.

Example 3

Adcorp, a New Zealand advertising agency, places an advertising campaign on a New Zealand national radio station. A US resident manufacturer of sports shoes engaged Adcorp to act as its agent to arrange this campaign. The advertisements promote a popular brand of sports shoes, which are available from retailers throughout New Zealand. Are the services provided by the radio station zero-rated?

GST treatment

The services provided by the radio station are subject to GST at 12.5%. Section 11(2)(e) does not apply to this supply because:

- The radio station supplies services contractually "to" a non-resident. Section 60(2) of the GST Act deems the supply to be made to the non-resident sports shoe manufacturer, as principal. Adcorp receives the supply as agent only.
- However, the New Zealand resident retailers of the sports shoes enjoy the benefits of the advertising. The supply is "for" New Zealand residents and so the "for and to" test in section 11(2)(e) is not met.

GST treatment of types of advertisement

Category	Description of advertisement	Residence of person(s) who receive benefit	GST treatment
1	Advertising services for sale in NZ	NZ resident	Standard-rated
2	Advertising goods for sale outside NZ	NZ resident	Standard rated
3	Advertising goods for sale in NZ	Non-resident	Zero-rated
4	Advertising goods for sale in NZ	NZ resident	Standard-rated
5	"Image" advertising for goods and services sold in NZ	• NZ resident • Non-resident	• Standard-rated • Zero-rated

Computer software - application of tax policy to be addressed

In May 1993 the Commissioner issued a policy statement on the income tax treatment of computer software (see Appendix to TIB Volume Four, No. 10 - May 1993). The policy is based on his view of the law, and incorporates the new depreciation rules introduced in 1993. It is also consistent with generally accepted accounting principles.

The Commissioner considers that sufficient time has now elapsed for any problems with applying the policy to emerge. He is therefore seeking written submissions from people who have had problems in applying the policy.

If you would like to make a submission, please send it in writing to:

Director (Rulings)
Inland Revenue Department
Head Office
PO Box 2198
Wellington

The closing date for submissions is Wednesday 23 November 1994.

Questions we've been asked

This section of the Tax Information Bulletin sets out the answers to some day-to-day questions that people have asked. We have published these as they may be of general interest to readers.

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

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Income Tax Act 1976

Cost of function ticket - when charitable portion can qualify for rebate

Sections 56A and 147 - Qualifying Gifts: A promoter is organising a charitable function. Tickets for the function will sell at $60, and the promoter has guaranteed that $15 of the ticket price will be donated to a recognised charity. The promoter wanted to know Inland Revenue's requirements that will enable purchasers of tickets to claim the charitable donation of $15 in their income tax returns.

If a proportion of the ticket price is guaranteed by the promoters as being a donation to a charitable organisation, that amount could qualify for the purposes of sections 56A and 147 of the Income Tax Act 1976. However, to obtain this approval the ticket must meet all of these conditions for a receipt:

- it must be officially stamped with the name of the organisation
- it must show the amount of the donation content
- it must show the date the donation was received
- it must be signed by a person authorised by the organisation to accept donations.

To qualify for the rebate, the donation must be for at least $5.00.

Alternative methods for returning income from financial arrangements

Section 64C - Accruals in relation to income and expenditure in respect of financial arrangements: A taxpayer asked what alternative methods to yield to maturity (YTM) - for example, straight line or the rule of 78 methods - could be

used to return income from financial arrangements. The taxpayer was not a cash basis holder under section 64D as it held financial arrangements of more than $600,000 in the income year. Historically, the taxpayer had recognised financial arrangement income on a straight line basis.

The taxpayer did not qualify to use the straight line method under section 64C(2A). That provision is only available for taxpayers that hold or issue financial arrangements of $1,000,000 or less on every day within the income year. Also, section 64C(2A)(c) of the Act did not apply. (See page 16 of TIB Volume Three, No.1 (July 1991) for a full discussion of the requirements of section 64C(2A)).

Additionally, it was possible for the taxpayer to calculate income or expenditure using the YTM method. Accordingly, section 64C(3) was not relevant.

Section 64C(2) generally requires holders and issuers of financial arrangements, except cash basis holders, to calculate income or expenditure using the YTM method so as to allocate it in a fair or reasonable manner.

Broadly however, the proviso to section 64C(2) allows a taxpayer to use an alternative to the YTM method if the alternative meets all of these conditions:

- it has regard to the principles of accrual accounting
- it conforms with commercially accepted practice
- it is consistently applied for financial reporting purposes
- it results in an allocation that is not materially different from that under YTM.

The taxpayer's use of the straight line method did not meet the materiality test under the proviso. It would have resulted in a materially different allocation of financial arrangement income to a YTM method. Accordingly, the taxpayer could not use the method.

The taxpayer was not permitted to use the rule of 78 method for the same reason. The rule of 78 method may produce results materially different from YTM in certain circumstances, but it has an inherent bias which accelerates the interest amounts to earlier periods of a loan. The bias tends to become greater the higher the interest rate or the longer the term.

Inland Revenue required the taxpayer to use a YTM method.

Recovery of interest when property sold within ten years

Section 129(A1) - No application to transactions after 24 July 1990: Two taxpayers owned a rental property. They claimed mortgage interest as a deduction against the rental income. At the time they bought the property they knew that if they sold it within ten years they would be assessed on the interest that they had deducted. They asked if this is still the situation.

Under section 129, deductions which were previously allowed for certain assets become assessable if the assets are sold within ten years of acquisition. However, section 129(A1) states that section 129 does not apply to property sold after 24 July 1990.

Accordingly, if the taxpayers sell their rental property within 10 years of buying it, the interest previously deducted will not be assessed.

Depreciation on library books

Section 108 - Annual depreciation deduction: A consultant asked if the cost of setting up a library for his new consulting business is deductible.

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Books are depreciable items under sections 107A and 108. The depreciation rates for books are set out on page 56 of the appendix to TIB Volume Four, No 9 (April 1993). In this case the rate is 9.5% diminishing value or 6.5% straight line.

If the consultant buys a business-related book which costs less than $200, under section 108O(2) he may elect to write it off as a "low value asset". This means he can claim the cost of the book as a deduction against his assessable income, rather than claiming depreciation at the appropriate rate.

If the consultant claims a low value asset deduction for any book, and later sells it, he will have to declare the sale proceeds as assessable income in the year of sale.

Any amount spent on maintaining the library books is also deductible.

Note: If two or more books are purchased from the same supplier on the same day, and the depreciation rate is the same for each item, a further rule applies. The books must be treated as a single item for the purpose of determining whether they qualify for the low value write-off.

Special tax code - privacy of information

Section 344(10) - Notice of cessation: An employee advised us of the following situation:

At the time of taking up her current employment with Mr X, she agreed to obtain his permission before commencing any additional employment. An opportunity has now arisen for her to take an additional job with Mrs Y that will pay more than she receives from Mr X. She doesn't want Mr X to know of her plans, but realises that if she accepts the job with Mrs Y, the job with Mr X will become secondary employment.

She asks if she can retain the G tax code for her Mr X job, as asking him to alter her IR 12 to show the SEC code would reveal her situation.

Section 344(10) requires an employee to notify the employer of a change of tax code entitlement within 4 days of becoming aware of the necessitating circumstances.

However, in this situation the employee could apply for a special tax code certificate under section 351, because she has income from more than one employer. Under section 351(3), once the new employer receives that certificate the section 344(10) requirement would effectively be overridden.

Estate and Gift Duties Act 1968

When gifts of land and shares are said to be complete

A taxpayer planned to gift a section of land (valued at $100,000) and some shares (valued at $1,500) to a friend. She was aware of the "12 month rule", under which any gifts that the same donor makes within 12 months of making a dutiable gift must be aggregated with the dutiable gift for the purpose of calculating gift duty. (This period will be either the 12 month period that starts on the date of the dutiable gift, or the twelve month period that ends on that date. It does not include both of these periods.)

The taxpayer asked when the planned gifts would be considered complete, and therefore, when liability for gift duty on the transactions would arise.

Until an intended gift is complete, the donor can revoke it at any time. The following are the relevant dates of completion:

Land subject to the Land Transfer Act 1952

The earlier of these dates:

- the date on which the instrument of transfer is registered with the Land Transfer Office
- the date on which the beneficiary has in his or her possession all the documents needed for registration to be effected. However, where a valid trust is created, the trust's creation date is used.

Shares

The earlier of these dates:

- the date on which the company registers the instrument of transfer
- the date on which the beneficiary has in his or her possession all the documents needed for registration to be effected.

Note: Dates of completion may differ for shares transferred under a system approved under section 7 of the Securities Transfer Act 1991.

In this particular case, the gift of land was completed at the date of registration with the Land Transfer Office, and the gift of shares was effective two weeks later when the transfer was registered by the company. As the gifts were made within 12 months of each other, they must be aggregated under section 62 of the Estate and Gift Duties Act 1968. The gift duty on $101,500 is calculated under the Third Schedule to the Act as follows:

Value of gift	$101,500		
Gift duty on	$ 72,000	=	$ 5,850
Gift duty on balance	$ 29,500	@ 25% =	$ 7,375
Total gift duty payable			$13,225

Adjustment to conditions on mortgage to family member

A taxpayer provided his son with substantial business funds by way of mortgage in July 1992. The son's business currently has some liquidity problems. In order to assist his son, the taxpayer is considering adjustments to the mortgage conditions, but realises that there may be gift duty implications.

The taxpayer asked about the gift duty consequences of these actions:

- postponing the date that repayments are due
- granting an "interest holiday"
- reducing the interest rate payable.

Postponing repayments of principal required under the mortgage does not involve a gift if the postponed repayments continue to attract interest.

Granting an "interest holiday" involves a gift of the interest forgiven for the period of the holiday. However, if the mortgage provides for payment of interest only if demanded by the lender each year, and the lender does not exercise this right to demand, no gift is involved (see *Re Marshall* [1965] NZLR 851).

A simple reduction in the interest rate payable under a mortgage does not involve a gift, unless the reduced rate of interest is set at an unrealistically low level, given the particular circumstances of the transaction. If the new rate was set at current commercial rates there would be no gift duty implications.

Stamp and Cheque Duties Act 1971

Stamp duty reduced if gift duty payable on transferred property

Section 23 - Conveyance duty reduced if gift duty paid on conveyance: A taxpayer has asked if a gift of land can attract both conveyance duty and gift duty.

A gift of land can attract both gift and conveyance duties. However, section 23 of the Stamp and Cheque Duties Act 1971 allows a reduction in the value of the property being conveyed (and consequently a reduction in conveyance duty) if a dutiable gift is involved. For section 23 to apply, gift duty must have been payable.

Example

A block of land valued at $35,000 is gifted, and gift duty is charged on that value as follows:

5% of ($35,000 - $27,000) $8,000 = $400.

If the land for conveyance duty purposes is valued at $35,000, this amount is reduced under section 23 by the value of the land for gift duty purposes (i.e., $35,000), resulting in nil value and therefore no conveyance duty.

Gifts on which no duty is payable or that are exempt under the Estate and Gift Duties Act 1968 do not qualify for the reduction. For example, if one person makes gifts to another in good faith and as part of the donor's normal expenditure, the gifts will not be subject to gift duty if their total value does not exceed $2,000 in a single calendar year.

Upcoming TIB articles

In the next few months we'll be releasing policy statements on these topics in the Tax Information Bulletin:

- When Inland Revenue can grant relief from payment of tax in cases of financial hardship
- GST and temporary imports
- Tax treatment of salaries and emoluments received by NZ residents employed by the International Monetary Fund, World Bank and similar entities
- Losses of individual NZ resident insurance underwriters
- Treatment of dividend imputation credits and dividend withholding payment credits in the hands of trustees and beneficiaries
- GST and secondhand goods
- Meaning of terms "own" and "acquired" for depreciation purposes
- Personal sickness and accident and loss of earnings insurance policies
- Tax status of bodies corporate
- Keeping a logbook for a vehicle used for both business and private purposes
- Imputation credit accounts as they relate to consolidated groups of companies
- Conveyance duty on property conveyed on behalf of a company yet to be incorporated
- Treatment of rental losses for Family Support purposes
- GST and payments made by instalments
- Qualifying company election formula - meaning when factor "b" is negative

We'll publish these statements as soon as we've finished consulting with commentators outside Inland Revenue.

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.

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Profits on sale of shares - capital or revenue

Rating: • • •

Case: Rangatira Limited v Commissioner of Inland Revenue AP 76/93, 250/93

Act: Income Tax Act 1976 - sections 65(2)(a) and (e) and former section 191(4A)

Keywords: *Share gains and losses, capital v revenue*

Summary: The taxpayer carried on an investment business involving company shares. The volume of its transactions increased in the 1980s and Inland Revenue assessed gains on transactions under sections 65(2)(a), (e) and 191(4A). Certain gains were found to be taxable under the second limb of section 65(2)(e). Otherwise the gains were not taxable.

Facts: The taxpayer was an unlisted public company that carried on an investment business. The shareholders were charitable and family trusts established by the

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company founder. The overall scheme was that the taxpayer administered the assets of the charitable trusts and the trusts allocated the income received.

Until 1983, the policy of the taxpayer's directors was capital maintenance and the provision of regular dividends. During the 1980s the taxpayer made substantial gains on the sale of shares. Inland Revenue assessed the taxpayer for gains in the 1986 to 1990 income years for these reasons:

- the taxpayer was in the business of share dealing under section 65(2)(a) or the first limb of section 65(2)(e) of the Act
- particular transactions were within the second and third limbs of section 65(2)(e)
- a wholly owned subsidiary of the taxpayer was a share dealer and section 191(4A) applied.

Decision: Justice Gallen in the High Court held that:

- The tax treatment under section 65(2)(a) and the first limb of section 65(2)(e) was as formulated in *Californian Copper Syndicate (Limited and Reduced)* v *Harris (Surveyor of Taxes)* [1904] 5 TC 159. Under this treatment, when the owner of an ordinary investment chooses to realise it, any gain is not normally a taxable profit. However, such a gain is taxable when securities are realised not on a mere realisation or change of investment, but when done in the carrying on, or carrying out, of a business.
- Although there were factors leading to the opposite conclusion, the facts fell into the first case. The economic situation of the 1980s required regular reinvestment by the taxpayer. There was no fundamental change to the investment philosophy or approach of the taxpayer. Investments made in a certain group of companies were consistent with this philosophy. Also, some of the share realisations were to allow the company to switch investments to a car-parking building.
- The second and third limbs of section 65(2)(e) applied to some, but not other, categories of transactions. Twenty-two categories of transactions were analysed case by case.
- Losses on certain investments could not be deducted, where corresponding profits would not have been assessable under section 65(2)(e).
- Section 191(4A) did not apply to the transactions. Justice Gallen noted that the fact that the transactions carried out by the taxpayer did not come within the category of transactions normally operated by the share dealing subsidiary indicated that it should not apply. He concluded that the tax status of the transactions should be as under section 65.

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

Loss on disposition of depreciated property

Rating: • • •

Case: TRA 93/211

Act: Income Tax Act 1976 - section 117

Keywords: *Motor vehicle value, depreciation, loss on sale*

Summary: The taxpayer company sold a motor vehicle to its directors/shareholders at below book value. The taxpayer claimed a deduction for the loss. The Commissioner disallowed the deduction on the basis that the sale was below market

value. The TRA upheld the Commissioner's decision, finding that the taxpayer had not established on the balance of probabilities that the sale price was the market value.

Facts: The taxpayer purchased the motor vehicle in early 1988. The sale occurred in early 1989 at a price well below book value. The taxpayer claimed a deduction for the difference between book value and the sale price. The Commissioner considered the sale was at less than market value and disallowed the deduction. The taxpayer relied on the sale prices of the same vehicle in the 1992 and 1993 income years to justify the 1989 price, and also relied on notional depreciation figures for the 1990 to 1992 income years.

Decision: The TRA upheld the Commissioner's assessment. Generally, the onus of proof in a tax case rests with the taxpayer on the balance of probabilities. When the Commissioner forms the view that a vehicle is sold below market price (under the previous section 117(5)(b)) the Commissioner should determine a price on the basis of information supplied by the taxpayer. In this case, it was reasonable for the Commissioner to arrive at a higher selling price by disallowing the loss. Particularly important was the taxpayer's failure to supply reasonable information as to the true value of the vehicle.

The information supplied by the taxpayer was inadequate to establish, on the balance of probabilities, that the selling price was the market value. It was hearsay evidence. While the TRA can accept hearsay evidence, in this case the TRA could not rely on, or make reasonable conclusions from, the particular evidence supplied by the taxpayer. Sale prices years after the original sale did not help with valuation at the time of that first sale. Nor did notional depreciation figures.

The TRA favoured a practical approach to valuation using the robust attitude of the market, not a minute assessment of the particular vehicle. The TRA would have accepted a letter of valuation from a motor vehicle dealer as appropriate evidence. It may even have been acceptable to obtain such a letter some years after the sale on the basis of a similar valuation in the past. There may have even been information from the dealer's records as to what was the earlier valuation. Also, from an inspection of the vehicle, the dealer may have been able to establish its earlier value. However, although given every opportunity to do so, no such evidence was tendered by the taxpayer.

Comments: The taxpayer is not appealing this decision.

Wages subsidised by Employment Service - employer to deduct tax

Rating: • • •

Case: TRA 93/100

Act: Income Tax Act 1976 - section 338(1)

Keywords: *Employer, person making payment, subsidy*

Summary: Under the Community Restart Programme an organisation can employ workers and receive a subsidy for their wages from the New Zealand Employment Service (NZES). In such cases it is the organisation, not the NZES, which is obliged to deduct PAYE and ACC levies.

Facts: A charitable trust received subsidies from the NZES for workers referred to it under the Community Restart Programme. It engaged these workers to carry out the purposes of the trust. The trust did not deduct PAYE or ACC levies from payments it made to the workers because it understood the NZES to be the employer and the trust itself to have no such responsibilities. The Commissioner

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issued an assessment for the outstanding PAYE and ACC levies. The trust objected on the ground it was not the employer. The TRA heard evidence as to the nature of the relationship between the NZES, the trust, and the workers, and as to the advice that was given to the trust. The TRA accepted there had been a genuine misunderstanding by well motivated people who did not profit from the omission to make the deductions.

Decision: The payment by NZES to the trust was a subsidy. It is not possible for an employer to "subsidise" the wages of its own staff. It should have been clear therefore that NZES was not the employer.

On the facts the trust was the employer under general law. Even if this had not been the case, the trust would still be obliged by section 338(1) to make PAYE tax deductions. The payments to the workers fell clearly under the definition of "salary or wages" in section 2. They were therefore "source deduction payments". Section 338(1) imposes the obligation to make deductions from source deduction payments on "the employer or other person by whom the payment is made". The assessments were therefore correct.

The TRA observed that it had no jurisdiction to deal with the hardship to the trust.

Comments: The taxpayer is not appealing this decision.

Profits from subdivision of land

Rating: • •

Case: Prouse v Commissioner of Inland Revenue CA 239/93

Act: Land and Income Tax Act 1954 - section 88AA

Keywords: *Land subdivision, sale or other disposition, retrospective application of statute.*

Summary: This was a Court of Appeal judgment from the High Court decision of Justice Gallen in *Prouse v CIR* [1993] NZTC 10,271. This case was about the sale of sections in a subdivision following a change in the law. Profits on sections sold after the change were subject to income tax despite the fact that the scheme or undertaking commenced before the new law change.

Facts: The taxpayer entered into a scheme to subdivide his land in May 1973. This was before the Government announced the intention to introduce new legislation relating to the sale of land.

The 1973 Amendment Act introduced section 88AA(1)(e) which dealt with profits and gains from the subdivision of land. After 10 August 1973 (the date of the public announcement of the intended legislation) Inland Revenue assessed the profits and gains from the sale of property.

The taxpayer argued that the legislation should only apply to undertakings or schemes begun after the date of the public announcement. In the High Court, Justice Gallen held that the amendment applied to profits and gains on the sale of sections after the application date of the new legislation. The fact that Inland Revenue had previously confirmed that the subdivision proposal was not taxable did not affect the situation.

The taxpayer appealed to the Court of Appeal.

Decision: The Court of Appeal dismissed the appeal and agreed with the conclusions reached by Justice Gallen in the High Court and by Justice Tompkins in *Aubrey v Commissioner of Inland Revenue* (1984) 6 NZTC 61,765, on which Justice Gallen relied.

The Court of Appeal held that the 1973 legislation was intended to apply to all sales of land after 10 August 1973. It did not matter whether any undertaking or scheme involved was embarked on before or after that date. Factors that influenced the Court of Appeal's decision were:

- The 1973 statute changed the rules applying to land transactions. Any sale before 10 August was dealt with under the old provision, and any sale after that date under the new provision.
- The legislative focus on sales and on the dates of sales was entirely rational in policy terms as it prevented a tax gap caused when the old section ceased to apply.
- In the Court of Appeal's view the words of the legislation were clear. Section 9(5) of the Amendment Act 1973 applied to any profit derived from any sale made on or after 10 August 1973. The legislation could not be read down to exclude sales if the undertaking or scheme commenced before that date.

Comments: The taxpayer is not appealing this decision.

Whether subdivision work was of a minor nature

Rating: • • •

Case: Costello v Commissioner of Inland Revenue CA 237/93

Act: Income Tax Act 1976 - section 67(4)(e)

Keywords: *Profits from subdivision, work of a minor nature*

Summary: This was an appeal to the Court of Appeal from the High Court decision of Justice Speight in *Costello v Commissioner of Inland Revenue* (1993) 15 NZTC 10,285. The Court of Appeal held that on the overall judgment of the facts of the case, the work was not of a minor nature.

Facts: The taxpayers were the joint owners of property consisting of nine self-contained flats. They decided to subdivide the flats into unit titles and sold the resulting nine lots individually. The subdivision did not require any physical work and the surveying, valuation and legal work involved was straightforward. The fees charged by the solicitor and surveyor were only $560 plus $13 disbursements and $1,012 plus $92 disbursements respectively. The valuer, whose work only involved allocating percentages of the total value to the respective units, did not charge a fee and it seems received a small gift.

The units were sold at a profit and the Commissioner assessed the taxpayers under section 67(4)(e) of the Income Tax Act 1976.

In the High Court, Justice Speight held that the complicated nature of the subdivision scheme and the number of resulting lots meant that the development or subdivision work was not of a minor nature. The scheme was caught under section 67(4)(e) as the other elements of the provision were satisfied on the facts of the case. The taxpayers appealed to the Court of Appeal.

Decision: The Court of Appeal said that whether the work in question was of a minor nature was a matter of fact to be determined on all the circumstances of the particular case. Every subdivision of a larger area into lots would include some survey work, the preparation of appropriate plans, obtaining planning consents and local authority permits and associated legal work including the depositing of subdivisonal plans and the issue of any separate titles. Each particular case called for an assessment of what was done, which in practical terms may require consideration of the time, effort and expense involved.

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The Court of Appeal considered the facts of the case. The property was subdivided into nine lots, six of which had street frontage. There were four separate buildings involved. Each unit had one or more accessory units which had to be delineated on the plan and four common property areas were provided. Although the surveyor's fee was very modest in 1994 prices, and the total professional charges were very small relative to land values, the job took 36 hours of time in order to achieve the object of a subdivision into nine lots. In addition there was the associated legal work including the establishment of a new corporate body for the property under the Unit Titles Act.

Taking the facts into account, the Court of Appeal held that the work was not of a minor nature and dismissed the taxpayers' appeal.

Comments: The taxpayer is not appealing this decision.

GST and subdivisions

Rating: •••••

Case: Newman v Commissioner of Inland Revenue HC Dunedin AP 83/92

Act: Goods and Services Tax Act 1976 - section 6

Keywords: *Taxable activity, continuously, regularly*

Summary: On appeal, the High Court upheld the TRA decision that a "one-off" property subdivision can constitute a taxable activity for GST purposes.

Facts: This case involved a builder who purchased a block of land on which he intended building a family home for himself. During the construction of the house, he subdivided the property to fund the completion of the house. This subdivision was independent from his taxable activity of building. Following the sale of the subdivided land Inland Revenue determined that the subdivision activity was a taxable activity and GST was assessed on the sale.

The taxpayer's objection to the assessment was disallowed and he requested that a case be stated to the TRA. The TRA found that the assessment was correct and the taxpayer appealed to the High Court.

Decision: Justice Fraser held that the ordinary and natural meanings of the words "continuous" and "regular" did not preclude a one-off subdivision from being characterised as a taxable activity. Justice Fraser held that the series of sequential steps undertaken in the subdivision process, such as drainage, electrical and access work and the usual real estate and lawyers fees, constitute an "activity". He likened the transaction to that of a person who as a single venture constructs a commercial building for ultimate sale. Even though it is "one off", it would still be described as an activity because of the series of acts involved in the building's construction.

In the case at hand the builder carried on the activity without interruption from the time the decision was made to proceed with the subdivision until the time the section was sold. This meant the activity was carried on "continuously". Justice Fraser concluded that the subdivision process was a taxable activity in its own right.

Comments: The taxpayer is appealing this decision to the Court of Appeal.

Whether chartering a private launch constitutes a business

Rating: • • •

Case: LR Lawrence v Commissioner of Inland Revenue HC Auckland M695/92

Act: Income Tax Act 1976 - sections 2, 33(13) and 104.

Keywords: *deductions, carrying on a business, request for case to be stated directly to the High Court*

Summary: The High Court held that a taxpayer could not deduct the running costs of a launch against his assessable income as he did not use the launch in carrying on a business.

Facts: The taxpayer purchased a launch that was suitable for charter operations as well as personal use. He claimed most of the expenditure incurred in running the launch as a deduction against his income as a dentist. The Commissioner disallowed the deduction. The taxpayer requested that the case be stated directly to the High Court on the grounds he incurred that expenditure in carrying on a business under section 104(b) of the Income Tax Act 1976.

Decision: Justice Fisher held that the running costs of the launch were not deductible as the taxpayer had not used the launch for carrying on a business. These are the reasons that Justice Fisher took into account:

- There had been no serious inquiry into the feasibility of the charter business before purchasing the launch.
- There had been no serious attempt by the taxpayer to promote the charter venture.
- There was a small proportion of chartering use compared to private use.
- There had been limited availability of the launch for charter use.
- Following the financial year in question the taxpayer kept the launch for his own personal use.

The Judge refused the Commissioner's application for costs because the Commissioner had consented to a High Court hearing in the first instance, when in the Judge's view, the Taxation Review Authority should have heard the case as it did not involve difficult questions of law or large sums of money.

Comments: Inland Revenue is still considering whether to appeal the Judge's decision to refuse the Commissioner's application for costs.

Exchange of yachts - whether supply of taxable activity as a going concern

Rating: • • •

Case: Allen Yacht Charters Limited v Commissioner of Inland Revenue, HC Auckland M 118/94

Act: Goods and Services Tax Act 1985, sections 6(1), 8(1) and 11(1)(c).

Keywords: *Taxable activity, going concern*

Summary: The case concerned a sale of a yacht in return for another yacht with the difference paid in cash. The High Court found that in each case there was a taxable activity, but there was no supply of a taxable activity as a going concern.

Facts: Allen Yacht Charters Limited (the objector) entered into an agreement to sell its yacht *Chateau Briand* to a Mr and Mrs Macalister (the Macalisters) in exchange

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for the Macalister's yacht *Laissez Faire* and $80,000 in cash. The objector issued a tax invoice to the Macalisters which showed the GST as being nil and stating the *Chateau Briand* was sold to the Macalisters as a going concern. The Commissioner issued an assessment to the Macalisters showing the purchase of the *Chateau Briand* to be of a going concern. The Macalisters objected on the basis that the purchase was not the purchase of a going concern and therefore they were entitled to an input claim for the GST. The objection eventually came before the Taxation Review Authority. In a TRA Case, *Q1* (1993) NZTC 5001, Judge Willy upheld the objection and found that the Macalisters did not purchase the business as a going concern and therefore were entitled to claim a refund of GST on the purchase. The Commissioner then reassessed the GST liability to the objector charging GST on the sale, the objector objected to that assessment and the case stated resulted.

The Court decided that the issues to be determined were

- Whether the activity carried on before the exchange by the objector with *Chateau Briand* and by the Macalisters with *Laissez Faire* was a taxable activity
- If so, whether there was in each case a "supply" of that taxable activity "as a going concern".

Decision:

Justice Tompkins in both cases held that both the objector and the Macalisters were carrying on a taxable activity but there was no supply of that taxable activity as a going concern. In approaching the question of whether a taxable activity had been supplied as a going concern Justice Tompkins referred to *Variety Leisure Corporation v Commissioner of Inland Revenue* (1988) 10 NZTC 5255. The one reservation Justice Tompkins had with this decision was Justice Hardie Boys' reference to an undertaking remaining active and operating "before, during and after its transfer to the new ownership". He did not consider that it was necessary for the undertaking to remain active after its transfer. He considered that the purchaser may be supplied with the vendor's going concern but may, immediately after acquisition, close it down. There would still have been the supply of a going concern. He considered, however, that the concern must be going at the time of transfer to the new owner.

In relation to the *Chateau Briand* transaction Justice Tompkins concluded that the sale to the Macalisters was only of the assets of the business and there was no supply of the business as a going concern. Relevant facts were that there was no payment for goodwill, there was no transfer to the Macalisters of forward bookings, there was no examination of the accounts of the business, there were no steps taken for the Macalisters to take over the objectors' customers, and there was little evidence that the Macalisters had any detailed knowledge of the business.

In relation to the *Laissez Faire* the Macalisters' management agreement with a chartering company came to an end on the day the yacht was sold to the taxpayer. For this reason Justice Tompkins decided there was no supply of a going concern. The fact that the objector effected a new agreement with the same company on that same day was not considered sufficient to change the decision. Justice Tompkins commented that if the clause in the agreement between the Macalisters and the management company prohibiting the sale of *Laissez Faire* without the purchaser signing a management agreement with Rainbow had been enforced, there would be good grounds for concluding that the transaction involved the carrying on by the objector of the same taxable activity as had been carried on by the Macalisters. However, this had not happened.

Comments:

We do not know whether the taxpayer will appeal this decision.

List of Inland Revenue booklets

This list shows all of Inland Revenue's information booklets as at the date of this Tax Information Bulletin. There is also a brief explanation of what each booklet is about.

Some booklets could fall into more than one category, so you may wish to skim through the entire list and pick out the booklets that you need. You can get these booklets from any IRD office.

For production reasons, the TIB is always printed in a multiple of eight pages. We will include an update of this list at the back of the TIB whenever we have enough free pages.

For people in business

A guide to Inland Revenue audits (IR 297) March 1994

For business people and investors. It explains what is involved if you are audited by Inland Revenue; who is likely to be audited; your rights during and after the audit, and what happens once an audit is completed.

ACC premiums (published by ARCI Corporation) 1994/95

Explains the ACC employer premium, and gives the premium rates payable by employers and self-employed people. ACC publish this book.

Approved issuer levy (IR 291A) May 1994

For taxpayers who pay interest to overseas lenders. Explains how you can pay interest to overseas lenders without having to deduct NRWT.

Consolidation (IR 4E) March 1993

An explanation of the consolidation regime, which allows a group of companies to be treated as a single entity for tax purposes.

Depreciation (IR 260) April 1994

Explains how to calculate tax deductions for depreciation on assets used to earn assessable income.

Employers' guide (IR 184) 1994

Explains the tax obligations of anyone who is employing staff, and explains how to meet these obligations. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.

Entertainment expenses (IR 268) April 1993

Covers the tax treatment of business entertainment expenses, under the rules applying from 1 April 1993.

Fringe benefit tax guide (IR 409) June 1992

Explains fringe benefit tax obligations of anyone who is employing staff, or companies which have shareholder-employees. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.

GST - do you need to register? (GST 605) May 1994

A basic introduction to goods and services tax, which will also tell you if you have to register for GST.

GST guide (GST 600) 1994 Edition

An in-depth guide which covers almost every aspect of GST. Everyone who registers for GST gets a copy of this booklet. It is quite expensive for us to print, so we ask that if you are only considering GST registration, you get the booklet "GST - do you need to register?" instead.

Imputation (IR 274) February 1990

A guide to dividend imputation for New Zealand companies.

Inland Revenue employers' tax calendar (IR 24E) 1994

A list of all the more common tax due dates that employers have to remember. If you have a balance date other than 31 March, you may find the full tax calendar (IR 24) more useful.

Inland Revenue tax calendar (IR 24) 1994

A complete list of all the tax due dates. It covers everything from filing tax returns to the due dates for non-resident Student Loan repayments.

Non-resident withholding tax payers' guide (IR 291) Jul 1994

A guide for people or institutions who pay interest, dividends or royalties to people who are not resident in New Zealand.

PAYE deduction tables

- Four-weekly and monthly (IR 184Y) 1994
- Weekly and fortnightly (IR 184X) 1994

Tables that tell employers the correct amount of PAYE to deduct from their employees' wages.

Qualifying companies (IR 4PB) October 1992

An explanation of the qualifying company regime, under which a small company with few shareholders can have special tax treatment of dividends, losses and capital gains.

Resident withholding tax on dividends (IR 284) Oct 1993

A guide for companies, telling them how to deduct RWT from the dividends that they pay to their shareholders.

Resident withholding tax on interest (IR 283) March 1993

A guide to RWT for people and institutions which pay interest.

Running a small business? (IR 257) Jan 1994

An introduction to the tax obligations involved in running your own business.

Surcharge deduction tables (IR 184NS) 1994

PAYE deduction tables for employers whose employees are having national super surcharge deducted from their wages.

Tax help for sprouting young businesses (IR 257C)

A promotional pamphlet for Inland Revenue's Small Business Tax Information Service.

Taxpayer Audit (IR 298)

An outline of Inland Revenue's Taxpayer Audit programme. It explains the units that make up this programme, and what type of work each of these units does.

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For non-profit groups

Charitable organisations (IR 255) May 1993

Explains what tax exemptions are available to approved charities and donee organisations, and the criteria which an organisation must meet to get an exemption.

Clubs and societies (IR 254) June 1993

Explains the tax obligations which a club, society or other non-profit group must meet.

Education centres (IR 253) June 1994

Explains the tax obligations of schools and other education centres. Covers everything from kindergartens and kohanga reo to universities and polytechnics.

Gaming machine duty (IR 680A) February 1992

An explanation of the duty which must be paid by groups which operate gaming machines.

Grants and subsidies (IR 249)

An guide to the tax obligations of groups which receive a subsidy, either to help pay staff wages, or for some other purpose.

GST for non-profit bodies (GST 605A) September 1992

Tells non-profit groups whether they'll need to register for GST, and on what activities they must account for GST.

For individual taxpayers

Dealing with Inland Revenue (IR 256) April 1993

Introduction to Inland Revenue, written mainly for individual taxpayers. It sets out who to ask for in some common situations, and lists taxpayers' basic rights and obligations when dealing with Inland Revenue.

Estate and gift duties (IR 634) Nov 1991

An explanation of estate and gift duties, written for individual people rather than solicitors or legal firms. Estate duty has been repealed since this book was written.

Interest earnings and your IRD number (IR 283L) September 1991

Explains the requirement for giving to your IRD number to your bank or anyone else who pays you interest.

International tax guide (IR 275) June 1989

Deals with controlled foreign companies, foreign investment funds, and people who have interests in them.

IR 56 taxpayer handbook (IR 56B) April 1994

A booklet for part-time private domestic workers, embassy staff, nannies, overseas company reps and Deep Freeze base workers who make their own PAYE payments.

Koha (IR 278) August 1991

A guide to payments in the Maori community - income tax and GST consequences.

New Zealand tax residence (IR 292) April 1994

An explanation of who is a New Zealand resident for tax purposes.

Objection procedures (IR 266) March 1994

Explains how to make a formal objection to a tax assessment, and what further options are available if you disagree with Inland Revenue.

Provisional tax (IR 289) March 1994

People whose end-of-year tax bill is over $2,500 must generally pay provisional tax for the following year. This booklet explains what provisional tax is, and how and when it must be paid.

Putting your tax affairs right (IR 282) May 1994

Explains the advantages of telling Inland Revenue if your tax affairs are not in order, before we find out in some other way. This book also sets out what will happen if someone knowingly evades tax, and gets caught.

Resident withholding tax on investments (IR 279) April 1993

An explanation of RWT for people who receive interest or dividends.

Retiring allowances and redundancy payments (IR 277) June 1994

An explanation of the tax treatment of these types of payments.

Self-employed or an employee? (IR 186) April 1993

Sets out Inland Revenue's tests for determining whether a person is a self-employed contractor or an employee. This determines what expenses the person can claim, and whether s/he must pay ACC premiums.

Special tax codes (IR 23G) January 1994

Information about getting a special "flat rate" of tax deducted from your income, if the regular deduction rates don't suit your particular circumstances.

Stamp duties (IR 665) June 1992

Explains what duty is payable on transfers of real estate and some other transactions. Written for individual people rather than solicitors and legal firms.

Student Loans and Inland Revenue (SL 1)

A guide to your tax obligations if you've taken out a Student Loan.

Student Loan repayments - everything you need to know (SL 2) January 1994

A more in-depth guide to making student loan repayments.

Superannuitants and surcharge (IR 259) January 1994

A guide to the surcharge for national superannuitants who also have other income.

Tax facts for income-tested beneficiaries (IR 40C) September 1992

Vital information for anyone who receives an income-tested benefit and also has some other income.

Problem Resolution Service (IR 287) November 1993

An introduction to Inland Revenue's Problem Resolution Service. You can use this service if you've already used Inland Revenue's usual services to sort out a problem, without success.

Child Support booklets

Child Support - a guide for bankers (CS 66) August 1992
An explanation of the obligations that banks may have to deal with for Child Support.

Child Support - a guide for tax practitioners (CS 4) March 1992
A summary (mainly for accountants) of how Child Support works, and the rates for calculating payments.

Child Support - a parent's guide (CS 1) March 1992
An in-depth explanation of Child Support, both for custodial parents and parents who don't have custody of their children.

Child Support - an introduction (CS 3) March 1992
A brief introduction to Child Support.

Child Support - does it affect you? (CS 50)
A brief introduction to Child Support in Maori, Cook Island Maori, Samoan, Tongan and Chinese.

Child Support - how to approach the Family Court (CS 51) June 1992
Explains what steps people need to take if they want to go to the Family Court about their Child Support.

Child Support - the basics - a guide for students
A basic explanation of how Child Support works, written for mainly for students.

Due dates reminder

September

5 Large employers: PAYE deductions and deduction schedules for period ended 31 August 1994 due.

7 Provisional tax and/or Student Loan interim repayments: first 1995 instalment due for taxpayers with May balance dates.
Second 1995 instalment due for taxpayers with January balance dates.
Third 1994 instalment due for taxpayers with September balance dates.

1994 end-of-year payments of income tax, Student Loans and ACC premiums due for taxpayers with October balance dates.

Non-IR 5 taxpayers: annual income tax returns due for taxpayers with May balance dates (SL 9 to be attached for Student Loan borrowers).

QCET payment due for companies with October balance dates with elections effective from the 1995 income year.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 September 1994 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 August 1994 due.

Gaming machine duty return and payment for month ended 31 August 1994 due.

RWT on interest deducted during August 1994 due for monthly payers.

RWT on dividends deducted during August 1994 due.

Non-resident withholding tax (or approved issuer levy) deducted during August 1994 due.

30 GST return and payment for period ended 31 August 1994 due.

Non-resident Student Loan repayments: second instalment of 1995 non-resident assessment due.

October

5 Large employers: PAYE deductions and deduction schedules for period ended 30 September 1994 due.

7 Provisional tax and/or Student Loan interim repayments: first 1995 instalment due for taxpayers with June balance dates.
Second 1995 instalment due for taxpayers with February balance dates.
Third 1995 instalment due for taxpayers with October balance dates.

1994 end-of-year payments of income tax, Student Loans and ACC premiums due for taxpayers with November balance dates.

Non-IR 5 taxpayers: annual income tax returns due for taxpayers with June balance dates (SL 9 to be attached for Student Loan borrowers).

QCET payment due for companies with November balance dates with elections effective from the 1995 income year.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 October 1994 due.

Small employers: PAYE deductions and deduction schedules for period ended 30 September 1994 due.

FBT: return and payment for quarter ended 30 September 1994 due.

Gaming machine duty return and payment for month ended 30 September 1994 due.

RWT on interest deducted during September1994 due for monthly payers.

RWT deducted in period 1/4/94-30/9/94 due for six-monthly payers.

RWT on dividends deducted during September 1994 due.

Non-resident withholding tax (or approved issuer levy) deducted during September 1994 due.

30 GST return and payment for period ended 30 September 1994 due.

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Questions we've been asked

Answers to enquiries we've received at Inland Revenue, which could have a wider application.
See page 18 or the inside front cover for a list of topics covered in this bulletin.

Legal decisions - case notes

Notes on recent cases heard by the Taxation Review Authority, the High Court, the Court of Appeal and the Privy Council. See page 23 or the inside front cover for a list of cases covered in this bulletin.

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