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.

Bonus payments - tax deductions and assessability

Public Ruling - BR Pub 95/7

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

Taxation law

This ruling applies in respect of sections OB 1 and OB 2 (2) of the Income Tax Act 1994.

Arrangements to which this ruling applies

This ruling applies to employers that make bonus payments (whether the bonus is an annual bonus or an irregular or regular bonus) to employees. The term "bonus" has the ordinary meaning of that term, and is a monetary payment made to an employee in respect of or in relation to that employee's employment.

In this ruling a "regular bonus' is a bonus that is paid regularly throughout the year and is linked to the employee's normal pay periods. An "irregular bonus" is any other bonus paid to the employee.

The period for which this ruling applies

This ruling applies to bonuses paid to an employee in the 1997, 1998, and 1999 income years.

The ruling

An employer must make tax deductions from any bonuses paid to employees. The tax deduction must be calculated using the appropriate tax rates in force at the time of payment.

Annual or irregular bonuses

An annual or irregular bonus paid to an employee is an "extra emolument" because of its irregular nature, so the employer must make tax deductions at the extra emolument rate when paying the bonus to the employee (unless the employee gives a special tax code certificate to the employer which authorises the employer to make deductions at a different tax rate).

Regular bonuses

A bonus that is regularly included in the salary or wages paid to an employee is treated as salary or wages. The bonus must be added to the salary or wages paid

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for the same pay period to calculate the tax to be deducted. The employer must calculate the tax in the normal manner using the tax deduction tables, and deduct the tax when paying the salary or wages to the employee.

Assessability to the employee

When an employer pays a bonus to an employee (other than a shareholder-employee to whom section OB 2 (2) applies), the bonus is assessable to the employee in the year of receipt. This is the case even where the bonus relates to services performed by the employee in a previous income year. The year that the bonus is deductible to the employer is not relevant to when it is assessable to the employee. The employer must make the correct tax deductions from the bonus in the year that it is received by and assessable to the employee.

Shareholder-employees to whom section OB 2 (2) applies

When an employer pays a bonus to a shareholder-employee to whom section OB 2 (2) applies, under section EB 1 (3) the bonus is assessable to the shareholder-employee in the same income year that it is deductible to the employer. Section EF 1 determines when monetary remuneration (such as a bonus) is deductible to the employer.

An employer does not need to make tax deductions from a bonus paid to a person who is a shareholder-employee to whom section OB 2 (2) applies. The bonus is income of the shareholder-employee which the shareholder-employee must take into account in calculating residual income tax for provisional tax purposes.

This ruling is signed by me on the 4th day of December 1995.

Martin Smith
General Manager (Adjudication and Rulings)

Analysis of public ruling BR Pub 95/7

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

Over the past few years there has been a trend toward the greater use of performance related payments by employers. Many managers and other employees now receive bonus payments.

Bonuses may be paid on an irregular basis, such as bonuses given after an employee's annual review or after the completion of a project. Alternatively, bonuses may be paid regularly throughout the year and be linked to normal pay periods or production periods.

There has been some confusion about the year in which a bonus is assessable to an employee when it is paid for services performed by the employee in the previous income year. There has also been confusion about whether a bonus which is paid within 63 days of the end of an income year should be "added back" to the employer's previous year's IR 68P and IR 68A for the purposes of deducting PAYE (including earner premium) and assessing employer premium. This is not the correct treatment. The correct treatment is set out in the ruling and the following analysis.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
EB 1 (3)	75(3)
EF 1	104A
NC 1 to NC 21	337-353, 355, 361, 372-374
NG 15 (g)	353(1)(e)
OB 1 "extra emolument", "salary or wages"	2
OB 2 (2)	6(3)

The calculation of tax to be deducted from bonus payments depends on whether the payment is "salary or wages" or an "extra emolument". These terms are defined in section OB 1. Relevant parts of the definitions are as follows:

"Extra emolument", in relation to any person, means a payment in a lump sum (whether paid in one sum or in 2 or more instalments) made to that person in respect of or in relation to the employment of that person (whether for a period of time or not), being a payment which is not regularly included in salary or wages payable to that person for a pay period, but not being overtime pay; and includes any such payment made -

(a) By way of bonus, gratuity, or share of profits: ...

"Salary or wages", in relation to any person, means salary, wages, or allowances including all sums received or receivable by way of overtime pay, bonus, gratuity, extra salary, commission, or other remuneration of any kind, in respect of or in relation to the employment of that person; and includes -

(a) ...

but does not include -

(j) A payment of exempt income, or an extra emolument, or a withholding payment; or

(k) Any salary, wages, or other income to which section OB 2 (2) applies; or ...

The deduction of tax from employee remuneration is governed by sections NC 1 to NC 21.

Application of legislation

Earner and employer premium in respect of bonus payments

When an employer pays a bonus to an employee (other than a shareholder-employee to whom section OB 2 (2) applies), ACC earner premium in respect of the bonus must be deducted at the same time as normal tax deductions. The employer premium on such bonuses is chargeable in the year that the bonus is received by the employee, and should be paid when the employer furnishes a section NG 15 (g) reconciliation statement for that year. See section 115 of the Accident Rehabilitation and Compensation Insurance ("ARCI") Act 1992 and regulation 3 of the ARCI (Earnings Definitions) Regulations 1992.

Annual or irregular bonuses

The ruling states that the employer must deduct tax at the extra emolument rate from annual or irregular bonuses (unless the employee has provided a special tax rate certificate to the employer). The employer should also deduct ACC earner premium from the bonus at the same time. The current extra emolument rate is 28 cents per dollar and the current rate of earner premium is 0.6 cents per dollar. This means that tax deductions from annual or irregular bonuses should total 28.6 cents per dollar.

Regular bonuses

The ruling states that a regular bonus is salary or wages which must be added to the employee's other salary or wages for the pay period. The employer must make tax deductions (including deductions of ACC earner premium) from the salary or wages including the bonus payment at the employee's marginal tax rate.

When a regular bonus is payable for a period that is greater than one pay period, the tax to be deducted from the bonus must be calculated separately. The bonus should be added to the total salary or wages paid to the employee over the period. The tax deduction that applies to the bonus can be calculated using the following formula:

Tax on (wages for the period + bonus)	-	(tax on wages for the period)

This ensures that tax will not be over-deducted from the bonus.

Bonus paid within 63 days of the beginning of the employer's income tax year

When a bonus is paid to an employee (other than a shareholder-employee to whom section OB 2 (2) applies) within 63 days of the beginning of the employer's income tax year, the employer should treat the bonus in the same manner as any other bonus paid during that income year. The bonus is assessable to the employee in the year that it is paid, and the employer should make the appropriate tax deductions (including earner premium) from, and account for employer premium in respect of, that bonus in the year that the bonus is paid.

Shareholder-employees to whom section OB 2 (2) applies

Section OB 2 (2) states:

Where a taxpayer is a shareholder in and an employee of a close company and in any income year (or in the taxpayer's accounting year corresponding with any year), -

(a) Salary or wages of a regular amount for regular pay periods of one month or less are not throughout that year regularly paid or credited to the taxpayer or applied on the taxpayer's account in the taxpayer's capacity of an employee of the company; or

(b) The total of the salary or wages derived by the taxpayer in that year in the taxpayer's capacity of an employee of the company by way of regular payments throughout that year of a regular amount for regular pay periods is less than two-thirds of the total income which the taxpayer derives in that year from the company by way of director's fees and by way of salary, wages, or other income for or on account of the taxpayer's service in the capacity of an employee of the company; or

(c) Any amount is paid or credited to the taxpayer, or applied on the taxpayer's account, in anticipation or in respect of any income that may subsequently be allocated to the taxpayer in the taxpayer's capacity of a director or employee of the company, -

all income that the taxpayer derives from the company in every subsequent year by way of director's fees and by way of salary, wages, or other income for or on account of the taxpayer's service in the capacity of an employee of the company shall for the purposes of this Act, except the FBT rules, be deemed to be income derived otherwise than from source deduction payments, unless, and only to the extent that, the Commissioner determines from time to time in any case or class of cases that that income shall be deemed to be income derived from source deduction payments. If any question arises as to whether or not this subsection applies, or as to the

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extent to which this subsection applies, to any taxpayer or to any class of taxpayers, or to any director's fees, salary, wages, or other income, it shall be determined by the Commissioner, and the Commissioner's decision shall be final.

In summary, section OB 2 (2) applies to shareholder-employees of close companies (including directors) who have previously received remuneration from the company irregularly, unevenly, or in advance of it being allocated (note that until 1 April 1997, the term "close company" includes a private company registered under the Companies Act 1955).

The ruling states that a bonus paid to a section OB 2 (2) shareholder-employee is assessable to the shareholder-employee in the same year that the bonus is deductible to the employer (section EB 1). The year that the bonus is deductible to the employer is determined by section EF 1. The employer does not have to make tax deductions from a bonus paid to such a shareholder-employee. Instead:

- The shareholder-employee must take the bonus into account when calculating residual income tax for provisional tax purposes; and
- The employer must deduct earner premium from, and pay employer premium in respect of, the bonus,

by the employer's terminal tax date for the year that the bonus is assessable to the shareholder-employee and deductible to the employer. See section 115(19) of the ARCI Act and regulation 3A of the ARCI (Earnings Definitions) Regulations 1992.

Bonuses paid to shareholder-employees to whom section OB 2 (2) does not apply should be treated in the same way as bonuses paid to other employees.

Examples

These examples do not form part of the ruling.

The tax in the examples has been calculated using the tax deduction tables.

***Example 1** - Annual or irregular bonuses*

B receives a one-off bonus of $1,500 in August 1995.

The tax deduction at the extra emolument rate is $1,500 ((0.28 + 0.006) = $429

Note that if B's annual income is over $30,875, his top or marginal income tax rate will be 33 cents per dollar - 5 cents higher than the extra emolument deduction rate. In these circumstances the tax deducted from B's bonus will be less than the tax B will have to pay on the bonus. B may find, therefore, that after filling out his tax return he has extra income tax to pay.

***Example 2** - Regular bonuses*

C receives weekly performance-related bonuses along with her weekly wages. She has a G tax code.

Ordinary weekly wages	$300
Weekly bonus for first week of November 1995	$ 28
Total weekly earnings	$328

The tax to be deducted from total weekly earnings is $70.05.

***Example 3** - Regular bonus for period longer than a regular pay period*

D has a production-related bonus added to her wages every four weeks. Her wages of $1,100 are paid fortnightly, and she has a G tax code.

Four-weekly bonus paid on 20 October 1995	$ 140
Wages received for the four weeks (2 x $1,100)	$2,200
Total	$2,340

The tax to be deducted from the bonus is the four-weekly tax on $2,340 less the four-weekly tax on $2,200:

= $574.24 - $534.20 = $40.04.

If D's four-weekly bonus were simply added to her fortnightly income of $1,100 to calculate tax, the deduction would be calculated on the basis that her fortnightly earnings were $1,240. The tax attributable to the bonus would be too high at $42.66.

***Example 4** - Bonus paid within 63 days of beginning of employer's tax year*

E is an employee of F Ltd. F Ltd has a standard balance date. F Ltd pays E a one-off bonus on 1 May 1995 for a project undertaken and completed by her in December 1994.

The bonus is deductible by F Ltd under section BB 7 because it is expenditure incurred in gaining F Ltd's assessable income. As the bonus is paid for services performed in the 1995 income year and is paid within 63 days of the end of the 1995 income year, F Ltd can deduct the bonus in the 1995 income year (under section EF 1).

The bonus is assessable to E in the year that she receives the bonus - the 1996 income year. F Ltd must deduct PAYE at the appropriate rate (including earner premium) and pay employer premium in respect of the bonus in the 1996 income year. The fact that F Ltd is able to deduct the bonus in calculating its assessable income for the 1995 year is irrelevant to when that payment is assessable to E and to when tax deductions should be made and employer premium paid.

Tertiary student association fees

Public ruling- BR Pub 95/8

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

Taxation law

This ruling applies in respect of section KC 5 of the Income Tax Act 1994.

Arrangements to which this ruling applies

This ruling applies where a student at a tertiary institution pays fees to the tertiary student association at that tertiary institution.

The period for which this ruling applies

This ruling applies to fees that tertiary students pay to tertiary student associations during the period 1 April 1996 to 31 March 1999.

The ruling

Where a student pays a single fee to the student association to become a member of the student association, and the fee as a whole confers some rights on members, the payment is not a gift for the purposes of section KC 5 (4). As the payment of the fee is not a gift, the student is not entitled to a rebate under section KC 5.

This ruling is signed by me on the 4th day of December 1995.

Martin Smith
General Manager (Adjudication and Rulings)

Analysis of public ruling BR Pub 95/8

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

This ruling is intended to confirm current IRD policy.

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

Legislation

Cross-reference table

Income Tax Act 1994	**Income Tax Act 1976**
KC 5	56A

Section KC 5 states:

(1) Subject to this section and section BB 10, in the assessment of every taxpayer, other than an absentee or a company or a public authority or a Maori authority or an unincorporated body, or a trustee assessable and liable for income tax under sections HH 3 to HH 6, HK 14, and HZ 2, there shall be allowed as a rebate of income tax the amount of any gift (not being a testamentary gift) of money of $5 or more made by the taxpayer in the income year to any of the following societies, institutions, associations, organisations, trusts, or funds (being in each case a society, an institution, an association, an organisation, a trust, or a fund in New Zealand), namely:

(aa) A society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual and the funds of which are, in the opinion of the Commissioner, applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purposes within New Zealand:

(ab) A public institution maintained exclusively for any one or more of the purposes within New Zealand specified in paragraph (aa):

(ac) A fund established and maintained exclusively for the purpose of providing money for any one or more of the purposes within New Zealand specified in paragraph (aa), by a society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual:

(ad) A public fund established and maintained exclusively for the purpose of providing money for any one or more of the purposes within New Zealand specified in paragraph (aa):

(ae) - (bp) [A list of organisations]

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(2) The rebates provided for in this section shall not, in the case of any taxpayer, in any income year exceed in the aggregate the smaller of-

(a) $33^{1}/_{3}$% of the aggregate of all gifts described in subsection (1):

(b) $500.

(3) No rebate shall be allowed under this section in respect of any gift unless the taxpayer furnishes to the Commissioner in support of the taxpayer's claim for the rebate a receipt evidencing to the satisfaction of the Commissioner the making of the gift by the taxpayer.

(4) In this section, "gift" includes a subscription paid to a society, institution, association, organisation, trust, or fund, only if the Commissioner is satisfied that the subscription does not confer any rights arising from membership in that or any other society, institution, association, organisation, trust, or fund.

Application of legislation

Where the recipient has charitable status, section KC 5 provides a rebate for the donor of a gift of money in certain circumstances.

The meaning of the term "gift"

In *Mills v Dowdall* [1983] NZLR 154, (in the Court of Appeal) the nature of a gift was referred to by Justice Cooke, who said:

in general a gift is something truly gratuitous, although it is possible that nominal or very small considerations may not prevent transactions from being classed as gifts for some purposes: see 20 Halsbury's Laws of England.

In the same case, Justice Richardson said that at common law, the term "gift" refers to:

a transaction where the owner of property conveys the ownership of that property to another without consideration.

Similar views were expressed in *Federal Commissioner of Taxation v McPhail* [1966] 117 CLR 111, where the Court held that a "gift" has the following attributes:

- The property transferred was transferred voluntarily and not as the result of a contractual obligation to transfer it; and
- No advantage of a material nature was received by the transferor by way of return.

Payments of student association fees are not "gifts" in the ordinary meaning of that word, as payment is not voluntary, and benefits may arise from the payment.

The definition of gift in section KC 5 (4)

Section KC 5 (4) expands the meaning of "gift" for the purposes of section KC 5, to include subscriptions paid to a society, institution, association, organisation, trust, or fund, if the Commissioner is satisfied that the subscription does not confer any rights arising from membership in that or any other society, institution, association, organisation, trust, or fund.

It is arguable whether student association fees are subscriptions. There are many definitions of "subscription", some of which are wide enough to include student association fees.

In *Case M128* (1990) 12 NZTC 2,825 payments to a school for camp fees, a school trip, stationery, and a manual were not gifts. They conferred rights on the pupil. The Court noted that school activity fees had been allowed as a deduction by the Commissioner because they came within the expanded definition of "gift". Other fees which conferred a right were not allowed as a deduction. The Court did not comment on what the definition of a subscription was.

However, assuming that the fees paid are a subscription, the fees will only be a "gift" for the purposes of section KC 5 (4), and will only qualify for a rebate, if the Commissioner is satisfied that the payment does not confer any rights on the payer. A subscription will only qualify as a "gift" for the purposes of section KC 5 if the payer receives no rights to do anything, receive anything, or to have access to anything in return for the payment of the subscription. Thus, the payment of a subscription is in the nature of a donation because the payer does not get any direct rights in return for the payment. The requirement that the subscription confers no rights does not contain any words of apportionment (such as "to the extent to which"). It is absolute in its terms. Accordingly, if any rights are conferred by any part of the subscription, section KC 5 does not apply, and no rebate is available.

The provision refers only to rights being conferred: the rights do not have to be exercised or enjoyed by the taxpayer.

In *Case J76* (1987) 9 NZTC 1,451, a taxpayer paid the fees of a number of disadvantaged children at a school which qualified as a charitable institution. The Taxation Review Authority held that the payments were not gifts, as the payment of the fees meant that the school had a contractual duty to educate the children. The Court quoted the expanded definition of gift, but did not discuss either the definition of "subscription", or whether the payments were a subscription (and thus covered by the extended definition of gift). The case was decided in terms of whether the fees paid were a "gift" in the ordinary meaning of the word.

Students attending tertiary institutions pay a sum for membership of a student association or union. Being a member commonly gives rights to benefits from the student association and other organisations, such as:

- Access to advice, welfare, and counselling services.
- Liaison services between students and teaching staff.
- Access to newsletters and other information.
- Facilities on campus, such as the library, health facilities, sports and recreation facilities.
- Student discounts on various goods and services.

In addition, it could also be argued that the payment of the student association fee is one of a number of payments a student must make, and things a student must do, in order to qualify for enrolment at a tertiary institution. If the student association fee (or a substitute payment to a charity of the student's choice) is not paid, the student does not qualify for enrolment. The payment of the student association fee, therefore, confers a further right on students - the right to enrolment if the other conditions of enrolment are met. Similarly, payments to the student association (together with payment of other fees and meeting terms) give students the right to attend university and sit examinations.

The student makes his or her payment to the student association, not to any other body which may later be allotted funds by the student association (for example, trust funds, hardship funds). The payment to the student association is a payment which confers rights on the student.

For the reasons outlined above, section KC 5 does not apply where the payment of a student association fee confers any rights. In these circumstances, no rebate is available.

Example

This example does not form part of the ruling.

A student enrols at a Polytech. He pays the student association fees, and is able to use the gym facilities, counselling services, and the subsidised health care programme. The student association has charitable status.

As the payment of the student association fees confers certain rights on the student, the payment does not qualify for a rebate as a donation to the student association.

However, if a person who is not a student makes a donation to the student association at the Polytech and no rights are conferred because of the payment, a gift is made and a rebate is allowed.

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.

FBT on benefits provided in NZ to employees of non-resident employers

Summary

This item explains how fringe benefit tax (FBT) applies to benefits provided in New Zealand to employees of non-resident employers.

All legislative references in this item are to the Income Tax Act 1994 unless otherwise indicated. All references to an "FBT period" are to the employer's FBT period (which is normally three months, but may be an income year for some employers).

Paragraph (n) of the definition of "fringe benefit" excludes from that definition benefits received by an employee who does not receive source deduction payments that are assessable in New Zealand in that FBT period. Source deduction payments are generally assessable in New Zealand if either of these conditions is met, and the earner is not otherwise exempt (under the Act or a double tax agreement (DTA)):

- A New Zealand resident earns the source deduction payments
- The source deduction payments are earned in New Zealand.

When a New Zealand resident employee works in New Zealand for a non-resident employer, the employee's source deduction payments are assessable in New Zealand, so any fringe benefits the employee receives are subject to FBT.

When a non-resident employee works in New Zealand for a non-resident employer, the employee's source deduction payments may be tax exempt in New Zealand under the Act or under the provisions of a relevant DTA. When all of the employee's source deduction payments are not assessable in New Zealand in an FBT period, any fringe benefits that the employee receives in that period are not subject to FBT. When some or all of the employee's source deduction payments are assessable in New Zealand in an FBT period, any fringe benefits that the employee receives in that period are subject to FBT.

Background

On page 1 of TIB Volume Six, No.8 (January 1995) we published the item *Fringe benefits granted to employees of overseas branches of New Zealand companies*. That item stated the Commissioner's policy on benefits provided by the overseas branch of a New Zealand employer to non-resident and New Zealand resident employees. This item states the Commissioner's policy on the application of the FBT provisions to benefits provided by non-resident employers to New Zealand resident and non-resident employees in New Zealand.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
BB 1 (1), (2)	38(1), (2)
BB 3	242
CB 1 - 15	61
CB 2 (1)(c)	61(19)
CI 1	336N(1) "fringe benefit" definition
NC 18	350A
ND 1	336S(2)
OB 1	336N(1)
OB 2 (1)	6(1)
OE 1	241(1) - (5)
OE 4 (1)(c)	243(2)(c)

FBT is imposed by section ND 1, and is payable by employers on the value of fringe benefits that they provide to their employees. Section CI 1 defines "fringe benefit" for the purposes of the FBT rules and states:

"Fringe benefit" ...

does not include: ...

(n) Any benefit to the extent to which the Commissioner is satisfied that it is a benefit received or enjoyed by the employee in a quarter or (where fringe benefit tax is payable on an income year basis under section ND 4) income year, in which the employee derives a source deduction payment that is, or, as the case may be, source deduction payments all of which are, not liable for income tax under section BB 1 ...

Section OB 1 defines "employee", and "employer":

"Employee" -

...

(d) ...in the FBT rules, means a person who will receive, receives, or has at any time received, or who will be, is, or has at any time been entitled to receive, a source deduction payment (not being a payment of any of the kinds referred to in paragraphs (d), (f), (g), (h), and (i) of the definition of "salary or wages" and not being a withholding payment of the kind specified in Part E of the Income Tax (Withholding Payments) Regulations 1979) in respect of which the person is liable for income tax under section BB 1:

"Employer" -

...

(b) ... in the FBT rules, means a person who will pay, pays, or has at any time paid, or who will be, is, or has at any time been liable to pay, a source deduction payment (not being a payment of any of the kinds referred to in paragraphs (d), (f), (g), (h), and (i) of the definition of "salary or wages" and not being a withholding payment of the kind referred to in Part E of the Income Tax (Withholding Payments) Regulations 1979); ...

Part E of the Schedule to the Income Tax (Withholding Payments) Regulations 1979 refers to withholding payments to non-resident contractors. A non-resident contractor is not an employee, and a person who pays a non-resident contractor is not the employer of that contractor.

Section OB 2 (1) defines "source deduction payment" as:

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

Application of legislation

The definition of "fringe benefit" excludes benefits received by an employee in an FBT period in which the source deduction payments received by that employee are not liable for income tax under section BB 1.

Section BB 1 imposes income tax. Section BB 3 states when income derived from New Zealand or overseas is assessable in New Zealand. It provides that:

- **Income derived by a New Zealand resident is assessable in New Zealand.** Section OE 1 contains the tests of residence. In summary, under section OE 1 persons (who are not a company) are New Zealand residents if they have a permanent place of abode in New Zealand or if they are personally present in New Zealand for more than 183 days in a 12-month period. Persons lose New Zealand resident status when they are absent from New Zealand for more than 325 days in a 12-month period (and they do not have a permanent place of abode in New Zealand).
- **Income derived from New Zealand is assessable in New Zealand, whether derived by a New Zealand resident or not.** Section OE 4 (1)(c) deems persons to derive income from New Zealand if they earn salary, wages, allowances, or emoluments in New Zealand, whether or not the employer or principal is a New Zealand resident.

When a non-resident's source deduction payments are not taxable in New Zealand

A source deduction payment derived by a non-resident is not taxable in New Zealand when a provision in the Act or in any relevant DTA deems that income to be tax exempt in New Zealand.

(A) Exemptions provided by the Act

Under sections CB 1 - 15 certain types of income are exempt from taxation. An exemption that may apply to a non-resident's employment income is section CB 2 (1)(c) which provides an exemption for:

Income derived by a person who is not resident in New Zealand, from personal (including professional) services performed by that person within New Zealand during a visit to New Zealand, if -

(i) That visit does not exceed a period of 92 days; and

(ii) In the country or territory in which that person is resident, that income, being exempt from income tax in New Zealand, is chargeable with any tax which in the opinion of the Commissioner is substantially of the same nature as income tax under this Act; and

(iii) Those services are performed for or on behalf of a person who is not resident in New Zealand:

Provided that this paragraph shall not apply to the income of public entertainers ...

Provided also that this paragraph shall not apply to the income derived in any income year by a person who is present within New Zealand for a period or periods exceeding in the aggregate 92 days during that year.

Section CB 2 contains other exemptions that may apply to the employment income of non-residents (i.e., income derived by non-resident entertainers, or visiting experts or students).

(B) Exemptions provided by DTAs

The DTAs to which New Zealand is a contracting party generally provide variations on the following provisions:

1. Personal services remuneration is subject to tax in the earner's country of residence unless the earner performs the services in the other contracting state ("the country of source"). When this is the case, the remuneration may also be subject to tax in the country of source.
2. The above rule does not apply and the remuneration is tax exempt in the country of source when a dependent personal services article applies. Dependent personal services articles generally provide that remuneration is tax exempt in the country of source when:

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- The individual is present in the country of source for no more than 183 days in an income year or a consecutive 12 month period (depending on the particular DTA); and
- The remuneration is paid by an employer who is not a resident of the country of source; and
- The remuneration is not borne by (deducted by) a permanent establishment or a fixed base which the employer has in the country of source.

3. The DTAs each provide specific exemptions for the income of certain types of persons in certain circumstances. A DTA may provide special exemptions for the income of certain teachers, professors, students, entertainers, and government employees.

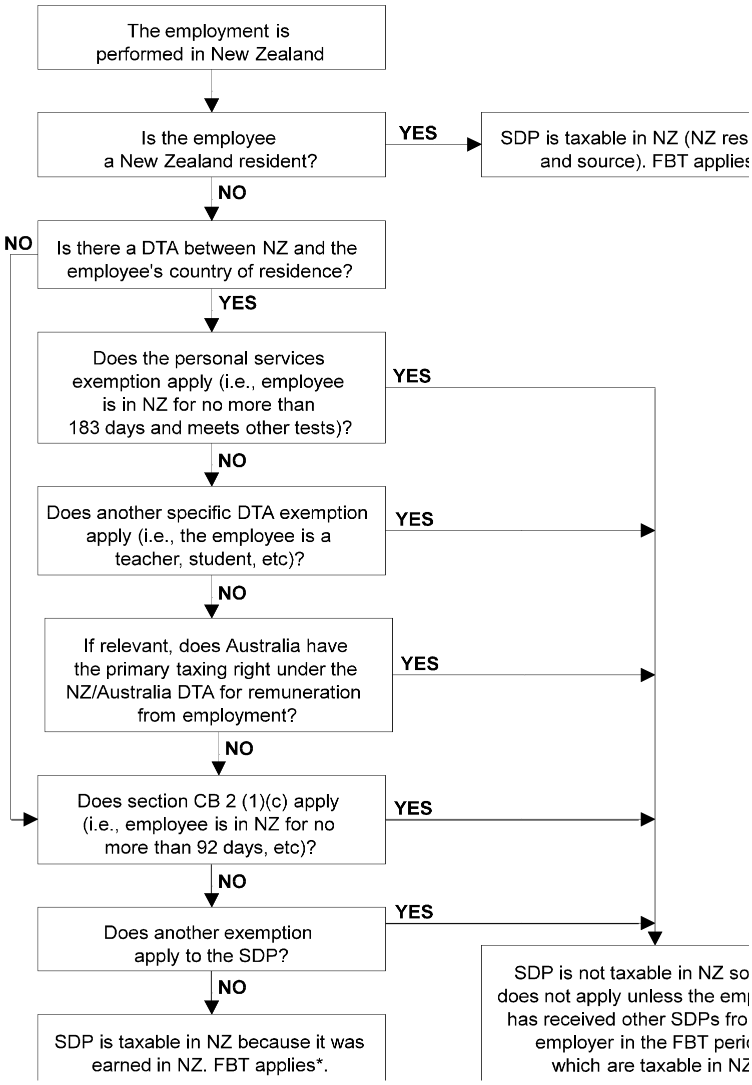
(C) DTA between New Zealand and Australia

In addition to the general terms set out in (B) above, article 16 of the new DTA between New Zealand and Australia, effective 1 April 1995, specifically provides for the taxation of fringe benefits. In summary, under article 16 when a fringe benefit would otherwise be subject to FBT in both New Zealand and Australia, the benefit is only taxable in the country that has the sole or primary right to tax the remuneration from the employment to which the benefit relates. A country has the primary right to tax remuneration if the DTA entitles that country to tax that remuneration and the other country is required under the DTA to allow relief for taxes imposed in the first country.

Summary - FBT on benefits provided to NZ or non-resident employee employed by a non-resident employer in NZ

The following flow chart summarises the effect of paragraph (n) of the definition of "fringe benefit" on the application of FBT to benefits provided to employees of non-resident employers. For the purposes of the flow chart, "source deduction payment" is abbreviated to "SDP".

Taxation of benefits provided in relation to employment



* Note that the employer's NZ FBT liability is determined by whether the employee has received an SDP in the FBT period. If the employee receives such an SDP, then the employer is liable for FBT regardless of its NZ tax residence status.

FBT on benefits provided to NZ resident employee employed in NZ by non-resident employer

The flow chart on the previous page shows that source deduction payments paid to a New Zealand resident employee employed in New Zealand are taxable in New Zealand. This is because the employee earns the payments in New Zealand and because he or she is a New Zealand resident. Benefits provided to the employee are subject to FBT, regardless of the fact that the employer is a non-resident.

Section CB 2 (1)(c) ("the 92 day exemption") and the provisions of any relevant DTA do not affect a New Zealand resident employee's liability to New Zealand tax. These provisions only apply to non-resident employees working in New Zealand.

FBT on benefits provided to a non-resident employee employed in NZ by a non-resident employer

A non-resident employee's source deduction payments will not be assessable in New Zealand in either of the following situations:

- if an exemption under the Act applies to those source deduction payments
- if there is a DTA between New Zealand and the employee's country of residence and the source deduction payments are exempt under that DTA.

When neither of the above occurs, the source deduction payments are assessable in New Zealand because the employee earns the payments in New Zealand, and therefore derives them from New Zealand. When source deduction payments are taxable in New Zealand in an FBT period, any benefits the employer provides to the employee in that period are subject to FBT. The employer is liable for FBT, regardless of the fact that it is a non-resident.

The length of time that an employee will stay in New Zealand may not be clear at the time of that employee's arrival in New Zealand. When the length of the visit is not clear, the Commissioner is not able to establish immediately whether the employee's source deduction payments (and, therefore, his or her fringe benefits) will be eligible for an exemption from New Zealand tax under the Act or the relevant DTA. The Commissioner's policy is:

1. The employer must determine whether the employee will be subject to New Zealand tax on source deduction payments during the year. Factors to consider in making such a determination include:
    - the terms of the employee's visa, work permit, and employment contract and whether these documents indicate that the employee will satisfy the terms of an exemption under the Act or the relevant DTA.
    - the employer's knowledge of the employee's plans and intentions (i.e. if the employer knows that the employee intends to return to New Zealand during the year and will therefore not meet the terms of an exemption under the Act or the relevant DTA) and the employer's control over whether the employee returns to New Zealand during the year (an employer will have more control over an employee than over an independent contractor).
2. Under section NC 18, in situations when it is ***absolutely clear*** from the outset that the employee will meet the terms of an exemption under the Act or the relevant DTA, and will therefore not be liable for income tax in New Zealand, the Commissioner may accept a bond or other security from the employer in substitution for the employer's liability to make PAYE deductions. Section NC 18 does not allow the employer to pay a bond in substitution for paying FBT on benefits provided to employees. In these circumstances, Inland Revenue may also issue the employee with a NIL special tax code certificate, in which case the employer will not be required to make PAYE deductions from the employee's source deduction payments. The payment of the bond or the issuing of a NIL special tax code certificate does not affect whether or not the employee's income is ultimately assessable in New Zealand.

    In situations where it is ***absolutely clear*** that the employee will not be liable for tax in New Zealand, and the employer is not deducting PAYE from the employee's source deduction payments (because of a bond and/or a NIL special tax code certificate), the employer may treat those source deduction payments as if they were not liable for income tax in New Zealand for the purposes of paragraph (n) of the definition of "fringe benefit" - the employer may treat any benefits that it provides to the employee as not being fringe benefits subject to FBT.
3. In situations when it is ***not absolutely clear*** from the outset that the employee meets the terms of an exemption under the Act or the relevant DTA, the Commissioner considers that he can only properly ascertain whether the employee is entitled to an exemption from income tax after the employee has left New Zealand. The Commissioner will not know until that time whether the employee has been in New Zealand for less than the applicable maximum period and has met the other applicable criteria. The Commissioner's policy is that, during the employee's stay in New Zealand, the employee's source deduction payments are subject to tax in the normal way from arrival, and benefits provided to the employee are subject to FBT in the normal way from arrival.

    At the end of the employee's stay in New Zealand, the Commissioner will review the employee's New Zealand tax liability to determine whether the employee meets the terms of any exemption. If the employee's source deduction payments are not taxable in New Zealand, any fringe benefits provided to the employee will not be subject to FBT in New Zealand. If this is the case, the Commissioner will

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refund any FBT paid by the employer. If the employee is not entitled to an exemption, the FBT will have been correctly paid and will not be refunded.

Enforcement of non-resident employer's FBT liability

The payment of FBT is an employer's obligation which the Commissioner seeks to enforce, whether or not the employer is a New Zealand resident.

In some situations a non-resident employer may arrange for an employee to account for the FBT on fringe benefits that the employer provides to the employee. In this situation the employee pays the FBT as the agent of the employer. However, if the employee fails to pay the FBT, liability for compliance with the FBT rules remains with the employer.

Example 1

CleanCo is a US resident company which advises firms on pollution reduction. SmellCo, a New Zealand resident company, engages CleanCo to analyse the content of certain emissions from its Auckland plant and to develop a pollution reduction strategy.

CleanCo sends an employee, Maxine, to New Zealand to study the emissions, conduct tests, and report on her findings. There is clear evidence that Maxine will not be in New Zealand for any longer than six weeks.

During Maxine's stay in New Zealand, CleanCo pays her salary, pays for her hotel accommodation, and provides a car for her use.

Maxine is not a New Zealand resident as she does not have a permanent place of abode in New Zealand and is in New Zealand for less than 183 days during the year. Maxine derives her salary from New Zealand because she earns it in New Zealand.

Maxine's visit to New Zealand is for less than 93 days, her salary is assessable for income tax in the USA, and she is performing the services on behalf of a USA resident, CleanCo. Her salary is therefore exempt from New Zealand income tax under section CB 2 (1)(c).

Maxine is in New Zealand for less than 183 days, and a non-resident employer which does not have a fixed base or permanent establishment in New Zealand pays her salary. Therefore, her salary is also exempt from New Zealand tax under the dependent services article of the DTA between New Zealand and the USA (Article 15).

As Maxine has documentary evidence that she will meet the terms of the section CB 2 (1)(c) or DTA exemption, she applies for and is issued with a NIL tax code certificate. CleanCo does not need to deduct PAYE from Maxine's salary. As it is clear that Maxine will meet the terms of the income tax exemptions, and as CleanCo is not deducting PAYE from her wages, CleanCo may treat the private use and availability for private use of the car as not being a fringe benefit that is subject to FBT in New Zealand.

Example 2

Maxine recommends that SmellCo installs several pollution reduction devices. At SmellCo's request, CleanCo sends Ken, another employee, to New Zealand to supervise the installation of the devices and to monitor the reduction of pollutants in SmellCo's emissions. SmellCo and CleanCo agree that Ken will work in New Zealand for approximately seven months. As with Maxine, CleanCo pays Ken's salary and hotel expenses and provides him with the use of a car during his stay in New Zealand.

Because Ken is present in New Zealand for more than 92 days in a year, the section CB 2 (1)(c) exemption does not apply to his salary. The dependent personal services exemption in the New Zealand/USA DTA also does not apply to his salary because he is in New Zealand for more than 183 days.

As Ken's salary is not exempt from tax in New Zealand, the private use and availability for private use of the car is a fringe benefit. CleanCo is subject to FBT on that benefit in New Zealand.

Example 3

BurnsCo is a United Kingdom resident which has a branch office in New Zealand. Helen is seconded from the UK head office to the New Zealand branch for five months. The New Zealand branch of BurnsCo pays Helen's salary during her secondment.

Helen's salary is not exempt from New Zealand tax under section CB 2 (1)(c) as she is in New Zealand for more than 92 days. The dependent services exemption of the DTA between New Zealand and the UK does not apply when remuneration is borne by (deducted by) a permanent establishment or fixed base which a non-resident employer has in New Zealand. A "permanent establishment" includes a branch office. Helen's salary is paid by the New Zealand branch of BurnsCo, so her salary is not exempt under the dependent services provision of the DTA.

As Helen's salary is derived in New Zealand, and as no Act or DTA exemption applies to that salary, the salary is assessable in New Zealand. As Helen receives source deduction payments that are subject to tax in New Zealand, BurnsCo is liable to pay FBT in New Zealand on any fringe benefits it provides Helen during the FBT periods that she receives salary which is assessable in New Zealand.

All enquiries from non-resident contractors should be made to the Corporates Unit of the Wellington District Office of Inland Revenue.

GST - specified agent for incapacitated persons

Summary

This item states the Commissioner's view on how the law relating to "specified agents" who carry on taxable activities for incapacitated GST registered persons applies.

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

Background

Under section 58, there are special registration rules when a GST registered person dies, becomes incapacitated, or goes into receivership, liquidation, or bankruptcy. Section 58(1A) deems the person who conducts the relevant taxable activity (the "specified agent") on behalf of the incapacitated person to be personally carrying on the taxable activity and to be GST registered for that purpose. The deeming applies from the date on which the specified agent becomes entitled to carry on a taxable activity for an incapacitated person. It ends when the person ceases to be a specified agent, or on the earlier registration of any other person in respect of the taxable activity.

Section 58(2) deals with a similar situation when a mortgagee is in possession of mortgaged land or other property of a GST registered mortgagor. Under that section, the Commissioner may deem the mortgagee to be a registered person in respect of, and to the extent to which the mortgagee carries on, any taxable activity of the mortgagor.

Legislation

Section 8(1) imposes GST on the supply (other than an exempt supply) in New Zealand of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person.

Section 51 sets out the requirements of registration for persons carrying on taxable activities. Sections 55 to 61A deal with registration and GST liability issues in certain special cases. Section 58 sets out special registration rules when a GST registered person dies, becomes incapacitated, or goes into receivership, liquidation, or bankruptcy. It also deals with the position of mortgagees in possession.

Section 58(1) defines "incapacitated person" as:

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

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

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

Section 58(1A) and (2) states:

> (1A) For the purposes of this Act and notwithstanding section 60 of this Act, where any person becomes a specified agent that person shall, during the agency period, be deemed to be a registered person carrying on the taxable activity of the incapacitated person, and the incapacitated person shall during that period be deemed not to be carrying on that taxable activity:
>
> Provided that a specified agent shall not be personally liable for any liabilities under this Act incurred by the incapacitated person before the agency period.
>
> (2) Where a mortgagee is in possession of any land or other property previously mortgaged by the mortgagor, being a registered person, the Commissioner may, from the date on which the mortgagee took possession of that land or other property, until such time as the mortgagee ceases to be in possession of that land or other property, deem the mortgagee, in any case where and to the extent that the mortgagee carries on any taxable activity of the mortgagor, to be a registered person.

Section 58(3) requires any person who becomes a specified agent, or who as a mortgagee in possession carries on any taxable activity of the mortgagor, to give the Commissioner written notice of that fact within 21 days of becoming a specified agent or commencing that taxable activity of the mortgagor. The notice must include the date on which the agency period started or the mortgagee took possession, and in the case of an incapacity other than those expressly defined, the nature of the incapacity and the date on which it began.

"Agency period" means:

> the period beginning on the date on which a person becomes entitled to act as a specified agent carrying on a taxable activity in relation to an incapacitated person and ending on the earlier of-
>
> (a) The date on which some person other than the incapacitated person or the specified agent is registered in respect of the taxable activity; or
>
> (b) The date on which the person ceases to be a specified agent in relation to the incapacitated person:

Under section 15(8), when any registered person dies, or goes into liquidation or receivership, or becomes bankrupt, the date of death, liquidation, receivership, or bankruptcy, as the case may be, is deemed to be the last day of that person's taxable period.

Section 6(2) deems anything done in connection with the commencement or termination of a taxable activity to be carried on in the course or furtherance of that taxable activity.

Application of legislation

Section 58 deems specified agents who carry on the taxable activity of incapacitated persons to be doing so as registered persons in their own right. The specified agent is personally liable for any liabilities under the

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Act incurred during the agency period. The specified agent is not personally liable for any liabilities under the Act incurred by the incapacitated person before the agency period.

The registration of a specified agent is automatic. This compares with the position of mortgagees in possession. The Commissioner has a discretion as to whether to deem a mortgagee in possession who carries on any taxable activity of a GST registered mortgagor to be a registered person.

Specified agents (and mortgagees) must notify Inland Revenue that they are carrying on the taxable activity, and the circumstances that gave rise to their carrying on the taxable activity, e.g., the death or illness of the registered person, or the registered person's receivership or liquidation. Inland Revenue will keep a record of the start of the agency period. The GST registration number remains the same as for the incapacitated person.

Pre-agency period

Although specified agents are not personally liable for pre-agency period GST liabilities, in practice they may, when they have authority to do so, take responsibility as agents for the incapacitated registered person for GST obligations relating to that time. For example, a specified agent may file outstanding returns for the pre-agency period, although he or she is not liable to do so.

In certain situations a specified agent may wish to claim an input tax deduction for a supply acquired for the taxable activity during the pre-agency period. Under the proviso to section 20(3), the specified agent may seek input tax deductions relating to prior periods. Alternatively, a specified agent may file an amended return for the period to which the input tax claim relates. The Commissioner accepts that in both cases specified agents are acting on behalf of the incapacitated person in administrating that person's GST rights and obligations for the pre-agency period. For the same reasons the Commissioner accepts that a receiver or liquidator who is a specified agent may wish to make a deduction under section 26 for a bad debt relating to a taxable supply made during the pre-agency period.

Filing returns

The effect of section 15(8) is that when any registered person dies, or goes into liquidation or receivership, or becomes bankrupt ("the incapacity"), the specified agent in such circumstances is able to file a return for the short period from the date of the incapacity to the end of the relevant taxable period. The specified agent is responsible for filing this return. A return for the short period from the start of the taxable period up to, and including, the date of the incapacity must also be filed. The specified agent is not liable for filing this return, but may choose to do so.

Termination of taxable activity

The combined effect of sections 58 and 6(2) is that a person is deemed to be a registered person carrying on a taxable activity of an incapacitated person even if he or she only acts in connection with the termination of that activity. For example, selling off the assets of a business.

Example 1

Mele is a sole trader. She owns and operates a florist business trading as "Blooming Good". She is registered for GST on the invoice basis and files returns two-monthly. Her taxable periods end on the last day of February, April, June, August, October, and December. Mele employs her only sister Tala.

Mele dies suddenly on 3 April. When Mele first went into business she made a will. Her will provides that all her property passes to her spouse, Tom. The will appoints Tom and Tala as Mele's executors. Tom and Tala agree that in the short term it would be prudent for Tala to carry on the business as she knows all the customers and is familiar with how it operates. Following Mele's death the florist shop is closed for a week. Tala reopens the shop on 10 April. Tala wonders what she must do to continue to meet the business's GST obligations, and contacts her local Inland Revenue office.

Tala is told to provide formal notification in writing that she is now carrying on Mele's taxable activity, i.e., the florist business as Mele's personal representative, and the date of Mele's death. Inland Revenue advises that she must do so before 25 April, i.e., 21 days from, but not including, 3 April. Under the GST legislation, Tala is now deemed to be a registered person carrying on Mele's taxable activity. Tala is told that she is personally liable for the GST obligations and liabilities of the florist business incurred on and after 3 April while she continues to carry on the business as Mele's personal representative.

Inland Revenue staff remind Tala that she will need to file a return for the March/April taxable period ending 30 April. This return is due by 31 May. This will involve making two returns: one for the period 1 March to 3 April, the other for the period 4 April to 30 April.

Example 2

"Blooming Good" operates from leased premises. The landlord is Get Smart Limited. At the beginning of May Tala receives an invoice dated 1 May requesting the monthly rental payment for June of $300, plus GST of $37.50. The rental payment is due on or before 21 May. This reminds Tala that the monthly rental payment for May has probably not been paid. She checks the business records and finds this to be the case. The date of the tax invoice for the month of May is 1 April, payable on or before 21 April.

Tala rings the owner of Get Smart Limited to clarify the position. She explains that Mele has died, and that she is carrying on the business for the time being. Tala apologises for the delay in paying the May rental, and promises to pay it, and the June rental, as soon as possible.

Tala is able to claim an input tax deduction for both supplies. In the case of the GST component of the May rental payment, Tala is making the claim for an input tax deduction on Mele's behalf. Section 9(3) deems the time of supply for the May lease period to be 1 April, i.e., prior to the agency period. In the case of the GST component of the June rental payment, Tala is making the claim for an input tax deduction as the registered person deemed to be carrying on the florist business during the agency period.

Example 3

Tom decides to keep the business running and employ Tala as manager. Tala agrees.

Tom registers for GST. The registration indicates that Tom intends to carry on the business from the date of distribution. The business is distributed to Tom in accordance with Mele's will. The supply is made by Tala, as specified agent for Mele, to Tom, the beneficiary under the will. The supply is of a going concern. To comply with section 11(1)(c)(ii), Tala and Tom record in writing, prior to the distribution, that the supply of the business is a supply of a going concern.

Tala ceases to be a specified agent from the date of distribution. This is the date on which some other person, i.e., Tom, is registered for the taxable activity.

RWT on matrimonial property settlement interest

Summary

This item states the Commissioner's policy on whether the payer should deduct resident withholding tax ("RWT") on the interest granted by the Family Court to a spouse under proceedings under the Matrimonial Property Act 1976. Unless there has been money lent, RWT is not deductible.

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

Background

In some cases the Family Court orders one spouse to pay interest on an amount outstanding to the other spouse, or former spouse, until the other spouse is paid. This interest can date back to the date that the matrimonial property claim came into existence. Taxpayers have asked Inland Revenue whether RWT is deductible from that interest.

Subpart F of Part N of the Act contains the legislation applying to RWT on both interest and dividends. The objective of RWT is to reduce the scope for the evasion or deferral of income tax payable on interest and dividends.

In relation to interest, the legislation achieves this by requiring the payer to deduct RWT from the interest at the time of payment. Section NF 2 (4) only requires a person to deduct RWT if the person is either resident in New Zealand or the person is carrying on a taxable activity in New Zealand through a fixed establishment, and any of these conditions are met:

- at the time of payment, the person holds a valid certificate of exemption
- the payment is made wholly or partly in the course or furtherance of a taxable activity
- the payment is a payment of dividends by a company on shares issued by that company.

The last of these categories does not apply in a matrimonial property case. The only two categories of relevance are when the payer holds a valid certificate of exemption or if there is a transfer of assets forming part of a taxable activity. The term "taxable activity" has the same meaning as in the Goods and Services Tax Act 1985, except that it also includes activities relating to the making of exempt supplies. An example of a supply in the course or furtherance of a taxable activity is: the supply of goods applied by a registered person for the principal purpose of making taxable supplies which are transferred to a spouse to satisfy that person's claim under the Matrimonial Property Act 1976.

The recipient includes the gross resident withholding income in his or her tax return, and can claim a credit for the RWT deducted. The RWT deduction rate is 24% for interest, but if the recipient does not provide his or her IRD number to the person paying the interest, RWT is deducted at the higher "no declaration rate" of 33%.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
NF 1 (2)	327B(2)
NF 2 (4)	327C(4)
OB 1 "money lent"	2
OB 1 "interest" para (a)	2
OB 1 "interest" para (e)	327A
OB 1 "resident withholding income"	327A

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Section OB 1 states that "resident withholding income":

... has the meaning assigned by section NF 1; and, unless the context otherwise requires, in relation to any amount of resident withholding income, includes any amount of resident withholding tax required to be deducted from that income in accordance with the RWT rules:

Section NF 1 (2) states:

The RWT rules shall apply to any amount paid (referred to as "resident withholding income") that consists of -

(a) Interest, ...

The definition of "resident withholding income" excludes certain types of interest, but they are not relevant in this case.

Section OB 1 defines "interest" in paragraph (a) as:

In relation to the deriving of income, resident withholding income, or non-resident withholding income by any person (in this definition referred to as the "first person"), means every payment (not being a repayment of money lent and not being a redemption payment), whether periodical or not and however described or computed, made to the first person by any other person (in this definition referred to as the "second person") in respect of or in relation to *money lent* to the second person making the payment or to any other person: (emphasis added)

Section OB 1 further defines "interest" for the RWT rules in paragraph (e) as including "a redemption payment".

Section OB 1 also contains a definition of money lent. This states:

"Money lent", in relation to any person, means-

(a) Any amount of money advanced, deposited, or otherwise let out, whether on current account or otherwise, by the person:

(b) Any amount of credit given (including the forbearance of any debt), whether on current account or otherwise, by the person:

(c) Any amount advanced, deposited or let out, or for which credit is given, by the person under any obligation or arrangement that is similar to any advancing, depositing, letting out, or giving of credit, of any of the kinds referred to in paragraph (a) or paragraph (b):

(d) Any amount paid to, or for the benefit of, or on behalf of, or dealt with in the interest of or on behalf of, any other person in consideration for an agreement to pay or a promise to pay by the other person, where that amount is exceeded by the amount payable to the person in accordance with the agreement or the promise, -

whether or not the advancing, depositing, or letting out, or the giving of credit, or the obligation or arrangement, or the agreement to pay or promise to pay, is secured or evidenced by writing; and, for the purposes of paragraph (d), the expression "other person", where it last appears in that paragraph, shall include any further person where the other person and the further person are associated persons:

Policy

Subject to the requirements set out in section NF 2 (4), a payer must deduct RWT from any payment of resident withholding income. However, the payment the Family Court describes as "interest", and which is payable by one spouse until payment is made to the other spouse, is not interest in terms of the definition of "interest" for RWT purposes. In other words, it is not resident withholding income.

Resident withholding income consists of interest and dividends, subject to certain exceptions listed in section NF 1. Section OB 1 defines "interest" in paragraph (e) for the purposes of the RWT rules as including a redemption payment. This has no relevance in the context of an interest payment ordered by the Family Court. It is necessary to consider the other paragraphs of the definition of "interest" in section OB 1. The only part of the definition relevant to this issue is the paragraph (a) definition of "interest". The paragraph (a) definition includes the requirement that the interest be in respect of or in relation to money lent. In order for the payment described as "interest" by the Family Court to be "interest" in terms of the RWT rules, there is a requirement that money has been lent.

Section OB 1 also contains a definition of "money lent". This is cited in the legislation section of this item. In most cases, the spouse receiving the payment under the Family Court order will not have lent money. The spouse will not have made an advance of that money or forborne the debt. The debt only comes into existence when the Family Court makes the order.

It is possible that a spouse or former spouse might agree not to enforce the judgment of the Court, and elect to receive further interest in return for a delay in payment. In this situation money would be lent. Provided the other requirements in section NF 4 (2) are met, RWT would be deductible on the further interest derived from that agreement or arrangement. Nevertheless, in most cases, there will be no forbearance of any debt nor any money lent. Therefore, any payment of interest made in accordance with the Family Court order will not be resident withholding income. RWT is not deductible if there is no resident withholding income.

Unless there is some agreement to forbear payment or advance money, no resident withholding tax is deductible on the "interest" awarded under a Family Court order. Even if there was forbearance, the payer would still have to be within the provisions of section NF 2 (4) before there was a liability to deduct RWT.

Occasionally, the High Court or some other court will make an order in relation to matrimonial property issues. In such cases the same principles apply as for the Family Court.

Although such payments are not "interest" for the purposes of the RWT rules, this does not mean that such payments are not assessable in the hands of the recipient. The issue as to whether the payments are assessable is a separate and different consideration and will depend on the facts of individual cases.

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.

Depreciation on yachts - draft determination

Introduction

Currently there is one asset class for all types of yachts, with a depreciation rate of 12% DV.

The Commissioner proposes to issue a general depreciation determination which will set two new asset classes for yachts. The draft determination is reproduced below. The determination will set a new depreciation rate of 15% diminishing value ("DV") for the asset class "Yachts (international ocean-going)". The other asset class will clarify that the existing rate of 12% DV continues to apply, but to "Yachts (other than international ocean-going)" rather than to all "Yachts".

The proposed new depreciation rate for "Yachts (international ocean-going)" of 15% DV is based on an estimated useful life ("EUL") of six years and a residual value of 40% of cost. The EUL of six years reflects that this type of yacht typically has a useful charter life of six years and after this period is not usually useful for charter (i.e., producing assessable income). The estimated residual market value of this type of yacht at the end of six years is typically 40% of cost.

Exposure draft - General Depreciation Determination DEPX

This determination may be cited as "Determination DEPX: Tax Depreciation Rates General Determination Number X".

1. Application

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

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

2. Determination

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

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

Transport	Estimated useful life (years)	DV banded depn rate (%)	SL equiv banded depn rate (%)
Yachts (international ocean-going)*	6	15	10
Yachts (other than international ocean-going)	15.5	12	8

* Residual value has been estimated at 40%.

- Deleting from the "Transport" asset category the general asset class, estimated useful life, and diminishing value and straight-line depreciation rates listed below:

Transport	Estimated useful life (years)	DV banded depn rate (%)	SL equiv banded depn rate (%)
Yachts	15.5	12	8

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3. Interpretation

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

If you wish to make a submission on these proposed changes you can write to:

Manager
Rulings Directorate
National Office
Inland Revenue Department
PO Box 2198
WELLINGTON

All submissions to be made by 16 February 1996.

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

Rental property - deducting maintenance expenses while property vacant

Section BB 7 (section 104, Income Tax Act 1976) - Expenditure or loss incurred in production of assessable income: A taxpayer has asked whether the expenses involved in maintaining a vacant rental property are tax deductible.

Section BB 7 allows a tax deduction for expenditure that is:

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

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

A landlord will generally incur a number of costs in respect of a rental property, regardless of whether it is tenanted at the time. For example, rates, insurance, electricity and interest costs will still be payable. If the property is available for rental, or temporarily unavailable for rental while maintenance work is being carried out, such costs will continue to be deductible.

Example 1

Albert has a flat that he rents to tenants. The tenant that was occupying the flat moved out, and Albert has been seeking a new tenant without success. Albert is still incurring ongoing expenses such as rates, insurance, mortgage interest, and some minor repairs and maintenance.

These expenses continue to be tax deductible.

If a rental property is temporarily taken off the market, any ongoing expenses that are incurred will still be tax deductible.

Example 2

Albert concludes that the reason for not finding a new tenant is that the flat is too run down. He decides to take it off the market so that he can fix it up. Once the flat has been repaired, cleaned and painted, he will look for a new tenant.

The ongoing expenses that Albert incurs will still be deductible. To the extent that they are making good fair wear and tear, the repairs and maintenance will also be deductible. Any expenses incurred in improving the property are of a capital nature and are not deductible.

When a taxpayer incurs a tax deductible loss, but has no other income against which the loss can be offset, it can be carried forward to be offset against income earned in later years.

Rental property - deductibility of renovation costs

Section BB 7 (section 104, Income Tax Act 1976) - Expenditure or loss incurred in production of assessable income: A taxpayer who owns a number of domestic rental properties wants to renovate a kitchen that is outdated, dark, and a

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condensation trap. The taxpayer also intends to replace rotten wooden window frames with low maintenance aluminium ones. He has asked whether the costs incurred can be offset against rental income.

Generally, the cost of keeping an asset in a reasonable state of repair and efficiency is a revenue cost, allowed as a deduction by section BB 7. Before a deduction can be allowed as repairs and maintenance, the expenditure must have been incurred in making good fair wear and tear that occurred to the asset while it was producing assessable income. The deductibility of this type of expenditure will depend on the specific circumstances of each individual case.

Under section BB 8 (a) (section 106(1)(a), Income Tax Act 1976), no deduction is allowed for expenditure of a capital nature. Case law has produced several tests which Inland Revenue applies in deciding whether expenditure incurred is revenue or capital. These tests, which are not exhaustive or to be considered in isolation, consider the questions:

- Does the expenditure increase the useful life of the asset, its output, or efficiency?
- Is the expenditure a one-off expense?
- Does the expenditure create a new asset that did not exist before?
- Does the expenditure confer an enduring benefit to the taxpayer?
- Does the expenditure relate to the profit-earning structure, rather than the profit-making process, of the business?

If the answer to these questions is predominantly "yes", the expenditure is likely to be of a capital nature.

In this case, the renovations to the kitchen do not fall within the criteria for being repairs and maintenance as the value of the property will be substantially improved. The improvements are of a capital nature, and the costs cannot be offset against rental income. However, the cost of the replacement windows may be either revenue or capital. A decision on this cannot be made on the information provided.

The cost of the renovations that are capitalised can be added to the cost of the property, and depreciation claimed in the normal manner.

Rental property - deductibility of interior redecorations

Section BB 7 (section 104, Income Tax Act 1976) - Expenditure or loss incurred in production of assessable income: An owner of a domestic rental property that has been rented out for 8 years plans to do some interior redecoration. Wear and tear over the years necessitates new paint and paper. Rather than inconvenience the tenants, she is considering completing the work on the expiry of the tenancy agreement when she will take over the occupancy of the house herself. She has asked if the timing of the redecorations affects the deductibility of their cost.

In any situation involving repairs and maintenance, it is necessary to consider the application of section BB 8 (a) (section 106(1)(a), Income Tax Act 1976) which denies a deduction for capital expenditure. On the facts here, the work is making good wear and tear, and so the section does not apply.

Under section BB 7, a deduction is permitted, unless the Act provides otherwise, when it:

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

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

This means that for the expenditure to be deductible, it must be closely linked to the income producing process.

If the redecorating takes place when the property owner is living in the house, no deduction will be available as it will then be expenditure of a private or domestic nature under section BB 8 (b) (section 106(1)(j), Income Tax Act 1976), and will not come within section BB 7.

In the Taxation Review Authority decision *Case J97* (1987) 9 NZTC 1,552, it was held that expenditure incurred in one year to repair damage sustained in earlier years could not be related back, once the renting activity had ceased, to rent received in those years.

We advised the taxpayer that the timing of the redecorations was relevant, and that for a deduction to be claimed the work should be carried out whilst the renting activity was still carried on.

Inland Revenue's policy on repairs and maintenance is provided in TIB Volume Five, No.9 (February 1994) at page 1.

Netting used to protect grapes from birds - deduction

Section BB 7 (section 104, Income Tax Act 1976) - Expenditure or loss incurred in production of assessable income: A grape grower has resorted to using netting to keep birds off her grapes, at a cost of $12,000. The netting is estimated to last for little more than a year. The grower has asked how she can claim the cost of the netting.

Section BB 7 allows a claim for expenditure or loss incurred in the production of assessable income. The netting is expenditure incurred in the production of income. However, section BB 8 (a) (section 106(1)(a), Income Tax Act 1976) denies a deduction for expenditure of a capital nature.

Case law has produced several tests which Inland Revenue finds useful in deciding whether expenditure incurred is revenue or capital. These tests are set out in the item at the top of the previous page. If the answer to them is predominantly "yes", it is likely that the expenditure is of a capital nature.

In this case, the netting is not capital in nature for these reasons:

- It does not increase the useful life of an asset.
- It is recurrent, rather than one-off.
- It does not confer an enduring benefit on the taxpayer.

The taxpayer can therefore claim a deduction for the cost of the netting in the year she incurs the expenditure.

Employee home telephone costs - reimbursement by employer

Section CB 12 (section 73, Income Tax Act 1976) - Power to exempt employee's allowances: A tax practitioner has asked if an employer needs to gain the Commissioner's approval before treating reimbursements of an employee's employment-related home telephone costs as not assessable in the hands of the employee. This situation arises when an employee uses a home telephone partially for employment purposes, pays the resulting employment-related expenses, and is specifically reimbursed for those expenses by the employer.

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The employer does not need to gain the Commissioner's prior approval before treating the reimbursements as not assessable in the employee's hands. The specific reimbursement payments are exempt under section CB 12 (1)(a).

The application of section CB 12 is considered in detail in Tax Information Bulletin Volume Six, No.12 (May 1995). Section CB 12 sets out the amended rules regarding reimbursing allowances and payments on account of employees that were formerly contained in sections 73 and 73A of the Income Tax Act 1976.

The Commissioner's policy on the tax treatment of employee home telephone costs is set out more fully on page 4 of TIB Volume Four, No. 8 (April 1993).

Motor vehicle dealers - valuation of trade-in stock

Section EE 1 (section 85, Income Tax Act 1976) - Valuation of trading stock, including livestock: Motor vehicle dealers are able to use a formula method to value trade-in vehicles for the purposes of section EE 1. A dealer in motorcycles has asked whether she can use the same method to value trade-in motorcycles.

Section EE 1 (1) states:

> Where any taxpayer owns or carries on any business, the value of the taxpayer's trading stock at the beginning and at the end of every income year shall be taken into account in ascertaining whether or not the taxpayer has derived assessable income during that year.

Under section EE 1 (3), the taxpayer can choose to value trading stock at its cost price, its market selling value, or the price at which it can be replaced.

Inland Revenue has approved the following formula for use by motor vehicle dealers who are master agents or sub-agents (i.e. the franchise holder or an agent of the franchise holder), for valuing trade-in vehicles:

If on the floor less than 1 month	at the basic (trade-in) value
After 1 month	basic value less 10 percent
After 2 months	basic value less 20 percent
After 3 months	basic value less 30 percent
After 4 months or longer	basic value less 40 percent

We recognise that turnover is the only principle for determining values of trade-in vehicles in the used car market. If a car remains on the floor for any length of time, it must be assumed that the price is wrong or there is something wrong with the car, i.e., the purchase price or trade-in allowance is in excess of true value.

The formula for write-down of the basic value applies to all secondhand vehicles, including tractors, whether purchased outright or as a trade-in for a new vehicle. The cost of reconditioning a trade-in vehicle is capitalised in all cases.

Demonstration vehicles (vehicles purchased new but used for demonstration) are written down on the same basis.

The approval to use the formula method does not apply to secondhand car dealers who are not master agents or sub-agents.

A dealer in motorcycles must register as a motor vehicle dealer with the MVDI. As long as the dealer in this case meets the required criteria, she is able to value trade-in motorcycles using the above formula.

Using this formula method is not mandatory. A dealer can value stock at the lower of cost, market value, or replacement cost.

Goods and Services Tax Act 1985

Distributorship contract is a chose in action

Section 2(1) - Definitions of "Goods" and "Input tax": A GST registered person has acquired a business consisting of a vehicle and a distributorship contract from a non-registered person. The contract, amongst other things, grants her exclusive rights to distribute and sell a company's products within a defined territory. She has asked if, for the purposes of obtaining an input tax deduction under paragraph (c) of the section 2(1) definition of "Input tax", the contract is considered to be goods or a chose in action, and seeks more information on identifying choses in action.

In order for a GST registered person to claim an input tax deduction for secondhand goods acquired from a non-registered person, or from a registered person when the goods are outside that person's taxable activity, the definitions of "Input tax" and "Secondhand goods" must be satisfied. However, before considering the criteria within those definitions, the registered person must first determine that what has been acquired meets the definition of "goods". Section 2(1) defines "goods":

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

A chose in action is a thing recoverable by action e.g., a lawsuit, as opposed to a chose in possession which is a thing that a person not only owns but also has actual physical possession of, e.g., clothes, a dog, a television set. The term "chose in action" is used for both corporeal (tangible, having a material existence) and incorporeal (intangible, not having a material existence) personal property which is not in possession.

The distributorship contract is a chose in action because it grants rights which someone else (the company whose products are being sold) owns. The taxpayer is unable to take physical possession of those rights, and would need to sue for them if they were withheld.

As choses in action are not goods, they cannot be secondhand goods and, therefore, cannot come within paragraph (c) of the Input tax definition. No deduction is available under section 20(3), as no GST is chargeable by the non-registered vendor of the business.

Other examples of things considered by the courts to be choses in action are:

Debts: bills of exchange: debenture stock: an option to purchase land or shares: rights under a hire purchase agreement: a ticket in a sweepstake: the benefit of a contract: shares in a company: copyrights: a share in a partnership: a share in a racehorse: bills of lading: policies of insurance: a right to rent.

"Services" as defined in section 2 are anything which is not goods or money, so choses in action are services.

Multi-draw lottery - time of supply for GST

Section 9(2) - Time of supply in certain circumstances: A company is running a large lottery, and will make three prize draws over a six-week period. The company has a one month GST taxable period. A company representative has asked when GST on the proceeds of the lottery must be accounted for.

Under section 5(10), a supply occurs when a person pays money to participate in a lottery. The amount paid is deemed to be for a supply of services by the person, society, licensed promoter, or organiser who conducts the lottery.

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Section 9(2) and (3) give time of supply rules that are exceptions to the general rule under section 9(1). Under section 9(2)(e), a supply of goods and services is deemed to take place:

> Where that supply is deemed to be made pursuant to section 5(10) of this Act, on the date on which the first drawing or determination of a result of the ...lottery...commences...

This ensures that when there is more than one drawing or determination of prizes in any lottery or other competition, the GST liability arises on the date of the first draw or determination.

Under section 10(14), the consideration for a supply deemed to be made under section 5(10) is the total proceeds of the lottery, less any cash prizes. The company must account for one-ninth of the net amount as GST in its return period that includes the date of the first draw. The company may deduct the GST content of any non-cash prizes it has purchased, using the general time of supply rule under section 9(1), provided the tax invoice requirements of section 24 have been met.

Accident Rehabilitation and Compensation Insurance Act 1992

ACC employer premiums not payable by employees

Section 101 - Premiums payable by employers: The employees of a small company have been asked by their employer to agree to reimburse the company for the amounts of the employer premiums paid on their behalf. One of the employees has asked Inland Revenue for details of the premiums, so she can be sure that she is paying no more than her employer has paid.

Section 101(1) requires a basic premium to be paid by every employer, at a prescribed rate, on the amount of employees' earnings paid by the employer. Section 101(2) states:

> No employer shall charge to any employee any premium payable by that employer or deduct from any payment to any employee any amount representing the amount of premium payable by that employer in respect of that employee under this Act; whether or not such charging or deduction is authorised by any contract between the employer and the employee.

Section 101(3) goes on to say that an employer who breaches section 101(2) commits an offence, and is liable on summary conviction to a fine not exceeding $5,000.

Section 101(2) reflects the fundamental intention of the legislation to place liability for the employer premium solely with the employer: the premium is to fund the cost of work-related accidents.

We told the employee that she should not make payment of the employer premium to her employer. Inland Revenue has contacted the employer's manager and made him aware of the illegality of seeking reimbursement, or making a deduction, of the employer premium from employees. Even if the employees had agreed to reimburse the employer, the actions of the employer would still have been in breach of section 101(2).

The Double Taxation Relief (China) Order 1986

Extension of New Zealand/China Double Taxation Agreement to Hong Kong

A tax practitioner has asked if the double taxation agreement (DTA) between New Zealand and China will extend to Hong Kong when it is handed over to China in 1997.

On 1 July 1997 Hong Kong will be handed back to the People's Republic of China (PRC). The relations between the PRC and Hong Kong after the hand-over are framed by the 1984 Sino-British Joint Declaration and by the Basic Law on Hong Kong, the latter being legislation promulgated by the PRC which becomes effective on 1 July 1997.

The Joint Declaration established the concept of "one country, two systems", and guarantees maintenance of local rule for 50 years after the hand-over.

Under the Basic Law on Hong Kong, Hong Kong will be a "special administrative district" of the PRC, and the laws of the PRC will not apply to Hong Kong for a period of 50 years following the 1997 hand-over.

The DTA defines "China" as meaning the People's Republic of China and includes the territory of the PRC in which the Chinese laws relating to taxation apply. Under the Basic Law on Hong Kong the Chinese taxation laws will not apply to Hong Kong, so the DTA between New Zealand and China will not be extended to include Hong Kong.

Tax Administration Act 1994

The binding rulings provisions have been in effect since 1 April 1995, and a number of technical issues have been encountered in connection with their operation. In this and subsequent editions of the Tax Information Bulletin, we will publish a series of questions and answers on the binding rulings process. These will include questions raised at the 1995 Tax Conference of the New Zealand Society of Accountants, and other questions and issues referred to us.

"Taxation law" covered by a binding ruling

Section 91E - Commissioner to make private rulings on request: A taxpayer wants to know whether a sale of shares is taxable as a sale of personal property under section BB 4 (c) of the Income Tax Act 1994 (section 65(2)(e), Income Tax Act 1976). She drafts a private ruling to the effect that the sale is not taxable under that section, and forwards it to Inland Revenue to obtain a private binding ruling. Inland Revenue issues the ruling as drafted. The taxpayer follows it, and the Commissioner is, therefore, bound by it. Two years later Inland Revenue audits the taxpayer and issues an assessment taxing the profits on the transaction under section BB 4 (a) (section 65(2)(a)). The taxpayer has asked if Inland Revenue can do this.

Section 91E requires the Commissioner, on application by a person, to make a private ruling on how a taxation law applies to that person. "Taxation law" is defined in section 91B as a "provision" contained in the various revenue Acts specified in section 91C (1). These Acts include the Income Tax Act 1994.

Inland Revenue's view is that a "provision" is any operative section, subsection, paragraph or subparagraph (as the case may be) of the relevant Act, as referred to in the ruling. In this case the taxation law on which the Commissioner has ruled is paragraph (c) of section BB 4. He can therefore assess under section BB 4 (a) as this provision is not the taxation law on which he gave his ruling. Inland Revenue will ensure that the information provided in a ruling it gives will be as clear as possible as to the specific taxation law to which the ruling relates. In some cases, Inland Revenue may seek to raise with an applicant taxation laws (or provisions) relevant to an arrangement that are not identified in an application. However, the scope of a ruling is the concern of the applicant and Inland Revenue cannot guarantee to point out potentially relevant provisions in any particular case. Applicants should therefore identify carefully which provisions they wish the ruling to cover.

Application for a private ruling by a company whose taxation affairs are handled by Inland Revenue's Corporates Unit

Section 91EC - Applying for a private ruling: A company is a "client" of Inland Revenue's Corporates Unit, and wishes to apply for a private ruling. Its representative has asked whether it should apply directly to the Rulings Directorate or liaise through its account manager at the Corporates Unit.

On page 3 of TIB Volume Seven, No.2 (August 1995), in an item Binding rulings series, we stated that taxpayers who are clients of Inland Revenue's Corporates Unit should deal with their account manager who will liaise with Rulings. After seeking comments from companies and tax practitioners, we have reviewed this statement. As Rulings Directorate handles all applications for binding rulings, the Corporates' client should send its application direct to Rulings, who will liaise with the Corporates Unit, and send them a copy of the application.

Estimates of fees to be charged for binding rulings

Section 91I - Regulations: Inland Revenue charges $105 per hour (GST inclusive) for providing private and product rulings. A company has applied for a ruling and is meeting with Rulings' staff to discuss the matter. Inland Revenue is represented at the meeting by three Rulings' staff and two staff from the Corporates Unit. The company assumes that it is paying $525 per hour (i.e., $105 per hour for each of the five staff members) for the service and wonders whether that represents value for money.

Inland Revenue must provide an applicant for a binding ruling with an estimate of the fees payable. If Inland Revenue later considers that an original estimate is incorrect, it must provide another estimate as soon as practicable. Additionally, Inland Revenue is required to ensure that every effort is made, within reason, to minimise the fees payable. These requirements are set out in regulations 3 and 4 of the Tax Administration (Binding Rulings) Regulations 1995.

In the above case, the taxpayer should have been provided with an estimate of the fees payable and of any subsequent revised estimate prior to the meeting. The attendance of Corporates' staff at such a meeting would not ordinarily be charged for by Inland Revenue, unless they were involved in providing specialist input (as distinct from keeping Corporates informed on the progress of the ruling application). Furthermore, if any Rulings' staff are attending for training or experience purposes, their time would not be charged to the applicant. Inland Revenue is always mindful of the requirement to keep fees to a minimum when deciding on the number of staff to use in producing a ruling.

When expenditure falls within the period specified in the ruling

Section 91DC - Application of a public ruling: A public ruling is issued that states:

"This ruling applies to any person who incurs the (specified) expenditure from 1 April 1995 to 31 March 1998".

In January 1998, a company acquires goods and incurs expenditure of the type referred to in the ruling. However, under the accrual expenditure provisions of section EF 1 of the Income Tax Act 1994 (section 104A, Income Tax Act 1976), the company is required to defer the deduction for a portion of that expenditure until the year ended March 1999. Also, in February 1998, the company signs a contract to purchase a certain quantity of goods over the next two years. The company's manager has asked whether the public ruling applies to expenditure the company will be required to defer (for deduction purposes) until after 31 March 1998.

The expenditure incurred by the company in January 1998 falls within the period covered by the public ruling as the ruling refers to the time the person "incurs" the expenditure. The expenditure is "initially" deductible in the 1998 year. The accrual expenditure provision requires the unexpired portion of the accrual expenditure to be added back as assessable income in that year, but the effect of the ruling will apply to the deduction of that unexpired portion in the subsequent income year.

The same principle applies to the 1998 contract, subject to Inland Revenue being satisfied as to when the expenditure in relation to the contract is originally "incurred" for income tax purposes.

When income derived progressively falls within the period specified in a ruling

Section 91DC - Application of a public ruling: A public ruling is issued that states:

"This ruling applies to arrangements entered into between 1 April 1995 and 31 March 1998 and to income derived during the period 1 April 1995 to 31 March 1998 from such arrangements".

In December 1995, a company enters into an arrangement of the type specified in the ruling. The income derived from the arrangement will arise progressively over five years. A company representative has asked whether the ruling applies to the entire income flow.

The ruling applies only to income derived up until 31 March 1998. Income derived after this date, even though it results from an arrangement entered into before 31 March, is not covered by the ruling.

When goods purchased fall within the period specified in a GST public binding ruling

Section 91DC - Application of a public ruling: A public ruling that deals with GST input tax deduction claims on the purchase of goods states:

"This ruling applies to purchases of the (specified) goods made during the period 1 April 1996 to 31 March 1998."

In March 1998, a GST registered company enters into a conditional contract for the purchase of such goods. A non-refundable deposit is paid on that day. The contract becomes unconditional on 1 April 1998 and settlement takes place in May of that year. The company's manager has asked whether, in line with the ruling, the company can claim an input tax deduction for the goods acquired under the contract.

The company is entitled to an input tax deduction for goods under this contract in accordance with the terms of the ruling. The ruling is in respect of a GST matter and the time of supply rules will apply to the transaction. Under section 9(1) of the GST Act 1985, the time of supply will be triggered by the payment of the deposit, i.e., March 1998. If the company is on the invoice basis of accounting for GST, it will be entitled to an input tax deduction for the total contract price in the taxable period in which the deposit was paid. If the company is on the payments basis of accounting, the input tax deduction available in the taxable period in which the deposit was paid is in respect of that deposit only (section 20(3) of

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the GST Act 1985). In the latter case, payments made after the expiry of the application period are also covered by the ruling, as it is considered (for the purposes of the public ruling) that the purchase of the relevant goods occurred before 1 April 1998. In the normal course, however, a ruling pertaining to GST would be likely to refer to the time of supply rather than purchase.

Product ruling sought by person who does not intend to be a party to the arrangement

Section 91FC - Applying for a product ruling: A professional adviser wants to obtain a product ruling for a generic type of arrangement that may be entered into by, or recommended to, his clients or potential clients. He has requested a ruling, and included a form of document with his application.

The Commissioner will decline to rule on such an application. In the context of the binding rulings provisions, an "arrangement" is any contract, agreement, plan, or understanding (whether enforceable or unenforceable), including all steps and transactions by which it is carried out. ("Arrangement" is defined in section OB 1 of the Income Tax Act 1994, as incorporated into the Tax Administration Act 1994 through section 3(2) of that Act.) Each of these notions requires the involvement of a party to it - either an existing party, or one who is considering entering into such an arrangement.

Further, under section 91F (4)(b) the Commissioner may decline to issue a product ruling where the arrangement is "not seriously contemplated by the applicant". The words of this paragraph mean that a ruling may be declined when an applicant is not genuinely considering becoming a party to the "arrangement" referred to: a conclusion that is supported by the use of the word "seriously" and particularly reinforced by the fact that identical words are used in section 91E (4)(b) in the context of private rulings. (Section 91E clearly anticipates that the applicant for a private ruling will or may be "entering into" the relevant arrangement).

These conclusions are consistent with the purpose of the binding rulings provisions, stated in section 91A, to provide taxpayers (rather than advisers or uninvolved promoters) with certainty about the way the Commissioner will apply the taxation laws so as to help them meet their taxation obligations.

Accordingly, Inland Revenue will only consider requests for private or product rulings when the applicant is a party, or is seriously contemplating becoming a party, to the actual or proposed "arrangement". Thus, a taxpayer company intending to market an "arrangement" to its customers (when it will enter into the same arrangement with a range of persons whose identity would not affect the operation of the taxation law upon the arrangement) may seek and obtain a product ruling regarding its position under such "arrangements".

Of course, a taxpayer's application for a binding ruling may be made directly, or through a professional adviser who is acting as agent for that applicant.

When an arrangement is "entered into"

Section 91E (5) - Commissioner to make private rulings on request: A taxpayer executed a conditional contract with a development company for the sale of one of her commercial properties. She then made an application for a binding ruling on whether the profit from the proposed sale would be assessable income under section CD 1 (2) of the Income Tax Act 1994 (section 67(4), Income Tax Act 1976).

The Commissioner declined to give a ruling under section 91E (5) of the Tax Administration Act 1994 on the grounds that this was an arrangement "entered into" before he received the application for the ruling.

Under section 91E (5), the Commissioner is precluded from making a private ruling before 1 April 1996 on an arrangement entered into before he received the ruling application. It is the Commissioner's view that a conditional contract is an "arrangement" and is "entered into" when executed.

The definition of an "arrangement" includes:

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

The wide definition means that there need not be a legally enforceable commitment before an arrangement is seen to have come into existence. This reasoning is reinforced by the definition referring to "all steps and transactions", which means that the existence of an "arrangement" does not require a completed transaction. A conditional contract is a "contract" nevertheless, and this approach is consistent with one of the initial purposes of the binding rulings system - namely, to provide tax certainty that would facilitate taxpayers' decisions to embark upon commercial transactions and undertakings. Therefore, the Commissioner is currently unable to rule on conditional contracts as they are considered to be arrangements "entered into" by the taxpayer. The same criteria apply to the withdrawal provisions contained in section 91EI. Under these provisions, if the Commissioner withdraws a private ruling, the ruling does not apply if the arrangement was "entered into" after the date of withdrawal. Therefore, an unconditional contract/arrangement entered into before the Commissioner withdraws a private ruling, will be binding on him.

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.

GST - supply of a going concern

Rating: • •

Case: Pine v Commissioner of Inland Revenue HC No. 32/94 (Auckland Registry)

Act: Goods and Services Tax Act 1985 - section 11(1)(c)

Keywords: *going concern, supply of a taxable activity, output tax*

Summary: The High Court held that the taxable activity supplied, commercial leasing, ceased at the point either when the agreement for sale and purchase became unconditional or on settlement. As a consequence, there was no supply of a taxable activity as a going concern.

Facts: A vendor entered into an agreement to sell a commercial property. A partnership between the purchaser and his father had leased that property for some years. The partnership lapsed during the term of the lease, and the purchaser had taken responsibility for the lease, holding it on trust for his father. The vendor was not aware of the termination of the partnership. The agreement provided that the purchase price was “inclusive of GST if any”, and subject to the existing tenancy. The purchaser requested, and the vendor had permitted, the alteration of the settlement statement to show a breakdown between the purchase price and GST.

The purchaser believed he was entitled to an input tax deduction, while the vendor believed and intended that the transaction was zero-rated.

The purchaser claimed and received an input tax deduction. Following an audit, the deduction was disallowed. The purchaser objected, and a case was stated to the Taxation Review Authority. The TRA held that the sale and purchase was not of a going concern, and the purchaser was entitled to the input tax deduction. The Commissioner then stated a case to the High Court, requesting the Court to decide whether the Commissioner had acted correctly in assessing the vendor for output tax on the sale of the property.

Decision: The issue was whether there was supply of a taxable activity as a going concern. The difficulty arose because the purchaser and the tenant were one and the same person. Consequently, the landlord/tenant relationship ceased as soon as the purchaser acquired the property. If the purchaser had been someone else, the supply would have been zero-rated.

The taxable activity supplied (as a going concern) ceased at the point either when the purchaser obtained an equitable interest in the fee simple (when the agreement for sale and purchase became unconditional), or when he obtained the estate in fee simple on settlement. At that point, there was no longer a going concern.

The Court said that, in general, the test for whether there has been a supply of a going concern will be applied at the date of takeover, but there may be occasions when an earlier test date is appropriate

The High Court agreed with the approach taken in *Allen Yacht Charters Limited* (1994) 16 NZTC 11,270 that the business or undertaking must be "going" in the sense of actively operating at the time of its transfer to the new owner.

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

Whether value of land at end of year to be taken into account for tax purposes

Rating: • • • •

Case: Garwen Holding Limited v CIR (1995) 17 NZTC 12,396

Act: Income Tax Act 1976 - sections 85, 104 (Income Tax Act 1994 - section OB 1)

Keywords: *land, trading stock, accounting practice*

Summary: A dealer in land was entitled to a deduction under section 104 for the cost price of each parcel of land in the year of purchase. However, in calculating its assessable income, it had to bring back into its accounts the value of any land that was unsold at the end of the income year.

Facts: The Commissioner and the taxpayer company agreed that the taxpayer company was a dealer in land for the purposes of section 67(4) and was entitled to a deduction under section 104 for the cost price of the land. The Commissioner contended that although the cost price of each parcel of land was deductible as expenditure in the year of purchase under section 104, the value of any land that was unsold at the end of an income year had to be brought back into the taxpayer's accounts for that year in calculating its assessable income. The Commissioner contended that although the legislation was silent on the precise formula for calculating profits or gains from the sale of land by a dealer in land, the Commissioner was entitled to use ordinary commercial methods of calculating profits or gains. The taxpayer maintained that in the case of trading stock falling outside section 85 it was entitled to a deduction and there was nothing elsewhere in the Act requiring an accounting for tax purposes on a basis analogous to that set out in section 85.

Decision: Justice Blanchard held that the scheme of the Act had to be viewed against the general accounting background. He noted that section 85 (which deals with the valuation of trading stock) excluded land only for the purposes of that section. His Honour stated that he could see no general intention to prevent recognition of a dealer's land as stock-in-trade. He pointed out that an existing practice may co-exist with a statutory provision consistent with that practice. To read section 85 as altering the long-standing practice regarding the accounting treatment of land as trading stock would be to create a glaring accounting anomaly. Justice Blanchard held that, where land of the taxpayer was purchased for the purpose of resale and was left unsold by the taxpayer at the end of the income year, the Commissioner was entitled to require that its value (equivalent to cost price) be brought back into its profit and loss account for that income year.

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

Booklets available from Inland Revenue

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

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

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

General information

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

Dealing with Inland Revenue (IR 256) - Apr 1993: *Introduction to Inland Revenue, written mainly for individual taxpayers. It sets out who to ask for in some common situations, and lists taxpayers' basic rights and obligations when dealing with Inland Revenue.*

Inland Revenue audits (IR 297) - May 1995: *For business people and investors. It explains what is involved if you are audited by Inland Revenue; who is likely to be audited; your rights during and after the audit, and what happens once an audit is completed.*

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

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

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

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

Problem Resolution Service (IR 287) - Nov 1993: *An introduction to Inland Revenue's Problem Resolution Service. You can use this service if you've already used Inland Revenue's usual services to sort out a problem, without success.*

Provisional tax (IR 289) - Jun 1995: *People whose end-of-year tax bill is over $2,500 must generally pay provisional tax for the following year. This booklet explains what provisional tax is, and how and when it must be paid.*

Putting your tax affairs right (IR 282) - May 1994: *Explains the advantages of telling Inland Revenue if your tax affairs are not in order, before we find out in some other way. This book also sets out what will happen if someone knowingly evades tax, and gets caught.*

Rental income (IR 264) - Apr 1995: *An explanation of taxable income and deductible expenses for people who own rental property. This booklet is for people who own one or two rental properties, rather than larger property investors.*

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

Self-employed or an employee? (IR 186) - Apr 1993: *Sets out Inland Revenue's tests for determining whether a person is a self-employed contractor or an employee. This determines what expenses the person can claim, and whether s/he must pay ACC premiums.*

Special tax codes (IR 23G) - Jan 1995: *Information about getting a special "flat rate" of tax deducted from your income, if the regular deduction rates don't suit your particular circumstances.*

Stamp duty and gift duty (IR 665) - Mar 1995: *Explains what duty is payable on transfers of real estate and some other transactions, and on gifts. Written for individual people rather than solicitors and legal firms.*

Student Loans (SL 5) - 1996: *Published jointly by Inland Revenue and the Ministry of Education. Explains how to get a Student Loan and how to repay it.*

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

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

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

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

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

Visitors Tax Guide - (IR 294) - Nov 1995: *An explanation of how New Zealand taxes apply to visitors to this country.*

Business and employers

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

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

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

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

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

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

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

IR 56 taxpayer handbook (IR 56B) - Apr 1995: *A booklet for part-time private domestic workers, embassy staff, nannies, overseas company reps and Deep Freeze base workers who make their own PAYE payments.*

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

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

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

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

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

Resident withholding tax and NRWT

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

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

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

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

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

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

Non-profit bodies

Charitable organisations (IR 255) - May 1993: *Explains what tax exemptions are available to approved charities and donee organisations, and the criteria which an organisation must meet to get an exemption.*

Clubs and societies (IR 254) - Jun 1993: *Explains the tax obligations which a club, society or other non-profit group must meet.*

Education centres (IR 253) - Jun 1994: *Explains the tax obligations of schools and other education centres. Covers everything from kindergartens and kohanga reo to universities and polytechnics.*

Gaming machine duty (IR 680A) - Feb 1992: *An explanation of the duty which must be paid by groups which operate gaming machines.*

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

Company and international issues

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

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

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

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

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

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

Child Support booklets

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

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

Child Support - an introduction (CS 3) - Mar 1992: *A brief introduction to Child Support.*

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

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

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

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

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

Due dates reminder

January 1996

5 Large employers: PAYE deductions and deduction schedules for period ended 31 December 1995 due.

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

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

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

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

(For all amounts due on 7 January 1996, we will accept payments received on Monday 8 January 1996 as on time.)

15 GST return and payment for period ended 30 November 1995 due.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 January 1996 due.

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

FBT return and payment for quarter ended 31 December 1995 due.

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

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

RWT on dividends deducted during December 1995 due.

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

(For all amounts due on 20 January 1996, we will accept payments received on Monday 22 January 1996 as on time.)

31 GST return and payment for period ended 31 December 1995 due.

February 1996

5 Large employers: PAYE deductions and deduction schedules for period ended 31 January 1996 due.

7 Provisional tax and/or Student Loan interim repayments: first 1997 instalment due for taxpayers with October balance dates.
Second 1996 instalment due for taxpayers with June balance dates.
Third 1996 instalment due for taxpayers with February balance dates.

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

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

20 Large employers: PAYE deductions and deduction schedules for period ended 15 February 1996 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 January 1996 due.

Gaming machine duty return and payment for month ended 31 January 1996 due.

RWT on interest deducted during January 1996 due for monthly payers.

RWT on dividends deducted during January 1996 due.

Non-resident withholding tax (or approved issuer levy) deducted during January 1996 due.

28 GST return and payment for period ended 31 January 1996 due.

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