Using a special tax code

Summary

This item states the Commissioner's current policy on issuing special tax code certificates, those who are eligible for such a certificate, and how they may apply. All legislative references in this item are to the Income Tax Act 1976.

Background

The purpose of a tax code is to set the amount of PAYE to be deducted from an employee's salary or wages. An employee who expects the amount of PAYE deducted at ordinary rates from salary or wages during the year to exceed or be less than the end of year tax liability may apply to Inland Revenue for a special tax code certificate. Section 351 gives the Commissioner the authority to issue a special tax code certificate at his discretion. When a special tax code is granted, the taxpayer gives it to the employer making the payment. The special tax code will increase or decrease the rate of tax deductions made by the employer.

Policy

Who may apply for a special tax code

Any employee who expects the amount of ordinary rate PAYE deductions from salary or wages during the year to exceed or be less than the end of year tax liability may apply to Inland Revenue for a special tax code certificate (IR 23).

How to get a special tax code

An employee applies for a special tax code by filling in an IR 23B application form, and returning it to the local Inland Revenue office. Inland Revenue will then consider the application and approve a special tax code if one is appropriate.

These are typical situations in which a special tax code is appropriate:

- An employee has two or more jobs and the secondary employment PAYE deduction rate is too low. In this case the certificate will specify an increased rate of PAYE deductions for the secondary income.
- The employee has no regular full-time employment, works at a series of casual jobs, and has no "primary" employment. The certificate will be addressed to all the employee's employers generally. This may help employees who perform agricultural work, if their overall income is such that the rate of PAYE deductions for casual agricultural employees is inadequate.
- The employee conducts a business (including as a partner) which is operating at a loss, and can deduct the losses from employment income, or the employee is entitled to deduct past losses carried forward from employment income.

If Inland Revenue approves a special tax code, we will issue a certificate which shows the duration of the code, the employment to which it relates, and the rate of PAYE deductions. When the employee receives the special tax code certificate, he or she must give it to his or her employer. The special tax code may apply to primary or secondary employment income, or to both. It may specify that no tax deductions are to be made, or that the deductions are to be made from only part of each payment.

Family Support and GMFI not taken into account

Section 351(2A) ensures that when an employee applies for a special tax code certificate, his or her Family Support and/or Guaranteed Minimum Family Income entitlement is not taken into account when working out the special tax code rate. This is to prevent an employee from receiving any tax credit entitlement through a "certificate of entitlement" as well as receiving those benefits through reduced tax deductions under a special tax code certificate.

Employer's responsibilities

When the special tax code relates to one specific employment, the employer keeps the certificate. The employer should later attach it to the completed top copy of the employee's IR 12 PAYE deduction certificate. The employer sends the top copies of the IR 12s for all employees to Inland Revenue with the annual reconciliation. The employees get the bottom copies of the IR 12s, to go in their income tax returns.

When the special tax code certificate is addressed to several employers of the employee, each employer must record on the IR 12 the employee's name, address, IRD number, the number of the special tax code certificate, and the tax code or rate of PAYE deduction authorised. The employer then returns the certificate to the employee. The employer sends the top copy of the IR 12 to Inland Revenue with the annual reconciliation.

When the special tax code applies

The special tax code operates from one of these dates:

- the current pay period (if this is the first pay period in which the employer employs the employee)
- the pay period following that in which the employee produced the certificate (if the employer is already employing the employee).

The special tax code then operates in place of the code shown on the IR 12 declaration.

Expiry of special tax code

Every special tax code will expire on 31 March at the end of the income year for which it is issued. If an employee wants a certificate for the following income

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year, he or she must apply for a new one before the current certificate expires. Before the start of an income year (or at the latest, before 4 April in the new year), employees must give to their employer either an IR 12 tax code declaration or an IR 23 special tax code certificate for the new year. The code on this new declaration or certificate will then apply from the start of the new year, when the old code ceased.

When an old code has ceased to apply and the employee does not give the employer a new declaration or certificate by 4 April, the employer must deduct tax at the "no declaration" rate until the pay period following that in which the employee delivers a declaration or certificate to the employer. This is inconvenient for both the employee and the employer, so it is important that the employee fills in an IR 12 or gets a new special tax code certificate in time for the start of the new income year.

If the taxpayer's circumstances change so that the entitlement to a special tax code certificate no longer exists, he or she must fill in an IR 12 in the normal way.

Annual tax return

Anyone with a special tax code must file an annual tax return, even if he or she earned less than $20,000 in salary and wages and could otherwise have been a pay-period taxpayer and not required to file a tax return.

Return of certificate

The Commissioner may cancel a special tax code certificate at any time. If this happens, the employee must return the certificate to Inland Revenue within seven days of receiving notice that it has been cancelled.

Definition of a qualifying trust

Introduction

This item considers the definition of a "qualifying trust". It looks at the situation when there is no trustee income because all the income of the trustees has been distributed to the beneficiaries as "beneficiary income".

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

Background

We have been asked to explain how the definition of a qualifying trust applies. There is concern that if a trust pays out all its income as beneficiary income it would fall outside the definition of a qualifying trust. Broadly, the significance of being a qualifying trust is that distributions which are not beneficiary income are not assessable to beneficiaries. Most trusts which are established by resident settlors and whose trustees are resident in New Zealand are qualifying trusts.

Legislation

Section 226(1) defines a "qualifying trust" as:

"Qualifying trust", in relation to any trust, other than a superannuation fund, and any income year in which a distribution is made from that trust, means any trust where all trustee income derived by the trustee of that trust in income years commencing with the income year in which a settlement was first made to or for the benefit of that trust or on the terms of that trust until the income year in which the distribution is made has been liable under this Act to New Zealand income tax (other than only as non-resident withholding income) or would have been so liable had it not been for-

(a) The fact that no income was derived in any relevant income year; or

(b) The application in any relevant income year of section 61 of this Act; or

(c) Deductions allowable under this Act exceeding income derived by the trustee in any relevant income year or losses carried forward pursuant to section 188 of this Act offsetting all of the income derived by the trustee in any relevant income year,-

and all the trustee's obligations under this Act in respect of the trustee's liability to New Zealand income tax have been satisfied:

Provided that a superannuation fund shall be a qualifying trust on and after the 1st day of April 1990.

Section 226(1) also defines "trustee income" as:

"Trustee income", in relation to any trust and any income year, means income derived in that income year by a trustee of that trust that is not beneficiary income for any beneficiary of that trust.

What is a qualifying trust

A trust is a qualifying trust if these two requirements are satisfied:

1. From the income year during which a settlement was first made on the terms of the trust until the income year in which the distribution is made, all trustee income derived by the trustees has been liable to New Zealand income tax other than only as non-resident withholding income.
2. The trustee's obligations in respect of that liability have been satisfied.

We have received an inquiry about the definition of a qualifying trust in section 226(1). It was suggested that a trust might fall outside the definition of a qualifying trust under paragraph (a) of the definition if the trust derived income but paid it all out as beneficiary income. In such a case the trust would derive income but the trustees would not pay income tax on it.

This is not in accordance with the Commissioner's view. The definition of a "qualifying trust" considers whether the trustee income has been liable to income tax or would have been liable if there had been any trustee income. Therefore, by implication, the reference to "no income" being derived in paragraph (a) of the definition of a "qualifying trust", is a reference to "no trustee income" being derived. "Trustee income" is defined to exclude "beneficiary income". If all the income is paid out as "beneficiary income", the requirements of paragraph (a) are satisfied because "no trustee income" was derived.

The tax treatment of qualifying trusts is discussed in more detail in the Appendix to TIB Volume One, No. 5 (November 1989). The Commissioner set out his views in the Appendix at paragraph 4.82:

The trustees may derive no income in terms of the trustee income definition in two situations. First, they may have derived no income at all because the trust was dormant or their investments yielded no income during the income year. Second, they may have derived income but there was no trustee income because all of the income was beneficiary income. In both situations the "qualifying trust" definition is applied on the basis of whether there would have been a liability to income tax if there had been trustee income. Where all of the income derived by the trustee is beneficiary income it is consistent with the purpose of the "qualifying trust" definition to ensure that the fact that there is no trustee income does not prevent the trust from being a qualifying trust. In cases where the trustee passes all of the income through to the beneficiaries there is no deferral of tax with respect to any New Zealand resident beneficiaries. Thus, if the trustee income would have been liable to New Zealand income tax in a particular income year if the income had not all been passed through to the beneficiaries it is appropriate to treat the requirements of the "qualifying trust" definition as having been satisfied for that income year.

Example

Mr Smith has set up a qualifying trust which was to provide for the education of his grandchildren. The trust has a number of investments from which the trustees derive income. In 1994 the trustees distributed all of the income to the settlor's only grandchild, Toby Smith. Toby Smith used the money to pay his university fees. The trust remains a qualifying trust and the trustees deducted tax from the beneficiary income as the agent of Toby Smith.

Fractional shares in land - value for gift duty

Introduction

This item explains how the Estate and Gift Duties Act 1968 applies when valuing a fractional share in land for gift duty purposes. It sets out the factors taken into account when valuing a fractional share in land. If the legal title to a parcel of land is owned by two or more people, each owner holds a fractional share in that land.

All legislative references in this item are to the Estate and Gift Duties Act 1968 unless otherwise stated.

Background

A transfer of property for inadequate consideration is a dutiable gift to the extent that the actual value of the property exceeds the consideration given for it. The Commissioner may examine transactions involving related parties to see whether any dutiable gifts are involved. If the Commissioner considers that the consideration given for any land included in the agreement is inadequate, he may request a special valuation from the Valuer-General of Valuation New Zealand. This applies regardless of whether the share being transferred is a full or only a fractional share in the land.

If the Valuer-General determines a higher land value than the consideration provided for in the agreement, that value is substituted for the value originally shown in the agreement. Gift duty is payable to the extent that the consideration is inadequate. However, if the agreement contains provisions that allow it, the parties have the option to increase the consideration paid for the land, thus avoiding gift duty. Such a situation can arise if a person makes dutiable gifts exceeding $27,000 in any 12 month period, because gift duty would then be payable on the excess.

Legislation

Section 20 deals with the valuation of land included in a dutiable estate. Section 20(1) defines "capital value" and "land" as:

For the purposes of this section, the terms "capital value" and "land" have the same meanings as in the Valuation of Land Act 1951.

Section 20(2) states:

For estate duty purposes, the value of any land situated in New Zealand shall -

(a) Be determined by agreement between the Commissioner and the administrator; or

(b) In default of agreement be determined by the Commissioner in accordance with -

  (i) The capital value of the land as it appears in the district valuation roll in force under the Valuation of Land Act 1951, at the date on which the value of the land is to be determined, together with the cost of any improvements not included in the valuation appearing in the roll; or

  (ii) A special valuation of the capital value of the land, made by the Valuer-General on the requisition of the Commissioner for the purposes of this Act, as at the date on which the value of the land is to be determined.

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Section 67 deals with the valuation of property for gift duty purposes. It states:

> For gift duty purposes, and subject to sections 68 to 70 of this Act, the value of any property shall be ascertained by the Commissioner in such manner as he thinks fit.

Section 68 concerns the application of other sections of the Act to valuations for gift duty purposes. Section 68(1) states:

> Sections 20, 22, 23, 24, and 25 of this Act shall, with all necessary modifications, apply with respect to valuations for gift duty purposes in the same manner as they apply with respect to valuations for estate duty purposes.

Section 2 of the Valuation of Land Act 1951 contains the definition of "capital value" used in section 20. It states:

> "Capital value" of land means the sum which the owner's estate or interest therein, if unencumbered by any mortgage or other charge thereon, might be expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a bona fide seller might be expected to require.

Application

The value of a fractional share in a parcel of land is determined independently of the entire parcel's value. The value is determined by arriving at the figure that a willing seller and willing buyer, who are unrelated, would agree on for the fractional share. A fractional share in land is not valued by valuing the property as a whole, dividing that total value by the owner's share, and then deducting a set "rule of thumb" percentage discount to recognise the fractional share. This principle is supported in cases *Re Jackson* [1961] NZLR 50, *Public Trustee for NSW v CIR* [1966] NZLR 257, and *CIR v Flaxbourne Trust* (1983) 6 NZTC 61,953.

In *CIR v Flaxbourne Trust*, the Court identified the relevant factors which would be taken into account by a willing seller and a willing buyer when determining the price of a fractional share in a parcel of land. These factors are:

1. The number of parts into which the land is divided and the manner in which they are held.
2. The nature of the property and its value.
3. The size of the interest and whether it is greater or less than a half share.
4. The income from the property.
5. Whether partition would be in the interests of all parties.
6. Whether physical partition is possible.
7. Whether there is any special demand for fractional shares.
8. The legal position regarding partition.
9. The costs involved in partition.

Example

This example is based on the facts as disclosed in *CIR v Flaxbourne Trust*. John Jones is a sheep farmer. The farm's land is owned by John and his sister Carol equally as tenants in common. Carol is not involved in the farming operation. She has agreed to transfer her half share to John for $325,000. At the date of the sale, the land's total value is $875,000.

The Commissioner considers that the value of $325,000 does not represent the true value of Carol's half share and requests a special valuation by the Valuer-General. In determining the value of Carol's half share, the Valuer-General takes into account the relevant factors listed above.

The Valuer-General finds that a willing purchaser would consider these factors:

1. The fact that John is occupying the farm homestead and actively engaged in farming the land. The purchaser would have to weigh up his or her own chances of participating in the whole farming operation.
2. The ability of the property to provide an income for two separate owners.
3. The suitability of the property for subdivision into two units, and the fact that subdivision is possible, even though one unit would then carry a surplus of buildings.
4. Whether the fractional share could be used as security for a mortgage loan.
5. What type of sole ownership farm could be acquired for a similar price.
6. The prospect of John wishing to sell in the future and gaining full ownership.

After considering the above factors, the Valuer-General determines the value of Carol's half share to be $400,000. Note that this is considerably less than one-half of the land's total value, i.e. $437,500.

Gift duty is payable on $75,000, which is the shortfall between the land's value of $400,000 and the consideration being paid of $325,000. If Carol made no other dutiable gifts in the previous 12 months, the gift duty payable would be $6,600. (The rates of gift duty are contained in the Third Schedule to the Estate and Gift Duties Act 1968, and are set out below.)

If the agreement between John and Carol contains a provision which allows them to increase the consideration John is paying Carol for her half share, they would have the option of doing this and avoiding the gift duty liability.

Each case is considered on its own facts, and will not always produce the same result as in the above example.

Gift duty rates

Value of gift $	Duty payable $
0 - 27,000	Nil
27,001 - 36,000	5% on excess over $27,000
36,001 - 54,000	$450 + 10% of excess over $36,000
54,001 - 72,000	$2,250 + 20% of excess over $54,000
72,001 & over	$5,850 + 25% of excess over $72,000

Imputation credit account and dividend withholding payment account - penalty tax and additional tax

Summary

Companies that operate an imputation credit account (ICA) or a dividend withholding payment account (WPA) may be subject to penalty tax and additional tax. This item explains when the taxes apply, and the situations in which companies are entitled to relief from the taxes.

- Companies are charged penalty tax when their ICA or WPA is in debit at 31 March in any year.
- Companies are charged additional tax when they do not clear the debit balance in their ICA or WPA by the due date, or when they do not pay their ICA or WPA penalty tax by the due date.

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

How the legislation applies

Imputation credit account

If a company has a debit closing balance in its ICA at 31 March in any year, the company must make a payment to clear the balance under section 394L(1). This payment is an income tax payment called further income tax.

Dividend withholding payment account

If a company has a debit closing balance in its WPA at 31 March in any year, the company must make a payment to clear the balance under section 394ZZF(1). This payment is called a further dividend withholding payment.

If either the ICA or WPA is in debit, the company may be subject to penalty and additional taxes under the imputation and dividend withholding payment rules.

Penalty tax

Under sections 394N(1) and 394ZZG(1), imputation penalty tax and dividend withholding payment penalty tax are special taxes imposed when a company has to pay further income tax or further dividend withholding payments.

Imputation penalty tax and dividend withholding payment penalty tax are due under sections 394N(2) and 394ZZG(2). They are calculated at the rate of ten percent on the amount of any further income tax or a further dividend withholding payment.

Under sections 394N(3) and 394ZZG(3), the due date for payment is 20 June following the end of the imputation year (31 March) in which the debit balance arose in the ICA or WPA. If the company fails to pay any of the penalty tax by the due date, it is liable to pay additional tax which compounds every six months until it is paid.

Company ceasing to be an ICA company or resident in New Zealand

A company that has a debit balance in its ICA when it ceases to be an ICA company is not liable for imputation penalty tax imposed by section 394N.

A company that has a debit balance in its WPA when it ceases to be a resident in New Zealand is not liable for dividend withholding payment penalty tax imposed by section 394ZZG.

Additional tax

Generally a company is liable to pay additional tax in either of these situations:

- if it does not pay its income tax or dividend withholding payments by the due date
- if it does not pay its imputation penalty tax or dividend withholding payment penalty tax by the due date.

Additional tax of ten percent is imposed on any amount outstanding after the due date. After that, a further ten percent is added, on a compounding basis, for every six months that the balance remains outstanding.

Circumstances in which additional tax is charged

1. Additional tax is charged under section 394L(6) if the ICA has a debit balance at the end of the imputation year (always ending 31 March), and this balance was not removed by payment of further income tax equal to the debit balance by the following 20 June.
2. If a company has a debit balance in its ICA immediately before it ceases to be an ICA company, under section 394L(3) and (4) it is liable to pay further income tax to clear the debit balance by the last day on which it is still an ICA company. Additional tax is charged under section 394L(6) if the company fails to clear the debit balance by the last day on which it is still an ICA company.
3. Additional tax is charged under section 394ZZF(6) if the WPA has a debit balance at the end of the imputation year and this balance was not removed by payment of a further dividend withholding payment equal to the debit balance by the following 20 June.
4. Under section 394ZZF(3) and (4), if a company has a debit balance in its WPA immediately before it ceases to be resident in New Zealand, the company must pay a further dividend withholding payment to

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clear the debit balance by the last day on which it is still resident in New Zealand. Additional tax is charged under 394ZZF(6) if the company fails to clear the debit balance by the last day on which it is still resident in New Zealand.

5. Additional tax is charged under section 394ZN(4) and (5) if withholding payment liabilities were not paid on the due date of the 20th of the month following the end of the quarter in which the company became liable to deduct the withholding payment from foreign dividends received.
6. Additional tax is charged under sections 394N(4) and 394ZZG if any imputation penalty tax or dividend withholding payment penalty tax remains unpaid by the following 20 June.
7. Additional tax is charged under section 398 if default is made for payment of tax.

Example

Roseanne is the accountant for Dan's Building Co. Ltd. The company's ICA had a debit balance of $20,000 at 31 March 1994. The company would incur the following penalties and additional tax if the total tax was not paid until 21 December 1994:

ICA debit balance 31 March 1994	$20,000
Imputation penalty tax ($20,000 x 10%)	$ 2,000
	$22,000
Additional tax if not paid by 20 June 1994 ($22,000 x 10%)	$ 2,200
	$24,200
Additional tax if not paid by 20 December 1994 ($24,200 x 10%)	$ 2,420
Total tax to pay if not paid until 21 December 1994	$26,620

No ICA or WPA credits for penalty and/or additional tax payments

Section 394D(1) and (2) state the situations when imputation credits arise and when they are recorded. A payment of imputation penalty tax or additional tax cannot be allocated to shareholders as an imputation credit.

Section 394ZV(1) and (2) state the situations when dividend withholding payment account credits arise and when they are recorded. A payment of dividend withholding payment penalty tax or additional tax cannot be allocated as a dividend withholding payment account credit.

Remission

The Commissioner has no general discretion to remit penalty and additional tax. However, in limited situations there may be relief if certain statutory criteria are met.

Imputation credit accounts

Imputation penalty tax can only be remitted in either of these situations:

- The liability arose under section 394O(1)(a) from a debit to the ICA in respect of an arrangement to obtain a tax advantage, and a subsequent credit arises to the ICA when it is established that no such arrangement existed.
- The liability arose under section 394O(1)(b) because a debit balance arose because an income tax refund was sent to the company, but was not received before the end of imputation year.

The first situation occurs when the Commissioner applies the anti-avoidance provisions of section 394ZG and it is later discovered that section 394ZG does not apply. The second situation may occur when a company is sent a tax refund it is unaware of, and therefore does nothing to eliminate the debit balance which may be a consequence of the refund.

Under section 394O(2), when the Commissioner remits any imputation penalty tax under section 394O, the Commissioner must also remit any additional tax imposed under section 394N(4) to the extent that he is satisfied that the additional tax was imposed on the imputation penalty tax remitted.

Under 394O(3), when the Commissioner remits any imputation penalty tax under section 394O(1)(a), the Commissioner must also remit any additional tax under section 394L(6) to the extent that he is satisfied that the additional tax was imposed on the amount of further income tax that gave rise to the imposition of the imputation penalty tax remitted.

Withholding payment account

The Commissioner must remit any dividend withholding payment penalty tax imposed on a WPA company under section 394ZZH in these two situations:

- If the Commissioner is satisfied that under section 394ZZH(1)(a), the liability arose from a debit to the WPA in respect of an arrangement to obtain a tax advantage, and subsequently a credit arises to the WPA when it is established that no such arrangement existed.
- If the Commissioner is satisfied that under section 394ZZH(1)(b), liability for the tax arose because a refund of a dividend withholding payment was been sent out, but the company did not receive it (or did not know that it had received it) before the end of the imputation year.

Under section 394ZZH(2), when the Commissioner remits any dividend withholding payment penalty tax under section 394ZZH, he must also remit any additional tax imposed under section 394ZZG(4) to the extent that he is satisfied that the additional tax was imposed on any dividend withholding payment penalty tax remitted.

Under section 394ZZH(3), when the Commissioner remits any dividend withholding payment penalty tax under section 394ZZH(1)(a), he must also remit any additional tax under section 394ZZF(6) to the extent that he is satisfied that the additional tax was imposed on the amount of the further dividend withholding payment that gave rise to the imposition of the dividend withholding payment penalty tax remitted.

Assessments and objections

The Commissioner can make an assessment for any of these things:

- The closing balance of the ICA, if the Commissioner does not agree with the company's calculation under section 19.
- The amount of further income tax under section 394L(7).
- The amount of any imputation penalty tax under 394N(5).

Any assessment issued is subject to objection in the same way as an income tax assessment.

Commissioner's powers under section 400 of the Income Tax Act 1976

Summary

This item explains how section 400 of the Income Tax Act 1976 applies. Section 400 enables the Commissioner to require people to pay to Inland Revenue funds which they are holding which are payable to a taxpayer who has defaulted on income tax liabilities.

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

Background

The Commissioner has wide powers to recover outstanding income tax liabilities from taxpayers who have not complied with requests to make payment. Section 400 gives the Commissioner the power to require people holding funds payable to a taxpayer with outstanding income tax liabilities to pay those funds to him.

The Commissioner does this by giving a written notice, called a "section 400 notice". This notice requires a person to deduct a specified sum from any amount which is or will become payable to the defaulting taxpayer. The taxpayer also receives a copy of the notice, at his or her last known address.

Section 400(7A) deems the person required to make the deduction to be acting under the taxpayer's authority, and indemnifies the person in respect of the deduction. The person making the deduction must pay the amount to the Commissioner within the time stated in the notice.

The Commissioner may issue section 400 notices to banks, building societies, legal practitioners, or others who may be holding funds belonging to, or due to become payable to, the taxpayer. The recipient must then deduct sums from client funds. The Commissioner also may require employers to recover unpaid tax from employees.

There are similar provisions in other legislation - for example, section 43 of the Goods and Services Tax Act 1985, section 46 of the Student Loan Scheme Act 1992, section 154 of the Child Support Act 1991, and section 130 of the Accident Rehabilitation and Compensation Insurance Act 1992.

Legislation

Section 400(2) states:

Where any taxpayer has made default in the payment to the Commissioner of any income tax (or any part thereof) payable by the taxpayer or any penalty (or any part thereof) incurred by him, the Commissioner may from time to time by notice in writing require any person to-

(a) Deduct or extract, in one sum, from any amount that is, or becomes, an amount payable in relation to the taxpayer such sum as is equal to the lesser of -

(i) The amount that, pursuant to the notice, is required to be deducted or extracted:

(ii) The amount that, at the time at which the deduction or extraction is required to be made in compliance with the notice, is the said amount payable:

(b) Subject to subsection (4) of this section, deduct or extract from time to time, by way of instalment, from any amount that is or, as the case may be, from time to time becomes, an amount payable in relation to the taxpayer such sum as is equal to the lesser of-

(i) The amount that, at the time at which the deduction or extraction is required to be made in compliance with the notice, is the amount required to be so deducted or extracted:

(ii) The amount that, at the time at which, pursuant to the notice, the amount of the instalment, is required to be deducted or extracted, is the said amount payable, -

and require that person to pay to the Commissioner, within such time as is specified in the notice, every sum so deducted or extracted, to the credit of,-

(c) To the extent that that sum is in respect of or in relation to income tax (or any part thereof) assessed on taxable income, the taxpayer who derived that taxable income:

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(d) To the extent that that sum is in respect of or in relation to the whole or any part of a tax deduction or a penalty, an account maintained by the Commissioner in relation to that tax deduction or, as the case may be, that penalty.

Section 400(2) applies when a taxpayer has defaulted in paying any income tax payable or any penalty. The Commissioner may send a written notice to a person, requiring that person to deduct the lesser of these amounts from any amount payable to the taxpayer:

- The amount specified in the notice
- The amount payable to the taxpayer at the time the deduction is to be made.

The section 400 notice can require the amount to be taken in one sum or by instalment.

Regarding deductions from wages or salary, section 400(4) states:

...the sums required to be deducted therefrom shall be computed so as to not exceed the greater of-

(a) An amount equal to the lesser of the following amounts:

(i) An amount calculated at the rate of 10 percent per week of the income tax due and payable by the taxpayer at the date of the notice:

(ii) An amount calculated at the rate of 20 percent of the said wages or salary payable:

(b) The amount of $10 per week.

This calculation is on the gross amount of wages or salary.

Section 400(1) provides that "amount payable" means any amount payable by the person who receives the notice (whether on his or her own account, or as an agent, or as a trustee, or otherwise howsoever) to the taxpayer. It includes money (including interest) on deposit or standing to the credit of the defaulter in a bank. Section 400(1) excludes money in certain accounts (specified in the section) from the definition of "amount payable", so that the Commissioner cannot require amounts to be deducted from these particular accounts. These accounts (which are no longer offered) are:

- a Home Lay-by Account within the meaning of the Post Office Act 1959
- a Home Ownership Account within the meaning of the Home Ownership Savings Act 1974
- a Farm Ownership Account within the meaning of the Farm Ownership Savings Act 1974
- a Fishing Vessel Ownership Account within the meaning of the Fishing Vessel Ownership Savings Act 1977.

A person commits an offence under section 400(9) if he or she does not comply with a section 400 notice.

Example

Ida owns the Plants 'R' Green Nursery, specialising in citrus trees. The nursery is expanding rapidly, so she employs Bella. Bella owes $1,768.50 in unpaid taxes from the time she had been self-employed as a line dance instructor. Ida receives a section 400 notice, requiring her to deduct amounts from Bella's pay every payday. From Bella's pay of $295 per week, Ida must deduct either:

- $59, which is the lesser of 10% of the unpaid taxes ($176.85), or 20% of the wages ($59)
- $10

whichever is the greater.

As $59 is greater than $10, Ida must return this amount under the section 400 notice.

Guaranteed Minimum Family Income - self-employed people's eligibility

Summary

Section 374E of the Income Tax Act 1976 provides for Guaranteed Minimum Family Income (GMFI). This item sets how this section applies to self-employed people, as there has been some confusion in this area.

There is a perception that self-employed people are not eligible for GMFI. This is incorrect. When determining whether a self-employed person is eligible for GMFI the issue is whether the person is in "employment" as defined in section 374E(1), not whether the person is self-employed. Most self-employed people will not be in "employment", but some people may be, such as self-employed people who receive withholding payments.

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

Background

GMFI is one part of the Family Support scheme. It was introduced to ensure that full-time earners with dependent children receive a guaranteed minimum income.

There is some confusion over whether people who are self-employed are entitled to receive a GMFI tax credit.

How the legislation applies

Under section 374E, GMFI is available to a qualifying person who is a full-time earner. "Qualifying person" is a defined term under the GMFI rules. This item sets out how the legislation applies to determine whether a self-employed person is a full-time earner for GMFI purposes.

In summary, under section 374E(1) a person is a "full-time earner" in any week if he or she meets either of these conditions for that week:

- He or she does not have a spouse and is engaged in employment for at least 20 hours.
- He or she has a spouse and either the person or the person and the spouse between them are engaged in employment for at least 30 hours.

"Employment" is defined in section 374E(1). A person who performs activities which entitle him or her to receive a source deduction payment which is not excluded by the section is in employment for GMFI purposes.

Section 6 defines a "source deduction payment" as:

"a payment by way of salary or wages, an extra emolument, or a withholding payment."

As stated, section 374E(1) excludes certain source deduction payments from the definition of "employment" for GMFI purposes, and in this way excludes certain self-employed people from being full-time earners. In summary, a self-employed person is entitled to GMFI if he or she receives a withholding payment and is *not* one of the following:

- A working partner in a partnership from which the amount of the payment to the partner does not exceed either:
  - the amount payable in the partner's contract of service; or
  - the amount payable in the partner's contract of service plus bonuses paid by the partnership to the partner
- A non-resident contractor.
- A major shareholder of a close company. A major shareholder is a person who owns, has the power to control, or the right to acquire 10% or more of the ordinary shares or voting shares of the company, or who has 10% or more of the control of the company by any other means.

  A "close company" is a company (other than a special corporate entity) in which five or fewer natural people hold more than 50% of the voting interests between them. If a market value circumstance exists, then a close company is a company in which five or fewer natural people hold more than 50% of the market value interests. If any of the natural people are associated, they are treated as one person.
- A person who receives a payment from his or her spouse.
- A person who receives a payment from the business of his or her spouse, if the business is carried on by two or more people either in partnership or otherwise.

Example 1

A taxpayer is married and has two children. He runs a company with his brother; and they each own 50% of the shares. As managing director of the company the taxpayer works 35 hours a week and is paid a salary.

The taxpayer is not entitled to receive GMFI because he is a major shareholder of a close company.

Example 2

A taxpayer is single and has two children. She is in partnership with two other people, running a plant nursery. She has a contract of service with the partnership, for which she works 25 hours a week and is paid the amount specified in her contract. She also works 10 hours a week in council gardens and is paid an hourly wage.

The taxpayer is not entitled to GMFI as her payment from the partnership is excluded from the definition of source deduction payment. Although she receives a source deduction payment (which is not excluded from employment) from her employment with the council, she does not work 20 hours a week in that job.

Comparative tables: section numbers of Income Tax Act 1994, Income Tax Act 1976, and other tax Acts

The appendix to this TIB deals with the following Acts, which were enacted in December 1994:

- Income Tax Act 1994
- Tax Administration Act 1994
- Taxation Review Authorities Act 1994

These new Acts resulted from the Income Tax Bill 1994, the Tax Administration Bill 1994 and the Taxation Review Authorities Bill 1994 respectively, which were introduced into Parliament in October 1994.

The bulk of the appendix consists of comparative tables, to cross-refer between sections in the new tax Acts to their equivalent sections in the old Acts. You may wish to keep it in a handy location, to refer to when working with 1994 tax legislation.

Base price adjustment when a company purchases its own debt instrument

Summary

This item explains how section 64F of the Income Tax Act 1976 applies when a company purchases its own debenture, bond, or similar debt instrument, with the purpose of extinguishing the debt. Section 64F the Act requires the company to calculate the base price adjustment (BPA) amount and return it in the income year that the it purchases the debt instrument which it previously issued.

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

Background

A company may decide to issue a debt instrument to raise funds. At a later date it may decide to purchase back the debt instrument that it previously issued.

For example, a company decides to expand its business, by investing in new technology in an industry related to one of its existing businesses. It decides to raise funds by issuing a debenture for a five-year term, rather than by issuing equity. After two or three years the new business venture has earned higher returns than forecast. The company decides to clear the debt, and so purchases the debenture it previously issued.

Legislation

Section 64F(2) states:

Subject to subsection (3) of this section, where, in relation to any person, a **financial arrangement matures or is remitted (other than by way of being written off as a bad debt), sold or otherwise transferred** by the person in any income year, the amount of the base price adjustment in relation to that income year, that person, and that financial arrangement shall be an amount calculated in accordance with the following formula: *(Emphasis added)*

$$a - (b + c)$$

Section 64F(2) goes on to define a, b, and c. The meaning of these amounts is summarised in the table under step 4 of the Appendix below entitled "Accrual Income & Expenditure - The Four Steps to calculate using the YTM Method".

Section 64B(1) defines the term Financial Arrangement:

"Financial Arrangement" means

(a) Any debt or debt instrument; and

(b) Any arrangement ... whereby a person obtains money in consideration for a promise by any person to provide money to any person at some future time or times, or upon the occurrence or non-occurrence of some future event or events ...; and

(c) Any arrangement which is of a substantially similar nature ..., -

but does not include any excepted financial arrangement that is not part of a financial arrangement.

Section 64F(1)(e) states:

The term **"maturity"** in relation to a financial arrangement, means **the date on which the last payment contingent upon the financial arrangement is made** and the term "matures" has a corresponding meaning:

Provided that where a financial arrangement has not matured and where the amount which has not been paid is immaterial and the financial arrangement has been structured to avoid the application of this section, the financial arrangement shall be deemed to have matured. *(Emphasis added)*

Section 64B(1) defines the terms holder and issuer as follows:

"Holder" means - ... a person who, if the ... amounts payable under the financial arrangement [e.g. the debenture] were due and payable at that time, would be entitled to receive, ... a pecuniary benefit ....

"Issuer" means ... a person who is a party to the financial arrangement and is not a holder in relation to the financial arrangement:

Under section 64B(1), debentures to which section 192 or section 195 apply are "excepted financial arrangements". The accrual rules do not govern these debentures.

Application

A bond, debenture, or similar debt instrument is a "financial arrangement", which is subject to the accrual rules in sections 64B to 64F.

When a company purchases its own debt instrument (i.e. a debt instrument that it previously issued) section 64F requires it to calculate the BPA amount and return it, because the debt instrument has come to maturity.

The BPA is a final adjustment. The accrual rules require this final adjustment to ensure that on the maturity of a financial arrangement, the taxpayer returns all income and expenditure attributable to the financial arrangement.

To calculate the BPA for the final income year it is necessary to know the amount of item 'c' in the BPA formula. For the issuer, 'c' is the accrual expenditure he or she incurred (less the accrual income deemed to be derived) in previous income years on the financial arrangement. The issuer will know these amounts as he or she will have returned them in previous years' income tax returns.

The yield to maturity (YTM) method is one of the methods used to calculate accrual income and expenditure for the income years during the term of the financial arrangement other than for the final year. For further information on how to calculate the accrual income or expenditure using the YTM method see the section at the end of this item called "Accrual income and expenditure - the four steps to calculate using the YTM method".

Example

Timber Plantations Limited issues a debenture with a face value of $750,000 on 15 November 1991 for a 5-year term. The debenture pays coupon interest at six-monthly intervals from the date of issue. The coupon interest rate is 14% per annum.

Mutual Life Savings Society purchased the debenture for $735,000. On 15 May 1994 Timber Plantations Limited buys the debenture back from Mutual Life Savings Society for $770,000. Timber Plantations Limited has a 31 March balance date.

To calculate the BPA for the 1995 income year it is necessary to know the amount of item 'c' in the BPA formula for the issuer - that is, the accrual expenditure incurred (less the accrual income derived) by Timber Plantations Limited in previous income years on this debenture. Timber Plantations Limited calculated its accrual income or expenditure for each of the income years during the term of the debenture using the YTM method.

Timber Plantations Limited calculated and deducted accrual expenditure in the 1991-92, 1992-93, and 1993-94 income years of $(40,325), $(107,269), and $(107,696) respectively. (For details of how these amounts were calculated refer to "YTM Calculations" at the end of the example.)

Calculating Timber Plantations Limited's BPA for 1995 income year

Each coupon payment is $52,500 (i.e. $750,000 x 14% x .5). Mutual Life Savings Society is the "holder", because it would be entitled to receive the payment if the amounts payable under the debenture were due and payable at that time. Timber Plantations Limited is the "issuer".

(continued in opposite column)

Calculating final year's accrual income or expenditure by using BPA

The BPA for Timber Plantations Limited (the issuer) in the 1994/95 income year is as follows:

a = the five coupon payments of $52,500 each (paid on 15 May 1992, 15 November 1992, 15 May 1993, 15 November 1993, and 15 May 1994), and the purchase price of $770,000 paid by Timber Plantations
= (5 x 52,500) + 770,000
= $1,032,500

b = the sale price of $735,000 received by Timber Plantations Limited
= $735,000

c = the accrual expenditure incurred by Timber Plantations Limited in the income years ended 31 March 1992, 1993, and 1994 of $(40,325), $(107,269), and $(107,696) respectively
= $255,290

BPA= 1,032,500 - (735,000 + 255,290)
= $ 42,210

As the BPA is positive, Timber Plantations Limited has incurred accrual expenditure in the 1994/95 income year of $42,210.

YTM Calculations

The accrual income or expenditure for the income years ended 31 March 1992, 1993, and1994 was calculated using the YTM method as follows:

1. Calculate the Yield to Maturity %:

   Calculate the YTM on the cashflows in the table below. The YTM (i.e. the yield over the period from the date of issue (15/11/91) to the date of maturity (15/11/96)) on this debenture is 14.5771% per annum.

2. Calculate the accrual income or expenditure and the principal outstanding for each period alternately:

Period Ended	Type of Payment	Cashflow ($)	Principal outstanding ($)	Accrual income or (expenditure) ($)	Number of days
15/11/91	purchase price	735,000	(735,000) (1)		
15/05/92	coupon interest	(52,500)	(736,071) (3)	(53,571) (2)	182
15.11.92	coupon interest	(52,500)	(737,220) (5)	(53,649) (4)	184
15.05.93	coupon interest	(52,500)	(738,453)	(53,733)	181
15.11.93	coupon interest	(52,500)	(739,775)	(53,823)	184
15.05.94	coupon interest	(52,500)	(741,194)	(53,919)	181
15.11.94	coupon interest	(52,500)	(742,717)	(54,022)	184
15.05.95	coupon interest	(52,500)	(744,350)	(54,133)	181
15.11.95	coupon interest	(52,500)	(746,103)	(54,252)	184
15.05.96	coupon interest	(52,500)	(747,983)	(54,380)	182
15.11.96	principal & coupon interest	(802,500)	0	(54,517)	184
	Net Expenditure	(540,000)		(540,000)	

The calculations for the first five amounts of principal outstanding (P.O.) and accrual expenditure (A.E.) are set out on page 12.

(1) P.O. = 0 + (735,000) + 0 - 0
= (735,000)

(2) A.E. = (735,000) x $\frac{14.5771}{100 \times 2}$
= (53,570.84)

(3) P.O. = (735,000) + 0 + (53,570.84) - (52,500)
= (736,070.84)

(continued in opposite column)

(4) A.E. = (736,070.84) x $\frac{14.5771}{100 \times 2}$
= (53,648.89)

(5) P.O. = (736,070.84) + 0 + (53,648.89) - (52,500)
= (737,219.73)

3. Apportion the accrual income or expenditure for each accrual period on a daily basis to an income year:

Period ended	Accrual income or expenditure for each accrual period (a)	Total number of days in each accrual period (b)	Days in each period (c)	Accrual income or exp. allocated to income year	Income year	Total income or expenditure for income year
15/11/91						
31/03/92			137	(40,325) (1)	91-92	(40,325)
15/05/92	(53,571)	182	45	(13,246) (2)	92-93	
15/11/92	(53,649)	184	184	(53,649)	92-93	
31/03/93			136	(40,374) (3)	92-93	(107,269)
15/05/93	(53,733)	181	45	(13,359) (4)	93-94	
15/11/93	(53,823)	184	184	(53,823)	93-94	
31/03/94			136	(40,514) (5)	93-94	(107,696)
15/05/94	(53,919)	181				
						(255,290)

(1) 91-92 A.E. = ((53,571) / 182) x 137
= (40,325.42)

(2) 92-93 A.E = ((53,571) / 182) x 45
= (13,245.58)

(3) 92-93 A.E. = ((53,733) / 181) x 136
= (40,373.97)

(4) 93-94 A.E. = ((53,733) / 181) x 45
= (13,359.03)

(5) 93-94 A.E. = ((53,919) / 181) x 136
= (40,513.72)

Accrual income and expenditure - the four steps to calculate using the YTM method

Apply these four steps to calculate the accrual income or expenditure using the YTM method:

1. Calculate the yield to maturity percentage

The YTM method is described in Determination G3: Yield to Maturity Method. The YTM percentage is the constant annual rate at which the cashflows accumulate to zero. It is calculated over the period of the financial arrangement from the date of issue to the date of maturity. Another name for the YTM is the internal rate of return.

2. Calculate the accrual income or expenditure and the principal outstanding for each period alternately

The formulae to calculate these amounts are also set out in Determination G3: Yield to Maturity Method. The formulae for these two amounts are:

Principal outstanding
for a particular period = Principal outstanding in the previous period
+ the amount payable by holder or receivable by issuer immediately before the start of this period
+ the amount of accrual income or expenditure in the previous period
- the amount receivable by holder or payable by issuer immediately before the start of this period

$$\text{Accrual income or expenditure for a particular period} = \text{principal outstanding at start of this period} \times \frac{\text{YTM \%}}{(100 \times N)}$$

If all periods are of equal length, the variable 'N' takes the following values:

Length of period	Value of 'N'
12 months	1
6 months	2
3 months	4
1 month	12
a fortnight	26
a week	52

If the length of one or two periods is different to the equal period, N = 365/No of days in the period (excluding start date and including ending date).

3. Apportion the accrual income or expenditure for each accrual period on a daily basis to an income year

The apportionment method is set out in Determination G1A: Apportionment of Income and Expenditure on a Daily Basis. The formula is:

The amount of accrual income or expenditure allocated to a given income year = $\frac{a}{b} \times c$

a = the amount of accrual income or expenditure for a period which spans a balance date

b = the total number of days in the accrual period which spans the balance date

c = the number of days in the accrual income / expenditure period that relate to a particular income year

4. Calculate the Accrual Income or Expenditure in the final income year by using the BPA

Calculate the BPA for the holder or issuer for the final income year as follows:

$$BPA = a - (b + c)$$

For the **holder**

a = the sum of all consideration that has been paid or will become payable to the holder

b = the acquisition price in relation to the holder, ie all consideration provided by the holder

c = all accrual income derived (less accrual expenditure deemed to be incurred or deemed to be an allowable deduction) by the holder in previous income years

If the BPA is:

positive = income derived
negative = allowable deduction

For the **issuer**

a = the sum of all consideration that has been paid or will become payable by the issuer

b = the acquisition price in relation to the issuer, ie all consideration provided to the issuer

c = all accrual expenditure incurred (less accrual income deemed to be derived) by the issuer in previous income years

If the BPA is:

positive = expenditure incurred
negative = income derived

Exemption from NZ income tax for foreign international aircraft operators

Summary

This item states the Commissioner's current policy on the income tax exemption for foreign international aircraft operators under section 64A of the Income Tax Act 1976.

When there is no Double Tax Agreement (DTA) between New Zealand and the foreign country in which the international aircraft operator is resident, the operator will need to apply for an exemption under section 64A so as not to be taxed in two countries.

Section 64A(2) gives the Commissioner the authority to exempt from income tax any aircraft operator who meets all of these conditions:

- It is resident in a country outside New Zealand.
- It is not resident in New Zealand.
- It is engaged in air transport from New Zealand.

This exemption will apply to the aircraft operator's income derived from air transport from New Zealand. However, the Commissioner must be satisfied that if a New Zealand resident aircraft operator was to operate in that country in similar circumstances, the New Zealand resident would not be liable to, or would be exempt from, income tax in that jurisdiction.

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

Background

The tax laws of many countries tax both of these types of income:

- the worldwide income of taxpayers who are resident in those countries
- any income that is derived from those countries, regardless of whether taxpayers are resident in those countries.

If there were no exemptions in the domestic tax laws and/or DTAs, this would result in people and businesses who earn income from several countries being double taxed; once by the country of their residence and a second time by the country from which the income was derived. For foreign international aircraft operators, this would mean that some of their income would be taxed twice.

For example, without section 64A or the DTA between Australia and New Zealand, an Australian international aircraft operator would be subject to New Zealand income tax and Australian income tax on income derived from New Zealand. The Australian operator would be liable to New Zealand income tax under section 242(b), and to Australian income tax under section 25(1)(b) of the Australian Income Tax Assessment Act 1936.

Legislation

Section 242 sets out the source rules for determining the income tax liability of income derived from New Zealand and abroad. Section 242 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.

(emphasis added)

Section 243 deems various classes of income to be "derived from New Zealand". It states:

Subject to section 244 and 245 of this Act, the following classes of income shall be deemed to be **derived from New Zealand**:

...

(q) **Income derived from the carriage** by sea or **by air** of merchandise, goods, livestock, mails, or passengers shipped or **embarked in New Zealand**:

... (emphasis added)

Section 64A(1) states:

For the purposes of this section -

"Aircraft operator" means a person engaged in the business of operating any aircraft for air transport from any airport:

"Air transport" means the carriage by any aircraft of merchandise, goods, livestock, mails, or passengers emplaned or embarked on that aircraft at any airport:

"Air transport from New Zealand" means the carriage outside New Zealand by any aircraft of merchandise, goods, livestock, mails, or passengers emplaned or embarked on that aircraft at any airport in New Zealand; and such carriage shall be deemed to be outside New Zealand notwithstanding that the aircraft calls at any one or more other airports in New Zealand before leaving New Zealand on the flight for which that emplaning or embarking occurred:

"Income tax", in relation to any country or territory outside New Zealand, means any tax which, in the opinion of the Commissioner, is substantially of the same nature as income tax imposed under this Part of this Act.

Section 64A(2) states:

Where any aircraft operator, or any class or classes of aircraft operators, being resident in a country or territory outside New Zealand and not being resident in New Zealand, is or, as the case may be, are engaged in air transport from New Zealand, **the Commissioner may exempt** in whole or in part **such**

operator or class or classes of operators **from liability to pay income tax in New Zealand in respect** of income derived from that air transport from New Zealand, **if and so far** as he is satisfied that **in corresponding circumstances the like aircraft operator** or, as the case may be, the like class or classes of aircraft operators, **being resident in New Zealand, are not liable to or are exempt from income tax imposed by the laws of that country** or territory outside New Zealand.

[emphasis added]

Section 294(1) states:

Where arrangements have been made with the Government of any territory outside New Zealand with a view to -

(a) Affording relief from double taxation; or

(b) Exchanging information -

in relation to income tax or excess retention tax and any taxes imposed by the laws of that territory included in the arrangements, the Governor-General may from time to time by Order in Council declare that those arrangements shall, notwithstanding anything in this Act or any other enactment, have effect in relation to income tax and excess retention tax accordingly.

Application

An international aircraft operator who is resident in a foreign country is liable to New Zealand income tax on all income "derived from New Zealand", under section 242(b). This liability may be modified by the operation of section 64A or a DTA between New Zealand and the other country, as discussed below.

Section 243(2)(q) deems income "derived from New Zealand" to include income derived from the carriage by air of merchandise, goods, livestock, mails, or passengers embarked in New Zealand.

The Concise Oxford Dictionary defines "embark" to mean:

1. Put or go on board a ship or aircraft (to a destination).

Section 64A Exemption

If there is no DTA between New Zealand and the foreign country in which the international aircraft operator is resident then the operator will need to apply for an exemption under section 64A, to avoid being taxed in two countries.

Section 64A provides an exemption from New Zealand income tax for an aircraft operator (or class or classes of operators) which meets all of these conditions:

- It is resident in a country or territory outside New Zealand.
- It is not resident in New Zealand.
- It is engaged in air transport from New Zealand.

The Commissioner may wholly or partly exempt the operator (or class or classes of operators) from any New Zealand income tax liability on income derived from air transport from New Zealand.

The Commissioner may only grant the exemption if, and to the extent that, he is satisfied that in corresponding circumstances a like New Zealand resident aircraft operator (or class or classes of operators) is not liable to, or is exempt from, income tax imposed by the laws of that foreign country.

The exemption only applies to income tax; it does not apply to goods and services tax.

Double Tax Agreements

The purpose of a DTA is to provide relief from double taxation and to facilitate the exchange of information between two countries. DTAs override the domestic tax laws of both countries. New Zealand's DTAs override anything in the Income Tax Act 1976 or any other Act.

New Zealand has 24 DTAs. They all contain an article dealing with international air transport. In most cases, the article on international air transport has these effects:

- It grants the right to charge income tax on the profits derived by an international aircraft operator to the country:
  - in which the operator is resident (in some DTAs), or
  - in which the place of effective management is located (in other DTAs).
- It prevents New Zealand from taxing the income of an aircraft operator who is resident in a foreign country.

In practice, this means that if there is a DTA in operation between New Zealand and the other country, a foreign international aircraft operator won't have to apply for an exemption under section 64A.

The countries with which New Zealand has DTAs are:

Australia	Italy
Belgium	Japan
Canada	Korea
China	Malaysia
Denmark	The Netherlands
Fiji	Norway
Finland	Philippines
France	Singapore
Germany	Sweden
India	Switzerland
Indonesia	United Kingdom
Ireland	United States of America

Policy

When considering whether to grant an exemption under section 64A (and whether to grant it in whole or in part) the Commissioner considers how the foreign country taxes a New Zealand resident international aircraft operator.

In some cases the domestic tax laws of a foreign country may provide conclusively that a New Zealand resident international aircraft operator is not liable to, or is exempt from, income tax in that country.

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In other cases the foreign tax laws may provide the foreign tax authority with a discretion to grant a New Zealand resident international aircraft operator an exemption from income tax in that country. In these cases, the Commissioner requires written confirmation from the foreign tax authority as to how it applies its discretion to a New Zealand resident international aircraft operator.

The Commissioner's policy is that he will not grant an exemption while a DTA is in force. If a DTA ceases to remain in force the Commissioner may grant an exemption under section 64A, if he receives an application.

A person who requests an exemption under section 64A must enclose conclusive evidence that a New Zealand resident aircraft operator (or class or classes of operators) is not liable to or is exempt from income tax in the foreign country. Address any requests for an exemption under section 64A to:

The Manager (Tax Policy)
Rulings
Inland Revenue Department
PO Box 2198
WELLINGTON

Example 1

A Canadian resident aircraft operator has flights scheduled between Vancouver and Auckland.

Under Article 8 in the DTA between Canada and New Zealand, Canada taxes the income derived from New Zealand by the Canadian aircraft operator. New Zealand cannot tax this income.

Example 2

A Samoan resident aircraft operator has flights scheduled between Apia and Auckland.

There is no DTA between Samoa and New Zealand. If the Samoan tax laws provide that a New Zealand resident aircraft operator would not be liable to or would be exempt from income tax in Samoa, then the Commissioner has the authority under section 64A to grant an exemption from New Zealand income tax to the Samoan aircraft operator.

FBT - prescribed interest rate increased to 9.2%

The prescribed rate of interest used to calculate the fringe benefit value of low interest employment-related loans has been increased to 9.2% for the quarter starting on 1 January 1995. This rate will also apply to all subsequent quarters unless it requires further revision. The new rate reflects the increased market interest rates.

The prescribed rate was previously 8.4% for the quarter starting on 1 October 1994.

Student Loan scheme - repayment threshold raised

The Government has reviewed the repayment threshold for the Student Loan scheme, and increased it to $13,884 for the 1995-96 income year.

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

Assessability of salary when employee breaches terms of study bond

Section 65(2)(b) - Assessable income: A taxpayer was granted study leave on full pay. Under an agreement with her employer, if she left the company's employment within a year of completing the study leave, she would be required to repay a proportion of the study leave salary. As PAYE and ACC deductions are being made from her salary, she wonders if she can request a reassessment of her taxes if she ceases her employment upon the expiry of the study leave and is obliged to repay a part of her earnings.

Any salary received while undertaking a full-time course of study is fully assessable in the tax year in which it is received. The salary is assessable under section 65(2)(b), even though there is the prospect that some of it may need to be repaid if the employee fails to fulfil the terms of the study bond. Any amount that must be repaid for the non-fulfilment of the terms of the agreement is calculated by reference to the amount of salary paid. It is not a refund of the salary, so it does not entitle the employee to any reassessment.

The salary becomes the taxpayer's absolute property when it is paid to her, and what happens subsequently under the conditions of the bond does not change the character of the salary received. The case of *Bowcock v CIR* (1981) 5 NZTC 61,062 is the judicial authority supporting this treatment.

Deductibility of new building ceremony expenses

Section 104 - Expenditure allowed as a business expense, and section 108 - expenditure capitalised and depreciated: A business firm wishes to stage ceremonies to mark the building of new premises. A representative of the company has asked what income tax deductions are available.

There are three ceremonies usually associated with the erection of new buildings. They are concerned with laying the foundations, the “topping off” ceremony (when the roof is put on), and the opening day. For income tax purposes, the foundation laying and the “topping off” expenditure should be capitalised to the buildings’ account, and depreciation claimed at the appropriate building rate.

Opening day expenses such as food and drink, hall hire, transport hire, special booklet costs, scaffolding and seating, entertainment for children, and labour can be claimed as a revenue expense.

The rules about deducting entertainment expenditure may also affect any deductions for expenditure on items such as food, drink, and entertainment. Generally, only 50% of business-related entertainment expenditure, or loss, incurred for the purposes of providing food, drink, or recreation is deductible, unless the expenditure is specifically excluded or exempted from the rules.

Deducting costs of travel between home and work base when business calls made en route

Section 104 - Expenditure or loss incurred in production of assessable income: A self-employed real estate agent has asked how she should categorise the travel between her home and work when she visits clients en route.

Section 104 allows a deduction for expenses incurred in the production of assessable income, or necessarily incurred in carrying on a business for that purpose.

If the real estate agent is merely using her car to commute between her home and place of business, the expenditure is of a private nature and not deductible.

In this situation, the visit to the client is in the course of the journey to the taxpayer’s office base, and is necessarily incurred in carrying on her business for the purpose of gaining assessable income, so she is allowed a deduction for the cost of the travel between home and place of business.

Depreciation recovered on sale of a building

Section 117 - Gain or loss from disposition of depreciable property: A taxpayer read the item in TIB Volume Six, No.1, page 9 (July 1994) on spreading depreciation recovered on buildings. He has a non-standard balance date of 31 October, and has asked if the new section 117 applies to him before 1 April 1993 for depreciation recovered on buildings.

In the July TIB we said:

> The spreading provision does not apply to buildings or other assets sold on or after 1 April 1993. Depreciation recovered after this date is covered by the new section 117.

Section 117 applies to intangible property from 1 April 1993, but for other assets it applies from the 1993-94 income year onwards.

The taxpayer in the July item had a standard balance date of 31 March, so the new section 117 applied to him from 1 April 1993. However, in this case the taxpayer has a non-standard balance date of 31 October, so the new section 117 applies to him from 1 November 1992 (the start of his 1993/1994 income year) for depreciation recovered on buildings and any other assets (except intangible property).

Assessability of gain made on depreciated property

Section 117 - Gain or loss from disposition of depreciated property: A taxpayer has been renting a residential property for which she has been claiming a deduction for depreciation. Now that she is selling the property, she wonders if she is required to repay any depreciation claimed.

Under section 117(2), when a property is sold for more than its "adjusted tax value", the depreciation recovered is to be treated as assessable income.

As depreciation cannot be claimed on land, the value of the land is excluded from the calculations. If the separate values of the land and buildings are not stipulated in the sale and purchase agreement, it is acceptable if the Government valuation prevailing at the time of sale is used to make the apportionment.

The amount of depreciation recovered is the lesser of these two amounts:

- the allowable depreciation deductions
- the amount by which the sale proceeds exceed the "adjusted tax value" of the property at the date of disposition.

The "adjusted tax value" of the property is the original cost price, less the depreciation allowed during the period of ownership. This calculation ensures that any capital profit made on the sale of the property is not included as assessable income.

Example:

Original purchase price (excluding land value)	$100,000
Total depreciation allowed	$ 10,000
Adjusted tax value	$ 90,000
Sale price (excluding land value)	$125,000
Gain on sale	$ 35,000
Depreciation recovered (assessable income)	$ 10,000

The depreciation allowable ($10,000) is less than the gain on sale ($35,000), and will be included as assessable income.

Deductibility of mortgage repayment insurance taken out to obtain a business loan

Section 136 - Expenditure incurred in borrowing money or obtaining lease: A business taxpayer had to take out a mortgage and mortgage repayment insurance, in order to borrow money which is to be used to produce assessable income. The taxpayer asked if the insurance premiums are deductible, and whether their deductibility hinges on the obligation to take out the insurance.

Section 136 allows a deduction for expenses incurred in borrowing money to be used in the production of assessable income. This would include the cost of the mortgage repayment insurance. Examples of other expenses that may be claimed include: legal and registration fees, valuation fees, and solicitors' fees. The deduction is not contingent upon the insurance being a condition of the loan.

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Provided any payment received as a result of a claim against this policy is not of the nature of a "loss of profits", it would be considered to be a capital payment, and would not be liable to income tax.

Effect on New Zealand tax payable of overseas tax subject to a refund

Section 305 - Recovery of excess credit allowed through not taking into account refund of foreign tax: A taxpayer has advised that she received an unexpected refund of overseas tax for which she had earlier claimed a credit against New Zealand tax payable. She has asked what the consequences are.

Any refund of overseas tax can affect any related New Zealand tax credit allowed. Section 305 deems any refunds from overseas taxes paid, which have been allowed as a tax credit, to be income tax due and payable thirty days after the later of these dates:

- The date of the notice of determination of the overseas tax credit
- The date on which the taxpayer receives the overseas refund.

However, if an overseas tax refund does not reduce the overseas tax paid below the amount of the credit allowed, there is no excess credit and the taxpayer is not required to make any payment.

In simple terms, the amount of any overseas tax credit claimed is reduced by the amount refunded. If this adjustment results in further tax to pay, the tax is payable as set out above.

Example 1	As originally filed	Adjusted for refund	Difference	
Overseas tax credit	1,500	1,500		
Refund		(1,000)	(1,000)	
Adjusted tax credit	1,500	500	(1,000)	
Maximum credit: NZ tax on overseas income	1,000	1,000		
Tax credit utilised	1,000	500	**(500)**	← *Difference payable to IRD*
Excess tax credits	500	Nil	(500)	

The overseas refund has effectively reduced the amount of overseas tax credit available to $500, so the taxpayer must pay the difference (i.e. $500) to Inland Revenue.

Example 2	As originally filed	Adjusted for refund	Difference
Overseas tax credit	1,500	1,500	
Refund		(500)	(500)
Adjusted tax credit	1,500	1,000	(500)

In this example the overseas tax refund was only $500, so the overseas tax paid has not been reduced below the credit allowed. The taxpayer therefore does not have to make any payment.

What is an "emergency call" for FBT purposes?

Section 336N(1) - Definition of "Emergency call": As part of his duties, a freezing-plant maintenance engineer is required to inspect a client's large freezing unit each day to ensure that the correct temperature is being maintained. The check is made at noon on each day. On Saturday and Sunday, the engineer travels from his home to conduct the check. The engineer has been provided with a vehicle by his employer to conduct the check, and the employer has asked whether the FBT emergency call exemption applies.

Fringe benefit tax is payable for any day that an employer-supplied vehicle is used (or available for use) for the private use or enjoyment of an employee. Private use or enjoyment includes travel by the employee to or from his or her home. However, any day on which the employee is required to use the vehicle to make an "emergency call" is not counted as a day on which the motor vehicle is available for the private use or enjoyment of the employee.

An emergency call is a visit that the employee is required to make, in the course of employment, from home. The purpose of the visit must be to provide services that meet one of these conditions:

- They are essential to the operation of any plant and machinery of the employer or client or customer.
- They are essential to the maintenance of any service provided by a public or local authority, or by any business which comprises the supply of any energy or fuel to the public.
- They are emergency services relating to the health or safety of any person.

Except for the third purpose above, the emergency call must be made between 6.00 pm and 6.00 am on any week day or at any time on a Saturday, Sunday, or statutory public holiday.

In this case, the maintenance of the correct temperature is essential to the operation of the client's freezing unit. Therefore, the maintenance engineer's visits on Saturday and Sunday qualify as emergency calls. Any Saturday, Sunday, or public holiday on which such an inspection visit is made will not be a day on which FBT is payable on the vehicle.

Treatment of loss when determining income for Family Support

Section 374B(1) - Assessable income or loss: A taxpayer conducted a number of allied activities, namely painting and decorating, and carpentry. Because of health problems he has found it necessary to give up those jobs and to take a lighter job; that of an insurance agent. During the income year, the allied activities produced a loss of $14,000, the withholding income from insurance commission totalled $8,000.

When making his claim for Family Support, the taxpayer wanted to know if his entitlement could be based on a nil income figure. He believes that his "businesses" should not be separately identified, i.e. the insurance selling should be included with the other activities. Because the taxpayer was registered for GST, he had to account for GST on all his sources of income, except for any exempt supplies.

The taxpayer's Family Support entitlement will be based on the withholding income of $8,000. It is true that GST must be accounted for on all taxable activities, but this rationale cannot be used to link clearly separate sources of income for Family Support purposes.

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Under section 374B(1)(f), for Family Support purposes the profits of each business are included for the purposes of calculating the assessable income or loss: the losses are not included and cannot be offset against income from other sources.

LAQC shareholder must offset loss in year incurred

Section 393 - Qualifying Company regime: A taxpayer was a shareholder of a loss attributing qualifying company (LAQC) which incurred a loss in the 1993 income year. He asked if he could offset his share of the loss against income derived in the 1994 year.

The reason for this request was that the taxpayer was eligible to claim rebates for payment of a charitable donation and childcare fees in the 1993 year, and was not going to have tax to pay in that year's income tax return. If he claimed the LAQC loss in the 1993 year he would get no tax saving from it. He was unable to claim any rebates in the 1994 year, and asked if it was possible instead to claim the 1993 LAQC loss in that (1994) year.

A qualifying company (QC) is a closely-held company that meets the criteria of section 393B. An LAQC is a QC that meets the criteria of section 393N. In either situation, an election for QC or LAQC status will have been made by the shareholders and directors of the company concerned.

Some of the features of the QC rules are that:

- Dividends paid by a QC will either be tax free or will have maximum imputation credits attached.
- Capital gains (both realised and unrealised) can be distributed tax-free without winding up the company.
- Shareholders of an LAQC can offset losses passed through from the LAQC against their assessable income.

The QC rules are explained in TIB Volume Three, No. 7 issued in April 1992.

Under section 393P, an LAQC's loss is deemed to have been incurred by the shareholders in proportion to their effective interest in the LAQC. The LAQC's loss is attributed to the shareholders, to offset against their assessable income, in that income year.

Section 393P(1)(b) provides that the LAQC's loss is treated for the purposes of the Act as if it were a loss incurred by that shareholder. If the shareholder does not have other assessable income in that year to offset the loss against, he or she may carry the loss forward to the following year in accordance with section 188.

The loss of an LAQC is effectively the loss of the shareholders and not the company. As such the shareholder cannot choose when the loss is attributed. As the taxpayer had assessable income in the 1993 year, he was obliged to offset the LAQC loss in that year.

Goods and Services Tax Act 1985

Whether share trading is a taxable activity

Section 3 - Meaning of term "financial services": A taxpayer is considering going into the business of trading in shares. She has asked if such trading constitutes a taxable activity under the Act.

Section 6(1) defines the term "taxable activity". The ability to register for GST purposes depends upon whether or not a person is conducting a taxable activity. A person who is conducting a taxable activity must register if the total value of supplies made from all taxable activities exceeds $30,000 in any 12 month period, or may voluntarily register if that total is not exceeded. A taxable activity includes any activity which meets all of these conditions:

- It is carried on continuously or regularly, whether or not for a pecuniary profit.
- It involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration.

Section 6(3)(d) expressly excludes the making of exempt supplies from the definition of "taxable activity". Exempt supplies are listed in section 14. An exempt supply includes the supply of financial services.

Section 3 defines "financial services", to include: 3(1)(d) "the issue, allotment, or transfer of ownership of an equity security or a participatory security."

A share is an equity security. Therefore, trading in shares cannot constitute a taxable activity for GST purposes, as it is a financial service which is an exempt supply.

GST registered person receiving a benefit on a customer's behalf

Section 5 - Supply received: A taxi operator advised that one of his frequent customers was disabled and required special assistance when she was travelling. The customer was entitled to a disability allowance paid under Part I of the Social Security Act 1964. As the disability allowance was paid by the New Zealand Income Support Service (NZISS) to cover the costs of the transportation, the disabled person considered it was more convenient to authorise NZISS to pay the allowance directly to the taxi operator.

The taxi operator received a weekly amount from NZISS. If this amount was insufficient to cover the services provided during the week, the customer made further payment in cash. The taxi operator asked if receiving the disability allowance was for a taxable supply, and if he should include it in his GST return.

If a disabled person arranges for a disability allowance to be paid directly to a third party to pay for services provided in the course of that third party's taxable activity, the allowance is treated as a payment made in respect of a taxable supply.

The taxi operator must include the disability allowance payments from NZISS in his GST return in the same manner as payments received from his other customers.

As the taxi operator accounted on the payments basis, he must account for the disability allowance when he receives it from NZISS. He must also account for any cash amounts received from the beneficiary at the time he receives them.

Lost property sold by non-profit body

Section 8(1) - Imposition of Goods and Services Tax on supply: The treasurer of a golf club that is a non-profit body has asked if the club must account for GST on the sale of unclaimed lost property. From time to time golfers leave personal items such as clothing, shoes, and clubs, on the course. After a reasonable time of holding and advertising the items, any items remaining unclaimed are sold.

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Section 8(1) imposes GST at the rate of 12.5 percent on the supply of all goods and services made by registered persons, in the course or furtherance of their taxable activity.

Section 14(b) exempts "the supply by any non-profit body of any donated goods and services", from GST.

The above exemption will not apply, as the lost property which was sold was not "donated" to the golf club. The golf club must account for the GST on the above sale. It can claim input tax to recover any GST incurred in advertising the lost goods or attempting to locate the owners, provided the usual tax invoice requirements are met.

GST input tax deductions on secondhand goods where payment not in a lump sum

Section 20(3)(a)(ia) - Deductions from output tax: A GST registered person accounts for GST on the invoice basis, and files returns 2-monthly. She has recently acquired a $12,000 secondhand asset from a non-registered person for use in her taxable activity. The supplier has provided an invoice for the goods, and the parties have agreed that the goods will be paid for over a 6-month period. The registered person has asked if she can claim a secondhand goods input tax deduction of one-ninth of $12,000 in her next GST return, as she holds the records required by section 24(7) in the form of the invoice.

When a GST registered person purchases secondhand goods from a non-registered person for use principally in a taxable activity, he or she can claim an input tax deduction of one-ninth of the purchase price. Under section 20(3)(a)(ia), that input tax deduction is limited to the extent that a payment for the supply has been made during the relevant taxable period. This limitation applies regardless of the purchaser's accounting basis.

To support a claim for the input tax deduction, the purchaser must record these details:

- the name and address of the supplier
- the date of purchase
- the quantity of the goods
- the price paid.

In this instance, the registered person's input tax deduction claim will be limited to the amount paid in each taxable period. Assuming the $12,000 is paid in six equal instalments, the input tax deduction will be limited to one-ninth of $4,000 in each 2-month taxable period.

Student Loan Scheme Act 1992

Loan repayment obligations of a student going overseas

Section 32 - Repayment obligations of non-residents: A student who has taken out a student loan plans to go abroad for five years and will be classed as a non-resident for tax purposes. He has asked for details of his repayment obligations during that period.

Section 37 requires any student loan borrower going overseas for more than 3 months to provide the Commissioner with any information he might reasonably require to determine the borrower's non-resident repayment obligation (if any).

In the income year the borrower leaves New Zealand, no non-resident repayment obligation is calculated. However, the borrower may have a resident repayment obligation for the period of residence up to the date of departure, which is based on income earned up to that date.

A non-resident's repayment obligation is based on the outstanding loan balance at 31 March following the date of departure, e.g., the borrower departs on 17 June 1993 - the repayment obligation is based on the loan balance as at 31 March 1994 and calculated as at 1 April 1994.

In April each year Inland Revenue sends a non-resident assessment to any borrower who has left New Zealand and ceased to be a resident. The amount payable by a non-resident borrower will be the lesser of the loan balance or $1,000 per annum (or 1/15th of the loan balance if this was $15,000 or over).

Section 32B allows the Commissioner to estimate interest on a non-resident borrower's loan balance. The interest estimate takes into account the payments that are due during the year. Any overpaid or underpaid interest will be added to, or deducted from, the outstanding loan balance except in the final year.

The annual repayment is due in four instalments, which are due on 30 June, 30 September, 31 December, and 31 March.

Example A

Sam leaves New Zealand on 15 December 1994; his loan balance on 31 March 1995 is $4,990. If Sam remains a non-resident, his non-resident annual repayment obligation each year will be $1,000 plus estimated interest until the fifth year, when his repayment will be the remaining balance of $990 plus estimated interest.

Example B

Sally leaves New Zealand on 31 August 1994; her loan balance as at 31 March 1995 is $17,800.

Sally's non-resident annual repayment obligation is $1,186 (that is $17,800 divided by 15), plus estimated interest each year.

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.

Depreciation of a yacht used for charter hire

Rating: • •

Case: TRA Nos 94/86 and 94/87

Act: Income Tax Act 1976 - former section 108

Keywords: *Depreciation, rate, leased asset*

Summary: The TRA found that the taxpayers were entitled to claim an increased rate of depreciation for a yacht they rented out even though it was not used exclusively for that purpose.

Facts: The objectors, a husband and wife operating in partnership, purchased a yacht to operate as yacht charterers. They entered into a management agreement with a management company which handled all chartering matters. The use of the yacht for private purposes was no more than four or five days per 365 days. The Commissioner's policy was to allow depreciation at the rate of 10% per annum with an extra allowance of a further 10% when the yacht was used exclusively for renting out to a series of lessees, both rates being on a diminishing value basis. The Commissioner argued that the management agreement was not a "lease" and also that, as the yacht was not exclusively rented out it did not qualify, under the Commissioner's policy, for the extra 10% depreciation.

Decision: The Court found that in terms of the Commissioner's policy the taxpayers qualified for the extra 10% depreciation. The Court found that private use of the yacht, being just over 1% of the year, was immaterial and should be disregarded in this case. The Court also found that the fact that the management agreement was not strictly speaking a lease was immaterial. The Court said that the Commissioner's policy recognised the extra wear and tear that leased assets were subject to and that the policy was applicable in this case.

Comment: Inland Revenue is not appealing this decision.

Company loss not able to be offset amongst group

Rating: • •

Case: TRA Nos. 93/93 and 93/96

Act: Income Tax Act 1976 - former sections 188(4) and (6) and 191(5), (7A) and (7B).

Keywords: *Group company losses, loss of offset, remission/cancellation of debts*

Summary: The taxpayer companies could not offset certain losses derived from a loss-making group company. This is because those losses arose from deductions claimed for interest payable on debentures, when the interest had not in fact been paid and the underlying debt was subsequently cancelled. The Commissioner could deny the taxpayer companies the loss offset even though he could not issue amended assessments to the loss-making company as that company had been struck off.

Facts: This case involves the offsetting of group company losses. For the period 1978 to 1983 losses incurred by one group company were offset consecutively against the profits of the taxpayer group companies. In 1991 the loss-making company was in liquidation and subsequently struck off the Register of Companies. Just prior to this, the Commissioner determined that certain debenture interest deductions, which had resulted in that company returning a loss for the 1981 to 1983 income years inclusive, were not deductible. This was because the interest had not in fact been paid, and the underlying debt was remitted or cancelled under section 188(6). The Commissioner calculated that the company had assessable income for the 1981 and 1982 income years and a reduced loss in 1983. Before the Commissioner could issue amended assessments for that company, it was struck off. The Commissioner issued amended assessments for the taxpayer group companies, reducing their respective loss offsets. The taxpayers contended that, reading the relevant sections together, the Commissioner could not reassess them without first reassessing the loss-making company.

Decision: Judge Barber confirmed the Commissioner's amended assessments of the taxpayer companies. He found that in terms of sections 188(4) and (6) the payments by the receivers of the loss-making company to the relevant debenture holder must be treated as repayments of capital and not interest. Accordingly, no interest expenditure had been incurred and none would be incurred as that debt had been cancelled. Judge Barber applied the approach to statutory interpretation outlined by the Court of Appeal in *CIR v Alcan NZ Ltd* (1994) 16 NZTC 11,175. He held that the proper interpretation of the linkage between sections 188(4) and 191(7B) permits the Commissioner to alter the taxpayers' assessments. This is possible at any time so as to give effect to a reduction in available losses if those losses are not "genuine" because they have been wholly or partly remitted or cancelled.

Comment: The taxpayers will be appealing this decision.

Assessable income for low income rebates

Rating: • •

Case: TRA Case No. 93/236

Act: Income Tax Act 1976 - sections 50C and 50D

Keywords: *Assessable income, taxable income, loss carried forward, transitional tax allowance, low income rebate*

Summary: The case establishes that losses arising in previous income years are not taken into account in determining assessable income for the purposes of the transitional tax allowance and the low income rebate available under sections 50C and 50D of the Income Tax Act 1976.

Facts: A farmer taxpayer incurred a substantial loss in the 1990 income year. This loss was partially offset in the 1991 income year, but the majority of the loss was carried forward and offset against the 1992 profit from the farm and other income of $87,622.61. The net income subject to tax in the 1992 income year, after deducting the losses, was $7,246.50. The taxpayer claimed both the transitional tax allowance and the low income rebate on the basis that his income for the purposes of the rebates was less than the limits set by the relevant sections.

The Commissioner disallowed the claims and the subsequent objection to the assessments he issued, on the basis that the assessable income used to determine eligibility for the rebates is the income before the offsetting of losses carried forward. The taxpayer requested that a case be stated to the TRA.

Decision: Judge Barber found in favour of the Commissioner. Sections 50C and 50D provide a threshold of eligibility for the rebates based upon “assessable income derived by that taxpayer” and not on the basis of the taxable income. Assessable income is the income derived in any particular year before the offsetting of any losses carried forward from any earlier income year. In this case the taxpayer’s assessable income was the income before the losses carried forward were taken into account, so the taxpayer could not claim the rebates. The assessment made by the Commissioner was confirmed.

Comment: The taxpayer is not appealing this decision.

Assessability of profit on sale of shares

Rating: • •

Case: TRA No. 91/89

Act: Income Tax Act 1976 - section 65(2)(a) and (e) (section BB 4(a) and (c) of the Income Tax Act 1994)

Keywords: *Sale of shares, business profit, dealer, purpose of resale, purpose of making a profit*

Summary: The issue in this case was whether the profit on the sale of shares was assessable. On the facts of this case, the Taxation Review Authority decided that the taxpayer did not make a profit. Even if the taxpayer had made a profit, this was not assessable, as it did not meet any of the tests in section 65(2).

Facts: The taxpayer subscribed for 16 million $1 shares of R Investments Ltd. Later, another group of companies acquired a majority shareholding in the group of companies to which the taxpayer belonged. The acquiring group had losses, and five companies in the taxpayer’s group (but not the taxpayer) agreed to make a subvention payment to an acquiring group company. Concurrently, the taxpayer sold all its shares in R Investments to a subsidiary of the acquiring group for around $38.5 million. The Commissioner assessed the taxpayer on the profits of the share sales, on the basis that:

- The profit was derived from the carrying on of a business; or
- The taxpayer was a dealer in shares; or
- The taxpayer acquired the shares for the purpose of resale; or
- The profit was derived from a scheme entered into for the purpose of making a profit.

The taxpayer objected to the assessment.

Decision: The Taxation Review Authority decided, on the facts, that the taxpayer did not make a profit on the sale of the shares in R Investments. The difference between the price the taxpayer paid for the shares and the amount it received when selling was intended to restore a fair value to the companies making the subvention payment. The sale was to be treated as part of the larger transaction between the two groups of companies. In the alternative, Judge Willy held that even if there had been a profit, none of the tests of assessability in section 65(2)(a) or (e) were satisfied for these reasons:

- The taxpayer did not sell the shares in the course of carrying on its business. It was a one-off transaction of a capital nature.
- The taxpayer was not a dealer in shares.
- The shares were not acquired for the purpose of resale. The shares were acquired as an investment of surplus funds.
- There was no evidence that there was any scheme or undertaking to make a profit on the sale of the shares.

Comment: Inland Revenue is appealing this decision.

Upcoming TIB articles

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

- Calculation of New Zealand Superannuitant Surcharge by a taxpayer with a non-standard balance date
- Are restraints of trade payments deductible by the employer?
- Fringe benefit tax and "availability for private use or enjoyment"
- Taxation of the earnings of young persons - the child rebate
- Deductibility of expenditure incurred in the purchase of fertiliser or lime
- PAYE and bonus payments
- Effect of a company's residence on the obligation to maintain an imputation credit account

List of Inland Revenue booklets

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

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

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

For people in business

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

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

ACC premiums 1994/95

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

Approved issuer levy (IR 291A) May 1994

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

Company amalgamations (IR AP) February 1995

A guide to the tax obligations of amalgamating companies. This leaflet also contains a declaration of amalgamation form.

Consolidation (IR 4E) March 1993

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

Controlled foreign companies (IR 275) Nov 1994

An in-depth explanation of the controlled foreign company rules, for New Zealand residents who hold interests in overseas companies.

Depreciation (IR 260) April 1994

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

Employers' guide (IR 184) 1994

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

Entertainment expenses (IR 268) April 1993

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

Foreign investment funds (IR 275B) Oct 1994

Information for taxpayers who have overseas investments (more for larger investors, rather than those with minimal overseas investments).

Fringe benefit tax guide (IR 409) Nov 1994

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

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

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

GST guide (GST 600) 1994 Edition

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

Imputation (IR 274) February 1990

A guide to dividend imputation for New Zealand companies.

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

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

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

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

Qualifying companies (IR 4PB) October 1992

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

Resident withholding tax on dividends (IR 284) Oct 1993

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

Resident withholding tax on interest (IR 283) March 1993

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

Running a small business? (IR 257) Jan 1994

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

Surcharge deduction tables (IR 184NS) 1994

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

Tax help for sprouting young businesses (IR 257C)

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

Taxpayer Audit (IR 298)

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

For non-profit groups

Charitable organisations (IR 255) May 1993

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

Clubs and societies (IR 254) June 1993

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

Education centres (IR 253) June 1994

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

Gaming machine duty (IR 680A) February 1992

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

Grants and subsidies (IR 249) June 1994

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

For individual taxpayers

Dealing with Inland Revenue (IR 256) April 1993

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

Estate and gift duties (IR 634) Nov 1991

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

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

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

IR 56 taxpayer handbook (IR 56B) April 1994

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

Koha (IR 278) August 1991

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

New Zealand tax residence (IR 292) April 1994

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

Objection procedures (IR 266) March 1994

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

Provisional tax (IR 289) March 1994

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

Putting your tax affairs right (IR 282) May 1994

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

Resident withholding tax on investments (IR 279) April 1993

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

Retiring allowances and redundancy payments (IR 277) June 1994

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

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

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

Special tax codes (IR 23G) January 1995

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

Stamp duties (IR 665) June 1992

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

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

An in-depth guide for people with Student Loans.

Superannuitants and surcharge (IR 259) January 1995

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

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

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

Problem Resolution Service (IR 287) November 1993

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

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Child Support booklets

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

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

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

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

Child Support - how to approach the Family Court (CS 51) July 1994
Explains what steps people need to take if they want to go to the Family Court about their Child Support.

Child Support - the basics - a guide for students
A basic explanation of how Child Support works, written for mainly for students. This is part of the school resource kit "What about the kids?"

Your guide to the Child Support formula (CS 68)
Explains the components of the formula and gives up-to-date rates.

Child Support administrative reviews (CS 69A)
Explains how the administrative review process works, and contains an application form.

Due dates reminder

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 1995 instalment due.

April

5 Large employers: PAYE deductions and deduction schedules for period ended 31 March 1995 due.

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

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

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

All employers: IR 12s and IR 13s to be completed, and yellow copies given to workers.

FBT return and payment for quarter ended 31 March 1995 due.

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

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

RWT on interest deducted 1 October 1994 - 31 March 1995 due for six-monthly payers

RWT on dividends deducted during March 1995 due.

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

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

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Contents

Contents continued - questions and legal case notes

Questions we've been asked (pages 17-25)

Legal decisions - case notes (pages 26-29)

Depreciation review under way, submissions invited

The rules governing the tax treatment of depreciation are being reviewed as part of a series of reviews to ensure that the Government's new taxation policies are implemented as intended.

The review of the new depreciation regime (enacted in 1993) is looking at the following areas:

- remedial issues
- the composition of the depreciable intangible property schedule
- operational aspects of the intangible property regime
- Operational aspects of the computer software regime.

The Minister of Revenue has said that the review is concerned with the operation of the legislation, not the policy upon which it is based.

The Government has invited submissions on problems that taxpayers face in complying with the current depreciation legislation. Submissions close on 10 March 1995.

Address any submissions to:

The Director
Legislative Affairs
Inland Revenue Department
P O Box 2198
WELLINGTON