Value of pooled vehicles for FBT purposes

Introduction

This item sets out how employers should calculate fringe benefit tax (FBT) under section CI 3 and Schedule 2 of the Income Tax Act 1994 for pooled vehicles that they make available for the private use or enjoyment of their employees.

In this item "pool" refers to an employer's pool of vehicles. It does not refer to the pool method of depreciation.

All legislative references in this item are to the Income Tax Act 1994, unless otherwise indicated.

Background

A pooled vehicle arrangement exists when there are a number of motor vehicles available for an employee to use.

A pooled vehicle which is available for the private use or enjoyment of an employee is a fringe benefit. FBT is imposed on the value of the benefit to the employee.

Section CI 3 and Schedule 2 set out the basis on which such a fringe benefit is to be valued.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
CI 3	336O
CI 3 (1)(a)	336O(1)(a)
CI 3 (1)(b)	336O(1)(b)
CI 3 (1)(c)	336O(1)(c)
CI 2 (4)	336N(4)
Schedule 2	Tenth Schedule

Formulae for calculating value of fringe benefit

The formula to be used for calculating the value of the fringe benefit depends on whether an employer returns FBT on a quarterly, annual, or income year basis.

Quarterly basis

If FBT is returned on a quarterly basis, the value of the fringe benefit is calculated using the following formula, set out in section CI 3 (1)(a):

$$\frac{y \times z}{90}$$

where-

y is the lesser of -

(i) The number of days, during the quarter, on which that benefit occurred, reduced by the number of days (if any), during the quarter, in relation to which the motor vehicle is a work related vehicle; or

(ii) 90; and

z is the amount, calculated in accordance with Schedule 2, that in relation to the quarter and to the motor vehicle is the value of the benefit that would be able to be enjoyed by the employee if the employee had unlimited private use or enjoyment of the motor vehicle in that quarter:

Annual basis

If FBT is returned on an annual basis, initially the above formula in section CI 3 (1)(a) is used. Under section CI 3 (1)(b), liability on an annual basis is then calculated by adding the four quarterly amounts for the four quarterly periods that fall within the relevant year.

Income year basis

If FBT is returned on an income year basis, the following formula set out in section CI 3 (1)(c) is used:

$$\frac{y \times z}{365}$$

where:

y is the number of days, in the income year, on which that benefit occurred, reduced by the number of days (if any), in the income year, in relation to which the motor vehicle is a work related vehicle; and

z is the amount, calculated in accordance with Schedule 2, that in relation to the income year and to the motor vehicle is the value of the benefit that would be able to be enjoyed by the employee if the employee had unlimited private use or enjoyment or availability for private use or enjoyment of the motor vehicle in that income year.

Calculating the value of the benefit provided to employees

The value of the fringe benefit provided to employees by making a vehicle available for their private use or enjoyment is calculated by referring to certain factors set out in Schedule 2. The flowchart on page 2 summarises these factors. The value for FBT purposes of such a vehicle is 6% in each quarter (or 24% on an annual or income year basis) of either the cost price or the market value of the vehicle.

Clauses (1)(e)(i)-(iii) of Schedule 2 set out the manner in which pooled vehicles must be valued using either the cost price or market value method. These clauses must be read in conjunction with clauses (1)(a)-(c) of Schedule 2 which set out the circumstances in which the cost price or market value method is to be used.

These factors in Schedule 2 determine the value of a pooled vehicle for FBT purposes:

- whether the employee does or does not primarily use the same vehicle
- whether the employer is in the business of selling cars and the vehicles made available for the private use or enjoyment of employees are trading stock

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- whether the employer owns or leases the vehicle
- whether the employer leases the vehicle from an associated person
- whether any such lease or rental agreement began on or after 23 September 1985.

If the employee primarily uses one particular vehicle in the pool of vehicles, under clause 1(e)(i) either that vehicle's cost price or its market value (as appropriate) must be used.

If the employee does not primarily use one particular vehicle in the pool of vehicles and the employer is not in the business of selling motor vehicles, under clause 1(e)(iii) the employer must use either the highest cost price or highest market value (as appropriate) of all the vehicles used by the employee.

If the employer is in the business of selling motor vehicles and the vehicles available for use by the employee are trading stock, under clause 1(e)(ii) the employer must use the average cost price of all the vehicles that are trading stock and are available for the employee's use.

Cost price or market value

Use of the cost price or the market value of the vehicle depends on whether the employer owns or leases it. If the vehicle is leased, the value that must be used is either the cost price or market value of the vehicle on the date the lease or rental agreement began.

The cost price of the vehicle must be used in either of these situations:

- if the employer owns the vehicle
- if the employer leases or rents the vehicle from an associated person, and the lease or rental agreement began on or after 23 September 1985.

The market value of the vehicle must be used in either of these situations:

- if the employer leases or rents the vehicle, and the lessor is not an associated person
- if the employer leases or rents the vehicle from an associated person and the lease or rental agreement began before 23 September 1985.

Commissioner not satisfied with market value

If the Commissioner is not satisfied with the market value established by the taxpayer, under clause 1(d) of Schedule 2 the Commissioner may establish the market value.

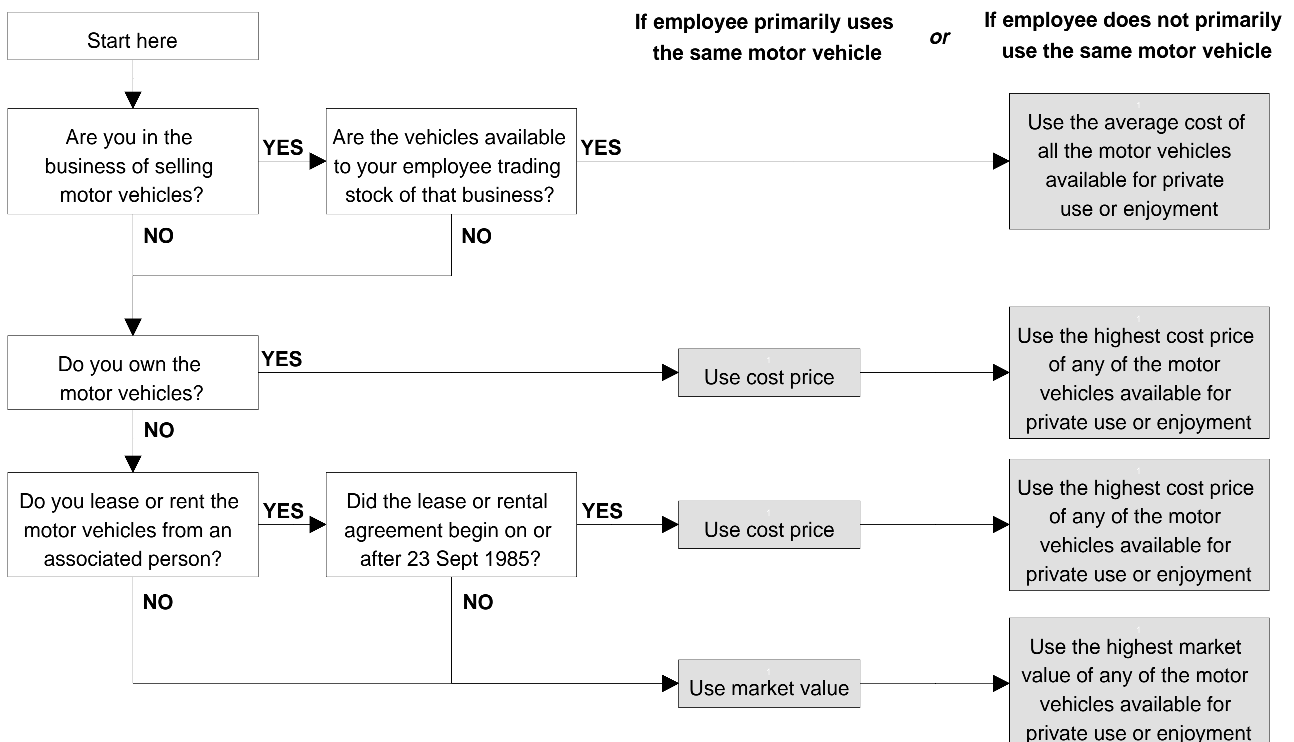
FBT value to include GST

From 1 July 1991, FBT is payable on the GST inclusive cost price or market value of the vehicle.

Multiple drivers

Fringe benefit tax is imposed on the value of the benefit to the employee, unless on any particular day the same motor vehicle is used or available for the private use or enjoyment of more than one employee. In such situations section CI 2 (4) deems that only one fringe benefit has been provided in relation to that vehicle on that day.

The following diagram summarises the requirements of Schedule 2:



Examples

Example 1: employee uses one particular vehicle in the pool of vehicles

Schedule 2 Clause 1(e)(i) applies.

z is 6% (GST inclusive) of the market value or cost price of the vehicle in each quarter or 24% (GST inclusive) on an income year basis.

June is an employee of Bright Lights Limited, and uses a company vehicle that is in a pool of vehicles available for use by all staff. Bright Lights Limited leases all its vehicles from Autolease Limited, a company that is not an associated person of Bright Lights Limited.

June usually uses the same car from the pool of vehicles, and drives that vehicle home each night. She also uses the car at weekends. The taxable value of the fringe benefit to June is based on the market value of the vehicle on the date on which the leasing began.

Assuming the market value of the vehicle on the day the leasing began is $24,000 (GST inclusive), the taxable fringe benefit is calculated as follows:

$$\frac{90^* \times 6\% \text{ of } \$24{,}000}{90} = \$1{,}440$$

* The number of days the vehicle was available for private use

Example 2: employee does not primarily use one particular vehicle in pool

Schedule 2 Clause 1(e)(iii) applies.

z is 6% (GST inclusive) of the highest market value or highest cost price of all the vehicles used by the employee or 24% (GST inclusive) on an income year basis.

Potted Palm Nurseries Limited owns a pool of ten vehicles that are used by its employees when making deliveries of exotic palms to clients. Six of the vehicles are used by four employees for private purposes. The cost price of the vehicles to Potted Palm Nurseries Limited was $18,000, $18,000, $22,000, $24,000, $24,000, and $26,000. In one quarter, the vehicles were available for private use by all the employees for 75 days.

6% of the highest cost price vehicle in the pool = $26,000 x 6% = $1,560

$$\frac{75^* \times \$1{,}560}{90} = \$1{,}300 \times 4 \text{ (no. of employees)} = \$5{,}200$$

* The number of days the vehicle was available for private use

Example 3: employer sells motor vehicles; vehicles available for use are sales stock

Schedule 2 Clause 1(e)(ii) applies.

z is 6% (GST inclusive) of the average cost price of all vehicles that are trading stock and are available for employees' use during a quarter, or 24% (GST inclusive) on an income year basis.

Fast Cars Ltd sells new and secondhand cars. Over 13 weeks, Fast Cars Ltd bought 500 secondhand and 200 new vehicles. Each vehicle was registered and available for sale. Employees were permitted to use the secondhand vehicles for private use and enjoyment, but were expressly forbidden to use the new vehicles. Five salespersons had access to the sales stock, and one clerical employee used a company-owned vehicle that was not sales stock. The secondhand vehicles and company car were available for private use every day of the quarter.

Salespersons

To calculate the taxable value of the fringe benefit to the salespersons, the company should add together the cost price of the 500 secondhand vehicles (say $3,600,000) and divide by 500, being the number of vehicles available in that quarter. The average cost price of each vehicle for fringe benefit tax purposes is $7,200.

6% of the average cost price of a secondhand vehicle in the pool = $7,200 x 6% = $432

$$\frac{90^* \times \$432}{90} = \$432 \text{ for each salesperson}$$

* The number of days the vehicles were available for private use.

The base figure used for the sales stock will vary from quarter to quarter, depending on the cost price of the vehicles coming into the car saleyard and the number available for private use, as the employer is likely to restrict or prohibit the use by employees of the most expensive cars.

In this example, the employer may have restricted the availability of sales stock for private use by the five salespersons to the eight cheapest vehicles. The eight vehicles could sell three times over in a week, so that the number of vehicles available for private use, although only eight in a day, is 24 in a week and 312 in a quarter. Schedule 2 allows one figure to be used in the quarterly value, which under those circumstances would be the aggregated cost of the 312 available vehicles, divided by 312.

Clerical employee

The fringe benefit value for the clerical employee who used the company vehicle that was also available for private use and enjoyment, based on the cost price of the vehicle being, say $25,000, is calculated as follows:

$$\frac{90^* \times 6\% \times \$25{,}000}{90} = \$1{,}500$$

* The number of days the vehicle was available for private use

Time limits for new companies to make QC elections

Summary

This item states the Commissioner's current policy on the time limits for the directors and shareholders of newly-incorporated companies to make qualifying company ("QC") elections. Directors' and shareholders' elections for a newly-incorporated company to become a qualifying company or loss attributing qualifying company ("LAQC") or to make a foreign loss election, can take effect from the beginning of the company's first year. This is provided that Inland Revenue receives the elections within the time allowed for the filing of the company's income tax return for its first income year.

For shelf companies, the Commissioner is prepared to treat certain pre-existing shelf companies which have not traded previously as being newly-incorporated companies. Companies whose returns are subject to extension of time arrangements must have their shareholders' and directors' elections filed with the company's income tax return or before the filing of the return. When there is an extension of time arrangement and a company's returns are filed electronically, there is a concession that the elections which cannot be filed electronically will be treated as being filed with the return if Inland Revenue receives them shortly after the electronic filing. This item also explains the Commissioner's policy on the transitional provisions, and confirms that such elections for newly-formed companies did not have to be filed by 31 March 1993 for the 1992-93 year.

All legislative references in this item are to the Income Tax Act 1994 unless otherwise indicated.

Background

A number of queries have arisen concerning the last date for Inland Revenue to receive director and shareholder elections when a company that has not previously traded seeks to become a QC or an LAQC from the beginning of its first income year. To qualify both shareholders and directors must file notices of election.

In general, elections take effect on the first day of the income year following the income year in which the shareholders and directors made their elections, although they may nominate later income years if they wish. This means that, generally, shareholders and directors must make their elections in the income year before the year in which the company wishes to become a QC. However, there are special legislative provisions for companies that have not previously been required to file tax returns. The queries concern which companies qualify for this "new company" treatment and the time allowed for filing the elections.

Legislation

Cross-reference table

Income Tax Act 1994	**Income Tax Act 1976**
HG 3 (3)	393C(3)
HG 4 (5)	393D(5)
HG 14 (c)(ii)	393N(c)(ii)
HG 17 (2)(b)(ii)	393Q(2)(b)(ii)
Omitted	393S
Tax Administration Act 1994	**Income Tax Act 1976**
36	14A
37	17
43A	(New section - first applies from 1/4/95)
Tax Administration Act 1994	**Inland Revenue Department Act 1974**
40	17A

Shareholders and directors of newly-formed companies can nominate that the company is to be a QC from the first day of the company's first income year. This is provided that Inland Revenue receives the elections within the time allowed under section 37 of the Tax Administration Act 1994 for filing the company's tax return for its first income year.

Regarding director elections, section HG 3 (3) states:

> Notwithstanding subsection (2), any election under this section in relation to any company that has not previously been required to furnish an annual return of income under the Income Tax Act 1976 or the Tax Administration Act 1994 may take effect on the first day of the company's first income year if the notice of election so requests and is received by the Commissioner not later than the time allowed in accordance with section 37 of the Tax Administration Act 1994 for the furnishing of a return of income in respect of that first income year of the company.

Section HG 4 (5) contains a similar provision for shareholder elections:

> Notwithstanding subsection (4)(a), any election under this section in relation to any company that has not previously been required to furnish an annual return of income under the Income Tax Act 1976 or the Tax Administration Act 1994 may take effect on the first day of the company's first income year if the notice of election so requests and is received by the Commissioner not later than the time allowed in accordance with section 37 of the Tax Administration Act for the furnishing of a return of income in respect of that first income year of the company.

Sections HG 14 (c)(ii) and HG 17 (2)(b)(ii), (which deal with LAQC and foreign loss elections respectively) provide that the elections shall take effect for any income year for a company that has not previously had to file a return, if Inland Revenue receives the elections by the time specified in section HG 4 (5) for shareholder elections.

Shelf companies

Shelf companies are companies incorporated by accountants, solicitors, or certain specialist firms. People buy these companies "off the shelf". The purchasers become the shareholders in the company. Taxpayers have asked Inland Revenue whether a shelf company that was purchased in the current income year, but which was incorporated before the current income year, can take advantage of the provisions for elections for newly-formed companies. Taxpayers have suggested that such shelf companies were not liable to file tax returns before their purchase, and the companies would come within the provisions for companies which had not previously been required to file returns of income.

The Commissioner requires shelf companies to file tax returns. From 10 April 1995, this policy is subject to section 43A of the Tax Administration Act, which excuses certain non-active companies from the requirement to file tax returns. In some cases, a shelf company would have had to file a tax return for an income year before the income year in which the application for QC status is made. Strictly speaking, the company will not fulfil the requirements of section HG 3 (3) and HG 4 (5) and the other sections that apply when a company has not previously been required to file a return.

However, the Commissioner will treat such companies as not previously having been required to file a tax return. This concessionary treatment will only apply to shelf companies that have never traded before the current year for which the shareholders and directors wish to make elections. The Commissioner will treat the year that the shelf company is purchased as the company's first income year, provided that it is not an income year earlier than the 1992-93 income year.

Example

Mr and Mrs Jones wished to set up a computer rental business. On 30 June 1994 they purchased a shelf company from their solicitors. Mr and Mrs Jones became the directors, each owning 50% of the shares.

The solicitors had incorporated the company in July 1993 and it had never traded. There was a failure to file the return for the 1993-94 income year.

Mr and Mrs Jones started business almost immediately, and filed directors' and shareholders' elections on 1 August 1994 for the company to be a QC and LAQC. Although the shelf company was a company that had previously been required to file an income tax return, Inland Revenue treated it as a newly-formed company and the Commissioner approved the company's QC and LAQC status from the beginning of the 1994-95 income year.

Last date for elections for newly-formed companies on an agency listing

The QC provisions require directors and shareholders to file their elections for newly-formed companies within the time allowed by section 37 of the Tax Administration Act 1994 for filing a tax return if the election is to take effect on the first day of the company's first income year. Taxpayers have asked what is the last date for filing an election for a newly-formed company which is subject to an extension of time arrangement.

Section 37 of the Tax Administration Act 1994 contains the extension of time provisions for practitioners. Under section 37(4) of the Tax Administration Act 1994 and its predecessor, section 17 of the Income Tax Act 1976, the Commissioner enters into extension of time arrangements. This is to enable accountants to spread their workload. Subject to certain requirements, the following people will qualify for the extension of time arrangements:

- a person who carries on a professional public practice
- a person who carries on any business in which annual returns to be furnished are prepared
- the Maori Trustee
- the nominated officer of a group of companies.

Inland Revenue's Tax Practitioners' Handbook (IR 271) contains the details of these extension of time arrangements. The extension of time arrangements for the 1993-94 year provided the following target dates:

- 45% of clients' returns filed by 23 September 1994
- 65% of clients' returns filed by 18 November 1994
- 82.5% of clients' returns filed by 24 February 1995
- 100% of clients' returns filed by 31 March 1995.

If the return for a newly-formed company is subject to an extension of time arrangement then this extends the time for filing the company's tax return. When there is an extension of time arrangement, provided that Inland Revenue receives the elections by the date that the company's return is filed, the elections for the newly-formed company will be within the time section 37 of the Tax Administration Act 1994 allows for the filing of returns.

Taxpayers have asked if the new company's QC status will apply from the beginning of the company's first income year if Inland Revenue receives the elections by 31 March of the next year, even though the company's tax return was filed before 31 March. For example, for the 1993-94 income year the practitioner may have filed the return by December 1994 to meet the requirement that he or she file 82.5% of returns by 24 February 1995, but then after filing the return, the shareholders and the directors decide in March 1995 that the company should become a QC and the practitioner files the elections by 31 March 1995.

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In the case of a company subject to an extension of time arrangement, elections made after the company's return of income has been filed are not within the time allowed by section 37 of the Tax Administration Act 1994 for the filing of returns. Once the practitioner has filed the returns of income, those returns are no longer within the extension of time arrangements.

It is important to note that if a company's return is filed before 7 July, which is the last day for companies to file their tax returns if there are no extension of time arrangements, the shareholders and directors will still have until 7 July to file any QC elections. This applies whether or not the return is subject to an extension of time arrangement. This is because a company with a standard balance date, according to section 37(1) of the Tax Administration Act 1994, has until 7 July to file its return. (In cases where the company has a late balance date, the date for the filing of the return will differ from 7 July and it will be that date which will apply in place of 7 July.) As a matter of practice, Inland Revenue assumes that in most cases the company will file the elections before or with the return to avoid having to amend the return.

Example

Miss Smith and her sister wish to set up a flower shop. They purchase a shelf company in April 1993. Their accountants advise them that the company should become a QC and LAQC. The Misses Smith agree that this is a good idea. Their accountants had an extension of time arrangement with Inland Revenue. The accountants completed the tax return for the company and attached the QC elections signed by the Misses Smith as the directors and shareholders of the company. The accountants filed the return and the elections on 12 January 1995. The Commissioner approved the company's QC and LAQC status from the beginning of the 1993-94 income year.

Electronically-filed returns when there are extension of time arrangements

Some queries have also arisen about electronic filing of returns when there are extension of time arrangements. Section 40 of the Tax Administration Act 1994 deems a return not to have been duly furnished until the information contained in the return has been transmitted in the prescribed electronic form in accordance with an approval given under section 36 of the Tax Administration Act 1994 and received by an office of Inland Revenue. Inland Revenue will receive the data on the day that the practitioner transmits it, so the return will be furnished on that day. If the practitioner posts the shareholders' and directors' elections at the same time, Inland Revenue will receive the elections some days after the return is deemed to have been received. Technically, Inland Revenue receives these elections after the time allowed to furnish the return.

The Commissioner's policy is that if Inland Revenue receives the notices of election within a reasonable time after the practitioner electronically files the returns, this will be sufficient. Inland Revenue will treat receipt of the elections within six working days of the return being electronically filed as being received at the same time that the practitioner filed the return. If there has been some unforeseen delay, Inland Revenue will consider requests for a further extension of that time.

Elections for newly-formed companies and the 1992-93 transitional year

Taxpayers have asked the Commissioner to explain his policy on newly-formed companies and the 1992-93 income year. There was initially a transitional period when Parliament enacted the QC rules. Section 393S of the Income Tax Act 1976 deemed any election (directors', shareholders', loss attributing, and foreign loss elections) made by 31 March 1993 to take effect from the first day of the 1992-93 income year, unless the notice of election specified a later income year.

The Commissioner did not interpret section 393S of the Income Tax Act 1976 as being a complete code for all 1992-93 elections. The Commissioner did not require that elections for newly-formed companies be received by 31 March 1993 in order for the company to be a QC for that year. Provided that such elections were made within the time allowed in section 17 of the Income Tax Act 1976 for filing returns for the 1992-93 income year, as discussed above, the Commissioner treated the elections as being made in time for the 1992-93 income year for newly-formed companies.

Section 393S was not carried over into the Income Tax Act 1994 because it related to a period before the Income Tax Act 1994 came into effect.

Example

Miss Jones wished to set up a fish processing plant. In July 1992 her solicitor, Mr Legal, incorporated a company for her. To satisfy the requirements of the Companies Act 1955, Mr Legal held one share as a nominee for Miss Jones, with Miss Jones owning the rest of the shares.

Miss Jones decided that the company should become a QC and LAQC. She instructed her accountants and the necessary elections were signed. The accountants had an extension of time arrangement with Inland Revenue.

On 30 November 1993, the accountants filed the return for the company and included the notices of election for QC and LAQC status. The Commissioner approved the company's QC and LAQC status from the beginning of the 1992-93 income year.

Non-residents registering for GST

Summary

This item discusses whether a person who is not a resident of New Zealand (a "non-resident") can register for GST purposes. It concludes that a non-resident who carries on a taxable activity may have to register for GST purposes, depending on the value of supplies made in New Zealand. Alternatively, a non-resident can voluntarily register for GST purposes if he or she carries on a taxable activity or intends to carry on a taxable activity.

Supplies made by a non-resident are deemed to be made in New Zealand in either of these situations:

- if the goods are in New Zealand at the time of supply
- if the services are physically performed in New Zealand by any person who is in New Zealand at the time the services are performed.

However, if the non-resident makes supplies to a registered person for the purposes of carrying on that person's taxable activity, the goods and services are deemed to be supplied outside New Zealand unless the non-resident and the recipient agree otherwise.

A non-resident who is registered (or liable to be registered) for GST purposes must return output tax on all supplies deemed to be made in New Zealand in the course or furtherance of a taxable activity. The non-resident can also claim an input tax deduction on goods and services acquired for the principal purpose of making taxable supplies. A non-resident cannot claim an input tax deduction on goods and services acquired for the principal purpose of making non-taxable supplies.

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

Legislation

Registration

Section 51(1) requires a person to register if both of these conditions are met:

- That person carries on a taxable activity (as defined in section 6).
- The total value of all the person's supplies made in New Zealand in the course of carrying on the taxable activity either exceeds $30,000 in the previous 12 months, or there are reasonable grounds for believing that the value of such supplies will exceed $30,000 in the next 12 months.

A person is not required to register if the value of supplies exceeds $30,000 solely as a consequence of either of these events:

- any cessation of the person's taxable activity, or any substantial and permanent reduction in its size or scale
- the replacement of any plant or other capital asset used in the person's taxable activity.

A person can register voluntarily under section 51(3) even when the value of supplies is less than $30,000, if that person carries on, or intends to carry on from a specified date, a taxable activity.

Taxable supplies

Section 8(1) imposes GST on the supply (other than an exempt supply) in New Zealand of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person. Section 2(1) defines a "registered person" to mean a person who is registered or is liable to be registered.

Supplies made in New Zealand

The general rule under section 8(2) is that goods and services are deemed to be supplied in New Zealand if the supplier is resident in New Zealand. Goods are deemed to be supplied outside New Zealand if the supplier is not resident in New Zealand. Whether a person is resident in New Zealand depends on whether the person falls within the definition of "resident" contained in section 2(1). The definition of "resident" was discussed in TIB Volume Five, No. 12 (May 1994) on page 4.

Despite the above general rule, in some circumstances supplies made by a non-resident are deemed to be made in New Zealand. Paragraph (a) of the proviso to section 8(2) states:

> Goods and services shall be deemed to be supplied in New Zealand if the supplier is not resident in New Zealand and either -
>
> (i) The goods are in New Zealand at the time of supply; or
>
> (ii) The services are physically performed in New Zealand by any person who is in New Zealand at the time the services are performed.

There is an exception to the above rule. This occurs when the goods and services are supplied to a registered person for the purposes of carrying on that registered person's taxable activity. In this case, paragraph (b) of section 8(2) states:

> Where goods and services that are deemed to be supplied in New Zealand pursuant to paragraph (a) of this proviso are supplied to a registered person for the purposes of carrying on that person's taxable activity, those goods and services shall be deemed to be supplied outside New Zealand unless the supplier and the recipient agree that this paragraph shall not apply to that supply.

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Application to non-residents

Registration

A non-resident who carries on a taxable activity may be required to register for GST purposes. A non-resident must register if the total value of the supplies made in New Zealand in the previous 12 months exceeds $30,000. A non-resident must also register if there are reasonable grounds for believing that he or she will make supplies in New Zealand exceeding $30,000 in total value in the next 12 months. However, a non-resident does not have to register if his or her supplies exceed (or will exceed) $30,000 solely as a consequence of either of these events:

- any cessation of the non-resident's taxable activity, or any substantial and permanent reduction in its size
- the replacement of any plant or other capital asset used in the non-resident's taxable activity.

If a non-resident has not made, or does not expect to make, supplies in excess of $30,000, he or she can still register voluntarily under section 51(3) when a taxable activity is carried on, or intended to be carried on from a specified date. The taxable activity may be carried on inside or outside New Zealand.

When supplies by non-resident are made in New Zealand

Supplies made by a non-resident are deemed to be supplied in New Zealand in either of these situations:

- The goods are in New Zealand at the time of supply.
- The services are physically performed in New Zealand by any person who is in New Zealand at the time the services are performed.

However, if the above deemed supplies are made by the non-resident to a registered person for the purposes of carrying on that registered person's taxable activity, the supplies are deemed to be made outside New Zealand unless the non-resident and the registered person agree otherwise.

Consequences of non-resident being registered and making supplies in New Zealand

A non-resident who is registered (or liable to be registered) must account for GST on the supply of goods and services in New Zealand in the course or furtherance of a taxable activity (unless the supplies are exempt supplies). The non-resident will need to return output tax on the supplies.

The non-resident will also be able to claim input tax deductions. However, this is only to the extent that the person acquires goods and services for the principal purpose of making taxable supplies (i.e. those supplies subject to GST at the rate of 12.5 percent under section 8(1) or zero percent under section 11). The non-resident cannot claim input tax deductions on goods and services acquired for the principal purpose of making non-taxable supplies.

Example 1

Mrs Lee is a non-resident who carries on the taxable activity of supplying architectural services. Mrs Lee comes to New Zealand to provide services to Construction Company Ltd ("CCL"). CCL carries on a taxable activity as a building business and is registered for GST purposes. Mrs Lee does not expect to make supplies exceeding $30,000 in value but voluntarily registers for GST. Mrs Lee and CCL do not agree that her services are supplied in New Zealand.

Because the services are supplied in New Zealand to a registered person for the purposes of carrying on that person's taxable activity, the services are deemed to be supplied outside New Zealand and are not subject to GST unless Mrs Lee and CCL agree otherwise. Mrs Lee and CCL have not agreed otherwise so Mrs Lee is not required to return output tax on the services supplied. Mrs Lee cannot claim input tax deductions on goods and services purchased while she is in New Zealand, because the goods and services will not be acquired for the principal purpose of making taxable supplies.

Example 2

Wool Company Ltd ("WCL") is a non-resident carrying on a taxable activity as a wool distributor. A representative of WCL visits New Zealand and buys wool from NZ suppliers (who are registered for GST). WCL stores this wool in a NZ warehouse and then sends it back to WCL's country of residence.

While WCL could voluntarily register for GST purposes because it is carrying on a taxable activity, it is not making any taxable supplies in New Zealand. WCL cannot claim input tax deductions on the wool bought from the New Zealand suppliers because the wool is not acquired for the principal purpose of making taxable supplies.

FBT - prescribed interest rate increased to 11.0%

The prescribed rate of interest used to calculate the fringe benefit value of low interest employment-related loans has been increased to 11.0% for the quarter starting on 1 April 1995. This rate will also apply to all subsequent quarters unless it requires further revision. The new rate reflects increased market interest rates.

The prescribed rate was previously 9.2% for the quarter starting on 1 January 1995.

1993 IR 6 income tax return guide - error regarding LAQC losses

Summary

The 1993 IR 6 income tax return guide contained an error at Note 17. It states that when the estate/trust is a shareholder in a loss attributing qualifying company ("LAQC") and any attributed loss cannot be offset in the estate/trust return, the loss must be allocated to the beneficiaries.

This was an incorrect statement of the law. There is no mechanism under the LAQC rules, nor under the Income Tax Act 1976 generally or in law, for the allocation of losses to beneficiaries. A share of any attributed losses resulting from the ownership of shares in an LAQC by a trustee of any estate or trust must be allocated to the trustee. Such losses are then available for offset against other income of the estate or trust.

If an estate or trust has filed an incorrect IR 6 return on the basis of Note 17, it should now request a reassessment. This may also affect the beneficiaries' IR 3 returns if they have incorrectly claimed an attributed loss as if they were a shareholder in an LAQC.

It is the Commissioner's view that although there is no mechanism for the allocation of losses to beneficiaries, an exception exists when LAQC shares are held on bare trust. In this situation, any attributed losses resulting from the ownership of those shares can be allocated to the beneficial owner under the bare trust.

Note 17 of the 1994 IR 6 guide now reflects the correct allocation of LAQC losses.

Background

Trustees of estates and trusts must file IR 6 income tax returns. The IR 6 income tax return guide explains each section of the IR 6 return. Each note corresponds to a section of the return.

Section 17 of the 1993 IR 6 return asks: Can the estate/trust claim a loss from a loss attributing qualifying company? Note 17 of the 1993 IR 6 guide included the following paragraph:

> Where the Attributed loss cannot be offset in the Estate/Trust return it must be allocated to the beneficiaries. If the Estate/Trust cannot offset any losses in 1993, write zeros (0.00) in Box 17B.

Policy

Error

Note 17 of the 1993 IR 6 income tax return guide is an incorrect statement of the law in so far as it directs trustees of estates and trusts to allocate losses from shares they hold in LAQCs to beneficiaries. There is no mechanism under the LAQC rules, nor under the Act generally or in law, for the allocation of losses to beneficiaries. A share of any attributed losses resulting from the ownership of shares in an LAQC by a trustee of any estate or trust must be allocated to the trustee. Such losses are then available for offset against other income of the estate or trust, either in that income year, or by carrying forward to later years to the extent that the losses have not been offset in that year.

Note 17 of the 1994 IR 6 guide now reflects the correct position as regards the allocation of LAQC losses.

As a result of the error in Note 17 of the 1993 IR 6 guide, some IR 6 returns filed for the income years ended 31 March 1993 and 31 March 1994 may have incorrectly allocated attributed LAQC losses to beneficiaries. It is also possible that some beneficiaries may have filed incorrect IR 3 returns for the income years ended 31 March 1993 and 31 March 1994 by claiming attributed losses from LAQCs, as if they were shareholders in such companies.

If incorrect 1993 and 1994 returns have been filed, the relevant taxpayers should now make a written request for a reassessment. No penalty or additional tax will be imposed, provided that a request for a reassessment is made.

Bare trusts

It is the Commissioner's view that although there is no mechanism for the allocation of losses to beneficiaries, an exception is made in the case of bare trusts. When shares in an LAQC are held on bare trust, any attributed losses resulting from the ownership of such shares can be allocated to the beneficial owner under the bare trust.

For the purposes of the LAQC rules, a bare trust occurs when shares in an LAQC are registered in the name of one person who holds those shares on bare trust for another person, the beneficial owner. In such a situation the trustee:

- has no active duties to perform in respect of those shares
- possesses all rights and powers resulting from the legal ownership of those shares on behalf of the beneficial owner
- must exercise or refrain from exercising those rights and powers at the direction of the beneficial owner.

Any attributed losses resulting from the ownership of shares in an LAQC by a trustee of a bare trust can be allocated to the beneficiary. Such losses are then available for offset against the beneficiary's other income.

In every case the onus is on the party wishing to file a return for a bare trust to substantiate its existence and terms.

Deductibility of FBT when FBT period spans employer's balance date

Summary

When a fringe benefit period spans an employer's balance date, fringe benefit tax ("FBT") which relates to benefits provided to employees in the earlier income year, is deductible in the earlier income year, although the employer does not pay the FBT until the subsequent income year.

All legislative references in this item are to the Income Tax Act 1994 unless otherwise indicated.

Legislation

Cross-reference table

Income Tax Act 1994	**Income Tax Act 1976**
ED 2	140AA(1)
ND 2	336T
ND 3 (1) - (6)	336TA
ND 4 (1) - (6), (8)	336TB
Tax Administration Act 1994	**Income Tax Act 1976**
123(1) - (4)	336TC

FBT is generally payable in New Zealand on a quarterly basis (the quarters end on 31 March, 30 June, 30 September, and 31 December respectively). Section ND 2 requires most employers to file the appropriate FBT return and pay the FBT within 20 days of the end of each quarter.

Section ND 3 sets out the circumstances in which an employer may elect to pay fringe benefit tax on an annual basis for employees (who are not shareholder-employees). An employer who has made such an election must file the appropriate FBT return and pay the FBT by the 31 May following the end of the income year.

Section ND 4 sets out the circumstances in which an employer may elect to pay fringe benefit tax on an income year basis for shareholder-employees. An employer who has made such an election must file the appropriate FBT return and pay the FBT by terminal tax date for each income year.

Section ED 2 sets out the rule for determining the year in which FBT is deductible. Section ED 2 was formerly section 140AA(1) of the Income Tax Act 1976, which was inserted into that Act by the Income Tax Amendment Act 1989, with application to benefits provided after 1 April 1989.

Section ED 2 provides:

For the purposes of calculating the assessable income derived in any income year by any taxpayer, any amount of fringe benefit tax that becomes due and payable by the taxpayer in respect of fringe benefits provided or granted in that income year shall be deemed to be expenditure incurred by the taxpayer in that income year and in no other income year, and the deduction (if any) allowable in respect of the fringe benefit tax under section BB 7 shall be computed accordingly.

How the legislation applies

The effect of section ED 2 is that FBT is deductible in the income year that the employer provides or grants the benefit that gives rise to the tax. This will not necessarily be the same income year as the income year in which the employer pays the FBT. A company that pays FBT on a quarterly basis and has a non-standard balance date may have an FBT quarter spanning two income years. The FBT on benefits provided by the company before the end of the earlier income year is deductible in that earlier income year. The FBT on benefits provided in the later income year is deductible in that later income year.

When an employer pays FBT on an annual or income year basis, FBT is deductible in the income year in which the employer provides the benefits to which the FBT relates (even if the FBT is not paid on that benefit until the next income year).

Interest on FBT paid on an annual or income year basis is fully deductible for income tax purposes as provided for by section 123 of the Tax Administration Act 1994. Interest on FBT is deductible in the same year or years and to the same extent that the FBT to which that interest relates is deductible under section ED 2.

Example 1

S Ltd has a standard balance date of 31 March and pays FBT on a quarterly basis. S Ltd provides fringe benefits to its employees during the FBT period 1 January 1994 - 31 March 1994. The FBT on those benefits is due and payable on 20 April 1994 (20 days after the end of the March FBT quarter).

The FBT in this case is deductible in the 1994 income year as this is the income year in which S Ltd provides the benefits, rather than in the 1995 income year when the tax is due and payable.

Example 2

L Ltd has a non-standard balance date of 31 May and pays FBT on a quarterly basis. L Ltd provides fringe benefits to its employees during the FBT period 1 April 1994 - 30 June 1994. Because of the company's non-standard balance date the FBT quarter spans two income years. The company pays FBT for the June quarter on 20 July 1994.

L Ltd can deduct the FBT on benefits that it provides to employees before the end of the 1994 income year in the 1994 income year (year ending 31 May 1994).

L Ltd can deduct the FBT on benefits that it provides after 31 May 1994 in the 1995 income year (year ending 31 May 1995).

Example 3

C Ltd has a standard balance date and pays FBT on an annual basis. C Ltd provides fringe benefits to its employees during the income year 1 April 1994 - 31 March 1995. C Ltd pays FBT for this annual period on 31 May 1995.

The FBT is deductible in the 1995 income year (year ending 31 March 1995) as this is when the benefits are provided, rather than in the 1996 income year when the FBT is paid.

Deductibility of fines and levies paid by hotel licensees

Summary

This item states the Commissioner's current policy on the deductibility of fines and levies paid by licensees. Neither fines nor legal expenses incurred by licensees for breaches of the Sale of Liquor Act 1989 are deductible. Fines incurred by employees of licensees and paid by the licensee are deductible. Legal and other expenses incurred in giving evidence before the Liquor Licensing Authority are deductible, provided they are not incurred in an application for a new licence as this is a capital expense. Levies payable to the Hotel Association of New Zealand are deductible.

All legislative references in this item are to the Income Tax Act 1994 unless otherwise indicated.

Background

This item updates Inland Revenue's policy by referring to the new bodies and legislation governing the sale of liquor since the enactment of the Sale of Liquor Act 1989. The substantive policy is unchanged.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
BB 7	104

Section BB 7 is a general provision allowing deductions for tax purposes. It states:

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

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

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

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

Policy

Fines and legal costs

The Sale of Liquor Act imposes fines for various offences such as the sale or supply of liquor to minors. No deduction is permitted for any fines and legal costs incurred by a licensee for offences under the Sale of Liquor Act. This is because the fine is imposed on the offender as a personal deterrent and a punishment, and is not within section BB 7. This was the view taken in cases such as the High Court decision of *Robinson v CIR* [1965] NZLR 246. It was held that a fine imposed on a legal practitioner by the Disciplinary Committee of the New Zealand Law Society was in the nature of a punishment imposed on the practitioner personally, rather than a loss incurred in the practice of his profession.

However, the Commissioner does permit a deduction when the employer pays a fine incurred by an employee for a breach of the Sale of Liquor Act committed by the employee while carrying out employment duties.

A deduction is permitted for legal expenses and other expenditure incurred in appearing before the Liquor Licensing Authority or a District Licensing Agency, provided that the expenditure does not relate to the granting of a new licence as this is a capital item.

Levies paid to the Hotel Association of New Zealand

Levies payable to the Hotel Association of New Zealand are deductible. These levies are collected from licensees by means of a percentage added to invoices for stocks purchased by the licensees. The Commissioner treats these levies as deductible under section BB 7 as necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income for any income year.

National standard costs for specified livestock - 1995

Under the authority of section EL 4 (1) of the Income Tax Act 1994 (section 86C (1) of the Income Tax Act 1976), the Governor-General has declared the national standard costs for specified livestock for the year starting on 1 April 1994.

The costs allow farmers to value their livestock under the national standard cost option for the 1994-95 income tax year. Farmers using the scheme apply the national standard costs to stock bred on the farm or on hand at the beginning of the year, while stock purchased is valued at its purchase price. The average of these costs is applied to the stock on hand at year's end to derive the closing value of livestock on hand.

In announcing the values the Minister of Revenue, Hon Wyatt Creech, said values had increased for all livestock types other than pigs, reflecting improving farm incomes being channelled back into repairs and maintenance, fertiliser, and feed. The additional money spent on these items increased the average cost for livestock bred and reared on the farm. The increases for the 1995 national standard costs predominantly resulted from increased inputs, not from inflationary increases in farm costs.

The national standard cost for rising one-year dairy cattle has increased by a greater percentage than the costs for other classes of livestock. The increase is due partly to improved statistical information. The average number of calves reared to weaning age on dairy farms has now been found to be less than estimates made in previous years, thereby increasing the average per head cost of production. This is a one-off adjustment, correcting under-costings in 1993 and 1994. About half of the 1995 increase results from increased farm inputs on dairy farms in response to favourable market conditions for dairy products.

The Minister went on to say that the national average market values of livestock, which farmers use to value livestock under the herd scheme, will be released in May this year after a national survey of market values taken at 30 April.

The national standard costs for the 1994/95 income year are listed in the following table.

Type of	Category of Livestock	National Livestock Standard Cost $
Sheep	Rising 1 year	16.10
	Rising 2 year	9.10
Dairy Cattle	Purchased	
	bobby calves	142.00
	Rising 1 year	397.00
	Rising 2 year	68.70
Beef Cattle	Rising 1 year	131.00
	Rising 2 year	76.40
	Rising 3 year male	
	non-breeding cattle (all breeds)	76.40
Deer	Rising 1 year	38.50
	Rising 2 year	19.70
Meat and Fibre Goats	Rising 1 year	12.10
	Rising 2 year	7.30
Dairy Goats	Rising 1 year	79.20
	Rising 2 year	12.40
Pigs	Weaners to 10 weeks of age	75.00
	Growing pigs 10 to 17 weeks of age	55.20

Depreciation - metal speed humps

The Commissioner has issued Determination PROV3: Tax Depreciation Rates Provisional Determination Rates Provisional Determination Number 3, which applies to metal speed humps. It is reproduced below.

Determination PROV3: Tax Depreciation Rates Provisional Determination Number 3

This determination may be cited as "Determination PROV3; Tax Depreciation Rates Provisional Determination Number 3".

1. Application

This determination shall apply from the 1994/95 and subsequent income years to metal speed humps acquired on or after 1 April 1993.

2. Determination

Under the provisions of section EG 10 of the Income Tax Act 1994, I have determined the following provisional basic economic rate:

Determination DEP1 (as amended) is amended by inserting in the asset categories Building Fitout and Transportation, the additional class set "Metal Speed Humps" with the following details:

Estimated Useful Life	5 years
DV Banded Depn Rate (%)	33
SL Equiv Banded Depn Rate (%)	24

3. Interpretation

In this determination, unless the context otherwise requires, expressions have the same meaning as in section OB 1 of the Income Tax Act 1994.

This determination is signed by me on the 2nd day of May 1995.

Philippa Kerr
Manager (Rulings)
Head Office
Inland Revenue Department

Details inadvertently omitted when completing IR 10 form

In Tax Information Bulletin Volume Five, No.3 (September 1993) we outlined Inland Revenue's policy on the IR 10 and section 25 of the Income Tax Act 1976 (now section 108 of the Tax Administration Act 1994). Some taxpayers have expressed concerns on this subject, so this item further clarifies our policy.

We confirm the existing policy as set out in TIB Volume Five, No.3. However, the situation could arise in which information that is included in the financial statements and which should be included in the IR 10 may be omitted from the IR 10 in error. This may occur in an E-Filed return or in a return filed manually.

Our policy in these cases is that if an audit reveals such a situation this omission in itself would not be grounds to reopen a statute barred back year assessment under section 108(2) of the Tax Administration Act 1994 (section 25(2) of the Income Tax Act 1976) unless there is conclusive evidence that the omission from the IR 10 was part of a scheme to fraudulently or wilfully mislead the Commissioner.

Provisional tax use of money interest rates increased

The new provisional tax use of money interest rates have been increased for the 1995-96 income year.

The Income Tax (Provisional Tax Interest Rates) Regulations 1995 increased the provisional tax use of money interest on underpayments to 14.2 percent and the rate on overpayments to 8.5 percent. These new rates reflect the increase in domestic interest rates.

The interest rates set by the new regulations apply to all provisional tax underpayments and overpayments for the 1995-96 income year. The previous rates of 9 percent for underpayments and 4.5 percent for overpayments continue to apply for the 1994-95 income year.

As with the rates that applied for the 1994-95 income year, the new rates continue to be assessable and deductible. The 1993-94 rate (flat rate of 6 percent on both underpayments and overpayments) was non-assessable and non-deductible.

Questions we've been asked

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

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

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Income Tax Act 1994

Income tax treatment of tips

Section BB 4 (b) (section 65(2)(b) of the Income Tax Act 1976) - Assessable income: A taxpayer has asked whether tips are taxable and, if so, how they are taxed.

Section BB 4 (b) deems all monetary remuneration received by a taxpayer to be included in that person's assessable income. Section OB 1 (section 2 of the Income Tax Act 1976) defines "monetary remuneration" to include gratuities received in respect of or in relation to the employment or service of the taxpayer.

For a tip or gratuity to be included in assessable income, it must have been received by the taxpayer in recognition of employment or service provided by the taxpayer. It does not have to have been paid by the taxpayer's employer.

The method of taxing gratuities differs, depending on the manner in which they were received by the taxpayer. Gratuities paid directly by a customer to the taxpayer or placed in a common pool for the benefit of a number of employees should be returned in the taxpayer's annual tax return. Gratuities paid by way of a service charge added to the customer's bill and later paid by the employer to the taxpayer are source deduction payments. Employers must deduct PAYE on such payments made to employees.

Employer paying wages into employee's personal account with an organisation

Section BB 4 (b) (section 65(2)(b), Income Tax Act 1976) - Monetary remuneration: A racehorse owner proposes paying $150 cash each week into his stable-hand's account at a betting agency, instead of going through the formalities of paying wages by cheque or to a bank account and deducting and paying PAYE to Inland Revenue.

The stable-hand has other employment elsewhere, but works for the racehorse owner for a minimum of 20 hours per week. Under the rules of the betting agency account, the stable-hand would be free to place bets with that money and/or make cash withdrawals. The racehorse owner will not be paying the employee any other remuneration in the form of wages.

The racehorse owner has asked for confirmation that he is not required to deduct PAYE from the payments.

Under section BB 4 (b), "monetary remuneration" is assessable for income tax purposes. Monetary remuneration is defined in section OB 1 (section 2, Income Tax Act 1976) as:

> ...any salary, wage, allowance, bonus, gratuity, extra salary, compensation for loss of office or employment, emolument (of whatever kind), or other benefit in money, in respect of or in relation to the employment or service of the taxpayer; and includes any expenditure on account of an employee; but does not include any employer superannuation contribution.

The $150 payment into the employee's betting agency account is considered to be monetary remuneration. Accordingly, it is assessable for income tax purposes.

Under section NC 2 (1) (section 338(1), Income Tax Act 1976), an employer must deduct PAYE from any "source deduction payment" made to an employee.

A "source deduction payment" is defined in section OB 2 (1) as:

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

"Salary or wages" is defined in section OB 1 and includes:

> ...all sums received or receivable by way of overtime pay, bonus, gratuity, extra salary, commission, or other remuneration of any kind, in respect of or in relation to the employment of that person....

Under section NC 3 (section 339, Income Tax Act 1976), when a source deduction, though not actually paid, is credited to or applied on account of any employee entitled to it, the amount is deemed to be paid and PAYE must be deducted accordingly.

The racehorse owner must meet the usual tax obligations of an employer, including deducting PAYE and paying it to Inland Revenue.

Telephone rental deductions for sharemilkers

Section BB 7 (section 104, Income Tax Act 1976) - Expenditure or loss incurred in production of assessable income: A sharemilker has read the item "Telephone rental deductions for businesses based at home" in TIB Volume Five, No.12 (May 1994), and noted the 100% deduction obtainable by farmers. She has asked if, for the purposes of this item, she is classed as a farmer.

Inland Revenue accepts that the following are activities carried on for farming or agricultural purposes:

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- agriculture - soil cultivation, cropping, animal husbandry (including sharemilking)
- horticulture - growing plants, shrubs, or flowers
- orcharding - growing fruit
- viticulture - growing grapes
- apiculture - beekeeping
- poultry farming - keeping poultry
- aquaculture - rock oyster farming, mussel farming, scallop farming, sea-cage salmon farming, freshwater fish farming.

Activities outside the definition of farming are:

- growing trees for the production of timber (silviculture)
- businesses providing services to persons who are carrying on a farming or agricultural business, e.g. seed dressing, coolstores, agricultural contracting, aerial topdressing
- dealing in livestock
- bailment or leasing of livestock.

Taxpayers whose principal or full-time occupation is farming (or agricultural) will be allowed to claim a deduction of 100% of their telephone rental.

Any taxpayer who considers that his or her business is of a farming or agriculture nature, but is not listed above, should contact the local Inland Revenue office for confirmation of the status of the activity.

Lump sum payment to building owner for surrender of lease

Section BB 8 (section 106(1)(a), Income Tax Act 1976) - Certain deductions not permitted: A taxpayer leased a large building in Auckland on a 20-year lease. The building held machinery which was used in her business. Ten years into the lease term the taxpayer no longer required the building, so she entered into an agreement with the building owner to surrender the lease. As the lease had 10 years to run, the taxpayer made a lump sum payment of $200,000 to surrender it. She has asked if she can deduct the $200,000 as an expense against her assessable income.

Section BB 7 allows a deduction for any expenditure or loss which is incurred in gaining or producing assessable income, or is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. However, section BB 8 (a) prohibits a deduction for expenditure incurred which is capital expenditure.

In this case, the lease itself was a capital asset of the taxpayer, and its surrender was the cost of disposing of a capital item. The $200,000 payment was capital expenditure and not deductible to the taxpayer. This point derives support from *CIR v McKenzies NZ Ltd* (1988) 10 NZTC 5,233. However, if the $200,000 bore a relationship to the present value of the future payments, the payment may be deductible.

In certain cases a lease could represent an asset on revenue account (for example, if a taxpayer trades in leases). In such cases, the cost of surrender would be a deductible expense.

Audio recording of logbook details

Section DH 3 (section 106D, Income Tax Act 1976) - Use of logbook to establish business use proportion of motor vehicle: A taxpayer has asked whether it is acceptable to Inland Revenue for her to use a dictaphone to record business use of a motor vehicle, with the information being transcribed into a logbook at a later date.

Section DH 3 (1) states:

Subject to this section, where a taxpayer maintains in relation to any motor vehicle -

(a) A logbook that complies with the requirement of subsection (2); and

(b) A record of the total distance travelled during every income year or part of an income year that falls within the logbook application period determined in relation to the logbook under subsection (3), -

the details of the logbook and record so maintained shall be used for the purposes of section DH 1 (3) to calculate the business use proportion of the motor vehicle in respect of any income year or part of an income year that falls within that logbook application period.

For more information about logbook-keeping when a vehicle is used for both business and private purposes, see the item on this subject on page 10 of TIB Volume Six, No.3 (September 1994).

There is nothing within the Act that sets out how the information required in the logbook is to be recorded. If the taxpayer finds it is easier in the first instance to record on a dictaphone the business mileage covered, this will be acceptable to Inland Revenue, provided the information in the logbook complies with section DH 3, and the information is transcribed to the logbook.

Any taxpayer electing to record information on a dictaphone will need to safeguard the tape against loss or damage until its contents are transcribed to the logbook, because without this information claims could be jeopardised.

Valuation of trading stock acquired for less than independent valuation

Section EE 1 (section 85, Income Tax Act 1976) - Valuation of trading stock, including livestock: A private company was forced to sell its business assets to avoid receivership. The company's trading stock was purchased for $38,000 by a person who is not associated with the company. This purchaser obtained an independent valuation of the trading stock at the time of settlement which showed it to be worth $60,000. He has asked if he may adopt the valuation figure of $60,000 in his accounts.

Section FB 4 (section 90, Income Tax Act 1976) enables the Commissioner to make a determination of the value of trading stock if he is not satisfied with the apportionment accredited to trading stock in the sale and purchase agreement. Section GD 1 (section 91, Income Tax Act 1976) also allows the Commissioner to value the trading stock when a person makes a distribution of trading stock to any other person for nil or inadequate consideration.

When trading stock is purchased from an unrelated party, the price specified in the sale contract is deemed to be the consideration received or receivable for the trading stock.

The value of the purchased trading stock that the purchaser must adopt in his accounts is the cost price of $38,000. However, under section EE 1 (3), he may value his closing trading stock at: the cost price, the market selling value, or the replacement price.

Family Support entitlement when leaving NZ part-way through year

Section KD 2 (Section 374D of the Income Tax Act 1976) - Family Support credit of tax: A single parent is the principal caregiver for his son. The parent was resident and present in New Zealand for five years before getting a job transfer to Australia. He is leaving New Zealand permanently part-way through the 1995-96 income year with his son, and has asked how he should calculate his Family Support entitlement.

Family Support is not calculated on an annual basis. Instead, the year is divided into specified periods according to a person's circumstances, and his or her entitlement is then calculated separately for each period. Section KD 2 (1) sets out a single person's Family Support entitlement for each specified period.

A new specified period starts on each of these dates:

- the first day of the person's income year
- any day on which the person starts or stops being the principal caregiver of any dependent child (for example, when a child starts or stops living with that parent)
- any day on which a child starts or stops being a dependent child for which that person is the principal caregiver (for example, when a child is born or becomes financially independent)

A person's income year can consist of several specified periods, or it can be a single specified period (if none of the above events occur).

The parent in this case will be entitled to Family Support for his son for the period during which they live in New Zealand. His entitlement will be calculated as follows:

- The parent's income for the period he is in New Zealand will be "grossed up" to work out what it would be for a full year.
- The Family Support entitlement will be worked out based on this grossed up income.
- This entitlement will then be "grossed down" according to the number of days that the parent is in New Zealand.

Resident withholding tax deduction when interest less than $1

Section NF 2 (section 327C, Income Tax Act 1976) - Deduction of resident withholding tax: A taxpayer has queried the right of her bank to deduct resident withholding tax (RWT) from amounts of interest that are less than $1; and from any amount of cents additional to whole dollar sums (e.g. 72 cents when interest of $4.72 has been earned). She quoted Schedule 14 to the Act (Nineteenth Schedule to the 1976 Act), which states that:

"For the purposes of section NF 2, the rate of the resident withholding tax deduction from payments of resident withholding income, being interest, for every $1 of those payments shall be..."

Although the rate in Schedule 14 refers to a rate of 24 and 33 cents "for every $1", the amounts of tax to be deducted are calculated according to the formula in section NF 2.

If the payment consists of interest, the formula which must be used at the time the interest is paid is:

$$(a \times (b+c)) - c$$

In this formula:

a is the appropriate RWT rate, *expressed as a percentage*, as specified in clause 1 of Schedule 14 to the Act.

b is the amount of interest paid (before deducting RWT).

c is the amount of foreign withholding tax paid or payable on that interest.

From the above formula, that amount of RWT is calculated on the *amount of interest paid*, at rates in Schedule 14 *expressed as a percentage*.

In this particular case, there is no authority for the payer of the interest to round the interest down to the nearest whole dollar when calculating the RWT liability. The RWT must be calculated on the interest paid. RWT is calculated on an amount that is less than $1, and in this case on $4.72, not $4.

Refugees' entitlement to Family Support

Section OB 1 (section 374A of the Income Tax Act 1976) - "Qualifying person": A spokesperson for a child welfare agency has asked if a refugee family is entitled to Family Support. She is particularly concerned about the residence status of such persons.

A person must be a "qualifying person" to claim Family Support. A person is a qualifying person if all of these conditions from the definition in section OB 1 are met:

- The person must be 16 years old or over.
- The person must be the principal caregiver of one or more dependent children.
- *Either* the person must have been both resident and present in New Zealand for a continuous period of twelve months at any time, *or* each of the dependent children for whom the person is the principal caregiver must be both resident and present in New Zealand.

For a person (who is a principal caregiver) to be a "qualifying person", either that person or the dependent children must meet the residence tests. The difference is that the principal caregiver must have been both resident and present in New Zealand for a period of 12 months at any time, but each dependent child need only be resident and present in New Zealand during the specified period.

"Resident" is defined for Family Support purposes in section OB 1 as meaning "ordinarily resident". However, the definition contains a number of specific exclusions. It excludes people who are unlawfully in New Zealand, and those people who are lawfully in New Zealand but merely by virtue of holding visitors' permits, temporary work permits, or permits issued for the purposes of study. The Shorter Oxford English Dictionary defines a "resident" as "One who resides permanently in a place".

If a refugee family has received a residence permit from the Department of Immigration, then for Family Support purposes the holder is a resident. Once the refugee's residence status has been determined, the remaining criteria must be considered and met before Family Support is available. Family Support cannot be claimed until the Department of Immigration issues the residence permit.

Taxation of payment made to an employee in lieu of notice

Section OB 1 (section 2, Income Tax Act 1976) - Definition of "Extra emolument": An employer has dismissed an employee for his misconduct, making him a payment in lieu of notice. The employer has asked how she should treat the payment for tax purposes.

The Commissioner's opinion is that a payment made to a person in lieu of notice is an "extra emolument."

Section OB 1 defines an "extra emolument" as:

> ... a payment in a lump sum (whether paid in one sum or in 2 or more instalments) made to that person in respect of or in relation to the employment of that person (whether for a period of time or not), being a payment which is not regularly included in salary or wages payable to that person for a pay period, ...

The payment is made to the person in relation to his employment, but is not a payment which is regularly included in his salary or wages. The employer should deduct PAYE at the extra emolument rate of 28.6 cents in the dollar, which includes earner premium of 0.6 cents.

Income Tax (Depreciation Determinations) Regulations 1993

Charges for depreciation determinations

Income Tax (Depreciation Determinations) Regulations 1993: A tax adviser has asked why Inland Revenue charges fees for depreciation determinations, and queries our right to do so.

Taxpayers applying to Inland Revenue for any depreciation determination (other than a provisional rate) are charged a fee for that determination. The fees payable (inclusive of GST) are:

- an initial fee of $50, payable with the application
- a processing fee of $30 per hour (or part hour) after the first two hours' work by Inland Revenue Officers
- a fee of up to $300 for the cost of advice from consultants engaged by Inland Revenue
- fees for the cost of consultants, if the applicant asks Inland Revenue to have a consultant carry out further work, or for a conference (if the applicant or Inland Revenue nominates a consultant).

The fees became operative from 5 August 1993. Inland Revenue's right to charge them is governed by the Income Tax (Depreciation Determinations) Regulations 1993.

The rationale behind charging the fees is that the applicant gains a benefit if Inland Revenue decides to issue a determination. For example, in the case of a special economic depreciation rate the applicant gains an increased depreciation deduction, and no other taxpayer gains any benefit. A provisional depreciation rate applies to all taxpayers, so there is no reason why an individual taxpayer should bear this cost.

Goods and Services Tax Act 1985

Bloodstock cannot be "secondhand goods"

Section 2(1) - Definition of "Secondhand goods": A taxpayer asked whether bloodstock is "livestock" within the section 2(1) definition of "secondhand goods".

A registered person who purchases secondhand goods may be entitled to an input tax deduction even if the supply is not a taxable supply. Section 20(3) allows a notional input tax deduction for purchases of secondhand goods when the notional tax on the supply satisfies paragraph (c) of the definition of "input tax" in section 2. The supply must be by way of sale, must not be a taxable supply, must relate to secondhand goods situated in New Zealand, must be from a non-registered person, and must be acquired for the principal purpose of making taxable supplies.

The section 2(1) definition of "secondhand goods" excludes livestock from being secondhand goods. Bloodstock (thoroughbred horses) are livestock for GST purposes. The ordinary meaning of "livestock" is any animals kept or dealt in for use or profit. Bloodstock used for breeding or racing is within that definition as it is kept or dealt in for use or profit from breeding or racing activities. Further, in *Land Projects Limited v CIR* [1964] NZLR 723, 727 the Court was of the view that livestock means all live animals. Therefore, "livestock" will include bloodstock. Adopting this reasoning "livestock" would also include standardbred horses.

A registered person is not entitled to a notional input tax deduction for purchases of bloodstock from a non-registered person, as bloodstock is livestock and therefore does not come within the definition of secondhand goods.

Repairs to goods temporarily imported into New Zealand

Section 11 - Zero-rating of goods and services: A company has recently won a contract to effect certain repairs to international shipping vessels docking at a New Zealand port. A representative of the company has asked if the company may automatically zero-rate all the supplies it makes to international vessels under the contract, as such supplies are all made to acknowledged temporary imports.

Section 11(1)(ba) permits the supply of goods to be zero-rated if:

The goods have been supplied in the course of repairing, renovating, modifying, or treating any goods to which subsection (2)(ca) of this section applies and the goods supplied -

(i) Are wrought into, affixed to, attached to, or otherwise form part of those other goods; or

(ii) Being consumable goods, become unusable or worthless as a direct result of being used in that repair, renovation, modification, or treatment process;

Section 11(2)(ca) provides for the zero-rating of services which:

(i) Are supplied directly in connection with goods referred to in either section 47(2) [Goods imported for re-export, or imported as ship's stores] or section 181 [Temporary Imports] of the Customs Act 1966, notwithstanding that the goods are in New Zealand; and

(ii) Are supplied to a person who is not resident in New Zealand at the time the services are performed:

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Examples of services that may be covered by the above provisions are repairs to ships, aircraft, or containers, which are temporarily imported into New Zealand; and plant or equipment temporarily imported into New Zealand for repair and/ or modification, then re-exported.

Provided the recipient of the goods or service is not a resident of New Zealand at the time the goods are provided or the service is performed, the supply may be zero-rated. If the service is provided to a person who is a resident of New Zealand, consumption occurs in New Zealand and GST must be charged at the standard rate of 12.5 percent.

The term "resident", means a person who is resident in New Zealand for income tax purposes. It also means persons covered by the proviso in section 2 of the Goods and Services Act 1985 which states (amongst other things) that:

> A person shall be deemed to be resident in New Zealand to the extent that that person carried on, in New Zealand, any taxable activity or any other activity, while having any fixed or permanent place in New Zealand relating to that taxable activity or other activity.

Whether or not the recipient is a resident will be a question of fact. To avoid possible problems with zero-rating goods and services, we suggest that suppliers obtain from recipients a written assurance that the recipient is not a resident of New Zealand. The supplier would then be able to zero-rate the supply, relying on that assurance.

If it later turns out that the recipient was a resident, the supplier will have to account for GST at 12.5% on the value of the supply invoiced, (or in the case of a supplier accounting for GST on the payments basis - 12.5% on the consideration received). To recover the resulting "under charge", the supplier may issue a further debit note as provided under section 25(1)(b), which states:

> The previously agreed consideration for that supply of goods or services has been altered, whether due to the offer of a discount or otherwise.

Goods not exported within 28 days of being invoiced

Section 11(1C) - Extension of 28-day export period: A New Zealand manufacturing company intends to purchase a bulk supply of labels that will be affixed to goods it exports to Asia. The charge for the labels is not included in the contract price for the goods, and the overseas customer will be charged separately for them. To take advantage of discounts available for large runs of these labels, the manufacturer purchases six months' supply of the labels at a time. The manufacturer invoices the overseas customer for the labels before the goods to which they will be affixed are exported. The manufacturer's manager has asked if this invoice should have GST charged at zero percent.

Section 11(1) allows goods which will be exported by the supplier within 28 days of the time of supply to be zero-rated. The time of supply is normally the earlier of any payment being received or an invoice being issued. Section 11(1B) requires goods not exported within 28 days to be charged with GST under section 8 at the standard rate of 12.5 percent. In this case, most of the labels will not be exported within 28 days.

Section 11(1C) allows the Commissioner to grant an extension to the 28-day rule if the supplier applies in writing and either of these conditions apply:

- Circumstances beyond the control of the supplier and recipient have prevented, or will prevent, the exportation of the goods within 28 days of the time of supply.

- Due to the nature of the supply, it is not practicable for the supplier to export the goods, or a class of the goods, within 28 days of the time of supply.

In these situations the Commissioner may extend the 28-day limit.

In this instance, the manager should write to the local Inland Revenue office and request an extension of the 28-day exportation period. The application should set out the reasons for the delay in exporting the goods.

GST implications when exported goods are re-imported

Section 12 - Imposition of GST on imports: A food processor sent a shipment of goods to Canada. The purchaser took delivery of the goods and paid for them. The goods were then subject to a health department inspection which resulted in them being returned to New Zealand. The producer is confident that following re-testing in New Zealand the Canadian owner will re-import the goods, which at the moment have a nil value. The producer's agent has sought an assurance that GST will not be charged on the goods when they arrive back in New Zealand.

Under section 12, any goods imported into New Zealand may have GST levied and collected by New Zealand Customs.

Section 12(4)(aa) provides that GST will not be levied:

> in respect of goods that are imported by the same person as the person who exported them from New Zealand if, at the time of their export from New Zealand, those goods were not -
>
> (i) A supply of goods charged with tax at the rate of zero percent pursuant to section 11 of this Act; or
>
> (ii) A supply of goods, made before the 1st day of October 1986, that would have been charged with tax at the rate of zero percent pursuant to section 11 of this Act if the supply of those goods had taken place on the 1st day of October 1986.

Since the goods were exported after 1 October 1986, and when originally exported GST was charged at zero percent, neither of the above provisions apply. GST will be levied by New Zealand Customs upon re-importation. The importer will be entitled to make an input tax deduction claim in the relevant GST return to recover the GST levied by New Zealand Customs.

Upcoming TIB articles

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

- Employment, commission agents and deductions
- Taxation of income from illegal activities
- GST - the meaning of "open market value"
- Income tax treatment of remitted specified suspensory loans
- Individual claims for overseas travel expenses
- Whether an activity is a GST activity or a hobby
- Remission of underestimation penalty when taxpayer makes an incorrect interpretation
- Assessability of retraining payments made on termination of employment
- LACQs with shares carrying the right to appoint representative directors
- Non-resident contractors' withholding tax - who is affected by the non-resident contractors' withholding tax rules?
- Non-resident shipping operators engaging within New Zealand's coastal waters
- Applications to retain records in Maori
- GST status of cash dividends

Legal decisions - case notes

This section of the Tax Information Bulletin sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, the Court of Appeal and the Privy Council.

We have given each case a rating as a reader guide to its potential importance.

- ••••• Important decision
- •••• Interesting issues considered
- ••• Application of existing law
- •• Routine
- • Limited interest

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision. Where possible, we have indicated if an appeal will be forthcoming.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

CIR v Rag Doll Fashions	•••	Modified hatchback cars were “work-related vehicles” for FBT purposes	24
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Modified hatchback cars were “work-related vehicles” for FBT purposes

Rating: •••

Case: CIR v Rag Doll Fashions (NZ) Ltd HC Auckland M No 981/94

Act: Income Tax Act 1976 - section 336N(1)
(Income Tax Act 1994 - section OB 1)

Keywords: *motor car, work related vehicle*

Summary: Vehicles that are motor cars (i.e., designed exclusively or principally for the carriage of persons) when they leave the factory can be altered so that they become work-related vehicles for FBT purposes.

Facts: The objector was a manufacturing company. Much of the objector’s work was done at the home of the husband and wife shareholders. The objector owned two cars which were used to transport goods between work, home, and outwork places. The cars were hatchbacks but the back seats were folded down and shaped fitted plywood covers were placed over the folded down seats. The covers extended from the back of the front seats to the tailgate. Because of this the back seats could not be used.

The TRA found that the vehicles were "work-related vehicles" as defined in section 336N(1). The Commissioner appealed to the High Court. The issue before the High Court was whether the TRA was correct in finding that the vehicles were not motor cars.

Decision: Justice Morris held that the TRA was justified in finding that the vehicles were work-related vehicles rather than motor cars. While the vehicles were motor cars when they left the factory, they had been altered by lowering the back seats and placing the plywood covers over them. Because of these alterations they were no longer exclusively and principally designed for the carriage of persons.

Comment: Inland Revenue is appealing this decision.

Lump sum payment to enter a franchise agreement is a capital expense

Rating: • • •

Case: TRA No. 93/46

Act: Income Tax Act 1976 - sections 101, 104, 106(1)(a)
(Income Tax Act 1994 - sections BB 6, BB 7, BB 8 (a))

Keywords: *franchise agreement, capital, revenue*

Summary: A lump sum payment for a comprehensive franchise agreement is a capital payment.

Facts: A husband and wife operated a sports goods store for a number of years. They sold the store to their company (the objector) which then entered into a franchise agreement. Under the agreement the objector was able to operate a specialty sports goods shop for ten years with a right of renewal for a further five years. The franchisor group was well known and the objector was able to fit into its established network and receive the benefits of its name and buying powers. The objector received help in setting up its new shop. It received advice on management, advertising, marketing, and technical matters. It also received training for its staff. In return the objector had to accept obligations relating to how it ran its business. The initial cost of the agreement was $22,000. However, the objector had to pay further fees to cover general management services and further training.

The objector sought to deduct the initial cost of the franchise agreement.

Decision: Judge Barber found that the cost was capital. He reached his decision by applying three tests. Firstly, the objector obtained an enduring benefit. It did not matter that the objector already had a sports goods store as the character of the business changed substantially. Nor did it matter that the agreement was limited to ten years as "enduring" does not have to be forever. Secondly, the payment related to the structure of the business not the conduct or operation of the business. Thirdly the payment was a lump sum. It was of little relevance that the franchisor treated the payment as revenue.

Comment: The taxpayer is not appealing this decision.

No remission or maturity of debentures when payments suspended

Rating: • •

Case: TRA No. 94/18

Act: Income Tax Act 1976 - sections 64F(1),(3) and (5)
(Income Tax Act 1994 - sections EH 4 (9), OB 1, EH 4 (2) and (4))

Keywords: *deductibility of loss on debentures, matured, remitted*

Summary: The appointment of a statutory manager who suspends a company's obligation to repay debt does not give rise to an implied remission or maturity of debt.

Facts: The objector wound up his building business in March 1988. On 21 January 1988 the objector placed $15,000 in Equiticorp debentures to mature on 21 January 1989.

On Friday 20 January 1989, the objector was to be repaid $17,988.78, being the original $15,000 face value of the debentures plus $2,805.78 as interest and withholding tax of $183. On 20 January 1989, because of Equiticorp's collapse, Equiticorp's bankers dishonoured all Equiticorp cheques which were in the banking system. This meant that the objector and his wife were not credited with the sum of $17,988.78

Statutory receivers for the Equiticorp Group were appointed on 22 January 1989 under the Companies Special Investigations Act 1958. Subsequently, under the Corporations (Investigation and Management) Act 1989, a statutory manager was appointed on 3 April 1989. The statutory manager suspended Equiticorp's repayment of debt to the objector and his wife until a later time.

The objector was a cash basis holder.

The issue before Judge Barber was whether the objector could claim a deduction under section 64F(5) for a loss relating to the debenture in the 1989 income year (for some unknown reason the taxpayer claimed a loss in the 1988 year. However, this has no effect on the outcome of the case). The objector submitted that under section 64F(3), the debenture had matured or was remitted because of the repayments being suspended. The definitions of "remitted" and "matured" are found in sections 64F(1)(c) and (e).

Decision: Judge Barber held that the facts of the case did not meet the definition of "remitted" under section 64F(1)(c). The objector's situation was simply not provided for in section 64F(1)(c). The types of deemed remission situations for a financial arrangement provided for in (c) did not include a delay or freeze in meeting contractual repayment obligations by virtue of the Corporations (Investigation and Management) Act 1989.

The objector, referring to *CIR v Alcan New Zealand Limited* (1994) 16 NZTC 11,175, argued that section 64F(1)(c) should be interpreted to prevent injustice caused by a literal interpretation of the section. Judge Barber said that there needed to be some doubt about the plain and ordinary meaning of the words before he could consider whether there was injustice. The wording of section 64F(1)(c) was quite clear and the objector's situation was not one where the financial arrangement was deemed to be remitted under that section.

The objector's other substantive argument was that the financial arrangement of the debenture investment matured on 21 January 1989. The subsequent application of the formula under section 64F gave a negative base price adjustment because of the non-repayment to the objector as at 21 January 1989. A loss therefore resulted.

Judge Barber said there can be little doubt that the ordinary and natural meaning of the words used in section 64F(1)(e) was that the maturity of a financial instrument took place when the last payment due under the arrangement had been made. That had not happened with the objector. He said that the definition of "maturity" under section 64F(1)(e) was not capable of being understood to have some meaning which would favour the objector. In any case, there was no injustice to the objector from maturity of the financial arrangement being contingent on final payment under the debenture contract.

Judge Barber also commented that if the investment in the debentures had formed part of a business enterprise then it could have been written off as a bad debt and the parts of it eventually recovered would be assessable income. However, this was not a business matter and was considered under the accrual rules. A loss did not take place and there has been no remission or maturity of the transaction. There had only been a suspension of obligations by the issuer under the financial arrangement which was still in place, and distributions continued to be made under it.

Comment: The taxpayer is not appealing this decision.

Payment on employment termination was redundancy, not severance

Rating: • •

Case: TRA No. 94/107

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

Keywords: *redundancy, severance*

Summary: Judge Willy held that a lump sum payment received by the taxpayer on the termination of her employment was a redundancy payment and not a severance payment as the Commissioner had argued.

Facts: The taxpayer had been employed by the Auckland Area Health Board under a three year employment contract dated 6 August 1990. Her employment was terminated prematurely on 23 March 1991 and she received a lump sum payment of $30,625 from her employer on 29 August 1991.

The taxpayer contended that the payment was a redundancy payment and produced correspondence that indicated that the taxpayer had been made redundant because her position had become surplus to requirements. The Commissioner argued that the lump sum was a 'severance payment' and not a 'redundancy payment'.

The Commissioner relied on the evidence of the taxpayer's former manager. The manager, in his brief of evidence, had said that the payment was not compensation for redundancy. Instead he stated the payment was made in compromise of a claim for lost remuneration arising from an alleged breach of contract by the employer. However, during the course of the hearing, the manager gave evidence that the contract had been terminated due to the incompetence of the objector.

Decision: Judge Willy found that the manager was not a credible witness as his evidence during the hearing conflicted with the documentary evidence available. Having rejected the evidence of the manager, his Honour concluded that the weight of the arguments was in favour of the taxpayer and accordingly found for the taxpayer.

Comment: Inland Revenue is not appealing this decision.

Subsidiary's bad debt written off was capital expenditure

Rating: • •

Case: Mitsui & Co (NZ) Limited v CIR HC Wellington AP 171/93

Act: Income Tax Act 1976 - section 101, 104, 106
(Income Tax Act 1994 - section BB 6, BB 7, BB 8 (a))

Keywords: *capital, revenue, trading advances*

Summary: Mitsui advanced substantial credit to a subsidiary over a number of years. The advances were not repaid and Mitsui wrote off the debt and claimed a deduction. The High Court found that Mitsui was not entitled to a deduction as the loss was of a capital nature.

Facts: Mitsui acquired partial and then total ownership of a company that sold computers. Over a number of years Mitsui advanced substantial credit to the subsidiary. At first this was through Mitsui supplying its subsidiary with computer equipment, the cost of which the subsidiary owed Mitsui. During Mitsui's control of the subsidiary, the subsidiary paid for less than half of the supplies it received from Mitsui.

Mitsui argued that these advances were as a result of loose financial controls within Mitsui, rather than a deliberate policy of funding the subsidiary. The advances were trade debts and deductible when written off. The Commissioner argued that credit was advanced to the subsidiary as a means of providing capital. The only reason the subsidiary did not collapse was because Mitsui did not call in the subsidiary's trade debts. The advances were of a capital nature and non-deductible.

Decision: Chief Justice Eichelbaum found for the Commissioner. The money the subsidiary owed to Mitsui was of a capital nature and non-deductible.

Chief Justice Eichelbaum found that Mitsui had decided to advance unlimited credit to its subsidiary. He accepted the Commissioner's argument that during most of Mitsui's ownership of the subsidiary, the capitalisation of the subsidiary and the continuation of its operations was totally dependent on the non-payment of amounts owing to Mitsui.

After this finding His Honour applied the Court of Appeal decision of *Levin v CIR* [1963] NZLR 801. That case provides a test as to whether an advance is capital or revenue. Justice Turner in *Levin* said that if the advances were by way of capital assistance to the subsidiary, then they were not incurred in the production of the assessable income, and were capital. If the advances were genuine banking advances to a customer made in the course of trading operations, intended and expected to be repaid, then they were paid out in the production of the assessable income, and were on revenue account.

He then adapted the guidelines for the test set out in *Levin* to Mitsui's circumstances. The steps in considering whether advances are capital or revenue are:

- A closer examination of the facts is required when the advances are from a parent company to a subsidiary.
- Mitsui has the onus of showing that advances were made in the course of its normal business of allowing trade credits.
- It is necessary to consider Mitsui's purpose in advancing the funds.
- If the monies were advanced in the course of Mitsui's ordinary business the loss would not be capital and would be incurred in production of assessable income.

- If advances were made materially with the object of supporting a subsidiary or securing an enduring source of supply the loss would be a capital loss and would not be incurred in the production of the assessable income.

The basic question is one of fact, the purpose or object in the minds of those controlling Mitsui.

His Honour found that Mitsui acquired shares in the subsidiary to acquire entry into New Zealand's computer sales market. The subsidiary was undercapitalised and advances were made for the purpose of capitalising the company.

His Honour recognised that some advances may have been in the ordinary course of Mitsui's business. He concluded that Mitsui's decision to allow its subsidiary unlimited credit converted existing advances into capital amounts, and meant that further advances were capital from the outset. (The date of the decision to allow unlimited credit could not be identified, but His Honour did not consider this to be important.) He also stated that the losses were incurred to secure an enduring benefit for Mitsui; the establishment of its subsidiary in the computer business.

Mitsui failed to satisfy the Court that amounts written off were other than capital in nature. It failed to convince the Court that the losses were incurred in the course of its normal trading activities.

Comment: We do not yet know whether the taxpayer will be appealing this decision.

Oil well testers were independent contractors

Rating: • • •

Case: TRA 93/45, Decision No 10/95

Act: Income Tax Act 1976 - section 338 (Income Tax Act 1994 - section NC 2 (1))

Keywords: *employee, independent contractor, contract of service, contract for services*

Summary: The objector, an oil-well testing company, claimed that it engaged well-testers as independent contractors rather than employees. Judge Barber found that the well-testers were independent contractors, although their relationship with the objector had many of the hallmarks of a contract of employment.

Facts: The contract between the objector oil-well testing company and the oil-well testers stated that the company engaged the well testers as independent contractors.

Decision: Judge Barber found that the well testers were independent contractors. In reaching this decision, Judge Barber applied the principles set out in the Court of Appeal judgment of *TNT Worldwide Express Ltd v Cunningham* [1993] 3 NZLR 681 and the five traditional tests of employment status (control, integration, the fundamental test, intention and the multiple test).

Judge Barber considered that the degree of direct supervision and control exercisable by the objector over the testers was similar to that normally exercisable by a contractor over a subcontractor. He found that the workers were in business on their own account. The business risk faced by the testers was that if they declined any engagement or did not perform to a high standard the company would not offer further work to them.

Judge Barber found that there was no doubt that the parties intended a contract for services. He accepted that the arrangement had many of the features of an employment contract (e.g., the provision of accommodation, food, equipment,

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uniforms, transport to the well-site, and regular remuneration at an hourly rate). However, he stated the nature of the location, the hours worked, and the type of work made the provision of these things sensible. He noted the method of remuneration and the fact that the testers did not receive holiday pay, sick leave, or overtime rates of pay, that there was no guarantee of work, no real on-site supervision, and no fixed pattern to the job. He said that these factors were inconsistent with a contract of employment.

Judge Barber said that, although in many respects this was a borderline situation, he could find no compelling reason to ignore the wishes of the parties or the ordinary and natural interpretation of their contract.

Comment: Inland Revenue is appealing this decision.

Retirement allowance can be paid at time of redundancy

Rating: • • •

Case: TRA No. 94/110

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

Keywords: *retiring allowance, redundancy*

Summary: Judge Willy held that, given the facts of the case, a retiring allowance paid to the taxpayer on redundancy was severable from the redundancy payment, and only 5 percent of it was taxable.

Facts: Part of the payment to the taxpayer upon being made redundant was an amount of $23,557.69. The taxpayer contended that only 5 percent of this payment was taxable as it was a retiring allowance separate from the redundancy payment. The Commissioner argued that the whole of the payment was made on the occasion of the redundancy. As such the payment was not divisible and was subject to tax at 28 cents in the dollar.

Decision: The outcome of this case depended on the interpretation of the employment contract. Judge Willy determined that the contract was constructed to ensure that a redundant worker did not lose the right to receive, in addition to any other payment that may flow from the redundancy, such entitlement to payment for early retirement as may have accrued.

Judge Willy stated that this additional payment was a payment that was due to the worker whether the worker was made redundant or not and was not paid as a result of being made redundant. The fact that the payment was made on the occasion of the redundancy was not sufficient to categorise the payment as a redundancy payment. As a result, Judge Willy found that only 5 percent of the payment was taxable.

Comment: Inland Revenue is appealing this decision.

Booklets available from Inland Revenue

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

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

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

For people in business

A guide to Inland Revenue audits (IR 297) March 1994
For business people and investors. It explains what is involved if you are audited by Inland Revenue; who is likely to be audited; your rights during and after the audit, and what happens once an audit is completed.

ACC premium rates March 1995
There are two separate booklets, one for employer premium rates and one for self-employed premium rates. Each booklet covers the year ended 31 March 1995.

Approved issuer levy (IR 291A) May 1994
For taxpayers who pay interest to overseas lenders. Explains how you can pay interest to overseas lenders without having to deduct NRWT.

Binding rulings (IR 115G) May 1995
Explains binding rulungs, which commit Inland Revenue to a particular interpretation of the tax law once given.

Consolidation (IR 4E) March 1993
An explanation of the consolidation regime, which allows a group of companies to be treated as a single entity for tax purposes.

Controlled foreign companies (IR 275) November 1994
Information for NZ residents with interests in overseas companies. (More for larger investors, rather than those with minimal overseas investments)

Depreciation (IR 260) April 1994
Explains how to calculate tax deductions for depreciation on assets used to earn assessable income.

Employers' guide (IR 184) 1995
Explains the tax obligations of anyone who is employing staff, and explains how to meet these obligations. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.

Foreign dividend withholding payments (IR 274A) Mar 1995
Information for NZ residents with interests in overseas companies. This booklet also deals with the attributed repatriation and underlying foreign tax credit rules. (More for larger investors, rather than those with minimal overseas investments)

Foreign investment funds (IR 275B) Oct 1994
Information for taxpayers who have overseas investments. (More for larger investors, rather than those with minimal overseas investments).

Fringe benefit tax guide (IR 409) Nov 1994
Explains fringe benefit tax obligations of anyone who is employing staff, or companies which have shareholder-employees. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.

GST - do you need to register? (GST 605) May 1994
A basic introduction to goods and services tax, which will also tell you if you have to register for GST.

GST guide (GST 600) 1994 Edition
An in-depth guide which covers almost every aspect of GST. Everyone who registers for GST gets a copy of this booklet. It is quite expensive for us to print, so we ask that if you are only considering GST registration, you get the booklet "GST - do you need to register?" instead.

Imputation (IR 274) February 1990
A guide to dividend imputation for New Zealand companies.

Non-resident withholding tax guide (IR 291) March 1995
A guide for people or institutions who pay interest, dividends or royalties to people who are not resident in New Zealand.

PAYE deduction tables
- Four-weekly and monthly (IR 184Y) 1996
- Weekly and fortnightly (IR 184X) 1996

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

Qualifying companies (IR 4PB) October 1992
An explanation of the qualifying company regime, under which a small company with few shareholders can have special tax treatment of dividends, losses and capital gains.

Record keeping (IR 263) March 1995
A guide to record-keeping methods and requirements for anyone who has just started a business.

Resident withholding tax on dividends (IR 284) Oct 1993
A guide for companies, telling them how to deduct RWT from the dividends that they pay to their shareholders.

Resident withholding tax on interest (IR 283) March 1993
A guide to RWT for people and institutions which pay interest.

Running a small business? (IR 257) Jan 1994
An introduction to the tax obligations involved in running your own business.

Surcharge deduction tables (IR 184NS) 1994
PAYE deduction tables for employers whose employees are having national super surcharge deducted from their wages.

Taxpayer Audit (IR 298)
An outline of Inland Revenue's Taxpayer Audit programme. It explains the units that make up this programme, and what type of work each of these units does.

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For non-profit groups

Charitable organisations (IR 255) May 1993

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

Clubs and societies (IR 254) June 1993

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

Education centres (IR 253) June 1994

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

Gaming machine duty (IR 680A) February 1992

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

Grants and subsidies (IR 249) June 1994

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

For individual taxpayers

Dealing with Inland Revenue (IR 256) April 1993

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

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

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

IR 56 taxpayer handbook (IR 56B) April 1995

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

Koha (IR 278) August 1991

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

New Zealand tax residence (IR 292) April 1994

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

Objection procedures (IR 266) March 1994

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

Provisional tax (IR 289) March 1994

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

Putting your tax affairs right (IR 282) May 1994

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

Rental income (IR 264) April 1995

An explanation of taxable income and deductible expenses for people who own rental property. This booklet is for people who own one or two rental properties, rather than larger property investors.

Resident withholding tax on investments (IR 279) April 1993

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

Retiring allowances and redundancy payments (IR 277) June 1994

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

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

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

Special tax codes (IR 23G) January 1995

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

Stamp duty and gift duty (IR 665) March 1995

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

Student Loan repayments (SL 2) January 1995

A guide to making student loan repayments.

Superannuitants and surcharge (IR 259) January 1995

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

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

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

Problem Resolution Service (IR 287) November 1993

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

Child Support booklets

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

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

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

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

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

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

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

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

Due dates reminder

June

5 Large employers: PAYE deductions and deduction schedules for period ended 31 May 1995 due.
(We will accept any payments received on Tuesday 6 June as on time.)

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

IR 5 tax returns due to be filed.

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

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

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

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

RWT on dividends deducted during May 1995 due.

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

Imputation: payment of debit balances as at 31 March 1995 due.

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

FBT: final day for "small" employers to elect to pay FBT annually.

Non-resident Student Loan repayments: first instalment of 1996 Student Loan non-resident assessment due.

July

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

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

Tax returns due to be filed for all non-IR 5 taxpayers with balance dates from 1 October 1994 to 31 March 1995.

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

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

FBT return and payment for quarter ended 30 June 1995 due.

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

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

RWT on dividends deducted during June 1995 due.

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

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

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Legal decisions - case notes

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