Fringe benefits granted to employees of overseas branches of New Zealand companies

Summary

This item states how paragraph (i) of the definition of the term "fringe benefit" applies to New Zealand employers who transfer employees to overseas branches.

All legislative references in this item are to the Income Tax Act 1976.

Background

Fringe benefit tax (FBT) is a tax payable by employers on the value of fringe benefits that they provide to employees. The provision of a benefit is taxable if both of these conditions are met:

- The benefit or advantage is provided to an employee by an employer.
- That benefit is provided in relation to, in the course of, or by virtue of the employee's employment with the employer.

FBT also applies when another party provides the employee with a fringe benefit under an arrangement between that party and the employer, or when the employer provides a benefit to an associated person of the employee.

Legislation

Section 336N(1) defines "fringe benefit", "employee", and "employer":

"Fringe benefit" ....

does not include-...

(i) Any benefit to the extent to which the Commissioner is satisfied that it is a benefit received or enjoyed by the employee in a quarter or (where fringe benefit tax is payable on an income year basis pursuant to section 336TB of this Act) income year, as the case may be, in which the employee derives a source deduction payment that is or, as the case may be, source deduction payments all of which are, not liable for income tax under part IV of this Act...

"Employee" means a person who will receive, receives, or has at any time received, or who will be, is, or has at any time been entitled to receive, a source deduction payment (not being a payment of any of the kinds referred to in paragraphs (ba), (c), (ca), (d), and (da) of the definition of the expression "salary or wages" in section 2 of this Act and not being a withholding payment of the kind specified in Part E of the Income Tax (Withholding Payments) Regulations 1979 in respect of which the person is liable for income tax under Part IV of this Act.

"Employer" means a person who will pay, pays, or has at any time paid, or who will be, is, or has at any time been liable to pay, a source deduction payment...;

Section 6(1) defines "source deduction payment":

Subject to this section, for the purposes of this Act the term "source deduction payment" means a payment by way of salary or wages, an extra emolument, or a withholding payment.

Section 242 provides the basic rules for the assessability of income in New Zealand. Section 242 is in Part IV of the Act and should be cross referenced to the definition of "employee". It states:

Subject to this Act, -

(a) All income derived by any person who is resident in New Zealand at the time when he derives that income shall be assessable for income tax, whether it is derived from New Zealand or from elsewhere:

(b) All income derived from New Zealand shall be assessable for income tax, whether the person deriving that income is resident in New Zealand or elsewhere:

(c) No income which is neither derived from New Zealand nor derived by a person then resident in New Zealand shall be assessable for income tax.

Application

"Fringe benefit" definition - paragraph (i)

Paragraph (i) excludes from the definition of "fringe benefit" benefits received by an employee in any FBT period in which that employee is not liable for New Zealand income tax on any source deduction payments received during that period.

Paragraph (i) applies only when the "employee" derives no source deduction payments liable to New Zealand income tax in the particular FBT period. If the employee derives a source deduction payment which is liable to New Zealand tax in any FBT period, the exception in paragraph (i) does not apply. This exclusion may affect the FBT liability of New Zealand employers that transfer employees to overseas branches.

Example 1

Phil, a US national, was appointed as the manager of the Bermudan branch of a New Zealand bank, Kiwi-Bank (Kiwi-Bank NZ). As a matter of company policy, Phil was seconded to New Zealand for three months training before taking up her position. In that time she received source deduction payments from Kiwi-Bank NZ which are subject to New Zealand income tax under section 242(b). She received the first payment on 4 August 1993, and the last on 27 October 1993. Kiwi-Bank NZ accounts for FBT on a quarterly basis.

Phil is an "employee" as she receives a source deduction payment on which she is liable for New

continued on page 2

from page 1

Zealand income tax. Kiwi-Bank NZ is accordingly Phil's "employer".

When she returns to Bermuda, Phil is provided with a car which is paid for by Kiwi-Bank NZ. The car is completely at Phil's disposal, and she can use it for private as well as business purposes.

FBT treatment:

Whether Kiwi-Bank NZ is subject to FBT on the provision of a car in Bermuda depends upon when the car is provided to Phil. Under paragraph (i) fringe benefits are subject to FBT if they are provided in the same FBT period in which the employee receives source deduction payments subject to New Zealand income tax. Once the employee's source deduction payments cease to be subject to New Zealand income tax, the fringe benefit is not a "fringe benefit" in terms of section 336N(1), and therefore is not subject to FBT.

- If the car is provided on Phil's return to Bermuda on 1 November 1993, then Kiwi-Bank NZ is liable for FBT on that fringe benefit in the quarter ending 31 December 1993. This is because in that quarter Phil received source deduction payments liable to New Zealand income tax under section 242(b). She is an "employee" for FBT purposes in that quarter.
- Kiwi-Bank NZ does not have to account for FBT in the quarter starting on 1 January 1994, because Phil does not receive any source deduction payment for which she is liable for New Zealand income tax in that period. Therefore, for that quarter, provision of the car is not a "fringe benefit" within section 336N(1).

However, if Phil was liable for New Zealand income tax on source deduction payments she received, then Kiwi-Bank NZ would have to account for FBT in that quarter.

Example 2

Mike, a New Zealand resident, is appointed as Phil's assistant manager at the Bermudan branch. Mike receives the same training in New Zealand and also receives a car on the same conditions as Phil.

FBT treatment:

When a New Zealand resident is transferred overseas to work for a branch of a New Zealand company, the analysis is different to that of a non-resident discussed above.

If the New Zealand resident retains his or her resident status, a liability to New Zealand income tax continues under section 242(a). Therefore, any source deduction payments will be subject to New Zealand income tax, and paragraph (i) will not operate to exclude the fringe benefit from the definition of "fringe benefit". If the resident loses resident status (under a double tax agreement or the residence tests in section 241), the exclusion in paragraph (i) will apply.

- If Mike retains his New Zealand resident status, Kiwi-Bank NZ will continue to be subject to FBT on the provision of the car.
- If Mike loses his New Zealand resident status, Kiwi-Bank NZ will be subject to FBT in the same way as it is for Phil, as discussed above.

GST on gaming machines

Introduction

This item explains how GST applies to gaming machines.

Background

There are special GST rules which apply to gaming machines and to other coin- or token-operated machines. Section 2 of the Gaming and Lotteries Act 1977 defines the term "gaming machine" to include machines operated by coins or tokens for use in a game of chance.

Section 2 of the Gaming and Lotteries Act defines the term "game of chance" as a game in which consideration is paid to participate with a view to winning money or money's worth.

All legislative references in this item are to the Goods and Services Tax Act 1985 unless otherwise stated.

Legislation

Section 5(10) deems a supply of services to occur when money is paid to participate in a game of chance (as defined in the Gaming and Lotteries Act).

Section 9 sets the time of supply rules for GST purposes. Section 9(2)(f) states that the time of supply for any coin- or token-operated machine is the time that the coins or tokens are taken from the machine by the supplier.

Section 10 sets the valuation rules for GST purposes. Section 10(14) states that the value of a supply for a game of chance is the total proceeds less any cash prizes. This rule ensures that the prize money does not attract GST.

These special rules mean that the supplier of a gaming or coin-operated machine is liable to account for GST on the amount of money taken from the machine, at the time the supplier collects the coins or tokens from the machine.

Site fee

Gaming machine owners are usually required to pay a site fee for the machine to a shop or arcade owner. This fee may be paid straight from the proceeds of the machine. A GST registered machine owner must account for GST on the total proceeds taken from the machine, before the payment of any expenses. The machine owner may claim an input tax credit if the site fee includes GST and a tax invoice is received.

Example

Mary Smith owns two video game machines and is registered for GST. Her taxable periods are two-monthly, ending on the last day of the even-numbered months of the year. On 25 June she empties the machines and receives a total of $5,000 net of all prizes paid to participants. She pays $100 site fee for the machines to the shop where the machines are situated. The shop owner issues a tax invoice for the site fee. Mary will show $5,000 as taxable supplies made and claim an input tax credit for 1/9th of $100 in her May/June GST return.

Expenses incurred in pollution control

Summary

This item sets out the provisions of section 124 of the Income Tax Act 1976. Section 124 allows a deduction for certain expenditure incurred to prevent or combat pollution of the environment. The section does not apply to taxpayers who are engaged in a farming or agricultural business, or to expenditure which is deductible as depreciation or otherwise under any other provision of the Act.

All legislative references in this item are to the Income Tax Act 1976.

Legislation

Section 124 applies to business taxpayers, except taxpayers who are involved in farming or agricultural businesses. In summary, it allows these taxpayers to claim a deduction for expenditure in constructing any of the following items on land in New Zealand, if the expenditure is to prevent or combat pollution of the environment:

- earthworks
- ponds
- settling tanks
- similar improvements primarily for the purpose of treating industrial waste.

The amount of the deduction they can claim is 20% in the income year in which the expenditure was incurred, and 20% in each of the four succeeding income years. The Commissioner may reallocate the amount allowed so that a minimum of $1,000 or the balance of the expenditure is allowed in an income year, whichever is the smaller.

No deduction is allowable under section 124 for expenditure which is eligible for a depreciation deduction or a deduction under any other provision of the Act.

Application

Expenditure on the construction of earthworks, ponds, settling tanks, or similar improvements is eligible for a deduction under section 124 as long as a deduction is not available under some other provision of the Act; the most likely deduction being depreciation.

The new depreciation regime (which generally applies from the 1993/1994 income year) extends the types of property that may be depreciated. Because of this, it is now more likely that pollution control expenditure will not be deductible under section 124. Page 46 of Inland Revenue's booklet "Depreciation Guide - 1994 Edition" (IR 260) explains which types of expenditure must be depreciated.

Pollution control expenditure that is depreciable includes such items as borewells, tanks, reservoirs, pipes, and screens. The only items of expenditure listed in section 124 that are not depreciable are earthworks and settling ponds, although there may be occasions when such expenditure qualifies for a depreciation deduction, e.g. in the case of a dam.

Example

In December 1993 Industrial Giant Ltd, which has a 31 March balance date, undertook certain expenditure for the purposes of treating its industrial waste. The expenditure consisted of certain earthworks, installing a settling tank, and pipes and pumping machinery at a total cost of $550,000.

The settling tank, pipes and pumping machinery are able to be depreciated. The earthworks which cost $150,000 are not, and therefore Industrial Giant can claim a deduction of $30,000 under section 124 in each of the 1994, 1995, 1996, 1997, and 1998 income years.

Overseas teachers and researchers deriving salaries and wages in New Zealand - income tax treatment

Summary

This item sets out the income tax exemptions on salary and wages derived by non-resident teachers and researchers in New Zealand. The item also sets out the Commissioner's current policy on collecting income tax from such teachers and researchers.

All legislative references in this item are to the Income Tax Act 1976 unless otherwise stated.

Background

Non-resident teachers and researchers are normally subject to New Zealand tax on salary and wages they derive from New Zealand under section 242(b). However, teachers or researchers may not be taxable if a legislative exemption applies to that income. Their income tax liability may also be altered if they are resident in a country that has a Double Tax Agreement ("DTA") with New Zealand and a provision of the DTA applies to their income.

Note that the employer of the non-resident teacher or researcher may be liable to pay fringe benefit tax on any employment-related benefits provided to that teacher or researcher in New Zealand.

Legislative exemptions

Section 61 sets out two general tax exemptions which may apply to the personal services income of non-resident taxpayers, including non-resident teachers or researchers. The application of the exemptions to non-resident teachers and researchers can be summarised as follows:

1. Section 61(19) provides a tax exemption for personal services income if the teacher or researcher meets both of these conditions:

(continued in opposite column)

   - He or she is in New Zealand for no more than 92 days in an income year (if the visit falls entirely within a single income year), or is in New Zealand for no more than 92 days in total (if the visit spans two income years, for example from 25 January to 15 April)
   - He or she is paying tax on that income in the country of residence, and is performing the teaching or researching services for or on behalf of a person who is not a New Zealand resident.

2. Section 61(38) provides a tax exemption for personal services income if the teacher or researcher meets either of these conditions:
   - He or she works for or on behalf of an employer who is not a New Zealand resident,
   - He or she is paid an allowance under an assistance arrangement entered into by the New Zealand Government. (Section 60(1) sets out such arrangements, for example a United Nations programme for professional, expert, educational, technical, economic, or cultural assistance.)

Double taxation agreements

Some DTAs provide a specific exemption from New Zealand income tax for teachers' and researchers' remuneration, as well as a general exemption from New Zealand income tax for income from personal services. Other DTAs only contain the general personal services income exemption. The following table summarises the provisions of the various DTAs New Zealand has entered into which affect the taxation of teachers' and researchers' income. Note that a researcher is not necessarily covered by a DTA exemption that applies to teachers and professors.

Exemption	Country/DTA Article
A. Specific exemptions:	
(1) Teacher in NZ for less than two years:	
(a) General terms	(1)(a)
A **teacher or professor** who teaches in New Zealand, and who meets the following three conditions, is exempt from tax on his or her teaching income: • He or she is teaching for a period which does not exceed two years. • He or she was a resident of the other DTA country immediately before coming to New Zealand. • He or she is subject to tax in the other DTA country.	Australia (Article 15) Fiji (Article 17) Sweden (Article 19)

Exemption	Country/DTA Article
(1) Teacher in NZ for less than two years (continued):	
(b) Variations	
(i) Research	(1)(b)(i)
The DTAs with these countries also exempt (on the same terms as set out in (1)(a)) the income of non-residents who carry out research in New Zealand. To be exempt such research must be undertaken in the public interest, rather than for the private benefit of specific person(s). The DTA with Philippines states that "remuneration" includes remittances from sources outside New Zealand which are sent to enable the person to carry out the teaching or research.	India (Article 21) Indonesia (Article 20) Italy (Article 20) Malaysia (Article 15) Netherlands (Article 20) Philippines (Article 20)
(ii) Tax in country of residence	(1)(b)(ii)
The exemption set out in (1)(a) applies, except these DTAs do not state that the teacher's income must be subject to tax in that teacher's country of residence. The DTAs with China, Germany, and Korea also exempt the income of individuals who are engaged in research in New Zealand. The DTAs with Germany and Korea require that the research is primarily in the public interest and not for the private benefit of a specific person or persons before the exemption applies.	Belgium (Article 20) China (Article 20) Germany (Article 20) Korea (Article 21)
(iii) Tertiary education only	(1)(b)(iii)
The exemption set out in (1)(a) only applies if the teacher is teaching at a tertiary institution. The DTA does not require the teacher to have been a resident of Japan immediately before visiting New Zealand or to be subject to tax on that income in Japan.	Japan (Article 11)
(2) Income exempt for two years	(2)
A teacher or researcher who meets both of the following conditions is exempt from New Zealand tax on that income for two years: • He or she was resident in France immediately before coming to New Zealand. • He or she is in New Zealand for the purpose of teaching or engaging in research. The DTA with France states that the exemption only applies to researchers whose research is in the public interest.	France (Article 21)
B. General exemption - personal services:	
All countries with which New Zealand has a DTA contain a form of this general exemption for personal services income. This general exemption is subject to any specific exemption set out in (A) above.	
(1) General rule:	(1)
A person who performs personal services in New Zealand and who meets all of the following conditions is not taxable in New Zealand: • He or she is present in New Zealand for no more than 183 days in the income year. • He or she receives remuneration paid by or on behalf of a New Zealand non-resident. • He or she receives remuneration which is not borne by a permanent establishment or fixed base which the payer has in New Zealand.	Belgium (Article 15) Canada (Article 14) Denmark (Article 15) Finland (Article 15) France (Article 15) Germany (Article 15) Italy (Article 15) Korea (Article 15) Netherlands (Article 15) Philippines (Article 15) Singapore (Article 11) Sweden (Article 16) Switzerland (Article 15)

Exemption	Country/DTA Article
(2) Variations	(2)(a)
(a) 183 days in any consecutive 12 months The same rule as set out in (1) applies, except that the person must be present in New Zealand for no more than 183 days in any consecutive 12 month period.	China (Article 15) India (Article 15) Indonesia (Article 15) Ireland (Article 17) Malaysia (Article 11) Norway (Article 15) United Kingdom (Art. 16) United States (Article 15)
(b) Income not taxed may be taxed in NZ	(2)(b)
The same rule as set out in (1) applies, except that any income which is not taxed in Norway may be taxed in New Zealand. The DTA with Norway also provides that, for the exemption to apply, the recipient must be present in New Zealand for no more than 183 days in any consecutive 12 month period.	Norway (Article 15)
(c) Tax in country of residence	(2)(c)
The same rule as set out in (1) applies, except that the remuneration must be taxable in the country of residence. *(d) Performance of services for non-resident* The DTA between New Zealand and Japan states that a person who performs personal services in New Zealand and who meets the following three conditions is not taxable in New Zealand: • He or she is present in New Zealand for no more than 183 days in the income year. • He or she performs the services for or on behalf of a Japanese resident. • He or she receives remuneration which is subject to tax in Japan.	Australia (Article 11) Fiji (Article 12) Japan (Article 10)

Policy

In the following paragraphs the word "employee" refers to a non-resident teacher or researcher.

Employees exempt if in NZ for less than 92 days (section 61(19) exemption) or 183 days (general DTA exemption)

The following policy applies when an employee's employment is covered by the section 61(19) exemption (an employee who is in New Zealand for no more than 92 days, whose income is taxable in his or her country of residence, and who is employed by a non-New Zealand resident) or by the general "less than 183 days" DTA exemption (set out in B. in the table above - an employee who is in New Zealand for no more than 183 days, whose income is paid by a non-NZ resident).

When it is clear (e.g. from the visa, passport, or contract of employment) that the employee will be in NZ for less than 92 days or 183 days, as the case may be, the employee may apply for a NIL special tax code certificate (see procedure below). If Inland Revenue issues such a certificate, the employee will not be liable to tax in New Zealand on income earned from teaching or researching services in New Zealand.

If it is not clear whether the employee will be in New Zealand for less than 92 days, or 183 days, as the case may be, the options set out in the following section apply.

Employees exempt if in NZ for less than 92 days, 183 days, or two years

The following policy applies when an employee qualifies for an exemption under a DTA which contains a "less than two years" rule (set out in A.(1) in the table above). It also applies when it is not clear whether the employee will qualify for the "92 day rule" (section 61(19)) or a "183 day rule" contained in the relevant DTA (set out in B. in the table above).

In these cases, the Commissioner considers he can only properly ascertain whether an employee has a right to an exemption after the employee has left New Zealand. The Commissioner will not know until that time whether the employee has been in New Zealand for less than the applicable maximum period and has complied with the other criteria set out in section 61(19) or the relevant DTA.

The Commissioner's policy is that an educational institution which employs a visiting teacher or researcher who may fall under the section 61(19) or applicable DTA exemption should make normal PAYE deductions from that employee's wages.

Alternatively, the educational institution may enter into an arrangement under section 350A, whereby it pays Inland Revenue a bond or other security, in substitution for any liability to withhold PAYE. The amount of the bond is determined by the circumstances of the case. Once the bond is in place the educational institution is not liable to deduct PAYE from the employee's wages. The institution will only be liable to deduct PAYE if the Commissioner specifies a date when the institution is to recommence deductions or if the employee outstays the time limit set out in section 61(19) or the relevant DTA and becomes liable for New Zealand tax. In some cases the employee may pay such a bond.

The Commissioner will require an employee in this situation to file annual tax returns.

At the end of the employee's stay in New Zealand, the Commissioner will review the New Zealand tax liability. The employee will need to complete an application for refund by persons leaving New Zealand permanently or for more than 325 days (IR 50). This form requires the employee to sign a declaration that he or she is leaving New Zealand permanently or for more than 325 days, and to provide evidence of departure (e.g. air tickets or, if these are not available, a letter from the employee's travel agent confirming departure). If the employee meets all the tests set out in section 61(19) or the relevant DTA one of the following situations will apply:

- If the educational institution made tax deductions, the New Zealand tax paid on the teaching income will be refunded to the employee.
- If the educational institution paid a bond to Inland Revenue instead of making PAYE deductions, the bond will be refunded to the educational institution.
- If the employee paid a bond to Inland Revenue, the bond will be refunded to the employee.

If an employee stays in New Zealand beyond the maximum period, or otherwise does not comply with the terms of section 61(19) or the relevant DTA, he or she is liable for tax on his or her earnings from the date of arrival in New Zealand. The section 61(19) or relevant DTA exemption does not apply. If the educational institution paid a bond to Inland Revenue instead of deducting PAYE, Inland Revenue will refund the bond to the employer and collect the tax owing from the employee.

The Commissioner will make an exception to this rule if the employee has arranged to leave New Zealand before the end of the relevant maximum period but is unable to do so due to circumstances beyond his or her control (e.g. illness or accident). As long as the circumstances are genuine and the employee leaves as soon as possible, the Commissioner will apply the article of the relevant DTA to exempt the income.

France - income exempt for 2 years

Employees who were French residents immediately before coming to New Zealand are not liable for New Zealand tax on their teaching income for a period of two years, even if they are in New Zealand for longer than two years (see A.(2) in the table above).

Employees from France should apply for a NIL special tax code certificate (see the following procedure). Employers of such employees should not deduct PAYE during the first two years of their visit.

Applying for a NIL special tax code certificate and other enquiries

To apply for a NIL special tax code certificate, an eligible employee should contact Taxpayer Services at the local Inland Revenue office. The employee will need to produce evidence confirming appointment as a teacher or researcher in New Zealand, and of his or her current residence (e.g. the letter of appointment, work permit, certificate of residence from the country of residence, visa, or passport). If the local district office is not known because the employee has not yet arrived in New Zealand, contact Inland Revenue's Non-resident Centre in Dunedin instead.

Once the employee has a special tax code certificate he or she must give it to the employer. The employee must still file an annual tax return.

Other income

Employees who are present in New Zealand for more than 183 days in a twelve month period become New Zealand tax residents under section 241(1). As New Zealand residents, they are taxable in New Zealand on their worldwide income. If such New Zealand resident employees are also resident in another country and a DTA exemption for teachers or researchers' income applies, the employees are taxable in New Zealand on their worldwide income, except for their income from teaching or researching.

Teachers or researchers who receive contract payments

The above policy applies to teachers and researchers who receive salary or wages in New Zealand. The non-resident contractors withholding payments rules may apply to teachers and researchers who receive payments under a contract for services. In certain circumstances such teachers and researchers may apply for an exemption certificate from tax on the withholding payments.

For more information about non-resident contractors withholding payments, contact the Corporates Unit (Oils and Minerals Portfolio) at Inland Revenue's Wellington District Office.

Depreciation claims mandatory

Summary

This item states the Commissioner's current policy on what options taxpayers have in claiming depreciation.

It is now mandatory for taxpayers to claim at least the minimum amount of depreciation to which they are entitled. However, the Commissioner considers that taxpayers do not have to claim the extra depreciation on "excluded depreciable property" (generally property purchased before 1 April 1993). This extra depreciation is allowed in one of these ways:

- as a supplementary depreciation allowance under section 113A
- as a 25% interim loading under section 108N.

All legislative references in this item are to the Income Tax Act 1976.

Background

The new depreciation regime was introduced from the 1993-94 income year. It removed the Commissioner's discretion and gave a statutory basis to depreciation. New economic depreciation rates were also introduced. Generally, the new depreciation rates can be used for assets purchased after 31 March 1993.

Legislation

Depreciation is governed by sections 107A to 117.

Excluded depreciable property

Excluded depreciable property is defined in section 107A. It means any taxpayer's depreciable property which meets any of these conditions:

- The property was used or available for use by the taxpayer within New Zealand, other than as trading stock, before 1 April 1993.
- Before 16 December 1991, the taxpayer entered into a binding contract to purchase the property or have it constructed.
- It is or has been a qualifying asset of the taxpayer under section 108N(1).
- It is or has been a qualifying improvement of the taxpayer under section 108N(1).
- It is an intangible asset that was used or was available for use by the taxpayer before 1 April 1993.

Excluded depreciable property does not include property in existence at the end of the 1992-93 income year that was accounted for using the standard value, replacement value, or annual revaluation method.

The annual depreciation rate for excluded depreciable property is given by section 108H(1). The rate is the depreciation rate that applied in the 1992-93 income year, excluding any additional depreciation allowed by sections 108N or 113A. However, section 108H(2) provides that the depreciation rate may be adjusted upwards to include any additional depreciation allowed by sections 108N or 113A.

Section 108N

Section 108N was inserted into the Act in 1992 (initially as section 108A), and it applied from the 1991-92 income year. The purpose of the section was to add a 25% loading to the normal depreciation rates for most new assets purchased between 16 December 1991 and 31 March 1993. The loading was only an interim measure given in anticipation of the pending review of depreciation rates.

Section 113A

Section 113A was inserted into the Act with effect from the 1978-79 income year. Its purpose was to give an increased depreciation rate for machinery used for two or three shifts (i.e., 16-24 hours) per day. An extra three or six percent was allowed to be added to the normal depreciation rate for the first five years when the Commissioner allowed a higher rate for more than one-shift operation. Section 113A does not apply to the new basic economic depreciation rates.

Depreciation rate for property acquired before the end of the 1994/95 income year

Section 108D gives taxpayers a choice of two depreciation rates for depreciable property (which is not excluded depreciable property) acquired before the end of the 1994/95 income year. The depreciation rate can be either the new basic economic depreciation rate or the asset's "pre-1993 depreciation rate". This choice can continue as long as the taxpayer holds the property.

The pre-1993 depreciation rate for any asset is the depreciation rate the Commissioner allowed to be used for that class of property in the 1992-93 income year. The pre-1993 depreciation rate always includes any supplementary depreciation allowance that would have been allowed under section 113A, and the 25% interim loading if it would have been allowed by section 108N.

Policy

For tax purposes, it is now mandatory for taxpayers to claim the whole amount of the depreciation to which they are entitled.

However, taxpayers do not have to claim the extra depreciation on "excluded depreciable property" (generally property purchased before 1 April 1993), when this extra depreciation is allowed in either of these ways:

- as a supplementary depreciation allowance under section 113A
- as a 25% interim loading under section 108N.

When a taxpayer has a choice between old and new depreciation rates (as generally occurs for property purchased between 1 April 1993 and the end of the 1994-95 income year) the taxpayer can choose to use the lower depreciation rate.

Further, a taxpayer can choose between the diminishing value (DV) and straight line (SL) method of calculating the depreciation rate to be used for any income year (except for fixed life intangible property). Changing from one method to another part way through an asset's life will slow depreciation deductions. When switching from the diminishing value to the straight line method of calculating depreciation, the cost of property is deemed to be its adjusted tax value.

Example 1

F Co owns a meat processing factory in which the machinery runs 24 hours a day. F Co has a 30 June balance date. Meat processing machine X was purchased new in June 1992. At that time the general depreciation rate for plant and machinery operating 24 hours a day was 15% DV. The depreciation rate was calculated as follows:

Basic rate	15.0%
Supplementary Allowance (s.113A)	6.0%
	21.0%
25% Interim Loading (s.108N)	5.3%
	26.3%

An additional meat processing machine Y was purchased new in January 1994. The basic economic depreciation rate for meat and fish processing plant (for assets not described more specifically in the schedule) is 12% DV. However, under section 108D the higher pre-1993 depreciation rate of 26.3%, as calculated above, can be claimed instead.

F Co expects to make a loss in the 1994-95 income year, and wants to know the minimum rate of depreciation that can be claimed on both machines in that income year.

As Machine X is excluded depreciable property (because it was purchased before 1 April 1993 and is a qualifying asset under section 108N(1)), the minimum rate of depreciation that can be claimed is the old basic rate of 15% DV or the SL equivalent of 10%.

For Machine Y, F Co can claim the new basic economic depreciation rate of 12% DV (or 8% SL) instead of the higher pre-1993 depreciation rate of 26.3% DV.

Example 2

Mr A is a self-employed consultant with a 31 March balance date. He buys a personal computer on 5 April 1993 for $4,000. He claims the new basic economic depreciation rate of 40% DV, giving him a depreciation deduction of $1,600 (40% x $4,000) for the 1993-94 income year.

Mr A expands his business and will make a loss in the 1994/95 income year. Mr A wants to know the minimum amount of depreciation he has to claim.

Mr A can switch to using the straight line (SL) method of depreciation and use the pre-1993 SL depreciation rate of 16.9% (13.5% + 25% loading) for personal computers. SL depreciation is calculated from the cost of an asset. However, because Mr A has switched from the diminishing value method, cost is deemed under section 108B(6) to be the adjusted tax value of $2,400 ($4,000 - $1,600). Mr A's minimum depreciation claim is therefore $405.60 (16.9% x 2,400).

Residential property exempt from conveyance duty

Summary

This item states the Commissioner's current policy on the exemption from conveyance duty for residential property. The Commissioner's policy is that the exemption applies to flats and rest homes, provided the rest home residents are long term residents. The exemption does not apply to hotels, motels, boarding houses and similar buildings.

When land is purchased for the purpose of erecting a dwellinghouse, the Commissioner's general policy is that the dwellinghouse must be erected and occupied within 24 months from the date of purchase of the land, if the conveyance duty exemption is to apply to the purchase of the land. However, the Commissioner will consider individual circumstances if a dwellinghouse cannot be built and occupied within 24 months of acquiring the land.

All legislative references in this item are to the Stamp and Cheque Duties Act 1971.

Background

Some instruments of conveyance are exempt from conveyance duty if they meet the criteria set down in the Stamp and Cheque Duties Act 1971. The exemption from conveyance duty applies to instruments of conveyance that convey dwellinghouses (as defined by the Act), land acquired for the purpose of building a dwellinghouse, and shares in a flat- or office-owning company that carry a right to use and occupy a dwellinghouse.

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Legislation

In summary, section 10 makes stamp duty payable on all instruments executed on or after 17 March 1988 that convey or lease land, or convey shares in a flat- or office-owning company, unless the instruments are exempt under some other provision in the Act. Section 15(1) provides for stamp duty payable on an instrument of conveyance to be conveyance duty computed on the value of the property conveyed.

Under section 24, conveyances of residential property are exempt from conveyance duty, and conveyance duty will be apportioned on an instrument which conveys a partly-exempt property:

24(1) Subject to subsection (2) of this section, no conveyance duty is payable on any instrument of conveyance where the property conveyed is-

(a) A dwellinghouse; or

(b) Land acquired for the purpose of having a dwellinghouse erected on it; or

(c) Shares in a flat or office owing company that carry a right of use and occupation of a dwellinghouse, -

and the Commissioner is satisfied that the dwellinghouse will, as soon as practicable after the date of execution of the instrument of conveyance, be occupied primarily of principally as a residence.

24(2) Where-

(a) The property conveyed by an instrument consists partly of property referred to in paragraphs (a) to (c) of subsection (1) of this section, and partly of other property; or

(b) The property conveyed is greater in area than -

(i) 4,500 square metres; or

(ii) An area that would be reasonably appropriate for residential purposes, having regard to the size and character of the dwellinghouse or dwellinghouses erected or to be erected on the property, and to the nature of the property, -

whichever is the greater; or

(c) Any building or buildings on or to be erected on the property are to be used partly as a dwellinghouse or dwellinghouses and partly for other purposes,-

such proportion of the value of the property conveyed as the Commissioner determines is not attributable to the purposes of occupation as a dwellinghouse shall be subject to conveyance duty as if the instrument of conveyance related to that proportion of the property only.

24(3) In this section, the term “dwellinghouse” means a building, or part of a building, that is a house, flat, townhouse, home unit, or similar dwelling erected primarily and principally as a residence, and includes any land, improvements, or appurtenances belonging to the dwellinghouse or usually enjoyed with it.

Policy

Definition of “dwellinghouse”

It is the Commissioner’s policy that the definition of “dwellinghouse” within the meaning of section 24(3) includes flats and rest homes, as long as the rest home residents are residents on a long-term basis. It does not include hotels, motels, or boarding houses.

To qualify for the exemption, the purchaser must satisfy the Commissioner that the dwellinghouse will be occupied primarily or principally as a residence, but it is not necessary that the dwellinghouse is occupied as a principal place of abode. Nor is it necessary for the dwellinghouse to be occupied by the purchaser or a member of the purchaser’s family.

Occupied “as soon as practicable”

When a dwellinghouse is purchased, the Commissioner must be satisfied that it will be occupied primarily or principally as a residence as soon as practicable after the date of execution of the instrument of conveyance.

When land is purchased for the purpose of erecting a dwellinghouse, the dwellinghouse must be erected and occupied as soon as practicable. In this situation the Commissioner interprets “as soon as practicable” to mean within 24 months from the date of purchase of the land. However, the Commissioner will consider individual circumstances if a dwellinghouse cannot be built and occupied within 24 months of acquiring the section.

Example 1

JB purchases a house that is erected primarily and principally as a residence, and immediately rents it out as a residential tenancy.

Conveyance duty is not payable on the instrument of conveyance that conveyed the house to JB, because the house is erected primarily and principally as a residence and it is not a requirement of section 24 that the house is occupied by its owner.

Example 2

A motel property is transferred. The total consideration is $600,000. The value of that part of the motel that is the manager’s residence is $150,000. The value on which the instrument of conveyance of the motel will be assessed for conveyance duty is $450,000.

Persons eligible to apply for a RWT certificate of exemption

Introduction

This item lists the persons who are eligible to apply for a resident withholding tax (RWT) certificate of exemption. All legislative references in this item are to the Income Tax Act 1976.

Background

Generally, a person who pays interest or dividends must deduct RWT. However, there are a number of situations in which the person making the payment is not required to deduct RWT. One of these situations is when the recipient of the interest or dividends holds a valid certificate of exemption. Paragraphs (a)(ii) and (b)(iv) of section 327B(2) remove such interest or dividends from being subject to RWT.

Persons who hold a certificate of exemption are only exempt from having RWT deducted from the payments they receive. In most cases they must still deduct RWT from any dividends or interest they pay.

Persons who wish to apply for a certificate of exemption should use Inland Revenue form IR 15E.

Application

Section 327M(1) lists a number of persons who may apply for a certificate of exemption. Further, section 327M(12) gives the Commissioner a discretion to grant a certificate of exemption to certain persons who do not fall within the subsection (1) list.

Persons who may apply under sec 327M(1)

The following list summarises the persons who may apply to the Commissioner for a certificate of exemption under section 327M(1). Persons who wish to apply for a certificate of exemption should check the specific provisions of section 327M(1) too see whether they are one of the persons listed in that section.

- Registered banks
- Building societies
- Trustee banks
- The Public Trustee (and, from 19 December 1989, any company that would be a member of the same wholly-owned group of companies as the Public Trustee if the Public Trustee were a company for the purposes of the Act)
- The Maori Trustee
- Trustee companies
- A person whose principal form of business is both of the following:
  - The borrowing of money or acceptance of deposits, whether on demand or for a fixed term, or the receiving of credit or the selling of any credit instrument
  - The lending of money or granting of credit or buying or discounting of credit instruments
- A solicitor's nominee company (effective 19 December 1989)
- A broker's nominee company (effective 19 December 1989)
- A solicitor (applies only to operations of that solicitor's trust account - effective 19 December 1989)
- A person whose tax returns are up to date, and whose most recent tax return includes total assessable income before deductions of more than $2 million
- A person who reasonably believes that his or her assessable income before deductions for the next accounting year will exceed $2 million
- A person whose income is wholly or partly exempt under section 61 because that person is one of the following:
  - A public authority
  - A local authority (effective 19 December 1989)
  - A friendly society
  - A society for scientific or industrial research
  - A charity
  - An estate applied for charitable purposes
  - A veterinary services promoter
  - A herd improvement promoter
  - An amateur sports promoter
  - A racing club
  - The trustee of a sick, accident, or death benefit fund (effective 19 December 1989)
  - A district improvement society
  - The trustees of Cornwall Park
  - A person whose income is exempted from income tax by an Act other than the Income Tax Act 1976 (effective 19 December 1989)

  (In these cases, the certificate of exemption relates only to the tax-exempt activity).
- A non-profit body whose income, in its last accounting year, did not exceed the exemption threshold of $1,000.

If an entity is seeking approval as a charity, amateur sports promoter, or other non-profit organisation, it must supply a copy of its constitution with the application. Any organisation without a constitution or set of rules controlling the use of funds by members will not be considered for a certificate of exemption.

Any other person or entity who is applying for a certificate of exemption will not generally need to supply any supporting evidence.

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Commissioner's discretion under sec 327M(12)

The Commissioner has a discretion under section 327M(12) to grant a certificate of exemption to persons who do not fall within the section 327M(1) list. The Commissioner may do this where he believes that the person will meet one of the following conditions during the period covered by the certificate:

- The person will or is likely to incur a loss.
- The person will or is likely to have no taxable income because his or her aggregate tax deductions are equal to or exceed his or her assessable income
- The person will or will be likely to be entitled to claim RWT credits exceeding his or her income tax liability by an amount of at least $500.

Such an applicant must supply budgeted accounts detailing the projected income, deductions, RWT credits and income tax liability, as well as any other information required by the Commissioner. In some cases, the Commissioner will accept pro forma accounts rather than full budgeted accounts if the applicant is a company in receivership or liquidation and is not able to produce full accounts to confirm the losses. The circumstances in which the Commissioner will accept pro forma accounts are set out in TIB Volume Four, No.5 (December 1992) at page 41.

Part-time domestic work - tax treatment of payments

Introduction

This item states the tax treatment of payments made for domestic work. All legislative references are to the Income Tax Act 1976.

Background

Many householders engage people such as gardeners, cleaners, or nannies to perform part-time work in private residences. Such workers often fall within the statutory definition of "private domestic worker". When they do, the householder does not have to deduct PAYE from the payment, as would be the case in a normal employment situation. The domestic worker is responsible for paying the tax.

Inland Revenue has received a number of enquiries as to when these provisions apply. This item identifies the type of worker who meets the definition of "private domestic worker", and explains the correct tax treatment of payments made to these people.

Legislation

Section 338 states:

338(1) For the purpose of enabling the collection of income tax from employees by instalments, where an employee receives a source deduction payment from an employer, the employer or other person by whom the payment is made shall, at the time of making the payment, make a tax deduction therefrom in accordance with this Part of this Act:

Provided that no tax deduction need be made from any source deduction payment made to any employee in respect of his employment as a private domestic worker:

Provided also that if a tax deduction is not made by the employer in any such case section 355 of this Act shall apply to the employee.

Section 355 requires the employee to furnish a return and pay any tax due by the 20th of the month following the month in which the payment was made.

Section 2 defines the term "Private domestic worker":

"Private domestic worker" means a person employed by any other person where -

(a) The employer is the occupier or one of the occupiers of a dwellinghouse or other premises used exclusively for residential purposes; and

(b) The employment is for the performance of work in or about the dwellinghouse or premises or the garden or grounds appurtenant thereto; and

(c) The employment is not in relation to any business carried on by the employer or to any occupation or calling of the employer; and

(d) The employment is not regular full-time employment.

Section 2 defines the terms "Employee" and "Employer":

"Employee" means a person who receives or is entitled to receive a source deduction payment:

"Employer" means a person who pays or is liable to pay a source deduction payment; and includes -...

Section 6(1) defines the term "Source deduction payment":

6(1) Source deduction payment "...means a payment by way of salary or wages, an extra emolument, or a withholding payment."

Summary and application

Generally, an employer must deduct PAYE from a source deduction payment (that is, from any payment that is salary or wages, an extra emolument, or a withholding payment).

An exception to this general rule is a payment made to a private domestic worker. In no case is the person making a payment to a private domestic worker obliged to make a tax deduction from that payment. Section 355 imposes tax obligations on the worker.

"Private domestic worker " is defined in section 2. It means a person who is employed by the occupier of premises which are used exclusively for residential purposes, to do work in or about the premises or the garden or grounds. The employment must not be related to any business carried on by the employer, and must not be regular full-time employment. For example, a student hired by a householder as a part-time nanny or gardener is a private domestic worker.

The definition requires a "private domestic worker" to be a person "employed by" another person, referred to in the definition as the "employer". The terms "employee" and "employer" are also defined in section 2.

For the purposes of the Act, an "employee" is a person who receives a source deduction payment. This is a person who receives a payment that is salary or wages, an extra emolument, or a withholding payment. Withholding payments are payments to people who are independent contractors, and which are made for particular kinds of work specified in the Income Tax (Withholding Payments) Regulations 1979.

"Private domestic workers" can receive withholding payments

The concept of employment in the section 2 definition of "employee" applies to "private domestic workers". This means that a person who does part-time work for a householder, and who is covered by the withholding payments rules, is a private domestic worker. An example of this is a freelance musician who is hired to play for a private party at a residence.

Tax treatment

A householder does not have to deduct tax from payments made to a private domestic worker. This type of worker accounts for tax directly to Inland Revenue under section 355 on the 20th of each month, using forms IR 66N and IR 56.

ACC earner premium

Similarly, householders do not have to deduct earner premium from payments made to private domestic workers. The same rule applies as for income tax. Section 355 imposes the obligation on the worker.

Payments by householders to other part-time workers

The only people doing part-time work for householders who do not come within the definition of private domestic worker are those who can show that they are independent contractors, and not covered by the Withholding Payments Regulations. Such workers are provisional taxpayers, and the householder is not concerned with their tax. An example is a tradesman engaged to repair plumbing or electrical circuits.

There is no obligation on the householder to deduct tax from payments made to these workers as they are provisional taxpayers and meet their own tax obligations.

Determination G27: Swaps

The Director of Rulings recently signed a determination detailing the periodic recognition of income and expenditure from financial arrangements referred to as swaps.

Swaps typically involve the exchange of payment streams without necessarily requiring an exchange of principal. This determination details the general principle of treating a swap as if it comprises two simultaneous loans. It provides methods to spread income or expenditure arising from the most commonly undertaken swap transactions. It does not apply to the more complex swaps such as those involving commodities, equity, property, more than two currencies, or an amortisation or accretion of principal.

Of the four methods, method C will most commonly apply:

- Method C requires the person to treat the swap as if it comprises two simultaneous loans and then to apply the normal accrual rules to these deemed loans.

The other three methods recognise that persons may adopt alternative methods to method C subject to the specific statutory provisions that apply:

- Method A applies to persons who can have regard to market valuation under subsection 64C(4) of the Act.
- Method B enables the use of Determination G14, issued by the Commissioner under section 64E of the Act, if the swap involves a forward contract for the exchange of currencies.
- Method D acknowledges that a person may adopt an alternative method to method C, under the provisions of paragraph 64C(3)(a), if that method has regard to the principles of accrual accounting, conforms with commercially acceptable practice, is consistently applied, and the amounts are not materially different from those calculated under method C.

The determination applies to all qualifying swaps entered into after 19 January 1995. This is the date of publication of the determination in the New Zealand Gazette.

The full text of the determination is printed in the appendix to this TIB.

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.

Income Tax Act 1976

Tax on diplomat's private investment income sourced from within New Zealand

Section 61(50) - Incomes wholly exempt from tax: A foreign diplomat serving in New Zealand has had resident withholding tax (RWT) deducted from the interest earned on his private bank account. The diplomat believes that diplomats are not required to pay tax in the host country. He has asked that the RWT be refunded to him.

The Income Tax Act imposes tax on all New Zealand sourced income, unless it is specifically exempted. Section 61(50) exempts any:

"Income expressly exempted from income tax by any other Act, to the extent of the exemption so provided:"

Under the Diplomatic Privileges and Immunities Act 1968 and the Consular Privileges and Immunities Act 1971, income derived from employment as a diplomat and income from sources outside New Zealand is exempt from New Zealand income tax. That exemption does not apply to a diplomat's private income, such as investments made or held in New Zealand.

Unless the double taxation agreement between the diplomat's home country and New Zealand specifies otherwise, the interest earned is subject to tax in New Zealand, and the section 61(50) exemption cannot apply.

Deduction of stress management course fees

Section 104 - Expenditure or loss incurred in production of assessable income: A self-employed fashion designer whose marriage had failed, and who was experiencing family problems, has recently attended a course on stress management. He has asked if the cost of the course is tax deductible.

Section 104 allows a deduction for expenditure incurred in gaining or producing assessable income, or necessarily incurred in carrying on a business for that purpose. If the expenditure incurred in attending a stress management course is necessarily incurred in carrying on the fashion designer's business, a deduction is allowable for the course fee. However, if the course fee is not necessarily incurred in carrying on the business nor incurred in gaining or producing assessable income, a deduction is not allowed under section 104. Notwithstanding section 104, section 106(1)(j) also prohibits a deduction of, "Any expenditure or loss to the extent to which it is of a private or domestic nature".

In this case, a deduction was not allowed as the stress management course was not necessarily incurred in carrying on the fashion designer's business, but was undertaken as a result of his marriage breakdown and family problems.

If the designer attended the stress management course due to stress in the work place, the expense would be necessarily incurred in carrying on the fashion designer's business and would be deductible.

Deductibility of viticulture expenses

Section 104 - Expenditure or loss incurred in production of assessable income: A taxpayer asked if she could deduct the costs of attending viticulture training seminars and fees incurred in joining wine growers' organisations. The taxpayer has already planted grape vines, but it will be some time before she will derive any income from her viticulture business. Currently she receives employment income.

Section 104 permits a deduction for expenditure incurred in gaining or producing assessable income for any income year, or necessarily incurred in carrying on a business for that purpose. Each case must be examined on its facts to determine whether the expenditure is sufficiently linked to the taxpayer's income-earning process. Whether or not a business is being carried on needs to be determined on a case by case basis.

In this instance, the training seminars and membership fees to the wine growers' organisations are deductible, as the expenses are sufficiently connected with the viticulture business activities.

Whether Lotto franchise fees are depreciable

Section 107A - Interpretation - depreciation: A taxpayer has asked whether franchise fees paid to the New Zealand Lotteries Commission are depreciable under the new depreciation regime.

Section 108 provides for an annual depreciation deduction for depreciable property. Section 107A defines "depreciable property" as property which might reasonably be expected in normal circumstances to decline in value while used or available for use in gaining or producing assessable income, or in carrying on a business for that purpose. The depreciation regime extends the definition of

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"depreciable property" to the types of intangible assets listed in the 22nd Schedule to the Income Tax Act 1976.

Before operating a New Zealand Lotteries Commission franchise, the franchisee must pay a one-off franchise fee to the New Zealand Lotteries Commission. Under the terms of the agreement entered into between the franchisee and the Commission, the value of the intangible property rights acquired by the franchisee is not reasonably expected in normal circumstances to decline in value while used or available for use by the franchisee. Therefore, the franchise fee does not fall within the section 107A definition of "depreciable property", and the franchisee cannot claim a depreciation deduction on it.

Public Information Bulletin 179 (May 1989) addresses the issue of whether the Lotto franchise fee is deductible. The Commissioner's policy is that the franchise fee is a capital expense and therefore not deductible to the retailer.

Deduction for new fencing on a forestry block

Section 128B - Expenditure on land improvements used for forestry: A farmer is constructing new fences on a forestry block. In the past, she claimed a deduction of 10 percent per year on the diminished value of her fences under section 128B. She has asked if the 10 percent deduction applies in the 1995-96 income year and subsequent years.

Section 128B allows a yearly deduction for certain expenditure on land improvements in the forestry industry. Although depreciation is not allowed on land itself because land does not depreciate, certain land improvements are depreciable. The amount of land improvement expenditure which can be claimed as a deduction is reduced by the total of both of these amounts:

- Every amount of the expenditure which has been allowed as a deduction to any taxpayer in any preceding income year
- Every amount of the expenditure which has been allowed as a deduction under any other section of the Act in that income year.

A deduction is not allowed in the income year in which the taxpayer sells or otherwise disposes of that land, or when the taxpayer ceases to carry on the forestry business on that land.

The types of expenditure and the rates of deduction are set out in Part II of the Thirteenth Schedule to the Act. Paragraph (j) of Part II of the Thirteenth Schedule relates to expenditure incurred in the construction of fences on the land.

For any expenditure incurred in the taxpayer's 1995-96 income year, the rates set out in the Thirteenth Schedule are increased by 20 percent on the previous rate.

In this case, the farmer is eligible for a deduction under section 128B for the new fences. In the 1995-96 income year, the rate set out under paragraph (j) of Part II of the Thirteenth Schedule is increased by 20 percent on the previous rate, e.g. the rate of 10 percent becomes 12 percent.

Income tax consequences when land development encouragement loan remitted

Section 172 - Specified suspensory loans: A farmer had a land development encouragement loan (a specified suspensory loan under section 172(1)), which was remitted by the Rural Bank. He has asked about the income tax consequences of this remission. The loan involved is a pre-accruals loan, so the accrual rules will not apply to it.

Under section 172(2), when a taxpayer's liability under a loan is wholly or partly remitted, the amount remitted is deemed to be assessable income derived equally in three income years. Those three years are the year in which the amount is remitted, and the next two succeeding income years.

However, the proviso to section 172(2) allows a taxpayer to elect to reallocate all or part of the amount which has been deemed to be income derived in either of the "next two succeeding income years". This income may be reallocated to either the year in which the amount was remitted, or the year following that year. Such an election is irrevocable.

A taxpayer who wants to make such an election must send it to the Commissioner within the time for filing the tax return for the year to which the income is to be allocated. The Commissioner may allow extra time for making this election.

Example:

Farmer Brown has a 30 June balance date. He had his land development encouragement loan of $9,000 fully remitted in June 1994. Under section 172(2), the $9,000 is deemed to be assessable income derived as follows:

- $3,000 in the year ended 30/6/94, being the year the amount is remitted
- $3,000 in each of the years ending 30/6/95 and 30/6/96, being the next two succeeding income years.

However, under the proviso to section 172(2), Farmer Brown could elect to have all or part of the $6,000 assessable in the "next two succeeding income years" treated as income in any earlier year of the three-year period.

Definition of a "work related vehicle" for FBT purposes

Section 336N(1) - Work related vehicle: A company director has asked whether the van that his company has purchased will qualify for the "work related vehicle" fringe benefit tax (FBT) exemption. The company director has advised that the van has seating for ten people and is signwritten with the company's name. The company does not have adequate secure parking at its premises, so the company's production manager is required to garage the vehicle overnight at his home.

Benefits provided to employees are liable to FBT. Motor vehicles that are available for employees' private use or enjoyment are subject to FBT, unless otherwise exempted. One such exemption applies to work related vehicles.

Under section 336N(1), a vehicle is a "work related vehicle" if it meets all of these conditions:

- It is a motor vehicle, but not a motorcar
- It has the employer's name, logo, or acronym prominently and permanently displayed on it.
- On the day in question, it is used (or available for use) by the employee, but only for travel between the employee's home and work, or for other incidental private use arising through the performance of the employee's duties.

The terms "motor vehicle" and "motorcar" are defined terms, and the distinction is important in this case.

A "motor vehicle" is a motor vehicle as defined in section 2(1) of the Transport Act 1962, but it does not include a vehicle that has a gross laden weight of more

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than 3,500 kilograms. Most motor vehicles on New Zealand roads will meet the Transport Act's definition of a motor vehicle.

A "motorcar" is defined as:

"... a motor vehicle (other than a motor cycle or a moped or a minibus) designed exclusively or principally for the carriage of persons; and includes a motor vehicle designed principally for the carriage of passengers but which has rear doors or collapsible rear seats; but does not include a motor vehicle that is a taxicab".

Note that the definition of motorcar excludes a "minibus". A minibus is defined in section 336N(1) as being:

"... a motor vehicle, designed exclusively or principally for the carriage of persons, the interior of which contains either-

(a) Three seats, each of which is designed for the seating of 2 or more adult persons and each of which is permanently affixed to the motor vehicle and is neither collapsible nor capable of being folded down; or

(b) Contains more than 3 seats, of which not less than 3 are each designed for the seating of 2 or more adult persons and are each permanently affixed to the motor vehicle and are each neither collapsible nor capable of being folded down."

The company's van in this case qualifies as a minibus. The company director has confirmed that the van is signwritten with the company's name, and that the only private use available to the production manager (the employee) is travel between his home and work. Therefore, as long as these conditions continue to be met, the work related vehicle FBT exemption is available and no FBT will be payable.

Lump sum payment made by employee into superannuation fund

Section 336ZB - Deduction of specified superannuation contribution withholding tax: A taxpayer won a cash prize in a lottery. She decided to save some of the winnings for her retirement by paying a lump sum into the superannuation scheme run by her employer, so as to boost her eventual payments from the fund. Her employer has told her that a tax at 33 cents in the dollar is applied to contributions to a superannuation fund. She asks if her employer is correct.

Under section 336ZB, an employer must deduct specified superannuation contribution withholding tax (SSCWT) from any specified superannuation contribution.

A "specified superannuation contribution" is defined in section 2 as:

"an employer superannuation contribution (being a contribution in money) made to a superannuation fund on or after the 1st day of April 1989".

An "employer superannuation contribution" is also defined in section 2, and means:

"any superannuation contribution provided by an employer for the benefit of an employee or employees of that employer".

As the taxpayer's employer is not making the payment in this instance, SSCWT does not have to be paid.

Contracting out of the employment relationship

Section 338 - Tax deductions to be made by employers: A taxpayer has entered into a contract to work as a full-time housekeeper. She and her employer have agreed that they will call the contract a contract for services (as opposed to a contract of employment) and that they will call her an independent contractor in that contract. She asks whether she can account for her own taxes on the payments she receives.

An employer is not required to deduct taxes from payments made to a "private domestic worker". However, this taxpayer is not a "private domestic worker" because the definition of that term in section 2 excludes people in regular full-time employment.

An employer must deduct taxes from salary or wages paid to an employee. Legal tests developed by the Courts determine whether a person is an employee or self-employed. Inland Revenue explains these tests in TIB Volume Four, No.7 (March 1993) in an article titled "Employee or Independent Contractor". We also explain how to apply these tests in our "Employers' Guide" (IR 184), and in our "Self-employed or an employee?" leaflet (IR 186). Alternatively, Tax Education Office Newsletter No.63 (18 November 1992) reproduces Inland Revenue's checklists for guidance in deciding whether a taxpayer is self-employed or an employee.

A close examination of the terms of the contract between the parties, in conjunction with their intentions and actions, will determine whether a taxpayer is self-employed or an employee. The parties to a contract cannot contract out of what is an employment relationship simply by labelling the contract a contract for services and calling the employee an independent contractor.

Family Support - effect of receiving free board and lodging

Section 374B(1) - Assessable income or loss: An employee who worked for a religious order was assessed by Inland Revenue for the value of board and lodging supplied by his employer. The employee has asked how the value of board and lodging affected his Family Support calculation.

The determination of assessable income for Family Support purposes is calculated on the level of the family's income for the year and the number of children cared for.

When an employer provides free board or lodgings, the value of the accommodation is monetary remuneration (salary and wages) which must be added to the employee's salary or wages. Therefore, the value of such board and lodging is included as income for the purposes of calculating Family Support.

Use-of-money interest and companies with residual income tax of $30,000 or less

Section 398A(2) - Interest payable: A company secretary has asked whether a company in its first year of operation is liable to pay use-of-money interest. The company's residual income tax (RIT), i.e. tax to pay at the end of the year, was $13,000.

Use-of-money interest is charged if RIT is greater than $2,500. All companies are charged use-of-money interest if RIT is greater than $2,500, and their provisional tax paid, including voluntary payments, is less than the RIT.

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Section 398A(2) provides for the charging of use-of-money interest. The amount of interest charged is calculated on a daily basis at a rate set by Order in Council. The interest is charged on the difference between the provisional tax paid by the third instalment and the taxpayer's actual RIT for the income year. The reverse also applies, so that Inland Revenue pays use of money interest on overpaid provisional tax.

The Commissioner's policy on the provisional tax rules for the 1994-95 year onwards is set out on page 14 of TIB Volume Five, No.11 (April 1994). Companies which begin a taxable activity during the 1994-95 income year are liable for use-of-money interest if their RIT for the current year is greater than $2,500. If their RIT is $30,000 or less, two-way interest applies from the third provisional tax instalment date.

Use of money interest applies from the first provisional tax instalment date for taxpayers whose RIT is over $30,000.

Use of money interest is calculated using the following formula set out in section 398A(3):

$$\frac{a \times b}{365}$$

In this formula:

a is the amount of income tax that is payable in an income year, less any provisional tax paid

b is the specified rate of interest applying (currently 6%).

In this case, the company is liable for use of money interest, charged as follows:

a = $13,000

b = 6%

$\frac{\$13{,}000 \times 6\%}{365}$ = $2.14 use of money interest payable for each day of the interest liability period specified in section 398A(2).

Goods and Services Tax Act 1985

Coverage of activities under GST registration

Section 6 - Meaning of term "taxable activity": A GST registered builder plans to buy a small farm. He has asked if his current registration will cover the farming activity.

Once a person is registered for GST, the registration covers all taxable activities undertaken by that person. However, each separate activity must be a taxable activity in terms of section 6(1)(a). A taxable activity is:

"Any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club."

Section 6(3)(a) excludes from this definition:

"Being a natural person, any activity carried on essentially as a private recreational pursuit or hobby."

Provided the farming activity is a "taxable activity", and not a private recreational pursuit or hobby, the builder's original registration will also cover the farming activity.

Evidence of export for goods sent by mail

Section 11(1) - Zero-rated goods: A GST registered person intends to export some products by mail. She asked what documentation she must hold as evidence of having exported those goods.

If a supplier sends goods overseas, section 11(1) allows GST to be charged on the goods at zero percent. To qualify for this zero-rating, the goods must be (or be intended to be) exported by the supplier under the Customs Act 1966, or the supplier must be able to satisfy the Commissioner that the goods have been exported by the supplier to a place outside New Zealand.

For exports with a value of $1,000 or more, a customs export entry is required. The export entry and a copy of an international parcels customs declaration (Form C2/CP3) stamped by a postal officer when the parcel is posted, are sufficient evidence of export.

A customs export entry is not required for exports with a value of less than $1,000. Acceptable evidence of export is either an international parcels customs declaration, (Form C2/CP3 for parcels with a value of $620 or more, or Form C1 for parcels with a value of less than $620) stamped by a postal officer at the time of posting, or a till receipt for the overseas postage.

The article on page 13 of TIB Volume Six, No.7 deals with the zero-rating of exported goods in more detail.

GST input tax deductions - goods acquired before registration

Section 20(3) - Deductions from output tax: A taxpayer owns two commercial properties which are rented. At present the total rental income is less than $30,000 each year and the taxpayer is not liable to register for GST. She is considering registering voluntarily and has asked what input tax deductions she could claim if she were to register.

Since no input tax deduction has previously been claimed, provided the properties were acquired on or after 1 October 1986, section 21(5) permits an input tax deduction to be made when the taxpayer registers in her own name.

The amount of input tax to be deducted is one-ninth of the lesser of these values:

- The cost of the properties
- Their open market value.

No input tax can be deducted for properties acquired before 1 October 1986.

In addition, some expenses, such as insurance and rates, relating to the two properties may have been paid in advance. Provided the taxpayer holds the relevant tax invoices (if more than $50), she may claim an input tax deduction for these expenses, on a pro rata basis, in her first GST return.

Unclaimed Money Act 1971

Voluntarily paying unclaimed wages to Inland Revenue as unclaimed money

Section 4 - Unclaimed money/section 5 - Holder: An employer has made several attempts to locate a former employee in order to pay wages owing. The employer has asked if he can pay the money to Inland Revenue as unclaimed money under the Unclaimed Money Act 1971.

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Section 4 states what unclaimed money consists of, and section 4(1)(e) covers money such as wages. Under section 4(1)(e), the money must have been held by the holder (i.e. the employer) for a period of six years following the date when the wages became payable by the employer.

Under section 4(3), if the holder has ceased business or died, and the holder (or the holder's representative) has held or owed unclaimed money for six months or longer immediately after the date of cessation or death, the money can be paid to Inland Revenue together with particulars of the payment.

Section 5(2) deems any person, firm, body, or institution to be a holder of such money held or owing by that person or entity.

The employer must hold the unpaid wages for six years before passing them to Inland Revenue as unclaimed money, unless he dies or ceases business. In either of these circumstances, if the money remains unclaimed for six months following the date of death or cessation of business, it may then be paid to Inland Revenue. As a holder of unclaimed money, under section 13 the employer is also responsible for:

- maintaining an unclaimed money register
- notifying the owners and Inland Revenue of the register entries annually
- paying unclaimed money to Inland Revenue when required
- allowing Inland Revenue access to the register.

An employer who does not meet these obligations can be fined up to $500 by the courts for each offence.

See TIB Volume Five, No.7 (December 1993) for an explanation of how the Unclaimed Money Act operates.

Upcoming TIB articles

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

- Valuation of bailed livestock
- Special tax codes - their use and operation
- Tax treatment of directors' indemnity insurance
- Can a qualifying trust retain its status if there is no trustee income?
- The valuation for gift duty purposes of a fractional interest in land
- Imputation penalty tax and additional tax under the imputation rules
- The Commissioner's powers under section 400
- Eligibility of self-employed persons for Guaranteed Minimum Family Income (GMFI)
- When Inland Revenue can grant relief from paying tax in cases of financial hardship
- Meaning of terms "own" and "acquired" for depreciation purposes
- GST and rates apportionment

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.

Contents

Interest deductibility

Rating: • • •

Case: TRA 94/85

Act: Income Tax Act 1976 - sections 71 and 106(1)(h)

Keywords: Interest deductibility

Summary: A taxpayer could not deduct interest on borrowed money that he on-lent to an associated company. Although the taxpayer received indirect benefits as a result of on-lending the money (by way of increased salary from the company), the loan did not gain or produce income for the taxpayer in any direct sense.

Facts: The taxpayer had extensive business interests, including a majority shareholding in a company, VHL. VHL distributed its profits to the taxpayer and his wife by way of salary. In 1984 the taxpayer borrowed money from an overseas lender which he on-lent to VHL interest-free and on-demand. VHL used the money to pay off mortgages over some of its land. The savings VHL made from not having to pay interest on the mortgages enabled it to earn larger profits than it would otherwise have earned. These increased profits were distributed to the taxpayer and his wife by way of larger salaries.

There was no written agreement between the taxpayer and VHL concerning the terms of the loan. In 1990 the taxpayer and VHL agreed that VHL would pay interest to the taxpayer, retrospectively, for the period 1984 to 1990.

The taxpayer sought to deduct the interest he paid to the overseas lender. The Commissioner denied a deduction for the 1987, 1988 and 1989 income years.

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Decision: Judge Barber confirmed the Commissioner's assessment for the three income years. The taxpayer was not entitled to an interest deduction.

Section 106(1)(h)(ia) allows a deduction for interest necessarily payable in carrying on a business for the purpose of gaining or producing assessable income. Judge Barber found that the taxpayer could not use section 106(1)(h)(ia) to deduct the interest because he was not in the business of lending money or being a financier.

Section 106(1)(h)(i) allows a deduction for interest payable in gaining or producing assessable income. In applying section 106(1)(h)(i) the TRA looked at the actual use of the funds. Judge Barber found that the taxpayer could not deduct the interest under section 106(1)(h)(i) because the loan capital was not used by the taxpayer to gain income. There were indirect benefits to the taxpayer, through the increased salary, but no income from the loan itself. The indirect benefits were not sufficiently connected to the taxpayer's own income-earning process to allow interest deductibility. Judge Barber said that deductibility does not flow from indirect or side benefits of a loan but from the direct financial advantage from the actual use of the loan capital.

In his decision Judge Barber applied and extended the reasoning in *Case Q35* (1993) 15 NZTC 5, 171, and cited with approval *Pacific Rendezvous Ltd v CIR* (1986) 8 NZTC 5, 146, *Eggers v CIR* (1988) 10 NZTC 5153 and *CIR v Brierley* (1990) 12 NZTC 7184 (CA). He did not apply the reasoning in the Australian case of *FCT v Total Holdings* (Aust) Pty Ltd 79 ATC 4, 279.

The taxpayer's attempt to retrospectively impose interest was ineffective. When taxpayers create records that do not accurately reflect the character of a prior transaction, they will not change the nature of that transaction. The TRA found that VHL was under no obligation to pay interest until 1990. The agreement in 1990 to retrospectively charge interest for the period 1984 to 1990 did not change this.

The TRA also considered the issue of deductibility of exchange variation losses under section 71. Although this was not in issue, the TRA's view was that the taxpayer would have difficulty satisfying the requirements of section 71(3). In particular, it would be difficult for the taxpayer to show his borrowings were in relation to a business he was carrying on in New Zealand.

Judge Barber noted that it would have been reasonably straightforward for the taxpayer to achieve interest and foreign exchange variation deductibility by structuring the loan differently. However, he concluded that he had to apply the law to the arrangements actually undertaken, not arrangements that could have been used.

Comment: The taxpayer is not appealing this decision.

Former section 129: sale or disposition before 1 April 1983

Rating: • •

Case: Peter McKay and Colin Malcolm Bell v Commissioner of Inland Revenue M681/94

Act: Income Tax Act 1976, former section 129

Keywords: Sale or disposition, oral agreement, interest deductions

Summary: An oral agreement made before 1 April 1983 for the sale of land was later effected by a written contract in December 1983. The oral contract was held to be a "sale or disposition" for the purposes of section 129, and the interest clawback provisions of section 129 did not apply

Facts: The appellants appealed a decision of the Taxation Review Authority reported as *Case M73* (1990) 12 NZTC 2427.

The appellants owned land from which they carried on the business of motor car dealing. In December 1982 they entered into an oral agreement to sell the land to a third party. In December 1983 the appellants and the third party executed a written contract with the same material terms as the oral agreement for the sale of the land.

The appellants claimed they sold the land to a third party under the oral agreement in December 1982. The Commissioner claimed the sale or disposition did not occur at the time of the oral agreement, but in December 1983, at the time of the written contract. Because there was a sale after 1 April 1983, the Commissioner added back the amounts of interest previously allowed as deductions as assessable income under section 129.

The issue was whether the oral agreement meant there was a sale or disposition of the land before 1 April 1983, such that the transaction was not caught by the "interest clawback" provisions of section 129.

Decision: Justice Blanchard found that as at 1 April 1983 and down to the date of the final execution of the agreement in December 1983 there was no enforceable agreement for the sale of the land.

However Justice Blanchard found that, on the unusual facts of the case, in entering into the written form of agreement and in conveying the land pursuant to it the parties were simply implementing the original oral agreement of sale.

Justice Blanchard thought that a "sale" in terms of section 129 meant there had to be a pre-April 1983 transaction which was at some time carried into effect. In other words, the transaction did not have to be carried into effect or performed before 1 April 1983. The question was therefore whether the December 1983 agreement was the same transaction as the December 1982 oral deal in all material respects.

Justice Blanchard found that the terms and conditions contained in the December 1983 written agreement were not materially different from the original oral agreement in December 1982. The written agreement was merely carrying into effect the oral agreement.

In his view there was a sale of land before 1 April 1983 for the purposes of section 129 and the interest clawback provisions of section 129 did not apply.

Comment: Inland Revenue is not appealing this decision.

Allocation of profits in husband and wife rental partnership

Rating: • •

Case: TRA No. 94/116

Act: Income Tax Act 1976, section 97

Keywords: Partnership, allocation of profits and losses

Summary: A husband and wife contributed $8,000 and $2,000 respectively to purchase a rental property. Outgoings were met from matrimonial money. Judge Barber held that losses from the property must be allocated 50/50, and not all to the husband as the taxpayers argued.

Facts: A husband and wife contributed $8,000 and $2,000 respectively to purchase a rental property. The property was sold and another rental property purchased with the sale proceeds. They owned the properties as joint tenants. Outgoings

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on the properties were met from matrimonial money. The husband was responsible for managing the properties. There was no written partnership agreement.

The 1987 accounts were prepared for a partnership between the husband and wife, and losses were allocated on a 50/50 basis. However, from 1988 to 1992, the accounts allocated all rental losses to the husband.

The Commissioner reassessed the losses and allocated them for the 1989 to 1992 years on a 50/50 basis. The Commissioner has discretion under section 97 of the Act to reallocate profits, income, or losses of a partnership between relatives if he is of the opinion that the share of profits or losses is not allocated reasonably.

Decision: Judge Barber held that the husband and wife were partners carrying on a rental property business or income earnings process. The losses should be shared equally. Judge Barber rejected the submission that the rental losses should be allocated on the basis of the original contributions.

His Honour's decision was based on:

- the further contributions from matrimonial property towards the mortgage and other outgoings
- joint liability of the parties under the mortgage
- the fact that both were ratepayers and on the Valuation New Zealand roll
- the muddlement in the presentation of their accounts
- the fact that the 100% allocation of losses to the husband could be viewed as self-serving from a taxation point of view.

Comment: The taxpayer is not appealing this decision.

Government tax policy publications available

Discussion document on rewriting the Income Tax Act

The Government has released a discussion document outlining its proposals tor clarifying tax law by rewriting the Income Tax Act. The discussion document, *Rewriting the Income Tax Act; Objectives, Process, Guidelines*, describes the proposed approach to a progressive rewriting of the Act. It also proposes "plain language" guidelines for clearer drafting of tax law. Submissions on the proposals close on 28 February.

You can get this document, free of charge, by writing to:

Legislative Affairs
Inland Revenue Department
P O Box 2198
WELLINGTON

or by faxing: (04) 474 7217

Commentary on new tax bill

The Taxation Reform (Binding Rulings and Other Matters) Bill was introduced into Parliament on 7 December. A detailed commentary on the policy measures contained in this bill is available free of charge from the address above.

Consultative document on proposed procedures for resolving tax disputes

The Government has released a consultative document seeking comment on proposals for improving the resolution of tax disputes between taxpayers and Inland Revenue. This document, *Resolving Tax Disputes; Proposed Procedures*, outlines Government proposals for implementing recommendations of the Organisational Review of the Inland Revenue Department on the resolution of tax disputes. Public submissions on the proposals close on 28 February.

You can get this document free of charge, by writing to:

The Director
Legal Services
Inland Revenue Department
P O Box 2198
WELLINGTON

or by faxing: (04) 474 7235

Due dates reminder

February

5 Large employers: PAYE deductions and deduction schedules for period ended 31 January 1995 due.
(We will accept payments received on Tuesday 7 February as on time.)

7 Provisional tax and/or Student Loan interim repayments: first 1996 instalment due for taxpayers with October balance dates.
Second 1995 instalment due for taxpayers with June balance dates.
Third 1995 instalment due for taxpayers with February balance dates.

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

QCET payments due for companies with March-September balance dates with elections effective from the 1995 income year.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 February 1995 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 January 1995 due.

Gaming machine duty return and payment for month ended 31 January 1995 due.

RWT on interest deducted during January 1995 due for monthly payers.

RWT on dividends deducted during January 1995 due.

Non-resident withholding tax (or approved issuer levy) deducted during January 1995 due.

28 GST return and payment for period ended 31 January 1995 due.

March

5 Large employers: PAYE deductions and deduction schedules for period ended 28 February 1995 due.
(We will accept payments received on Monday 6 March as on time.)

7 Provisional tax and/or Student Loan interim repayments: first 1996 instalment due for taxpayers with November balance dates.
Second 1995 instalment due for taxpayers with July balance dates.
Third 1995 instalment due for taxpayers with March balance dates.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 March 1995 due.

Small employers: PAYE deductions and deduction schedules for period ended 28 February 1995 due.

Gaming machine duty return and payment for month ended 28 February 1995 due.

RWT on interest deducted during February 1995 due for monthly payers.

RWT on dividends deducted during February 1995 due.

Non-resident withholding tax (or approved issuer levy) deducted during February 1995 due.

31 GST return and payment for period ended 28 February 1995 due.

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

Contents continued - questions and legal case notes

Questions we've been asked (pages 14-22)

Legal decisions - case notes (pages 23-26)

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