Calculating NZ superannuitant surcharge - taxpayers with non-standard balance dates

Summary

This item states the Commissioner's current policy on how a New Zealand superannuitant with a non-standard balance date must calculate the New Zealand superannuitant surcharge.

The Commissioner's policy is that all income not associated with a superannuitant's business must be returned to 31 March. All business income must be returned to the non-standard balance date. However, for the purposes of the surcharge calculation, the Commissioner considers that all income derived in an income year can be treated as being received in that income year.

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

Background

A taxpayer's balance date is the last day of the taxpayer's income year. For most taxpayers this is 31 March. However, for taxpayers involved in a business, such as farmers, another balance date is sometimes adopted because it is more convenient. Any change to balance date must be approved by the Commissioner.

TIB Volume Four, No. 6 (January 1993) outlines the Commissioner's policy on non-standard balance dates and business income.

Legislation

Section 15 allows taxpayers to use non-standard balance dates, if they have the Commissioner's consent. Section 15 also provides that income returned to a balance date that is between 1 April and 30 September (including either of those dates) is deemed to be derived in the income year ending on the preceding 31 March. Income returned to a balance date that is between 1 October and 30 March (including either of those dates) is deemed to be derived in the income year ending on the following 31 March.

The New Zealand Superannuitant Surcharge rules are set out in sections 336A to 336M.

Policy

A New Zealand superannuitant with a non-standard balance date must return New Zealand superannuation and all other non-business income to 31 March. Any business income must be returned to the non-standard balance date approved for the business.

No special adjustment is required to any of the surcharge calculations. The Commissioner's view is that in applying the New Zealand superannuitant surcharge legislation, any amount derived in the relevant income year can be treated as being received in that income year.

Example

Ann is a farmer who adopted a standard farming balance date of 30 June with the approval of the Commissioner many years ago. Ann is now semi-retired. She receives New Zealand superannuation and a small amount of income from personal investments and farming. Ann receives New Zealand superannuation at the single rate.

In the 1994/95 income year Ann returns:

NZ super	(to 31 March 1995)	$12,209
Interest	(to 31 March 1995)	$ 3,826
Farming income	(to 30 June 1995)	$ 2,365
Total income		$18,400

Ann's New Zealand superannuitant surcharge is calculated in the normal way as follows:

- Other income is calculated according to section 336D(1) using the formula:

  $$a - b - c$$

  In this formula:

  a is total taxable income plus half of any non-taxable pension or annuity

  b is gross NZ superannuation

  c is any specified foreign social security pension

  All amounts except total taxable income are amounts received for the income year.

  Other income = $18,400 - $12,209 - $0 = $6,191.

- The specified exemption is calculated according to section 336E(1)(a) using the formula:

  $$4{,}160 \times \frac{\text{number of days NZ super was payable}}{\text{number of days in the income year}}$$

  $$= \$4{,}160 \times \frac{365}{365} = \$4{,}160$$

- Surcharge liability is calculated according to section 336C(1). It is 25 percent of the amount by which other income exceeds the specified exemption:

  $$= 0.25 \times (\$6{,}191 - \$4{,}160) = \$507.75$$

- Income tax on income of less than $30,875 is 24 cents per dollar of taxable income, less the low income rebate.

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The gross amount of income tax is:

$18,400 x 0.24 = $4,416.

The low income rebate is calculated under section 50D. For a superannuitant the rebate is 9 cents per dollar of assessable income, reaching a maximum of $855 when assessable income derived by the superannuitant is $9,500. The rebate then abates at 4 cents for each extra dollar of assessable income derived. In this case the rebate is:

$855 - [($18,400 - $9,500) x .04] = $499

Net income tax is, therefore:
$4,416 - $499 = $3,917.

- The amount of the surcharge may not exceed net NZ superannuation and clearly will not in this example. However, the calculation of net NZ superannuation is set out below. Net NZ superannuation is calculated according to section 336A, which gives the formula:

a - (b - c)

In this formula:

a is gross NZ superannuation received for the period.

b is net income tax payable on the NZ superannuitant's taxable income.

c is the net income tax on taxable income that is not NZ superannuation (i.e., other income less half of any non-taxable pension or annuity).

c = the gross tax on other income of $6,191, less low income rebate applicable to NZ superannuitants with income under $9,500.
= ($6, 191 x 0.24) - ($6,191 x .09)
= $928.65

Net NZ super is therefore:

$12,209 - ($3,917 - $928.65) = $9,220.65

Since the surcharge does not exceed net NZ superannuation, the amount of surcharge as calculated is correct.

Restraint of trade payments - deductibility for payer

Summary

A restraint of trade payment by an employer is generally capital expenditure, so the employer cannot claim a deduction for it. The deductibility of a restraint of trade payment by an employer is determined independently of whether that payment is assessable to an employee. A restraint of trade payment is generally not assessable to an employee.

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

Background

A restraint of trade agreement is an agreement between an employer and an employee under which, in return for payment, the employee agrees not to compete with the employer after leaving that employment. Under the agreement the employee may agree not to do one or more of these things:

- compete with the employer within a certain time or geographical area
- use trade information gained while working for the employer
- approach the former employer's customers.

Policy

The Commissioner's policy is that a restraint of trade payment is generally a payment on the payer's capital account, and under section 106(1)(a) it is not deductible. This is because the payment is a one-off payment which has the effect of reducing competition and protecting the value of the taxpayer's goodwill. The payment therefore relates to the income-earning structure of the business rather than the income-earning process, and is of a capital nature: *Buckley & Young v CIR* (1978) 3 NZTC 61,271, 61,276.

The deductibility and assessability of a restraint of trade payment are two separate and independent matters. The nature of the payment in the hands of the payer and recipient depends on the particular circumstances of the payment or receipt in each case. Payments that are capital expenditure in the hands of the payer are not necessarily capital receipts in the hands of the recipient.

The tax implications of an employee receiving a restraint of trade payment are discussed on page 7 of TIB Volume Four, No. 7 (March 1993). Such payments are generally of a capital nature in the hands of the employee, and are therefore not assessable.

FBT - meaning of "availability for private use or enjoyment"

Summary

This item examines whether the words "availability for private use or enjoyment" in the definition of "fringe benefit" in section 336N(1) apply to all fringe benefits, or just to motor vehicle benefits. The Commissioner's interpretation of the definition is that the words "available for private use or enjoyment" only apply to benefits that are motor vehicles. Other benefits that are only available for private use or enjoyment are not fringe benefits.

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

Legislation

The definition of "fringe benefit" in section 336N(1) states:

"Fringe benefit" in relation to an employee and to any quarter ... means any benefit that consists of -

(a) The private use or enjoyment ... of a motor vehicle ...:

(b) The availability for the private use or enjoyment ... of a motor vehicle ...:

(c) Any loan ...:

(d) Any subsidised transport:

(da) ... any contribution to any sick, accident, or death benefit fund ...:

(db) ... any specified insurance premium or any contribution to any insurance fund of a friendly society:

(de) Any contribution ... to any superannuation scheme ...:

(e) Any benefit of any other kind whatever... -

being, as the case may be, private use or enjoyment, **availability for private use or enjoyment**, a loan, subsidised transport, a contribution to a fund referred to in paragraph (da) of this definition; a specified insurance premium or a contribution to an insurance fund of a friendly society, a contribution to a superannuation scheme, or a benefit that is used, enjoyed, or received, whether directly or indirectly, in relation to, in the course of, or by virtue of the employment of the employee ... and which is provided or granted by the employer of the employee, ... *(emphasis added)*.

Interpretation

The Commissioner's interpretation of the definition of "fringe benefit" is that each of the benefits set out in paragraphs (a) to (e) relate, in order, to one of the phrases following paragraph (e). The words "being, as the case may be", which follow paragraph (e), indicate that each of the subsequent phrases apply specifically to one of paragraphs (a) to (e), rather than generally to all of the paragraphs.

The phrase "private use or enjoyment", which follows paragraph (e), relates to paragraph (a) which deals with the private use or enjoyment of a motor vehicle by an employee. The highlighted phrase, "availability for private use or enjoyment", relates to paragraph (b) which deals with the availability of a motor vehicle for the employee's private use or enjoyment. Each of the subsequent phrases listed ("a loan, subsidised transport ...") match up with their counterparts in paragraphs (c) to (de). The phrase which relates to paragraph (e) is "a benefit".

As a result of this interpretation, the mere availability for private use or enjoyment of any employee benefit except motor vehicles will not constitute a fringe benefit for the purposes of section 336N. A benefit which is not a motor vehicle and is provided by the employer will only be a "fringe benefit" if the employee has actually "used, enjoyed, or received" the benefit in relation to, in the course of, or by virtue of the employee's employment.

Example

A television rental company makes television sets and video recorders available to its employees for private use. FBT is only payable when an employee takes the equipment home and uses it for private purposes. The value of the fringe benefit is based on the market value of the benefit (i.e. what the company would have charged a customer for that use).

Fertiliser or lime - deduction for purchase and application

Summary

This item sets out the Commissioner's current policy on the deductibility of expenditure incurred in purchasing and applying fertiliser or lime. When the fertiliser or lime is both purchased and applied to the land in the year in which the expenditure was incurred, the Commissioner permits the deduction to be spread over the year in which the expenditure was incurred and any one or more of the four income years following that income year.

TIB Volume Three, No. 5 (March 1992) discusses the situation when farmers claim a deduction for fertiliser purchased before balance date, but do not apply the fertiliser to land until after that date.

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

Policy

Farmers engaged in any farming or agricultural business on land in New Zealand who apply fertiliser or lime to their farm properties are entitled to a deduction from assessable income. It is not necessary for the farmer to own the land in order to claim the deduction.

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It is sufficient that the farmer is the lessee of the land, or uses the land in a business activity.

To be deductible under the Act, expenditure must be of a revenue nature. A deduction is therefore available for any of these costs:

- buying the fertiliser or the lime
- transporting the fertiliser or the lime to the farm
- applying the fertiliser or the lime to the farm.

These costs are incurred in gaining or producing assessable income, so they are deductible under section 104.

Spreading purchase and application expenditure

If the fertiliser or lime is both purchased and applied to the land in the year in which the expenditure was incurred, section 133 applies.

Section 133(1) authorises the spreading of the deduction over the year the expenditure is incurred and any one or more of the following four income years.

For the purpose of section 133, "fertiliser" takes its meaning from section 2 of the Fertilisers Act 1982, namely:

> any substance which is in a state suitable for application to land or plants for the purpose of increasing the growth or productivity of beneficial plants and which contains, in the aggregate, not less than 3 percent of fertilising elements; but does not include animal manure, or animal or vegetable matter either in a fresh or partly decomposed condition, unless any such material has been so dried or otherwise treated that decomposition is arrested until the material is applied to land or plants:

Spreading expenditure - notice to Commissioner

Section 133(2) states that taxpayers must elect in writing if they wish to spread the deduction. They must give this notice to the Commissioner within the time limit for filing their tax returns for the year to which the expenditure is so allocated, or within such further time as the Commissioner in his discretion may allow.

All of the deduction must be allocated by the fourth year after the expenditure was incurred. Any part of the total amount of expenditure which is neither claimed as a deduction for the year in which the expenditure is incurred nor allocated to any one or more of the three immediately succeeding years must be deducted in the fourth income year following the year in which the expenditure was incurred.

Cessation of business

Section 133(3) covers the situation when a taxpayer who has made an election under section 133 to spread the deduction either dies or ceases to carry on business before the expiry of the fourth income year following the income year in which the expenditure was incurred. The taxpayer (or the taxpayer's personal representative if the taxpayer is deceased) can elect to have the remaining amount allocated in either of these ways:

- to the income year in which the taxpayer ceased to carry on that business
- equally to the income year in which that total amount was incurred and the succeeding income years in which the taxpayer has continued to carry on that business.

Partnerships

If two persons are in partnership and one of them withdraws, the continuing party's share of the cost of any unexpended balance of fertiliser and lime is allowed against that person's income in the remaining years covered by the election. The partner who withdraws is subject to the cessation of business provisions. However, if that person commences farming operations individually, his or her share of the unexpended portion of the cost of partnership fertiliser and lime can be claimed against individual farming income in the remaining years covered by the election.

If a sole trader goes into partnership (e.g. a parent takes a child into partnership) and the farming business continues on the same land, the cessation of business provisions do not apply. The farmer can carry forward the unexpended portion of the cost against his or her share of the partnership income in the remaining years covered by the election. No portion of the cost of the fertiliser or lime applied before the formation of the partnership is allowable against the child's share of the partnership income. To avoid confusion, the farmer should claim the unexpended cost in a personal tax return and not the partnership return.

Example

Bob and Mary are equal partners in a farming business. On 1 February 1992 Bob and Mary spent $10,000 on purchasing fertiliser and applying it to their paddocks. Instead of claiming the total or any part of that $10,000 in the year ended 31 March 1992, Bob and Mary elect to spread the deduction over the following four income years. In their 1992-93 return of income they attach a notice stating their intention to allocate 20% of the deduction to that income year. They have planned to spread the deduction in the following manner:

1992-93 - 20% of the total deduction allowed
1993-94 - 40% of the total deduction allowed
1994-95 - 10% of the total deduction allowed
1995-96 - 30% of the total deduction allowed.

In 1995 Bob withdraws from the partnership and ceases farming altogether. Bob is subject to the cessation of business provisions. He can elect to have his share of the remaining deduction allocated in either of these ways:

- to the year in which the business ceases
- equally to the income year in which the expenditure was incurred and subsequent income years up until the date the farming business ceased.

At the date of cessation, 40% of the total deduction is unallocated. Bob can elect to deduct his share of that amount (20% or $2,000) from his assessable income in the 1994-95 income year, or he can spread his 20% share over 1991-92 (the year in which the expenditure was incurred), 1992-93, 1993-94, and 1994-95. This works out to be a 5% or $500 deduction from assessable income in each of those income years.

Mary's share of the unallocated balance is allowed against her income in the remaining years covered by the election. In 1994-95 and 1995-96 she can deduct from her assessable income her share of the deduction allocated to those years by the partnership, i.e., $500 in 1994-95 and $1,500 in 1995-96.

Taxation of children's earnings and the child rebate

Summary

This item sets out how section 50A applies to children's earnings. Section 50A allows children a personal rebate of up to $156 for tax on income other than resident withholding income.

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

Background

If there was no rebate for children's earnings, this income would be fully taxable. Employers and children need to know the extent to which children's earnings are subject to the rebate.

Legislation

Section 50A Rebate in certain cases for children

50A Subject to section 57 of this Act, in the assessment of every taxpayer (other than an absentee) who at any time during any income year -

(a) Is under the age of 15 years; or

(b) Is under the age of 18 years and is attending -

(i) A private primary school or a State primary school or a private secondary school or department (in each case as defined in the Education Act 1964); or

(ia) An integrated school (as defined in section 2 of the Private Schools Conditional Integration Act 1975); or

(ii) A school providing special education (as defined in the Education Act 1964) for the deaf, the dumb, the blind, the mentally handicapped, the crippled, or the otherwise disabled, afflicted, or handicapped; or

(ba) Is a person under the age of 19 years who -

(i) During the preceding income year was a person to whom paragraph (b) of this section applied; and

(ii) Attained the age of 18 years on or after the 1st day of January in that preceding income year; and

(iii) Continues to attend a school of any of the kinds referred to in paragraph (b) of this section -

there shall be allowed a rebate of income tax for that income year of an amount equal to the lessor of-

(c) An amount calculated in accordance with the following formula:

$$(x - y) \times \frac{15}{100}$$

where-

x is an amount equal to the assessable income of the taxpayer for that income year; and

y is an amount equal to the resident withholding income derived by the taxpayer in that income year:

(d) $156.

Provided that in no case shall a taxpayer be allowed a rebate under this section in respect of any income year in respect of which he has been allowed a rebate under section 50C of this Act.

Section 57(1) provides that the amount claimed as a rebate cannot exceed the tax payable.

Application

Section 50A allows children a personal rebate of up to $156 for tax on income other than resident withholding income. Resident withholding income is interest and dividends. Because rebates do not apply to resident withholding income, that income still attracts tax of at least 24 cents in the dollar. Children will not receive a refund of resident withholding tax that has already been deducted from interest and dividend income by furnishing a return of income and claiming a child rebate.

To receive the maximum rebate of $156, the taxpayer's assessable income after deducting interest and dividend income must be equal to or more than $1,040 (1040 x .15 = 156). An annual income of $1,040 represents weekly earnings of $20.

Example

During the 1993 income year Sue, a 17 year old attending a State secondary school, derives assessable income of $1,280 of which $198 is interest

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earned. Sue's rebate entitlement is the lesser of:

- $156; and
- ($1,280 - $198) x $\frac{15}{100}$ = $162.30

Sue's child rebate is accordingly $156.

Allowing the rebate throughout the year

The rebate is usually allowed as an end of year rebate. The amount of any rebate is deducted from the total amount of income tax that would have been payable had it not been for the application of section 50A of the Act. However, section 350 gives the Commissioner the discretion to vary the PAYE requirements where it is appropriate for any class of employee.

Accordingly, if a child's weekly earnings do not exceed $20:

- The employer of the child employee is not required to make PAYE deductions from the weekly earnings; and
- The child is not required to complete an IR 12 or IR 13 deduction certificate.

This also applies if children receive more than $20 a week but their annual earnings are not expected to exceed $1,040.

If a child earns more than $20 a week and more than $1,040 annually, the child must complete an IR 12 or IR 13. The PAYE is deducted from the full payment.

If a child earns more than $1,040 annually and has only one employer, that employer is permitted to reduce the PAYE by $3 a week, thus allowing for a child rebate at the equivalent of $156 for the full year (3 x 52 = 156).

Transitional tax allowance (income under $9,880 rebate)

In the income year that a child leaves school and becomes a "qualifying person" under the provisions of section 50C, he or she can claim either the child rebate under section 50A or the transitional tax allowance (income under $9,880 rebate). The choice of the rebate is at the option of the taxpayer. The proviso to section 50A states that taxpayers are not allowed a child rebate under section 50A if they have claimed the transitional tax allowance rebate under section 50C.

ACC premiums

If an employer has not made any PAYE deductions from the earnings of a child because the child qualifies for the child rebate under section 50A, the employer must still pay an employer premium for that employee. The employer should keep a wage record of the employee's gross earnings in order to pay the premium. However, in these situations the employer does not need to make an earner premium deduction. Children will be liable for the earner premium if they file an income tax return.

Depreciation - psychological testing sets

The Commissioner has issued Determination PROV2: Tax Depreciation Rates Provisional Determination Number 2, which applies to psychological testing sets bought on or after 1 April 1993.

This determination is reproduced below.

Determination PROV2: Tax Depreciation Rates Provisional Determination Number 2

This determination may be cited as "Determination PROV2: Tax Depreciation Rates Provisional Determination Number 2".

1. Application

This determination shall apply to psychological testing sets purchased on or after 1 April 1993.

2. Determination

Under the provisions of section 108I of the Income Tax Act 1976, I have determined the following provisional basic economic depreciation rate:

Determination DEP1 (as amended) is amended by inserting in the asset category "Medical and Health", the additional class set "Psychological Testing Sets" with the following details:

Estimated Useful Life	10 years
DV Banded Depn Rate (%)	18%
SL Equiv Banded Depn Rate (%)	12.5%

3. Interpretation

In this determination, unless the context otherwise requires, expressions have the same meaning as in section 107A of the Income Tax Act 1976.

This determination is signed by me on the 27th day of January 1995.

Murray McClennan
Manager (Rulings - Tax Policy)
Head Office
Inland Revenue Department

Effect of a company's residence on the obligation to maintain an imputation credit account

Summary

This item sets out the requirements for a company to maintain an imputation credit account ("ICA"). Subject to certain exceptions, New Zealand resident companies must maintain an ICA for each imputation year. If a company is no longer resident in New Zealand then it cannot maintain an ICA, and must debit its ICA by the amount of the credits in the ICA just before it ceased to be resident in New Zealand.

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

Background

The imputation rules set out requirements for maintaining an ICA. They also specify when a company can no longer maintain an ICA, and what the company must do when it ceases to be an imputation credit account company.

How the legislation applies

Section 394B(1) provides that New Zealand resident companies, subject to certain exceptions, must maintain an ICA for each imputation year. These companies are referred to as imputation credit account companies. If a company becomes resident in New Zealand it must maintain an ICA unless it falls under any of the exceptions discussed below. Section 394A(1) defines imputation year as the period of 12 months starting on the 1st of April and ending the following 31st of March.

Section 394B provides that these companies cannot maintain an ICA:

- A company that is not resident in New Zealand.
- A company that is resident in New Zealand but because of a Double Taxation Agreement ("DTA") is treated as not resident in New Zealand and is not subject to New Zealand income tax on all or part of its income because of that DTA. (The type of company contemplated here is a dual resident company which for the purpose of a DTA is deemed to be not resident in New Zealand, and consequently all or part of its income is not subject to tax in New Zealand.)
- A company acting only in the capacity of trustee (except a company that is a group investment fund that derives income that is category A income). Section 394B picks up the definition of group investment fund and category A income in section 211A. A group investment fund with category A income is treated as a company and required to maintain an ICA. All category A income distributed to an investor is a dividend.
- A company whose constitution prohibits the distribution of all its income or property to any proprietor, member, or shareholder of the company (for example, an incorporated friendly society).
- A company whose income is wholly exempt from tax other than under section 63 (for example, an incorporated charity).
- A local authority.
- A Crown research institute.
- A Crown health enterprise.

Which companies are New Zealand residents

Section 241(6) sets out the tests to determine a company's residence. A company is resident for New Zealand tax purposes if it is incorporated in New Zealand, or its head office or centre of management is located in New Zealand or if control of the company by its directors, acting in their capacity as directors of the company, is exercised in New Zealand. PIB 180 (June 1989) explains in detail the rules that determine the residence of individuals and companies for tax purposes.

Section 2 defines company as:

> any body corporate or other entity which has a legal personality or existence distinct from those of its members, whether that body corporate or other entity is incorporated or created in New Zealand or elsewhere; and includes anything deemed to be a company for the purposes of this Act by any provision of this Act; but does not include a Maori authority:

The reference to entities that are deemed companies would include entities such as unit trusts. This means a unit trust that satisfied the residence test would be required to maintain an ICA.

The imputation rules broaden this definition by specifically including group investment funds that derive income that is category A income as companies for imputation purposes.

When a company is or becomes a New Zealand resident

A company that is or becomes a New Zealand resident must maintain an ICA from the day it becomes resident, unless it is not permitted to maintain an ICA. It must continue to keep the ICA for each imputation year . Under section 394D(1)(iv) a company cannot obtain a tax credit in its ICA for any income tax paid before it became a resident in New Zealand.

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When a company ceases to be a New Zealand resident

Under sections 394E(1)(i) and 394E(2)(h)), a company that is no longer a New Zealand resident must debit its ICA by the amount of its credit ICA balance just before it lost its resident status.

If the ICA is in debit immediately before the company ceases to be resident in New Zealand, section 394L(3) provides that the company is generally liable to pay further income tax of an amount equal to that debit balance. Section 394L(4) provides that the company must make that payment not later than the last day on which it is still an imputation credit account company.

Section 394K(2) provides that a company that is no longer resident in New Zealand must file an imputation return within two calendar months after the last day on which it was still an imputation credit account company. The imputation return will cover the period starting on the first day of the imputation year and ending the last day on which the company is an imputation credit account company. The company should file this return at Inland Revenue's Non-Resident Centre in Dunedin.

Example

Company ABC Limited is incorporated in New Zealand and has its centre of management in New Zealand. The company moves its centre of management to Australia. The credit balance in its ICA just before the move is $10,000.

Under Article 3(4)(a) of the New Zealand/Australia Double Taxation Agreement the company is deemed to be an Australian resident as its centre of management is located in Australia. The company must debit its ICA by $10,000 immediately before it ceases to be resident in New Zealand. The company must also file an imputation return at Inland Revenue's Non-Resident Centre in Dunedin not later than two calendar months after the last day on which it was still an imputation credit account company.

Underlying foreign tax credits - eligible accounting years and information requirements for pre-commencement years

Sections 394ZMA(2) and 394ZMF, Income Tax Act 1976

Background

The UFTC rules were introduced to allow New Zealand resident companies holding a 10 percent or greater interest in a foreign company to claim a credit for underlying taxes paid by that foreign company. The New Zealand company claims this credit against the FDWP that it would otherwise have to pay on dividends received from the overseas company. This credit is in addition to any credit for NRWT deducted from the dividend in the foreign country.

The concept of an ***eligible accounting year*** is fundamentally important to the underlying foreign tax credit rules. The amount of underlying foreign tax credit that the NZ company can claim is based on the amount of tax paid by the foreign company during the eligible accounting years.

The purpose of this article is to describe how the term "eligible accounting year" applies, and to discuss the information requirements if accounting years ending before 28 September 1993 (called "pre-commencement years" in this article) are to be eligible accounting years. This article expands the previous discussion on this topic in TIB Volume Five, No.4 (October 1993).

This article also discusses the other information requirements of the underlying foreign tax credit regime.

Eligible accounting year - section 394ZMA(2)

An eligible accounting year is defined in relation to:

- a New Zealand corporate taxpayer, and
- each individual dividend received by that taxpayer from a foreign company.

For any dividend, an eligible accounting year is any accounting year in which the NZ company holds sufficient interest in the foreign company paying the dividend throughout the entire year, and when both of the following criteria are met:

1. The year is any of these:
    - the accounting year in which the dividend is paid
    - the accounting year immediately preceding the accounting year in which the dividend is paid
    - an accounting year immediately preceding an eligible accounting year.
2. If the year ends before 28 September 1993 (i.e., a pre-commencement year), it is a year for which the taxpayer has provided relevant details to the Commissioner under section 394ZMF(1).

Note that an eligible accounting year in relation to one dividend received by a NZ company from a foreign company will not necessarily be an eligible accounting year in relation to another dividend received by that NZ company from the same foreign company. This is because the NZ company must maintain a sufficient interest in the foreign company for a year if that year is to continue to be an eligible accounting year in relation to subsequent dividends paid by the foreign company. If the NZ company breached the requirement to maintain sufficient interest at any time, accounting years up to and including the year in which that breach occurred cannot be eligible accounting years in relation to dividends paid in accounting years following the year in which the breach occurred.

Information requirements for pre-commencement eligible accounting years - section 394ZMF(1)

For a year ending before 28 September 1993 to be an eligible accounting year in relation to a dividend paid by a foreign company, the NZ company must provide the following information to the Commissioner before 28 September 1995 (i.e., within two years of the introduction of the UFTC rules):

- details of the foreign company's earnings for any such year
- details of any tax paid or payable for those years
- details of any dividends paid by the foreign company during those years
- details of any UFTCs that would have arisen on those dividends, had the UFTC rules applied at the time those dividends were paid, and had all such dividends paid by the foreign company been paid to the NZ company.

The NZ company can give this information to the Commissioner after 28 September 1995, but it will only be accepted after that date if the reason for it not being provided on time is beyond the control of the NZ company.

The specific evidence which the NZ company must hold to support these details is dealt with later in this article.

There is a new form, IR 4FP, which taxpayers must use when they are requesting that an accounting year ending before 28 September 1993 is to be an eligible accounting year. There are two points to note when using this form:

- The taxpayer does not have to send in details of the calculations and supporting documentation with the form. However, this information must be available if the Commissioner requests it
- If a NZ company is providing details for more than one foreign company, it can complete a single IR 4FP form with its own name and IRD number, and attach details for all foreign companies to the back of the form, in a format that it finds convenient (e.g., in the form of a spreadsheet).

Return this form to:

The Manager
Banking and Finance Portfolio
Corporates Unit
Inland Revenue Department
PO Box 895
WELLINGTON

Relevance of eligible accounting years

Eligible accounting years are primarily important for non-grey list companies. This is because the taxes paid and after-income tax earnings of these companies for all eligible accounting years are included in the calculation of underlying foreign tax credits arising on a dividend paid by a foreign company.

The amount of tax a foreign company paid during eligible accounting years represents the maximum amount of UFTCs that may arise on dividends paid by that foreign company. If taxes paid in pre-commencement years are included in the calculations, the total amount of UFTCs that will be available over time will be greater than if the pre-commencement taxes are not taken into consideration.

However, note that because the taxes paid are allocated against each dividend on a ratio of taxes paid to after-income tax earnings, the benefit from pre-commencement date taxes will only arise once the foreign company makes distributions in excess of its post-commencement after-income tax earnings (i.e., in excess of its earnings for years ending after 28 September 1993).

Eligible accounting years are still important for grey list companies. If a grey list company has a credit balance in its tracking account (and therefore does not qualify for a deemed-paid tax credit), the amount of UFTC on any dividend will also be calculated based on actual taxes paid by the company, in the same way as the UFTC on a dividend from a non-grey list company is calculated. However, the UFTC on dividends paid by grey list companies will not need to be calculated based on actual taxes paid very often.

Taxes taken into account for low tax jurisdiction companies - sections 394ZMC(1) and 394ZMF(3)

In TIB Volume Five, No.4, we discussed which pre-commencement years can be eligible accounting years in relation to a low tax jurisdiction company. This section clarifies that point.

All accounting years of a low tax jurisdiction company ending before 28 September 1993 can be eligible accounting years, as long as Inland Revenue receives that company's relevant details by 28 September 1995. However, for the purpose of calculating the amount of after-income tax earnings and foreign taxes paid for those years, only the following taxes and earnings may be taken into account:

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- for years in which the foreign company was a CFC, all earnings and taxes paid for those years
- for any other years, only those earnings and taxes paid which relate to dividends derived in those years from grey list companies.

This effectively allows all pre-commencement years to be eligible accounting years in relation to a low tax jurisdiction company, but limits the amount of tax credit arising in relation to those years.

Evidence requirements

Evidence of after-income tax earnings - section 394ZMF(5)

The NZ company must hold a profit and loss account for the foreign company which complies with these standards:

1. The accounts must comply with Generally Accepted Accounting Principles (GAAP) of New Zealand, and have been audited.
2. If the above accounts do not exist, the accounts must comply with the GAAP of the country in which the foreign company is resident.
3. If the above accounts do not exist, the accounts must be used by the company for reporting to any central or state government or creditors unassociated with the company, other than for income tax purposes.

If such accounts do not exist for any eligible accounting year (both pre- and post-commencement years), the amount of tax paid by the foreign company for that year, as well as the immediately preceding and immediately succeeding accounting years, is treated as nil.

Evidence to support a claim for foreign taxes - section 394ZMF(4)

The NZ company must hold one of the following as evidence of income tax paid by the foreign company:

- a copy of the receipt from the overseas tax authority confirming payment of the tax
- a copy of the tax return filed showing the amount of tax payable
- a copy of a statement or demand for the tax liability issued by the overseas tax authority
- some other evidence which is satisfactory to the Commissioner, such as an auditor's certificate, which confirms that the tax is payable.

The NZ company must be able to supply this information if the Commissioner requests it. Regardless of whether or not the Commissioner requests the information, the NZ company cannot claim a credit for any income tax for which none of the above evidence of is held.

General information requirements to support a claim for UFTC - section 394ZMF(6)

NZ companies do not have to provide details of the UFTC calculation on a dividend at the time they claim a credit. However, full details of the calculations (including details of the tracking account for a grey list company) and the basis for all amounts in the relevant calculation formulae must be available to Inland Revenue on request.

Forms available

There are a number of Inland Revenue forms available for UFTC purposes. Most of these are to help with calculations; taxpayers do not have to file them with Inland Revenue. However, there are three forms which taxpayers must file:

- **IR 4F (FDWP pay-in slip):** This form now includes additional boxes for UFTC purposes. NZ companies must file this form for each quarter in which they receive a dividend from a foreign company.
- **IR 4FP:** As discussed above, NZ companies must file this form if they want pre-commencement years to be eligible accounting years.
- **IR 4FR:** If the original payment of a FDWP liability is based on an estimated amount of UFTC on a dividend, NZ companies must complete and file this form once they know the exact amount of UFTC on a dividend.

You can get these forms from any Inland Revenue office.

The following forms are also available to help calculate the amount of UFTC arising on a dividend:

- **IR 4FC:** This form calculates the UFTC ratio arising under the formula in section 394ZMC. It is referred to in completing the IR 4FG and IR 4FN forms.
- **IR 4FG:** Use this form to determine the amount of UFTC arising on a dividend received from a grey list company.
- **IR 4FL:** Use this form when a foreign company receives a dividend from a lower tier company. It is referred to in completing the IR 4FC form.
- **IR 4FN:** Use this form to determine the amount of UFTC arising on a dividend received from a non-grey list company.
- **IR 4FT:** Use this form to record details of entries in a grey list company's tracking account.

You can get these five forms, along with the IR 4FP form, as a set from your local Inland Revenue office. You'll need to photocopy them and use them as-and-when required. Note that they are printed as a guideline only; a company does not have to use them if it has a satisfactory alternative method of calculating the amount of UFTC on a dividend.

Reregistration fee and associated legal costs under 1993 companies legislation - deductibility

Summary

This item sets out the Commissioner's policy on the deductibility of these items:

- the fee for companies re-registering under the 1993 companies legislation
- the associated legal costs.

The Commissioner considers that these costs are revenue items and are deductible.

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

Background

The new companies legislation was passed in 1993 and took effect on 1 July 1994. The Companies Reregistration Act 1993 requires all companies to apply for reregistration before 30 June 1997. If companies do not re-register within the required time they will be re-registered automatically. The Companies Office charges a reregistration fee. In addition, companies may incur legal costs in the course of re-registering.

Legislation

Section 104 states:

In calculating the assessable income of any taxpayer, any expenditure or loss to the extent to which it -

(a) Is incurred in gaining or producing the assessable income for any income year; or

(b) Is necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income for any income year-

may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer in the income year in which the expenditure or loss is incurred.

Section 106(1)(a) states that no deduction is allowed for capital expenditure.

Policy

The fee for reregistration under the companies legislation and any associated legal fees are deductible under section 104, if there is a sufficient nexus with the income-earning process.

The Commissioner considers that this expenditure meets the test in section 104(b), because it is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. Section 106(1)(a) does not prohibit the deduction of this expenditure as the reregistration fees and related legal fees are not capital expenditure.

In reaching his view the Commissioner examined four factors that the courts look at in determining whether an expense is capital or revenue. These factors are:

- What is to be obtained by the payment? Is it some asset or advantage with lasting or enduring qualities or will it last for a short time only?
- What is the nature of the payment? Is it a single lump sum payment made once and for all, or are there to be recurrent payments?
- In what manner is the advantage to be used, relied on, or enjoyed? Will it have a quality of recurrence which will point to an income nature, or will it bear a static aspect which points to a capital nature?
- What is the expenditure calculated to effect from a business and practical point of view?

On balance, the Commissioner considers that these factors indicate that the payment of the reregistration fee and associated legal fees are not capital expenditure, for these reasons:

- No new asset is created: the companies are merely altering the rules by which they are governed.
- From a practical and business point of view some companies are re-registering to obtain the transactional advantages that the new Act allows.

Both the reregistration fee and the associated legal costs are deductible.

Student Loan Scheme - interest rates for 1995-96

The interest rate for the Student Loan Scheme will be 9.0 percent for the year starting on 1 April 1995. This rate is made up of the base interest rate of 7.6 percent and the interest adjustment rate of 1.4 percent.

Non-resident withholding tax - monthly statements no longer required

Section 316(1) of the Income Tax Act 1976 (s.49 (1), Tax Administration Act 1994) currently states that people who deduct non-resident withholding tax (NRWT) from non-resident withholding income, or who pay NRWT on non-cash dividends, must generally file a statement in the prescribed form (the IR 202) by the 20th of the month following the month in which the NRWT deductions or payments are made. Under section 316(2), (s.49 (2), Tax Administration Act 1994) the Commissioner has the discretion to waive the requirement for NRWT payers to file monthly statements and to allow them to file annual statements.

Legislative change will be suggested to Government, requiring NRWT payers to file annual reconciliation statements, rather than monthly statements. Under this legislative change, NRWT payers will have to file their NRWT deduction certificates and NRWT reconciliation statements (IR 67S) after the end of each income year. We expect this legislation to be enacted during the 1996 income year.

The Commissioner is exercising his discretion under section 316(2) for the period from 1 April 1995 until the proposed legislation is enacted. From 1 April 1995, NRWT payers do not have to file monthly IR 202 NRWT deduction statements. However, payers will need to file an annual reconciliation statement for the 1995-96 income year. Under the proposed legislative change this annual reconciliation statement will be due on 31 May 1996.

NRWT payers will still need to file a final monthly statement for NRWT deductions or payments made during March 1995. This final monthly statement is due by 20 April 1995.

NRWT payers should continue to forward NRWT payments, together with the NRWT payment form, to the Commissioner on a monthly basis in accordance with section 315 (s.NG 11, Income Tax Act 1994).

If you have any questions on this subject, please contact:

Non-Resident Centre
Inland Revenue Department
Private Bag 1932 Phone 0800-246224
DUNEDIN Fax (03) 479 0659

Depreciation rates available from end of 1994-95 income year onwards

The new depreciation rules, which generally apply from the 1993-94 income year, contain transitional provisions about the depreciation rates which taxpayers can use. These provisions generally provide that any property acquired after 1 April 1993 and before the end of a taxpayer's 1994-95 income year can be depreciated at any of these rates:

- the old or pre-1993 depreciation rates
- the interim depreciation rates (the old rates plus 25%), if the property was new or newly-imported
- the new economic depreciation rates.

Taxpayers will no longer be able to use these options from the end of their 1994-95 income year onwards. For example, a taxpayer with a 31 March balance date will have to depreciate property acquired after 31 March 1995 at either of these rates:

- the new economic depreciation rates
- the new economic depreciation rates plus 20% for new or newly-imported property.

New or newly-imported property, for the purposes of both the interim 25% loading and the 20% loading to the new economic depreciation rates, means property that has not been used or held for use in New Zealand, other than as trading stock, by any person before the date the taxpayer acquired it, and is neither a building or a used imported motorcar.

The table below sets out the new economic rates with and without the 20% loading

General DV rate	with 20% loading	General SL rate	with 20% loading
2	2.4	1.5	1.8
4	4.8	3	3.6
6	7.2	4	4.8
7.5	9	5.5	6.6
9.5	11.4	6.5	7.8
12	14.4	8	9.6
15	18	10	12
18	21.6	12.5	15
22	26.4	15.5	18.6
26	31.2	18	21.6
33	39.6	24	28.8
40	48	30	36
50	60	40	48
63.5	76.2	63.5	76.2
100	100	100	100

The rates shown on pages 25-54 of Inland Revenue's Depreciation booklet - 1994 Edition (IR 260) show the economic rates without the 20% loading. That booklet also contains a full commentary on depreciation and applicable depreciation rates.

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

Payment of salary after 31 March relating to previous year

An employee (not a shareholder-employee) wanted to know into which income year her wages for the last working week of March 1994 would fall. She would receive her pay for the week ended Wednesday 30 March 1994 on Wednesday 6 April 1994.

Salary or wages are assessable in the income year in which they are paid to an employee, or credited to the employee's bank account, or otherwise dealt with on the employee's behalf.

Wages earned in the week ending 30 March 1994 and paid to the employee on 6 April 1994 are assessable in the income year ending 31 March 1995.

Taxation of jury fees received from the Crown

Section 61 - Exempt income: A self-employed taxpayer has asked if fees she has received from the Justice Department for jury service in court are subject to income tax.

Section 61(55) provides an income tax exemption for these types of income:

- jurors' fees paid by the Crown
- fees paid to witnesses (other than expert witnesses) by the Crown.

This exemption applies to amounts paid on or after 13 October 1986.

Accordingly, the taxpayer is not required to include the income in her tax return.

Private investor's deduction for loss on sale of Government stock

Section 64F(3) - Base price adjustment for cash basis holder: On 9 March 1992 a taxpayer purchased government stock for $10,600, believing it to be a secure investment with a reasonably good return. The stock had a redemption value (face value) of $10,000. Interest of $500 was paid on 15 April 1992, 15 October 1992, and 15 April 1993 when the stock was redeemed. The taxpayer is not in the business of buying and selling government stock or other securities, and comes within the section 64D definition of "cash basis holder". She has asked how she should show the income for tax purposes, and if she can claim a deduction for the loss on redemption.

The taxpayer must include the coupon interest payments in her returns for the years in which she received the payments, other than in the year of disposal. In the year of disposal she must calculate a base price adjustment. Under section 64F(3), a person who is a cash basis holder must account for the sale or redemption of government stock by using this formula:

$$a - (b + c)$$

In this formula:

a is the sum of all consideration received in respect of that government stock by the person.

b is the acquisition price of the government stock.

c is the sum of all amounts that have been returned as income in previous income years.

Under section 64F(5), if the above formula results in a positive amount, the taxpayer must return that amount as assessable income in the year of sale. If the formula results in a negative amount, the taxpayer can claim it as a deduction in the year of sale.

From the information supplied, the calculation for this taxpayer's Government stock is as follows:

$$a - (b + c)$$

In this case:

a is $11,500, being the sum of the $10,000 received upon redemption, the $1,000 interest received in the previous income year, and the $500 received on 15 April 1993.

b is the $10,600 purchase price of the government stock.

c is the $1,000 interest returned in the previous income year.

This taxpayer's base price adjustment is therefore:

$$\$11,500 - (10,600 + 1,000) = (\$100)$$

She must include the following derived income in her tax returns:

Year ended 31 March 1993

Interest received 15 April 1992	$ 500
Interest received 15 October 1992	$ 500
Income for year ended 31 March 1993	$1,000

Year ended 31 March 1994

Loss calculated from base price adjustment	($100)
Loss for year ended 31 March 1994	($100)

The taxpayer can claim a deduction for this loss in the year of redemption, even though she is not in the business of buying or selling government stock.

An acceptable alternative is set out in Appendix D of TIB Volume One, No.9. If supporting evidence is available, this alternative provides for an apportionment between the transferor and transferee of any interest due or accruing at the date of the transfer.

Appendix D of TIB Volume One, No.9. also contains a full commentary on the accrual tax accounting rules for government stock.

Depreciation adjustment for disposal of a property

Section 117 - Gain or loss from disposition of depreciable property: A taxpayer rented out a number of residential properties and claimed depreciation on them. She now plans to live in one of the properties, and has asked if she needs to make a depreciation adjustment for the property she intends to occupy.

From the 1993-94 income year, section 117(10)(a)(iii) deems an asset to have been disposed of if there has been a change in its use. The disposal is deemed to take place on the first day of the income year following the year in which the change in use occurred.

Section 117(7)(d) deems the property to have been disposed of for a consideration equal to its market value, or (if the property has been disposed of for a consideration that the Commissioner believes is not the market value) at a consideration specified by the Commissioner. The difference between the market value and the adjusted tax value must be taken into account for tax purposes.

The taxpayer in this case obtained an independent property valuation, which Inland Revenue accepted. The difference between this value and the adjusted tax value must be taken into account. If the market value is greater than the original cost price of the property, the excess is a capital gain and is not taxable.

Accordingly, Ms Smith has to account for depreciation recovered as follows:

Property purchase price	$50,000
Depreciation allowed as a deduction	$ 8,950
Adjusted tax value	$41,050
Property's market value	$60,000
Total gain on sale	$18,950
Depreciation recovered - assessable	$ 8,950
Capital gain - exempt	$10,000

Under the new depreciation rules, as the property is deemed to be disposed of on the first day of the subsequent year, the depreciation recovered will be taxable in that year and not in the year in which the change of use took place. Previously, if the depreciation recovered exceeded $1,000, the taxpayer could elect to spread the amount over the year of sale and up to three back years.

Spreading royalty income - effect on New Zealand superannuitant surcharge

Section 336D - Determination of other income: A taxpayer who has received income from assigning copyright of her book is considering spreading the income received. She has asked how the spread would affect her New Zealand superannuitant surcharge.

A New Zealand superannuitant is liable for surcharge on his or her “other income”. The amount of “other income” is determined by section 336D. Income from the assignment of copyright by the taxpayer will form part of “other income”.

Section 84(3) allows taxpayers who receive a lump sum payment of royalties to spread the income received. The number of years over which the income can be spread depends on the number of years the taxpayer was engaged on the making of the work.

If the taxpayer was engaged on the work for less than two years, the income can be spread over the current year and the previous year. If the taxpayer was engaged for more than two years, the income can be spread over the current year and the two previous years.

Spreading the income received from assigning copyright will have these two effects:

- It will lessen the amount of “other income” in the year the money is received.
- It will increase the amount of “other income” in the year(s) to which the money is spread.

When deciding whether to spread any of the income, it would be to the taxpayer’s advantage to consider what “other income” relates to the years affected, and the resulting effect on surcharge liability.

GMFI - full-time earner’s entitlement

Section 374E - Guaranteed Minimum Family Income Credit of Tax: A solo parent asked if she is entitled to a tax credit under the Guaranteed Minimum Family Income provisions of the Act. She worked approximately 1,700 hours in the year, giving an average weekly time spent in employment of 32 hours per week. For 12 weeks of the year she was not employed.

In this case, the taxpayer’s entitlement is calculated under the formula set out in section 374E(3), i.e.,

$$\left((x - y) \times \frac{z}{52}\right) - w$$

In this formula:

w is the person’s entitlement for the eligible period (that is, for the time when the person is a single qualifying person and the principal care-giver to any dependent child) calculated under section 374D(2).

x is $14,456 plus family support tax credit entitlement.

y is the net specified income calculated in section 374C.

z is the number of weeks (if any) that the taxpayer was a full-time earner and principal care-giver of dependent children, and therefore entitled to the tax credit.

When a "full-time earner" has no spouse, the term means any person, who in the week, is engaged in employment for not less than 20 hours. The taxpayer's average hours over the year are not relevant.

Item "z" in the formula is 40, which takes into account the actual number of weeks that the hours of employment were 20 or more.

The solo parent in this situation is entitled to a GMFI tax credit using the above formula.

Attributing profits to shareholders of a loss attributing qualifying company

Section 393 - Qualifying Company Regime: The representative of a loss attributing qualifying company (LAQC) has asked if the LAQC's profits are deemed to have been derived directly by the shareholders. The representative was aware that the losses incurred by an LAQC are able to be distributed to the shareholders in proportion to a shareholder's effective interest.

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. Details of the qualifying criteria are contained in TIB Volume Three, No. 7 issued in April 1992.

Under section 393P, a loss suffered by an LAQC 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 or to be carried forward to the following income year.

However, there is no provision that deems a profit of a QC or an LAQC to have been derived by the shareholders, and so any profit derived by a QC or LAQC cannot be attributed to the shareholders.

The company may instead consider paying a dividend to the shareholders.

Goods and Services Tax Act 1985

Sharemilking - a taxable activity for GST purposes?

Section 6 - Meaning of the term "Taxable Activity": A taxpayer who intends to go sharemilking has asked if he can register for GST.

Only those people who are conducting a "taxable activity" can register for GST. The section 6(1) definition of "taxable activity" includes any activity, carried on continuously or regularly, whether or not for a profit, that involves, or intends to involve, the supply of goods or services for a consideration. Section 6(3)(b) excludes from that definition any engagement, occupation, or employment under a contract of service.

Sharemilkers who are contracted under a sharemilking contract in terms of the Sharemilking Agreements Order 1990 are carrying on a taxable activity, as are those with "non-standard" contracts who have been accepted as being self-employed for income tax purposes. Sharemilkers whose turnover exceeds, or is expected to exceed, $30,000 in any twelve month period, must, under section 51(1), register for GST when they start work under the contract. If their turnover will be less than $30,000, they may elect to register voluntarily under section 51(3) .

Contract milkers who are not engaged under the above contracts are generally regarded as employees. As such, they are not conducting a taxable activity and

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cannot register for GST in respect of their contract milking activities. Contract milkers who have been accepted as being self-employed for income tax purposes are conducting a taxable activity and can register for GST.

Sharemilkers and contract milkers who are unsure as to whether they are self-employed or not should contact their local Inland Revenue office for a ruling.

Goods supplied to exporter - no zero-rating on supply

Section 11(1) - Zero-rated goods: An export marketing company purchases goods from a New Zealand supplier, who delivers them to the wharf for loading and transportation overseas. The export marketing company completes all export documentation, but at no stage in the proceedings does it take physical possession of the product. A representative of the export marketing company has asked Inland Revenue to approve the zero-rating of the supply from the supplier to the company, as the goods are destined for export.

Under section 11(1)(a) and 11(1)(aa), goods can only be zero-rated if the supplier exports them, or arranges for their export. To gain zero-rating under section 11(1)(a) and 11(1)(aa), the supplier must have entered the goods for export, or the goods must have been deemed to be entered for export under the Customs Act 1966, and the goods must be exported by the supplier.

In this case, the export marketing company is entering the goods for export. The New Zealand supplier does not meet the requirements of section 11(1), so it must charge GST at the standard rate of 12.5%. As the export marketing company is the supplier who enters the goods for export, the supply by the marketing company can be zero-rated under the above provisions.

GST on imported goods and royalties

Section 12 - Imposition of goods and services tax on imports: A GST-registered person has paid GST to New Zealand Customs for imported goods received. She must now pay GST on the royalties that are payable to the franchisor of the goods, a GST registered New Zealand company. She has asked if it is correct that GST should be charged twice on the same goods.

Section 12 imposes GST on imported goods. This is collected by New Zealand Customs at the time goods are imported, and is imposed on the sum of these amounts:

- the cost of the goods
- any duty or other taxes or levies imposed by Customs
- the value of freight and insurance paid to transport the goods to New Zealand.

This GST is imposed to ensure that imported goods do not receive any cost advantage over locally-produced goods. Registered persons can claim an input tax deduction to recover the GST charged by Customs, in the same way that all GST incurred "in the course or furtherance of a taxable activity" can be claimed.

The royalties payable to the franchisor are a separate supply, and are additional to the cost of the goods themselves. GST has been properly charged under section 8. The registered person can also claim an input tax deduction to recover the GST paid on the royalties, as long as she holds a tax invoice, (if the royalties are more than $50).

GST has not been charged twice for the same supply. The first supply was the supply of imported goods, and GST was correctly paid to Customs. The royalties payable are a separate supply, also liable to GST as the franchisor is registered for GST.

Employee's temporarily-imported goods - no input tax deduction

Section 12 - Imposition of Goods and Services Tax on imports: A New Zealand employer has employed an Australian specialist for a short term. The employee had to pay GST on specialist tools he brought into the country. He will be taking the tools with him when he returns to Australia. The employer wants to know whether she can claim an input tax deduction for the GST paid by the employee.

The GST treatment of imported goods is contained in section 12, administered by New Zealand Customs. Customs has advised that this situation comes within section 181 of the Customs Act 1966, which provides that if goods are brought into New Zealand for less than 12 months they are treated as temporary imports.

A deposit equal to the sum of the GST and duty may be payable to Customs on the value of the goods imported. If the goods are removed from New Zealand within the 12 month period following their importation, the deposit is refunded.

This employer cannot claim a deduction for these reasons:

- The goods were imported by the employee.
- No GST was paid on importation. Rather, Customs charged a deposit equal to any GST and duty that would have been payable. This deposit will be refunded to the employee when the goods are re-exported.

Buyer-created tax invoices - responsibility for ensuring that a person is registered for GST

Section 24(2) - Invoice created by recipient: A forestry contractor who has self-billing approval has asked if he must obtain proof of registration from workers who are subject to the Income Tax (Withholding Payments) Regulations 1979, before paying GST to them. If a worker is later found not to be registered, will the input tax deducted by the contractor be disallowed, or will Inland Revenue collect the output tax from the non-registered worker?

Section 24(2) allows the Commissioner to give approval for the issue of a tax invoice by a recipient of goods or services who is a registered person, and for that person to make an input tax deduction for that supply. The term for these invoices is "buyer-created tax invoices".

A person who wishes to issue a "buyer-created tax invoice" to a supplier must establish if that person is registered for GST. If so, the supplier's registration number should be obtained for inclusion on the tax invoice. Generally, obtaining details of the supplier's registration number is sufficient proof that the supplier is registered for GST. Note that the person who issues the buyer-created tax invoice (in this case the forestry contractor) cannot verify details of the supplier's registration by contacting Inland Revenue. Information about a taxpayer is considered confidential between Inland Revenue and that taxpayer. We will not give information about a taxpayer without the written approval of the taxpayer concerned.

In this case, if the worker is later found not to be registered for GST, the forestry contractor will still be entitled to the input tax deduction. Under section 27(1)(b),

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the Commissioner is able to make an assessment of the amount that, in his judgment, is the tax payable by:

"Any person, not being a registered person, who supplies goods and services and represents that tax is charged on that supply".

In this way, Inland Revenue can recover the output tax incorrectly paid to the worker.

The above may not apply where the supplier and the recipient are closely associated. If the recipient can be reasonably expected to know that the supplier is not registered, any input tax deduction incorrectly claimed will be disallowed.

Secondhand goods obtained through agent - records to be kept

Section 60(1) - Supply by an agent: A GST-registered farmer bought a tractor through a secondhand dealer who was selling it on behalf of an unregistered person. The farmer has asked if she should obtain a tax invoice from the secondhand dealer. If this is not appropriate, can she make a claim under the secondhand goods provisions? If so, whose name and address (the dealer's or the former owner's) should she record?

Under section 60(1), when an agent makes a supply on behalf of a principal, the supply is deemed to be made by that principal. In this case, the secondhand dealer is making the supply as agent for the owner of the tractor, who is not registered for GST. The purchaser can claim an input tax deduction for the secondhand goods received, provided she records these details as required under section 24(7):

- the supplier's name and address
- the date on which she bought the secondhand goods
- a description of the goods supplied
- the quantity or volume of the goods supplied
- the consideration paid for the supply

The farmer should record the name and address of the tractor's former owner, not those of the agent.

Accident Rehabilitation and Compensation Insurance Act 1992

Earnings not liable for ACC premiums

A taxpayer has asked for details of earnings that are not subject to accident compensation premiums.

The definition of "earnings as an employee" in the Accident Rehabilitation and Compensation Insurance (Earnings Definition) Regulations 1992 sets out details of earnings liable for earner premium.

The Regulations also define "earnings other than as an employee" to mean the amount of assessable income which depends on a person's personal exertions, that, if the person were to suffer any incapacity, he or she would cease to derive.

The earner premium is payable by the earner on both "earnings as an employee" and "earnings other than as an employee". The employer premium is payable by the employer on all "earnings as an employee". A person who is self-employed is liable to both earner and employer premiums.

Almost all earnings are subject to the earner and employer premium. The main exceptions are:

- interest and dividends
- non-taxable allowances
- student allowances
- most New Zealand Income Support Service income tested benefits
- a sleeping partner's share of the assessable income of a partnership
- New Zealand superannuation
- veteran's pension
- Living Alone payments
- redundancy payments paid on or after 1 July 1992
- retiring allowances paid on or after 1 January 1994
- lease and bailment income
- rents, except where renting property is a business activity
- estate and trust income
- income specifically exempt from income tax
- all employee earnings in excess of $76,648 per annum.

One of the purposes of the ARCI Act is to provide a continuing income source in the event of an accident. For that reason, premiums, in a general sense, apply only to income derived from "physical exertion". Earner premium is used to fund the cost of non-work accidents. Employer premium funds the cost of work accidents.

Student Loan Scheme Act 1992

Spreading timber sale income - effect on student loan repayments

Section 14 - Repayment obligation based on assessable income: A taxpayer has received income from selling some timber during the 1994 income year. He is considering taking advantage of special rules on the taxation of income from timber sales. He understands that it is possible to apply for some of the income received in the 1994 income year to be spread back to the 1993 year, when his assessable income was much lower. Before applying, he has asked how any spread of income might affect the amount he has to repay from his Student Loan.

Under section 14, a resident borrower's repayment obligation for an income year is the amount by which the borrower's assessable income exceeds the repayment threshold, multiplied by the repayment percentage. Section 2 defines "assessable income" to mean assessable income as defined in section 2 of the Income Tax Act 1976 ("the Act").

Section 2 of the Act states that assessable income:

> "means income of any kind which is not exempted from income tax otherwise than by way of a special exemption expressly authorised as such by this Act".

Profits and gains from selling timber are assessable income under section 74 of the Act. Under section 81A of the Act, income derived under section 74 from selling timber may be spread between the income year of receipt and any of the three preceding income years. To spread the income, the taxpayer must apply in writing within twelve months of the end of the income year that the income was received.

The income spread to a prior year is deemed to have been derived in that year, and is assessable income for that year.

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If the taxpayer elects to spread income to the 1993 income year, he will be assessable in that year for the purposes of calculating both income tax and Student Loan repayments. The additional income to be included in the 1993 year will change the 1993 Student Loan assessment.

In the 1994 income year, the taxpayer's assessable income for income tax and Student Loan repayment purposes will not include the amount spread to the 1993 income 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.

Determining other income for National Superannuitant surcharge

Rating: • •

Case: TRA No. 94/74

Act: Income Tax Act 1976 - sections 336C and 336D

Keywords: *National Superannuitant Surcharge, other income, part-year calculation*

Summary: The TRA decided that the Commissioner correctly determined the taxpayer's "other income" which was liable for National Superannuitant surcharge under section 336C.

Facts: This case involved a National Superannuitant who elected to receive earnings-related compensation from the Accident Compensation Corporation instead of National Superannuation (as it was then known) for a two and three-quarter month period during the 1993 income year.

The taxpayer filed a 1993 tax return and calculated the National Superannuitant surcharge on the basis that the surcharge was payable on part-year income only under section 336D(2).

In effect, the taxpayer argued that the surcharge should only apply to the period during which she received National Superannuation. The Commissioner issued an assessment that calculated the taxpayer's surcharge according to sections 336C(1) and 336D(1).

Decision: Judge Barber held that the formula in section 336D(2) can be used to determine "other income" for part-year calculation in two specific circumstances only. These are when during the year the person either starts receiving National Superannuation or permanently leaves New Zealand. Neither of these two circumstances applied to this taxpayer's situation.

Judge Barber confirmed the Commissioner's 1993 income tax assessment on the basis of the definition of "other income" under section 336D(1). He concluded that the clear and unambiguous words of sections 336C and 336D provide no apportionment or relief to the taxpayer.

Comment: The taxpayer is not appealing this decision.

Meaning of "lump sum" for redundancy payments

Rating: • • •

Case: Alliance Group Ltd v Commissioner of Inland Revenue HC Wellington AP 261/93

Act: Income Tax Act 1976 - section 68(2A) (since repealed)

Keywords: *lump sum redundancy payments*

Summary: The term "lump sum redundancy payments" relates to the nature of the payment, rather than the manner of payment.

Facts: Alliance, in accordance with the terms of the agreement it had with its employees, made compensation payments to some of its workers who became redundant. Alliance credited each employee's account with the total redundancy payments due to the worker.

Some employees were paid two equal payments at separate times.

Under section 68(2A) any lump sum redundancy payment was assessable only to a limited extent. If this section had not existed, the payments would have been fully assessable.

The issue was the meaning of "lump sum", a term that the Act did not define. Alliance argued that the term related to the nature of the payment, rather than the way in which it made the payment. Alternatively, Alliance argued that there was only one payment because the whole amount was credited to each employee's account.

The Commissioner contended that the term related to the manner of payment. In order to qualify as a lump sum redundancy payment, the amount would have to be in one payment.

Decision: The Court found that the redundancy payments were lump sum redundancy payments. A lump sum redundancy payment is the amount calculated according to the relevant redundancy agreements.

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The term "any lump sum redundancy payments" related to the nature of the payment, not the manner in which it was made. The employees' entitlements were lump sums even though in most cases they were paid in two instalments.

The Court was not persuaded by Alliance's alternative argument, because in its view a credit to an employee's account could not constitute a payment until the employee could draw upon the account.

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

Residence of New Zealand parent company's foreign subsidiary

Rating: • • •

Case: New Zealand Forest Products Finance NV v Commissioner of Inland Revenue HC Wellington AP 59/92

Act: Income Tax Act 1976 - until 1 April 1988 section 241(2) and (3), after that date section 241(6); section 243(2)(m)(i)

Keywords: *Company residence, head office, centre of administrative management*

Summary: The High Court found that the taxpayer company was not a New Zealand resident because all its control and management, including its day to day management, took place outside New Zealand. As the taxpayer company was not a New Zealand resident it was not subject to the non-resident withholding tax rules.

Facts: The taxpayer company was incorporated in the Netherlands Antilles in 1984 as a wholly-owned foreign subsidiary of New Zealand Forest Products Ltd ("NZFP"). Its purpose was to obtain finance on the Eurobond market for the use of the NZFP group.

The Commissioner assessed interest that the taxpayer company paid to investors as subject to non-resident withholding tax for the 1986 to 1990 income years. The taxpayer company objected to the assessment on the grounds that it was not a New Zealand resident and therefore not subject to the non-resident withholding tax rules.

Alternatively, the taxpayer company argued that if it was a New Zealand resident, the interest was not subject to non-resident withholding tax because it did not have a source in New Zealand. It argued that, under section 243(2)(m)(i), the interest did not have a source in New Zealand because it was derived from money lent to a New Zealand resident which was used for the purposes of a business carried on outside New Zealand through a fixed establishment in Curacao.

Decision: Justice Doogue found that the taxpayer company was a truly foreign subsidiary of NZFP with all central management and control, including its day to day management, taking place outside New Zealand. Important factors in reaching this conclusion were that all directors' meetings were held and all transactions occurred outside New Zealand; the administration details and accounting functions were dealt with in Curacao; and the directors voted and acted independently of the parent company and were not mere pawns of NZFP.

As the taxpayer company was not a New Zealand resident it was not subject to the non-resident withholding tax rules.

On the second issue, Justice Doogue found that the taxpayer company was carrying on a substantial business through a fixed establishment outside New Zealand. Although not all the decisions of the directors were made there, Curacao constituted a fixed establishment because all the taxpayer company's business was carried out through Curacao in one way or another.

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

Year in which ACC earnings-related compensation is assessable

Rating: •

Case: TRA No 92/92

Act: Income Tax Act 1976, sections 38(2) and 65(2)(c)

Keywords: *derived*

Summary: Judge Barber held that earnings-related compensation the objector received from the Accident Compensation Corporation (ACC) was assessable in the year of receipt, and could not be spread back for assessment into the earlier year to which the compensation related.

Facts: The objector received earnings-related compensation from ACC in the 1991 income year. Part of that compensation was arrears that related to the 1990 income year. The Commissioner treated all of the compensation as assessable in the 1991 income year. The objector argued that the compensation payments due for the 1990 income year were assessable in that income year, although ACC did not make the payments until the 1991 income year.

Decision: Judge Barber adopted his reasoning in *Case N9* (1991) 13 NZTC 3,075 and confirmed the Commissioner's assessment. He said that it follows from the fact that the objector uses a cash basis of accounting that the objector derives income when he receives it. Accordingly it is not open to the objector to spread income back over an earlier year to which the compensation relates. This is because the objector did not actually receive the income in the earlier year.

Comment: The taxpayer is not appealing this decision.

Factors the Commissioner must consider when exercising discretion to accept late objections

Rating: • • • • •

Case: Wilson v CIR Unreported CP No. 83/94

Act: Income Tax Act 1976 - section 30

Keywords: *late objection, Commissioner's discretion, judicial review*

Summary: This was a judicial review action concerning the Commissioner's decision not to allow a taxpayer's late objection. The taxpayer was attempting to claim a deduction for share losses. Justice Greig held that the Commissioner had failed to consider all the relevant factors in his refusal to allow a late objection.

Facts: The plaintiff sought a review of the Commissioner's refusal to accept a late objection. The objection related to share losses claimed in the plaintiff's return for the year ended 31 March 1988. On 2 May 1989 the Commissioner issued a notice of adjustment rejecting the deduction of the share losses. The taxpayer's accountant telephoned Inland Revenue on 3 May 1989 and objected orally.

On 1 June 1989, the Commissioner issued a notice of assessment. There was no objection to this assessment but on 5 August 1991 the accountant wrote to Inland Revenue reasserting the taxpayer's claim. He informed Inland Revenue that he

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had not responded to the notice of assessment because he had made a filing error. The taxpayer had also been overseas from May 1989 to October 1990. The accountant sent further letters to Inland Revenue reiterating the taxpayer's claim.

On 21 November 1991, the Commissioner issued a further notice of assessment rejecting the deduction of the share losses. On 29 November 1991 the accountant sent a letter to Inland Revenue stating that it was a formal objection. Inland Revenue declined to accept the late objection. The accountant requested that the decision be reconsidered. The Commissioner confirmed his earlier decision.

In November 1992 the Court of Appeal issued its decision in *Inglis v CIR* (1992) 14 NZTC 9,180; (1992) 17 TRNZ 289 and its companion case *CIR v Stockwell* (1992) 14 NZTC 9,190; (1992) 17 TRNZ 301. These were cases dealing with share losses. Inland Revenue then issued Tax Information Bulletin Volume Four No 5 (December 1992). This included the following statement on page 34:

> Taxpayers who think they can claim a deduction for share sale losses they incurred in previous years can object to their assessments for the relevant income years. Inland Revenue will consider any such objections as late objections under section 30(2) of the Act.

On 18 May 1993 the taxpayer's accountant requested reconsideration of the case following the decision of the Court of Appeal in *Inglis v CIR*. The Commissioner confirmed his earlier decision not to accept the late objection. The taxpayer then brought judicial review proceedings.

Decision:

Justice Greig found for the taxpayer. He took the view that in the particular circumstances of the case deciding not to accept the late objection was unfair. He considered, following the decision of the Court of Appeal in *Inglis v CIR*, that the taxpayer appeared to have a clear entitlement to the deductions he had claimed. He found that despite the accountant's failure to object in time, the taxpayer had consistently (although not constantly or continuously) asserted his claim for a deduction. Justice Greig stated that a consistent assertion requires an original assertion and then no departure or contradiction of that assertion. The judge stressed that the taxpayer was not a person who had ascertained the new interpretation and then for the first time sought to take advantage of it; he was somebody who had been pursuing the matter beforehand.

Justice Greig found that, when deciding whether to accept the late objection, the Commissioner failed to have due regard to some factors and had undue regard to other factors. Inland Revenue had taken no account of the paramount consideration that there be an accurate assessment.

Inland Revenue should consider the merits of the case and the likelihood of the objection succeeding as part of the overall view of the matter. Inland Revenue had not done this.

There was a clear entitlement to the benefit of the judgment in *Inglis* and, on the face of it, to the deduction. That ought to have weighed heavily to discount the lapse of time and the failure on the part of the taxpayer's professional adviser.

There was a failure to give full account of the consistent assertion by the taxpayer that he was entitled to the deductions. He noted that an oral objection can be of little legal weight particularly when the objection is made to a notice of adjustment and not repeated when the notice of assessment is issued. Nevertheless, in Justice Greig's view the oral objection did reinforce the consistency of the assertion made by the taxpayer in his original tax return.

In this case Inland Revenue gave too much emphasis to the Commissioner's policy on late objections for which professional advisers were responsible. Justice

Greig did note that an omission by a professional adviser may be a significant factor if the law and the tax rules are clear. Failure by the professional adviser in those circumstances to take the proper and formal steps may be seen as a tacit representation that the assessment is accepted.

The policy statement concerning share losses in TIB Volume Four No 5 (December 1992) reasserted the primacy of the need for a live objection. The High Court in *Gisborne Mills v CIR* (1989) 11 NZTC 6,194, (1989)13 TRNZ 405 held that this was a fettering of the Commissioner's discretion. In addition that policy cited only three factors, thus leading the exerciser of the discretion to put undue weight on those factors.

Justice Greig held that the Commissioner's refusal to accept the late objection was unfair and in error. He held that the Commissioner had failed to exercise his discretionary power whether or not to accept a late objection in accordance with the law applicable in the circumstances of this case. Consequently, Justice Greig held that it should be declared void. He made an order directing the Commissioner to reconsider the application for reassessment made by the plaintiff.

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:

- Allocation of imputation credits to dividends where a company is liquidated
- Imputation returns where a company is liquidated
- Transferring a credit balance in a dividend withholding payment account to an imputation credit account where a company is liquidated
- Resident withholding tax and certain back to back loans
- Further income tax, additional tax and imputation penalty tax where a company is liquidated
- Successive supplies in the building and engineering industries under section 9(3)(aa)(ii) of the GST Act 1985
- GST and the de minimus rule

Due dates reminder

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.

May

5 Large employers: PAYE deductions and deduction schedules for period ended 30 April 1995 due.

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

(We will accept payments received on Monday 8 May as on time for 7 May.)

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

Small employers: PAYE deductions and deduction schedules for period ended 30 April 1995 due.

Gaming machine duty return and payment for month ended 30 April 1995 due.

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

RWT on dividends deducted during April 1995 due.

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

(We will accept payments received on Monday 22 May as on time for 20 May.)

31 GST return and payment for period ended 30 April 1995 due.

FBT annual liable return (1 April 1994 to 31 March 1995) and payment due - employers who elected to pay FBT on an annual basis.

PAYE/ACC annual reconciliations (IR 68P and IR 68A) and 1995 ACC employer premium due.

RWT annual reconciliation (IR 15S) due.

Specified dividend reconciliation (IR 17S or IR 17SA) due.

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