Binding rulings on taxation

Sections 91A - 91I, Tax Administration Act 1994

Introduction

The Commissioner of Inland Revenue is able to issue rulings on the interpretation of taxation law which will bind the Commissioner on the future application of that law. As a result, taxpayers will be able to conduct their business affairs with greater certainty about the Commissioner's view of the law.

This legislation gives effect to a 1992 Budget announcement of the Government's intention to introduce a system for issuing binding rulings on tax matters.

Key features

- The Commissioner may issue three types of rulings: public, private and product rulings.
- Private rulings are initially limited to specific arrangements entered into after Inland Revenue receives the application. From 1 April 1996 the rules will be extended to provide private rulings on current and completed arrangements.
- The Commissioner is bound to assess taxpayers in line with an applicable ruling.
- Taxpayers are not bound by a ruling, but they must file a disclosure return stating that they have applied for a private ruling and whether or not they followed it. They will also be obliged to disclose any material differences between the arrangement described in the ruling, and the actual arrangement.
- Applicants for private or product rulings must comply with strict disclosure requirements. If they don't comply the ruling will not be binding on the Commissioner.
- There is a statutory right to consultation on private and product rulings when the Commissioner intends to issue a ruling that differs from the one requested.
- Public rulings will apply to arrangements entered into in the period for which the ruling is issued. Private and product rulings apply for the period specified in the ruling.
- The Commissioner may withdraw a ruling, or a ruling may terminate following a change in taxation law.
- Private rulings and product rulings are charged for on a full cost-recovery basis.
- Public rulings and product rulings will be published.
- Private rulings will not be published, but if a private ruling raises an issue of wider significance, the Commissioner may issue a public ruling on that issue.

Application dates

Since 1 April 1995 the Commissioner has been able to issue public rulings and product rulings. Private rulings have also been available since that date, but only on specific arrangements entered into after the Commissioner receives the application for the ruling. From 1 April 1996, the rules will be extended to provide private rulings on current and completed arrangements.

Background

In June 1994 the Ministers of Finance and Revenue publicly released *Binding Rulings on Taxation; a discussion document on the proposed regime*. The document proposed that the Commissioner of Inland Revenue be able to issue rulings on the interpretation of taxation law which bind the Commissioner on the future application of that law. Interested parties were invited to make submissions on the proposed system.

In response to submissions, some of the proposals in the discussion document were changed. The major changes in the legislation introduced into Parliament were that private rulings will not be published and that the Commissioner will issue rulings on the tax treatment of products.

The proposed legislation was included in the Taxation Reform (Binding Rulings and other Matters) Bill. Submissions were heard and considered during the Select Committee process.

Additional minor changes were made during this process. The changes reduce the scope of the Commissioner's power to decline to rule and provide a right to consultation only where the Commissioner intends to issue a ruling that differs from the one requested.

Types of rulings

Public rulings

A public ruling on the Commissioner's interpretation of taxation law in relation to any person and any arrangement will be initiated by the Commissioner. Taxpayers will not be able to apply for a public ruling on a particular matter, although they may suggest that the Commissioner issue a public ruling on the interpretation of particular taxation laws (see section 91C).

Private rulings

Any taxpayer can apply for a private ruling on how taxation law applies to that taxpayer and a particular arrangement (see section 91EC).

Product rulings

A product ruling will specify how taxation law applies to a particular arrangement or product rather than how it applies to a person or class of persons in relation to an arrangement. In a product ruling the Commissioner will specify the tax treatment of the product. The ruling will then apply to anyone who subscribes for or purchases

continued on page 2

from page 1

that product. A product ruling only sets out the tax attributes of the product and not those of the subscribers or purchasers of the product.

Before issuing a product ruling the Commissioner must be satisfied that it is not practicable for the applicant to request a private ruling because of the difficulty in identifying the taxpayers who may enter into the arrangement. In addition, a product ruling may only be made when the characteristics of the taxpayers who may enter into the arrangement will not affect the content of the ruling (see section 91F).

Anyone may request a product ruling, though usually applicants will be promoters or issuers of particular products. A product ruling will only be made if the Commissioner receives an application for one.

Example

A company promoting a debenture issue that has not yet been publicly launched seeks a product ruling on whether the income stream from the debenture is interest and not a dividend.

Non-binding rulings

Not all public statements issued by the Commissioner are binding. The Commissioner will continue to issue general non-binding interpretations of the law in the Tax Information Bulletin and other Inland Revenue publications.

Scope of binding rulings (section 91C)

The legislation allows the Commissioner to make rulings on how taxation laws apply to arrangements. The term "arrangement" is defined in section OB 1 of the Income Tax Act 1994 (section 2 of the 1976 Act) and means:

"...any contract, agreement, plan, or understanding (whether enforceable or unenforceable), including all steps and transactions by which it is carried into effect."

The definition is broad to ensure that the Commissioner's scope to rule is not unduly limited and that varying forms of undertakings ranging from an informal but seriously contemplated proposal to a complex written contract are capable of being ruled on.

The Commissioner can make rulings on any provision of the following taxation laws and associated subordinate legislation:

- the Income Tax Act 1994
- the Goods and Services Tax Act 1985 (except sections 12 and 13 of that Act, which deal with imported goods and goods subject to excise duty)
- the Estate and Gift Duties Act 1968
- the Gaming Duties Act 1971
- the Stamp and Cheque Duties Act 1971.

The Commissioner cannot rule on any enactment that is not included in the above list. The Commissioner is also unable to rule on the following matters:

- the exercise of any right or obligation of the Commissioner to exercise penal or investigative powers, or prosecute or recover debt from any person
- the administration of the tax system
- applications for rulings on matters that fall within the Commissioner's powers to make formal determinations regarding financial arrangements, accrual expenditure, depreciation, livestock valuation, petroleum mining operations, and to issue exemption certificates for non-resident contractors under the withholding payments regulations.

Effect of binding rulings

Public rulings (section 91DB)

A public ruling binds the Commissioner in respect of all taxpayers to whom the ruling applies if those taxpayers calculate their tax liability in accordance with the ruling. A public ruling applies only to the particular facts outlined in the ruling.

Once bound by a public ruling, the Commissioner must administer the law in accordance with that ruling.

If two or more public rulings apply to a taxpayer and an arrangement, that taxpayer may choose which ruling is to apply to the particular arrangement.

Taxpayers are not bound to comply with a public ruling. This is consistent with the fact that binding rulings do not have the status of law.

Private rulings (section 91EA)

When a taxpayer has obtained a private ruling on an arrangement and applies that ruling in calculating his or her tax liability, the Commissioner must administer the taxation law in accordance with the ruling. The effect of a private ruling is therefore exactly the same as the effect of a public ruling - except that a private ruling binds the Commissioner only in respect of the particular person and arrangement identified in the ruling.

If two or more private rulings on a taxation law apply to a taxpayer and an arrangement, that taxpayer may choose which ruling is to apply to the particular arrangement.

There are strict requirements to ensure that every aspect of the arrangement which is relevant to the ruling is disclosed to the Commissioner (see section 91ED).

Product rulings (section 91FA)

The Commissioner may make a product ruling on how any taxation law applies to a particular product.

A product ruling binds the Commissioner in respect of the tax treatment of the product. However, taxpayers who are in any doubt about the application of a product ruling may request a private ruling (or a non-binding ruling) on their specific situation.

Example

In preparing a return a person treats a distribution from a superannuation fund as being exempt - as provided in a product ruling. The Commissioner will also treat the distribution as being tax exempt.

If two or more product rulings on a taxation law apply to a product, a taxpayer who subscribes for or purchases that product may choose which ruling is to apply.

When the Commissioner cannot - or may decline to - issue a private or product ruling (subsections 91E(3),(4) and 91F(3),(4))

The Commissioner may decline to make a private ruling or a product ruling in either of these situations:

- if the Commissioner considers that the correctness of the ruling would depend on which assumptions were made about a future event or other matter
- if the matter on which the ruling is sought is subject to an objection or appeal, whether in relation to the person who applied for the ruling or any other person.

The Commissioner cannot issue a private ruling or a product ruling in any of these situations:

- if the application requires the Commissioner to determine questions of fact
- if in the Commissioner's opinion the arrangement in relation to which the application is made is not seriously contemplated by the applicant
- if the application is frivolous or vexatious
- if the matter on which the ruling is sought is being dealt with (or in the Commissioner's opinion, should be dealt with) under a double tax agreement procedure
- if a ruling of the type requested already exists on how the taxation law applies to the arrangement, and the proposed ruling would apply to any period to which the existing ruling applies (A further ruling may be made for periods not already subject to an existing ruling.)
- if in the Commissioner's opinion the person who applied for the ruling has not provided sufficient information in relation to the application after the Commissioner has requested further information
- if in the Commissioner's opinion it would be unreasonable to make a ruling in view of the resources available to the Commissioner.

In addition, the Commissioner cannot make a private ruling in any of these situations:

- if the matter on which the ruling is sought concerns a tax, duty or levy that is due and payable (unless the Commissioner receives the application before the tax, duty or levy is due and payable)
- if the Commissioner has made an assessment in relation to the person, the arrangement, and any period to which the proposed ruling would apply (unless the Commissioner receives the application before the date of the notice of assessment)
- if the Commissioner is undertaking an audit on how the taxation law applies to the person and the arrangement for any period to which the proposed ruling would apply.

Application of rulings (sections 91DC, 91EB, and 91FB)

A ruling on a taxation law will bind the Commissioner only if the taxation law is expressly referred to in the ruling and only for the period specified in the ruling. For example, a private ruling made for the 1997-99 income years will only apply for that period.

In addition, a public ruling will bind the Commissioner only in respect of specified arrangements that are entered into during the period for which the ruling applies, regardless of whether the arrangement was entered into before or after the date the ruling is made.

Example

A public ruling is made on 1 September 1996 to apply to all arrangements entered into during the 1997-99 income years. The ruling will bind the Commissioner for all arrangements entered into during those income years (including arrangements entered into between 1 April 1996 and 1 September 1996).

A public ruling does not apply to a taxpayer in relation to an arrangement entered into in a prior income year.

The Commissioner may extend the period of application of a public ruling or a product ruling (see sections 91DD and 91FI). Alternatively, the Commissioner may withdraw the ruling and if it is a public ruling, replace it with a more up to date ruling.

A private or product ruling will not apply in any of these situations:

- if the arrangement identified in the ruling is materially different from the arrangement which is actually carried out
- if any assumptions made by the Commissioner about future events or other matters stated in the ruling are incorrect
- if there was a material omission or misrepresentation in, or in connection with, the application for the ruling (see subsections 91EB(2) and 91FB(2)).

Applying for a private or product ruling (sections 91EC and 91FC)

There is a formal application procedure for private and product rulings to make sure that requests for rulings are clearly distinguishable from other correspondence and that all material facts are established at the outset.

An application for a private ruling or a product ruling must be made in the form prescribed by the Commis-

continued on page 4

from page 3

sioner. These forms (IR 113 for a private ruling and IR 114 for a product ruling) are available from any Inland Revenue office.

A taxpayer (or a group of taxpayers in the case of a private ruling) may apply for a ruling on their own behalf. Alternatively, agents may apply for a ruling on behalf of a taxpayer (or a group of taxpayers in the case of a private ruling), provided the taxpayers are identified in the application and have formally indicated their acceptance of the application for the ruling. The Commissioner will be bound to apply a private ruling only to those taxpayers who are listed in the ruling.

A person who has applied for a ruling may at any time withdraw the application by giving the Commissioner written notice (see subsections 91EC(4) and 91FC(3)). Withdrawal by one applicant will not affect a joint application for a private ruling provided that the arrangement is not materially affected and the Commissioner still has sufficient information to make the ruling (see subsection 91EC(5)).

Disclosure requirements (sections 91ED and 91FD)

A high standard of disclosure is required of taxpayers requesting a ruling. The ruling will bind the Commissioner only if all the relevant facts in relation to the arrangement are accurately disclosed.

An application for a ruling must disclose all of the following:

- the identity and IRD number of the taxpayer(s) to whom the ruling will apply
- all facts and documents in relation to the arrangement
- specific legislative provisions in respect of which the ruling is sought
- the propositions of law (if any) which are relevant to the issues raised in the application
- a draft ruling.

The last three requirements may be waived if the Commissioner considers that it would be unreasonable to expect the applicant to comply with any or all of these requirements (see subsections 91ED(2) and 91FD(2)).

Applicants can indicate on the application form whether they are seeking a waiver of these disclosure requirements. They will need to give reasons why they are unable to provide the information.

As well as complying with the above disclosure requirements, an applicant for a product ruling must explain both of the following:

- why it is not practical to seek a private ruling
- why the characteristics of the taxpayers who may enter into the arrangement will not be relevant to the content of the ruling (see paragraph 91FD(1)(c)).

Request for further information and ability to make assumptions (sections 91EE, 91EF, 91FE and 91FF)

The Commissioner can request any further relevant information. If this information is not provided, the Commissioner may decline to issue the ruling (see sections 91E(4)(h) and 91F(4)(f)).

The Commissioner can make assumptions about aspects of an arrangement, and will make these assumptions explicit in the ruling which is issued. If the Commissioner is not prepared to make any assumptions, he or she may decline to rule. The Commissioner has the power to request further information, and so cannot make assumptions about information which the applicant can provide (see sections 91EF(2) and 91FF(2)).

Statutory right to consultation (sections 91EG and 91FG)

Applicants have a statutory right to be consulted by the Commissioner on the content of a ruling if the Commissioner proposes to issue a ruling that differs from the one requested by the applicant.

Charging (section 91I)

The Tax Administration (Binding Rulings) Regulations 1995 authorise the fixing of fees payable for private and product rulings. These rulings are charged for on a full cost-recovery basis. The cost of applying for a ruling is $210 (GST inclusive). This fee covers the first two hours' work involved in making a ruling. An hourly rate of $105 (GST inclusive) is charged for additional time taken to make a ruling. These rates will be subject to review.

Reimbursement fees for specific work or services (including costs and reasonable disbursements incurred) are also charged if the Commissioner requires external advice to issue a ruling.

The Commissioner must give the applicant an initial estimate of the fee payable in excess of the application fee. The applicant will be advised of any change to that estimate.

The regulations also require the Commissioner to ensure that reasonable efforts are made to minimise the fees payable for a product ruling or a private ruling.

An applicant for a private ruling or a product ruling can advise the Commissioner that he or she wishes to withdraw the application at any time before the ruling is made. Withdrawal of an application will not affect the applicant's liability for any fees incurred in processing the application up to the date of withdrawal.

Timing

If the Commissioner considers that it will take longer than four weeks to issue a private ruling or a product ruling, regulations require the Commissioner to give the applicant an estimate of the likely date the ruling will be issued, and advise of any change to this estimate.

Publication of rulings

Public rulings and product rulings will be published. Private rulings will not be published, but if a private ruling raises an issue of wider significance, the Commissioner may issue a public ruling on that issue.

The Commissioner will notify the making of public and product rulings in the *New Zealand Gazette*. Public and product rulings will be published in the Tax Information Bulletin. Notices of extensions and notices of withdrawal of these rulings will also be published in the *Gazette* (see subsections 91DA(2), 91DD(1), 91DE(2), 91FH(2), 91FI(1), and 91FJ(2)).

Failure to publish a notice of a ruling or a notice of extension in the *New Zealand Gazette* does not invalidate a ruling or the extension of a ruling.

Private Rulings Disclosure Return (section 91EJ)

As part of the high standard of disclosure expected of applicants, they must also complete and file a disclosure return.

If a person meets the following conditions, he or she must disclose the existence of the ruling, and whether it has been followed:

- He or she has obtained a private ruling.
- He or she must file a return.
- In preparing that return, he or she must take into account the way in which a taxation law applies to the arrangement identified in the ruling.

The person must also disclose any material differences between the arrangement described in the ruling and the actual arrangement. The importance of this disclosure is reinforced by the general penalties that may arise for non-compliance with disclosure requirements.

A taxpayer who receives a private ruling will also receive a Private Rulings Disclosure Return (IR 115) and a Private Rulings Disclosure Attachment (IR 115A). Taxpayers must complete an IR 115A for each ruling that applies during the period of the return.

The IR 115 is an annual return and covers the period 1 April to 31 March. Disclosure must be made for all rulings that apply during the period of the return.

The IR 115 is to be completed for private rulings on any taxation law. For example, in one period a taxpayer may receive a ruling on GST and another on income tax. The taxpayer would complete an IR 115A for each ruling that applies during the period of the return and attach them to the single IR 115 required for that period.

The due date for filing the IR 115 and attached IR 115As is generally 7 July of each year, but there are these exceptions to this date:

- IR 5 taxpayers with a standard balance date - 7 June
- taxpayers with late balance date - 7th day of the 4th month following the end of the taxpayer's accounting year
- taxpayers who have been granted an extension of time under Part III of the TAA 1994 - the date required under that extension of time.

Withdrawal of a ruling (sections 91DE, 91EI and 91FJ)

To accommodate changes in the interpretation of the law, the Commissioner has the power to withdraw a ruling. Such a withdrawal will only affect arrangements entered into after the date specified in the notice of withdrawal. This will ensure that a person who begins an arrangement in reliance on a ruling may bind the Commissioner. However, if the Commissioner withdraws a ruling before the taxpayer enters into the arrangement the Commissioner will not be bound by the ruling.

The Commissioner must notify a withdrawal of a public or product ruling by making a public announcement (for example through a national press release) and by publishing a notice of withdrawal in the *New Zealand Gazette*.

The date of withdrawal of a public or product ruling may not be sooner than the earlier of these dates:

- the date a notice of withdrawal is published in the *New Zealand Gazette*
- the date on which a notice of withdrawal is publicly announced.

The Commissioner must also notify an applicant that a private or product ruling has been withdrawn. The date of withdrawal of a private ruling may not be earlier than the date on which the applicant could reasonably be expected to receive the notice of withdrawal.

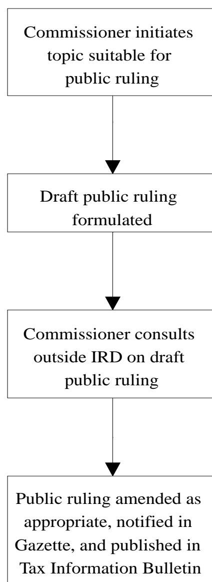
Changes in law (section 91G)

A ruling will cease to apply if any taxation law that is the subject of the ruling is repealed or materially amended in a way that alters how the law applies. The ruling will cease to apply from the application date of the repeal or amendment.

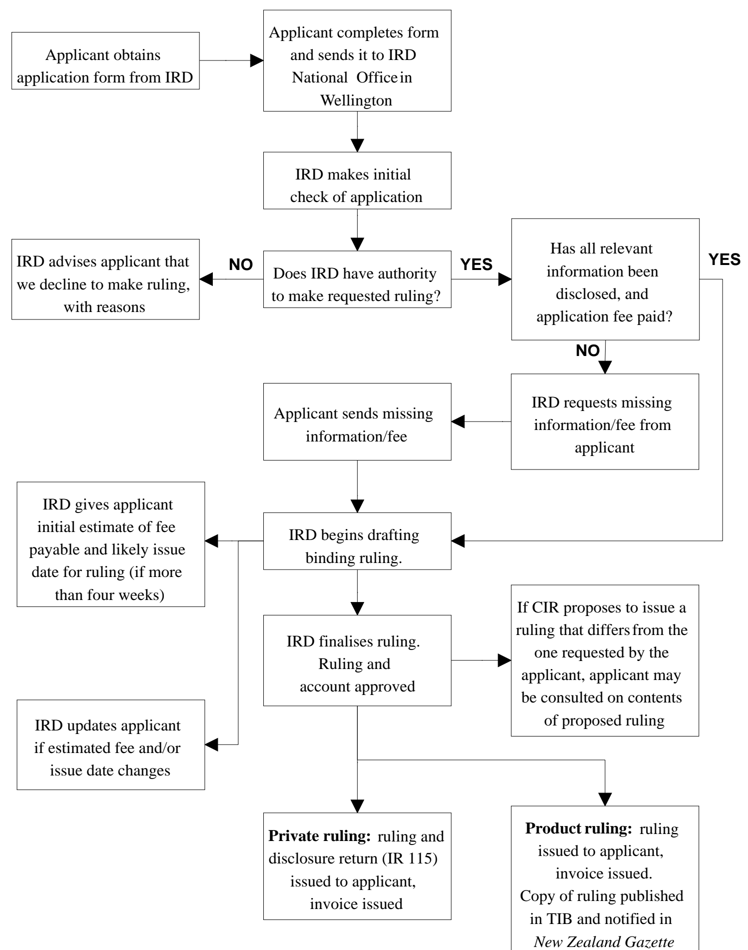
continued on page 6

Summary flowcharts - binding rulings processes

Public rulings



Private and product rulings



Nuiean company anti-avoidance rules

Section CB 8, Income Tax Act 1994

Introduction

An amendment has been made to tax concessions afforded to Niue contained in section CB 8 to ensure that New Zealand residents do not abuse them as a result of Niue becoming a tax haven last year.

Background

Niuean companies are required to register in New Zealand as Niue does not have its own Companies Act. By doing so, Niuean companies are deemed to be New Zealand residents for tax purposes and would be liable to tax on their world-wide income, even though they do not derive any income from New Zealand.

To remedy this problem, the Act contains specific income tax exemptions in section CB 8(1) for companies which are registered in New Zealand but are principally carrying on business in Niue. Section CB 8(1)(a) exempts from tax New Zealand companies principally carrying on business in Niue. Section CB 8(1)(b) exempts from tax dividends paid by a New Zealand company that derives its income principally from Niue.

Key issue

As a result of Niue becoming a tax haven last year, the Government was concerned that these exemptions could be exploited by New Zealand residents to avoid New Zealand tax.

Section CB 8 has therefore been amended by inserting subsection (4) into it. This subsection subjects New Zealand resident shareholders of these Niuean companies to the Foreign Investment Fund (FIF) rules to ensure they cannot benefit from these exemptions.

Application date

This amendment will apply to tax on income and dividends derived in the 1995-96 and subsequent income years.

Tax-free allowances

Section CB 12, Income Tax Act 1994

Introduction

The legislation dealing with tax-free allowances and payments on account of employees has been amended. Employers will now have to decide whether an allowance paid to an employee is tax free.

Background

Under the previous legislation dealing with tax-free allowances and payments on account of employees, the Commissioner of Inland Revenue had to determine whether an allowance or payment was exempt from tax. The amendment to the legislation now means that employers must determine the tax treatment of allowances paid to employees.

Key issues

Income tax exemption

An amount paid by an employer in respect of an employee's employment or service is exempt from tax if it meets either of these conditions:

- It reimburses the employee for expenditure that would be deductible in calculating the employee's assessable income, but for the existence of section DE 1.
- It is expenditure on account of an employee which, if incurred by the employee, would be deductible in calculating the employee's assessable income, but for the existence of section DE 1. (Expenditure on account of an employee is essentially a reimbursement of expenditure; that is, an employee has paid an amount and is reimbursed by the employer for that expenditure, or an employer pays an account which is in the employee's name.)

Section DE 1 prohibits deductions for expenditure or loss incurred in gaining or producing income from employment. In the absence of that prohibition, an employee would be able to deduct expenditure or loss when that expenditure or loss was incurred in gaining or producing assessable income.

Certain deductions are not allowed to be made when calculating assessable income. The relevant ones in relation to allowances and payments on account of employees are deductions for capital expenditure and private and domestic expenditure.

An allowance paid by an employer or a payment on account of an employee can be paid tax free when the allowance or payment reimburses an employee for expenditure which is or would be incurred in gaining or producing the employee's assessable income, provided the allowance or payment does not reimburse capital expenditure or expenditure of a private or domestic nature.

Employer-determined

Employers will now determine the tax treatment of allowances and payments paid to employees. Inland Revenue will publish guidelines in due course to provide guidance to employers as to which allowances and payments can be made tax free.

Employees

The previous legislation applied to allowances in respect of or in relation to the employment or service of any person. The amended legislation refers to amounts paid by an employer in respect of an employee's employment or service. In other words, only allowances paid to employees can be paid tax free.

An employee is any person who receives a source deduction payment, which is a payment of salary or wages, an extra emolument or a withholding payment. Therefore people who don't receive a source deduction payment are no longer eligible to receive tax-free allowances. The most obvious example is people who are major shareholder-employees who pay provisional tax and not PAYE. Such people are by definition not employees and are consequently no longer entitled to receive tax-free allowances from their company.

Transport allowances

Allowances paid for "additional transport costs" incurred by employees can be paid tax free in certain circumstances. The Amendment Act has not altered the statutory tests for transport allowances, apart from raising the threshold in the definition of additional transport costs in respect of public transport allowances from $1 to $5 a day.

Averaging

In determining the tax treatment of reimbursing allowances and additional transport cost allowances, employers may calculate the average expenditure incurred and pay tax-free allowances on the basis of that average expenditure. In other words, there is no need to calculate the expenditure incurred by each employee in each pay-period, since an average can be used.

Pre-payments

Section EF 1 is amended by the addition of subsection (5A). An employer can pay a tax-free allowance for expenditure which will be incurred by the employee in future years. Section EF 1(5A) matches the deduction which an employer can make on an allowance with the expenditure the allowance reimburses. An employer will only be entitled to a deduction for an allowance in an income year if the employee is expected to incur the underlying expenditure in that income year.

continued on page 8

from page 7

Under Determination E 10, an employer will only be subject to section EF 1(5A) if the amount pre-paid for services not otherwise dealt with in the Determination exceeds $12,000 and the length of time between the balance date and the period in which the underlying expenditure is likely to be incurred exceeds six months.

In other cases, the prepayment of the allowance will be deductible in the year the allowance is paid.

Application date

The amendments apply to allowances and payments made on or after 1 April 1995.

Relief from deemed dividends arising on transfer of property

Section CF 2, Income Tax Act 1994 / Section 4, Income Tax Act 1976

Introduction

Amendments have been made which are designed to provide relief from deemed dividends which may arise from the transfer of company property because of the subjectivity of market values.

Background

Dividends are deemed to arise under sections CF 2(1)(c), CF 2(1)(d) or CF 2(1)(k) of the 1994 Act and sections 4(1)(c), 4(1)(d) and 4(1)(l) of the 1976 Act when property is transferred to a shareholder or an associate of a shareholder for inadequate consideration, or when property passes from a shareholder or an associate for excessive consideration.

The objective of these sections is to ensure that taxpayers who are in a position to influence the values at which non-arm's-length transactions are completed undertake the transaction at values as close as possible to those that would have been used had the relationship between the parties not existed.

When the inter-corporate dividend exemption was generally removed from 1 April 1992, concern was expressed that companies which transfer property among themselves for commercial reasons may be subject to these deemed dividend provisions because of the subjectivity of what constitutes the "market value".

Companies might trigger a dividend under these sections that is only detected with the benefit of hindsight. A dividend could arise if the transferred property was not correctly identified at the time of valuation, or because of the different valuation methods that may be used.

Although the provision is designed primarily for inter-corporate transfers of property, the relief provision could apply to property transferred between companies and individuals. However, the requirement for additional consideration to be passed, or refunded as the case may require, may prohibit the effective use of this provision in those circumstances.

Key features

For the majority of inter-company transfers, which take place from parent to subsidiary, the dividend will be cancelled under section CF 2(13) [section 4(13) of 1976 Act]. However, for those cases not covered by that section, a new subsection (9A) [8A in the 1976 Act] has been added to section CF 2 of the 1994 Act [section 4 of the 1976 Act] to provide relief from section CF 2(1)(c) [4(1)(c)], CF 2(1)(d) [4(1)(d)] and CF 2(1)(K) [4(1)(l)] dividends when several conditions are met. These conditions are discussed below.

Incorrect market value

The relief provision applies when it transpires that the consideration provided at the time of transfer did not represent the market value. This could arise because of an incorrect or incomplete valuation of the property, or because more information is later available which discloses a value different from the original value.

"Reasonable steps"

The taxpayer must have taken "reasonable steps" to establish the value of the property at the time of transfer. This provision reinforces the broad thrust of the deemed dividend provisions, to ensure that property transferred among associated persons is transferred at market value.

Taxpayers should therefore already be making an effort to obtain a valuation of property when it is transferred among associated persons. When seeking to rely on the provision it will not be sufficient for the company to have simply relied on an informed guess as to the valuation of the property by an officer of the company or an employee.

The requirement that "reasonable steps" be taken to value the property at the time of transfer is to safeguard the tax base from those circumstances when a company simply assigns a value to the property, knowing that this relief provision will apply if the value is not correct.

For the relief provision to apply the company must have sought the opinion of someone qualified to value property of that nature. Generally this would be an independent person. However, if a company can demonstrate that an officer or employee of the company is suitably qualified to value the property and has made a genuine effort to value it accurately then this may be acceptable. The onus will be on the company to satisfy the Commissioner that that was the case.

Consideration

The provisions require that the recipient (or the associated person) of the deemed dividend pays additional consideration or refunds any excess consideration which is the difference between the consideration provided at the time of the transfer and the ascertained market value.

This recognises that value has passed between the parties to the transfer for which either inadequate or excessive consideration was involved. In order to remove the dividend component of the transaction from the recipient's assessable income it is necessary that the consideration be corrected. In the case of associated companies the consideration may be simply corrected through appropriate accounting entries.

In the case of transactions with natural persons this requirement may not be able to be satisfied, or the parties may not want to correct the consideration. The dividend will then stand and no relief will be available under this section.

Adjustments

A final requirement is that the appropriate adjustments be made in the books of the parties to the transaction. This ensures that the value at which the property should have been transferred is corrected. This will primarily affect the depreciation positions of the respective parties to the transactions.

Provided the conditions above are satisfied, the Commissioner will not assess any dividend arising under sections CF 2(1)(c), CF 2(1)(d) and CF 2(1)(K) (or the appropriate sections of the 1976 Act). To the extent that the dividend has already been included in assessable income, the appropriate returns of income will be reassessed to exclude the dividend, provided it was ascertained after the date of enactment.

Application date

The amendments to the 1976 Act came into effect on 10 April 1995 (the date of assent) and apply to deemed dividends ascertained after the date of enactment. This will allow the change to apply to any property that has already been transferred when the deemed dividend has technically arisen but has not yet been identified.

The amendments to the 1994 Act apply from 1 April 1995.

Company law reform: dividend definition amended

Section CF 3, Income Tax Act 1994 / Section 4A, Income Tax Act 1976

Introduction

Two amendments have been made to the dividend definition arising out of the recent reform of company law. First, a cross reference in paragraph (e) of section 4A(4A) - which relates to treasury stock - is corrected. Secondly, a new subsection 4A(11B) is inserted.

Background

The Income Tax Act now contains a definition of "available subscribed capital" which in essence calculates amounts paid in on the issue of a company's shares, less amounts of capital paid out on the cancellation of shares. When the amount paid to a company for the issue of its shares is attributable to certain distributions made by the company, there is no increase in its available subscribed capital. Paragraphs (vi), (vii) and (viii) of the definition of "available subscribed capital" describe the types of distribution to which this restriction applies. Broadly they provide that there is no increase in a company's available subscribed capital when the amount paid to the company on the issue of its shares is attributable to an unimputed tax exempt dividend paid by the company.

This is illustrated in the following example.

Example

Parent Co ("PCo") owns all the shares in Subsidiary Co ("SCo") on capital account. PCo has $100 of available subscribed capital which it has invested in SCo. SCo has generated $200 of revenue reserves but has no imputation credits.

PCo

Available subscribed capital	$100	SCo (at cost)	$100

SCo

Available subscribed capital	$100	Cash	$300
Revenue reserves	$200		

When SCo pays a $200 dividend to PCo which is exempt under section 63 and PCo pays the $200 to SCo for the issue of shares in SCo, there is no increase in the subscribed capital of SCo.

This rule effectively ignores the transaction in SCo. However, because the payment of the dividend increases PCo's retained earnings, it can give rise to overtaxation if the corporate group is wound up from the top down (that is, PCo is wound up first).

continued on page 10

from page 9

Key issues

Section 4A(11B) is inserted into the Tax Act to overcome the problem of overtaxation. This is achieved by effectively providing that, for the purposes of calculating the capital gains distributed by PCo on liquidation, the cost price of the shares issued in SCo is deemed to be nil if the issue price did not increase available subscribed capital. The transaction is ignored in PCo for tax purposes by treating the entire value of the shares issued as a capital gain which is tax free on liquidation.

Application Date

The two amendments take effect from 1 July 1994.

Company law reform: PAYE on shareholder/employee salaries

Section OB 2, Income Tax Act 1994 / Section 6, Income Tax Act 1976

Introduction

Section 6 of the Income Tax Act 1976 has been amended. The section provides that, in certain circumstances, close companies that pay irregular salary to shareholder/employees do not have to deduct PAYE from those salaries.

Previously the term "close company" was deemed to include only a private company registered under the Companies Act 1955.

Key Issues

The amendment deems "close company" to include any company that has 25 or fewer shareholders. It therefore extends the scope of section 6 to include a company registered under the Companies Act 1993 which has 25 or fewer shareholders (and which therefore prior to reregistration was - or, if a new company, would have been eligible to be - a private company).

This is intended to be an interim measure, pending a review of section 6 before 1 April 1997.

Application Date

The amendment takes effect from 1 July 1994.

Company law reform: associated persons

Section OD 8(4), Income Tax Act 1994 / Section 67(2), Income Tax Act 1976

Background

A drafting error is corrected in section 67(2) of the Income Tax Act 1976 (which taxes profits from certain land transactions). The section includes its own test for determining when a company and an individual are associated for the purposes of the section.

This was recently amended to reflect changes in company law terminology.

The new provision deems a company and an individual to be associated when the individual or the individual's spouse or infant children or a trustee for any such spouse or infant children holds a 25% or greater voting interest in the company.

Key Issues

The amendment deems a company and an individual to be associated when a trustee for the individual holds a 25% or greater voting interest in the company. This was omitted in error from the revised section 67.

Application Date

The amendment takes effect from 1 July 1994.

Company law reform: amalgamations

Sections DD 3, FE 9, FE 6 and OB 1, Income Tax Act 1994 / Section 191WD, Income Tax Act 1976

Introduction

Four minor amendments have been made to the amalgamation provisions in the Income Tax Act.

Key Issues

1. Definition of "depreciating property"

A definition of "depreciating property" has been inserted into section OB 1 of the Income Tax Act 1994 [section 191WD, ITA 1976]. The term is used in, but not currently defined for the purposes of, subsection FE 6 (4) [subsection 191WD (15)], which relates to the transfer of depreciating property on an amalgamation.

2. No clawback on transfer of depreciating property

Subsection FE 6(1A) [Subsection 191WD(12A)] has been inserted to clarify that there is no clawback of depreciation on transfer of depreciating property on a qualifying amalgamation.

3. Interest deductibility

Section DD 3 [Subsection 191WD(9)] has been re-drafted to make its application more certain and to provide that any interest expense incurred in the year of amalgamation but before the amalgamation is deductible.

In order to achieve greater certainty, the reference to "but for the amalgamation" has been removed as it is not possible to know whether the amalgamating companies would have been in the same group at 31 March following the amalgamation. Instead, the relevant test is whether the companies were a group immediately before the amalgamation.

4. Amounts remitted or cancelled

A new provision has been inserted into section FE 9 [section 191WD(10A)] to provide that the assumption by an amalgamated company of the liabilities and obligations of an amalgamating company does not result in the amalgamating company deriving assessable income under section BB 5 [section 78] or reducing a loss under section IE 1 (6) [section 188(6)].

Application date

These amendments apply from 1 July 1994.

Company law reform: financial arrangements - treatment on amalgamation

Section FE 10, Income Tax Act 1994 / Section 191WE, Income Tax Act 1976

Introduction

A new section has been inserted to set out the tax consequences of the collapse of a financial arrangement on an amalgamation of the holder and issuer. In all cases the financial arrangement is deemed to have been discharged immediately before the amalgamation but the amount of the consideration passing from the issuer to the holder differs depending on whether the amalgamation is qualifying or non-qualifying, and whether the issuer is solvent or insolvent. A company is insolvent if it does not satisfy the solvency test in section 4 of the Companies Act 1993.

Key issues

Qualifying amalgamation - solvent issuer

If the issuer is solvent, or if it is insolvent but able to meet its obligations under a financial arrangement because the debt is secured against property of the company, the issuer is deemed to have paid to the holder the issuer's *outstanding accrued balance* of the financial arrangement.

This term is defined - it is essentially the principal and unpaid interest accrued to the date of amalgamation.

In most instances, the issuer and the holder will both be using the yield to maturity method to account for the financial arrangement. However, if the issuer and holder have used different methods, the holder's deemed income will reflect a matching of the issuer's total deductions, and not the accrued value of the financial arrangement to the holder. This is illustrated in the example below.

Example

- A Co loans B Co $100 on 1/4/96 for 3 years
- Zero coupon, $130 is payable on 31/3/99
- A Co and B Co amalgamate on 1/10/97
- A Co uses the yield to maturity method (assume accrual amounts would be $9, $10 and $11 in years 1 to 3)
- B Co uses the straight line method

The issuer's outstanding accrued balance on 1/10/97 is $115 calculated as follows:

a + b + c - d - e

a = $100 d = $0
b = $10 e = $0
c = $5

The base price adjustments of the holder and issuer will be:

B Co (issuer)

a - (b + c)

a = $115 c = $10
b = $100

a - (b + c) = $5 expenditure incurred

A Co (holder)

a - (b + c)

a = $115 c = $9
b = $100

a - (b + c) = $6 income derived

In total, the issuer has deemed expenditure under the financial arrangement of $15 and the holder has $15 income derived.

Deemed payment by the issuer of its outstanding accrued balance is in full satisfaction of its obligations and the holder is deemed not to have remitted any amount under the financial arrangement merely by virtue of its discharge.

If the amalgamating issuer and holder are consolidated for tax purposes, no tax consequences arise on amalgamation as section HB 2 (1)(a)(i) and (ii) [section 191M(1)(a)(i) and (ii)] apply. (There is no disposition of the financial arrangement in terms of paragraph (a)(iv)).

continued on page 12

from page 11

Non-qualifying amalgamation - solvent issuer

In a non-qualifying amalgamation, the issuer is deemed to have paid to the holder the market value of the financial arrangement immediately before amalgamation.

This is consistent with the general rule requiring transfer of property at market value in a non-qualifying amalgamation.

Qualifying and non-qualifying amalgamation - insolvent issuer

When the issuer is insolvent at the date of amalgamation, it is deemed to have provided to the holder consideration equal to the market value of the financial arrangement. This will result in income arising to the issuer to the extent that the market value of the financial arrangement has declined.

For the purpose of calculating its base price adjustment (item a), the holder is deemed to have remitted the difference between the market value of the financial arrangement and the tax book value of the arrangement to the holder (that is, the holder's outstanding accrued balance). This is to prevent the holder from obtaining a deduction for a bad debt unless the deduction is available under section 64G. This treatment is consistent with the underlying rules relating to deductions for bad debts under the accrual rules.

Application date

The new section takes effect on 1 July 1994.

Company law reform: "private company" reference

Section 178(3), Tax Administration Act 1994 / Section 386(3), Income Tax Act 1976

Key issues

The reference to "private company" in section 178(3) [section 386(3)] has been replaced by the term "close company". This is required as the Companies Act 1993 no longer distinguishes between private and public companies.

Application Date

The amendment takes effect from 1 July 1994.

FBT on vehicles - test period for liable days

Section CI 11, Income Tax Act 1994

Introduction

Employers who provide vehicles to their employees can now use a three-month test period to establish the number of days a vehicle is liable for FBT. The result of the test can be used in calculating FBT liability for three years.

Background

A vehicle is exempt from FBT on a day it is:

- used for an emergency call
- used by an employee who is away form home on business for 24 hours or more
- not available for private use
- a work related vehicle.

This amendment will relieve the employer from continually recording these events. It results from a Tax Simplification Consultative Committee recommendation.

Key issues

An employer can elect to keep a three-month test period to establish the use of a vehicle by an employee. The test result can be used to calculate FBT liability for an application period of three years.

If the employer pays FBT on a quarterly basis the test period must be a quarter as defined in section OB 1. The three-year application period begins on the first day of the test period.

If the employer pays FBT on an annual basis the test period must be a quarter as defined in section OB 1. The three-year application period begins on 1 April of the year in which the test period is run.

If an employer pays FBT on an income year basis the test period can be any three consecutive months within the income year. The three-year application period begins on the first day of the income year in which the test period is run.

Employers will be free to run further tests. If further tests are run, old test period results can no longer be used.

The test period must be representative of the three-year application period. If the actual days of liability for FBT in any quarter, year or income year are 20 or more percentage points higher than the test period result, the application period will end on the last day of that quarter, year or income year. Also, if the Commissioner considers that the test period result is not representative of the use of the vehicle, the Commissioner can disallow further use of that test period result. In these situations the employer will be free to run another test.

In the case of pool vehicles the test period can still be used to calculate the days available for private use.

Getting started

The method of conducting the test is no different from the record keeping currently required to record this information. Therefore employers who pay FBT quarterly could use the number of liable days obtained from their records for the period from 1 April 1995 to 30 June 1995 to calculate FBT liability in that quarter and the next 11 quarters, provided the result remains representative of use in those 11 quarters.

Application date

The amendment applies from 1 April 1995.

General insurance - disclosure of non-assessable premiums paid to non-resident insurers

Section CN 4, Income Tax Act 1994 / Section 209, Income Tax Act 1976

Introduction

Amendments give the Commissioner of Inland Revenue a clear legislative authority to collect details of insurance and reinsurance premiums paid by New Zealand taxpayers to residents of Switzerland and the Netherlands.

Background

General insurance premiums paid to non-resident insurers are assessable under section CN 4 of the 1994 Act [section 209 of the Income Tax Act 1976]. With effect from 1 July 1993, reinsurance premiums paid to non-resident insurers also became assessable. Before this date reinsurance premiums were specifically excluded from section 209.

However, under New Zealand's double tax agreements (DTAs) with Switzerland and the Netherlands these premiums will generally not be assessable in New Zealand, unless the insurer operates in New Zealand through a permanent establishment. The Government is concerned that this may encourage the use of these agreements to avoid the tax impost under section CN 4 [209].

Key features

The amendments introduce a new requirement to disclose to the Commissioner of Inland Revenue premiums which are not assessable in New Zealand because of the provisions of the Swiss and Dutch DTAs. The amendments will allow the Commissioner to monitor the flows of these premiums only, they are not assessing provisions.

The amendments require a person who is treated as the agent of the non-resident insurer for the purposes of section CN 4 [209] to disclose the amount of the premiums paid to residents of Switzerland or the Netherlands. Disclosure is made in the appropriate panel in the IR 4 company return of income.

Application date

For the 1976 Act, the amendments will apply to premiums paid from the start of the 1994/95 income year.

For the 1994 Act the amendment applies from 1 April 1995.

Unit trusts - temporary dividend exemption extended

Section CZ 4, Income Tax Act 1994

Introduction

The section that provides a temporary exemption for dividends paid by a unit trust to its manager has been extended.

Background

When the inter-corporate dividend exemption was repealed in 1991, the exemption for dividends paid by a unit trust to its manager was retained on a temporary basis. It was retained pending finalisation of permanent rules for the taxation of unit trusts and group investment funds.

Key issues

Section CZ 4(1) exempts the dividend component of a unit redemption paid to the manager of a widely-held unit trust, when the manager redeems units acquired in the course of its activities as manager of that unit trust.

This exemption has been extended for a further 12 months to apply to dividends paid before 1 April 1996.

Application date

The application date is 1 April 1995.

Deductibility of expenditure incurred in providing fringe benefits

Repeal of section DF 9, Income Tax Act 1994 / Section 105A, Income Tax Act 1976

Introduction

The repeal of section DF 9 [section 105A] gives effect to a Government announcement that rules relating to the deductibility of expenditure incurred in providing fringe benefits would be tightened.

Background

The combined effect of various changes to section DF 9 (introduced as section 105A of the 1976 Act) gave rise to a potential problem. Employers could use the section to claim a deduction for capital items such as the purchase price of motor vehicles used by employees. Normally, only the ongoing costs such as repairs and maintenance would be allowable, with the cost of the vehicle being depreciated over several years.

Deductions could also potentially have been claimed under section DF 9 for private expenditure such as the salary of a nanny or gardener paid by an individual outside the business context. This salary would normally be non-deductible, but under section DF 9 a deduction could be claimed by providing fringe benefits rather than paying monetary remuneration.

Deductions could also potentially have been claimed for full costs (for maintenance, depreciation, and the like) associated with assets which are essentially private (such as a yacht), when the use of the asset by employees (which is a taxable fringe benefit) is a small percentage of the total use of the asset. This is because section DF 9 did not contain specific apportionment wording; it did not refer to expenditure being deductible to the extent it was incurred in providing fringe benefits.

Key issues

Section DF 9 of the 1994 Act, and section 105A of the 1976 Act are repealed. The effect of this is that in future, a deduction for expenditure in providing fringe benefits will be available only under section BB 7, and will be subject to both the limitations contained in section BB 8 and the apportionment wording in section BB 7.

Expenditure incurred in providing fringe benefits to shareholder employees

Section CI 2(2) deems any benefits provided to shareholder employees to be provided to them in their capacity as employees, not as shareholders. Section CI 2(2) has been amended to apply for the purposes of section BB 7, as well as for the purposes of the FBT rules. This is to make it absolutely clear that the expenditure will be deductible under section BB 7, as is the cost of providing fringe benefits to other employees.

Section CF 3(1)(g) is unchanged, and provides that benefits paid to shareholder-employees which are subject to FBT are not taxed as dividends.

Expenditure incurred in providing fringe benefits to other employees

These costs continue to be deductible under section BB 7.

Expenditure incurred in paying FBT

The FBT remains deductible, under section BB 7. Although income tax is a prohibited deduction under section BB 8, FBT is specifically excluded from the definition of income tax for these purposes.

Application date

The repeal is effective from 1 April 1992, except for taxpayers who have filed returns claiming deductions under section 105A on or before 26 October 1994 (the date of the announcement of the proposed repeal).

This means that for the 1993 and 1994 income years, if deductions have been claimed in a return filed on or before 26 October 1994, the claims will be governed by section 105A of the 1976 Act. For the 1993 and 1994 income years, if deductions have not been claimed in a return filed on or before 26 October 1994, the claim will be governed by section 104 of the 1976 Act, as limited by section 106 of that Act.

For subsequent years, claims will be governed by section BB 7 of the 1994 Act, as limited by section BB 8.

Business entertainment deductibility rules

Sections CI 1, DG 1, EF 1, Schedule 6A, Income Tax Act 1994

Introduction

From 1 April 1995, the business entertainment deductibility rules have been replaced with a schedule of items of expenditure which are fifty percent deductible. This narrows the scope of the entertainment deductibility rules to reduce the compliance costs which were associated with the previous rules.

Background

New rules concerning the deductibility of business entertainment expenditure came into effect on 1 April 1993. From that date certain business expenditure on food, beverages, recreation and related accommodation and transportation was fifty percent deductible.

Following its introduction, it became apparent that aspects of the rules imposed compliance costs on taxpayers. The Government reviewed the rules with a view to minimising compliance costs while adhering to the underlying policy principle that expenditure on significant private benefits received from business entertainment should not be fully deductible.

After consulting with tax practitioner and taxpayer representatives, the Government modified the entertainment deductibility rules to take account of compliance cost concerns. A new section DG 1 and Schedule 6A entirely replace the previous entertainment deductibility rules.

Key issues

Purpose clause

The legislation states that, subject to the express provisions of the legislation, sections DG 1 and Schedule 6A are intended to reduce by fifty percent the deduction otherwise available for any expenditure or loss incurred on certain types of entertainment, being entertainment that generally involves a significant element of private benefit.

Fifty percent deductible

Any expenditure or loss on a specified type of entertainment, which would otherwise be deductible to the taxpayer in calculating assessable income, is fifty percent deductible, unless that entertainment or benefit is "excluded entertainment".

Definitions

The entertainment deductibility rules contain the following definitions:

"Business" includes any recurrent income-earning activity.

"Business contacts" includes clients, customers, shareholders, and other financiers of the taxpayer or of an associated person, but for a taxpayer who is a partner in a partnership, it does not include other partners in the partnership.

"Business premises" means the normal business premises or a temporary workplace of the taxpayer or of an associated person. It excludes premises or a workplace established principally for the purposes of enjoying entertainment.

"Specified type of entertainment" means a type of entertainment or benefit listed in Part A of Schedule 6A.

Specified types of entertainment

Part A of the new Schedule 6A of the Income Tax Act 1994 sets out the types of deductible expenditure or loss which are fifty percent deductible to the taxpayer, referred to as "specified types of entertainment". They are:

- Corporate boxes, corporate marquees or tents, and similar exclusive areas (whether permanent or temporary), at sporting, cultural, or other recreational events or activities occurring off the taxpayer's business premises. This includes tickets or other rights of entry to such boxes or other areas.
- Accommodation in a holiday home, time-share apartment, or similar leisure venue (excluding accommodation which is merely incidental to business activities or employment duties). This specified type of entertainment includes a hotel or motel room if the accommodation is similar to that provided in a holiday home or time-share (for example, if an employee receives a week's holiday in Queenstown as a bonus, and accommodation is provided in a hotel). It does not include overnight or short-term accommodation in a hotel or motel room. (For example, employees are flown to Auckland to watch a rugby test. They stay in a hotel overnight and return home the next day.) This expenditure may be subject to fringe benefit tax (see FBT discussion below).
- Yachts or other pleasure craft (whether owned or hired by the taxpayer)
- Food or beverages that meet any of these conditions:
  - They are provided or consumed as an incidence of any of the types of entertainment described above (for example, drinks and hors-d'oeuvres in a corporate box at a tennis match).
  - They are provided or consumed off the taxpayer's business premises (for example, a business lunch at a restaurant or a cocktail party for clients at the opening of an exhibition at an art gallery).
  - They are provided or consumed on the taxpayer's business premises in any of these situations:
    - at a party, reception, celebration meal or other similar social function (for example, Friday night drinks for staff.) This item only includes something in the nature of a party or similar social event. It would not include, things such as tea and coffee provided by an employer at a morning tea "shout" by an employee. Nor would it include everyday meals provided in a workplace cafeteria.
    - in an area such as a boardroom or an executive or client dining room which is reserved for use at the time only by those at a certain level of seniority and their guests, and not open to all of the taxpayer's employees who work in the premises (for example, a training room that is set aside one lunchtime a week for a luncheon for the partners in the firm). The area must be available for use by all those at that level of seniority.

Allowances

A taxpayer is treated as incurring expenditure on a specified type of entertainment to the extent that the taxpayer pays an allowance or reimburses an employee for that expenditure and the allowance or reimburse-

continued on page 16

from page 15

ment is exempt from tax. For example, when an employee takes a client out for lunch and is reimbursed by the employer, or an employee receives an allowance for such expenditure, the cost of that allowance is fifty percent deductible to the employer. Expenditure on allowances or reimbursements for excluded entertainment (including overtime meal allowances) is fully deductible.

Expenditure or loss

"Expenditure or loss on a specified type of entertainment" includes any incidental expenditure or loss on such matters as waiting staff, hireage of crockery, glassware or utensils, and music or other entertainment.

For corporate boxes, corporate holiday homes and pleasure craft, "expenditure or loss" also includes any deduction for depreciation or for a lease premium and any deduction for running costs and maintenance.

Excluded entertainment

Deductible expenditure or loss on a "specified type of entertainment" is fifty percent deductible unless the entertainment or benefit is specified as excluded entertainment in Part B of Schedule 6A. (In this case the expenditure or loss is fully deductible.) The list of "excluded entertainment" is as follows.

1. Food or beverages consumed while travelling on business, unless:

- the travel is principally for the purposes of enjoying entertainment; or
- consumed at a meal or other function at which an existing or potential "business contact" (a defined term) is a guest; or
- consumed at a party, reception, celebration meal, or other similar social function.

The previous entertainment rules allowed a $25 exemption for meals consumed while travelling on business. The expenditure is now fully deductible.

For the exclusion to apply, a person must be travelling or have travelled and received an allowance or a reimbursement of expenditure for any meals consumed.

Whether something is a "meal or other function" or a "party, reception, celebration meal, or other similar social function" will be a question of fact in each particular case. The examples below give an indication of the types of things included in these categories.

Examples

In the course of a week, a Palmerston North-based sales representative travels to Wanganui, New Plymouth and Hawera, staying in each place for a night. The sales representative is accompanied to Wanganui and New Plymouth by a fellow employee, who has just started working for the company. The sales representative and trainee dine together. The sales representative travels to Hawera alone. The night the representative is in Hawera she dines alone. The costs of all these meals are fully deductible to the employer.

The next week the sales representative travels to Napier, where she takes a client out for dinner. Because a business contact is a guest, the cost of both meals is fifty percent deductible.

The following week the sales representative travels to Gisborne, where she pays for dinner for a valued client and staff who are opening a new store. The cost is fifty percent deductible, because the food and beverages are being consumed at a meal at which a business contact is a guest.

The next day, the sales representative happens to be at another client's premises at morning tea time. She buys savouries and cakes for morning tea for the staff. The expenditure is fully deductible. A morning tea "shout" is not a "meal or other function". A "function" is some sort of meeting or get-together, such as Friday night drinks. It is something more than just a morning tea. Nor is it a "party or similar social function". "Party" is not defined in the legislation and so the word takes its ordinary meaning. In ordinary parlance, a morning tea is not a "party", nor is it a "reception, celebration meal, or similar social function".

As indicated above, "business contact" includes clients, customers, suppliers, shareholders, and other financiers of the taxpayer or of an associated person (not including other partners in a partnership).

Examples

A person travels from Wellington to Auckland on business and takes a client out to dinner. The costs of both of the meals will be fifty percent deductible.

Company A is a subsidiary of Company B. An employee of Company A travels from Christchurch to Auckland on business with an employee of Company B. If the employee of Company B is a guest of the employee of Company A at a meal (in other words, the meal is paid for by Company A), the cost of the meal will be fifty percent deductible. If the employees pay for their own meals, the costs will be fully deductible to their respective companies. This applies even if the companies are in a consolidated group of companies.

2. Food or beverages consumed at a conference, educational course, or similar event which lasts for at least four consecutive hours (excluding meal times), unless the event is principally for the purposes of entertainment.

The event must involve the conveying of knowledge. Seminars and conventions will therefore qualify for the exclusion, as will some meetings. The event must not be held principally for the purposes of entertainment. For example, a 4½ hour lunch cannot be re-characterised as a "conference", because the principal purpose of the lunch is entertainment.

Although the event must be at least four consecutive hours, excluding meal times, the four hours can include a morning or afternoon tea break.

Example

A course on negotiating skills runs from 10.00 am to 3.00 pm. Lunch is provided and there is a lunch break from 12.00 to 1.00. There are also two 10 minute coffee breaks at 11.00 and 2.00. The lunch is "excluded entertainment" and the cost is fully deductible. (The cost of providing the morning and afternoon tea is also fully deductible; see 3 below.)

3. Non-taxable overtime meal allowances paid to employees.

Example

A shop attendant is required to work late on Friday night. He is paid an overtime meal allowance which is non-taxable. The cost of paying the allowance is fully deductible to the employer.

4. Morning or afternoon tea, or a similar light refreshment, in an executive dining facility or at a conference or educational course of less than four hours' duration.

Examples

Morning tea is provided at an all-morning meeting of senior managers. The costs are fully deductible.

Afternoon tea is provided at a training course on management techniques which lasts from 2.00 to 5.00. The afternoon tea is excluded entertainment and the cost is fully deductible to the taxpayer (whether the course is held on or off the business premises).

5. A light meal provided in an executive dining facility by an employer to employees as part of their business or employment duties. A "light meal" is sandwiches and other "finger food" (such as savouries, fruit and muffins), salads and fruit juice. Normal commercial practice will be the yardstick to determine what constitutes a "light meal".

Example

Every week, the unit managers of a company have a lunch-time meeting. A light lunch of sandwiches and fruit is provided. Without this exclusion, the cost of this lunch would be fifty percent deductible because the meal is provided in an area of the premises which is reserved for use at the time by those of a certain seniority and not open to all employees working on the premises. Because such a meal does not provide a significant private benefit, it is "excluded entertainment" and the cost is fully deductible to the employer.

6. Entertainment that is merely an incidental part of a function open to the public, or a trade display principally held to advertise or promote a business or goods or services.

The term "trade display" means an event or function held to display and promote goods or services available. As long as the entertainment provided is incidental to the trade display, it will be excluded entertainment.

Examples

A manufacturer promoting a new model of video camera holds a demonstration for home appliance dealers. The costs of providing drinks and nibbles at the display are fully deductible.

A law firm holds a free seminar on employment issues for clients one evening from 5.30 to 7.30. The costs of providing drinks and nibbles at the end of the seminar are fully deductible.

7. Entertainment that is enjoyed or consumed outside New Zealand.

Example

A New Zealand business person takes a potential client out for dinner in Sydney. The costs will be fully deductible.

Some off-shore entertainment will be subject to fringe benefit tax (see section on FBT below).

8. Entertainment to the extent that it is sponsored principally to advertise or promote to the public a business or goods and services, provided none of the following have a greater opportunity to enjoy the entertainment than members of the public generally:

- existing business contacts
- employees
- associated persons.

Examples

A soccer club arranges a sponsorship deal with a tavern. The tavern pays for the teams' uniforms (which have the tavern's name on them) and provides a dozen beer for the team to enjoy immediately after the game. The cost of providing the uniforms will be fully deductible to the tavern. It is essentially an advertising expense; it is not expenditure on a "specified type of

continued on page 18

from page 17

entertainment". The cost of providing the beer is fifty percent deductible. It is a specified type of entertainment (being beverages provided off the taxpayer's premises) and it is not excluded, as the beer cannot be enjoyed by members of the public.

A soccer club has an arrangement with a local tavern, under which the teams attend the tavern after their games and drinks are available at a special price. The costs incurred in providing the drinks are fully deductible to the tavern. Any member of the public is able to buy drinks at the special price and the drinks, although provided at a discount price, are provided in an arm's length transaction (see below).

9. Entertainment provided by the taxpayer for market value or otherwise in an arm's length transaction in the ordinary course of the taxpayer's business which consists of providing one or more of the specified types of entertainment.

Examples

The costs incurred in the following situations are fully deductible:

A pub has a happy hour every Friday from 6.00 to 8.00; drinks are half price.

A pub has a "toss the boss" hour every Friday night. For every drink purchased, a dart is thrown at a board and there is a chance to win a free drink.

This exclusion differs from the previous rules in that it recognises that entertainment may be provided in the ordinary course of business for less than market value. This is the reason that the words " or otherwise in an arm's length transaction" have been added to the legislation.

10. Entertainment that is provided as a sample for advertising or promotion purposes to persons who are not employees or associated persons.

Example

Samples of a new brand of breakfast cereal are distributed to households. The costs incurred are fully deductible.

11. Entertainment provided to members of the public for charitable purposes.

Example

A company provides food and beverages for a Christmas lunch for the homeless.

12. Entertainment that is provided to a person reviewing that entertainment for a paper, magazine, book or other medium.

Example

A food critic for a magazine has a meal at a restaurant and reviews that meal in her weekly food column. The costs of the dinner are fully deductible.

13. Entertainment that is assessable income to the person who enjoys or consumes it.

Example

An employee receives an entertainment allowance which is fully taxable in his hands. The allowance is fully deductible to the employer.

14. Entertainment that is a fringe benefit to which fringe benefit tax applies.

Example

As part of an incentive scheme, employee is given an voucher for a restaurant meal. This will be subject to FBT, and fully deductible to the employer.

Apportionment

If a taxpayer incurs expenditure or loss and only part of it is subject to fifty percent deductibility, then that part of the expenditure or loss is fifty percent deductible. If the taxpayer does not reasonably estimate the relevant part, the Commissioner may determine the relevant part.

Examples

A business owns a yacht. Sixty percent of the time the yacht is available for use by the business. The rest of the time the yacht is chartered out. Sixty percent of the yacht's costs will be subject to the deductibility rules. The remainder will be fully deductible.

A company sponsors a basketball team. In return the company gets the use of a corporate box. The cost attributed to the corporate box is fifty percent deductible; the remainder will be fully deductible to the company. The value of the corporate box may be specified in the contract; if not, market value should be used. If the value is not reasonably estimated, the Commissioner may determine it.

Fringe benefit tax

Fringe benefit tax may be payable when a benefit which is provided to an employee meets all of these conditions:

- It is a specified type of entertainment
- The employee can choose when to consume or enjoy the benefit
- The benefit is not consumed or enjoyed in the course of employment duties.

For example, FBT is payable on the value of a meal voucher awarded to an employee as part of an incentive

scheme. The meal can be enjoyed at the employee's discretion and is not enjoyed in the course of the employee's employment duties.

The general exclusion for benefits provided on the premises applies in determining whether a specified type of entertainment provides a fringe benefit subject to fringe benefit tax.

Fringe benefit tax is also payable when a benefit which is a specified type of entertainment is "excluded entertainment" because it is enjoyed or consumed outside New Zealand and the benefit is not enjoyed or consumed in the course of employment duties. For example, as a sales incentive, staff who achieve certain targets receive an all-expenses paid trip to Hawaii.

Fringe benefit tax may also be payable on the travel costs of an employee travelling to a corporate box, a yacht or a holiday home. The FBT rules exclude from FBT expenditure on an employee's transport and accommodation when the travel is to enable the employee to perform the employee's employment duties (section CI 4(4) of the Income Tax Act 1994). If the travel does not have a "business purpose", the expenditure will be subject to FBT, unless section CI 4(4) applies.

Example

Dunedin employees are flown to Auckland to watch a rugby test in the company's corporate box. The costs of the corporate box will be subject to the entertainment deductibility rules and the transport and accommodation costs will be subject to FBT.

Goods and services tax

As with the previous rules, a GST adjustment must be made of one-ninth of the non-deductible portion of entertainment expenditure (the GST-exclusive amount for GST registered persons). GST must be returned in the taxable period in which the income tax return is filed or is due to be filed (whichever is the earlier).

Application date

The new entertainment rules apply from 1 April 1995, regardless of balance date.

Foreign income - year in which assessable in NZ

Section EP 1, Income Tax Act 1994

Introduction

An amendment will allow New Zealand residents to choose to return the income they earn overseas (apart from interest and dividends) in the New Zealand tax year in which their balance date in the overseas jurisdiction falls. The intention of the amendment is to reduce compliance costs.

Background

Problems associated with returning foreign income currently arise because income years vary from country to country. As a result, New Zealand residents will receive information about their overseas income in a form that cannot be readily used for their domestic tax returns.

For example, a New Zealand resident who has rental income from the US must file a New Zealand return for the year ended 31 March 1995. The taxpayer will therefore require the US accounts for the years ended 31 December 1994 and 31 December 1995 to make an apportionment calculation. This would involve at least a nine-month delay in the preparation of the taxpayer's return.

This amendment will simplify the timing rules relating to returning foreign income in many circumstances. In the above example, under the new rule a New Zealand resident would simply return the rental income earned in the year ended 31 December 1993 in the New Zealand income year ending 31 March 1994.

The amendment results from a Tax Simplification Consultative Committee recommendation.

Key features

New Zealand residents will be able to return the income they earn overseas (apart from interest and dividends) in the New Zealand tax year in which their balance date in the overseas jurisdiction falls.

The new recognition rule does not apply to income that is subject only to withholding tax in the foreign country.

The new recognition rule is available to taxpayers whose total overseas income (excluding interest and dividends) does not exceed $100,000, measured in terms of the corresponding income year of the relevant foreign jurisdiction.

The amendment will not apply to income governed by the foreign investment fund, controlled foreign company and foreign dividend withholding payments rules.

Taxpayers may use the new recognition rule for interest and dividends, on a case by case basis, if they apply to the Commissioner. The criteria the Commissioner will consider will be the effects on New Zealand's tax base and the taxpayer's compliance costs. In considering the compliance costs, the Commissioner will essentially

continued on page 20

from page 19

look at whether the interest or dividends are subject to income tax (and not merely withholding tax) in the foreign jurisdiction.

Application date

The amendment applies from the income year commencing 1 April 1995.

Family Support tax credits

Sections KD 5, KD 6, KD 7 of the Income Tax Act 1994

Introduction

The Department of Social Welfare (DSW) will be allowed to continue to pay Family Support for four weeks after a person has ceased to receive an income-tested benefit. In addition, Inland Revenue will be able to pay arrears of Family Support and Guaranteed Minimum Family Income (GMFI) back to the date that DSW stopped paying Family Support. The changes will help beneficiaries to exit the benefit system by providing continuity in their Family Support payments.

Background

These changes arose from the need to bridge the gap in payment of Family Support when a person moves off an income-tested benefit paid by DSW, and starts to receive Family Support from Inland Revenue instead.

Key issues

Two changes have been made:

- DSW will be able to continue to pay Family Support for a period to be agreed between the Director General of Social Welfare and the Commissioner of Inland Revenue. Initially this period has been set at four weeks.
- The circumstances under which Inland Revenue may pay Family Support and GMFI arrears have been relaxed to allow arrears to be backdated to when DSW stopped paying Family Support.

Application date

The changes apply from the date of assent, 10 April 1995.

Underlying foreign tax credit rules amended

Section LF 5(3A), Income Tax Act 1994

Introduction

A technical amendment has been made to the underlying foreign tax credit (UFTC) tracking account with respect to life insurance companies resident in grey list countries (i.e., countries listed in Schedule 3). The UFTC tracking account formula has been amended to exclude the income of foreign policyholders. This change is consistent with the calculation of the branch equivalent income of a life insurance controlled foreign company (CFC).

Background

In 1993 an amendment to the CFC rules introduced a special rule for life insurance CFCs to provide that the branch equivalent income or loss of the CFC is an amount actuarially determined to be the profit or loss attributable to the shareholders, and not the policyholders. A similar amendment was not made to the UFTC tracking account.

The same issue applies with respect to amounts received by grey list life insurance companies for purposes of determining the UFTC tracking account. Some of the amounts received are attributable to the policyholders and not the shareholders. The amendment provides that only amounts attributable to the shareholders need to be included in the UFTC tracking account.

Key issues

An amendment relating to grey list life insurance CFCs is made to section LF 5 to specify that the tracking account formula uses only the amounts based on an actuarial determination of the profit or loss attributable to the shareholder (rather than policyholders).

Application date

The amendment applies to dividends paid on or after 28 September 1993, the application date of the UFTC rules.

Provisional tax payment relief

Sections MB 2 and MB 4, Income Tax Act 1994

Introduction

Sections MB 2 and MB 4 of the Income Tax Act 1994 have been amended to provide clarification about provisional tax payment obligations for those taxpayers who have not furnished their last year's income tax returns, and who do not know whether their last year's residual income tax (RIT) is over $2,500.

Background

Provisional taxpayers who have not furnished their last year's income tax return at the time their first or second provisional tax payment is due, and who do not know whether their last year's RIT is over $2,500, can face a high degree of uncertainty. This uncertainty arises because these taxpayers have a choice of:

- not paying any provisional tax, risking a liability for additional tax
- paying provisional tax, with those payments being refunded without any compensating use of money interest if they are not liable to pay provisional tax
- estimating their current year's RIT and paying provisional tax on that basis. This exposes them to the risks of interest and underestimation penalty if their estimate is less than 80% of their RIT.

Key issues

The amendment provides that provisional taxpayers do not have to pay provisional tax until the next instalment date on or after the date when their tax return for the immediately preceding income year is filed, if they meet both of these conditions:

- They have not furnished their last year's income tax return,
- Their residual income tax for the year before last was less than $2,500.

Application date

The amendment applies to income derived in the 1995-96 income year and subsequent years (i.e., 1996 provisional tax).

Shareholder continuity provisions - imputation and dividend withholding payment rules

Sections ME 5 and MG 5, Income Tax Act 1994

Introduction

An anomaly in the shareholder continuity provisions which apply to the imputation and dividend withholding payment rules has been corrected.

The amendments provide that for shareholder continuity purposes, credits can be offset against debits in a company's memorandum accounts, regardless of the time debits arise.

Background

Under the imputation and dividend withholding payment rules, when the shareholding in a company changes by more than the threshold specified in the shareholder continuity rules, the legislation requires credits arising before the change to have been cancelled out by "subsequent" debits.

Shareholder continuity is measured for each credit from the time the credit arises to the time continuity is breached.

Before 6 December 1994, when shareholder continuity was breached, a debit could arise in a company's imputation or dividend withholding payment account if a credit had been cancelled out by a prior rather than a subsequent debit, even if the account was actually in balance at the time of the breach. This would give rise to a further tax burden on the company.

Key issues

The intention of the imputation and dividend withholding payment rules is to pass credits for tax paid by a company on to the shareholders. The rules which apply when shareholder continuity is breached are to ensure that the tax credits are passed to the appropriate shareholders.

The previous requirement for credits to be cancelled only by subsequent debits had anomalous consequences in this situation:

1. A company distributes imputation credits in anticipation of making tax or dividend withholding payments, giving rise to debits in the memorandum accounts.
2. The company satisfied those tax or dividend withholding payment liabilities, giving rise to credits which put the memorandum accounts in balance.
3. The company then had a change in shareholding which breached the shareholder continuity threshold.

continued on page 22

from page 21

Because the credits in this situation have been cancelled by prior rather than subsequent debits, a further income tax or withholding payment liability fell on these companies, thus penalising the company and its new shareholders.

The amendments ensure that on a change in shareholder continuity, credits that have not been cancelled by either prior or subsequent debits are taken into account in deciding if further tax is payable. No further tax will arise if the memorandum accounts are in balance.

Application date

The amendments apply from 6 December 1994, the date on which the Taxation Reform (Binding Rulings and Other Matters) Bill was introduced into Parliament.

Casual agricultural and election day workers

Sections NC 8, NC 10, OB 1 and Schedule 19, Income Tax Act 1994

Section 17, Student Loan Scheme Act 1992

Regulations 2 & 3, clause 10 of Part A & clause 6 of Part B of the Schedule, The Income Tax (Withholding Payments) Regulations 1979

Introduction

Casual agricultural and election day workers have been removed from the Withholding Payment Regulations and made subject to PAYE deductions at 20 cents in the dollar. As with all other employees, their employer will deduct the ACC earner premium at the time income tax is deducted and their employer will be responsible for payment of the employer premium.

Background

Before this amendment, casual agricultural and election day workers were responsible for paying both the ACC earner premium and the employer premium. This resulted in unexpected tax bills for people who are in effect employees. Making them subject to PAYE deductions, rather than withholding deductions, will mean that the ACC earner premium is deducted at the same time as the PAYE deduction is made and that the employer premium correctly becomes the responsibility of the employer.

Key issues

- Casual agricultural and election day workers are subject to PAYE deductions at 20 cents in the dollar.
- The ACC earner premium, presently 0.6 cents in the dollar, will be deducted at the same time as the PAYE deduction is made.
- Two new codes have been created to identify these persons, 'CAW' for casual agricultural workers and 'EDW' for election day workers.
- A casual agricultural worker has been defined as:

  ... a person engaged on a day to day basis for a period not exceeding 3 months as a casual seasonal worker for the exclusive purpose of doing seasonal agricultural, horticultural, orchard, tobacco farming, market gardening, or nursery work, or other seasonal work that, in the opinion of the Commissioner, is work of a like nature to those classes of work.

- An election day worker has been defined. People who previously came within the provisions of the Income Tax (Withholding Payments) Regulations for this type of work will be election day workers.
- Casual agricultural and election day workers will no longer be required to file tax returns, provided they come within the definition of a pay period taxpayer.
- As a result of these changes, the following consequential changes have been made to the Student Loan Scheme Act 1992 and to the Income Tax (Withholding Payments) Regulations 1979.

Student Loan Scheme Act 1992

- Casual agricultural and election day workers have been added to the list of employees for whom an employer is not required to make repayment deductions. As these workers are taxed at a flat rate in the dollar, it is not possible to take the Student Loan repayment threshold into account when making PAYE deductions. These workers will therefore have any repayment obligation determined when they file their tax returns at the end of the tax year.

The Income Tax (Withholding Payments) Regulations 1979

- The provisions in The Income Tax (Withholding Payments) Regulations relating to casual agricultural and election day workers have been removed.

Special tax code certificates

Any casual agricultural or election day worker who considers that the deduction of 20 cents in the dollar will result in an underpayment or overpayment of tax may apply to the Commissioner for a special tax code certificate.

People employed in agricultural and similar work - tax treatment

Before this amendment people engaged in agricultural and similar work came within one of three categories:

- Employees who were (and continue to be) salary and wage earners and therefore subject to 'ordinary' PAYE deductions at either one of the primary or secondary tax codes. For these employees the employer is responsible for the ACC employer premium and the earner premium is incorporated in the PAYE tables.
- Casual agricultural workers who came within clause 10 of Part A of the Schedule to the Withholding Payments Regulations were subject to a deduction of 15 cents in the dollar. These people were responsible for payment of the ACC earner and employer premiums.
- Agricultural contractors who came (and continue to do so) within clause 4 of Part A of the Schedule to the Withholding Payments Regulations are also subject to a deduction of 15 cents in the dollar. These people are responsible for payment of the ACC earner and employer premiums.

As both casual agricultural workers and agricultural contractors came within the Withholding Payments Regulations, and both were subject to a deduction of 15 cents in the dollar, employers were only required to distinguish employees subject to 'ordinary' PAYE deductions and those subject to withholding tax. In the March 1994 Tax Information Bulletin Inland Revenue restated our policy on who could be treated as a casual agricultural worker. However, this policy was not fully accepted by the industry and other interested parties. When the legislative changes described above were being developed the industry and other interested parties were consulted. The current definition of a 'casual agricultural worker' is one result of that consultation.

People engaged in agricultural and similar work will continue to come within one of three categories. The only difference is in who is regarded as a casual agricultural worker and how such workers are taxed. The following guidelines will help employers distinguish between agricultural workers who should be subject to 'ordinary' PAYE deductions, casual agricultural workers who should be subject to PAYE deductions at 20 cents in the dollar (plus the ACC earner premium) and agricultural contractors who should be subject to withholding deductions of 15 cents in the dollar. In any case where doubt exists, the employer should seek a ruling from Inland Revenue.

Casual agricultural workers

From 1 April 1995 there are four criteria that people must meet before they can be treated as a casual agricultural worker. These are:

- They must be employed on a day to day basis.
- The period of employment must not exceed three months.
- The type of work that they are engaged in must be casual seasonal work.
- They must be engaged exclusively in agricultural (or similar) work.

In Tax Information Bulletin Volume Five, No. 10 (March 1994) Inland Revenue issued a policy statement that restated our policy that a person employed to do work that would last a week or more, even if the worker only received payment for the days actually worked, would not be regarded as a casual agricultural worker. This no longer applies. A casual agricultural worker is a person who is employed on an as-needed basis for a period of up to three months. However, once that three month period is exceeded any continuing employment is subject to 'ordinary' PAYE deductions.

Example

Mr A is engaged by a market gardener for a period of 13 weeks to pick strawberries. The terms of his employment are that he will only be required to work on fine days and will be paid a set amount for each chip of strawberries he picks. He is a casual agricultural worker and is subject to a flat deduction of 20 cents in the dollar, plus the ACC earner premium.

At the end of the 13-week period there are still plenty of strawberries and the market gardener decides to continue to employ Mr A for a further period of two weeks. Any income earned by Mr A in that two-week period is subject to PAYE at the G or SEC code that is appropriate to Mr A's circumstances.

Salary and wage earners

A salary and wage earner is a person who is an employee, other than a casual agricultural worker.

Example

Ms B is engaged by a winery for a period of two months to pick grapes as and when they ripen. When there are no grapes to be picked she helps in a restaurant attached to the winery. She works forty hours per week and is paid $300 per week. Although Ms B has been engaged for a period of less than three months, she is not engaged *exclusively* in casual agricultural work, nor is she employed on a day to day basis. She is therefore subject to 'ordinary' PAYE deductions and should use whichever primary or secondary tax code that is appropriate to her circumstances.

Agricultural contractors

An agricultural contractor will be a self-employed person who comes within clause 4 of Part A in the Schedule to the Income Tax (Withholding Payments)

continued on page 24

from page 23

Regulations 1979. This clause makes the following payments subject to a withholding tax deduction of 15 cents in the dollar:

Payments for agricultural work, maintenance work, development work of any of the kinds referred to in section 127 of the Act, or other work on or in connection with land used or intended to be used for farming or agriculture, being other work of the nature of any of the following, namely:

(a) Firewood cutting or post or rail splitting, including the incidental cutting down of trees:

(b) Grass or grass seed cutting:

(c) Hedge cutting:

(d) Planting trees:

(e) Planting or cutting flax:

(f) Threshing, chaffcutting, hay making, hay baling, or harvesting or gathering crops.

From the 1991-92 income year deductibility of expenditure on land used for farming or agricultural purposes was governed by section 127(A1) of the Income Tax Act 1976. This is now section DO 3 of the Income Tax Act 1994. The list of works in section DO 3 that qualify for a deduction are:

(a) The destruction of weeds or plants detrimental to the land:

(b) The destruction of animal pests detrimental to the land:

(c) The clearing, destruction, and removal of scrub, stumps, and undergrowth:

(d) The repair of flood or erosion damage:

(e) The planting and maintaining of trees for the purpose of preventing or combating erosion:

(f) The planting and maintaining of trees for the purpose of providing shelter:

(g) The construction on the land of fences for agricultural purposes, including the purchase of wire or wire netting for the purpose of making new or existing fences rabbit-proof.

A person must be *both* self-employed *and* engaged in one of the types of work set out above to come within the Withholding Regulations. The usual tests will be used to determine whether a person is self employed. These are set out in TIB Volume Four, No. 7.

Example

Mr C enters into a contract with an apple grower. The contract provides that Mr C will employ such workers as are necessary to harvest the apples within a six week period and that he will supply any equipment that those workers need. For this he is paid a set amount per tonne of fruit harvested. Mr C is a self-employed person. The work he is doing comes within clause 4 of Part A of the Schedule to the Withholding Payments Regulations. He is subject to withholding tax at 15 cents in the dollar.

Application date

These changes apply from 1 April 1995.

NZ Superannuation and pay-period taxpayers

Section OB4(1)(g), Income Tax Act 1994 / Section 356(2)(g), Income Tax Act 1976

Introduction

The pay-period taxpayer provision for New Zealand superannuitants is amended to ensure that it applies as intended.

Background

As currently drafted, income from employment includes NZ Superannuation so most superannuitants (except when the superannuitant's income including NZ superannuation is less than $3,120) must file returns.

Key features

The pay-period taxpayer provision for a person receiving NZ Superannuation is amended to ensure that a superannuitant doesn't have to file a tax return if his or her other income from employment and interest and dividends is less than $3,120. Section OB 4(1)(g) [section 356(2)(g) of the 1976 Act] is amended by clarifying that income from employment does not include NZ Superannuation.

Application date

The amendment applies from 1 April 1992 to coincide with the re-introduction of the surcharge rules.

Miscellaneous amendments to the Income Tax Act

Annual tax rates

The income tax rates for the 1993-94 income year will continue to apply for the 1994-95 income year.

Charitable organisations - name change (Section KC 5(1), Income Tax Act 1994) (Section 56A(2), Income Tax Act 1976)

The amendment reflects the change in name of the Rotary (District 922) Charitable Trust, which has charitable donee status. This Trust is now known as the New Zealand Rotary Clubs Charitable Trust.

Charitable organisations - additions (Section KC 5(1), Income Tax Act 1994)

The following organisations have been granted charitable donee status:

- Adventist Development and Relief Agency
- Mobility Equipment for the Needs of Disabled Trust
- The Serious Road Trip Charitable Trust
- Valehead Community Health Centre Trust

Donations made to these organisations on or after 1 April 1995 entitle individual taxpayers to a rebate of 33 $^{1}/_{3}$ percent, to a maximum for all donations of $500 per annum. A company (other than a closely held company) is entitled to a deduction from assessable income up to the amounts prescribed by section DJ 4.

Family Support interim instalments (Schedule 12, Income Tax Act 1994) (Eleventh Schedule, Income Tax Act 1976)

This change is a consequential one arising from the increase in the first abatement threshold from 1 October 1994 from $17,500 to $20,000. It ensures that people whose annual income does not exceed $20,000 receive the full amount of Family Support in their interim payments.

Inland Revenue has paid the full amount from 1 October 1994 in anticipation of this amendment.

Minor remedial amendments

There have been several minor remedial amendments made to the Income Tax Act 1976, the Income Tax Act 1994, the Tax Administration Act 1994 and the Goods and Services Tax Act 1985.

Depreciation - interpretation

Subsection 107A(2) of the Income Tax Act 1976 defines “income year”, for depreciation purposes, as including “corresponding non-standard accounting years”. An amendment has been made extending the definition to section 117, as this section also forms part of the depreciation rules. An equivalent amendment has been made to subsection OF 2(2) of the Income Tax Act 1994.

The amendment applies to tax on income derived in the 1993-94 income year and subsequent years, to coincide with the original application of the new depreciation rules.

Year in which accident compensation levy, earner and employer premiums deductible

An amendment has been made to section 140A of the Income Tax Act 1976 clarifying that the use of the term “income year” in that section (which specifies the year in which accident compensation levy, earner premium and employer premium are deductible) includes non-standard accounting years. An equivalent amendment has been made to section OF 2(2) of the Income Tax Act 1994.

The amendment applies from 1 April 1995.

Specified lease provisions

Section FC 8 of the Income Tax Act 1994 [Section 222D, Income Tax Act 1976] has been replaced with a new section which clarifies that the specified lease provisions are subject to a limitation in relation to the use of a leased asset, preventing a deduction for the lease of an asset used solely for personal use.

The amendment applies from the original application date of the specified lease provisions, 6 August 1982, except when taxpayers have filed a return claiming a deduction for personal expenditure under the specified lease provisions before the introduction of the amendment (6 December 1994).

Aquacultural improvement expenditure

Paragraph DO 5(3)(b) of the Income Tax Act 1994 contains a formula for calculating the amount of deduction available when a taxpayer has incurred expenditure in relation to aquacultural improvements in the 1995-96 income year and subsequent income years. This formula did not cover all approved types of aquacultural expenditure for which deductions can be claimed, so an amendment has been made to extend the formula to cover all approved types of aquacultural expenditure.

The amendment applies from the 1995-96 income year.

continued on page 26

from page 25

Classes of income derived from New Zealand

Subsection OE 4(1) of the Income Tax Act 1994 [subsection 243(2), Income Tax Act 1976] has been amended by including payments received under the Accident Rehabilitation and Compensation Insurance Act 1992 within the meaning of "income deemed to have been derived in New Zealand".

The amendment applies to payments derived in the 1992/93 income year and subsequent years, to coincide with the original application of the section.

Other minor amendments

Sections 191SA and 191SB of the Income Tax Act 1976, sections EI 14, ME 11, and ME 12 of the Income Tax Act 1994, and section 81(4) of the Tax Administration Act 1994 have section reference corrections.

Sections CG 19, LD 3, NH 5, and OB 1 of the Income Tax Act 1994 have been amended by minor grammatical changes.

Section 5(6C) of the Goods and Services Tax Act 1985 has been amended by the correction of references to a repealed Act.

Inflation adjusted bonds: repeal of tax exemption - section 61(51), Income Tax Act 1976

The tax exemption for inflation adjusted bonds has been repealed.

Section 61(51) of the 1976 Act contained a tax exemption for the interest and inflation premium payable on inflation adjusted bonds. All outstanding bonds were redeemed in 1994, and the Government decided that any new issue of inflation adjusted bonds would be taxable.

Section 61(51) was therefore repealed from 1 April 1995.

Organisational review of Inland Revenue Department

Sections 3, 6, 6A, 6B, 8 to 11, 12 and 13, Tax Administration Act 1994

Introduction

Amendments to the Tax Administration Act 1994 have put into effect recommendations of the Organisational Review of the Inland Revenue Department (Richardson Committee).

The amendments relate to the obligations and responsibilities of Ministers, the Commissioner and officials concerning the collection of taxes and other functions, together with some matters consequential on the reorganisation of Inland Revenue.

Background

In its April 1994 report, the Richardson Committee recommended amendment of the former section 4 of the Inland Revenue Department Act 1974 (since 1 April 1995, section 6 of the Tax Administration Act 1994) to incorporate the following features:

- explicit recognition of the Commissioner's requirement to operate within limited resources in the care and management of all of the functions committed to the charge of the Commissioner
- protection of the integrity of the tax system including a clear definition of what is sought to be protected
- provision for Ministerial directions and their publication.

Three new provisions have been enacted to give effect to the Committee's recommendations.

Key issues

The former section 6 of the Tax Administration Act is repealed. In its place are enacted three new provisions as follows:

Section 6: Ministers' and officials' responsibility to protect integrity of tax system

The new section 6 requires every Minister and every officer of any Government agency who has responsibilities under any Act in relation to the collection of taxes and other functions imposed by the Inland Revenue Acts at all times to use their best endeavours to protect the integrity of the tax system.

The term "integrity of the tax system" is defined inclusively by reference to the following six factors:

- taxpayer perceptions of that integrity
- the rights of taxpayers to have their liability determined fairly, impartially, and according to law
- the rights of taxpayers to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other taxpayers
- the responsibilities of taxpayers to comply with the law
- the responsibilities of those administering the law to maintain the confidentiality of the affairs of taxpayers
- the responsibilities of those administering the law to do so fairly, impartially, and according to law.

These factors are of equal value and are therefore not prioritised. Prioritisation would be inappropriate because the relevance of the various factors will vary according to the particular circumstances of each case where "integrity" is an issue. Further, because the definition is inclusive, regard may be had to other non-prescribed factors relevant in a particular case. An inclusive form of definition is adopted because it is not possible to define all potentially relevant factors.

"Government agency" is defined in section 3 as including any department or Crown entity (as those terms are defined in the Public Finance Act 1989) and any public authority (as defined in the Income Tax Act 1994).

Section 6A: Commissioner of Inland Revenue

The office of Commissioner of Inland Revenue is continued, with the person appointed as chief executive of the Department under the State Sector Act 1988 being designated the Commissioner of Inland Revenue. The Commissioner is charged with the "care and management" of the taxes covered by the Inland Revenue Acts and with such other functions as may be conferred on the Commissioner.

Subsection (3) provides that, in collecting the taxes committed to the Commissioner's charge, and notwithstanding anything in the Inland Revenue Acts, it is the Commissioner's duty to collect over time the highest net revenue that is practicable within the law, having regard to:

- the resources available to the Commissioner
- the importance of promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue acts
- the compliance costs incurred by taxpayers.

The provision consolidates the requirements of the former section 4 of the Inland Revenue Department Act, and those of the State Sector Act 1988 and the Public Finance Act 1989 which impact on the performance of the Commissioner of Inland Revenue's functions.

In broad terms, the new provision confirms what has always applied in practice. That is, the Commissioner has a discretion in managing limited resources as to the best means of obtaining for the Government, from the taxes committed to the Commissioner's charge, the highest net return practicable having regard to resources available and the costs of collection.

In exercising this discretion, the Commissioner must also consider potential impacts on the integrity of the tax system and taxpayer compliance, especially voluntary compliance. The new provision does not extend the current managerial discretion.

Section 6B: Directions to Commissioner

Powers to direct the Commissioner of Inland Revenue in the performance of the functions and obligations of that office exist under the general law and in various enactments. This provision is intended to restate those powers and to clarify their scope by identifying the functions in respect of which Ministers may not direct the Commissioner.

With due regard to the requirements of sections 6 and 6A and the provisions of the State Sector Act 1988 and the Public Finance Act 1989, the Governor-General may by Order in Council issue directions to the Commissioner about the administration of the Inland Revenue Acts.

Such directions may not concern the tax affairs of individual taxpayers or the interpretation of tax law.

Every Order made under this provision must be published in the *Gazette* and be laid before the House of Representatives together with any accompanying statement of the reasons for the order and any advice from the Commissioner about it. An order becomes binding on the Commissioner on the 7th day after the date on which it is made.

Other issues

For the purposes of sections 6, 6A and 6B, "Tax" is defined in section 3 as including any revenue or entitlements covered by the Inland Revenue Acts; and "taxpayer" has a corresponding meaning.

Since enactment of the State Sector Act in 1988, provisions in the Inland Revenue Department Act 1974 establishing the positions of Deputy Commissioners of Inland Revenue, Regional Controllers of Inland Revenue, District Commissioners of Inland Revenue, District Officers of Inland Revenue and "other officers" have been redundant. These provisions are repealed with effect from 10 April 1995.

As a consequence of the repeal of section 10 of the Tax Administration Act, section 12 (2), which provides for an official seal to be held in the custody of each District Commissioner, is repealed.

The rules contained in section 13 concerning the proof of the signatures of the Commissioner of Inland Revenue and certain other officers are also consequentially amended.

Application date

These amendments apply from 10 April 1995.

Returns of non-active companies

Section 43A, Tax Administration Act 1994

Introduction

An amendment has introduced a new section 43A into the Tax Administration Act 1994. It gives non-active companies (which currently must file income tax returns even if they have no income) the opportunity to be relieved from the obligation to file, thereby reducing their compliance costs.

Background

There are a number of companies which are not trading and have no income or assets, but are retained for purposes such as name-protection or to be available as shelf companies. Each year these companies must file income tax returns, imposing compliance costs for no perceivable benefit.

Key issues

Non-active companies are no longer required to file annual income tax and imputation returns.

A company must fulfil certain criteria in order to qualify as a non-active company. These are, that throughout the income year to which the filing relief is to apply, -

- The company has not derived any income.
- It has not disposed of any assets.
- It has not been involved in any transactions which give rise to income, fringe benefits, or debits in the company's imputation credit account or dividend withholding payment account.

In determining whether a company complies with these criteria, no account is to be taken of company filing fees, bank charges or other minimal administration costs totalling not more than $50 in the income year. Minimal bank interest may be earned, to the extent of these administrative costs.

To apply for the exemption a company must complete a declaration, firstly, that it is a non-active company and secondly, that it will inform the Commissioner if it ceases to be so. The company is thereby placed under a statutory obligation to inform the Commissioner if its circumstances change.

Special rules apply when a company has a tax loss or a credit balance in its imputation credit account or dividend withholding payment account, and has been non-active for a period of one or more income years. The loss or credit balance may not be used, unless the company notifies the Commissioner of its intention to do so and satisfies the Commissioner that from the beginning of its non-active period until the time of use the shareholder continuity provisions have not been breeched.

At the time any of the criteria cease to apply to a company it must notify the Commissioner that it is no longer non-active.

If the company had a tax loss or credit balance in its imputation credit account or dividend withholding payment account at the start of its non-active period it must, at the time it returns to active status, inform the Commissioner of any changes of ownership which would affect the shareholder continuity provisions of the Income Tax Act 1994.

Despite the relief this new section contains, the Commissioner can request returns at any time.

Application date

The amendment takes effect from 1 April 1995 and applies to returns due on or after that date.

Provisional tax use of money interest - "spiral effect"

Sections 121 and 122, Tax Administration Act 1994

Introduction

Special timing rules have been introduced to remove the problems associated with reassessments of tax returns when a taxpayer is subject to provisional tax use of money interest.

The problems arose from the fact that from the start of the 1994-95 income year, provisional tax use of money interest became assessable and deductible. Reassessments that changed the amounts of use of money interest could therefore affect tax returns and associated use of money interest calculations in subsequent income years and so on, thus creating a "spiral effect".

Background

Under the current rules, when a taxpayer underpays provisional tax and pays use of money interest to Inland Revenue the interest is deemed by section 121(7)(a) to

be incurred in the income year in which the notice of assessment is issued. This will generally be the year of assessment, that is, the year following the income year to which the assessment relates. When a taxpayer overpays provisional tax and receives use of money interest from Inland Revenue, the interest will be assessable in the income year in which it is paid or credited. There are no special provisions in the provisional tax rules governing the timing of assessability of the interest.

When a tax return is reassessed and the provisional tax use of money interest figures change on reassessment, in the ordinary course of events there will be a flow-on effect to the following year's return in which either the use of money interest deduction was taken or the interest was returned as assessable income. This means that the following year's return would also have to be reassessed, simply because of the change in the provisional tax use of money interest in the previous income year.

Depending on the taxpayer's circumstances, this could have a flow-on effect for returns filed after the following year's return and so on, up to the year in which the reassessment was made. This is the "spiral effect".

The only situation in which use of money interest does not cause this spiral effect is when there has been an increase in use of money interest paid to the taxpayer on provisional tax overpaid. Under these circumstances the normal rules regarding assessability of interest would mean that this additional interest would simply be assessable in the return that covers the period during which the interest was paid or credited.

Key features

When a reassessment is issued, any adjustment for use of money interest payable or receivable will be deductible or assessable in the income year following the year in which the reassessment is issued. This does not apply when use of money interest on overpaid provisional tax is increased.

To avoid unnecessary compliance and administrative costs associated with reassessments when provisional tax use of money interest has changed, special timing rules have been introduced into subsections (9A), (9B) and (9C) of section 121 and subsections (7A), (7B) and (7C) of section 122 of the Tax Administration Act 1994 to alter the time in which any adjustment in use of money interest on reassessment is made.

The new rules allocate a square-up amount, which will be either an amount of income or a deduction, to the income year that follows the income year in which the reassessment was made.

Example

Interest paid to IRD on underpaid provisional tax for 1994/95	$300
[This amount will be a deduction from assessable income in 1995/96]	
Reassessment of 1995 return of income issued in 1997/98 income year, decreasing residual income tax.	
Use of money interest decreased to	$200
Deduction claimed in 1995/96 is now overstated by	$100

A square-up amount of $100 is included as income in the taxpayer's return for the 1998-99 year.

This offsets the taxpayer's interest expense overstated in the 1995-96 return. If the taxpayer received interest from Inland Revenue which had been decreased on reassessment, an offsetting deduction will be allowed in the return for the year following the year of reassessment.

Resident withholding tax (RWT) amounts will not be adjusted. This means that if a taxpayer received provisional tax use of money interest from Inland Revenue and subsequently this is changed to a lesser amount of interest, for which a deduction is permitted in the return of income following the income year in which the amended assessment is issued, the original RWT deduction is unaffected. The RWT credit would have been allowed in the taxpayer's assessment when the interest was originally returned and therefore does not need to be changed.

During the select committee process a further provision was added to ensure that no taxpayer is disadvantaged by application of the provisions discussed above. For example, if a taxpayer's use of money interest has been reassessed upward and the taxpayer dies in between the time the amended assessment is issued and the deduction taken by the taxpayer, the taxpayer's representative will not be able to take advantage of the deduction.

In these circumstances the new rules provide that, upon application by the taxpayer (or the taxpayer's representative), the previous rules that applied in relation to reassessments will apply. That is, the taxpayer will get the benefit of the adjustment as all previous years' returns will be reassessed.

The same situation could also arise for some non-individual taxpayers whose existence is terminated during this intervening period by, for example, liquidation or amalgamation.

Application date

These provisions will apply from the date of assent of the Tax Administration Amendment Act 1995, 10 April 1995.

Provisional tax use of money interest

Section 121(7), Tax Administration Act 1994 / Section 398A(8), Income Tax Act 1976

Introduction

An amendment corrects a drafting oversight in the Income Tax Amendment Act (No.2) 1993 relating to the remission of interest rules that apply to use of money interest charged on underpaid provisional tax. The remission of interest provision in sections 121(7) of the Tax Administration Act 1994 and 398A (8) of the Income Tax Act 1976 has therefore been corrected.

Background

Section 398A(8) replaced the previous section 398A(9), which applied until the end of the 1993-94 income year. However, a drafting error in the Income Tax Amendment Act (No.2) 1993 restricted the application of section 398A(8).

As enacted, section 398A(8) gave the Commissioner the power to remit interest charged on underpaid provisional tax when the law or Commissioner's policy was changed "on or after the 1st [first] day of the month" in which the relevant amount was due.

However, the wording of section 398A(8) should have been the same as its predecessor, section 398A(9). The remission provision in section 398A(9) applied where the law or the Commissioner's policy was changed "on or after the 1st day of the month preceding the month" in which the tax instalment was due.

Key features

The amendments insert the words "preceding that" in each case after the words "1st [first] day of the month" where they occur in paragraphs (a) and (b) of section 121(7) of the Tax Administration Act 1994 and section 398A(8) in the Income Tax Act 1976.

Application date

For the 1976 Act, the amendment applies to tax on income derived in the 1994-95 income year.

For the Tax Administration Act 1994, the amendment applies from date of assent, 10 April 1995.

Family Support/GMFI tax credits and provisional tax use of money interest

Sections 121(12) and 122(10) of the Tax Administration Act 1994

Sections 398A and 413A of the Income Tax Act 1976

Introduction

The provisional tax use of money interest provisions have been amended to ensure the correct treatment is given to Family Support and guaranteed minimum family income (GMFI) end-of-year square-up amounts, and that the treatment is consistent when provisional tax has been either overpaid or underpaid.

Background

The current provisional tax use of money interest rules treat Family Support and GMFI as follows:

- When a taxpayer has underpaid provisional tax, the interest calculation includes Family Support and GMFI end-of-year debits and excludes Family Support and GMFI end-of-year credits (section 121 of the Tax Administration Act 1994 and 398A of the Income Tax Act 1976).
- When a taxpayer has overpaid provisional tax, the interest calculation includes interim instalments of Family Support and GMFI paid to the taxpayer during the income year by either Inland Revenue or the Department of Social Welfare, as opposed to the actual square-up amount (section 122 of the Tax Administration Act 1994 and 413A of the 1976 Act).

The treatment of Family Support and GMFI was inconsistent, both in terms of its treatment in section 121 [398A] and in its treatment between sections 121 [398A] and 122 [413A]. This amendment will ensure consistent treatment of Family Support and GMFI credits and debits in both sections 121 and 122 of the Tax Administration Act 1994 [sections 398A and 413A of the 1976 Act]. Debits and credits will now be taken into account for the purposes of calculating use of money interest.

Key features

Sections 121 and 122 of the Tax Administration Act 1994 [398A and 413A of the 1976 Act] will now both take Family Support and GMFI end-of-year square-up amounts into account for the purposes of calculating provisional tax use of money interest. This has been achieved by inserting a new definition of "Income tax payable" in section 121 [398A] and a new definition of "residual income tax" in section 122 [413A].

Section 121 of the Tax Administration Act 1994 [398A] has been amended by inserting a new definition of "income tax payable" to ensure Family Support and GMFI end-of-year credit amounts, calculated under section KD 4 (2)(d) [374F(2)(e)], are taken into account

in calculating use of money interest. This treats Family Support and GMFI end-of-year credits in the same manner as Family Support and GMFI debits arising under section KD 4 (2)(c) [374F(2)(d)].

Section 122 of the Tax Administration Act 1994 [413A] has likewise been amended to replace the current definition of "residual income tax". The current definition is deficient in that it refers only to interim instalments of Family Support and GMFI received from either the Department of Social Welfare or Inland Revenue. The new definition of residual income tax will ensure that in calculating provisional tax use of money interest under section 122 [413A], FSTC and GMFI will be treated the same as it is under section 121 [398A]. This means that only the end-of-year square-up amounts, not the interim instalment, will be taken into account.

Application date

For the 1976 Act, the amendment applies to tax on income derived in the 1994/95 income year.

For the Tax Administration Act 1994, the amendment applies from date of assent, 10 April 1995.

Zero-rating of going concerns

Sections 2, 11 and 78E, Goods and Services Tax Act 1985

Introduction

An amendment inserts a definition of a going concern into the GST Act and provides that the supplier (vendor) and recipient (purchaser) must agree, in writing, that the supply is of a going concern before the supply can be zero-rated.

If the Commissioner does not accept that the supply was of a going concern and charges GST on the supply, the supplier may recover the GST that the Commissioner has charged if the contract does not provide for any increase in the consideration.

Background

The change gives effect to the Tax Simplification Consultative Committee's recommendation that the term "going concern" be defined.

Problems have arisen in relation to the supply of going concerns when one party to the transaction considers there is a supply of a going concern and the other does not. Despite considerable precedent determined by the Courts, disputes have continued to arise between the two parties to a transaction or between one of the parties and the Commissioner.

The change will reduce compliance costs for registered persons and administration costs for Inland Revenue by ensuring that the nature of the supply is clearly understood by both parties.

Key issues

A supplier and recipient must agree, in writing, that the supply is of a taxable activity (or part of a taxable activity that is capable of separate operation) as a going concern before the supply can be zero-rated.

To be accepted as a "going concern" the following criteria must be met:

- The supplier must have carried on the taxable activity (or part that is capable of separate operation) at the time of supply.
- All of the goods and services that are necessary for the continued operation of the taxable activity (or part that is capable of separate operation) are included in the supply.
- The supplier must continue to carry on the taxable activity (or part that is capable of separate operation) to the time of transfer.

Whether the supply was of a taxable activity (or part that is capable of separate operation) as a going concern will be determined at the time of supply, as this is determined for the purposes of section 9 of the GST Act, not at the time of settlement or transfer.

If the supplier and the recipient have treated the supply as that of a going concern (and therefore zero-rated it) and the Commissioner subsequently charges GST on the supply (and the Commissioner's decision is not overturned by the Courts) the supplier may recover the GST that the Commissioner has charged from the recipient in certain circumstances. These are if:

- The contract does not contain any provision for an increase in the consideration for the supply if the Commissioner is successful in charging GST on the supply, or
- The contract is silent on the issue of any change to the consideration.

The amendment only allows the supplier to recover any GST that the Commissioner is successful in charging. Any other amounts charged by the Commissioner (for example, any additional tax charged for late payment) are not covered by the amendment and is a matter to be resolved between the supplier and the recipient, having regard to the terms of the contract.

Application date

This change applies to contracts entered into on or after the date of assent, 10 April 1995.

GST - minor consequential changes

Sections 2, 5, 9, 10 and 19A, Goods and Services Tax Act 1985

A number of technical adjustments have been made to the Goods and Services Tax Act 1985 as a result of changes to the Public Finance Act 1989.

The definitions in section 2 of "public authority" and "revenue from the Crown" have been changed to ensure consistency in terminology between the Public Finance and GST Acts.

The references to appropriations of public money under Mode A in section 5 have been removed, as the Mode A method of appropriation has been repealed.

Two consequential changes have been made to sections 9 and 10.

The specific provision in section 19A that allowed public authorities to account for GST on a payments basis have been repealed.

The amendments above apply from the date of assent, 10 April 1995.

GST - minor technical amendment - sections 5(6A) and 5(6B), Goods and Services Tax Act 1985

Sections 5(6A) and 5(6B) of the GST Act have been amended to replace references to the Ministry of Transport with references to the Land Transport Safety Authority. The purpose of the amendments is to reflect the fact that the Land Transport Safety Authority is now a separate agency.

The amendments apply from 10 April 1995, the date of assent.

GST and racing

Section 5(8), (9) and 10(12), Goods and Services Tax 1985

Introduction

A number of amendments have been made to the GST Act provisions relating to the imposition of GST on racing. In particular, the amendments relate to:

- deductions made from bets to fund the Marketing Account established by the New Zealand Racing Industry Board to market and promote racing
- the name change of the New Zealand Racing Authority (NZRA) to the New Zealand Racing Industry Board (NZRIB)
- the introduction of fixed-odds betting on races
- renumbering references in the GST Act to the Racing Act 1971 as a result of the enactment of the Racing Amendment Act 1992.

Background

GST is imposed on the aggregate of the various deductions made from bets. In this way the difference between the amount bet and the amount returned to punters as winnings is subject to GST.

The Racing Amendment Act 1992:

- established a racing industry Marketing Account, which is funded by deductions from bets to meet the costs of marketing and promoting racing
- allowed the NZRIB to introduce fixed-odds betting on races
- changed the name of the NZRA to the NZRIB.

Key features

Sections 5(8) and (9) (meaning of term "supply") and 10(12) (value of supply of goods and services) of the GST Act, which provide the mechanism to impose GST on a bet placed on a race, are amended to ensure that:

- Deductions from bets to fund the Marketing Account are taken into account in calculating the amount of GST that is payable.
- The NZRIB is deemed to supply services when any money is placed as a fixed-odds bet registered on any fixed-odds betting system and the amount bet is dealt with in terms of section 99E of the Racing Act 1971. The value of this supply is the consideration in money paid to the NZRIB under section 99E of the Racing Act 1971.
- The reference to the NZRA is replaced with the reference to the NZRIB.
- A number of cross references in the GST Act to provisions in the Racing Act are renumbered to reflect the recent amendments contained in the Racing Amendment Act 1992.

Application date

The amendments which relate to ensuring GST is payable on fixed-odds betting apply to such supplies made on or after the date of assent.

The rest of the amendments apply to supplies made on or after 1 August 1992, to coincide with application date of the Racing Amendment Act 1992. The racing industry has been accounting for GST on deductions to fund the Marketing Account since 1 August 1992. The amendments will give legislative confirmation to the existing situation.

GST and subdivisions

The proposed amendments to section 6 of the GST Act relating to subdivisions were removed following the *Newman* decision in the Court of Appeal, as that decision made the amendment unnecessary.

Inland Revenue will be issuing a policy statement in the near future setting out how we propose to apply the Court of Appeal decision.

Gift duty and community trusts

Section 73(2), Estate and Gift Duties Act 1968

Sections 225C, 225D, 225K and 225L, Local Government Act 1974

Introduction

Transfers from local authorities to certain community trusts have been exempted from gift duty. Provisions of the Local Government Act dealing with these community trusts have also been amended.

Background

The Local Government Act provides that local authorities may establish community trusts from the proceeds of the sale of shares in port companies. In the absence of these amendments, transfers to these trusts would be subject to gift duty.

Key issues

Gift duty

An amendment exempts from gift duty any payment from a local authority to its community trust if the payment is funded from one of these sources:

- proceeds of the sale of port company shares or equity securities
- any of the income or capital gain derived from the sale proceeds, and that income or capital gain is paid to the community trust before a date which will be set by Order in Council.

Local Government Act

The Local Government Act 1974 has also been amended.

A specific provision now ensures that local authorities can transfer to these community trusts both the income and capital gained from the proceeds of the sale of port company shares.

Community trust deeds must include certain matters. There is now a requirement that trust deeds be approved by the Minister of Local Government in consultation with the Minister of Revenue. This will ensure that community trusts' activities conform with the legislation and are not inconsistent with the purposes of the trust. The Local Government Act has also been amended to clarify that each local authority can only establish one such community trust and that its purposes should include all the purposes which are specified in the Act. Community trusts are intended to benefit the whole community.

Application date

These amendments apply from 10 April 1995, the date of Royal assent.

Suspensory loans

Section EH 4, Income Tax Act 1994; section 64F, Income Tax Act 1976

Introduction

Amendments remove any tax liability arising under the accrual rules if suspensory loans paid by specified government agencies are remitted.

Background

Several suspensory loan packages are provided by government agencies for social policy reasons, including the package included in last year's Budget to assist Housing New Zealand tenants to purchase their properties from the Crown.

Under the accrual rules debts waived under suspensory loans are deemed to be assessable income to borrowers and taxable in their hands, thereby reducing the net value of the assistance.

These amendments provide that the intended value of the suspensory loan packages will be maintained by changing the accrual rules to exempt from tax any income that would otherwise arise from the waiver of suspensory loans by specified government agencies.

Key features

A taxpayer who has received a suspensory loan for social policy reasons from a specified government agency will not be required to pay tax when the loan is remitted. These amendments change sections 64F(1) and 64F(7C) of the Income Tax Act 1976 and sections EH 4(7) and (9) of the 1994 Act.

The schedule to the Income Tax (Social Assistance Suspensory Loans) Order 1995 lists three social assistance suspensory loans:

- any suspensory loan made by the Housing New Zealand Corporation under the "Right to Buy" programme
- any suspensory loan made by the Department of Social Welfare under:
  - section 14 or section 16A of the Disabled Persons Community Welfare Act 1975; or
  - Part IX of the War Pensions Regulations 1956

Application date

The amendments apply from the 1985-86 income year, to coincide with the introduction of the accrual rules.

Volume Six, No.12 May 1995

The introduction of the Taxation Reform (Binding Rulings and Other Matters) Bill in December 1994 has resulted in the recent enactment of several Amendment Acts:

- Income Tax Act 1976 Amendment Act 1995 (enacted 31 March 1995)
- Income Tax Act 1994 Amendment Act 1995 (enacted 31 March 1995)
- Income Tax Act 1976 Amendment Act (No.2) 1995 (enacted 10 April 1995)
- Income Tax Act 1994 Amendment Act (No.2) 1995 (enacted 10 April 1995)
- Goods and Services Tax Amendment Act 1995 (enacted 10 April 1995)
- Tax Administration Amendment Act 1995 (enacted 10 April 1995)
- Estate and Gift Duties Amendment Act 1995 (enacted 10 April 1995)
- Local Government Amendment Act 1995 (enacted 10 April 1995)
- Student Loan Scheme Amendment Act 1995 (enacted 10 April 1995)

This Tax Information Bulletin deals with the legislation contained in these Acts.

This TIB has no appendix

Contents

Binding rulings on taxation 1

Nuiean company anti-avoidance rules 6

Tax-free allowances 7

Relief from deemed dividends arising on transfer of property 8

Company law reform
- Dividend definition amended 9
- PAYE on shareholder/employee salaries 10
- Associated persons 10
- Amalgamations 10
- Financial arrangements - treatment on amalgamation 11
- "Private company" reference 12

FBT on vehicles - test period for liable days 12

General insurance - disclosure of non-assessable premiums paid to non-resident insurers 13

Unit trusts - temporary dividend exemption extended 13

Deductibility of expenditure incurred in providing fringe benefits 14

Business entertainment deductibility rules 14

Foreign income - year in which assessable in NZ 19

Family Support tax credits 20

Underlying foreign tax credit rules amended 20

Provisional tax payment relief 21

Shareholder continuity provisions - imputation and dividend withholding payment rules 21

Casual agricultural and election day workers 22

NZ Superannuation and pay-period taxpayers 24

Miscellaneous amendments to the Income Tax Act 25

Minor remedial amendments 25

Inflation adjusted bonds: repeal of tax exemption - section 61(51), Income Tax Act 1976 26

Organisational review of Inland Revenue Department 26

Returns of non-active companies 28

Provisional tax use of money interest - "spiral effect" 28

Provisional tax use of money interest 30

Family Support/GMFI tax credits and provisional tax use of money interest 30

Zero-rating of going concerns 31

GST - minor consequential changes 32

GST - minor technical amendment 32

GST and racing 32

GST and subdivisions 33

Gift duty and community trusts 33

Suspensory loans 34