Binding rulings

This section of the TIB contains binding rulings that the Commissioner of Inland Revenue has issued recently.

The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates tax liability based on it.

For full details of how binding rulings work, see our information booklet "Binding Rulings" (IR 115G) or the article on page 1 of TIB Volume Six, No.12 (May 1995) or Volume Seven, No.2 (August 1995). You can order these publications free of charge from any Inland Revenue office.

At the back of this TIB there is a page listing draft binding rulings that Inland Revenue will soon be finalising. You can use that page to order copies of any of those drafts if you want to comment on them before we finalise them.

GST: Secondhand goods input tax deduction for forestry rights

Public ruling - BR Pub 95/3

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation law

This ruling applies in respect of sections 2(1) (the definition of "input tax" at paragraph (c) and the definition of "secondhand goods") and 20(3) of the Goods and Services Tax Act 1985.

Arrangements to which this ruling applies

This ruling applies when a GST registered person acquires a forestry right by way of sale and the sale is a non-taxable supply.

The period for which this ruling applies

This ruling applies to the sale of forestry rights where the time of supply occurs between 1 October 1995 and 30 September 1998.

The ruling

A forestry right can be a secondhand good for GST purposes, for which an input tax deduction may be available (within the section 2(1) definition of "input tax", paragraph (c), and section 20(3)). For an input tax deduction to be available, the supply of the forestry right must be a non-taxable supply, must be by way of sale, and must be acquired by the recipient for the principal purpose of making taxable supplies. The forestry right must be situated in New Zealand at the time of supply.

To be "secondhand" the forestry right must have been used by at least one previous owner for its intrinsic purpose. If an input tax deduction is available, it is limited to the extent that a payment is made for the supply during the relevant taxable period.

This ruling is signed by me on the 8th day of September 1995.

Jeffrey Tyler
Director (Rulings)

Analysis starts on page 2

Analysis of the ruling

This analysis of the ruling does not form part of the ruling.

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

Background

We have been asked to clarify whether a GST registered person who buys a forestry right by way of a non-taxable supply may make a secondhand goods input tax deduction. It has been unclear whether a forestry right can be a secondhand good.

Legislation

Section 2(1) of the Forestry Rights Registration Act 1983 defines "forestry right" (for the purposes of that Act):

"Forestry right" means a right granted by the grantor of any land to any other person to-

(a) Establish, maintain, and harvest; or

(b) Maintain and harvest,-

a crop of trees on that land, together with-

(c) Any ancillary rights of access and of constructing and using such tracks, culverts, bridges, buildings, and other works and facilities as may be necessary to establish, maintain, and harvest or, as the case may be, to maintain and harvest that crop; and

(d) Any provisions for charges, payments, royalties, or division of the crop or the proceeds of the crop,-

whether or not such rights or provisions are coupled with an obligation; but no such right shall be capable of conferring a right of exclusive possession of that land.

Section 3(1) of the Forestry Rights Registration Act 1983 states:

Notwithstanding any rule of law or equity to the contrary, every forestry right shall be deemed to be a *profit à prendre*

Section 2(1) defines "goods":

"Goods" means all kinds of personal or real property; but does not include choses in action or money.

Section 2(1)(c) defines "input tax" in relation to secondhand goods:

"Input tax", in relation to a registered person, means-

(c) Any amount equal to the tax fraction (being the tax fraction applicable at the time of supply within the meaning of section 9 or any other provision of this Act) of the consideration in money for the supply, being a supply by way of sale that is not a taxable supply, to a registered person of any secondhand goods situated in New Zealand,-

being in any case goods and services acquired for the principal purpose of making taxable supplies.

Section 20(3) allows deductions from output tax. Section 20(3) states:

Subject to this section, in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period-

(a) In the case of a registered person who is required to account for tax payable on an invoice basis pursuant to section 19 of this Act, the amount of input tax-

...

(ia) In relation to the supply of secondhand goods to which paragraph (c) of the definition of the term "input tax" in section 2(1) of this Act applies, to the extent that a payment in respect of that supply has been made during that taxable period:

...

(b) In the case of a registered person who is required to account for tax payable on a payments basis or a hybrid basis pursuant to section 19 of this Act, the amount of input tax-

(i) In relation to the supply of goods and services made to that registered person, being a supply of goods and services which is deemed to take place pursuant to section 9(1) or section 9(3)(a) or section 9(3)(a)(a) or section 9(6) of this Act, to the extent that a payment in respect of that supply has been made during the taxable period:

Application of legislation

Under sections 2(1) and 20(3), seven conditions must be met before the purchase of a forestry right by a GST registered person will permit a secondhand goods input tax deduction:

- Forestry rights must be "goods" as defined in section 2(1).
- The supply of a forestry right must be by way of sale.
- The supply of the forestry right must be a non-taxable supply.
- The sale must involve payment in the taxable period for which an input tax deduction is sought.
- The forestry right must be secondhand.
- The forestry right must be acquired for the principal purpose of making taxable supplies.
- The forestry right must be situated in New Zealand at the time of sale.

The following paragraphs consider some of these requirements.

"Goods"

The Commissioner considers that a forestry right (as defined in section 2(1) of the Forestry Rights Registration Act 1983) is a "good" for GST purposes. "Goods" means all real and personal property. Section 3(1) of the Forestry Rights Registration Act 1983 deems forestry rights to be profits à prendre. This confirms the com-

mon law position that a forestry right is a profit à prendre. A profit à prendre is a right to take something off another person's land. A profit à prendre is an interest in land. It is not a chose in action because the rights under a profit à prendre are of a possessory nature, whereas a chose in action can only be enforced by action. Accordingly, a forestry right is real property and a "good" for GST purposes.

"Sale"

A secondhand goods input tax deduction is only available where there is a supply by way of sale. Forestry rights are a form of transferable property right, like other profits à prendre, and may be sold. It will be a question of fact whether there has been a sale rather than a lease or sub-grant of a forestry right. Because of the definition of "input tax" paragraph (c), a secondhand goods input tax deduction is available only where there is a sale.

The sale must be by way of a non-taxable supply for an input tax deduction to be available.

"Payment"

An input tax deduction is only available to the extent that there has been payment for the goods in the relevant taxable period. Therefore, if there is a sale by instalments, input tax deductions will be available only in the taxable period in which each instalment is paid.

"Secondhand"

The forestry right must be "secondhand" before an input tax deduction is available. The Commissioner considers that land is a secondhand good. This is supported by case law, for example, *Case N13* (1991) 13 NZTC 3,105. The Court of Appeal decision in *Coveney v CIR* (1995) 17 NZTC 12,193 appears to have confirmed this view, notwithstanding obiter dicta that land may not be a secondhand good in *L R McLean v CIR* (1994) 16 NZTC 11,211 (CA) and *King v Bennetts* (1994) 16 NZTC 11,370.

However, when a specific interest in land, like a forestry right, is newly created, it is a unique mix of rights distinct from the original land over which it was created. Accordingly, the original grant of a forestry right cannot be a sale of secondhand goods. The forestry right is a new item of property. Before a forestry right can be a secondhand good, at least one prior owner must have made use of the right for its intrinsic purpose, *L R McLean v CIR* (CA).

Example

The following example does not form part of the ruling.

Purchaser is a GST registered person who intends to enter the forestry industry in a small way. On 1 July 1996 he buys a forestry right from Supplier, who is not registered for GST. Supplier had bought the right 18 months earlier from a farmer who had decided not to diversify into forestry. Supplier had used the right on a small scale to remove a small amount of timber.

The purchase price is $20,000 payable in four quarterly instalments. The first payment is made on 1 August 1996.

Purchaser is entitled to a secondhand goods input tax deduction because the forestry right was disposed of by sale, the seller was unregistered (non-taxable supply), the forestry right was secondhand, and Purchaser acquired the right for the principal purpose of making taxable supplies. In Purchaser's next GST return (for the two months ending 31 August 1996) he should deduct as input tax the tax fraction of the amount of the first instalment ($5,000). Accordingly, he may deduct $555.55.

Companies claiming an income tax deduction for gifts of money

Public ruling - BR Pub 95/4

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation law

This ruling applies in respect of section DJ 4 of the Income Tax Act 1994.

Arrangements to which this ruling applies

This ruling applies when a company other than a "close company" makes gifts of money to any of the organisations listed in section KC 5 (1).

The period for which this ruling applies

This ruling applies to gifts of money made during the 1996, 1997, and 1998 income years, and applies to taxpayers with standard, early, or late balance dates for these years.

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The ruling

The "assessable income" figure used for the purposes of calculating a deduction for gifts of money by a company under section DJ 4 subparagraphs (a)(i) and (b)(ii) is the company's total income less allowable deductions (excluding the deduction for the gifts).

This ruling is signed by me on the 8th day of September 1995.

Jeffrey Tyler
Director (Rulings)

Analysis of the ruling

This analysis of the ruling does not form part of the ruling.

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

Background

Section DJ 4 applies when a company other than a "close company" makes gifts of money to any society, institution, organisation, trust, or fund of the kinds listed in section KC 5 (1). Section DJ 4 allows the company to claim a deduction for these gifts. The maximum amount that can be claimed is calculated under paragraphs (a) and (b) of section DJ 4 and is based on the company's "assessable income".

A donation by an individual donor to a society, institution, organisation, trust, or fund of the kinds listed in section KC 5 (1), entitles the donor to the charitable donations rebate, subject to the receipting requirements of section KC 5 (3) being met.

Section DJ 4 superseded section 147 of the Income Tax Act 1976 with respect to the tax on income derived in the 1995-96 and subsequent income years. Section 147 was amended from 1 July 1994 as part of the taxation amendments resulting from the reform of company law. Up to 1 July 1994, section 147 applied to "public companies". Following the amendment, section 147 applied to any company other than a "close company".

There has been some uncertainty over the operation of subparagraphs (a)(i) and (b)(ii) of section DJ 4. In subparagraph (b)(ii) it is stated that the assessable income used to calculate the maximum total deduction for all gifts is the company's assessable income before any deduction is allowed under section DJ 4. However, there is no statement to that effect in subparagraph (a)(i) when calculating the maximum deduction for gifts made to any one donee. There has also been some uncertainty over whether the term "assessable income" means the company's total income before or after allowable deductions.

The ruling considers whether the maximum deduction available to a company other than a close company is based on the company's "assessable income" having been calculated before or after:

- The deduction for the gifts of money; and
- The deduction of other allowable expenses from the total gross income.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
DJ 4	147
KC 5 (1)	56A(2)

Section DJ 4 states:

Subject to this section, any company (not being a close company) shall, in calculating the assessable income derived by it in any income year, be entitled to deduct the amount of any gift of money (being an amount that is not deductible otherwise than under this section) made to any society, institution, organisation, trust, or fund of any of the kinds referred to in section KC 5 (1):

Provided that the amount of the deduction under this section -

(a) In respect of the aggregate of all gifts made in that income year by any company (not being a close company) to any one donee, shall not exceed the greater of -

(i) One percent of the company's assessable income; or

(ii) $4,000; and

(b) In respect of the aggregate of all gifts made in that income year by any company (not being a close company), shall not exceed -

(i) The sum of $1,000; or

(ii) 5% of the assessable income (being the assessable income before any deduction is allowed under this section) derived by the company (not being a close company) in that year, -

whichever is the greater.

Section OB 1 defines the term "close company":

Means, at any time, a company in respect of which at that time there are 5 or fewer natural persons (with any natural person and all natural persons who are associated at the time with the natural person being treated as one natural person for this purpose)-

(i) The aggregate of whose voting interests in the company exceeds 50%; or

(ii) In any case where at the time a market value circumstance exists in respect of the company, the aggregate of whose market value interests in the company exceeds 50%;-

but does not include a special corporate entity.

Application of legislation

Section DJ 4 determines the amount that can be deducted with respect to the tax on income derived in the 1995-96 and subsequent income years by companies other than close companies for gifts of money to any of the organisations listed in section KC 5 (1).

The maximum deduction that may be claimed is:

(a) In respect of gifts to any one donee, the ***greater*** of:

(i) 1% of the company's assessable income; or

(ii) $4,000.

(b) In respect of the overall deduction claim, the ***greater*** of:

(i) $1,000; or

(ii) 5% of the company's assessable income.

Maximum deduction

The Commissioner's view is that a company's assessable income for the purposes of both subparagraphs (a)(i) and (b)(ii) of section DJ 4 is the assessable income before a deduction for the gifts of money is allowed. This ensures that the "assessable income" figure used to calculate the maximum deduction is the same under both subparagraphs (a)(i) and (b)(ii).

Meaning of "assessable income"

The Commissioner considers that the phrase "assessable income" in section DJ 4 means the total income of the company less allowable deductions.

Example

This example does not form part of the ruling.

During the year ended 31 March 1996 Company A Ltd, which is not a close company, makes gifts of money to the following approved donee organisations:

• Red Cross	$2,000
• Amnesty International	$2,500
• Leprosy Mission	$5,000
	$9,500

Company A Ltd derives assessable income in the 1996 income year (after allowable deductions but before the deduction for gifts) of $150,000. The maximum amounts that can be claimed by Company A Ltd for the gifts of money are:

(a) In respect of donations to any one donee, the greater of:

(i) $1,500 (1% of Company A Ltd's assessable income); or

(ii) $4,000.

In this case, a maximum deduction of $4,000 may be claimed in respect of each donee.

(b) In respect of the overall deduction claim, the greater of:

(i) $1,000; or

(ii) $7,500 (5% of Company A Ltd's assessable income).

In this case, a maximum overall deduction of $7,500 may be claimed.

Company A Ltd's deduction for the gift of $5,000 to the Leprosy Mission is limited to $4,000 under subparagraph (a)(ii). The excess of $1,000 is not deductible.

The overall deduction that Company A Ltd can claim for the gifts is limited to $7,500 under subparagraph (b)(ii).

United Airlines employee share purchase scheme

Product binding ruling published in Gazette

The following notice of the issue of a product ruling appeared in the New Zealand Gazette of 31 August 1995.

Notice of product ruling

1. This is a notice of a product ruling made under section 91F of the Tax Administration Act 1994.
2. Product ruling No. 95/2 was issued on 11 August 1995. It relates to an employee share purchase scheme for the benefit of the employees of United Airlines New Zealand branch.
3. A copy of the ruling may be obtained by writing to the Manager (Systems), Rulings Directorate, National Office, Inland Revenue, PO Box 2198, Wellington.

Policy statements

This section of the TIB contains policy statements issued by the Commissioner of Inland Revenue. Generally, these statements cover matters on which Inland Revenue wishes to state a policy, but which are not suitable topics for public binding rulings.

In most cases Inland Revenue will assess taxpayers in line with the following policy statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of assessment we consider that the earlier advice does not follow the law.

Retraining payments made on employment termination - assessability

Summary

This item sets out the income tax treatment of retraining payments made by an employer to an employee on the termination of employment. When the employer makes retraining payments instead of a redundancy payment, the payments are assessable as monetary remuneration of the former employee and the employer must deduct PAYE.

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

Background

When an employee's employment is terminated, an employer may agree to continue to pay the former employee's salary while he or she attends an educational institution, instead of making a redundancy payment.

The Act provides an income tax exemption for scholarships and bursaries. If the retraining payments are paid as maintenance or allowances for attending an educational institution, as a scholarship or bursary, they will be exempt from income tax. If the retraining payments are not bursaries, the exemption will not apply and the payments will be assessable under section BB 4 (b) as monetary remuneration received in respect of employment.

The taxation of redundancy payments is dealt with on page 2 of TIB Volume Four, No.4 (November 1992).

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
BB 4 (b)	65(2)(b)
CB 9 (d)	61(37)
NC 2	338
NC 16	355
OB 1 "extra emolument", "monetary remuneration"	2
OB 2 (1)	6(1)

Section OB 1 defines "salary or wages" as including:

> ... salary, wages, or allowances ... in respect of or in relation to the employment of that person ...

The section OB 1 definition of "monetary remuneration" includes salary and wages received in respect of or in relation to the employment of the taxpayer. Monetary remuneration is assessable income under section BB 4 (b).

Section CB 9 (d) provides a tax exemption for:

> Income derived by any person from any maintenance or allowance provided for or paid to that person in respect of his or her attendance at an educational institution in terms of a scholarship or bursary other than a basic grant or an independent circumstances grant made under regulations made under section 193 of the Education Act 1964, section 303 of the Education Act 1989, or any enactment in substitution for those sections:

Policy

In the Court of appeal case *Reid v CIR* (1985) 7 NZTC 5,176, 5,184 Justice Richardson stated that the essential question, in determining whether a payment is a bursary, concerns the true character of the sums received by the recipient. The Court said that the character of the payment was to be found from a consideration of all the circumstances.

The Commissioner considers that the true character of retraining payments received by an employee on the termination of employment is that they are an alternative to a redundancy payment and are not a bursary for the purposes of the section CB 9 (d) exemption. This policy is based on a consideration of all of the circumstances of the payment, including the following factors:

1. The purpose of the payment

The section CB 9 (d) exemption requires the payment to be made in respect of the recipient's attendance at an educational institution. The courts have interpreted this phrase as requiring the principal purpose of the payment to be for the education of the recipient. The Court of Appeal in *Reid v CIR* and the High Court in *CIR v Drew* (1988) 10 NZTC 5,060 examined the purpose of payments when determining whether they were a bursary.

In *Reid* the Court of Appeal found that a student teacher allowance paid by the Wellington Education Board was a bursary. The Court stated that, in this case, the appellant received the allowances essentially for educational purposes.

In *Drew*, the High Court examined the purpose of payments made by the Post Office to an employee so that the employee could gain an accountancy qualification. It found that the employer's principal purpose in making the payments was to ensure that it secured the services of a suitably qualified staff member. The secondary purpose of the payments was to give the employee educational assistance. Educational assistance was not the primary reason for making the payments and so the payments were not bursaries.

When an employer makes retraining payments to a former employee, the circumstances of the payments (including the terms of any agreement under which the payments are made) may indicate that the principal purpose of the payments is to satisfy the employer's obligation to pay redundancy payments to the employee. The furtherance of the former employee's education through the provision of financial assistance may only be a secondary purpose of the payments. When this is the case, as in *Drew*, the primary reason for the payments is not educational assistance, and the payments are not bursaries.

2. The employment relationship between the parties

When the employee receives retraining payments instead of a redundancy payment, he or she receives the payments because of the termination of the employment relationship with the former employer. The employee would not have received the payments if the parties did not have this relationship.

In *Reid*, there was no employment relationship between the parties. One of the reasons the Court in *Drew* distinguished the *Reid* decision that the payment was a bursary, and found that the principal purpose of the payment was for the employer's benefit, was that in *Drew* the employment relationship between the parties continued during the term of the payments. The decision in *Reid* can be similarly distinguished when an employer makes retraining payments to a former employee. Unlike the taxpayer in *Reid*, the former employee receives the retraining payments because of his or her former employment relationship with the employer.

3. Examination of the contract between the parties

To establish whether the retraining payments are a bursary, the Commissioner will examine any contract under which the employer makes the retraining payments, the intention of the parties in entering into that contract, the manner in which the retraining payments are made, and any other material factors.

4. Merit

The Commissioner will also look at whether eligibility for the payments depends on some form of merit, effort, or achievement by each recipient. A factor which will weigh against a payment being a bursary will exist when the employee's terms of employment determine whether or not he or she is eligible for retraining payments, rather than the payments being awarded on the basis of merit.

When an employee receives retraining payments instead of a redundancy payment, the payments are not bursaries. The section CB 9 (d) exemption does not apply and the payments are assessable as monetary remuneration.

Employer's obligation to deduct tax at source

Section NC 2 requires an employer to deduct tax from source deduction payments that it makes to employees. Section OB 2 defines "source deduction payment" as including a payment by way of salary or wages or an extra emolument. Retraining payments paid to the employee in the form of continued salary are covered by the section OB 1 definition of "salary or wages" as they are allowances in respect of or in relation to the employment of the former employee. Retraining payments paid in a lump sum constitute an extra emolument. In either case, retraining payments are source deduction payments.

Even though the employee receives the retraining payments after the termination of his or her employment, the employer must deduct PAYE from the retraining payments. When the retraining payments constitute salary or wages, the employer must deduct PAYE at the employee's marginal tax rate. When the retraining payments constitute an extra emolument, the employer must deduct PAYE at the extra emolument rate. If the employer fails to make full PAYE deductions, section NC 16 requires the employee to pay the Commissioner the tax deductions that the employer should have made.

Example

A government department informs an employee, Jane, that she is surplus to staffing requirements. It offers her the choice of a lump sum redundancy payment of $80,000 or a retraining package. Under the retraining package the employer will continue Jane's salary, in fortnightly payments, for two years while she attends university (total gross payments of $80,000).

Jane accepts the retraining package offer. The contract provides that the government department will deduct tax at source from the payments of the continued salary.

The Commissioner considers that the payment of the continued salary is not a bursary. The agree-

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ment to make the payments relates to the former employment relationship between the parties, and the principal purpose of the payments is to satisfy the redundancy rights and obligations of the employer and employee. The provision of educational assistance to the employee is only the secondary purpose of the payments. The intention of the parties, as evidenced by the method of payment and the terms of the contract, is that the payments are a continuation of Jane's salary. Jane's entitlement to the payments arises out of her employment contract, rather than from an award based on merit, effort, or achievement.

The retraining payments are assessable income in Jane's hands, and the government department must deduct PAYE at Jane's marginal tax rate.

Difference between a taxable activity (GST) and a business activity (income tax)

Summary

This item states the Commissioner's current policy on when a "taxable activity" for GST purposes may constitute a "business" for income tax purposes. It sets out the differences between a taxable activity for GST purposes and a business for income tax purposes.

Background

We have been asked to clarify whether a taxable activity for GST purposes is a business for income tax purposes in every case. There is some uncertainty as to the differences between a taxable activity and a business. Some people have assumed that once the Commissioner accepts an activity as a taxable activity, it will also be accepted as a business.

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

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
OB 1	2

Section 6(1) of the Goods and Services Tax Act 1985 (GST Act) defines the term "taxable activity" for GST purposes:

For the purposes of this Act, the term "taxable activity" means -

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

(b) Without limiting the generality of paragraph (a) of this subsection, the activities of any public authority or any local authority.

Certain activities are excluded from the term "taxable activity" under section 6(3) of the GST Act. These include activities that are essentially in the nature of a private recreational pursuit or hobby. Section 6(3) states:

Notwithstanding anything in subsections (1) and (2) of this section, for the purposes of this Act the term "taxable activity" shall not include, in relation to any person, -

(a) Being a natural person, any activity carried on essentially as a private recreational pursuit or hobby; or

(aa) Not being a natural person, any activity which, if it were carried on by a natural person, would be carried on essentially as a private recreational pursuit or hobby...

Section OB 1 defines the term "business" for income tax purposes:

"Business"-

(a) Includes any profession, trade, manufacture, or undertaking carried on for pecuniary profit:

(b) Is further defined in Schedule 6A for the purposes of that Schedule.

Case law

A person conducts a taxable activity for GST purposes when all of the following characteristics are present:

- There is some form of *activity*.
- The activity is carried on *continuously or regularly*.
- The activity involves, or is intended to involve, the supply of goods and services to another person for *consideration*.

The definition of "taxable activity" specifically includes an activity carried on in the form of a business. This means that a business activity for income tax purposes will also constitute a taxable activity for GST purposes, unless it is an activity specifically excluded by section 6(3) of the GST Act.

"Activity" has a wide meaning, and does *not* necessarily have to be an economic or commercial activity. It is defined in the Concise Oxford Dictionary as being, amongst other things, "a particular occupation or pursuit". It is essentially a series of acts that a person chooses to do. In the High Court case of *Newman v CIR* (1994) 16 NZTC 11,229, Justice Fraser stated at page 11,233:

[Activity] is a word of considerable breadth. The New Shorter Oxford English Dictionary 1993 ascribes a number of varying meanings or shades of meaning, none of which is exactly apposite to the word in its context in s 6. The nearest, I think,

is 'an occupation, a pursuit' and (in the plural) 'things that a person, animal or group chooses to do'. In its context here I think the word means a course of conduct or series of acts which a person has chosen to undertake or become engaged in.

In the Court of Appeal case of *Newman v CIR* (1995) 17 NZTC 12,097, Justice Richardson added at page 12,100:

The legislation is directed at a course of conduct which can fairly be described as being carried on continuously or regularly. As I see it, it is not a matter of importing any overlay of commercial dealing or of trying to draw a distinction between the divestment of commercial assets and private assets. Rather it is whether the process engaged in, whatever the asset or its location or the occupation of the taxpayer, comes within the statutory language. The application of the test to the particular circumstances will necessarily involve questions of fact and degree.

An activity must be carried on continuously or regularly before it can be a taxable activity. The words "carried on continuously or regularly" refer to the activity which will culminate in the supply of goods and services, rather than to the actual supply of those goods and services.

In the *Newman* decision, the Court of Appeal considered whether the taxpayer's activity was carried on continuously or regularly by examining the activity as a whole, rather than the various sequential steps or components of which the activity was comprised. The Court's approach was to see whether the activity was carried on either continuously or regularly.

An activity is "continuous" if there is no significant cessation or interruption of the activity. In other words, it is carried on all the time. Temporary interruptions in the activity for holiday or health reasons, for example, will not generally mean that the activity is not "continuous". An activity is "regular" if it is repeated at reasonably fixed intervals.

It is important to note that to be a taxable activity, the activity need only be "continuous" ***or*** "regular".

Whether or not a taxable activity exists depends on the particular facts of each case. For example, a subdivision of land into two allotments, involving no development work, will not by itself amount to a taxable activity. However, the greater the number of allotments created and sold, the more extensive the development work, the more time and effort involved and the higher the financial commitment to the project, the more likely that the activity is carried on continuously. Therefore, it is more likely that there is a taxable activity.

The Commissioner's interpretation of the meaning of "taxable activity" in the context of subdivisions following the Court of Appeal's decision in *Newman* is set out in TIB Volume Seven, No.2 (August 1995).

A taxable activity does not include an activity which is clearly carried on as a private recreational pursuit or hobby for personal enjoyment and recreation. Factors which are taken into account when determining whether an activity is a taxable activity or a hobby include:

- the reasons for conducting the activity
- the business-like nature of the operations
- the time available to devote to the activity
- the level of financial investment
- the structure and organisation of the activity.

The factors that the Commissioner considers when deciding whether an activity is a taxable activity or a hobby are set out and discussed on page 5 of TIB Volume Six, No.14 (June 1995).

These principles are established and supported by the judgments in *Case N27* (1991) 13 NZTC 3,229 and *Case P83* (1992) 14 NZTC 4,553.

An activity is a business for income tax purposes if the nature of the activities is business-like, and the actions of the taxpayer indicate an intention to make a profit. The fundamental basis of a business is that it is an activity conducted in an organised and coherent way towards an end result. It is not necessary to show that the activity has a reasonable prospect of making a profit. However, a genuine intention to make a profit must be present. These principles are established and supported by the judgment in *Grieve v CIR* (1984) 6 NZTC 61,682.

Policy

A taxable activity for GST purposes will constitute a business for income tax purposes if the nature of the activity amounts to a business, and the actions of the taxpayer indicate an intention to make a profit. An activity's income tax status is determined independently from its GST status.

Although an intention to make a profit must be present before an activity can constitute a business for income tax purposes, it is not relevant when determining whether it is a taxable activity for GST purposes. The key element of a taxable activity is the supply of goods and services for a consideration. There can be a consideration for a supply even though no profit arises. Many supplies of goods and services are made without the intention of making a profit, for example, supplies by certain public sector agencies and some charities.

Example

Mrs Wilson operates a community newspaper designed to keep the community's residents informed of important local developments. A small number of advertising spots are also sold to local businesses, etc. The sale price and advertising revenue are only sufficient to cover costs. The activity does not have to be registered for GST purposes as its turnover does not exceed $30,000.

There is no intention to make a profit from the newspaper. Mrs Wilson receives no salary or other income from the venture, and, while she admits to

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deriving enjoyment from her labours, the operation is clearly not essentially a hobby or recreational pursuit for these reasons:

- The main aim of the newspaper is to benefit the community.
- The newspaper has planned continuity.
- The newspaper's operation is regular and it is published frequently.
- Mrs Wilson runs the newspaper in a business-like manner.
- Mrs Wilson devotes considerable time to the newspaper's activities.

On the basis of the facts presented above, Mrs Wilson could register her newspaper activity voluntarily with Inland Revenue as a taxable activity for GST purposes. However, without an intention to make a profit in the venture the newspaper activity does not constitute a business for income tax purposes.

Mrs Wilson should consider the implications of a voluntary GST registration carefully before registering. Even though the activity is not returning a profit, there may still be GST payable, as input tax is not a component of certain expenses, for example wages paid to employees.

Additional tax - remission when taxpayer makes an incorrect interpretation

Summary

This item states the Commissioner's current policy on the application of section 178(1)(c) of the Tax Administration Act 1994. This section allows the Commissioner to remit the additional tax charged for underestimating residual income tax when the underestimation is caused by an incorrect interpretation of tax legislation. The additional tax charged for underestimation is commonly known as 'underestimation penalty'.

Under section 178(1)(c), the Commissioner will remit additional tax charged for underestimation only if he is satisfied that both the following conditions are met:

- The taxpayer's residual income tax was higher than the amount estimated because the taxpayer adopted an incorrect interpretation of the tax legislation when calculating the estimate.
- The taxpayer's incorrect interpretation was reasonable given the circumstances of the case.

All legislative references in this item are to the Tax Administration Act 1994 unless otherwise stated.

Background

Provisional tax is normally calculated by adding 5% to a taxpayer's residual income tax for the previous income year. Alternatively, provisional taxpayers may estimate what they expect their residual income tax will be for the coming year and make provisional tax payments based on that estimate. However, if a provisional taxpayer makes an estimate and the amount of the estimate (and the amount of provisional tax paid by the final instalment date) is less than 80% of the actual residual income tax for that year, additional tax for underestimation is charged.

There are a number of grounds the Commissioner can use to remit the additional tax charged for underestimation. One of the grounds for remission is given by section 178(1)(c).

Legislation

Cross-reference table

Tax Administration Act 1994	Income Tax Act 1976
178(1)(c)	386(1)(c)
178(6)	386(6)

Section 178 allows for the remission of additional tax charged for the underestimation of residual income tax for the 1995-96 and subsequent income years. Section 178(1)(c) deals with underestimation caused by an incorrect interpretation and states:

> Where the Commissioner is satisfied that any provisional taxpayer has become liable to pay additional tax under section 144 by reason of- ...
>
> (c) The adoption by the provisional taxpayer of an incorrect interpretation of any provision of this Act, being an interpretation which, although incorrect, is reasonable having regard to the circumstances of the case; ...
>
> the Commissioner shall remit the additional tax or any appropriate part of the additional tax.

Section 178(6) imposes a further requirement of documentary evidence, stating:

> Notwithstanding subsections (1) or (2) of this section, no person shall be entitled to a remission of additional tax under this section unless the person satisfies the Commissioner, by the production of documents or such other information as the Commissioner may require, that the requirements of this section are fulfilled in relation to that person and that additional tax.

For the 1994-95 income year, remissions were allowed by section 386 of the Income Tax Act 1976. The requirement for documentary evidence was introduced

with effect from the 1994-95 income year by section 386(6) of the Income Tax Act 1976.

Policy

The Commissioner may remit additional tax charged for underestimating residual income tax when the underestimation resulted from an incorrect interpretation of tax legislation. To remit additional tax in these circumstances, the Commissioner must be satisfied that both the following conditions are met:

- The taxpayer's residual income tax was higher than the amount estimated because the taxpayer adopted an incorrect interpretation of the tax legislation when calculating the estimate.
- The taxpayer's incorrect interpretation was reasonable given the circumstances of the case.

To meet the first of these conditions, the taxpayer must explain the incorrect interpretation and demonstrate how it was incorporated into the estimate. The taxpayer must also have documentary evidence or other information to support the claim.

To satisfy the second condition, the taxpayer must demonstrate that reasonable care was taken in attempting to interpret the law. In determining what is reasonable, the Commissioner will consider how a reasonable taxpayer of the same type and size would have interpreted the law in similar circumstances. Larger, more sophisticated taxpayers are expected to exercise a higher standard of care than smaller, less sophisticated taxpayers.

Example 1

Mrs E is a self-employed professional. She expects her business turnover to decline, so estimates her 1994-95 residual income tax to calculate her 1994-95 provisional tax. In estimating her 1994-95 residual income tax, Mrs E makes certain assumptions about what expenses are deductible for tax purposes. She keeps supporting documentation.

When Mrs E's 1994-95 residual income tax is determined, the estimate is found to be within the tolerances allowed. However, when Mrs E is later investigated by Inland Revenue it is found that she wrongly claimed an expense because of the way she interpreted the legislation. Mrs E's 1994-95 residual income tax is adjusted upwards accordingly, and she is charged additional tax for underestimation.

Mrs E has become liable for underestimation additional tax because she interpreted the legislation incorrectly when calculating the estimate. Mrs E can produce documentary evidence to show that her estimate was based on, amongst other things, the disallowed expense claim being deductible. The additional tax charged can therefore be remitted if Mrs E can satisfy the Commissioner that her interpretation of the legislation (which flowed into the estimate of her residual income tax) was reasonable for a person in her circumstances. The Commissioner would consider whether a reasonable self-employed business person could have adopted the same interpretation.

Example 2

New Co made a small loss in the 1994-95 income year, its first year of operation, so it was not asked to pay provisional tax for the 1995-96 income year. However, in the 1995-96 income year New Co expected to make a substantial profit, but did not tell its tax adviser. The tax adviser had not previously told New Co that if it expected its residual income tax to be over $300,000, it must estimate its residual income tax and pay provisional tax based on the estimate. New Co, therefore, made no estimate and paid no provisional tax in the 1995-96 income year.

New Co's 1995-96 residual income tax was $500,000. Since this was over $300,000, New Co was deemed to have made an estimate equal to the amount of provisional tax paid - which was nil. New Co was therefore charged additional tax for underestimation.

New Co's tax adviser argues that the penalty should be remitted under section 178(1)(c) because New Co made no deliberate error.

The penalty cannot be remitted. New Co did not incorrectly estimate its residual income tax by misinterpreting the legislation. In fact, New Co made no estimate at all because the legislation was completely disregarded. Section 178(1)(c) cannot be used to remit the penalty when the estimate is deemed to have been made because the residual income tax exceeded $300,000.

Even if New Co deliberately made an estimate of nil on the basis that it made a loss in the previous income year, the penalty could still not be remitted. The Commissioner considers that a company taxpayer with residual income tax of $500,000 should know that the legislation requires any estimate to be fair and reasonable.

Employer premium rate - partnership earnings other than as an employee

Summary

This item states the correct employer premium rate applicable to a taxpayer's earnings from a partnership other than as an employee.

When a partner's earnings other than as an employee are solely from the partnership business, the employer premium rate is determined by the business activity of the partnership. When a partner engages in two or more business activities, the employer premium on ***all*** the partner's earnings other than as an employee is calculated using the rate for the business activity with the highest premium rate.

Background

Employer premium is payable by:

- employers on earnings paid to their employees; and
- self-employed people on their earnings other than as an employee.

A taxpayer in his or her capacity as a partner is self-employed and must pay employer premium on all earnings other than as an employee.

ACC has produced a schedule of employer premium classification units. These units cover a wide range of industrial, trade, business, and professional activities. Each unit description is based on what is produced or the service being offered. The premium for each activity is set at a basic rate to reflect the risk level of the particular industry.

Legislation

The Accident Rehabilitation and Compensation Insurance (Earnings Definition) Regulations 1992 define "earnings other than as an employee":

"Earnings other than as an employee", in relation to any person and any income year, means the amount of assessable income (if any) derived by the person in the income year for the purposes of the Income Tax Act 1976 which -

(a) Is dependent on the personal exertions of the person; and

(b) If the person were to suffer any incapacity, the person would cease to derive as a consequence of such incapacity, -

after deducting all amounts allowable as deductions to the person for the purposes of the Income Tax Act 1976 which are allowable by virtue of the person deriving the income referred to in this clause; but does not include any earnings as an employee.

The Accident Rehabilitation and Compensation Insurance (Employment Premiums) Regulations 1994 state:

3. Classification of earners for premiums purposes

   For the purposes of calculation and payment of premiums under the Act-

   (a) Earners shall be classified into their respective categories of -

      (i) Persons who have earnings other than as an employee; and

      (ii) Employees; and...

   (c) Except as provided in regulations 5 and 7 of these regulations, persons who have earnings other than as an employee shall be also classified according to the description or division of classification unit, as set out in the Schedule to these regulations, which most accurately describes their classification unit.

5. Classification where person who has earnings other than as an employee engaged in 2 or more classification units-

   Where a person who has earnings other than as an employee is engaged in 2 or more classification units, that person shall, for the purpose of calculation and payment of premiums, be classified in the description or division of those classification units for which the highest rate of premium is prescribed.

Application of legislation

The item "Self-Employed Accident Compensation Levy" in PIB 178 (February 1989) at page 16 stated that:

The industrial activity class applicable to each member of the partnership depends upon the industrial activity of the individual self-employed person, not the industrial activity of the partnership.

That statement referred to the self-employed levy that has now been replaced by the employer premium under the Regulations. We explain the current position below.

The rate of employer premium payable by a partner depends on the source or sources of earnings other than as an employee in the partner's personal tax return.

When a partner's earnings other than as an employee are solely from the partnership business, the premium is calculated using the employer premium classification unit description that best reflects the business activity of the partnership.

However, when a partner engages in two or more business activities (i.e. has earnings other than as an employee both outside and from the partnership), the premium is calculated on ***all*** earnings other than as an employee using the highest rate of the classification units in which the partner is involved.

Example

Margo and Hone are partners in a retail furniture store. Margo works in the shop and Hone does the book work and other administrative tasks.

The employer premium rate applicable to Margo and Hone's partnership income is determined by the

business activity of the partnership. The most accurate description for that activity is Furniture-Retailing (unit no. 52310) which has a premium rate of $1.53.

In her individual tax return Margo has further self-employed income from her bricklaying business. The premium rate for this activity is $5.55 (unit no. 42220). Hone has other income from his employment-agency business. The premium rate for this activity is $1.10 (unit no. 78610).

ACC premium treatment:

Margo has the premium rates of $1.53 and $5.55. She pays the employer premium at the higher rate of $5.55 on all her self-employed income, including her income from the partnership.

Hone has the premium rates of $1.53 and $1.10. He pays the employer premium at the higher rate of $1.53 on all his self-employed income, including his income from the partnership.

The higher rate applies to Margo and Hone because they have earnings other than as an employee both in their own right and from the partnership. When a taxpayer is involved in two or more activities, the premium rate of the highest rated activity is applied to all the activities.

Sleeping partners

A sleeping partner is a partner who has capital in a business and shares in its profits without taking any part in the management or day to day running. A sleeping partner is not liable for employer premium on his or her share of the partnership income.

Sleeping partners are excluded from the definition of "earnings other than as an employee" for these reasons:

- Their share of the partnership income does not depend on their personal exertion.
- Their share of partnership income would not cease if they suffered an incapacity.

Zero-rating goods and services for GST - where to enquire

Summary

This item clarifies Inland Revenue's and New Zealand Customs' roles in dealing with public enquiries on zero-rating goods and services tax (GST). Inland Revenue is responsible for answering all enquiries relating to section 11 of the Goods and Services Tax Act 1985 (the zero-rating section). NZ Customs is responsible for answering enquiries relating to sections 12 and 13 of the Act.

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

Background

Section 11 provides for the zero-rating of goods and services. Some paragraphs in sections 11(1) and 11(2) refer to the Customs Act 1966. Customers who have enquiries on a part of section 11 that refers to the Customs Act are sometimes unsure whether to contact NZ Customs or Inland Revenue for advice.

Legislation

Section 1(3) states:

> Sections 12 and 13 of this Act, and also section 42 of this Act in so far as it applies to the Comptroller of Customs, shall be deemed to be one of the Customs Acts.

Section 12 refers to the imposition of GST on imports, and section 13 refers to the imposition of GST on goods liable to excise duty and supplied at "in bond" prices.

Goods and services are zero-rated under section 11. Section 11(1) lists the goods that can be zero-rated.

Seven of the paragraphs in section 11(1) refer to the Customs Act. They are (a), (aa), (ac), (ad), (ae), (af), and (b). These paragraphs refer to:

- goods entered for export pursuant to the Customs Act
- goods whose supplier is licensed under the Customs Act either as an export warehouse (i.e., a duty free shop), or an export warehouse and a sealed bag operator.

Section 11(2) lists the services that can be zero-rated. Paragraph (ca) refers to the Customs Act. It states that services directly connected with goods referred to in sections 47(2) or 181 of the Customs Act may be zero-rated.

Section 47(2) of the Customs Act refers to ships' stores and goods whose destination is outside the territorial limits of New Zealand. The proviso applies to stores and goods that are not removed from the ship or aircraft while it is in New Zealand.

Section 181 of the Customs Act refers to goods which are temporarily imported.

Roles of Inland Revenue and NZ Customs

Customers are often unsure whom to contact when they have a query on a part of section 11 of the Goods and Services Tax Act which refers to the Customs Act. In this situation the customer should contact Inland Revenue. If the Inland Revenue officer who is handling the enquiry is unsure about any of the provisions of the Customs Act that section 11 of the Goods and Services Tax Act refers to, he or she will research the matter, and if necessary contact NZ Customs for clarification.

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In some situations the Inland Revenue officer may need to refer the customer to NZ Customs. These situations may arise when:

- The goods need to be entered for export to qualify for zero-rating. NZ Customs handles the process of entering goods for export.
- The supplier needs to obtain a licence to operate either an export warehouse, or an export warehouse and a sealed bag system, for the goods to qualify for zero-rating. NZ Customs is responsible for issuing licences.
- The relevant services are supplied in connection with goods for which a temporary import entry is needed before the services can qualify for zero-rating. NZ Customs is responsible for granting the temporary import entry for the goods.

NZ Customs is fully responsible for administering sections 12 and 13 of the Goods and Services Tax Act. These sections relate to imported goods and goods liable to excise duty. If the enquiry relates to either of these sections, the customer should contact NZ Customs.

GST registration - effective date when applicant requests backdated voluntary registration

Summary

This item sets out the Commissioner's policy on voluntary GST registration when the applicant requests registration to be effective from a date in the past under section 51 of the Goods and Services Tax Act 1985.

People who make taxable supplies of less than $30,000 may register voluntarily under the Goods and Services Tax Act 1985. The Commissioner has a broad discretion to set an effective date of registration. He normally exercises this discretion by registering the person from the date of the application, or from a date in the future if the taxpayer intends to carry on a taxable activity from a specified date.

In exceptional circumstances the Commissioner may register the person effective from a past date. The Commissioner will consider the individual factors of each case in determining whether the circumstances justify backdating the registration date. Some of the factors that the Commissioner may consider and weigh up when exercising the discretion are:

- the reason why the applicant did not request registration at the time that registration was first desirable
- whether the applicant proceeded in business in the belief that he or she was ineligible to be registered
- whether the applicant considered that he or she had been registered automatically
- whether the applicant can substantiate the amount of output tax payable
- the amount of time between the date of application and the date the applicant wishes to be registered from
- the possible effect on the administration of the Goods and Services Tax Act 1985.

This is not an exhaustive list. The Commissioner will consider other factors that the applicant can show are relevant to the backdating of the registration.

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

Background

Some people have applied for voluntary registration and have sought to have the registration effective from a date in the past. They have then sought to claim input tax deductions for those past periods.

These applications have resulted in queries as to how the Commissioner applies his discretion in determining the effective date of registration.

Legislation

Section 51 sets out the rules for registering for GST. Sections 51(3) and 51(4) relate to voluntary registration, and state:

Section 51(3)

Notwithstanding subsections (1) and (2) of this section, every person who satisfies the Commissioner that, on or after the 1st day of October 1986, -

(a) That person is carrying on any taxable activity; or

(b) That person intends to carry on any taxable activity from a specified date, -

may apply to the Commissioner in the prescribed form for registration under this Act, and provide the Commissioner with such further particulars as the Commissioner may require for the purpose of registering that person.

Section 51(4)

Where any person has-

(a) Made application for the registration pursuant to subsection (2) or subsection (3) of this section, and the Commissioner is satisfied that that person is eligible to be registered under this Act, that person shall be a registered person for the purposes of this Act with effect from such date as the Commissioner may determine; or

(b) Not made application for registration pursuant to subsection (2) of this section, and the Commissioner is satisfied

> that that person is liable to be registered under this Act, that person shall be a registered person for the purposes of this Act with effect from the date on which that person first became liable to be registered under this Act:
>
> Provided that the Commissioner may, having regard to the circumstances of the case, determine that person to be a registered person from such later date as the Commissioner considers equitable.

Policy

Application of legislation

The Commissioner will consider each request for backdated registration according to the facts of that particular case.

Generally, the Commissioner will select the date of application or a date in the future to be the date of registration, unless there are circumstances that justify registering the person effective from a date in the past.

The Commissioner will only register a person retrospectively when the circumstances show that it would be unfair on the taxpayer for the registration not to be retrospective. When considering whether to backdate the registration, the Commissioner may consider and weigh up the following factors:

- The reason why the applicant did not seek voluntary registration at the time that he or she is requesting to be registered from. The person must have been carrying on a taxable activity at that date and intending to register from that date, but circumstances prevailed that prevented registration. Persuasive circumstances are: absence overseas, illness, or personal tragedy. Ignorance of obligations over a long period of time, or failure to register are not persuasive reasons.
- Whether the applicant proceeded in business in the belief that he or she was ineligible to be registered. For example, the person's business activity might easily appear at first sight to be an exempt activity, but the applicant later discovered from a reliable source that the activity was a taxable activity.
- Whether the applicant has proceeded in business on the reasonable belief that he or she had automatically been registered. Evidence of this belief might be demonstrated by the applicant mistakenly charging GST on the goods and services supplied.
- Whether the applicant can substantiate the amount of output tax payable on the supplies made during that period. The applicant must have accurate accounting records to be able to establish the supplies that were made over the period and to whom.
- The amount of time between the date of application and the requested registration date will be a significant factor. The longer the time between the application date and the requested registration date, the less likely it will be that the Commissioner will exercise the discretion.
- The effect that this would have on the administration of the Act. This considers the effect that the backdating of the registration would have on other registered persons.

The above factors are not an exhaustive list; other factors particular to an applicant's circumstances may influence the Commissioner's decision.

Consequences of the Commissioner agreeing or declining to backdate the applicant's registration

When the Commissioner does backdate the registration, the applicant must do both of the following:

- return the output tax that should have been charged on past supplies made
- issue GST tax invoices to the recipients of the supplies made since the date of registration so that the recipients can claim GST input deductions in the current period.

The applicant may also reduce the output tax by the amount of input tax paid for goods and services acquired for the principal purpose of making taxable supplies for that period, provided that the applicant has the relevant tax invoices.

When the Commissioner does not backdate the registration, the person must account for GST from the date that the person is registered. From the registration date, the applicant will be able to claim input tax deductions for goods acquired for the principal purpose of making taxable supplies.

Example

A retailer has been selling beauty products for the past year. During that year the value of his supplies has not exceeded $30,000 in any 12-month period, and he has not registered for GST. He has not charged GST on the goods sold during this period.

Following advice from his accountant, he decides to apply for voluntary registration. He has requested that the registration is effective from the date that he started selling beauty products.

The relevant circumstances of this case are:

- The applicant has asked the Commissioner to register him for GST retrospectively once he became aware of the tax consequences of registration. The reason why he did not register initially is that he had not sought professional advice at that time. The delay in requesting registration is not due to external circumstances over which he had no control.
- The applicant has not proceeded in business in the belief that he was registered or liable to be registered.
- The applicant's accounting system is poor. It does not provide a reliable record of the number of

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sales nor to whom they were made, during that period.

- The applicant has sought registration effective from the date that he commenced selling beauty products. One year has passed since then.
- The length of time the applicant has been selling beauty products suggests that a number of other registered persons would be affected if the Commissioner retrospectively registered the retailer. Because of the poor accounts and records that have been kept, the applicant will not be able to issue GST tax invoices for those supplies.

In this case, the Commissioner would decline to backdate the retailer's GST registration, because on balancing the above factors it would be fair to decline to register the retailer retrospectively.

Conveyances involving intermediaries - conveyance duty

Summary

This item discusses the application of conveyance duty when an intermediary is involved in the conveyance of property. In these cases, section 16 of the Stamp and Cheque Duties Act 1971 may apply for the purposes of assessing conveyance duty. If section 16 applies, conveyance duty must be paid on the transfer from the vendor to the intermediary as well as on the transfer from the intermediary to the ultimate purchaser. This is the case even if the two (or more) transfers are effected by the one instrument of conveyance.

Whether or not section 16 applies will depend on the circumstances of each case. Generally speaking, if the transfer of property is from a vendor to a "true" nominee or agent, and then to a principal, conveyance duty is payable only once on the transaction. However, if the transfer of property is from a vendor to an intermediary to a third party by way of sale, assignment, or novation, conveyance duty is payable twice - once on the transfer from the vendor to the intermediary, and once on the transfer from the intermediary to the third party.

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

Background

Stamp duty is generally payable on instruments for conveyances and leases of commercial land and buildings (including conveyances of shares in flat or office owning companies) executed on or after 17 March 1988.

Stamp duty that is payable on an instrument of conveyance is referred to as "conveyance duty". Conveyance duty is assessed on the value of the property conveyed.

There are various ways in which property may be transferred. In some cases, property may be transferred from the vendor to a person other than that named as purchaser. In this case there is an intermediate transaction (or several intermediate transactions). Section 16 may operate to ensure that conveyance duty is payable on each of the intermediate transactions involved, and not only the transfer to the last purchaser.

Legislation

Section 16 states:

(1) This section applies to every instrument of conveyance whereby property is conveyed -

(a) By the direction, at the request, or with the consent of an intermediary who by any means whatsoever has the right to call for a conveyance of the property to himself or to any other person; or

(b) Pursuant to any derivative title obtained by the person to whom the property is conveyed from or through an intermediary by any means whatsoever.

(2) Every instrument of conveyance to which this section applies shall recite the fact of the direction, request, consent, or derivative title.

(3) Every instrument of conveyance to which this section applies shall, for the purposes of assessing conveyance duty, be deemed to be an instrument of conveyance of the property from the person conveying the property to the intermediary and to be also an instrument of conveyance of the property from the intermediary to the person to whom the property is conveyed.

(4) Every person who executes an instrument of conveyance to which this section applies, but which does not contain the recital required by subsection (2) of this section, commits an offence and is liable on summary conviction to a fine not exceeding $2,000.

Application of legislation

Section 16 applies when these two conditions apply:

1. There is an instrument of conveyance that conveys property.
2. ***Either*** the property is conveyed by the direction, at the request, or with the consent of an intermediary who has the right to call for a conveyance of the property to himself or herself or to any other person; ***or*** the property is conveyed under any derivative title obtained by the person to whom the property is conveyed from or through an intermediary.

Essentially, the question of whether an instrument of conveyance falls within section 16 is one of fact. This will be determined primarily by the documents evidencing the conveyance, as well as by the surrounding facts.

The general question to ask is, has there been one or more than one transaction? If there has been more than one transaction, section 16 is likely to apply. Factors that suggest that section 16 may apply are:

- a relationship between the intermediary and the ultimate purchaser which suggests an assignment or sale
- consideration passing from the ultimate purchaser to the intermediary.

If section 16 applies, the instrument of conveyance must recite the fact of the direction, request, consent, or derivative title. If the instrument of conveyance does not contain the recital, the person who executes the document commits an offence and can be fined up to $2,000.

For the purposes of assessing conveyance duty, the instrument of conveyance is deemed to be an instrument of conveyance of the property from both:

- the person conveying the property to the intermediary; and
- the intermediary to the person to whom the property is conveyed.

Case law

The High Court decision of *Eastern Bay Builders Ltd and Eastland Construction Ltd v CIR* (1989) 11 NZTC 6,014 discussed the distinction that arises between the situation when there is truly an on-selling of property (and two transactions) and the situation when there is a true nomination (where there is one transaction only). In that case, *Eastern Bay Builders Ltd* ("*Eastern Bay*") entered into an agreement for the sale and purchase of property with the vendors. One month later, a memorandum of transfer was executed between the vendors and *Eastland Construction Ltd* ("*Eastland*") for the property described in the sale and purchase agreement. The consideration in both documents was the same.

The issue for consideration by the Court was whether a transfer by direction had taken place under section 16, and whether duty was payable on both the agreement and on the transfer.

On page 6,015 of the judgment, Justice Gallen commented on the various ways in which property in a transaction may be transferred from the vendor to some person other than that named as purchaser:

Assignment - In the case of an assignment, as between the vendor and purchaser, the original contract remains in existence. There is clearly a second transaction involving a contract between the purchaser and the assignee.

Novation - In the case of novation, there is a new and substitutionary contract involving the parties. There is, by its very nature, a second transaction.

Nomination - In the case of nomination, the purchaser may simply direct that the property is to be transferred into the name of the nominee without there being any contractual relationship or transaction between the purchaser and the nominee at all. Alternately, there may genuinely be a second transaction between the purchaser and the nominee.

Justice Gallen noted on page 6,015 that section 16 was designed to ensure that duty may be recovered on one or more separate sales of the same piece of land. In this case the facts did not show separate sales of property between the vendor and Eastern Bay and between Eastern Bay and Eastland. The situation was one of a true nomination and there was nothing in the relationship between the purchaser and the nominee which indicated an assignment or sale, nor was there any question of consideration passing between the purchaser and the nominee.

Examples

Both examples assume that instruments of conveyance referred to are subject to conveyance duty.

Example 1

An agreement for the sale and purchase of land is entered into between Derek as vendor, and Basil or his nominee as purchaser. A document executed by Basil before settlement gave notice to Derek that Basil's nominee was B Ltd on whose behalf Basil was acting as agent. The related memorandum of transfer shows Derek as vendor and B Ltd as purchaser.

Section 16 does not apply in this case. B Ltd is not purchasing the property from Basil. The facts establish that there is no sale from Basil to B Ltd, nor is there any consideration passing between the parties. B Ltd is in the position of an original purchaser. Conveyance duty is only payable once on the transaction.

Example 2

An agreement for the sale and purchase of land is entered into between Moana as vendor, and Tina or her nominee as purchaser. After the agreement is signed, but before the settlement date, Tina offers to sell the property to a third party for $5,000 more than she had agreed to pay Moana. It is Tina's intention to make the new purchaser her nominee under the original contract with Moana.

In this case, section 16 applies. There are two distinct transfers in this case and each of the transfers is a sale for consideration. Conveyance duty is payable twice (on the instrument of conveyance from Moana to Tina and on the instrument of conveyance from Tina to the third party). The use of the words "or her nominee" do not affect the liability to conveyance duty.

Legislation and determinations

This section of the TIB covers items such as recent tax legislation, accrual and depreciation determinations, livestock values and changes in FBT and GST interest rates.

Golfing equipment - depreciation

Introduction

The Commissioner has issued Determination DEP 10: Tax Depreciation Rates General Determination Number 10, which is reproduced below. This Determination sets four new general depreciation asset classes and rates for various items of golfing equipment.

Expense items

In addition to setting new depreciation rates, the Commissioner has considered the income tax treatment of three other types of golfing equipment. The Commissioner's view is that the cost of the following items may be deducted as revenue expenditure:

- Golf tee mats (top mat only)
- Golf balls
- Golf tees.

General Depreciation Determination DEP10

This determination may be cited as "Determination DEP10: Tax Depreciation Rates General Determination Number 10".

1. Application

This determination applies to taxpayers who own the asset classes listed below.

This determination applies to "depreciable property" other than "excluded depreciable property" for the 1995-96 and subsequent income years.

2. Determination

Pursuant to section EG 4 of the Income Tax Act 1994 I hereby amend Determination DEP1: Tax Depreciation Rates General Determination Number 1 (as previously amended) by:

Inserting into the "Leisure" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

Leisure	Estimated useful life (years)	DV banded depn rate (%)	SL equivalent banded depn rate (%)
Golf driving ranges, netting (for golf driving nets)	5	33	24
Golf driving ranges, poles (for golf driving nets)	20	9.5	6.5
Golf ball placing machine and sensor	3	50	40
Golf mats (stance and base, at golf driving/practice ranges)	2	63.5	63.5

3. Interpretation

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

This determination is signed by me on the 15th day of September 1995.

Craig Neil
Manager (Rulings)

CCH electronic publications - depreciation

The Commissioner has issued Determination PROV 4: Tax Depreciation Rates Provisional Determination Rates Provisional Determination Number 4, which applies to some CCH electronic publications. The determination is reproduced below.

Provisional Depreciation Determination PROV 4

This determination may be cited as "Determination PROV 4: Tax Depreciation Rates Provisional Determination Number 4".

1. Application

This determination applies to taxpayers who own assets in the "CCH Electronic New Zealand Essential Tax Package, designed for a specific income year" and the "CCH Electronic New Zealand Master Tax Guide, designed for a specific income year" asset category.

This determination applies to "depreciable property" other than "excluded depreciable property" for the 1994/95 and subsequent income years.

2. Determination

Pursuant to section EG 10 (1)(b) of the Income Tax Act 1994 I hereby amend Determination DEP1: Tax Depreciation Rates General Determination Number 1 (as previously amended) by:

Inserting into the "software" asset category the provisional asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

Software	Estimated useful life (years)	DV banded depn rate (%)	SL equivalent banded depn rate (%)
CCH Electronic New Zealand Master Tax Guide, designed for a specific tax year.	1	100	100
CCH Electronic New Zealand Essential Tax Package, designed for a specific tax year.	1	100	100

3. Interpretation

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

This determination is signed by me on the 7th day of September 1995.

Craig Neil
Manager (Rulings)

FBT - prescribed interest rate lowered to 10.6%

The prescribed interest rate used to calculate the fringe benefit value of low interest employment-related loans has been lowered to 10.6% for the quarter starting on 1 July 1995. This rate will continue to apply to subsequent quarters until any further adjustment is made.

The prescribed interest rate was 9.2% for the quarter starting on 1 January 1995 and 11.0% for the quarter starting on 1 April 1995.

Wool combing machinery - depreciation

The Commissioner has issued Determination DEP11: Tax Depreciation Rates General Determination Number 11. This determination sets three new general depreciation asset classes for wool combing machinery. These new asset classes clarify the existing asset classes, but they do not change the depreciation rates that apply to the machinery.

Wool bins

The Commissioner believes that the applicable asset class for live bottom wool storage bins is "Blowing systems (for wool)" with an estimated life ("EUL") of 15.5 years. To clarify this, the Commissioner has set a new asset class "Bin (wool storage, live bottom)" with an EUL of 15.5 years.

Combing machines

Combing machines are not specifically listed in the depreciation table. The Commissioner believes that the rate that applies to combing machines is the default class of the "Textile, Garment and Carpet Manufacturing" industry category. The default class has an EUL of 15.5 years. To clarify this, the Commissioner has set a new asset class "Combing machines" with an EUL of 15.5 years.

Gill machines

The Commissioner believes that the applicable asset class for bump presses, preparers, finishers, and gill machines is "Sliver package machine" with an EUL of 20 years. To clarify this, the Commissioner has set a new asset class "Gill machines" with an EUL of 20 years.

The determination is reproduced below.

General Depreciation Determination DEP11

This determination may be cited as "Determination DEP11: Tax Depreciation Rates General Determination Number 11".

1. Application

This determination applies to taxpayers who own the asset classes listed below.

This determination applies to "depreciable property" other than "excluded depreciable property" for the 1994/95 and subsequent income years.

2. Determination

Pursuant to section EG 4 of the Income Tax Act 1994 I hereby amend Determination DEP1: Tax Depreciation Rates General Determination Number 1 (as previously amended) by:

Inserting into the "Textile, Garment and Carpet Manufacturing" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

Textile, garment and carpet manufacturing	Estimated useful life (years)	DV banded depn rate (%)	SL equivalent banded depn rate (%)
Bin (wool storage, live bottom)	15.5	12	8
Combing machines	15.5	12	8
Gill machines	20	9.5	6.5

3. Interpretation

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

This determination is signed by me on the 15th day of September 1995.

Virginia Flaus
Manager (Rulings)

Questions we've been asked

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

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

Income Tax Act 1994

German pension received by New Zealand resident - whether assessable

Section BB 3 (section 242, Income Tax Act 1976) - Liability to tax of income derived from New Zealand and abroad: A taxpayer who is resident in New Zealand receives a pension from the German Bundesversicherungsanstalt (equivalent to New Zealand Income Support Service). She has received a letter from the German Embassy stating that the pension is not taxable in New Zealand, and has asked Inland Revenue to confirm this.

Section BB 3 (a) states:

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

Section CH 1 (1) (section 65(2)(j), Income Tax Act 1976) states:

> Without in any way limiting the meaning of the term, the assessable income of any person shall for the purposes of this Act be deemed to include all pensions, save so far as express provision is made in this Act to the contrary.

However, under The Double Taxation Relief (Federal Republic of Germany) Order 1980, Article 18(2):

> Periodic or non-periodic social security pensions and other similar allowances received from a Contracting State, a "Land", a political sub-division, a local authority or a governmental instrumentality thereof, shall be taxable only in that State.

A double tax agreement overrides the domestic law of the contracting states, so the pension received is not taxable in New Zealand. Any taxpayer who has been assessed with tax in New Zealand on his or her pension from the German Bundesversicherungsanstalt, should apply to the local Inland Revenue office for a reassessment.

Deductibility of costs incurred in obtaining a limited (restricted) driving licence

Section BB 7 (section 104, Income Tax Act 1976) - Expenditure or loss incurred in production of assessable income: A self-employed taxpayer has incurred court costs and lawyers' fees amounting to $1,200 in a successful application to obtain a limited driver's licence for six months. The taxpayer lost her full licence when she was recently disqualified from driving. Her adviser has asked if the costs and fees are deductible as the taxpayer needs the licence for her business, and whether the success of the application is relevant to that deductibility.

We had to contact the adviser to ascertain the conditions on which the limited licence was issued. These were:

- The licence only applied to business use in the taxpayer's business vehicle.
- It was restricted to the taxpayer's business hours of 0800 - 1700 hours.

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- It covered a restricted area of travel, i.e. a radius of 25 kilometres from the taxpayer's home, enabling her to service her clients.

Section BB 7 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.

In this case, the taxpayer did not attempt to recover her full licence, but sought only to obtain a licence that would allow her to continue her business. The expenditure was incurred to preserve the taxpayer's income earning capacity, and as such was deductible. Deductibility hinges on the connection between the expenditure and producing assessable income or carrying on a business. Therefore, provided the criteria in section BB 7 are satisfied, the success or otherwise of the application is irrelevant.

Farm vendor mortgage income

Section CB 1 (1)(d) (section 61(52), Income Tax Act 1976): The trustee of a deceased person's estate is receiving income from a farm vendor mortgage. The trustee is aware that the income was exempt when received by the deceased, and has inquired if it is exempt when derived by the estate.

Section CB 1 (1)(d) exempts up to 50% of the income derived by a "person" from any farm vendor mortgage. However, for the purposes of the exemption, the term "person" does not include:

... a trustee assessable and liable to income tax under sections HH 3 to HH 6, HK 14, and HZ 2.

Therefore, any income from a farm vendor mortgage is taxable and the exemption does not apply.

A "farm vendor mortgage" is a mortgage which meets all the following criteria:

- It secures a loan provided by the vendor or vendors of a farm.
- It was approved by the Rural Banking and Finance Corporation of New Zealand for the purposes of the exemption mentioned above.
- The Corporation has sent a written notice of approval to Inland Revenue.

Goodwill charged on granting of a sublease - whether assessable income

Section CE 1 (1)(e) (section 65(2)(g), Income Tax Act 1976) - Investment income: A taxpayer who is the lessee of a parcel of land wishes to grant a sublease. Included in the charge for the sublease will be an amount for "site goodwill". The taxpayer has sought confirmation that, because he is not the owner of the land, section CE 1 (1)(e) will not apply.

Section CE 1 (1)(e) deems any payments of goodwill derived by the owner of land from any lease, licence, or easement affecting the land to be assessable income. The term "owner of land" includes any person with any right to the possession of the land. Therefore, in this situation the lessee is an "owner of land" for the purposes of the section, and consequently the amount received for goodwill from subleasing the land is assessable income.

The goodwill payment is treated as rental income "derived in anticipation". Under section EB 2 (section 80, Income Tax Act 1976), such income may be apportioned between the income year and up to five subsequent years. If apportionment is required, the taxpayer must apply to Inland Revenue within the year following payment of the goodwill.

Interest earned overseas - when assessable in New Zealand

Section EB 1 (section 75, Income Tax Act 1976) - Income credited in account or otherwise dealt with: A New Zealand resident taxpayer who is a cash basis holder under the accruals rules has on-call deposits of NZ$250,000 with an overseas bank. She plans to withdraw the funds, including accrued interest, when exchange rates are in a favourable position, and acknowledges that at that time she will need to account for any realised gains. She has asked when she will become liable for income tax on the interest earned.

Section BB 3 (a) (section 242(a), Income Tax Act 1976) creates a liability for income tax:

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

Section EB 1 (1) (section 75(1), Income Tax Act 1976) deems income to have been derived:

... every person shall be deemed to have derived income although it has not been actually paid to or received by the person, or already become due or receivable, but has been credited in account, or reinvested, or accumulated, or capitalised, or carried to any reserve, sinking, or insurance fund, or otherwise dealt with in the person's interest or on the person's behalf.

Section BB 1 (section 38, Income Tax Act 1976) imposes income tax:

(1) Subject to this Act, there shall be levied and paid for the use of the Crown, for the year commencing 1 April in each year, a tax in this Act referred to as income tax.

(2) Subject to this Act, income tax shall be payable by every person on all income derived by that person during the year for which the tax is payable.

The taxpayer must pay income tax on the interest in the year that it is credited to her overseas deposit account.

She will become subject to tax on any realised gains or losses at the time she makes a cash base price adjustment, assuming she meets the criteria of a cash basis holder contained in section EH 3 (section 64D, Income Tax Act 1976). This means that she will be taxed on realised foreign exchange gains or losses when she sells or otherwise transfers the financial arrangement.

Depreciable asset purchased and sold in same income year - loss deduction

Section EG 19 (3) (section 117(3), Income Tax Act 1976) - Gain or loss from disposition of depreciable property: A taxpayer has asked if she can claim a deduction for a loss on a depreciable asset purchased and sold in the same income year.

Section EG 19 (3) allows a deduction when any depreciable property (other than a building) is disposed of by a taxpayer for a consideration less than its "adjusted tax value" at the time of disposition. The amount by which the adjusted tax value exceeds the consideration received can be deducted from the assessable income in the year in which the disposition occurs.

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Adjusted tax value is defined in section OB 1. The definition includes this formula:

bv (base value) - ad (aggregate deductions)

Note that under section EG 1 (2), no deduction for depreciation is allowed for the income year in which the property is sold, except when the property is a building or "schedule depreciable property". Schedule depreciable property is depreciable property that is one of these:

- a petroleum drilling rig
- a support vessel for an offshore petroleum drilling rig
- a support vessel for an offshore petroleum production platform.

In this case, the taxpayer was able to claim for the loss incurred on the sale of the depreciable property.

Donations placed in donation boxes - rebate

Section KC 5 (section 56A, Income Tax Act 1976) - Rebate in respect of gifts of money: A taxpayer has asked whether payments made in a donation box at a church or other location qualify for a section KC 5 rebate.

Section KC 5 allows a rebate for a donation of $5 or more, paid during the year to specified donee organisations. The maximum rebate is $500 or 33 $^1/_3$ cents in the dollar of the donations made, whichever is the lower.

To claim the rebate, the taxpayer must produce receipts or be able to satisfy Inland Revenue that the payment has been made. A taxpayer who has a receipt or other proof of payment (such as a letter of acknowledgment) may claim a rebate. The organisation to which the donation is being made must be a qualifying organisation. Confirmation of an organisation's qualifying donee status may be obtained by contacting an Inland Revenue district office.

When the payment is made in a donation box at a church or elsewhere, a receipt may not be issued. In these cases, if the donor wishes to claim a rebate, he or she should put the donation in an envelope with a note containing the donor's name and address and asking for a receipt. As an alternative, payment can be made direct to the donee organisation so that it can issue a receipt.

In situations when a couple has made a joint contribution, the donation may be split between the two people and a claim made of their share, up to the maximum rebate of $500. In these cases only one receipt need be obtained. The receipt should be included with one return, and a note to that effect should be attached to the other person's return.

Qualifying company with five or fewer shareholders

Section OB 3 (3) (section 393B(3), Income Tax Act 1976) - Special rules for shareholding: A married couple are shareholders in a manufacturing company that is a qualifying company. They know that, being married, they count as a single person for the purposes of the "five or fewer shareholder" test. As the couple are about to divorce they have asked if this test will continue to be satisfied. There are four other shareholders.

Special rules are used to determine the number of taxpayers in a company for qualifying company purposes. Under section OB 3 (3)(b), shareholders who are

natural persons, and who are related by blood or marriage to within one degree of relationship are deemed to be one shareholder. Examples of the one degree of relationship test are parent/child and husband/wife.

Section OB 3 (3)(c) further provides that, as long as the person remains a shareholder, death or dissolution of a marriage does not break the one degree test, provided the company is a qualifying company at the time of the death or dissolution.

Secondary employment earnings - why taxed at a flat rate

Schedule 19 (Second Schedule, Income Tax Act 1976) - Basic tax deductions: A taxpayer has asked why secondary employment earnings have PAYE deducted at the flat rate of 28.6 cents in the dollar.

Under schedule 19, secondary employment earnings are subject to a basic tax deduction of 28 cents in the dollar. This is increased by the ACC earner premium of 0.6 cents in the dollar, giving a total deduction of 28.6 cents in the dollar.

The deduction rate of 28 cents in the dollar is based on the effective marginal tax rate of a person earning an annual income between $9,500 and $30,875. Taking into account the low income rebate, the following effective marginal tax rates apply in New Zealand:

Income $0-$9,500	15 cents in the dollar
Income $9,501-$30,875	28 cents in the dollar
Income over $30,875	33 cents in the dollar.

The "marginal tax rate" is the rate of tax that applies to the next dollar. For example, the tax on an income of $20,000 is not all at 28 cents in the dollar. The first $9,500 is taxed at an effective marginal rate of 15 cents in the dollar, while the balance is taxed at 28 cents in the dollar. These are the rates that generally apply, but they will alter depending on the type of income received, the individual's Family Support entitlement, and if the person receives New Zealand Superannuation.

The secondary tax rate is designed to suit most cases when a person is earning secondary income. In most cases, if a secondary tax code is not used (e.g. a taxpayer uses two "primary" tax codes, such as "G"), an underpayment of PAYE will occur. However, when a person's total taxable income is less than $9,500, use of the secondary tax code results in too much tax being paid. Similarly, when a person's primary income is more than $30,875, the secondary tax rate is insufficient to cover that person's tax liability. In such cases, the affected person may wish to apply for a "special tax code" from Inland Revenue. For details of the use and application of a special tax code, see page 1 of TIB Volume Six, No.9 (February 1995), or the IRD booklet "Special Tax Codes" (IR 23G).

Goods and Services Tax Act 1985

Unwanted wedding gifts - whether "secondhand goods"

Section 2 - definition of "secondhand goods": A GST registered dealer in secondhand goods sometimes acquires unwanted wedding gifts that she buys in response to newspaper advertisements. She has asked if these goods are "secondhand goods" for GST purposes.

In *Case N16* (1991) 13 NZTC 3,142, the Taxation Review Authority said at page 3,147:

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The word "secondhand" as an adjective to "good" or "goods" means, in my view, that in some way or another the item has been used or treated or stored by a previous owner in such a manner that it can no longer be regarded as new. Items in a retail shop are regarded as new, but they have quite possibly passed through a number of hands prior to being available at retail. Items in the shop of a secondhand dealer are regarded as secondhand, because they have been used for their intrinsic purpose by at least one prior owner; and even items which are in new condition will then be regarded as secondhand.

The goods in this situation have not been used for their intrinsic purpose, but may well have been "treated or stored by a previous owner in such a manner" so as to be no longer regarded as new. For example, they may have been stored for a number of years after the wedding, and may not be a current model. A secondhand dealer may be unaware as to whether certain goods have been used intrinsically.

Even though the unwanted wedding presents are unused they are still regarded as secondhand goods, both generally and for the purposes of the section 2 definition of "secondhand goods". However, in the event that they were goods specifically excluded from being secondhand goods as defined in section 2, (for example, a solid gold ring), no input tax deduction would be available.

The item *GST - the definition of secondhand goods* on page 1 of TIB Volume Six, No.5 (November 1994) considers the subject in greater detail.

Making a supply in the course of a taxable activity

Sections 5 and 6 - Meanings of "supply" and "taxable activity": A self-employed taxi driver also has a 25% share in a partnership which operates a wines and spirits outlet. Each business is separately registered for GST purposes; the partnership is registered for the wines and spirits business. The partnership sometimes uses the taxi in its business, usually to provide free delivery of clients' purchases. In order to cover the taxi's costs, there is an informal arrangement under which the partnership makes a regular cash payment to the taxi driver. The taxi driver has asked whether GST is payable, and what documentation is required.

The taxi driver is making a supply to the partnership. That supply is the delivery service that is being provided and for which consideration is being charged, i.e., the regular payment. The supply is being made in the course of the taxi driver's taxable activity, so the consideration is treated as being GST inclusive and output tax must be accounted for in the normal manner. Similarly, the partnership can claim an input tax deduction.

As a supply is being made, the taxi-driver must give the partnership a tax invoice. However, a tax invoice does not have to be issued if the consideration for the supply is less than $50.

Prefunding - time of supply

Section 9 - Time of supply: A GST registered importer is occasionally asked to make a part-payment for services still to be performed. Sometimes the advance part-payment is 10% of the total cost. On other occasions, where the total cost has not been established, the advance part-payment appears to be an arbitrary sum. The importer has asked how she should account for GST in these situations.

Under section 9(1), the normal time of supply rule is:

... a supply of goods and services shall be deemed to take place at the earlier of the time an invoice is issued by the supplier or the recipient or the time any payment is received by the supplier, in respect of that supply.

A practice, prevalent in the shipping and port services industry, is known as prefunding. In this situation, the provider of a service requires payment before performing the service. Such a payment creates a time of supply under section 9(1) above. The value of that supply is not always certain.

When the pre-payment is expressed as a percentage of the ultimate consideration, Inland Revenue considers the full consideration has been determined and a time of supply has occurred. GST is payable on the full value of the service at the earlier of the time the invoice requesting prepayment is issued, or payment is received. The importer may claim an input tax deduction provided she holds the necessary tax invoice. This applies when the supplier and the recipient account for the tax using the invoice basis of accounting, or when the supplier accounts using the hybrid basis. If they both account for the tax on the payments basis (or the recipient on the hybrid basis), GST must be accounted for to the extent that payment is made or received in the relevant taxable period.

When the final consideration has not been determined, and cannot reasonably be determined, GST is only payable on the amount of the part-payment invoiced or paid. GST is payable on the balance of the supply when the final consideration is established, and an invoice is issued or payment received.

Credits from wholesaler to retailer not a financial service

Section 25 - Credit and Debit notes: A wholesaler gives a supermarket manager a list of grocery lines that are to be sold as "specials" - often below cost. The wholesaler gives the supermarket a credit of an amount that restores the supermarket's usual profit margin on these goods. The supermarket has been advised that the wholesaler is treating the credit amount as a financial service and not subjecting it to GST. The supermarket, believing the amount not to be a financial service, is accounting for GST on the credit, but considers that it might be out of pocket as a result. The manager has asked for clarification of the issue.

Financial services are defined in section 3. This definition does not include arrangements as detailed above. In this instance, the issuing of a credit note is not a financial service.

Section 25 (1) requires a supplier who is a registered person to provide a credit or debit note when both of these conditions are met:

- The previously agreed consideration for a supply of goods and services has been altered, whether due to the offer of a discount or otherwise.
- The supplier has already provided a tax invoice for that supply and, as a result of the circumstances above, the tax charged on that supply is incorrect.

The supermarket manager is correct, and must continue to account for GST on the credit by including the gross amount of the credit in the total sales at Box 5 of the appropriate return - usually for the taxable period in which the credit note is received. If the credit note and the tax invoice relate to the same taxable period, the manager can simply reduce the amount of the total purchases for the taxable period by the amount of the credit note.

The wholesaler will be able to deduct the input tax by including the GST inclusive amount of all the credit notes issued during the taxable period in the total purchases (Box 12) of the relevant return. Alternatively, when the credit note is issued in the same taxable period as the tax invoice it relates to, the wholesaler can reduce the total sales (Box 5) by the amount of the credit note.

Company and receiver - liability to register for GST

Section 51(1) - Liability to register: A tax practitioner is acting for the receivers of a company that has gone into receivership. The company's major asset is a block of land from which it has derived rental income of less than the GST registration threshold of $30,000 in any previous period of 12 consecutive months. The receivers are endeavouring to sell the land for $150,000 and to wind up the company. The tax practitioner believes that section 51(1)(c), which exempts registration when the threshold is exceeded solely as a consequence of the cessation of a person's taxable activity, will act to exempt the company from registering, and as a result the receivers will not need to comply with the registration requirements of section 58. She has asked for confirmation of this.

Applied to this particular situation, section 51(1)(b) would render the company liable to register when firm arrangements existed for the sale of the land. However, section 51(1)(c) negates that liability when the Commissioner is satisfied that the registration threshold will be exceeded:

...solely as a consequence of-

(c) Any cessation of, or any substantial and permanent reduction in the size or scale of, any taxable activity carried on by that person...

In this instance, the activity is being reduced and ultimately ceased, and the value of supplies will exceed the threshold for that reason. The company will not be liable to register for GST as a result of the land being sold.

Section 58 deems a "specified agent" to be a registered person during the "agency period" in which the taxable activity of an "incapacitated person" is being carried on by the "specified agent".

Section 58(1) defines a "specified agent" as:

...a person carrying on any taxable activity in a capacity as personal representative, liquidator, or receiver of an incapacitated person, or otherwise as agent for or on behalf of or in the stead of an incapacitated person.

This would appear to bring the receivers within the deeming registration provisions of the section, but for the section 58(1) definition of "incapacitated person" which states:

"Incapacitated person" means a registered person who dies, or goes into liquidation or receivership, or becomes bankrupt or incapacitated:

Since the company in receivership is not a registered person (defined in section 2 as: ...a person who is registered or is liable to be registered under this Act:) and is not liable to be registered because of section 51(1)(c), it is not an "incapacitated person" under section 58. The receivers therefore do not have to register under the deeming provisions of that section.

Student Loan Scheme Act 1992

Whether student loan deductions will be made from ACC payments

Section 17 - Repayment deductions from salary and wages: A taxpayer has recently been involved in a serious vehicle accident and is now unable to work. She is receiving compensation payments under the Accident Rehabilitation and Compensation Insurance Act 1992. She is also in the process of repaying a student loan, and has asked if loan repayments must be deducted from the compensation payments, and if so, how are they dealt with. Her compensation payments will total $20,000 per annum.

The amount of a Student Loan to be repaid in any year depends on the borrower's assessable income. In the 1995-96 income year, people with student loans will repay 10 cents in every dollar they earn over $13,884.

Section 14(1) provides the authority for the repayment of student loans by resident borrowers.

A borrower who receives "salary and wages", as defined in section OB 1 of the Income Tax Act 1994, and whose assessable income is over the repayment threshold, must have repayment deductions made from his or her wages. Compensation payments are expressly included in the definition of "salary or wages".

A borrower who is liable to have repayment deductions made must notify an employer that repayment deductions are to be made from wages, by using a "G ED" and/or "SEC ED" code on his or her IR 12 form. This ensures that the repayment deduction is made in addition to the normal PAYE deductions.

Alternatively, a borrower may apply to Inland Revenue for a special tax code certificate (IR 23). The IR 23 replaces the tax code declaration part of the IR 12. Inland Revenue will calculate a rate that incorporates the Student Loan repayment. The employer will then be required to deduct tax at the specified rate shown on the special tax code certificate.

In this case, assuming the borrower does not have a special tax code certificate, she must notify the Accident Rehabilitation and Compensation Insurance Corporation (ACC) of her tax code - "G ED". This will ensure that the appropriate rate of 10 cents in every dollar over $13,884 is deducted by ACC each pay period along with PAYE.

Legal decisions - case notes

This section of the TIB 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.

Bad debts - deductibility

Rating: • • •

Case: Budget Rent A Car Ltd v CIR HC M.338/94 and M.761/94

Act: Income Tax Act 1976 - sections 104 and 106(1)(b)
(Income Tax Act 1994 - sections BB 7 and DJ 1(a))

Keywords: *bad debts, remitted or extinguished, deductible*

Summary: The High Court found that: (i) a deed agreeing not to pursue the debt against the debtor did not remit or extinguish the debt; (ii) the debt did not have to be written off in the income year the debt became bad; and (iii) the debt was deductible and a loss was available to be carried forward from the 1991 income year to the 1992 income year.

Facts: Budget Rent A Car Ltd ("Budget") carried on business in New Zealand as a motor vehicle rental company. In 1989, BRACS, a subsidiary company, owed Budget approximately $2.7 million. BRACS subsequently went into liquidation. As a result of the liquidation, in July 1990 Budget entered into a deed of covenant with BRACS providing that among other things, Budget would not pursue the debt of $2.7 million owed by BRACS. Budget then wrote off the debt in its books in November 1990, and sought to claim the debt as a deduction in its income year ended 30 September 1991.

In making the assessment for the year ended 30 September 1991, the Commissioner disallowed the claim for the deduction of the debt and as a result, also disallowed the carrying forward of a loss from the 1991 income year to the 1992 income year. The Commissioner disallowed the deduction for the debt on the grounds that the deed of covenant remitted or extinguished the debt. There was no debt in existence to write off in the 1991 income year.

Decision: Justice Tompkins considered the issues under two broad headings: (i) was the debt remitted or extinguished by the deed of covenant; and (ii) could Budget write off the debt in the 1991 income year?

On the first issue, Justice Tompkins accepted the Commissioner's submission that for a taxpayer to deduct from its assessable income the amount of a bad debt written off there must at the time of the write off be a debt in existence. If a debt has been effectively released, the effect is to extinguish it or put an end to its existence.

The question therefore was whether the parties, when they entered into the deed of covenant, intended to extinguish the debt. Justice Tompkins found, when having regard to the words the parties used, viewed in light of the surrounding circumstances, that the intention of the parties was to keep the debt in existence. Budget was entitled to write off the debt as bad.

Although no action can be brought to recover the debt, the debt remains in existence and can be pleaded as a defence by way of set off. Therefore if the liquidators of BRACS brought a claim against Budget, the latter company would be able to set off the amount due to it as a defence to that claim.

On the second issue, His Honour considered whether the write off of a bad debt had to occur in the same income year in which the debt became bad. In relation to bad debts, there was a connection between sections 104 and 106(1)(b). The requirements of both sections had to be satisfied.

A bad debt is not normally deductible. It becomes a deductible debt if it has been incurred in the production of assessable income and is written off. It follows that the crucial time is the time of the writing off, not the time the debt becomes a bad debt. There is no provision in the Act that requires the bad debt to be written off in the year the debt became bad.

Justice Tompkins held that Budget was entitled to write the debt off during the 1992 income year, even though the debt became a bad debt during the 1991 income year. As a result, Budget was entitled to carry forward a loss from the 1991 income year to the 1992 income year.

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

Share write-off - loss deductible

Rating: • • •

Case: TRA 93/235

Act: Income Tax Act 1976 - sections 65(2)(e), 104(a) and 106(1)(a)
(Income Tax Act 1994 - sections BB 4(c),BB 7(a) and BB 8(a))

Keywords: *share of shares, deduction of loss, purpose for resale*

Summary: The Taxation Review Authority established on the facts that the objectors had purchased shares for the purpose of resale and that the loss incurred on the write-off of the shares was deductible under section 65(2)(e). The Commissioner had acted incorrectly in disallowing the objectors' claim for a deduction for the write-off of shares.

Facts: The objectors were trustees of a family trust ("the trust") which was established on 26 October 1979. The trust was intended to be an investment trust acquiring a balanced portfolio of property and other investments. It was the trustees' intention that the trust actively trade in shares in order to make gains.

On 2 November 1987 the trust purchased 250,000 discounted Equiticorp shares for $867,500. The trust intended to turn over the shares quickly in order to take advantage of the expected short term gains on such shares. Shortly after the trust acquired the shares the sharemarket crashed.

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Acting on the advice of its accountant the trust decided to hold all the shares until the share price recovered. The share price did not recover and in January 1989 Equiticorp went into statutory management. The trust wrote off the shares for accounting purposes in the 1989 income year.

The trust's accountant was of the view that the shares could not be written off for tax purposes until the loss was certain. Certainty was not determined until Equiticorp was delisted in May 1989. An amended 1990 income tax return was filed claiming a deduction of $867,500 for the write-off of Equiticorp shares.

The issues was whether the Equiticorp shares were acquired for the purpose of selling or otherwise disposing of them within section 65(2)(e).

Decision: Judge Barber found in favour of the trust and held that the loss on sale of Equiticorp shares was deductible under section 65(2)(e). Judge Barber found that the trust succeeded on the ground that the shares were acquired on revenue account as circulating capital by virtue of the second limb of section 65(2)(e), in terms of *CIR v Inglis* [1992] 14 NZTC 9,180.

Judge Barber said that the essential issue arising in this case was whether or not there was a purpose of resale of the Equiticorp shares by or on behalf of the trust at the time of purchase. His Honour stated that in his view the decision would in effect turn on his findings as to the credibility of the evidence heard by him.

Looking at the evidence before him, Judge Barber found that as a matter of fact the trust had purchased the shares for short term investment and for resale and that was the dominant purpose at the time of the purchase. His Honour accepted that the trust's intention was to take advantage of the discounted price at which the shares were offered, wait for the price to move back up, and realise the gain by selling.

Judge Barber did not think that the trustees and their advisers could be blamed for thinking at some time that the loss was not deductible. He said that when the loss took place it was understandable for the accountant and the trust to think that it was doubtful that the loss was deductible, given that section 65(2)(e) was then a grey area of law.

Judge Barber referred to *Inglis v CIR*, and held that this decision clarified the law and showed that the trust's loss was deductible.

Comment: Inland Revenue is not appealing this decision.

Retirement village development - GST input credits not claimable

Rating: • • •

Case: Norfolk Apartments Limited v CIR (1995) 17 NZTC 12,212.

Act: Goods and Services Tax Act 1985 - sections 2(1), 14, 20(3)

Keywords: *retirement village, principal purpose, common areas, dwelling*

Summary: The Court of Appeal upheld the decision of the High Court, which had decided that the Commissioner had acted correctly in disallowing the taxpayer's objection to an assessment. The objection related to disallowed claims for input tax deductions or refunds of GST associated with the purchase of land and the costs of construction of a retirement village.

Facts: The taxpayer acquired land and constructed a retirement village. Residents purchased a licence to occupy a particular unit and a garage, and an ancillary right to use common areas, such as corridors, stairwells, parking areas, the grounds and recreation areas.

The right to use and enjoy the common areas was provided by an ancillary company, Norfolk Apartments Management Limited, to which the residents paid an apartment service fee. The taxpayer claimed an input tax deduction on the costs of acquiring the land and of construction. The Commissioner disallowed the claim.

In the High Court, Justice Robertson held that the taxpayer's principal purpose in purchasing the land, and developing and constructing the apartments was to supply accommodation to residents in a retirement village. This is an exempt supply under section 14. There was an associated supplementary intention to carry on a taxable activity by the provision of additional services, but this was an ancillary or incidental purpose. The building was not a commercial dwelling.

The taxpayer appealed to the Court of Appeal, arguing that the land was acquired and the construction costs incurred in order to create a retirement village complex. This amounted to the provision of a package to the residents, which included the common facilities. It claimed that there were two purposes and two supplies - exempt supplies of apartments and taxable supplies of the common areas and facilities. The taxpayer submitted that its principal purpose was not the provision of retirement accommodation. In support of this argument, the taxpayer pointed to the fact that two thirds of the land purchased was not required for the erection of the apartment building. It also argued that the definition of "dwelling" did not include the land surrounding the building.

Decision: The Court rejected the taxpayer's submission that its principal purpose was not the provision of retirement accommodation.

The taxpayer's principal purpose in acquiring and developing the land was to be able to provide accommodation in dwellings situated within a retirement village. That was an exempt supply. No input tax deduction was available. The definition of "dwelling" meant not only the building or premises, but also "any appurtenances belonging thereto and enjoyed with it". The common areas, including the grounds, were appurtenances to the dwellings.

Comment: The taxpayer is not appealing this decision.

Reopening assessments - limitation periods

Rating: • • •

Case: Hutchinson Brothers Limited v CIR, HC 216/94,26 July 1995

Act: Income Tax Act 1976 - sections 25(1) and 76(1)
(Tax Administration Act 1994 - section 108; Income Tax Act 1994 - section EC 1)

Keywords: *adjustment, assessment, preceding period*

Summary: Section 25 prohibits an adjustment under section 76 for understatements of income for any income year more than four years before the adjustment is made. An adjustment is in effect an alteration of an assessment. In terms of section 25 that alteration occurs when the Commissioner's decision to make the adjustment is conveyed to the objector, rather than the date on which the notice of assessment giving effect to that decision is issued.

Facts: In 1992, Inland Revenue advised the taxpayer that its income for the 1991 income year (the year of adjustment) would include amounts of rebates to which it was entitled in the years 1987 to 1991. The taxpayer did not object to the inclusion of the rebates for the years 1989 to 1991, but contended that the rebates for the years 1987 and 1988 were statute-barred by section 25. This was on the basis that although the Commissioner notified the taxpayer of his decision to include

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these rebates in 1992, he did not issue a notice of assessment until 1993 and therefore was statute-barred from doing so for the 1987 and 1988 years.

The parties accepted that

- Section 76 entitles the Commissioner to add to the assessable income in the year of adjustment, the understatements of assessable income in previous years. The amount of that understatement becomes part of the assessable income in the year of adjustment.
- Section 25 bars the Commissioner from altering an assessment after four years have expired from the end of the year in which the original assessment was issued.

The Commissioner contended that section 25 did not apply to an adjustment by the Commissioner under section 76. This was because such an adjustment did not require the Commissioner "to alter the assessment" made in respect of the earlier year. On the contrary section 76 authorised the Commissioner to adjust the assessable income in the year of adjustment so that what was being altered was the assessment for that year, not the assessment for the earlier year.

The taxpayer contended that the Commissioner was using section 76 as a "back door" route to avoid section 25.

Decision:

Justice Tompkins considered the scheme of the Act, and noted that when the legislature had intended that the four year limitation imposed by section 25 was not to apply in respect of specific provisions of the Act, it had said so. This was not the case in respect of section 76.

His Honour concluded that when the Commissioner makes an adjustment under section 76, he is in effect altering the assessments relating to the earlier years.

He held that the Commissioner was barred by section 25 from making an adjustment to include in the assessable income for the year of adjustment, amounts in respect of income years more than four years before the making of the adjustment.

As for the point of time when the limitation period started running, he considered three possible times: first, the time when the Commissioner decided to make the adjustment, second, the time when that decision was conveyed to the objector, and third, the time when the notice of assessment giving effect to that decision was issued. He followed authorities which stated that an assessment is not a piece of paper, it is an official act or operation. Neither the paper sent nor the notification it gives is the assessment, which is and remains the act or operation of the Commissioner.

He concluded that the Commissioner in effect altered the assessment at the time when, having arrived at the decision to make the adjustment, he conveyed that decision to the objector.

The consequence of this was that the 1987 rebate should not have been included in the 1991 year.

Comment:

Neither the Commissioner nor the taxpayer have yet decided whether to appeal this decision.

Judicial review - issuing of an amended income tax assessment

Rating: • • •

Case: Golden Bay Cement Company Ltd v CIR

Act: Income Tax Act 1976 - section 25, section 191(8)
(Tax Administration Act 1994 - section 108, Income Tax Act 1994 - section OF 2(2)).

Keywords: *judicial review, single joint assessment, amended assessments*

Summary: The applicant sought a judicial review of the Commissioner's decision to issue an amended assessment. The applicant challenged the validity of the assessment on the basis that it was issued outside the four years permitted under section 25.

The High Court found in favour of the Commissioner. Justice Fisher considered that the amended assessment could be regarded as five distinct assessments for the purposes of section 25. Accordingly, Justice Fisher held that the amended assessment was invalid insofar as it related to Golden Bay Concrete and Gravel Limited.

Facts: The applicant, Golden Bay Cement Company Ltd ("Golden Bay"), had four wholly-owned subsidiaries consisting of Waitomo Portland Cement Ltd ("Waitomo"), Wilsons NZ Portland Cement Ltd ("Wilsons"), Golden Bay Concrete and Gravel Ltd ("Gravel") and Delta Petroleum Ltd ("Delta"). These five companies constituted a group of companies for the purposes of section 191.

In 1984, the companies applied to the Commissioner for a joint assessment under section 191(8). The Commissioner allowed the request and the application was treated as a standing arrangement for the succeeding years.

For the financial year ended 31 March 1987 each of the five members of the group filed separate returns.

Inland Revenue's practice was to enter a zero in the computerised ledger for the individual member when that member's return was received and considered. The zero assessment was an internal processing arrangement and notification was not given to the member concerned. The assessable incomes and losses of all members of the group would be aggregated and a single joint assessment issued to a nominated member of the group.

Inland Revenue's practice was not adhered to for the 1987 year and notices of assessment were individually issued to three of the members of the group.

On 22 August 1988 the Commissioner issued a joint assessment for the whole group to the nominated member, Golden Bay. In 1992 the Commissioner learned that there has been a major change in the group's shareholding and subsequently issued an amended joint assessment.

Golden Bay objected to the validity of the amended assessment and filed judicial review proceedings.

Issue: The High Court considered two issues:

- whether the individual assessments made in 1987 for Waitomo, Wilsons and Gravel were valid assessments for the purposes of section 19 and section 25
- whether it was competent for the Commissioner to make an individual assessment for an individual member when there was a standing arrangement between the group and the Commissioner that there would be joint assessments.

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Decision: Justice Fisher held that the individual notices of assessment made in 1987 would be valid provided they were "assessments" for the purpose of section 19 and section 25. His Honour referred to Justice Richardson's statutory interpretation of "assessment" in *CIR v Canterbury Frozen Meat Co Ltd* (1994) 16 NZTC 11,150 to determine whether the individual notices amounted to an assessment. Based on the principles in that case Justice Fisher considered that to constitute an assessment four elements would normally be required:

- The Commissioner's consideration of the facts then in his possession concerning the relevant financial affairs of the taxpayer.
- The Commissioner's exercise of judgment to determine the taxpayer's taxable income and consequent tax liability.
- The Commissioner's identification of the specified sum of money due and payable as tax.

Justice Fisher found that the "zero" assessments issued to Waitomo and Wilsons were not "assessments" for the purpose of section 19 and section 25. He said that "it is not the form of the documentation that matters but its substance". There was no evidence to suggest that the elements of an "assessment" existed. Justice Fisher held that the first assessments for the 1987 income year were made as part of the single joint assessment of 22 August 1988 and accordingly the amended assessment, in relation to Waitomo and Wilsons, was made within the prescribed four year period.

Justice Fisher reached a different conclusion for Gravel. He found that there was a genuine attempt to assess Gravel's actual tax liability and that the steps actually followed by the Commissioner amounted to an actual assessment. He held that the individual notice of assessment was a valid assessment and consequently the 1992 amended joint assessment was out of time insofar as it related to Gravel.

On the second issue, Justice Fisher held even though the Commissioner had accepted the request for a joint assessment this did not nullify the Commissioner's statutory discretion to determine otherwise for subsequent years. Justice Fisher found that it was competent for the Commissioner to make an individual assessment for an individual member of the group.

Comment: The taxpayer is not appealing this decision.

When transactions by superannuation scheme trustees constitute "dealing in shares"

Rating: • • • • •

Case: Trustees of Alexander and Alexander Pension Plan v CIR, Auckland High Court M1048/94 M531/95

Act: Income Tax Act 1976 - sections 65(2)(a), 65(2)(e)
(Income Tax Act 1994 - sections BB 4(a), BB 4(c))

Keywords: *dealing in shares*

Summary: Whether a taxpayer is carrying on a business of dealing in shares is "a question of fact and degree." The issue had to be decided objectively, not subjectively, and the frequency of share dealing transactions is often decisive.

A superannuation scheme which has 176 share transactions in a three year period (i.e., an average of more than one a week) is in the business of dealing in

shares for the purposes of section 65(2)(e) of the Income Tax Act 1976. This is despite the fact that the transactions were carried out in order to comply with a weightings investment system rather than for the purpose of making a profit.

Facts: The trustees of a superannuation scheme employed a professional fund manager to manage its investments. The fund was for an indefinite duration. The trustees invested on a long term basis. Part of the capital was always to be invested in shares which they bought with the intention of retaining as part of the fund. Having decided what proportion of the fund was to be invested in the sharemarket, the manager decided regularly what shares were to be acquired, what shares were to be sold, what rights were to be sold, etc. These decisions were within strict parameters and in accordance with previously-decided weightings. The overall purpose was to manage and supervise the assets in order to ensure that there were no more losses than were inevitable in trading in the sharemarket and that the fund was prudently managed so that the trustees' statutory and fiduciary obligations were properly discharged. The superannuation scheme had 176 share transactions in a three year period i.e., an average of more than one a week.

Decision: Justice Temm held that during those years it was in the business of dealing in shares for the purposes of s.65(2)(e) of the Income Tax Act 1976. He followed the decision of the Court of Appeal in *CIR v Rangatira Ltd* (184/94, 24 May 1995), covered on page 29 of TIB Volume Seven, No.1 (July 1995). No doubt the trustees did not wish to trade in shares, and no doubt also their intentions throughout were to meet their obligations to act prudently, to protect the fund from erosion and to comply with a weightings investment system rather than for the purpose of making a profit. But the many share transactions made on their behalf during the period in question led to the conclusion that the fund was dealing in shares within the meaning of s 65(2) (e) during that period.

In holding that the taxpayer was in the business of dealing in shares, he rejected a number of arguments made on behalf of the trustees, that:

- The weighting system dictated the need to sell shares even on a rising market, whereas a trader would not sell until the market had reached or neared its peak;
- Shares were sold at times because of a significant change in the market, such as the offering of shares by an important new company, which might necessitate a selling of other shares in order to retain the weightings.
- The weighting system caused sales to be made to keep the prescribed balance between the various share investments and that such sales were not made for the purpose of making a profit;
- Many of the sales were dictated by the need to comply with the weightings system and that some of these sales were of parts only of a shareholding.
- Some sales took place at a loss because prudent management dictated liquidating the investment in some companies.

He also dismissed alternative arguments by the Commissioner, that:

- The trustees' equity investments were assessable under section 65(2)(a) as part of their "business activity." They were not in business at all. They had no customers, they were not trading in the ordinary business sense, and their sole purpose was to discharge their statutory and fiduciary obligations to act prudently in managing the fund.
- For the purposes of s 65(2)(a), a superannuation fund is in business in a similar sense to a life insurance company.

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- The profits were assessable under the "second and third limbs" of s 65(2)(e) as being derived from property acquired for the purpose of selling or other disposal, or from the carrying on of an undertaking or scheme entered into for the purpose of making a profit. He held that the activities of the trustees were for investment purposes and not for the purpose of taking a profit.

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

Upcoming TIB items

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

Policy Statements

- Applications to retain records in Maori
- Record keeping requirements for the purchase of goods or services for $50 or less
- Trust disclosure requirements
- Carrying forward unused imputation credits
- Consumable aids
- Export market development expenditure refunds and further income tax
- Application to deduct the adjusted tax value of an asset no longer used but retained by the taxpayer
- Application of the associated person provision when calculating the FBT value of a motor vehicle
- Taxation of allowances and expenditure on account of an employee

Public Binding Rulings

- Financial planning fees: income tax deductibility
- GST treatment of financial planning fees
- GST: importers and input tax deductions
- GST: what constitutes an invoice?
- GST: invoices and time of supply
- GST and supplies paid for in foreign currency

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.

General information

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

Dealing with Inland Revenue (IR 256) - Apr 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.*

Inland Revenue audits (IR 297) - May 1995: *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.*

Koha (IR 278) - Aug 1991: *A guide to payments in the Maori community - income tax and GST consequences.*

New Zealand tax residence (IR 292) - Apr 1994: *An explanation of who is a New Zealand resident for tax purposes.*

Objection procedures (IR 266) - Mar 1994: *Explains how to make a formal objection to a tax assessment, and what further options are available if you disagree with Inland Revenue.*

Overseas Social Security Pensions (IR 258) - Sep 1995: *Explains how to account for income tax in New Zealand if you receive a social security pension from overseas.*

Problem Resolution Service (IR 287) - Nov 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.*

Provisional tax (IR 289) - Jun 1995: *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) - Apr 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.*

Reordered Tax Acts (IR 299) - Apr 1995: *In 1994 the Income Tax Act 1976 and the Inland Revenue Department Act 1974 were restructured, and became the Income Tax Act 1994, the Tax Administration Act 1994 and the Taxation Review Authorities Act 1994. This leaflet explains the structure of the three new Acts.*

Self-employed or an employee? (IR 186) - Apr 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) - Jan 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) - Mar 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) - Jan 1995: *A guide to making student loan repayments.*

Superannuitants and surcharge (IR 259) - Jan 1995: *A guide to the surcharge for national superannuitants who also have other income.*

Tax facts for income-tested beneficiaries (IR 40C) - Sep 1992: *Vital information for anyone who receives an income-tested benefit and also has some other income.*

Taxes and Duties (IR 295) - May 1995: *A brief introduction to the various taxes and duties payable in New Zealand.*

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.*

Trusts and Estates - (IR 288) - May 1995: *An explanation of how estates and different types of trusts are taxed in New Zealand.*

Business and employers

ACC premium rates - Mar 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.*

Depreciation (IR 260) - Apr 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.*

Entertainment Expenses (IR 268) - May 1995: *When businesses spend money on entertaining clients, they can generally only claim part of this expenditure as a tax deduction. This booklet fully explains the entertainment deduction rules.*

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.*

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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.*

IR 56 taxpayer handbook (IR 56B) - Apr 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.*

PAYE deduction tables - 1996
- Weekly and fortnightly (IR 184X)
- Four-weekly and monthly (IR 184Y)
Tables that tell employers the correct amount of PAYE to deduct from their employees' wages.

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

Retiring allowances and redundancy payments (IR 277) - Jun 1994: *An explanation of the tax treatment of these types of payments.*

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.*

Resident withholding tax and NRWT

Approved issuer levy (IR 291A) - May 1995: *For taxpayers who pay interest to overseas lenders. Explains how you can pay interest to overseas lenders without having to deduct NRWT.*

Interest earnings and your IRD number (IR 283L) - Sep 1991: *Explains the requirement for giving to your IRD number to your bank or anyone else who pays you interest.*

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

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) - Mar 1993: *A guide to RWT for people and institutions which pay interest.*

Resident withholding tax on investments (IR 279) - Apr 1993: *An explanation of RWT for people who receive interest or dividends.*

Non-profit bodies

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) - Jun 1993: *Explains the tax obligations which a club, society or other non-profit group must meet.*

Education centres (IR 253) - Jun 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) - Feb 1992: *An explanation of the duty which must be paid by groups which operate gaming machines.*

Grants and subsidies (IR 249) - Jun 1994: *An guide to the tax obligations of groups which receive a subsidy, either to help pay staff wages, or for some other purpose.*

Company and international issues

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

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

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).*

Imputation (IR 274) - Feb 1990: *A guide to dividend imputation for New Zealand companies.*

Qualifying companies (IR 4PB) Oct 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.*

Child Support booklets

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

Child Support - a parent's guide (CS 1) - Mar 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) - Mar 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

October

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

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

1995 end-of-year payment of income tax, Student Loans and earner/employer premium due for taxpayers with November balance dates.

Tax returns due for all non-IR 5 taxpayers with June balance dates.

QCET payments due for companies with November balance dates with elections effective from the 1996 income year.

(We will accept payments received on Monday 9 October as in time for 7 October.)

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

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

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

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

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

RWT on interest due deducted 1 April 1995 to 30 September 1995 due for six-monthly payers.

RWT on dividends deducted during September 1995 due.

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

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

November

5 Large employers: PAYE deductions and deduction schedules for period ended 31 October 1995 due.
(We will accept payments received on Monday 6 November as on time.)

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

1995 end-of-year payment of income tax, Student Loans and earner/employer premium due for taxpayers with December balance dates.

Tax returns due for all non-IR 5 taxpayers with July balance dates.

QCET payments due for companies with December balance dates with elections effective from the 1996 income year.

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

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

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

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

RWT on dividends deducted during October 1995 due.

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

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

Public binding rulings: your chance to comment before we finalise them

This list shows the Public Binding Rulings that Inland Revenue is currently preparing. To give us your comments on any of these draft rulings, please tick the appropriate boxes, fill in your name and address, and return this page to us at the address below. We will send you a copy of the draft as soon as it's available.

In most cases the draft will be available on the date shown below. However, we will notify you if we are unable to supply it at that date for any reason.

We must receive your comments by the "Comment deadline" shown if we are to take them into account in the final ruling. Please send them ***in writing, to the address below***; as we don't have the facilities to deal with your comments over the phone or at our local offices.

Name ________________________________

Address ________________________________

	Ruling	*Date Available*	*Comment Deadline*
☐	**2533A**: Gifts where the donor reserves an interest or benefit - gift duty implications	06/10/95	27/10/95
☐	**2533B**: Gifts where the donor reserves an interest or benefit - income tax implications	06/10/95	27/10/95
☐	**3052**: Tertiary student association fees	06/10/95	27/10/95
☐	**3154**: Entertainment tax and hoteliers	06/10/95	27/10/95
☐	**1467**: Bad debts - income tax and GST treatment	13/10/95	03/11/95
☐	**2869**: Taxable distributions and non-resident beneficiaries of foreign trusts and non-qualifying trusts	13/10/95	03/11/95
☐	**2822**: GST treatment of games of chance and competitions where no amount of money is paid to participate	20/10/95	10/11/95
☐	**2861**: Deductibility of binding ruling fees	20/10/95	10/11/95
☐	**2690A**: Commissions received by life insurance agents on policies sold to themselves or immediate family	20/10/95	10/11/95
☐	**3105**: GST and payments by cheque or credit card	27/10/95	17/11/95
☐	**3175**: Depreciation - assets coming into existence - self-constructed assets	27/10/95	17/11/95
☐	**3019**: FBT - cost price of a motor vehicle	27/10/95	17/11/95
☐	**3009**: Taxation of payments to mayors and councillors	27/10/95	17/11/95
☐	**3246**: Definition of "transitional capital amount"	27/10/95	17/11/95

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National Office
Inland Revenue Department
P O Box 2198
WELLINGTON

Attention Public Rulings Consultation

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