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.

National Mutual policyholders

Summary of product ruling BR Prd 95/4

This summary of product ruling BR Prd 95/4 does not form part of the ruling.

Introduction

In August 1995, policyholders of National Mutual Life Association of Australasia Limited ("NM Life") voted to amend the articles of association of NM Life. The change to the articles of association results in policyholders losing certain rights they have in NM Life (including the right to vote at general meetings and the right to participate in any surplus on winding up). In exchange for giving up their rights in NM Life, the policyholders obtain the right to receive shares (or cash from the sale of the shares) in National Mutual Holdings Limited ("NMH"). It is intended that the policyholders will receive the shares (or the cash) in approximately two years from the vote to amend NM Life's articles of association.

A number of questions arise as to whether there are any tax consequences as a result of the policyholders giving up their rights in NM Life and receiving shares (or cash from the sale of the shares) in NMH. A product ruling has been sought on some of these questions.

The ruling

Essentially, the ruling explains that there will be no tax consequences for the vast majority of policyholders as a result of the arrangement whereby they receive shares in NMH (or cash from the sale of the shares). In particular:

- The issue of shares by NMH to policyholders will not be assessable as a dividend.
- For those policyholders who elect to receive cash rather than shares, the cash payment will not be assessable income as long as the cash payment does not exceed the value of the shares to which they would otherwise have been entitled.
- The arrangement whereby the policyholders give up rights and ultimately receive shares in NMH will not give rise to rise to "accrual" income.
- The policyholders will not be liable to pay gift duty.

The product ruling, together with an analysis of the ruling, follows. The Commissioner must follow the ruling if NM Life policyholders apply the tax laws in the way stated in the ruling.

National Mutual policyholders

Product ruling - BR Prd 95/4

This is a product ruling made under section 91F of the Tax Administration Act 1994.

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

Taxation law

This ruling applies in respect of:

- Section CE 1 (1)(c).
- Section CF 1.
- Section HH 6 (1).
- The definition of "corpus" in section OB 1.

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- The definition of "qualifying trust" in section OB 1.
- The definition of "unit trust" in section OB 1.
- Section 61 of the Estate and Gift Duties Act 1968.

Arrangement to which this ruling applies

The arrangement is that whereby policyholder members ("PHMs") of National Mutual Life Association of Australasia Limited ("NM Life") agree to extinguish certain ownership rights they have in NM Life in exchange for shares in National Mutual Holdings Limited ("NMH"). This arrangement can be described as the demutualisation of NM Life. This arrangement will be effected by the following steps:

1. NMH is established by incorporation in Australia. NMH will issue five shares, initially to five individual shareholders.
2. A trust ("the voting trust") is established with an Australian resident trustee. The trust is established for the benefit of all eligible PHMs (that includes New Zealand resident PHMs) of NM Life. The voting trust will purchase the five NMH shares from the five individual shareholders. The five shares have two special rights as follows:
   - The right to control 60% of the votes in a general meeting.
   - The right to direct that NMH use its share premium account to issue shares to NM Life PHMs.
3. A Deed of Entitlement is executed by NMH, AXA Societe Anonyme ("AXA") a non-New Zealand resident, and the trustee of the voting trust. Under the Deed of Entitlement, the parties give undertakings to NM Life PHMs that if the PHMs agree to amend NM Life's articles of association to allow for the demutualisation, PHMs will receive shares in NMH when NMH lists on the New Zealand and Australian stock exchanges. This listing will occur approximately two years from the vote by the PHMs to demutualise NM Life. Under a Supplemental Deed, NMH and NM Life agree that, for the purposes of the definition of "core acquisition price" in section OB 1 of the Income Tax Act 1994, the lowest price for the ownership rights the PHMs have in NM Life shall be an amount equal to the consideration provided for those rights (the consideration being rights the PHMs obtain under the voting trust and under the Deed of Entitlement, and the conversion of those rights into fully paid shares in NMH).
4. PHMs vote to amend NM Life's articles of association. Essentially, the amendment means that the PHMs ownership rights in NMH Life are extinguished and that NM Life is able to issue shares.
5. NMH will issue fully paid and partly paid shares to AXA. AXA will pay a premium for these shares. The shares will give AXA 40% of the voting rights in NMH that will increase to 51% once the partly paid shares are paid up.
6. NM Life will issue 100% of its share capital to NMH. NMH will use part of the funds it has arising from the premium paid by AXA to pay for the shares in NM Life.
7. Approximately two years from the amendment of NM Life's articles of association, NMH will be publicly floated. One of two things will happen:
   - Eligible PHMs in NM Life will be invited to apply for one ordinary share each in NMH. The PHMs will apply for one ordinary share each and the amount due on the shares will be paid by AXA. Following the issue of one ordinary share to each PHM, NMH will issue a number of fully paid shares ("the issue of shares") to the PHMs. The number of shares issued will depend on the type of NM Life policy held by the particular PHM. The

issue of shares by NMH will be funded from the premium paid by AXA for its NMH shares.

- For those eligible PHMs who do not apply for shares in NMH, the trustee of a trust ("the sale trust") will apply for one ordinary share on behalf of each such PHM. A separate trust will be formed for each PHM who does not apply for shares. Following the issue of one ordinary share to the trustee of the sale trusts on behalf of each PHM who does not apply, NMH will issue a number of fully paid shares ("the issue of shares"). The trustee of the sale trust will sell all of the shares held, invest the proceeds pending distribution, and distribute the proceeds to the relevant PHMs. Under the sale trust deed, the PHMs cannot direct the trustee to transfer the shares or proceeds to them at any particular stage.

8. Once all shares have been issued, either to PHMs or to the trustee of the sale trust, the special rights attached to the five shares held by the trustee of the voting trust extinguish. The voting trust is wound up and the shares sold or distributed in specie to NM Life's Staff Superannuation Fund.
9. AXA will pay the amount due on the partly paid shares in NMH which will increase their voting rights to 51%.

Other facts and details relating to the arrangement are contained in the Explanatory Memorandum dated 13 June 1995 issued by NM Life to its PHMs.

Assumptions

This ruling is based on the assumptions that:

- NMH will not make an election under section CF 8 (a) that the issue of shares will be a taxable bonus issue.
- The value of the NMH shares attributable to the PHM who is the beneficiary of any particular sale trust would not constitute assessable income if distributed to the PHM rather than to the trustee of the sale trust.
- All trustee income of the sale trusts will be liable for income tax in New Zealand where the PHM beneficiary is a New Zealand resident.
- The obligations of the trustees of the sale trust in respect of their liability for New Zealand taxation will be satisfied.

The period for which the ruling applies

This ruling applies from 8 August 1995 to 8 August 1998.

The ruling

The issue of shares by NMH to NM Life PHMs

The issue of shares by NMH to NM Life PHMs who are eligible to receive the shares under the Deed of Entitlement will not be assessable as a dividend under section CF 1.

The extinguishment of NM Life PHMs ownership rights in NM Life in exchange for shares in NMH

The agreement by NM Life PHMs to extinguish their ownership rights in NM Life in exchange for rights under the voting trust and the Deed of Entitlement and ultimately shares in NMH will not give rise to income under the qualified accruals rules under section CE 1 (1)(c).

The voting trust

The voting trust is not a "unit trust" as defined in section OB 1.

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The sale trusts

The sale trusts are not "unit trust[s]" as defined in section OB 1.

The sale trusts established for New Zealand resident NM Life PHMs are subject to the trust taxation regime in subpart H and, as such:

- The "corpus", as defined in section OB 1, of each sale trust will be an amount equal to the market value of the NMH shares issued to the trustee as at the date of issue.
- Any distribution made to the beneficiaries will not be taxable in their hands to the extent that the distribution does not exceed the corpus of the relevant sale trust.
- Each sale trust will be a "qualifying trust" as defined in section OB 1.
- The ordering rules in section HH 6 (1) will not apply to distributions made by the trustee of each sale trust.

The payment by AXA of the amount due upon application by NM Life PHMs (or by the trustee of the sale trusts) for one ordinary share in NMH

The amount paid by AXA on behalf of PHMs who have each applied for one ordinary share in NMH (or the amount paid by AXA on behalf of the trustee of the sale trust for those PHMs who do not personally apply) is not a dutiable gift and is not subject to gift duty under the Estate and Gift Duties Act 1968.

Signed

Simon Sherry
Rulings

Analysis of product ruling BR Prd 95/4

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

A ruling has been requested that relates to a number of issues arising as a consequence of the demutualisation of National Mutual Life Association of Australasia Limited ("NM Life"). The issues are discussed under the following headings:

- The issue by National Mutual Holdings Limited ("NMH") of fully paid shares to NM Life policyholder members ("PHMs").
- The agreement by NM Life PHMs to extinguish ownership rights in NM Life in exchange for rights under the voting trust and the Deed of Entitlement and ultimately shares in NMH.
- The voting trust.
- The sale trusts.
- The payment by AXA of amounts due upon application by NM Life PHMs (or by the trustee of the sale trusts) for one ordinary share in NMH.

Legislation

Cross-reference table

Income Tax Act 1994	*Income Tax Act 1976*
CE 1 (1)(c)	65(2)(jb)
CF 1	65(2)(j)
CF 2 (1)	4(1)
CF 3 (1)(a)	4A(1)(a)
HE 1	211(2)
HH 3	227
HH 4	228
HH 6	230
OB 1 "beneficiary income"	226
OB 1 "bonus issue"	3
OB 1 "corpus"	226
OB 1 "non-taxable bonus issue"	3
OB 1 "qualifying trust"	226
OB 1 "taxable distribution"	226
OB 1 "trustee income"	226
OB 1 "unit holder"	211(1)
OB 1 "unit trust"	211(1)

The issue of shares by NMH to NM Life PHMs

Following the issue of one ordinary share either to each NM Life PHM personally or to the trustee of a trust ("the sale trust"), NMH will issue a number of fully paid shares ("the issue of shares").

The question arises as to whether the issue of shares is assessable as a dividend.

The ruling states that the issue of shares to NM Life PHMs who are eligible to receive the shares under the Deed of Entitlement will not be assessable as a dividend.

Discussion

Under section CF 1, dividends are included within the assessable income of any person. Section CF 2 defines the meaning of the term "dividends". Section CF 3 sets out a number of exclusions from the term "dividends".

Of particular note, section CF 2 (1)(f) includes within the term "dividends", any "taxable bonus issue". Section CF 3 (1)(a) excludes from the term "dividends" any "non-taxable bonus issue".

Section OB 1 defines "bonus issue", in relation to a company, to mean:

(a) The issue of shares in a company

...

where the company receives no consideration (other than an election by the shareholder not to receive money or money's worth as an alternative to the issue) for the issue ...

Section OB 1 defines a "taxable bonus issue" to mean:

(a) Any bonus issue in lieu:

(b) Any bonus issue that the company elects in accordance with section CF 8 (a) ... to be a bonus issue that will be treated as a dividend for the purposes of this Act.

Section OB 1 defines a "non-taxable bonus issue" to mean:

any bonus issue

...

(b) In respect of which the company fails to make any election under section CF 8

There are two possible approaches to reaching the decision that the issue of shares is not a dividend. The approach taken depends on whether the issue of shares is characterised as a "bonus issue" as defined in section OB 1.

The first approach is that the issue of shares is, in the first instance, a "bonus issue" as defined in section OB 1. This approach takes the view that NMH does not receive any consideration for the issue of shares. Given that the issue of shares by NMH is not a bonus issue in lieu and assuming that NMH does not make an election under section CF 8 to treat the issue of shares as a taxable bonus issue, the issue of shares will be a non-taxable bonus issue. As a non-taxable bonus issue, the issue of shares is excluded from being a dividend.

The alternative approach is that the issue of shares is not a "bonus issue" because NMH does receive consideration for the issue of shares. The issue of shares therefore falls outside the definition of "bonus issue". Because the issue of shares is not a bonus issue, the issue of shares cannot be a "non-taxable bonus issue" and is not specifically excluded from the definition of "dividends" under section CF 3 (1)(a). As a consequence, the issue of shares could potentially be a dividend if the issue of shares falls within paragraphs (a) to (l) of the definition of "dividends" in section CF 2 (1). However, it is the Commissioner's view that the issue of shares does not fall within any of these paragraphs and, as such, will not be assessable income under section CF 1.

The Commissioner does not need to form a view on which approach is correct (and whether NMH does receive consideration for the issue of shares). This is not necessary because the end result is the same, i.e., the issue of shares to NM Life PHMs is not a dividend.

The extinguishment of NM Life PHMs ownership rights in NM Life in exchange for shares in NMH

Under the Deed of Entitlement, NMH, AXA and the trustee of the voting trust undertake with each NM Life PHM, in consideration of the PHMs voting to amend the articles of association of NM Life to:

- Issue one ordinary share in NMH upon receiving an application from each PHM (or from the trustee of the sale trusts); and
- Issue a number of fully paid shares in NMH to each PHM (or to the trustee of the sale trusts).

The amendment to NM Life's articles of association results in the extinguishment of certain ownership rights each PHM has in NM Life. In particular, the rights of PHMs to vote at general meetings and to vote on a change to the articles of association are removed. Also, a provision is inserted stating that only shareholders may vote at general meetings.

It is planned that the shares will be issued to the PHMs (or the trustee of the sale trusts) approximately two years from the alteration of the articles of association when NMH lists on the New Zealand and Australian stock exchanges.

The question arises as to whether the demutualisation and the eventual receipt by PHMs of shares in NMH give rise to income under the accruals rules for PHMs.

The ruling states that no income under the accruals rules will arise for PHMs by virtue of the PHMs agreeing to extinguish their ownership rights in NM Life in exchange for rights under the voting trust and the Deed of Entitlement and ultimately shares in NMH.

Discussion

Section CE 1 (1)(c) includes within the assessable income of any person:

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Income derived or deemed to be derived under the qualified accruals rules:

Generally speaking, income could be derived or deemed to be derived under the qualified accruals rules if the consideration paid to the NM Life PHMs for their ownership rights in NM Life exceeds the "acquisition price" as defined in section OB 1. A key element in the calculation of the "acquisition price" refers to:

The lowest price that the parties would have agreed upon for the property that is the subject of the agreement for the sale and purchase of property ... (... the "specified property") at the time at which the agreement for the sale and purchase of property was entered into ... on the basis of payment in full at the time at which the first right in the specified property is to be transferred.

A Supplemental Deed executed by NM Life and NMH essentially provides that the value of shares issued to the PHMs will be equal to the lowest price that the parties would have agreed on the basis of payment in full at the time the PHMs ownership rights in NM Life are extinguished. As a result, no accrual income will arise under section CE 1 (1)(c).

The voting trust

As part of effecting the demutualisation of NM Life, the trustees of a trust ("the voting trust") will purchase the five shares issued by NMH. These five shares have the right to control 60% of the votes in a general meeting of NMH and the right to direct that the share premium account of NMH be applied to make an issue of shares to NM Life PHMs. These rights are intended to protect NM Life PHMs in the period from the commencement of demutualisation to the listing of NMH's shares on the New Zealand and Australian stock exchanges, i.e., the trustee of the voting trust will hold voting rights in NMH in trust for the PHMs. Once all the NMH shares that PHMs are entitled to are issued, the special rights attached to the shares held by the trustee of the voting trust are extinguished. It is contemplated that the voting trust will be wound up and the five shares either sold or distributed in specie to the residual beneficiary (the NM Life Staff Superannuation Fund).

The question arises as to whether the voting trust is a "unit trust" as defined in section OB 1. If the voting trust is a "unit trust", then this has consequences for the beneficiaries because the voting trust will, generally speaking, be treated as a company for income tax purposes.

The ruling states that the voting trust is not a "unit trust" as defined in section OB 1.

Discussion

"Unit trust" is defined in section OB 1 as:

any scheme or arrangement ... that is made for the purpose of or has the effect of providing facilities for the participation, as beneficiaries under a trust, by subscribers, purchasers, or contributors, in income or gains (whether in the nature of capital or income) arising from the money, investments, and other property that are for the time being subject to the trust ...

"Unit holders" is defined in section OB 1:

in relation to any unit trust, means any person who holds a beneficial interest in the money, investments, and other property that are for the time being subject to the trusts governing that unit trust

Section HE 1 sets out certain income tax consequences of a scheme or arrangement being included within the definition of unit trust in section OB 1. Some of these consequences are:

- The unit trust is deemed to be a company; and
- The interests of the unit holders in the unit trust are deemed to be shares in the company; and
- The unit holders are deemed to be shareholders in the company.

The purpose of the voting trust is to protect the interests of NM Life PHMs through the holding, by the trustee of the voting trust, of the majority of voting interests in NMH. The voting trust is not a unit trust because it is not a scheme or arrangement that provides facilities for the beneficiaries to participate as subscribers, purchasers or contributors. The beneficiaries are not required to contribute anything to the trust.

The sale trusts

Sale trusts will be established for the benefit of those NM Life PHMs who do not personally apply for shares in NMH. A sale trust will be set up for each NM Life PHM who does not apply for NMH shares. The sale trust will not operate as a global trust for all NM Life PHMs who do not apply for shares. The trustee of each sale trust will:

- Apply for one ordinary share on behalf of each NM Life PHM who has not personally applied for the share.
- Receive the fully paid ordinary shares that are issued by NMH following the issue of the one ordinary share. The number of shares issued will depend on the particular NM Life policy held by the relevant PHM.
- Sell all of the NMH shares held on behalf of each PHM as soon as practicable for the best price reasonably obtainable.
- Invest the sale proceeds pending distribution.
- Distribute the sale proceeds to the NM Life PHM.

The question arises as to whether each sale trust is a "unit trust" as defined in section OB 1. If each sale trust is not a "unit trust", certain questions arise as to the income tax treatment of distributions from the sale trusts.

The ruling states that the sale trusts established for New Zealand resident NM Life PHMs are not unit trusts. The sale trusts established for New Zealand resident NM Life PHMs will be subject to the ordinary trust taxation regime set out in subpart H. In relation to this regime, the ruling states, on the basis of the assumptions made, that:

- The "corpus" of each sale trust will be an amount equal to the market value of the NMH shares issued to the trustee of the sale trusts as at the date of issue.
- Any distribution made to the beneficiaries will not be taxable in their hands to the extent that the distribution does not exceed the corpus of the relevant sale trust.
- Each sale trust will be a "qualifying trust" as defined in section OB 1.
- The ordering rules in section HH 6 (1) will not apply to distributions made by the trustee of each sale trust.

Discussion

The definition of "unit trust" is set out under the discussion relating to the voting trust above. The definition of "unit trust" requires that facilities are provided for participation by beneficiaries in income and gains. In this case, the element of participation is absent as each NM Life PHM will be a beneficiary under a separate trust. Furthermore, each PHM will be absolutely entitled to the entire share proceeds and any investment income as and when it is derived.

Given that the sale trusts are not unit trusts, they will be subject to the ordinary trust taxation regime set out in subpart H. The ruling makes four statements in relation to the application of the trust taxation regime.

That the "corpus" of each sale trust will be an amount equal to the market value of the NMH shares issued to the trustee as at the date of issue

The definition of "corpus" in section OB 1 means an amount equal to the market value at the date of settlement of any property settled on the trust. The property settled on each sale trust will be the NMH shares to which the NM Life PHM is entitled to (and that the trustee of the sale trust applies for on behalf of the PHM).

However, there are a number of exclusions from the definition of "corpus" in section OB 1. One of the exclusions, set out in paragraph (b) of the definition, is for a settlement of property which property would have, but for the settlement, have constituted assessable income of the settlor. It is possible that the shares settled on the sale trusts could constitute assessable income of a small minority of NM Life PHMs if the settlement was not made. For this reason, the ruling makes an assumption that the exclusion set out in paragraph (b) does not apply.

That any distribution made to the beneficiaries will not be taxable in their hands to the extent that the distribution does not exceed the corpus of the relevant sale trust

Section HH 3 states:

The assessable income of any person in any income year includes any beneficiary income and any taxable distribution derived by that person in that income year.

Section OB 1 provides the following definitions:

"Beneficiary income" in relation to any person who is beneficiary of a trust for any income year, means income derived during that income year by a trustee of the trust which -

(a) during that income year vests absolutely in interest in the beneficiary; or

(b) Is paid or applied by the trustee to or for the benefit of the beneficiary during, or within 6 months after the end of, that income year ...

"Taxable distribution" ... in relation to any income year and any trust (being in that income year a trust that is a non-qualifying trust or a foreign trust ...) ...

A distribution from a sale trust representing the corpus of the trust will be neither beneficiary income (because it is not income derived by a trustee) nor a taxable distribution (because the trust is a qualifying trust - see below). As such, distributions, to the extent they represent corpus, will not be assessable income in the hands of the beneficiaries.

Each sale trust will be a "qualifying trust" as defined in section OB 1

"Qualifying trust" is defined in section OB 1 as:

In relation to any trust ... and any income year in which a distribution is made from that trust, means any trust where all trustee income derived by the trustee of that trust in income years commencing with the income year in which a settlement was first made to or for the benefit of that trust or on the terms of that trust until the income year in which the distribution is made has been liable under this Act to New Zealand income tax ... and all the trustee's obligations under this Act in respect of the trustee's liability to New Zealand income tax have been satisfied.

"Trustee income" is defined in section OB 1 as:

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

Essentially, a trust will be a "qualifying trust" if all trustee income has been liable for New Zealand income tax and if all the trustee's obligations in respect of his or her liability to New Zealand income tax have been satisfied. For this reason, the ruling assumes that all trustee income of the sale trusts will be liable for income tax in New Zealand where the NM Life PHM beneficiary is a New Zealand resident. The ruling also assumes that the trustee's obligations in respect of his or her liability to New Zealand income tax will have been satisfied.

Based on these assumptions, the sale trusts will be "qualifying trusts" as defined in section OB 1.

That the ordering rules in section HH 6 (1) will not apply to distributions made by the trustee of each sale trust

Section HH 6 (1) deems distributions from trusts to consist of certain amounts according to the ordering rules set out in that section. However, by virtue of

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section HH 6 (2)(a), the ordering rules in section HH 6 (1) do not apply to any distribution from a qualifying trust. As explained above, the sale trusts will be qualifying trusts and will therefore not be subject to the rules set out in section HH 6 (1).

The payment by AXA of amount due upon application by NM Life PHMs (or by the trustee of the sale trusts) for one ordinary share

One ordinary share in NMH will be applied for either by each NM Life PHM personally, or by the trustee of the sale trusts for those NM Life PHMs who do not personally apply. AXA Societe Anonyme ("AXA") will pay the amount due on the one ordinary share on behalf of the PHMs (or on behalf of the trustee of the sale trusts). The question arises as to whether the amount of money paid by AXA is subject to gift duty.

The ruling states that the amount of money paid by AXA is not a dutiable gift and is not subject to gift duty under the Estate and Gift Duties Act 1968 ("the EGDA").

Section 61 of the EGDA imposes gift duty on every "dutiable gift". "Dutiable gift" is defined in section 63(1) to include and consist of:

(a) All the property, wherever situated, comprised in any gift made by any donor to any donee, where the donor is domiciled in New Zealand at the date of the gift or is a body corporate incorporated in New Zealand:

(b) All the property, situated in New Zealand, comprised in any gift made by any donor to any donee, where the donor is domiciled out of New Zealand at the date of the gift, or is a body corporate incorporated out of New Zealand.

AXA is neither domiciled nor incorporated in New Zealand. Therefore, the gift could only be a dutiable gift under section 63(1)(b). However, the gift, being the payment of money by AXA to NMH, will be made in Australia through NMH's bank account. The property comprised in the gift will not, therefore, be situated in New Zealand at the date of the gift and is, therefore, not dutiable.

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 28 September 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. 95/3 was issued on 30 August 1995. It relates to an employee share purchase scheme and sections BB 4 and CH 2 of the Income Tax Act 1994.
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.

Record keeping requirements: goods or services costing $50 or less

Summary

This item states the Commissioner's policy on the goods and services tax (GST) record keeping requirements for goods or services costing $50 or less.

A registered person who buys goods and services costing $50 or less must keep sufficient records to enable the Commissioner to readily ascertain the GST payable by that person. As a minimum, the Commissioner requires the registered person to record the date, description, cost, and supplier of all purchases. Ideally, supporting documentation, such as an invoice or receipt, will indicate if the supplier charged GST.

The Commissioner may disallow the GST input tax deduction on the purchase of a service or non-secondhand good if he establishes that the supplier was not registered for GST. Therefore, Inland Revenue advises registered persons purchasing goods or services to be wary of receipts and invoices that do not clearly show whether GST has been charged.

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

Background

Some registered persons mistakenly believe that they do not need to keep records of purchases for GST purposes if the cost of the purchase is $50 or less. However, general record keeping requirements still apply.

The misconception seems to have arisen because strict rules requiring the retention of tax invoices only apply for transactions exceeding $50. If a purchaser of goods or services costing over $50 does not hold a tax invoice (or for secondhand goods purchased that are not liable to GST, detailed records of the purchase), the GST legislation normally does not allow an input tax deduction.

Legislation

Section 24 specifies when a supplier must provide a tax invoice and also what details a tax invoice must contain. Section 24(7) imposes special record keeping requirements on the purchase of secondhand goods that have no GST charged on their supply. However, none of the record keeping requirements imposed by section 24 apply if the cost of a purchase is $50 or less.

Section 75 imposes general GST record keeping requirements that apply to all transactions. Section 75(3) states:

> Subject to subsections (4) and (5) of this section, every registered person who supplies in New Zealand goods and services shall keep in New Zealand copies of records issued by that registered person, and sufficient records in the English language to enable ready ascertainment by the Commissioner or any officer authorised by the Commissioner in that behalf, of that person's liability to tax and shall retain in New Zealand all such records for a period of at least 7 years after the end of the taxable period to which they relate: ...

Section 75(2) states:

> Without limiting the generality of subsection (1) of this section, the records required to be kept and retained, pursuant to subsection (3) of this section, shall contain-
>
> (a) A record of all goods and services supplied by or to that registered person showing the goods and services, and the suppliers or their agents, in sufficient detail to enable the goods and services, the suppliers, or the agents to be readily identified by the Commissioner, and all invoices, tax invoices, credit notes, and debit notes relating thereto; and ...

Section 75 is similar to section 22 of the Tax Administration Act 1994 (section 428, Income Tax Act 1976) which governs record keeping for income tax. Section 22(2) of the Tax Administration Act states:

> Subject to subsections (3), (4), and (6) of this section, every person who-
>
> (a) Carries on any business in New Zealand: ...
>
> shall keep in New Zealand sufficient records in the English language to enable ascertainment readily by the Commissioner, or any other officer authorised by the Commissioner in that behalf, of-
>
> (g) The assessable income derived by that person ... ; and
>
> (h) The deductions allowable in the calculating of that assessable income; ...

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Section 27 allows the Commissioner to make an assessment showing the amount of GST considered payable by certain persons, including a non-registered person who represents that tax is charged on a supply. Section 27(6) states:

For the purposes of this Part and Parts III, VI, and X of this Act, where-

(a) A person, not being a registered person, supplies goods and services and represents that tax is charged on that supply; ...

that person shall be deemed to be a registered person and any tax represented to be charged on the relevant supply by that person shall be tax payable by that person.

Policy

Persons registered for GST must keep a record of all purchases made that are related to their taxable activity. For all purchases costing $50 or less, the GST legislation imposes general record keeping requirements that are similar to the income tax record keeping requirements. The Commissioner generally expects that registered persons will, as a minimum, keep a record of the following details:

- purchase date
- a description of the goods or services purchased
- purchase price
- supplier's name.

The onus is on registered persons to demonstrate that their GST position is correct, so they should also keep any supporting documentation such as invoices, vouchers, or receipts (if obtained). Ideally, the supporting documentation will show whether the supplier was registered for, and charged, GST. This will give the registered person a sound basis for claiming an input tax deduction when the purchase is treated as including GST.

If the Commissioner finds that a registered person has claimed an input tax deduction on the purchase of a service or non-secondhand good, and the supplier of that good or service was not registered for GST, the Commissioner may disallow the input tax deduction.

However, if the non-registered supplier clearly represented that GST was charged on the supply, the Commissioner will allow the registered person to claim the input tax deduction and will attempt to recover the GST from the supplier.

Registered persons making purchases should therefore be wary of receipts and invoices that do not clearly show whether the supplier charged GST.

Example 1

Mr A is a GST registered self-employed consultant. On 6 May 1995 he uses a taxi to get to the premises of one of his clients. Mr A pays the fare of $23.50 in cash. The taxi company provides him with a receipt that gives the name of the taxi company, a GST number, and states "Fare (incl GST): $23.50". Mr A's accountant later records the date of the transaction, a description, the price paid and the name of the taxi company. The receipt is also kept.

Mr A has more than met the income tax and GST record keeping requirements for his taxi ride. Further, the taxi company clearly represented that GST was charged. Mr A can therefore safely claim an input tax deduction for the GST paid on the taxi fare.

Example 2

Mrs F is a small retailer registered for GST who sells arts and crafts. She regularly buys new items costing less than $50 from a local supplier, Mr G. She records each purchase in a cash book and retains the receipt given by Mr G. The receipt states that the price "includes GST if applicable" but gives no GST number. Mrs F assumes that Mr G is registered for GST and claims an input tax deduction for the assumed GST component of the purchases.

Inland Revenue audits Mrs F. Although the auditor accepts that Mrs F's records are adequate for income tax and GST purposes, further checking reveals that Mr G is not registered for GST. The items purchased from Mr G were new (so no secondhand goods input tax deduction can be claimed) and Mr G was not clearly representing that GST was charged, so the Commissioner disallows all the input tax deductions Mrs F claimed on her purchases from Mr G.

Trust disclosure requirements

Summary

This item outlines the circumstances when a settlor or nominee settlor must disclose information about a trust to the Commissioner, and what information must be provided.

Disclosure is required when there are no resident trustees.

These disclosure requirements do not apply to superannuation funds.

Legislation

The requirements discussed in this item are found in section 59 of the Tax Administration Act 1994 and section HH 7 of the Income Tax Act 1994.

Cross-reference table

Tax Administration Act 1994	Income Tax Act 1976
59(1)	231(2)
59(2)	231(3)
59(4)	231(6)
199	416
222(3)	427(3)
Income Tax Act 1994	**Income Tax Act 1976**
HH 7	231(4)
OB 1	226(2)

When disclosure is required

1. When a settlor is resident and there is no resident trustee at the time of settlement, the settlor must make a disclosure within three months of the date of settlement. (The meaning of "settlor" is discussed below.) The Commissioner's policy on residence is discussed in PIB 180 (June 1989).
2. When the settlor is resident, and, at any time after settlement of a trust there is no resident trustee, the settlor must make a disclosure within three months of the date on which the trust ceased to have a resident trustee.
3. When a person who is New Zealand resident makes a settlement on a trust:
   - as nominee for another person; or
   - of a nominal amount at the request of another person,

   and there is no resident trustee at the time of settlement, that person must make a disclosure within three months of the date of settlement.

Information to be disclosed

The settlor or nominee must disclose all of the following information:

- details of the settlement, including the date of the original settlement and the dates of any subsequent settlements
- the market value of the property transferred
- any consideration received by the settlor for the property
- the trustee's name and address
- the beneficiary's name and address
- a copy of the trust deed
- if a nominee is required to make a disclosure, the name and address of the person for whom the nominee is acting
- any further details the Commissioner requires.

If the property settled includes land, shares, financial arrangements, or the provision of services for less than market value, the settlor must also disclose:

- land - the legal description and the location of the property
- shares - the number, type, the name of the company, and its country of incorporation
- financial arrangements - the holder and issuer, and interest rate and term
- services - the nature of the service and consideration paid.

Who is a settlor

"Settlor" is defined in section OB 1 of the Income Tax Act 1994. A settlor includes someone who does any of the following to or for the benefit of a trust for less than market value:

- makes any disposition of property
- makes any property available (including financial assistance)
- provides any service.

Any person who acquires property or obtains the use of services from a trust for greater than market value is also a settlor.

See the Appendix to TIB Volume One, No. 5 (November 1989) for a detailed discussion of "settlors" and other aspects of the trust rules.

Disclosure form

The information must be disclosed using an IR 6D form.

When a disclosure is required, the person making the disclosure must include the IR 6D form with the trust's IR 6 income tax return. Some additional disclosures are required on the IR 6D form, relating to rights held in foreign entities and certain sales of property.

Failure to disclose

If a disclosure is not made, or if insufficient information is supplied, the Commissioner may determine the amount of trustee income for the income year in a fair and reasonable manner.

Penalties may also be charged for non-disclosure or knowingly giving any false information. The penalties are a fine of up to $50,000 or imprisonment for up to two years, or both. A person who aids, abets, or incites either of these offences is liable to the same penalties. These offences and penalties are set out in sections 199 and 222(3) of the Tax Administration Act 1994.

Imputation - carrying forward unused credits

Summary

This item sets out the tax treatment when a company in a tax loss situation receives an imputed dividend. A credit will arise in the loss company's imputation credit account when the dividend is paid. To the extent that the company's existing tax losses mean that the imputation credit is not fully utilised, a loss is deemed to occur. The company may carry this loss forward. This does not affect the balance in the company's imputation credit account.

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

Background

Under the imputation system, a company may allocate the tax it pays on its income to its shareholders by attaching imputation credits to the dividends it pays. Both the dividends and the imputation credits attached to the dividends are included in the shareholders' assessable income, and the shareholders are allowed to offset the imputation credit against their income tax liability. The credits are not refundable to shareholders, but to the extent to which the imputation credit is not credited in payment of income tax, a deemed loss to the shareholder arises.

Inland Revenue has received a number of questions about the correct tax treatment of imputation credits attached to dividends paid to a shareholder that is a company when that company is in a tax loss situation. Specifically, we have been asked whether a company may choose whether or not to convert unused credits into a loss, rather than retaining the credit in its imputation account.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
CB 10 (2)	63(2K)
LB 2 (3)	394ZE(3)
ME 4 (1)(d)	394D(1)(d)

Section LB 2 (3) states:

There shall be no refund to a taxpayer of any of a credit of tax under this section, but where the whole of the credit of the tax is not credited in payment of the income tax payable by the taxpayer for the income year -

(a) The taxpayer shall, in respect of any amount of the credit that is not so credited, be deemed to have incurred, on the date upon which the dividend to which the imputation credit was attached was paid, an amount of loss for the income year that may-

(i) To the extent permitted by sections IE 1 and IF 1, be carried forward and deducted from or set off against the assessable income of a succeeding income year; and

(ii) To the extent permitted by section IG 2, be deducted from or set off against the assessable income of another company for that or any succeeding income year; and

(b) The amount of any such loss that may be so carried forward or deducted or set off shall be an amount calculated in accordance with the following formula:

$$\frac{a}{b}$$

where-

a is the amount of the credit of tax not credited in payment of income tax payable for the income year; and

b is-

(i) In any case where the taxpayer is a company, the rate of resident companies' income tax, expressed as a percentage, stated in clause 5 of Part A of Schedule 1 and applying for the income year ...

Application

When a company receives a dividend with imputation credits attached, a credit arises to the company's imputation credit account. If the company is in a tax loss situation, it will not be able to use all of the credits to pay tax as its losses will reduce the amount of tax to pay. Section LB 2 (3) states that the unused credit cannot be refunded. However, section LB 2 (3) deems the company to have incurred a loss in respect of any unused imputation credits.

Under section LB 2 (3)(a)(i), the company can carry forward these losses and deduct them from its assessable income in subsequent income years. Alternatively, section LB 2 (3)(a)(ii) permits the losses to be deducted or set off against the assessable income of a company in the same group.

Section LB 2 (3)(b) provides the formula for working out the loss to be carried forward. The loss is calculated using the formula:

$$\frac{a}{b}$$

In this formula:

a is the amount of the credit of tax not credited in payment of income tax payable for the income year

b is 33% in the case of a company (the rate of resident companies income tax, expressed as a percentage).

Sometimes this process is described as converting the tax credits into a loss. This has led to confusion, because some taxpayers have assumed that the credit in the imputation credit account is lost when the deemed loss occurs. This is not so. The credit which is not used remains in the imputation credit account.

A limitation applies to dividends received from another company in a wholly-owned group. These are exempt from tax under section CB 10 (2). Such intercorporate dividends do not constitute assessable income of the recipient company, so the provisions discussed above about deemed losses for unused imputation credits do not apply. However, the amount of any imputation credit attached to a dividend paid to a company during an imputation year is available for crediting to the imputation credit account under section ME 4 (1)(d).

Example

X Co Ltd has a loss carried forward of $100 in the 1994 income year. Its only income is a fully imputed dividend from Y Co Ltd of $100. X Co Ltd and Y Co Ltd are not members of a wholly-owned group. The dividend included $33 of imputation credits.

The $33 imputation credit was credited to X Co's imputation credit account. X Co did not have to use the imputation credit to pay tax on the dividend it received from Y Co Ltd, as the dividend of $100 was set off against the X Co's existing $100 loss. Under section LB 2 (3)(b), X Co Ltd is deemed to have incurred a further loss of $100 (being $33/33%) in respect of the imputation credits which were not used. The $33 remains in the company's imputation credit account, and there are losses of $100 to be carried forward.

Consumable aids - deductibility of cost

Summary

Consumable aids are goods and materials used up in producing a product or service.

The cost of acquiring a consumable aid is deductible when incurred. However, if the provisions of section EF 1 apply, the expenditure incurred on consumable aids that are not used by the end of the income year is included in assessable income.

Under Determination E10, section EF 1 only applies to taxpayers when the cost of consumable aids unused at the end of the income year exceeds $58,000.

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

Background

Goods purchased by a taxpayer for use in a business are depreciable property, non-depreciable property, trading stock, or consumable aids. Each type of property has a different tax treatment.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
BB 7	104
EF 1	104A

The term "consumable aid" is not defined. Sections BB 7 and EF 1 govern the deductibility of expenditure incurred on consumable aids.

Currently, the accruals determination E10 modifies the application of section EF 1. Determination E10 was published in Tax Information Bulletin Volume Six, No. 4 (October 1994). Under the transitional provisions in section YB 5, all accruals determinations in force after 1 April 1995 that refer to sections in the Income Tax Act 1976 are interpreted as referring to the equivalent sections in the Income Tax Act 1994.

Policy

The Commissioner considers that consumable aids are goods or materials to which all of the following criteria apply:

- They are used in any way in the manufacture or production of goods or services from which a taxpayer derives assessable income.
- They are wholly or almost wholly consumed in the production process, or become unusable or worthless after being used once in the production process, or are capable of limited repetitive use, or have a very short life.
- They are not component parts of a finished product, or goods acquired for further processing.

Examples of consumable aids are the chemicals used by a plastic manufacturer, the printer ribbons used by an accountant, and the fertiliser used by a farmer.

Expenditure on buying consumable aids is deductible when incurred. However, such expenditure is accrual expenditure for the purposes of section EF 1. Under section EF 1, the unexpired portion of accrual expenditure must be included in assessable income.

For consumable aids, the unexpired portion of accrual expenditure is the amount of expenditure attributable to consumable aids that at the end of the income year have not yet been used by the taxpayer to produce assessable income.

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A determination made by the Commissioner under section EF 1 (3) exempts some taxpayers from complying with section EF 1. The most recent determination, determination E10, applies from the 1994-95 income year. Under it, section EF 1 does not apply to expenditure on the purchase of consumable aids when the unexpired portion of the expenditure is $58,000 or less.

However, determination E10 applies only to consumable aids in the possession of the taxpayer at balance date. Determination E10 also applies only if the expenditure has not been deferred for financial reporting purposes.

Unexpired accrual expenditure included in assessable income for an income year is deductible in the following income year.

Example

Bigfoot Shoes Ltd purchases 50,000 litres of solvent at a cost of $100,000 during the 1994-95 income year. The solvent is for use in shoe manufacturing. At the end of the income year drums containing 30,000 litres of solvent (with a cost of $60,000) remain unopened.

The entire cost of the solvent is deductible in the 1994-95 income year as expenditure on a consumable aid. However, because the unexpired portion of the expenditure on solvent is $60,000, and therefore greater than $58,000, section EF 1 applies. This means the unexpired accrual expenditure of $60,000 must be returned as income in the 1994-95 income year.

The $60,000 becomes deductible in the 1995-96 income year, but if section EF 1 applies again in the 1995-96 income year further income will arise from unexpired accrual expenditure.

Export market development expenditure refunds and further income tax

Summary

This item states the Commissioner's current policy on imputation credit accounts and further income tax liability caused by export market development expenditure refunds.

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

The Commissioner's policy is that section YB 4 (1) (section 394L(4A), Income Tax Act 1976) neutralises the further income tax liability caused by export market development expenditure refunds in the year of the refund, and in subsequent imputation years. However, section 394L(4A) of the Income Tax Act 1976 does not cancel the debit in the company's imputation credit account.

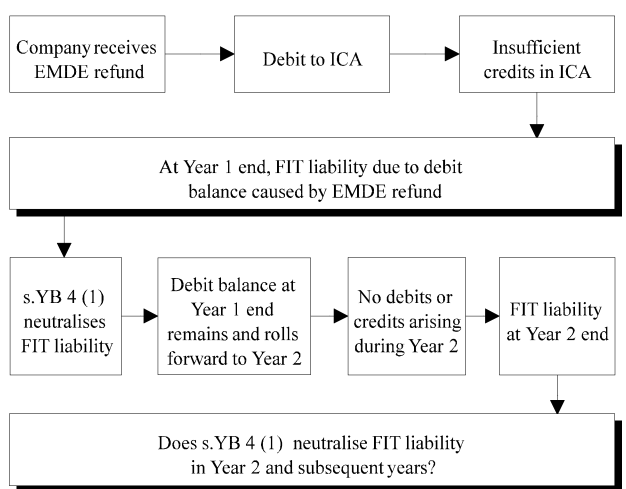
Taxpayers should contact their local Inland Revenue office if they have been incorrectly charged further income tax and penalty/additional tax on their debit imputation credit account balances resulting from export market development expenditure refunds.

Background

Section 156F of the Income Tax Act 1976 allows, up to the end of the 1990 income year, tax credits called export market development expenditure (EMDE) credits for expenditure incurred in relation to developing export markets. If the EMDE credits exceed a taxpayer's income tax liability, a refundable excess arises. When this is refunded to a company, a debit is made to the company's imputation credit account ("ICA").

If a debit ICA balance arises from the receipt of an EMDE refund at the end of the imputation year, under section YB 4 (1) no further income tax (FIT) is payable in the year of the refund. However, section YB 4 (1) does not cancel out the debit in the ICA. The debit will roll over into the next imputation year, and assuming that there are no debits or credits in that year, a FIT liability will again result.

The question is whether FIT liability can be neutralised by section YB 4 (1) in imputation years after the refund. The following diagram represents the issues involved.



Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
ME 9 (1)	394L(1)
YB 4 (1)	394L(4A)
Omitted	156F

Section YB 4 (1) is a savings provision, and states:

Notwithstanding the repeal by this Act of sections ...394L(4A)...those provisions shall continue to apply, as if they had continued in force, in the same manner as they applied immediately before the commencement of this Act.

Section 394L(4A) of the Income Tax Act 1976 states:

Where-

(a) Pursuant to section 156F(4) of this Act a company has been paid any refundable excess in respect of the income year commencing on the 1st day of April 1988 or any subsequent income year; and

(b) The amount of that refundable excess has in any imputation year arisen as a debit to the company's imputation credit account,-

any amount that the company would otherwise be liable to pay by way of further income tax pursuant to subsection (1) or subsection (3) of this section shall be reduced (so far as it extends) by an amount calculated in accordance with the following formula:

$$a - b$$

where

a is the sum of all such refundable excesses paid to the company on or before the date on which the relevant debit balance giving rise to the liability for further income tax is determined; and

b is the sum of any credits arising, in accordance with section 394C(2)(b)(i) and section 394D(1) of this Act, in the company's imputation credit account during the imputation year in which the amount of any such refundable excess first arose as a debit to the company's imputation credit account and during any subsequent imputation year.

Policy

The Commissioner's view is that section YB 4 (1) also applies to imputation years subsequent to the year that the EMDE credit is refunded. The formula in section YB 4 (1) requires taxpayers to trace back and aggregate the following entries over current and prior imputation years:

- all EMDE refund debits on or before the time the relevant debit balance is determined (variable "a")
- all credits that arise to the ICA during the year in which the EMDE refund debits first arose, and during subsequent imputation years (variable "b").

The sum of all credits is offset against the sum of all EMDE refund debits arising, and the balance of the EMDE refund debits remaining, if any, is the amount by which the FIT liability is reduced.

This formula enables taxpayers to neutralise the FIT liability that would otherwise be payable because of a debit balance arising from EMDE refunds. Note that the formula does not cancel the debit balance in the ICA.

Taxpayers should contact their local Inland Revenue office if they have been incorrectly charged FIT and penalty/additional tax on their debit ICA balances caused by EMDE refunds.

Example

URAP Ltd's ICA opening balance on 1 April 1989 is nil. During the year, URAP Ltd received an EMDE refund of $100,000 which resulted in a $100,000 debit to its ICA. It also received $30,000 worth of credits to the ICA during the year.

At the end of the imputation year 31 March 1990, URAP Ltd's ICA closing balance is $70,000 in debit.

Under section ME 9 (1), a FIT liability of $70,000 would ordinarily arise. However, under section YB 4 (1), the FIT liability is reduced by the formula, **a - b**, in which:

- "a" is the sum of all such refundable excesses paid to the company on or before 31 March 1990. This is $100,000.
- "b" is the sum of any credits arising in the company's ICA during the year in which the EMDE refund first arose, and during subsequent imputation years. This is $30,000.

Therefore, on 31 March 1990 the potential FIT liability of $70,000 from the debit balance will, under section YB 4 (1), be reduced by $70,000 ($100,000-$30,000) to nil.

The debit balance remains and rolls over into the next imputation year. On 1 April 1990 the ICA has an opening debit balance of $70,000.

During the 1990-1991 imputation year there are no debits to the ICA, and $50,000 credits to the ICA.

At 31 March 1991 the ICA will have a closing debit balance of $20,000, and a possible FIT liability of $20,000.

The formula in YB 4 (1), **a - b**, neutralises the $20,000 FIT liability that would arise at the end of the 1991 imputation year. Under the formula:

- "a" is the sum of all such refundable excesses paid to the company on or before 31 March 1991. Before 31 March 1991, the total EMDE refunds is $100,000.
- "b" is the sum of any credits arising in the company's ICA during the year in which the EMDE refund first arose, and during subsequent imputation years. This is $30,000 (1990) + $50,000 (1991) = $80,000.

Therefore, the FIT liability is reduced by $20,000 ($100,000 (a) - $80,000 (b)) to nil.

Asset no longer used but retained by taxpayer - application to deduct adjusted tax value

Summary

Section EG 12 of the Income Tax Act 1994 allows a taxpayer to apply to deduct the adjusted tax value (ATV) of an asset that can no longer be used, but which the taxpayer keeps.

Before allowing the deduction, the Commissioner must be satisfied that both of these conditions are met:

- The taxpayer no longer uses the property in the production of assessable income or in a business.
- The costs of disposing of the property would exceed any consideration that could be derived from its disposal.

The Commissioner must also have regard to whether the property could still be used in the production of assessable income or in a business.

When the Commissioner issues a determination, it will apply, at the taxpayer's option, in one of these years:

- the income year which finished immediately before the income year when the application is made
- the income year the applicant makes the application
- the income year in which the asset meets the three criteria set out in section EG 12 (6).

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

Background

There is some confusion surrounding section EG 12. Several taxpayers have applied to write off the remaining ATV of an asset under section EG 12 when the three criteria in section EG 12 (6) are not satisfied. For example, some taxpayers have applied for the deduction when they have already sold or otherwise disposed of the asset. Other taxpayers have applied for the deduction when the costs of disposal do not exceed the estimated consideration that they could receive from the disposal of the asset.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
EG 12	108K
EG 19	117

Section EG 12 states:

(1) The deduction on account of depreciation that may be claimed for any income year in respect of any depreciable property that can no longer be used (other than a building or property that has been depreciated using the pool depreciation method) shall be, if the Commissioner so determines, an amount equal to the adjusted tax value of that property.

(2) The deduction made under subsection (1) shall be an amount equal to the adjusted tax value of the property at the beginning of that income year.

(3) Where a deduction is made under subsection (1) in respect of any depreciable property,-

(a) The adjusted value of that property at the end of that income year shall be nil; and

(b) No deduction shall be calculated under section EG 2 in respect of that property in that income year.

(4) Section EG 19 shall apply if a taxpayer disposes of any property for which a deduction has been allowed under this section.

(5) A taxpayer may apply to the Commissioner for a determination stating that the taxpayer may deduct the remaining adjusted tax value of any depreciable property.

(6) When considering an application for a determination to deduct the remaining adjusted tax value of any depreciable property, the Commissioner-

(a) Shall be satisfied-

(i) That the property is no longer used by the taxpayer in the production of assessable income or in a business; and

(ii) That the costs of disposing of the property would exceed any consideration that could be derived from the disposition of the property; and

(b) Shall have regard to whether the property could still be used in the production of assessable income or in a business.

Section EG 19 contains the tax treatment of a gain or loss when depreciable property is disposed of. Section EG 19 (2) states:

Subject to subsection (4), where in any income year any property is disposed of by a taxpayer for a consideration that exceeds the adjusted tax value of that property on the date of disposition, the lesser of the following amounts shall be included in the assessable income derived by the taxpayer in that income year-

(a) The aggregate of amounts allowed under this Act and the Income Tax Act 1976 to the taxpayer as a deduction on account of depreciation in respect of the property (and additionally, in the case of property referred to in subsection (1)(a)(ii), any deduction allowed for the purchase or creation of that property); and

(b) The amount (if any) by which the consideration derived by the taxpayer from the disposition exceeds the adjusted tax value of the property as at the date of disposition.

Section EG 19 (3) states:

Subject to subsection (4), where in any income year any depreciable property (other than a building) is disposed of by a taxpayer for a consideration that is less than its adjusted tax

value at the time of disposition, the amount by which the adjusted tax value of the property as at the date of disposition exceeds the consideration derived by the taxpayer from the disposition shall be deducted from the assessable income of that taxpayer in the income year in which the sale or disposition occurs.

Application of legislation

Under the legislation the Commissioner must consider three issues when deciding whether to issue a determination allowing the deduction:

- The Commissioner must be satisfied that the taxpayer no longer uses the property in the production of assessable income or in a business.
- The Commissioner must be satisfied that the costs of disposing of the property would exceed any consideration that could be derived from the disposition of the property.
- The Commissioner shall have regard to whether the property could still be used in the production of assessable income or in a business.

If an item is disposed of, physically or otherwise, there is no need to make any application to claim a deduction. A taxpayer can generally claim a loss on sale or disposal against assessable income under section EG 19 (3).

If the Commissioner issues a determination to allow a taxpayer to write off the ATV of an asset that the taxpayer later sells, the amount of the consideration received (less costs of disposal) up to the total amount of depreciation deductions claimed, is depreciation recovered. Under section EG 19 (2), depreciation recovered is assessable income in the year the asset is disposed of.

Income year from which determination applies

The legislation does not provide a timeframe for making the application, nor for when the determination applies.

The taxpayer may apply for this deduction at any time after the date that the property can no longer be used.

The Commissioner has established new policy on when the determination applies. This policy supersedes that outlined in TIB Volume Five, No.10 (March 1994), in the item "Miscellaneous depreciation issues - questions and answers".

The new policy is that when the Commissioner issues a determination, it will apply, at the taxpayer's option, in one of these years:

- the income year which finished immediately before the income year the application is made
- the income year the applicant makes the application
- the first income year in which the asset meets the three criteria set out in section EG 12 (6).

The new policy recognises that most taxpayers decide to apply for a deduction for an asset that is no longer used, at the time of finalising the end of year accounts.

Example 1

X Bank Limited installs new computers that replace its outdated ones. The old computers are considered worthless, because of their age. X Bank has no room to store them, and so pays for their transport to the dump.

Although the cost of disposing of them exceeds any proceeds, the assets have actually been disposed of. X Bank must write off the computers under section EG 19 (3), and claim the loss against assessable income in that income year. X Bank does not claim a deduction under section EG 12.

Example 2

Anthony and Peter set up in business baking pies. They buy a small oven for this purpose. The business expands beyond their wildest dreams, and they realise that the oven is far too small for their requirements. They advertise the oven for sale several times, without response. Finally, they approach a local secondhand dealer who, knowing that there is a market for the item, offers to buy the oven for around half the price they expected. Anthony and Peter decide to store the oven for a few months, and continue to advertise, hoping to get a better price. Finally, they apply to write off the ATV of the oven under section EG 12.

The Commissioner declines their application. He considers that it does not meet the requirements of the section, as the oven can still be used in a business or in the production of assessable income. Also, it is likely that the costs of disposing of the oven would not exceed any consideration that could be derived from the disposition of the oven.

Example 3

Sarah and Angela have a lawn-mowing round. One of the mowers breaks down. It is uneconomical to repair it, so they decide to put it out for collection on the local Council's next non-organic rubbish collection day. In the meantime, they apply to write off the ATV of the mower under section EG 12. The Commissioner declines their application, as it does not meet the criterion that the costs of disposing of the property must exceed any consideration that could be derived from the disposition of the property.

Once the Council collects the mower on the non-organic rubbish collection day, Sarah and Angela can claim the loss on disposal against assessable income under section EG 19 (3).

Example 4

Minex Company Ltd installed railway tracks from one of its mines to its processing plant. As that mine is no longer productive, the line is no longer

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used. The cost of removing the tracks far outweighs their value as scrap metal, and no other business could use them. Minex leaves the tracks where they are, and applies for a write-off under section EG 12. The application meets the requirements for a write-off under section EG 12.

Example 5

Manufacturing Ltd modernises its factory for the first time in twenty years, replacing part of the production line with the latest electronic equipment. The replaced equipment is stored in the building, as the value of the scrap metal is less than the transport costs of getting it to the scrap metal dealer.

Manufacturing Ltd is aware that any manufacturer, buying equipment for that kind of production line, would only consider equipment incorporating the new technology as it produces a product far superior to that made using the older equipment.

The Commissioner considers that Manufacturing Ltd's application meets the criteria for a write-off under section EG 12. The taxpayer no longer uses the replaced part of the production line. The costs of disposing of it are more than its scrap value. It can no longer be considered useable in the production of assessable income or in a business.

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.

Library books and periodicals - depreciation rate review

We have been asked to review the rates set for library books and periodicals. These are the rates that currently apply:

Asset classes	Estimated useful life (years)	Diminishing value rate (%)	Straight-line rate (%)
Library books, and periodicals (if to be bound) (lending) (not specified)	8	22	15.5
Library books, and periodicals (if to be bound)(in-house)	20	9.5	6.5
Library books, and periodicals (if to be bound)(law)	20	9.5	6.5
Library books, and periodicals (if to be bound)(public)	8	22	15.5
Library books, and periodicals (if to be bound)(school)	8	22	15.5
Library books, and periodicals (if to be bound)(scientific)	20	9.5	6.5
Library books, and periodicals (if to be bound)(university)	8	22	15.5
Newspapers and periodicals (if not to be held)	expense	expense	expense
Newspapers (where to be held)	2	63.5	63.5
Periodicals (if to be held but not to be bound)	2	63.5	63.5

These rates are also set out on page 46 of the Depreciation Guide (IR 260), April 1994. It has been suggested to us that the rates are too low and that the various categories make compliance difficult and increase costs.

We invite you to make submissions on what the depreciation rates and categories should be. Send your submissions to:

The Manager (Rulings)
National Office
Inland Revenue
PO Box 2198
WELLINGTON

Please send any submissions by 30 November 1995.

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

Charitable exemption request following bequest to defunct organisation

Section CB 4 (1)(d) (section 61(26), Income Tax Act 1976) - Categories of exempt income: In her will, a deceased taxpayer left $100,000 to an organisation concerned with the harmful effects of gambling. The organisation wound up its operations in 1990, having never requested charitable status recognition from Inland Revenue. The deceased's trustee proposes to set aside the money in perpetuity to pay the income towards the objects of the defunct organisation. The trustee sent Inland Revenue a copy of the former organisation's constitution and rules, and asked us to grant an income tax exemption under section CB 4 (1)(d) to the sub-fund within the estate on the basis of that fund's charitable objects.

Under certain circumstances, by means of the cy-prés doctrine or through application of section 32 of the Charitable Trusts Act 1957, bequests made to charities that no longer exist are able to be carried out. Inland Revenue's concern is with the status of the sub-fund being set up within the deceased's estate.

Inland Revenue will take into account the documents relating to the defunct organisation only to the extent that the sub-fund has adopted them. Clearly the sub-fund will not have adopted the constitution and rules of the former organisation in total - such rules concerning meetings, for example, would have no relevance - but the sub-fund will have taken on its objects.

After a request from Inland Revenue, the trustee provided documentation that showed the sub-fund is a charitable entity in its own right. In this and similar cases it is necessary to look at the status of the ultimate recipient of the funds (in this instance the sub-fund), rather than that of the originally intended recipient. Regardless of whether or not the defunct organisation was charitable, the sub-fund was shown to be charitable so Inland Revenue granted an exemption under section CB 4 (1)(d).

Allowances paid to staff in wheelchairs - exemption

Section CB 12 (section 73, Income Tax Act 1976) - Power to exempt employees' allowances: An employer pays a daily allowance to staff confined to wheelchairs to cover the cost of parking close to their workplace. The employer has requested that the allowance be exempted from tax.

Under section CB 12 (1):

An amount paid by an employer in respect of an employee's employment or service is exempt from tax where and to the extent that the amount -

(a) Reimburses the employee for expenditure that, but for section DE 1, would be deductible in calculating the employee's assessable income for any income year; or

(b) Is expenditure on account of an employee which, if incurred by the employee and but for section DE 1, would be deductible in calculating the employee's assessable income.

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Under section DE 1 (section 105, Income Tax Act 1976), no deduction is allowed for expenditure or loss incurred in the production of income from employment.

Paying an allowance to cover parking costs is not a reimbursement of expenditure incurred in gaining or producing assessable income. It is the reimbursement of an expense incurred in putting the employee in a position to earn assessable income.

Accordingly, the allowance paid to the employees in wheelchairs cannot be exempted from tax, and is taxable in full to the employee.

Use of money interest and the accruals rules

Section EH 9 (section 64M, Income Tax Act 1976) - Application of accruals rules: A taxpayer has raised a concern that payments of use of money interest to Inland Revenue will involve her in a financial arrangement under the accruals rules. She has asked for an assurance that accounting under the accruals rules will not be necessary in these circumstances.

Section EH 9 gives a number of instances when the accruals rules will not apply. Section EH 9 (f) states that they are not applied:

> In relation to a financial arrangement to the extent that the income or expenditure incurred by a person in respect of the financial arrangement consists of interest payable to or by the Commissioner under section 121 or section 122 of the Tax Administration Act 1994, being interest payable in relation to the tax on income derived in the 1994-95 income year or any subsequent year.

Therefore, use of money interest payable either to the Commissioner under section 121, or by the Commissioner under section 122, does not have to be accounted for under the accruals rules.

Loss attributing qualifying company (LAQC) elections

Section HG 14 (section 393N, Income Tax Act 1976) - Loss attributing qualifying companies: A company has five shareholders, four of whom have agreed to sign election notices so that the company can become an LAQC under the qualifying company rules. The fifth shareholder who holds 10% of the company's shares has refused to sign. The four shareholders have asked whether the fifth shareholder's election is required.

A company that is a qualifying company (QC) can become an LAQC when all of the following conditions are met:

- the company is a qualifying company at all times during the income year.
- The company's shares each carry the same voting rights and rights to any profits or distributions of assets.
- No share in the company has been subject to any arrangement whose purpose is to defeat the intention of section HG 14.
- An election that the company be an LAQC is executed by each *sui juris* shareholder and each sui juris director of the company.

It is the last point that is of concern in this case. The fifth shareholder does not want the company to become an LAQC and has not executed an election. In the absence of an election from each *sui juris* shareholder, the company cannot become an LAQC. The legislation does not allow an election by a majority of shareholders to override this requirement.

Note: The term *sui juris* is a legal phrase used to describe people who are under no disability affecting their legal capacity to deal with their property, bind themselves by contracts, and to sue and be sued. People who do not have legal capacity (and are therefore not *sui juris*) include minors and people who are mentally disabled.

NZ Super surcharge - why only half of NZ superannuation fund pension included

Section JB 3 (1) (section 336D(1), Income Tax Act 1976) - Determination of "other income": A taxpayer has asked why, in determining other income for surcharge purposes, only half of some pensions or annuities is taken into account.

New Zealand superannuitant surcharge is imposed when a taxpayer's income, other than New Zealand superannuation, exceeds the stated minimum. In determining that "other income", the formula in section JB 3 (1) includes the taxable income of the New Zealand superannuitant, together with:

> ...one-half of any amount received in the form of a pension from a superannuation fund or an annuity to which section CB 9 (f) applies, which amount is not otherwise included in the taxable income of the New Zealand superannuitant...

The pensions and annuities of which only half is taken into account for surcharge purposes are those non-taxable pensions which are not included as income in a superannuitant's tax return. That is, non-taxable pensions or annuities from New Zealand registered superannuation schemes or life insurance funds, such as the Government Superannuation Fund, which are registered with the Government Actuary.

Income tax is already paid on this income by the funds themselves - but not surcharge. By including half the pension or annuity in the surcharge calculation, it is recognised that approximately half of those payments represents income earned, and the other half is a drawdown in capital. The 50% income earned is subject to the surcharge, as is interest earned in a bank account. The other 50% is effectively a return of capital, and is not subject to the surcharge.

Non-resident's liability to file income tax return

Section NG 1 (section 310, Income Tax Act 1976) - Application of non-resident withholding tax rules: A New Zealand national has lived in Australia for 20 years. She has recently received a bequest which will provide for payments of company dividends and interest from New Zealand. She has asked if she must file a tax return to Inland Revenue in New Zealand. The payer of the interest is neither an approved issuer in terms of section NG 6 (section 311B, Income Tax Act 1976), nor an associated person of the Australian resident.

Section NG 1 (2) makes income consisting of interest, royalties, and dividends deemed to be derived from New Zealand, by a person who is not resident in New Zealand, subject to the non-resident withholding tax rules.

Section NG 2 (1) (section 311, Income Tax Act 1976) sets the rates of NRWT applicable to non-resident withholding income:

- dividends - NRWT at 30%, section NG 2 (1)(a)
- interest (not paid by an approved issuer) - NRWT at 15%, section NG 2 (1)(c).

Under section BB 11 (section 294, Income Tax Act 1976), the provisions of a double taxation agreement (DTA) are able to modify domestic law. The Double Taxation Relief (Australia) Order 1995 (New Zealand - Australia DTA) sets the following rates:

- dividends - taxed at 15% under paragraph 2 of Article 10
- interest - taxed at 10% under paragraph 2 of Article 11.

Provided NRWT is correctly deducted and accounted for by the payer (or agent), and the Australian resident's only New Zealand-sourced income is non-resident

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withholding income, she will not have to file a tax return in New Zealand. This is because in her circumstances section NG 3 (section 317, Income Tax Act 1976) excludes the dividends and interest from assessable income, and makes NRWT the final tax payable.

Family Support for children living overseas

Section OB 1 (section 374A, Income Tax Act 1976) - Principal caregiver: A New Zealand resident taxpayer is unable to look after his children as his job requires him to travel around the country. His sister who lives in Australia has agreed to look after the children until his circumstances change. At this stage, the taxpayer and his sister consider that the children are living with her on a permanent basis. She looks after the children as if they were her own. The taxpayer sends money to her each week to meet the costs of looking after them. He has asked if he can claim Family Support for his children while they are living in Australia.

To be able to claim Family Support, a person must satisfy the definition of "qualifying person" in section OB 1. To be a "qualifying person", a person must, among other things, be the principal caregiver of the dependent children.

Section OB 1 also defines who is a "principal caregiver". A person is a "principal caregiver" when, in the Commissioner's opinion, the person has the primary responsibility for the day to day care of the child, other than on a temporary basis.

The definition excludes:

(a) Any body of persons (whether incorporated or unincorporated); or

(b) Any person who is the proprietor of, or employed in,-

(i) A residence established under the Children, Young Persons, and Their Families Act 1989; or

(ii) A home registered under the Disabled Persons Community Welfare Act 1975; or

(iii) Any other institution in which the child is being cared for.

In this case, the Commissioner considers that the New Zealand resident is not eligible to claim Family Support for the children living in Australia. He does not fulfil the role of principal caregiver for the children, as he does not look after them on a day to day basis. Because he is not a principal caregiver he cannot be a qualifying person for the purposes of the Act.

Income Tax Act 1976

Livestock sale income when farmer retires - can no longer be spread

Section 93 - Spreading of excess income derived on sale of livestock where unduly low standard values or nil value adopted (repealed): A tax practitioner has asked if any income spreading is available for income resulting from the selling up of farm livestock when a farmer retires.

The short answer is no. Up until the income year ending 31 March 1987, under section 93 (repealed from 1 August 1990) a farmer disposing of livestock upon retirement from the farming business could apply to Inland Revenue for income arising from such disposal to be apportioned between the year of sale and up to 3 subsequent years. Under the livestock rules in operation at that time, section 93 was necessary because large disparities often occurred between the sale price of livestock and prevailing book values. This resulted in significant income assessability.

In general, the advent of the herd scheme has seen livestock book values more closely approximate actual values achieved at the saleyards. However, in some circumstances farmers using the national standard cost scheme may find that there is a significant disparity between book values and market values. When this occurs, it may be advisable to progressively move livestock from the national standard cost scheme to the herd scheme so as to lessen the ultimate amount of assessable income at retirement.

Goods and Services Tax Act 1985

GST and fines imposed by sporting body

Section 5 - Meaning of the term "supply": A local sports association is registered for GST. It is responsible for running a sport in its particular area, and has authority under its constitution to impose fines on member clubs or individuals in certain circumstances. For instance, it may impose a fine on a club that fails to supply a team card or result card within a certain time, or on an individual who is considered to have breached accepted standards of behaviour (e.g. has abused an official or failed to meet dress standards). An official of the sports association has asked if the fines it collects under its constitution are subject to GST, and if an input tax deduction is available to a GST registered club that has paid a fine.

In the circumstances described above, the fines are imposed by the association as punishment for offences against its rules. Payment of the fine does not constitute payment for a supply of goods or services. Therefore, the association does not have to account for GST on the fines it collects, and no input tax deduction is available to a club that has been fined.

Trading in private car to obtain business vehicle - GST implications

Section 6 - "Taxable activity" defined: A self-employed taxpayer voluntarily registered for GST before he started his business activities. He used his private car for business use during the set up of the business. On average, the business use of the vehicle was 45%, based on his logbook. He is now in a position to trade this vehicle and purchase a more suitable business vehicle. He expects the new vehicle's business use to be around 90%. He has asked if he must account for GST on the trade-in value of his car when he purchases the business vehicle.

Section 6 defines the term "taxable activity", and excludes from the definition:

...any activity carried on essentially as a private recreational pursuit or hobby...

Although the vehicle to be traded was used in the taxpayer's business operations, it did not form part of the business assets. Therefore, when the vehicle is subsequently sold (in this case, traded in), the "sale" is considered to be that of a private asset, and the taxpayer does not need to account for GST on the trade-in value received.

The new vehicle will be acquired principally for business use, so the taxpayer will be able to claim one-ninth of the total purchase price in his GST return. He will be required to make an adjustment in each (subsequent) GST return to reflect the private (or non-taxable) use of the vehicle in that period. He can use a reasonable method to apportion the use of the new vehicle between taxable and private use. The acceptable methods are set out on page 15 of TIB Volume Five, No. 13 (June 1994).

GST on moveable personal property in New Zealand

Section 11(2) - Zero-rated services: A Japanese resident owns a racehorse that is trained and stabled in New Zealand. She is being charged GST at 12.5% on the costs incurred, and has asked if zero-rating should apply.

Generally, under section 11(2)(e), services are able to be zero-rated when:

> The services are supplied for and to a person who is not resident in New Zealand and who is outside New Zealand at the time the services are performed,...

The racehorse owner is such a recipient.

However, the section continues by saying:

> ...not being services which are supplied directly in connection with-
>
> (i) Land...;or
>
> (ii) Moveable personal property (other than choses in action, and other than goods to which paragraph (ca) of this subsection applies) situated inside New Zealand at the time the services are performed;-

In this scenario the racehorse is "moveable personal property", and as the services are supplied "directly in connection" with it, and it is not a temporary import (paragraph (ca)), zero-rating does not apply. GST is correctly being charged to the owner at 12.5%.

Trade display equipment temporarily imported into New Zealand

Section 12 - Imposition of goods and services tax on imports: An Australian company brought equipment into New Zealand for display at a trade exhibition, and paid GST on the items to NZ Customs. A company representative has asked Inland Revenue if the GST can be refunded now that the equipment has been re-exported. She has pointed out that as the Australian company was not conducting a taxable activity in New Zealand it was not able to register for GST. It could not get a GST refund from NZ Customs.

In these situations, and provided the goods will be re-exported within twelve months of being imported, the goods should be imported on a temporary basis only. This means that rather than paying duty and GST to NZ Customs at the time the goods enter New Zealand, NZ Customs takes a deposit which can be refunded when the goods are re-exported. This is only applicable when the goods are to be re-exported.

Alternatively, if the Australian company intends to start a taxable activity in New Zealand, it could register for GST before importing the equipment. This would enable it to claim input tax for the GST paid to NZ Customs in the normal manner.

In this particular case the Australian company was not conducting a taxable activity in New Zealand, so it was unable to register for GST. Consequently, Inland Revenue is unable to refund the GST.

Personal representative, receiver, liquidator, etc - liability to register for GST

Section 58 - Personal representatives, liquidators, receivers, mortgagees in possession: An executor plans to carry on the taxable activity of a deceased GST registered person. She has asked if she should continue to use the GST number allocated to the deceased, or if a new one is required.

She should continued to use the existing GST number.

When a registered person dies, section 58 deems the person who temporarily takes over the deceased's business affairs (being a taxable activity) to become a "specified agent", and deems that person to be a registered person carrying on the deceased's taxable activity.

A "specified agent" is:

> 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.

An "incapacitated person" is defined as:

> a registered person who dies, or goes into liquidation or receivership, or becomes bankrupt or incapacitated.

Under section 58(3), a person who becomes a specified agent must inform the Commissioner, in writing, of that fact within 21 days of becoming a specified agent.

The specified agent is personally liable for GST payable, and for all other requirements under the GST Act, such as filing returns, issuing tax invoices, etc., from the date that the person becomes the specified agent. The specified agent is not legally responsible for filing any returns outstanding or for any liabilities incurred by the incapacitated person before the agency period began.

The specified agent must continue to use the GST registration number allocated to the deceased for the period of the agency. In time, if the taxable activity is transferred to a trust or to any other person, e.g., if the business is sold, a new registration number will be required.

Estate and Gift Duties Act 1968

Gift duty on group superannuation scheme election

Section 74 - Exemption for certain elections by members of group superannuation schemes: A taxpayer is a member of a group superannuation scheme. He has elected to accept a reduced pension so that his wife can receive a pension after his death. He has asked if that election creates a gift duty liability.

Since its operative date of 1 January 1969, the Act has exempted from gift duty an election to accept a reduced pension from a group superannuation scheme in consideration for a pension to be paid to the spouse or other dependant of the member or participant after his or her death. This exemption is now provided for in section 74(a).

Section 74, as amended by section 2 of the Estate and Gift Duties Amendment Act 1992, states:

> Where a member of or a participant in any group superannuation scheme makes an election to accept from the group superannuation scheme a reduced retirement allowance or pension in consideration of the payment-
>
> (a) After his or her death, of a pension from the group superannuation scheme to the surviving spouse or any dependant of the member or participant; or
>
> (b) Commencing before his or her death, of a pension from the group superannuation scheme to the spouse of the member or participant,-
>
> the election shall not constitute a dutiable gift.

Since the operative date of the above amendment, 13 March 1992, section 74(b) allows an election to accept a reduced pension so that the spouse or dependant of the member or participant may be paid a pension concurrently with that paid to the member or participant, to be free of a gift duty liability.

Inland Revenue therefore told the taxpayer that no gift duty liability has been created.

Student Loan Scheme Act 1992

Employer's obligations concerning loan deductions

Section 19 - Employer to make repayment deductions: A taxpayer has just started in business and is about to employ a graduate who has a student loan. He will be paying the graduate $30,000 per annum, and has asked what his obligations are regarding the student loan deductions.

Under section 18, a student loan borrower must notify an employer of any student loan repayment obligation. Section 19 states:

(1) Every employer (being an employer who has in any income year received from a borrower a notice under section 18 of this Act) shall on each occasion on which that employer pays any amount to that borrower by way of salary or wages in respect of that income year, make a deduction from that amount.

(2) The deduction shall be made at the standard deduction rate or, if a special deduction rate applies, at that rate.

(3) The repayment deductions made under this section shall be in addition to any tax deductions required to be made under the PAYE rules of the Income Tax Act 1994.

The effect of section 19 is that when a borrower notifies his or her employer that student loan repayment deductions must be deducted from wages, that employer must make deductions in the same manner as PAYE deductions are made.

Borrowers who expect their primary income to exceed the current repayment threshold of $13,884 a year must advise their employer that loan repayment deductions are to be made, by adding “ED” to the “G” or “SEC” codes when completing their IR 12s.

The employer pays the deductions to Inland Revenue with the PAYE deductions for the same period. The due dates for these payments are the same as those for PAYE deductions. Student Loan deductions are credited to the borrower's account on the 15th of the month of the deduction.

When remitting repayment deductions for any borrower, the employer must complete a schedule (IR 66L) setting out the name and IRD number of the borrower and the amount of the repayment deduction remitted for that borrower.

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.

Newspaper advertising space sold to non-residents - zero-rating

Rating: ••••

Case: Wilson & Horton Limited v CIR CA 159/94

Act: Goods and Services Tax Act 1985 - section 11(2)(e)

Keywords: *zero-rating of services, for and to, advertising space*

Summary: The Court of Appeal allowed the appellant's appeal and overturned the High Court's decision in *Wilson & Horton Limited v CIR* (1994) 16 NZTC 11221 at 11228. The Court of Appeal held that the word "for" simply emphasises the word "to" in section 11(2)(e).

Accordingly, the Commissioner had acted incorrectly in excluding from zero-rated supplies, advertising space supplied by the appellant to persons who were not resident in New Zealand.

The Court of Appeal also dismissed the Commissioner's request to advance a new argument that zero-rating is excluded. The Commissioner's argument was that the services supplied by the appellant were directly in connection with moveable property situated inside New Zealand at the time the services were performed, namely published newspapers.

Facts: The appellant carries on the taxable activity of producing newspapers. It sold advertising space in the NZ Herald to overseas clients and zero-rated these supplies. The Commissioner audited the appellant and determined that the supplies had been incorrectly zero-rated.

The High Court found for the Commissioner. It agreed with the Commissioner's interpretation that "for" means "beneficially for". It held that the supply of advertising space to non-residents is subject to GST at 12.5% if a New Zealand resident benefits from the advertisement. Also, to qualify for zero-rating under section 11(2)(e), the services must be provided "contractually to" and "beneficially for" a non-resident person.

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The High Court also found that the supply of advertising space and related services were directly in connection with the advertising but not with the subject matter of the advertisement. Accordingly, services provided by the appellant were not supplied "directly in connection with" land or moveable property in New Zealand.

The appellant appealed the High Court decision.

Decision: The Court of Appeal rejected the High Court decision and found for the appellant. The Court held that the supply of advertising space to non-resident clients is zero-rated irrespective of any benefit arising to New Zealand residents.

Justice Richardson considered that the particular meaning intended by the phrase "for and to" hinged on the context in which the words are used and how they are used in that context. His Honour found that both words were employed to convey emphasis. The focus of section 11(2)(e) is on the contractual supply of services and it is the foreign client to which the expression "for and to a person" relates and not others that might be affected by the supply. Any benefit that may occur in supplying the services is not a relevant consideration in determining whether the services are zero-rated.

Justice Penlington also found that the purpose of the two words was for emphasis. His Honour considered that the word "for" is interchangeable with "to". Justice McKay agreed that "for and to" is a composite phrase meaning no more than that the supply of the goods and services is pursuant to a contract for and to an overseas resident.

The Commissioner was precluded from advancing the new argument that the services were supplied directly in connection with moveable personal property (the newspapers). The Court of Appeal held that doing so would change the basis on which the assessment was made and objected to. Justice Richardson considered that accepting the new ground would be inconsistent with the approach previously taken by the Commissioner in *Farnsworth v Commissioner of Inland Revenue* [1984] 6 NZTC 61770 at 61781.

Comment: Inland Revenue is not appealing this decision.

Revenue and capital - distinction

Rating: • •

Case: Union Steamship Company of New Zealand Ltd v CIR M1565/91

Act: Land and Income Tax Act 1954, Income Tax Act 1976

Keywords: *capital, revenue, losses, rent reduction, payment for surrender of option*

Summary: In return for surrendering an option to purchase three ships, the taxpayer received three annual amounts of compensation by way of cash payments from one company, and rent reductions from another company. The High Court found that the cash receipts were capital and should not be deducted from losses to be carried forward by the taxpayer. The rent reductions were found to reduce the taxpayer's expenses, and therefore reduce the losses available to be carried forward. The rent reductions were not receipts of capital.

Facts: The taxpayer leased three ships. The lease payments were paid to MCNZ. MCNZ chartered the ships from DSS, an associated company. The taxpayer had an option to purchase the ships. The taxpayer entered into an agreement with MCNZ and DSS by which the taxpayer surrendered its option in return for compensation. The compensation was calculated in the following way:

MCNZ was to accept a lower fixed rental ($250,000) for the ships in each of the 1975, 1976 and 1977 accounting years; and DSS was to pay the taxpayer $250,000 in each of the 1975, 1976 and 1977 accounting years.

The taxpayer took a deduction for the full rental payment in each of the three years, without reducing expenses for the lower rental. The amount from DSS was also not deducted from expenses.

The taxpayer argued that as the option to purchase involved ships that would have been capital assets, the surrender of the option was the sale of a capital asset, and the consideration for that surrender should be a capital amount. The Commissioner argued that the arrangements were for rent reduction, and that the amounts of compensation should be deducted from the revenue expenses for the respective income years. The Commissioner required the full amount of the compensation ($1,500,000) to be deducted from the losses that could be carried forward, as they should have been deducted from allowable expenses.

Decision: Justice Anderson analysed the transactions on the basis of their legal form, not their economic consequences, applying *Europa Oil (NZ) Ltd v CIR* [1976] 1 NZLR 546.

His Honour held that the cash payments that the taxpayer received from DSS were capital receipts. As such they did not need to be deducted from allowable expenses, and there should be no reduction in the amount of loss carried forward for DSS's payments.

The reduction in rent payable by the taxpayer to MCNZ was not a receipt of capital by the taxpayer, but consisted of amounts by which the costs of the taxpayer were reduced. Accordingly, the taxpayer's revenue expenses were reduced by $250,000 for each of the years in which the rent was reduced. There should be a reduction in the amount of loss carried forward for the rent reduction.

Comment: We do not yet know whether either party will be appealing this decision.

Land acquired for the purpose of erecting dwellinghouses - whether exempt from stamp duty

Rating: • •

Case: TRA No 93/241

Act: Stamp and Cheque Duties Act 1971 - section 24(1)(b)

Keywords: *conveyance duty, subdivision, residential sections, purpose*

Summary: Judge Barber followed *Howick Parklands Limited v CIR* (1995) 17 NZTC 12,246 and held that a developer who acquired land for subdivision with the purpose of having dwellinghouses erected was exempt from conveyance duty. The exemption only applies if the Commissioner is satisfied that the dwellinghouses will be erected as soon as practicable after the date the instrument of conveyance was signed.

Facts: The objector subdivided land for residential purposes and sold vacant sections. Sale agreements for a subdivision in Palmerston North contained a covenant that the purchaser must erect a residential dwelling within two years of obtaining possession of the section and must complete construction within one year of starting construction. However, sale agreements for a subdivision in Hamilton did not contain such a covenant, due to an oversight.

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The issue was whether the conveyance duty exemption under section 24(1)(b) for land acquired "for the purpose of having a dwellinghouse erected on it" was available to developers who acquire land for residential subdivision and sell vacant sections to purchasers who have agreed to erect a dwellinghouse.

Decision: Judge Barber, following Justice Fisher in the *Howick Parklands* case, held that the objector's purpose when purchasing the land was the relevant purpose for the conveyance duty exemption. If at the time of acquisition the objector had the purpose of exercising some form of power or control over others to require them to erect a dwellinghouse on the land, that would come within the relevant meaning of the section. The Judge was satisfied that this was the case with the subdivision at Palmerston North, but he was not satisfied in regard to the subdivision at Hamilton. The exemption was therefore granted to the former, but not to the latter.

Comment: Inland Revenue is not appealing this decision.

Inducement and restraint of trade payments - capital or income?

Rating: • • • •

Case: Fraser v CIR AP 262/91

Act: Income Tax Act 1976 section 65(2)(a), (b) and (l)
(Income Tax Act 1994 section BB 4)

Keywords: *revenue/capital distinction, restraint of trade, inducement payments*

Summary: The issue was whether certain payments made to a media personality for television commercials were properly characterised as an "inducement payment" and "restraint of trade agreement payments". The Court held the payments were an inducement payment and payments under a restraint of trade agreement, and therefore non-assessable.

Facts: The taxpayer was a well-known media personality. Colenso Communications Limited (Colenso) approached him to front an advertising campaign for the Bank of New Zealand. He entered into an agreement with Colenso through Moremedia Enterprises Limited, a company he had formed with his wife. The agreement provided not only for payments for services, but for other payments, one characterised as an inducement payment and three described as payments in respect of a restraint of trade. The agreement restrained the taxpayer from advertising or endorsing any other product. Also, Colenso had the power to veto appearances on television in any capacity, if Colenso deemed this to be in the BNZ's interest.

The Commissioner assessed the taxpayer on the basis that the inducement and restraint of trade payments were income. A case stated was requested.

Inducement payment

The taxpayer argued that the payment was an inducement, to compensate for the loss of career opportunities in television, and the risks he took in entering a new career.

The Commissioner argued that the payment could not be characterised as an inducement payment. It was a payment related to or in respect of services that the taxpayer provided to the BNZ. The payment was part of an overall arrangement whereby the taxpayer provided his services to the BNZ through Colenso, and he was effectively an employee of the BNZ.

Restraint of trade payment

The taxpayer argued that the payments were restraint of trade payments, made as compensation because he could no longer undertake other work advertising or endorsing products.

The Commissioner argued that:

- there was a high degree of arbitrariness in the allocation process between the fees paid for services and those in respect of restraint of trade;
- the payments applied to the time during which services were given, rather than only following termination of the service agreement. In other cases where restraint of trade payments were held to be capital, the restraint of trade applied after termination of the services.
- the payments were regular, having more the form of income.

Decision: The High Court held for the taxpayer.

The restraint of trade payments were intended as compensation for the restraint on the taxpayer's activities, separate from any payment for services. The taxpayer gave up a substantial sphere of his income-producing activities in return for the restraint of trade payments.

The Court did not accept the Commissioner's argument that there was a high degree of arbitrariness in the allocation process between the fees paid for services and those paid for the restraint of trade. Further, the restraint of trade extended beyond the period during which the taxpayer provided services to the BNZ. Obligations flowing from the restraint of trade were separate from the obligations flowing from the contract of service. They gave rise to different remedies in the event of any breach.

The payments were not regular in the sense that employment-related payments are. The relationship between the taxpayer and the BNZ was not one of employment.

The inducement payment was made in compensation to the taxpayer for giving up a capital asset in respect of his chosen career as a current affairs presenter.

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

The appropriate procedure for contesting a decision by the Commissioner

Rating: • • • • •

Case: Miller and O'Neil v CIR CA 158/93 Judgment 15 September 1995

Act: Income Tax Act 1976 - section 99 (anti-avoidance) (Income Tax Act 1994 - section BB 9) Income Tax Act 1976 - section 27 (assessment correct except on proceedings for objection) (Tax Administration Act 1994 - section 109) Judicature Amendment Act 1972 (judicial review).

Keywords: *assessment, judicial review, striking out*

Summary: There is a distinction between challenging the correctness of an assessment on the one hand, and challenging the process followed and the character of the resulting decision, on the other. In the first situation, the objection and appeal procedures apply and judicial review is not available, being precluded by section 27 of the Income Tax Act 1976. In the second, the process and the outcome may be challenged in other proceedings on traditional administrative law grounds. The legitimacy or validity of the process actually adopted by the Commissioner and the true character of the resulting decision may be challenged in judicial review proceedings if supported by an evidential foundation.

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Facts:

Assessment

(a) The Commissioner made amended assessments against the taxpayers under the general anti-avoidance provisions of section 99 of the Income Tax Act 1976.

(b) The taxpayers objected to the amended assessments.

(c) The Commissioner disallowed the objections.

(d) The Commissioner submitted the objections to the Taxation Review Authority for determination and hearing.

Judicial review

(a) The taxpayers issued proceedings in the High Court for judicial review, alleging that the Commissioner had improperly exercised his powers.

(b) The Commissioner applied to the High Court for an order striking out the taxpayers' proceedings on the grounds that:

- (i) Section 27 of the Income Tax Act 1976 prohibited a challenge to the amended assessments other than through the objection processes
- (ii) The proceedings did not disclose a cause of action.

(c) In the High Court, Justice Blanchard struck out the taxpayers' application for judicial review.

(d) The taxpayers lodged an appeal to the Court of Appeal.

Assessment

(a) Before the hearing in the Court of Appeal took place, Judge Barber in the Taxation Review Authority heard the case on the amended assessments and upheld them (with some modifications). He also held that the Taxation Review Authority did not have jurisdiction to deal with administrative law type issues, especially since they had already been dealt with by the High Court.

(b) The taxpayers have appealed the Authority's decision to the High Court.

The issues then are:

1. whether section 27 of the Income Tax Act 1976 precludes judicial review
2. whether the judicial review proceedings disclosed a cause of action.

Decision: Justice Richardson delivered the Court of Appeal's judgment.

On the first issue he held that although section 27 precludes judicial review of the correctness of an assessment, it does not preclude judicial review of the process followed and the character of the resulting decision.

On the second issue, after reviewing the affidavits before the Court, which showed substantial conflicts, he held that the only safe course in the interests of justice was to determine the appeal against the striking out order on the assumption that the allegations in the statement of claim were factually correct.

The allegation of fact was that the Commissioner assessed the taxpayers individually because they might be better able than their trading company to pay the income taxes which the Commissioner sought to claim. If this was true, it was outside the power of and a misuse of authority for the Commissioner to make an amended assessment on the footing that the person selected may have a greater ability to pay than the trading company through which the individuals concerned derived their income. Whether that allegation would be sustained would depend on the evidence adduced in the ordinary way at the hearing of the substantive review proceedings. But it could not be said, for the purposes of the striking out action, that the taxpayers' cause of actions was untenable.

The appeal against the striking out of the statement of claim was allowed.

Comment: Inland Revenue is not appealing this decision.

Crown payments and GST

Rating: • • •

Case: New Zealand Refining Company Limited v CIR (1995) 17 NZTC 12,307

Act: Goods and Services Tax Act 1985 - sections 2, 8(1)

Keywords: *supply of services, output tax*

Summary: The taxpayer was not required to account for output tax on payments that the Crown made under an agreement to compensate for the deregulation of the petroleum industry. The payments were not for a supply of services.

Facts: The taxpayer operated the Marsden Point oil refinery. In 1977, it entered into an agreement with the Government to expand the refinery, as part of the "Think Big" strategy. The agreement included price control and protection from competition for the taxpayer. In 1988, following the adoption of a policy of deregulation of the oil industry, the Government entered into a further agreement with the taxpayer. This provided for three annual payments to the taxpayer, conditional on the refinery still being operational, and cancellation of the 1977 contract.

The Commissioner assessed the taxpayer for output tax on the payments. The taxpayer objected and a case was stated.

Decision: The Court held that the taxpayer did not have to account for output tax on the payments under the legislation as it applied in 1988.

The Court held that the service the taxpayer supplied in its taxable activity was the conversion of feedstock into an end product, and not the availability of the refinery operations to oil companies.

The availability of the refinery operations to oil companies was a condition of the agreement under which the payments were made, but was not the service supplied in the course of the taxpayer's taxable activity. Therefore, payments were not in respect of, in response to or for the inducement of a supply of services. They were to achieve the taxpayer's acceptance of deregulation and to discharge the Crown's obligations under the 1977 agreement.

The Goods and Services Tax Act 1985 was amended in 1991. Payments of a grant or subsidy (as defined in the Act) made by the Crown or any public authority in respect of a taxable activity are now deemed to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made. The amendment provided that when an objection was lodged before 19 December 1990, the application of the amendment would not be retrospective. If the taxpayer had not lodged an objection in time, the amended legislation would have applied.

The Court noted that the amendment in 1991 applied only to payments made by or on behalf of the Crown or a public authority. There appears to be a strong argument that payments made by others must therefore be outside the ambit of the Act. This lends further weight to the view that payments in the nature of a grant or subsidy are not otherwise within the ambit of section 8(1).

Comment: Inland Revenue has not yet decided whether to appeal 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
- Taxation of allowances and expenditure on account of an employee
- Amounts received by way of insurance, indemnity, compensation, or damages for loss or damage to trading stock or consumable aids
- Remission under section 413 of the Income Tax Act 1976 of underestimation additional tax charged prior to 1994-95 income year
- Remission of additional or incremental tax
- Approved issuer levy - late registration of securities
- Cash basis holder status not optional
- 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
- Employers' liability to deduct PAYE from Employment Court awards for lost wages
- Tax deductions and bonus payments
- Applications to retain records in Maori
- Taxation of allowances and expenditure on account of an employee

Due dates reminder

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.

December

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

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

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

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

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

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

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

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

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

RWT on dividends deducted during November 1995 due.

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

31 Student Loan repayments - third instalment of 1996 non-resident assessment due. *(We will accept payments received on Wednesday 3 January 1996 as on time.)*

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 ______________________________

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	Ruling	*Date Available*	*Comment Deadline*
☐	**3123**: Value for FBT purposes of the benefit of subsidised transport provided by employers to employees	17/11/95	8/12/95
☐	**3398**: US Federal Insurance Contribution Act (FICA) and FBT	24/11/95	15/12/95

No envelope needed - simply fold, tape shut, stamp and post.

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Manager (Systems)
Rulings Directorate
National Office
Inland Revenue Department
P O Box 2198
WELLINGTON

Attention Public Rulings Consultation

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Legal decisions - case notes
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