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.

Investment Marketing Group Ltd's Geared Equities Investment

Product ruling - BR Prd 96/4

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

All legislative references are to the Income Tax Act 1994.

Taxation law

This ruling applies in respect of section OB 1, and the "qualified accruals rules" as defined in section OZ 1 (1) of the Income Tax Act 1994.

Arrangement to which this ruling applies

The arrangement is an investment product known as Geared Equities Investment ("GEI product"), which is issued in Australia by Macquarie Bank Limited ("Macquarie"), an Australian resident bank, and will be marketed by Investment Marketing Group Limited in New Zealand.

The arrangement will be as follows:

- Macquarie will offer to lend to persons who satisfy appropriate lending criteria ("investors"), 100% of the cost of acquiring shares, which are certain approved shares listed on the Australian Stock Exchange ("GEI loan").
- The "cost of acquiring shares" will include stamp duty, brokerage fees, and loan establishment fees.
- The investor will have the option of requiring Macquarie to purchase any shares acquired by the investor under the GEI loan at the original cost of acquiring those shares ("GEI option"). The GEI option may be exercised at any time during the loan term by the investor. The proceeds from this sale are then able to be used by the investor to settle in full the GEI loan principal or an appropriate part thereof owing to Macquarie.
- The investor may exercise the GEI option in respect of all shares held in one or more companies.
- The terms of the GEI loan will be:
  - Macquarie will hold a mortgage over the shares acquired as security for the principal amount.
  - A Macquarie nominee company will hold all shares scrip as custodian for investors, but at all times the investor will remain the beneficial owner of the shares acquired.
  - The loan will be denominated in Australian dollars.

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- Interest only will be payable during the term of the loan.
- The term will be fixed, with one to five-year terms, and the provision for investors to elect to rollover.

• The investor as beneficial owner of the shares will receive all dividend income paid by the listed companies.

• The investor will be free to select which shares to buy, how many shares, and when from a list of shares listed on the Australian Stock Exchange.

• The investor will not be required to pay a separate fee for the GEI option.

Assumptions

This ruling is based on the assumptions that:

1. The investor will be a New Zealand resident for income tax purposes.
2. The investor will not be associated with Macquarie under the definition of "associated person" in section OB 1 (a) of the Act.

The ruling

GEI loan will be a "financial arrangement"

The GEI loan will be a "financial arrangement" subject to the qualified accruals rules.

Investor will be an "issuer"

The investor will be an "issuer" under section OB 1 in respect of the GEI loan.

"Maturity" of GEI loan

Exercise of the GEI option resulting in full repayment of the balance of the GEI loan will involve "maturity" under section OB 1 requiring a base price adjustment under section EH 4 (1).

Base price adjustment on full repayment of GEI loan

Upon full repayment item 'a' of the investor's base price adjustment on the GEI loan will equal the sum of:

• all interest payments made under the GEI loan (converted from Australian dollars ("AUD") to New Zealand dollars ("NZD") at spot exchange rates prevailing at payment dates); and

• the loan balance on the GEI loan repaid by Macquarie crediting the proceeds of exercise of the GEI option (converted from AUD to NZD at the spot exchange rate on repayment).

Item 'b' will be the AUD amount of the GEI loan from Macquarie to the investor (converted from AUD to NZD at the spot exchange rate at the date of advance).

Item 'c' will be the amounts of expenditure or income returned for income tax purposes from the GEI loan in previous years (reflecting interest payments and foreign exchange movements).

Income or expense calculated under the base price adjustment will reflect:

• interest payments (to the extent they have not been returned); and

• foreign exchange gains and losses on the AUD denominated GEI loan principal.

Income or expense arising under the base price adjustment will not reflect any deemed forgiveness of debt or discharge of the GEI loan, being a financial arrangement, for an inadequate consideration where an investor exercises the GEI option.

Part repayment of the GEI loan

Part repayment of the GEI loan by exercise of the GEI option over some but not all of the shares will not involve "maturity" of the loan. It will not require a base price adjustment for the investor.

A base price adjustment will be required when an investor's GEI loan matures, is remitted, sold or otherwise transferred. A partial repayment (converted from AUD to NZD at the spot exchange rate at the date of repayment) should be included in item 'a' when a base price adjustment is performed. That base price adjustment will apply the methodology set out above.

Foreign exchange gains and losses

GEI investors will be required to account for any foreign exchange gain or loss arising on the AUD denominated GEI loan under the accruals rules according to their own personal circumstances.

The period for which this ruling applies

This ruling applies for GEI loans entered into in the period from 1 January 1996 to 31 March 2001.

Signed

Martin Smith
General Manager (Adjudication and Rulings)

Analysis of product ruling BR Prd 96/4

This analysis does not form part of the ruling.

All legislative references are to the Income Tax Act 1994.

Background

The arrangement is described under the heading "Arrangement to which this ruling applies" in the ruling.

The ruling concerns the consequences upon an investor's base price adjustment under the accruals rules for the GEI loan. Specifically, it concerns the result of that base price adjustment where an investor exercises the GEI option to enable repayment of part (or all) of the GEI loan. Where the investor exercises the option, the investor sells shares to Macquarie at the cost of acquiring the shares, which is equivalent to the principal lent on the GEI loan to purchase those shares (in both cases in Australian dollars ("AUD")).

Definitions in legislation

Under section OB 1, the expression "financial arrangement" includes "[a]ny debt or debt instrument". The GEI loan is a financial arrangement subject to the accruals rules.

Also under section OB 1, "excepted financial arrangement" means:

(g) In relation to a holder or an issuer, ... an option ... to sell or otherwise dispose of shares ...

On its own, the GEI option would accordingly be an excepted financial arrangement.

"Holder", for our purposes, under section OB 1:

(a) Means-

...

(iii) In relation to an option to sell or otherwise dispose of property, a person who is a grantee of the option:

...

(v) In relation to any other financial arrangement, a person who, if the amount or amounts payable under the financial arrangement were due and payable at that time, would be entitled to receive, or would receive a pecuniary benefit from, payment of the amount or amounts so payable or any part of them;-

"Issuer", for our purposes, is defined in section OB 1 as:

(a) In relation to a financial arrangement at any time, means a person who is a party to the financial arrangement and is not a holder in relation to the financial arrangement:

...

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If an investor is viewed purely as a borrower under the GEI loan, it is an "issuer" under section OB 1 for accruals rules purposes. If the GEI loan were due and payable the investor would not be entitled to receive any pecuniary benefit from amounts payable. On this basis, Macquarie would be the "holder".

(Note that if the GEI option was a separate financial arrangement from the GEI loan an investor would be a holder in respect of it. An investor would be a grantee of the option).

Maturity of GEI loan

Section OB 1 also provides:

'Maturity', in relation to a financial arrangement, means the date on which the last payment contingent upon the financial arrangement is made ...

Where the investor exercises the GEI option to repay all of the principal owing on the GEI loan, the investor will have made the last payment contingent on the GEI loan. Accordingly, there will be "maturity" of the GEI loan. Where the investor exercises the option to repay only part of the GEI loan, there will not be "maturity".

Maturity of a financial arrangement necessitates the investor performing a base price adjustment.

Base price adjustment on maturity

Section EH 4 (1) provides that a base price adjustment shall be calculated:

... where, in relation to any person, a financial arrangement matures ... in any income year, the amount of the base price adjustment in relation to that income year, that person, and that financial arrangement shall be an amount calculated in accordance with the following formula:

$$a - (b + c)$$

where-

a is-

(i) In the case of a holder, the sum of-

(A) The amount of all consideration that has been paid, and all further consideration that has or will become payable, to the person; and

(B) Any amounts that have been remitted by the person and that are not included in subsubparagraph (A):

(ii) In the case of an issuer, the amount of all consideration that has been paid, and all further consideration that has or will become payable, by the person-

in relation to the financial arrangement; and

b is the acquisition price of the financial arrangement in relation to the person; and

c is-

(i) In the case of a holder, all amounts that are income derived, less the aggregate of amounts of expenditure deemed to be incurred under section EH 1 or section EH 6 or deemed to be an allowable deduction under section EH 3 by the person in respect of the financial arrangement in all previous income years since the acquisition of the financial arrangement; and

(ii) In the case of an issuer, all amounts of expenditure incurred in respect of the financial arrangement in all previous income years since the issue of the financial arrangement, less the aggregate of-

(A) All amounts that are income deemed to be derived under section EH 1 or section EH 3 or section EH 6 by the person in respect of the financial arrangement in all previous income years since the issue of the financial arrangement; and

...

Two approaches to GEI product

In the Commissioner's view, the GEI product could be viewed in two ways, namely:

- purely as a loan (with an excepted financial arrangement option, that can be ignored for these purposes); or
- as a composite financial arrangement being a loan with an option attached.

Loan base price adjustment

If the GEI product is viewed as a pure loan, and an investor is accordingly an issuer, the following will be the components of a base price adjustment calculation upon maturity.

Item 'a' will equal the sum of:

- all interest payments made under the GEI loan (converted from AUD to New Zealand dollars ("NZD") at spot exchange rates prevailing at payment dates); and
- the loan balance on the GEI loan repaid by Macquarie crediting the proceeds of exercise of the GEI option (converted from AUD to NZD at the spot exchange rate on repayment).

Item 'b' will be the "acquisition price" of the GEI loan. This will effectively be the "core acquisition price" under paragraph (e)(ii) of the section OB 1 definition of that term, namely:

In relation to an issuer of the financial arrangement, the value of all consideration provided to the issuer in relation to the financial arrangement:

Accordingly, the acquisition price of the GEI loan is the AUD amount of the loan from Macquarie to the investor (converted from AUD to NZD at the spot exchange rate at the date of advance).

Item 'c' will be the amounts of expenditure or income returned from the GEI loan in previous years (reflecting interest payments and foreign exchange movements).

Income or expense calculated under the base price adjustment will reflect:

- interest payments (to the extent they have not been returned); and
- foreign exchange gains and losses on the AUD denominated loan principal.

Income or expense arising under the base price adjustment will not reflect any deemed forgiveness of debt or discharge of the GEI loan for an inadequate consideration where an investor exercises the GEI option.

***Example 1:** loan base price adjustment*

Assume that an investor is introduced by IMG to Macquarie and is lent AUD$100,000 by Macquarie. The AUD/NZD exchange rate is 1.1500 (and the NZD/AUD exchange rate is 0.8696). The investor applies this AUD$100,000 as follows:

GEI loan establishment costs	$	700
Stamp duty	$	147
Brokerage	$	1,224
Value of shares purchased	$	97,929
Total		AUD$100,000

Accordingly, the investor purchases AUD$97,929 worth of shares.

Subsequently, the investor pays AUD$10,000 of interest. The AUD/NZD exchange rate at the date of payment is 1.1000.

The value of the shares drops to AUD$80,000 and the investor exercises its option against Macquarie. The AUD/NZD exchange rate at the date of payment is 1.0500. Assume that the investor has not yet returned any income or expense for income tax purposes under the GEI loan.

The investor's base price adjustment would accordingly be:

$$a - (b + c)$$

where:

a = (100,000 x 1.0500) + (10,000 x 1.1000)

b = 100,000 x 1.1500

c = 0

giving:

116,000 - (115,000 + 0) = NZD$1,000 (expenditure)

Note that item 'a' is the amount of consideration paid by the investor. The first bracketed component is the NZD equivalent of AUD$100,000, the amount of the GEI loan repaid, not AUD$80,000, the market value of the shares put under the GEI option.

This NZD$1,000 expenditure can be viewed as the sum of:

- NZD$11,000 interest expense; and
- NZD$10,000 foreign exchange gain on the GEI loan principal.

The NZD$10,000 foreign exchange gain arises because AUD has depreciated. The investor has a reduced loan liability (in NZD) due to the depreciation. The investor's foreign exchange gain would have been accruals income, if there had been no interest payment.

Composite financial arrangement base price adjustment

Alternatively, the GEI product can be viewed as a composite financial arrangement involving both a loan and an option as one financial arrangement. The Commissioner considers that, in terms of the comments by Gault J in *CIR v Dewavrin Segard (NZ) Ltd* (1994) 16 NZTC 11,048, 11,052, there is interaction or interdependence between the elements of the GEI product.

The Commissioner has also considered the question of whether the listed Australian shares purchased with the GEI loan, and the dividends paid on them, could also be viewed as part of this composite financial arrangement. The Commissioner considers that the shares should not be so viewed, in this case.

"Holder"

As the GEI product arrangement is wider than "an option to sell or otherwise dispose of property", the investor's status as "holder" or "issuer" falls to be determined under paragraph (a)(v) of the "holder" definition in section OB 1.

In the Commissioner's view, in the situation envisaged in paragraph (a)(v), an investor would be entitled to receive a "pecuniary benefit" under the GEI product. The investor would accordingly be a holder of the composite financial arrangement.

Base price adjustment calculation

Exercise of the option to sell all of an investor's shares would trigger "maturity" of the composite financial arrangement and a base price adjustment.

In these circumstances, item 'a' of the investor's base price adjustment will be the sum of:

- the AUD amount of the loan from Macquarie to the investor (converted from AUD to NZD at the spot exchange rate at the date of advance); and
- the AUD amount applied by Macquarie to the investor's account, to repay the balance of the investor's GEI loan, upon exercise of the GEI option (converted from AUD to NZD at the spot exchange rate at the date of application).

Item 'b', the investor's acquisition price, will be the sum of:

- all interest payments made under the GEI loan (converted from AUD to NZD at spot exchange rates prevailing at payment dates); and
- the market value of the shares provided by the investor to Macquarie upon exercise of the GEI option (converted from AUD to NZD at the spot exchange rate at the date of exercise); and
- the loan balance on the GEI loan repaid by Macquarie crediting the proceeds of exercise of the GEI option (converted from AUD to NZD at the spot exchange rate on repayment).

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Item ‘c’ will the amounts of income or expenditure returned from the composite financial arrangement in previous years (reflecting foreign exchange movements and interest payments).

Total income or expense calculated under the base price adjustment will reflect:

- interest payments (to the extent they have not been returned); and
- foreign exchange gains and losses on the AUD denominated loan principal; and
- the gain on exercise of the GEI option; and
- foreign exchange gains and losses on the GEI option.

Again, income or expense arising under the base price adjustment will not reflect any deemed forgiveness of debt or discharge of the GEI loan for an inadequate consideration where an investor exercises the GEI option.

Section EH 2

Section EH 2 provides that:

The amount of the income deemed to be derived or the expenditure deemed to be incurred by a person in respect of a financial arrangement under the qualified accruals rules shall not include the amount of any income, gain or loss, or expenditure, that is solely attributable to an excepted financial arrangement that is part of the financial arrangement.

If the GEI product is a composite financial arrangement, then it is an arrangement with financial arrangement (loan) and excepted financial arrangement (option) elements. Applying section EH 2, any income, gain, loss or expenditure that is solely attributable to the option must be excluded from income or expense under the accruals rules, including under a base price adjustment. The interest payments and foreign exchange gains and losses on the AUD denominated loan principal are not attributable to the option and must be brought to account for accruals purposes. In the particular facts of this case, the Commissioner considers that the gain on exercise of the GEI option and foreign exchange gains and losses on the GEI option are solely attributable to the option excepted financial arrangement and should be excluded from accruals income or expense.

Example 2: *composite financial arrangement base price adjustment*

The facts are as in Example 1 above.

On the wider GEI product financial arrangement, the following consideration flows to and by the investor under our example:

Consideration paid to the investor:

- loan borrowed of AUD$100,000 @ 1.1500.
- application of put option to the investor’s account of AUD$100,000 @ 1.0500.

Consideration paid by the investor:

- interest payment of AUD$10,000 @ 1.1000.
- shares upon exercise of the put of AUD$80,000 @ 1.0500.
- loan repayment of AUD$100,000 @ 1.0500.

The investor’s base price adjustment would now be:

a - (b + c)

where:

a = (100,000 x 1.1500) + (100,000 x 1.0500)

b = (10,000 x 1.1000) + (80,000 x 1.0500) + (100,000 x 1.0500)

c = 0

giving:

220,000 - (200,000 + 0) = NZD$20,000 (income)

Breakdown of result

This NZD$20,000 gain can be broken out as:

1. interest expense:	(11,000)
2. effect of AUD depreciation on GEI loan principal (as in first base jprice adjustment):	10,000
3. gain on GEI option (ignoring foreign exchange movement):	23,000*
4. effect of AUD depreciation on gain on GEI option:	(2,000)†
	NZD$20,000

* = (AUD$100,000 - AUD$80,000) x 1.1500.
† = (AUD$20,000 x 1.0500) - (AUD$20,000 x 1.1500).

Alternatively, items 3 and 4 could be combined and expressed as the net option gain of NZD$21,000. Items 1 and 2 are the same as in the simpler base price adjustment.

Applying section EH 2, items 1 and 2 are expenditure or gains solely attributable to the loan element of the GEI product and properly subject to the accruals rules. In the Commissioner’s view, items 3 and 4 are however gains or losses solely attributable to the GEI option element of the wider GEI product. They must be excluded from accruals calculations, including the investor’s base price adjustment.

Accordingly the investor’s accruals expenditure under this base price adjustment would be NZD$1,000.

Commissioner’s view on base price adjustment methodology

The Commissioner considers that it is appropriate to not treat the GEI product as a composite financial arrangement.

Where it is necessary to produce the correct economic result, the Commissioner may choose to apply the accruals rules to a wider, composite financial arrangement. The rules do not require this in this case as the simpler loan approach produces the correct economic, and a fair, result.

Part repayment of the GEI loan

Part repayment of the GEI loan by exercise of the GEI option over some but not all of the shares will not involve "maturity" of the loan. It will not trigger a base price adjustment for the investor.

A base price adjustment will be required when an investor's GEI loan matures, is remitted, sold or otherwise transferred. A partial repayment (converted from AUD to NZD at the spot exchange rate at the date of repayment) should be included in item 'a' when a base price adjustment is performed. That base price adjustment will apply the methodology set out earlier under the heading "Loan base price adjustment".

Norwich Union Life Insurance (NZ) Ltd's Income Protection Policy (Indemnity Cover)

Product ruling - BR Prd 95/11

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

Taxation law

This ruling applies in respect of sections BB 4, BB 7, BB 8 (c) and CB 5 (1)(h) of the Income Tax Act 1994.

Arrangement to which this ruling applies

This ruling applies to an insurance product known as an Income Protection Policy (Indemnity Cover) issued by Norwich Union Life Insurance (NZ) Limited ("Norwich").

Assumptions

This ruling is based on the assumptions that:

- The Income Protection Policy (Indemnity Cover) is taken out by an individual and provides cover for that individual.
- The terms and conditions of the Income Protection Policy (Indemnity Cover) are contained in the Income Protection Policy Document (Indemnity Cover).

The Income Protection Policy Document (Indemnity Cover) contains defined terms. Where those defined terms are used in this ruling they have the same meanings.

The period for which this ruling applies

This ruling applies from 17 July 1995 to 17 July 1998.

The ruling

A. Indemnity Cover Policy

Based on the assumptions stated above, under an Income Protection Policy (Indemnity Cover) where the Life Insured has not contracted for any of the optional benefits:

- Any benefits received by the Life Insured under the Income Protection Policy (Indemnity Cover) by way of the Rehabilitation Benefit and Long Term Care Benefit will be exempt from income tax under section CB 5 (1)(h); and

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- All other benefits received by the Life Insured under the Income Protection Policy (Indemnity Cover) will be assessable for income tax in the hands of the Life Insured; and
- All premiums paid by the Life Insured for the Income Protection Policy (Indemnity Cover) will be deductible from the income of the Life Insured under section BB 7.

B. Indemnity Cover Policy Optional Benefits

Based on the assumptions stated above, under an Income Protection Policy (Indemnity Cover) where the Life Insured has contracted for the Nursing Care Benefit, Child Care Benefit or Guaranteed Insurability Option:

- Any benefits received by the Life Insured under the Income Protection Policy (Indemnity Cover) by way of the Rehabilitation Benefit, Long Term Care Benefit and Nursing Care Benefit will be exempt from income tax under section CB 5 (1)(h); and
- The portion of premium paid by the Life Insured under the Income Protection Policy (Indemnity Cover) for the Rehabilitation Benefit, Long Term Care Benefit and Nursing Care Benefit will not be deductible from the income of the Life Insured under section BB 8 (c); and
- Any benefit received by the Life Insured under the Income Protection Policy (Indemnity Cover) by way of the Child Care Benefit will not be assessable income under section BB 4; and
- The portion of premium paid by the Life Insured under the Income Protection Policy (Indemnity Cover) for the Child Care Benefit will not be deductible from the income of the Life Insured under section BB 7; and
- All other benefits received by the Life Insured under the Income Protection Policy (Indemnity Cover) will be assessable income in the hands of the Life Insured; and
- The portion of premiums paid by the Life Insured under the Income Protection Policy (Indemnity Cover) for all other benefits will be deductible from the income of the Life Insured under section BB 7; and
- The Guaranteed Insurability Option has no tax consequences.

Signed

Simon Sherry
Rulings

Analysis of product ruling BR Prd 95/11

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

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

Background

A ruling has been sought on the assessability of benefits and the deductibility of premiums under Norwich's Income Protection Policy (Indemnity Cover).

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
BB 4	65(2)
BB 7	104
BB 8 (c)	106(1)(k)
CB 5 (1)(h)	61(40)

Without in any way limiting the meaning of the term, section BB 4 deems a number of items to be assessable income unless expressly excluded by the Act.

Section BB 7 states that:

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

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

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

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

Section BB 8 provides that notwithstanding anything in section BB 7, no deduction (except as expressly provided in the Act) can be made in respect of:

(c) Any expenditure or loss to the extent to which it is incurred in gaining or producing income which is exempt from income tax:

Section CB 5 (1)(h) exempts from tax:

Income derived by any person, in respect of any period of incapacity for work, from any payment received by that person by way of a benefit under a personal sickness or accident policy of insurance, not being a payment calculated according to loss of earnings or profits:

Indemnity Cover Policy

Total Disability Benefit and Partial Disability Benefit

Income received under a loss of earnings ("LOE") policy is assessable, and the premiums are deductible under section BB 7.

A LOE policy is a policy which provides for benefits calculated with reference to income lost by the insured as a result of incapacitation.

Norwich's Income Protection Policy (Indemnity Cover) Total Disability Benefit and Partial Disability Benefit are calculated with reference to the Life Insured's Pre-Disability Earnings. Both benefits contain a maximum cap on the benefit that can be paid, the maximum cap being the amount of the Monthly Benefit specified in the Policy Summary. The Total Disability Benefit and Partial Disability Benefit are calculated with reference to earnings or profits lost by the Life Insured. Therefore, the Total Disability Benefit and the Partial Disability Benefit are LOE benefits and are assessable income. The existence of a cap does not change this.

Rehabilitation Benefit and Long Term Care Benefit

The Rehabilitation Benefit and the Long Term Care Benefit are payments of the Monthly Benefit which is an amount specified under the policy and payable during the period of incapacity. The amounts are not calculated with reference to loss of earnings or profit, and therefore are personal sickness or accident ("PSA") benefits which are exempt from income tax under section CB 5 (1)(h).

Mixed benefit policy

Norwich's Income Protection Policy (Indemnity Cover) is a mixed benefit policy because it contains both PSA and LOE benefits. The Commissioner accepts that under some mixed policies, only a negligible amount of each premium may relate to a flat sum (PSA) benefit while the rest of the premium relates to benefits calculated according to loss of earnings or profits. If the amount of the premium attributable to the flat sum benefits is 2 percent or less, the whole of each premium can be deducted.

The amount of premium attributable to flat sum benefits under the Income Protection Policy (Indemnity Cover) (where no optional benefits are contracted for) is 2 percent or less. Applying the Commissioner's policy, the amount of premium attributable to flat sum benefits is 2 percent or less, therefore the whole of the premium is deductible under section BB 7.

Even though the whole of the premium for the Income Protection Policy (Indemnity Cover) is deductible, the PSA benefits (the Rehabilitation Benefit and Long Term Care Benefit) are still exempt under section CB 5 (1)(h) upon receipt by the Life Insured. These flat sum benefits are exempt, although the premiums relating to these benefits are deductible.

Indemnity Cover Policy Optional Benefits

Nursing Care Benefit

The Nursing Care Benefit is a payment of an amount specified under the policy, and is payable during the period of incapacity. The amount is not calculated with reference to loss of earnings or profit, and therefore is a PSA benefit and is exempt from income tax under section CB 5 (1)(h).

As discussed above, Norwich's Income Protection Policy (Indemnity Cover) is a mixed benefit policy because it contains both PSA and LOE benefits. The Commissioner accepts that under some mixed policies, only a negligible amount of each premium may relate to a flat sum benefit while the rest of the premium relates to benefits calculated according to loss of earnings or profits. If the amount of the premium attributable to the flat sum benefits is 2 percent or less, the whole of each premium can be deducted.

The Rehabilitation Benefit and the Long Term Care Benefit are PSA benefits. Where the Life Insured has also contracted for the optional Nursing Care Benefit, the portion of premium relating to flat sum benefits exceeds 2 percent, and therefore the premiums must be apportioned on the basis of the benefits payable. The amount of premium relating to exempt benefits is non-deductible, and any benefits received are non-assessable to the Life Insured.

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Child Care Benefit

The Child Care Benefit is not assessable income in the hands of the Life Insured under section BB 4.

The Child Care Benefit is not income according to ordinary concepts and usages. Whether or not a particular receipt is income depends on its quality in the hands of the recipient (see *Reid v CIR* (1985) 7 NZTC 5,176 at 5,183). The Child Care Benefit does not have the character of income in the hands of the Life Insured.

The portion of premium paid for the Child Care Benefit is non-deductible from the income of the Life Insured under section BB 7.

Guaranteed Insurability Option

The Guaranteed Insurability Option is an option to increase the Monthly Benefit on specified option dates without further medical evidence.

This option has no income tax consequences.

Norwich Union Life Insurance (NZ) Ltd's Income Protection Policy (Agreed Value Cover)

Product ruling - BR Prd 95/12

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

Taxation law

This ruling applies in respect of sections BB 4, BB 7, BB 8 (c) and CB 5 (1)(h) of the Income Tax Act 1994.

Arrangement to which this ruling applies

This ruling applies to an insurance product known as an Income Protection Policy (Agreed Value Cover) issued by Norwich Union Life Insurance (NZ) Limited ("Norwich").

Assumptions

This ruling is based on the assumptions that:

- The Income Protection Policy (Agreed Value Cover) is taken out by an individual and provides cover for that individual.
- The Monthly Benefit is specified in the Policy Summary as a fixed dollar amount.
- The terms and conditions of the Income Protection Policy (Agreed Value Cover) are contained in the Income Protection Policy Document (Agreed Value Cover).

The Income Protection Policy Document (Agreed Value Cover) contains defined terms. Where those defined terms are used in this ruling they have the same meaning.

The period for which this ruling applies

This ruling applies from 17 July 1995 to 17 July 1998.

The ruling

A. Agreed Value Cover Policy

Based on the assumptions stated above, under an Income Protection Policy (Agreed Value Cover) where the Life Insured has not contracted for any of the optional benefits:

- All benefits received by the Life Insured under the Income Protection Policy (Agreed Value Cover) will be exempt from income tax under section CB 5 (1)(h); and
- All premiums paid by the Life Insured under the Income Protection Policy (Agreed Value Cover) will not be deductible from the income of the Life Insured under section BB 8 (c).

B. Agreed Value Cover Policy Optional Benefits

Based on the assumptions stated above, under an Income Protection Policy (Agreed Value Cover) where the Life Insured has contracted for the Nursing Care Benefit, Child Care Benefit or Guaranteed Insurability Option:

- Any benefit received by the Life Insured under the Income Protection Policy (Agreed Value Cover) by way of the Nursing Care Benefit will be exempt from income tax under section CB 5 (1)(h); and
- The portion of premium paid by the Life Insured under the Income Protection Policy (Agreed Value Cover) for the Nursing Care Benefit will not be deductible from the income of the Life Insured under section BB 8 (c); and
- Any benefit received by the Life Insured under the Income Protection Policy (Agreed Value Cover) by way of the Child Care Benefit will not be assessable income under section BB 4; and
- The portion of premium paid by the Life Insured under the Income Protection Policy (Agreed Value Cover) for the Child Care Benefit will not be deductible from the income of the Life Insured under section BB 7; and
- The Guaranteed Insurability Option has no tax consequences.

Signed

Simon Sherry
Rulings

Analysis of product ruling BR Prd 95/12

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

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

Background

A ruling has been sought on the assessability of benefits and the deductibility of premiums under Norwich's Income Protection Policy (Agreed Value Cover).

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
BB 4	65(2)
BB 7	104
BB 8 (c)	106(1)(k)
CB 5 (1)(h)	61(40)

Without in any way limiting the meaning of the term, section BB 4 deems a number of items to be assessable income unless expressly excluded by the Act.

Section BB 7 states that:

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

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

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

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

Section BB 8 provides that notwithstanding anything in section BB 7, no deduction (except as expressly provided in the Act) can be made in respect of:

(c) Any expenditure or loss to the extent to which it is incurred in gaining or producing income which is exempt from income tax:

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Section CB 5 (1)(h) exempts from tax:

Income derived by any person, in respect of any period of incapacity for work, from any payment received by that person by way of a benefit under a personal sickness or accident policy of insurance, not being a payment calculated according to loss of earnings or profits:

Agreed Value Cover Policy (where no optional benefits are contracted for)

Monthly Benefit

A benefit received under a personal sickness or accident ("PSA") policy is exempt from income tax under section CB 5 (1)(h), and premiums paid for a PSA policy are non-deductible under section BB 8 (c).

A PSA policy is a policy that provides for payment of a sum or sums specified in the insurance policy, and which is payable if the insured person is incapacitated as a result of an accident or sickness.

Norwich's Income Protection Policy (Agreed Value Cover) Monthly Benefit is specified in the Policy Summary as a fixed dollar amount. Therefore, the Income Protection Policy (Agreed Value Cover) is a PSA policy of insurance. The benefits payable under the policy (the Total Disability Benefit, Partial Disability Benefit, Long Term Care Benefit, and the Rehabilitation Benefit) are PSA benefits.

Agreed Value Cover Policy Optional Benefits

Nursing Care Benefit

The Nursing Care Benefit is a payment of an amount specified under the policy and payable during the period of incapacity. The amount is not calculated with reference to loss of earnings or profit. Therefore, it is a PSA benefit and is exempt from income tax under section CB 5 (1)(h). The portion of premium paid for the Nursing Care Benefit will not be deductible from the income of the Life Insured under section BB 8 (c).

Child Care Benefit

The Child Care Benefit is not assessable income in the hands of the Life Insured under section BB 4.

The Child Care Benefit is not income according to ordinary concepts and usages. Whether or not a particular receipt is income depends on its quality in the hands of the recipient (see *Reid v CIR* (1985) 7 NZTC 5,176 at 5,183). The Child Care Benefit does not have the character of income in the hands of the Life Insured.

The portion of premium paid for the Child Care Benefit will not be deductible from the income of the Life Insured under section BB 7.

Guaranteed Insurability Option

The Guaranteed Insurability Option is an option to increase the Monthly Benefit on specified option dates without further medical evidence.

This option has no income tax consequences.

Norwich Union Life Insurance (NZ) Ltd's Income Protection Policy (Business Expenses)

Product ruling - BR Prd 95/13

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

Taxation law

This ruling applies in respect of sections BB 4, BB 7, BB 8 (c) and CB 5 (1)(h) of the Income Tax Act 1994.

Arrangement to which this ruling applies

This ruling applies to an insurance product known as an Income Protection Policy (Business Expenses) issued by Norwich Union Life Insurance (NZ) Limited ("Norwich").

Assumptions

This ruling is based on the assumption that the terms and conditions of the Income Protection Policy (Business Expenses) are contained in the Income Protection Policy Document (Business Expenses).

The Income Protection Policy Document (Business Expenses) contains defined terms. Where those defined terms are used in this ruling they have the same meaning.

The period for which this ruling applies

This ruling applies from 17 July 1995 to 17 July 1998.

The ruling

A. Where the Income Protection Policy (Business Expenses) is owned by the Life Insured

Based on the assumption stated above, where the Life Insured under the Income Protection Policy (Business Expenses) is the same person as the Policyholder:

- All benefits received by the Policyholder under the Income Protection Policy (Business Expenses) are exempt from income tax under section CB 5 (1)(h); and
- All premiums paid by the Policyholder for the Income Protection Policy (Business Expenses) will not be deductible from the income of the Policyholder under section BB 8 (c).

B. Where the Income Protection Policy (Business Expenses) is owned by a corporate employer of the Life Insured

Based on the assumption stated above, where the Life Insured under the Income Protection Policy (Business Expenses) is not the same person as the Policyholder:

- All benefits received by the Policyholder under the Income Protection Policy (Business Expenses) are assessable income of the Policyholder under section BB 4; and
- All premiums paid by the Policyholder for the Income Protection Policy (Business Expenses) are deductible from the income of the Policyholder under section BB 7.

Signed

Simon Sherry
Rulings

Analysis of product ruling BR Prd 95/13

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

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

Background

A ruling has been sought on the assessability of benefits and the deductibility of premiums under Norwich's Income Protection Policy (Business Expenses).

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
BB 4	65(2)
BB 7	104
BB 8 (c)	106(1)(k)
CB 5 (1)(h)	61(40)

Without in any way limiting the meaning of the term, section BB 4 deems a number of items to be assessable income unless expressly excluded by the Act.

Section BB 7 states that:

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

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

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

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

Section BB 8 provides that notwithstanding anything in section BB 7, no deduction (except as expressly provided in the Act) can be made in respect of:

(c) Any expenditure or loss to the extent to which it is incurred in gaining or producing income which is exempt from income tax:

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Section CB 5 (1)(h) exempts from tax:

Income derived by any person, in respect of any period of incapacity for work, from any payment received by that person by way of a benefit under a personal sickness or accident policy of insurance, not being a payment calculated according to loss of earnings or profits:

When the Income Protection Policy (Business Expenses) is owned by the Life Insured

Total Disability Benefit

When the Life Insured under the Income Protection Policy (Business Expenses) is the same person as the Policyholder, the Total Disability Benefit is a personal sickness or accident ("PSA") benefit and is exempt from income tax under section CB 5 (1)(h). The premiums paid for the Total Disability Benefit will not be deductible from the income of the Life Insured under section BB 8 (c).

The Total Disability Benefit is paid when the Life Insured is unable to work in his or her usual occupation solely due to Sickness or Injury. Therefore, the Life Insured derives the benefit in respect of a period of incapacity for work. The payment is not calculated according to loss of earnings or profits.

Waiver of Premium Benefit

This benefit does not have income tax consequences.

When the Income Protection Policy (Business Expenses) is owned by a corporate employer of the Life Insured

Total Disability Benefit

When the Life Insured under the Income Protection Policy (Business Expenses) is not the same person as the Policyholder, the Total Disability Benefit is assessable income in the hands of the Policyholder under ordinary principles. The premiums paid for the Total Disability Benefit are deductible from the income of the Life Insured under section BB 7.

The Total Disability Benefit is not exempt from income tax under section CB 5 (1)(h) because it is not a benefit under a personal sickness or accident policy of insurance. A "personal sickness or accident policy of insurance" is a policy taken out by an individual that provides cover for that individual.

Waiver of Premium Benefit

This benefit does not have income tax consequences.

Debt forgiveness in consideration of natural love and affection

Public ruling - BR Pub 96/4

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

Taxation law

This ruling applies in respect of section EH 4 (6) of the Income Tax Act 1994. It also applies in respect of sections GD 11 and BB 9.

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

Arrangements to which this ruling applies

This ruling applies where an amount owing under a debt is forgiven by a natural person in consideration of natural love and affection.

The period for which this ruling applies

This ruling applies to amounts of debts forgiven in the 1996, 1997, and 1998 income years, and applies to taxpayers with standard, early, or late balance dates for these years.

The ruling

This ruling concerns section EH 4 (6) which allows relief for debtors (issuers) from assessability under the accruals rules. Section EH 4 (6) allows relief when an amount under a debt is forgiven by a natural person in consideration of natural love and affection. It does not apply when an amount is forgiven by a company.

Section EH 4 (6) can apply to:

- A debt forgiveness between near relatives, such as father and child, brother and sister, husband and wife, and de facto parents; and
- A debt forgiveness by testamentary disposition; and
- A debt forgiveness by a trust settlor or creditor to a family trust, being a fixed trust where the creditor has or would have had a relationship of natural love and affection with all of the trust beneficiaries, other than residual or default beneficiaries; and
- A debt forgiveness by a trust settlor or creditor to a family trust, being a discretionary trust where the creditor has or would have had a relationship of natural love and affection with all, or all the primary, trust objects or potential beneficiaries; and
- A partial debt forgiveness; and
- A conditional debt forgiveness (where the debt is not forgiven until the conditions are fulfilled),

provided that, in each case, the requirements of the section are satisfied.

The Commissioner considers that the section does not apply to:

- A debt forgiveness to a company (including a family company); or
- A debt forgiveness by a trustee to the trust beneficiaries; or
- A debt forgiveness that forms part of a tax avoidance arrangement in terms of a provision such as section GD 11 or section BB 9.

This ruling is signed by me on the 7th day of March 1996.

Martin Smith
General Manager (Adjudication & Rulings)

Analysis of public ruling BR Pub 96/4

This analysis of the ruling, including the examples, does not form part of the ruling.

The subject matter of this ruling was previously considered in PIB 170 (February 1988), page 1. This ruling replaces that earlier item.

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

Background

The relevant provisions of the accruals rules are sections EH 1 to EH 9.

Base price adjustment calculations for financial arrangements are contained in section EH 4. The base price adjustment is effectively a "wash up" calculation of all income or expenditure under a financial arrangement upon the maturity, transfer, or remission of that arrangement.

Generally, under section EH 4, any principal, interest, or other amount payable on a financial arrangement that is "remitted" is assessable income to the issuer. Where the debt is remitted, the issuer is the debtor.

This is illustrated by the examples below.

Example 1

Creditor lends Debtor $50,000 repayable in two years with $10,000 interest. In the second year of the loan, however, Debtor is in financial difficulties. Creditor agrees to accept $50,000 with no interest in full and final settlement of Debtor's obligations. The $10,000 interest is accordingly remitted in the second year. Debtor, however, claimed an income tax deduction for $5,000 of the interest in the first year (on an accruals basis).

Assume Creditor is not a cash basis holder.

Debtor's base price adjustment in the second year effectively results in the recapture of her income tax deduction of $5,000. She has assessable income of $5,000. Her assessable income is calculated as follows:

a + (b - c)
= $50,000 - ($50,000 + $5,000)
= - $5,000 (income).

(A negative result is income for an issuer).

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For Creditor, the holder of the financial arrangement, a bad debt deduction for the $5,000 forgiven would be available if the requirements of section EH 5 (1) were satisfied prior to the remission.

Example 2

Assume that Creditor made the loan under Example 1 and that Debtor had claimed an income tax deduction of $5,000 in the first year (on an accruals basis). Assume, however, that after the first year, Debtor's financial difficulties lead the parties to agree that only $40,000 of principal and $10,000 of interest would be repaid in the second year's full and final settlement. If the balance of the interest ($5,000) were deductible by Debtor in the second year, she would be assessable on $5,000 under the base price adjustment. This is because the deductible interest in that year would partly offset her assessable remission income of $10,000. Debtor's base price adjustment would be:

a - (b + c)
= $40,000 + $10,000 - ($50,000 + $5,000)
= - $5,000 (income).

Creditor could only claim a deduction for the remission under section EH 5 (2) if she satisfied the requirements of that subsection prior to the remission. Creditor would only be entitled to a bad debt deduction if she carried on a business of holding or dealing in such financial arrangements and was not associated with Debtor.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
BB 9	99
EH 4 (6)	64F(7B)
EH 4	64F
EH 5	64G
GD 11	64J

Section EH 4 (6) allows issuers relief from the assessability of remissions for certain intra-family and private debts. It replaces, without material amendment, the former section 64F(7B) of the Income Tax Act 1976. Section 64F(7B) applied to debt forgiveness from 1 October 1987.

Before 1 October 1987, section 64F(7A) applied to forgiveness by testamentary disposition, and section 64F(7) applied to other forgiveness. The terms and effect of those two subsections differ from sections 64F(7B) and EH 4 (6). Section EH 4 (6) applies to both testamentary and other debt forgiveness.

Section EH 4 (6)

It states:

Where an amount owing under a debt (including any amount accrued and unpaid at the time of the forgiveness) is forgiven by a natural person in consideration of natural love and affection, the amount forgiven shall, for the purposes of the qualified accruals rules, be deemed to have been paid when the amount is forgiven.

Application of legislation

Requirements of section EH 4 (6)

In summary, for section EH 4 (6) to apply:

- There must be an amount owing.
- It must be owing under a debt.
- It may include any amount accrued and unpaid.
- It must be forgiven.
- It must be forgiven by a natural person.
- It must be forgiven in consideration of natural love and affection.

The following discusses some of the requirements of the subsection.

"Debt"

Section EH 4 (6) only applies when there is "an amount owing under a debt". It is not available for forgiveness of all types of "financial arrangement" that may be subject to the accruals rules. "Financial arrangement" as defined in section OB 1 is a very broad term. For example, it includes sell-back and buy-back arrangements, debt defeasances, and assignments of income. None of these is, in itself, a debt.

"Debt" is not defined in the Act. Accordingly, the expression is given its ordinary or common meaning. In legal terms a "debt" is understood to be a liquidated money demand or something recoverable in court by action for debt. A debt is a certain sum due from one person to another, either by record (e.g., court judgment) or in writing.

"Forgiven"

An amount under a debt must be "forgiven" for section EH 4 (6) to apply. The expression "forgiven" does not necessarily mean the same thing as "remitted" (as defined for accruals rules purposes in section EH 4 (9)(c)). "Remitted" includes a wider range of events that are not necessarily forgiveness. These events could include when the issuer has been released from making payments by operation of statute (e.g., the Insolvency Act 1967) or lapse of time (e.g., become statute barred).

"Forgiven" is not defined in the Act. The expression must be given its ordinary or common meaning. That is the giving up of any claim to restitution or remedy for an obligation. That forgiveness must be a positive act by the creditor (holder) as opposed to a consequence of the operation of statute or the lapse of time.

Such forgiveness is normally evidenced by a deed or other document.

Partial forgiveness

The Commissioner considers that section EH 4 (6) can apply to a partial debt forgiveness. The subsection applies in broadly the same way as to a full debt forgiveness. It deems the amount forgiven to be paid for the purposes of the base price adjustment calculation. A difference, however, is that a partial debt remission does not trigger a base price adjustment, unless it accompanies maturity or transfer of the financial arrangement.

Conditional forgiveness

If a forgiveness is conditional, it does not occur until the conditions are fulfilled. Accordingly, the Commissioner considers that the amount conditionally forgiven is not deemed paid under section EH 4 (6) until the conditions are fulfilled.

"Natural person"

The person forgiving the debt (the creditor or holder) must be a "natural person". The expression "natural person" is a legal term. Its meaning is not altered by the Act. It is a human being as opposed to an artificial person (such as a company): *Pharmaceutical Society v London & Provincial Supply Assn*. (1880) 5 A.C. 857, 869-870.

This item sets out the Commissioner's interpretation of "natural person" for deceased persons and for trusts settled by natural persons.

"In consideration of natural love and affection"

This requirement of the subsection confines it to family and other private transactions. It does not apply to business or commercial arrangements.

The phrase "in consideration of natural love and affection" is another legal concept. It is not further defined in the Act.

Natural love and affection is generally considered to subsist between near relatives, such as parent and child, brother and sister, and husband and wife. The Commissioner considers that natural love and affection can equally subsist within families with married or de facto married parents.

Except as discussed below in relation to trusts, the Commissioner considers that section EH 4 (6) requires that the natural love and affection exist between the creditor and the debtor.

The Commissioner considers that in some cases it would be possible for natural love and affection to be present outside the strict married or de facto married family. For example it could be present between life-long friends (although not ordinary friends or colleagues).

Inland Revenue does not propose to publish detailed rules or guidelines on the degree of relationship necessary to establish natural love and affection. This question can only be considered on a case by case basis.

A forgiveness to a company or other non-natural person is not in consideration of natural love and affection.

Debt is deemed paid

If the requirements of section EH 4 (6) are satisfied, the amount of the debt forgiven is deemed paid. This includes any amount accrued and unpaid on the debt. This consequence is deemed for all purposes within the qualified accruals rules.

The main provisions when this deemed payment is relevant are sections EH 4 (base price adjustment) and EH 5 (bad debts). Broadly, the effect for the issuer or debtor is that no assessable remission arises on a base price adjustment. For the holder or creditor, no bad debt deduction is available under section EH 5 because the amount forgiven is deemed paid. Also, any interest or accruals income forgiven is assessable to the holder, for the same reason.

Example 3

Assume that the forgiveness is as in Example 1. Assume, however, that Creditor and Debtor are closely related (sisters) and that the requirements of section EH 4 (6) are satisfied.

Debtor has claimed a $5,000 interest deduction in the first year. In the second year, rather than $5,000 of assessable income as in Example 1, Debtor's base price adjustment would result in expenditure of $5,000. This is the balance of the interest remitted that is deemed paid. Her calculation would be:

$$
\begin{aligned}
& a - (b + c) \\
= \ & (\$50{,}000 + \$10{,}000) - (\$50{,}000 + \$5{,}000) \\
= \ & \$5{,}000 \text{ (expenditure).}
\end{aligned}
$$

(The amount deemed paid, $10,000, is added into item 'a').

Creditor is required over the two years to return the $10,000 of interest remitted as assessable income under the accruals rules. No bad debt deduction is available for the remission as it is deemed paid.

Example 4

Assume that the forgiveness is as in Example 2. Assume, however, that Creditor and Debtor are closely related (sisters) and that the requirements of section EH 4 (6) are satisfied.

Rather than $5,000 of assessable income as in Example 2, Debtor's base price adjustment would result in expenditure of $5,000. This is the balance of the interest paid. The $10,000 of debt remitted is not assessable to Debtor, as Debtor is deemed to have paid it. Debtor's calculation would be:

$$
\begin{aligned}
& a - (b + c) \\
= \ & (\$50{,}000 + \$10{,}000) - (\$50{,}000 + \$5{,}000) \\
= \ & \$5{,}000 \text{ (expenditure).}
\end{aligned}
$$

Creditor is assessed on the $10,000 interest received. She is not entitled to a bad debt deduction for the remission as it is deemed paid.

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Testamentary dispositions and trusts

Taxpayers and advisers have asked Inland Revenue to set out the Commissioner's interpretation of section EH 4 (6) for testamentary dispositions and trusts.

Testamentary dispositions

The question has arisen as to whether a deceased taxpayer can be a "natural person" for section EH 4 (6) purposes. For example, can section EH 4 (6) apply to a debt forgiveness by will when the other requirements of that provision are present?

The Commissioner considers that the deceased can be a "natural person" and that section EH 4 (6) can apply. This is because, under section 24 of the Wills Act 1837 (UK), in relation to the property of the deceased, a will speaks and takes effect from the time immediately prior to the deceased's death. (The Wills Act 1837 (UK) has been incorporated into New Zealand law).

Accordingly, the Commissioner considers that section EH 4 (6) will apply to a testamentary debt when its requirements would have been satisfied immediately prior to the deceased's death.

Family fixed trusts

The issue has also arisen of whether the forgiveness of debt to a trust may satisfy section EH 4 (6). The situation envisaged is when a trust settlor or creditor is a natural person. He or she has natural love and affection for the trust beneficiaries. The trust is a fixed trust (i.e., the trust deed sets out the share or interest that each beneficiary is to take) for beneficiaries. The trust owes the settlor or creditor a debt. The creditor forgives the debt to the trust.

The Commissioner considers that the subsection can apply, provided that all the requirements are satisfied. The Commissioner considers that it is necessary to "look through" the trust from the creditor to the beneficiaries in determining whether there is natural love and affection. The presence or absence of that state between the creditor and the trustee, in his or her private capacity, is irrelevant. Similarly, the presence or absence of that state between the trustee and the beneficiaries is irrelevant.

The state must exist, or have existed, between the natural person creditor and all of the trust's beneficiaries (subject to the comments below about certain residual or default beneficiaries).

Family discretionary trusts

The position is less clear for discretionary trusts when the class of beneficiaries includes persons for whom the settlor or other creditor has natural love or affection.

For the reasons outlined above, the Commissioner considers that the subsection can apply when either all, or all of the primary, trust objects or potential beneficiaries are persons for whom the creditor has or would have had natural love and affection.

Family trusts with certain residual or default beneficiaries

A related question is whether the subsection applies if a fixed trust has certain residual or default beneficiaries for which the settlor does not have natural love and affection. For example, it is common for family trusts to have charities and similar bodies as residual beneficiaries.

The Commissioner considers that this would not preclude the subsection from applying. The Commissioner considers that it will usually be sufficient if the creditor has, or would have had, natural love and affection for the primary beneficiaries of the trust.

Section EH 4 (6) will not apply when a charity or other person unrelated to the person forgiving is a primary beneficiary. Similarly, the subsection will not apply when family members are not the obvious focus of a discretionary trust deed. Inland Revenue does not propose to publish guidelines on the distinction between primary and minor beneficiaries. If necessary, this issue can be considered on a case by case basis.

Example 5

Son owes Father a debt of $10,000. Father dies, and his will provides for the debt to be forgiven. Section EH 4 (6) applies and Son is deemed to have paid the debt to Father for accruals purposes.

Example 6

Mother has established a trust, with her children as beneficiaries as to one-third each. The residual beneficiary, if the other beneficiaries pre-decease, is a charity for the promotion of musical education. Mother has sold her business assets to the trust for a debt back owed by the trust of $100,000. Mother forgives the $100,000 debt in consideration of natural love and affection of the beneficiaries. Section EH 4 (6) applies and the trustee is deemed to have paid the debt for accruals purposes. The existence of the residual beneficiary does not prevent the subsection applying.

Example 7

Prior to his death, the deceased established a family discretionary trust for his children. He lent the trust money to pay for an overseas trip by his children. His will provided for the loans to be forgiven. Section EH 4 (6) applies and the trustee is deemed to have paid the debt for accruals purposes.

Situations where section EH 4 (6) does not apply

The Commissioner considers that section EH 4 (6) is not applicable when:

- The party that owes the debt which is forgiven is a company. This includes a family company or close company. In the Commissioner's view, a person can never have natural love and affection for a company or other artificial person. The Commissioner has considered submissions that focus upon the similarities between family companies and family trust arrangements. However, there is a clear legal distinction between these chosen vehicles, in that a company has separate legal personality from its shareholders. Accordingly, any relationship between the creditor and the shareholders is irrelevant.

- A trustee forgives a debt owed by the trust beneficiaries. This is irrespective of a trustee's natural love and affection for the beneficiaries. The trustee's natural love and affection arises in his or her personal capacity. It would be improper for the trustee to forgive a debt in consideration of his or her natural love and affection for the beneficiaries. The trustee could only forgive in accordance with his or her duties as trustee (as set out in the trust deed). At least in the statutory context of section EH 4 (6), the Commissioner considers that a trustee acting in his or her capacity as trustee is not a natural person. The settlor's natural love and affection for the beneficiaries would also be irrelevant as the forgiveness would be by the trustee.
- The debt forgiveness forms part of a tax avoidance arrangement in terms of a provision such as section GD 11 or BB 9. For example, an individual taxpayer owes a bank an amount under a debt which she cannot pay in full. The individual pays what she can, and the bank, in turn, transfers the balance of the debt to the taxpayer's spouse for nominal consideration. The spouse forgives the balance supposedly within section EH 4 (6). In these circumstances the Commissioner might invoke an anti-avoidance provision such as section BB 9.

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.

Qualifying companies with trustee shareholders

Summary

A qualifying company ("QC") may have shareholders who are trustees if all QC income (not including non-cash dividends apart from taxable bonus issues) derived by the trustee is beneficiary income. There is a limited exception to the requirement that all QC dividend income derived by the trustee must be beneficiary income and this is discussed below. The trust beneficiaries must be either natural persons or another QC.

It is possible for a trustee shareholder to be a trustee of a trust which includes another trustee as beneficiary. However, the second trustee in the capacity of a trustee may not receive any dividend income from the QC, except for non-cash dividends other than taxable bonus issues.

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

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
OB 1 - beneficiary income	226
OB 3 (1) - qualifying company	393B
OB 3 (3A)	393B(3A)

The definition of a QC in section OB 3 (1) imposes certain requirements for a company to be a qualifying company. Section OB 3 (1)(c) sets out some of these requirements:

Each person who is at any time during the income year a shareholder in the company is-

(i) A natural person (other than a trustee); or

(ii) A trustee of a trust in respect of which all dividend income (not being income from non-cash dividends other than taxable bonus issues) derived by the trustee from any qualifying company during the income year is beneficiary income of beneficiaries (not being trustees or companies other than qualifying companies); or

(iii) Another qualifying company; ...

The requirement that all QC dividends derived by the trustee constitute beneficiary income is modified by section OB 3 (3A). Under that section, the QC will not lose its QC status if both of these conditions are met:

- As much of the QC dividend income derived by the trustee as is available to be distributed under general trust law is beneficiary income of natural persons or other QCs; and
- Since the company acquired QC status, at least some of the dividends derived by the trustee from the QC have vested or been distributed as beneficiary income of natural person or other QCs.

Section OB 1 contains the following definition of "beneficiary income":

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

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

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

but does not include income derived by a trustee of the trust in any income year during which the trust is a superannuation fund:

Policy

Section OB 3 (1)(c)(ii) limits the situations in which a trustee can be a shareholder in a QC. These limits prevent the trustee distributing income from a QC to persons who are neither natural persons nor another QC. This is consistent with the legislative intent of the QC rules that ultimate control of a QC should rest with natural persons. Since any other QC is controlled by a limited number of natural persons, it is acceptable to include QCs (but not companies which are not QCs) as beneficiaries of a trust.

Distributions to trustee beneficiaries

Section OB 3 (1)(c)(ii) permits a QC shareholder to be a trustee of a trust, even when that trust's beneficiaries include trustees of another trust. However, none of those beneficiary trustees (in their capacity as trustees of another trust) can receive any beneficiary income being dividends (except for non-cash dividends other than taxable bonus issues) derived from any QC by the shareholder trustee.

The shareholder trustee in the QC must ensure, within the powers granted to the trustee by the trust deed, that the cash dividends and taxable bonus issues derived from the QC are beneficiary income of either natural persons (not in their capacity as trustee) or another QC. In certain cases, where under general trust law not all of the QC dividends derived can be beneficiary income, the exception provided by section OB 3 (3A) which is discussed above may apply.

Trustees who are also beneficiaries

Trustee shareholders may be also be beneficiaries of the trust of which they are a trustee. They may receive beneficiary income from the trust. The Commissioner's policy is that this does not breach section OB 3 (1)(c)(ii), provided the person is receiving that beneficiary income in the capacity of a beneficiary and not as trustee of that or any other trust.

Example

P is a shareholder in QC Ltd, a QC, and holds the shares as trustee for the X Family Trust. The beneficiaries of the X Family Trust are P, M, and Company Ltd. Company Ltd is a beneficiary only in its capacity as the trustee of the Y Family Trust. In the relevant income year, P, as trustee of the X Family Trust derives dividends from QC Ltd.

QC Ltd will lose its QC status if:

P distributes any cash dividends or taxable bonus issues from QC Ltd to Company Ltd. (It is not relevant whether or not Company Ltd is a QC: it is its status as a trustee that is relevant).

QC Ltd may retain its QC status if:

P distributes all the dividends from QC Ltd as beneficiary income to M or himself; but not Company Ltd. The fact that P also happens to be a trustee as well as a beneficiary is acceptable, as he is receiving the beneficiary income in his capacity as a beneficiary.

Subject to the powers in the trust deed, P may also distribute non-cash dividends in accordance with the trust document from QC Ltd (none of which are taxable bonus issues) to Company Ltd.

ACC employer premium - accounting for experience rating adjustments

Summary

This item considers whether section ED 1 (2) of the Income Tax Act 1994 requires taxpayers to retrospectively adjust the deduction for the ACC employer premium payable on 31 May, if the experience rating adjustment occurs in an income year after they have claimed a deduction for the employer premium.

The term "employer premium" in this item (called "premium from employers" in section ED 1 (2)) refers to the basic premium payable on 31 May before the experience rating adjustment. Experience rating is a process in which the safety record of the employer is taken into account in determining whether the employer receives a refund or has to pay an extra amount (loading) to ACC.

If the experience rating adjustment occurs in an income year after the employer has claimed a deduction for the employer premium, the Commissioner's view is that section ED 1 (2) does not apply to retrospectively adjust the employer premium deduction by the amount of the experience rating adjustment. For tax purposes, the amount of the adjustment is assessable or deductible in that subsequent income year.

Refunds or loadings are GST inclusive, so employers who are GST registered persons need to account for the GST component of any experience rating adjustment in the taxable period in which the loading or refund occurs.

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

Background

Employers must pay the ACC employer premium by 31 May each year. The employer premium is based on the wages and salaries paid to the employer's employees under section 101 of the Accident Rehabilitation and Compensation Insurance Act 1992 ("the ARCI Act"). The employer premium calculation is subject to a two-step process:

- The employer premium is payable on 31 May each year.
- An "Experience Rating" assessment is carried out in November - July. Based on the employer's accident record, the experience rating assessment process results in either a discount (employers receive a refund from ACC); or a loading (employers have to pay extra to ACC).

Small employers who pay less than $10,000 in premiums in a year and who have not had a work injury claim during the year receive an automatic adjustment of the

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employer premium paid. Small employers are not subject to loadings.

Note that the experience rating adjustment currently applies only to the employer premium payable by employers. There is provision in the ARCI Act to experience rate earners who have earnings other than as employees, but ACC do not currently do this.

Legislation

Cross - reference table

Income Tax Act 1994	Income Tax Act 1976
BB 4 (a)	65(2)(a)
BB 7	104
ED 1	140A
ED 1 (2)	140A(4)
ED 1 (4)	140A(3)

Section ED 1 refers to provisions of the ARCI Act. The relevant provisions of the Income Tax Act 1994 and the ARCI Act are produced below.

Section ED 1 (2) standardises the income year in which the employer premium is deductible, by making it deductible only in the income year that it becomes due and payable:

> ... any amount of **premium from employers** ... **that becomes due from and payable by the taxpayer in that income year shall be deemed to be expenditure incurred by the taxpayer in that income year and in no other income year**, and the deduction (if any) allowable in respect of the premium under section BB 7 of this Act shall be computed accordingly. [emphasis added]

Section ED 1 (4) states:

> **"Premium from employers means"**, where a taxpayer is an employer, the premium payable by the employer under section 101 of the Accident Rehabilitation and Compensation Insurance Act 1992:

Section 101 of the ARCI Act states:

> (1) There shall be payable by every employer, in accordance with this Act and regulations made under this Act, a basic premium at such rate or rates as are prescribed on the amount of earnings paid or deemed to have been paid by that employer to its employees.

Section 104 of the ARCI Act states:

> (1) The basic premium payable under section 101 of this Act by an employer may be adjusted by reference to the accident experience of or attributed to that employer.
>
> (2) The adjustment referred to in subsection (1) of this section shall be by way of a premium loading being imposed on the employer or a premium discount being allowed to the employer.

Application of legislation

The legislation applies as follows:

- Section ED 1 (2) deems the "premium from employers" (which is defined under section ED 1 (4) as the premium payable under section 101 of the ARCI Act) to be deductible only in the income year that it is due and payable.
- Section 101 of the ARCI Act imposes an obligation on the employer to pay a "basic premium" at such a rate prescribed by the ARCI Act.
- Depending on the safety record of the employer, the basic premium payable under section 101 of the ARCI Act may be adjusted under section 104 of the ARCI Act.

This item considers whether section ED 1 (2) requires taxpayers to retrospectively adjust the deduction for the employer premium if the experience rating adjustment occurs in an income year after the employer has claimed a deduction for the employer premium.

Policy

The experience rating adjustment of the employer premium payable in May is carried out over the following November-July period, and may result in an additional loading or a refund. If the refund or loading from the experience rating adjustment is in the same income year as the employer premium payable on 31 May, the deduction is calculated by adjusting the employer premium by the amount of the experience rating adjustment. Taxpayers with a March balance date are generally in this category.

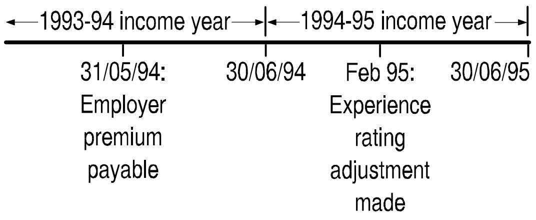
If the refund or loading occurs in an income year subsequent to the employer premium deduction, the Commissioner's view is that section ED 1 (2) does not apply to retrospectively adjust the employer premium deduction by the experience rating adjustment. Taxpayers will not need to file amended returns. For tax purposes, the refund or loading is treated as normal business income or expenses.

Analysis

Section ED 1 is not designed to retrospectively adjust the amount that is deductible in earlier income years. The predecessor to section ED 1, section 140A of the Income Tax Act 1976, was inserted in 1985 to standardise the different treatments of accident levy deductibility by making the levy deductible when it was due and payable. Taxpayers' practices had ranged from deducting levies on an accrual basis by making provision in the accounts before levies were due and payable, to claiming levies in the year they were paid; see PIB 136 Part 2 (May 1985).

Example

If a taxpayer has a 30 June balance date, the employer premium payable on 31 May 1994 is deductible in the income year ended 30 June 1994. However, if the experience rating adjustment is not made until February 1995, the loading or refund is deductible or assessable in the income year ended 30 June 1995.



Authority for deductibility of loadings

The loading is deductible as expenditure incurred under section BB 7 when there is a definitive commitment to pay the expenditure. There is only a definitive commitment to pay the loading in the income year that the experience rating assessment occurs.

Assessability of refunds

The refund is assessable as income under the general assessability provision, section BB 4 (a). The authority for this is *Cromwell Jockey Club v CIR* (1954) 6 AITR 188.

Cromwell Jockey Club, a decision of the New Zealand Supreme Court, concerning the exercise of a discretionary power by the Minister of Finance to refund duty paid on totalisator takings. In circumstances when the original payment and a refund were made in different financial years, it was held the refund was in its true nature an income payment and assessable in the year of receipt.

Other examples are *HR Sinclair & Son Pty v FCT* (1966) 114 CLR 537 concerning royalty payments claimed as a deduction one year and partially reimbursed in a later year; and *Automatic Totalisator Ltd v FCT* (1968) 119 CLR 666 concerning a refund of payroll taxes.

GST treatment of loadings or refunds

Refunds or loadings are GST inclusive, so employers who are GST registered persons must account for the GST component of any experience rating adjustment in the taxable period in which the loading or refund occurs. In the case of a loading, employers are entitled to claim an input tax deduction. In the case of a refund, employers must account for output tax.

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.

National standard costs for specified livestock - 1996

Under the authority of section EL 4 (1) of the Income Tax Act 1994 the Administrator of the Government (in the absence of the Governor-General) has declared the national standard costs for specified livestock for the year starting on 1 April 1995 (the 1995-96 income year).

Farmers using the scheme apply the national standard costs to stock bred on the farm or on hand at the beginning of the year, while stock purchased are valued at their purchase price. The average of these costs is applied to the stock on hand at year's end to derive the closing value of livestock on hand.

In announcing the values, Revenue Minister Peter Dunne said that the costs for dairy cattle and deer had increased this year, but those for sheep, beef cattle, goats, and pigs have changed little.

"The increases in the dairy and deer industries reflected the improved income in those sectors being channelled back into repairs and maintenance, fertiliser and feed. Also a reduction in the number of homebred calves reared to weaning, in the survey year to June 1994, increased the per head cost of producing dairy cattle offspring. This increased costing will generally be offset by the lesser number of rising one year heifers on hand at balance date."

"The increased national standard costs for both dairy cattle and deer will not necessarily result in additional income tax for farmers."

"The livestock valuation scheme had the built in flexibility to negate any undue tax consequences. Farmers who are presently using the national standard cost scheme to value rising one year animals had the option of moving these animals to either the herd scheme or the market value option. As with last year it is expected that both these options for dairy cattle will be lower than the national standard cost values", Mr Dunne said.

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

The national standard costs for the 1995-96 income year are:

Livestock	Category	National Standard Cost $
Sheep	Rising 1-year	16.10
	Rising 2-year	9.20
Dairy Cattle	Purchased bobby calves	123.00
	Rising 1-year	453.00
	Rising 2-year	70.80
Beef Cattle	Rising 1-year	132.00
	Rising 2-year	76.80
	Rising 3-year male non-breeding cattle (all breeds)	76.80
Deer	Rising 1-year	42.90
	Rising 2-year	21.90
Goats (Meat and fibre)	Rising 1-year	12.40
	Rising 2-year	7.60
Goats (Dairy)	Rising 1-year	80.90
	Rising 2-year	13.20
Pigs	Weaners to 10 weeks of age	71.50
	Growing pigs 10 to 17 weeks of age	56.00

Yachts - depreciation

Introduction

Previously there was one asset class for all types of yachts, setting a depreciation rate of 12% DV.

The Commissioner has issued Determination DEP12: Tax Depreciation Rates General Determination Number 12, which is reproduced below. The determination sets two new general depreciation asset classes for yachts. One of these asset classes "Yachts (international ocean going)" sets a new depreciation rate of 15% diminishing value ("DV"). The other asset class clarifies that the existing rate of 12% DV continues to apply, but to "Yachts (other than international ocean going)" rather than to all "Yachts".

The 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 is because this type of yacht typically has a useful charter life of 6 years and after this period is not typically 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.

General Depreciation Determination DEP12

This determination may be cited as "Determination DEP12: Tax Depreciation Rates General Determination Number 12".

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

3. Interpretation

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

This determination is signed by me on the 21st day of February 1996.

Virginia Flaus
Manager (Rulings)

Shipping containers, and insulated containers, bulkheads and pallet covers - depreciation

In TIB Volume Seven, No.5 (November 1995) we published proposed new depreciation rates for shipping containers, insulated containers, removable insulated bulkheads and insulated pallet covers. We invited TIB readers to make submissions on these proposals.

Here is the finalised determination:

General Depreciation Determination DEP13

This determination may be cited as "Determination DEP13: Tax Depreciation Rates General Determination Number 13".

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 (%)
Containers (shipping)	20	9.5	6.5
Containers (insulated, below 8m^3)	5	33	24
Bulkheads (insulated, removable)	4	40	30
Pallet Covers (insulated)	2	63.5	63.5

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

Transport	Estimated useful life (years)	DV banded depn rate (%)	SL equiv banded depn rate (%)
Containers	20	9.5	6.5

3. Interpretation

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

This determination is signed by me on the 4th day of March 1996.

Virginia Flaus
Manager (Rulings)

Amounts owing to chemists by the Department of Health for prescriptions

The amount chemists will be asked to bring into account for income tax purposes for prescriptions outstanding from the Health Benefits Centre for the year starting 1 April 1994, or equivalent balance date, is $20.79. We will publish the amount for the year starting on 1 April 1995 as soon as possible.

Shearers' tax-free allowances

The following allowances paid to shearers are exempt from income tax. These rates apply for the year that started on 1 June 1995:

- Shearers - $14.00 per 100 sheep.
- Shed hands - $1.25 per hour.
- Crutching - $7.00 per 100 sheep.
- Cooks - $10.00 per day.
  - $5.00 per half day.
- Cover combs - $8.33 per 100 sheep.

Tomato graders - proposed depreciation rates

The Commissioner proposes to issue a general depreciation determination for tomato graders. Under the current schedule the relevant rates for these assets appear in the "Agriculture, Horticulture and Aquaculture" and "Food Processing" industry categories with the following details:

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

It is proposed to insert the following new asset class into those categories:

	Estimated useful life (years)	DV banded depn rate (%)	SL equiv banded depn rate (%)
Graders (Tomatoes)	8	22	15.5

If you wish to make a submission on this proposed change you can write to:

Manager (Rulings)
Adjudication & Rulings
National Office
Inland Revenue Department
PO Box 2198
WELLINGTON

All submissions to be made by 1 May 1996

Fringe benefit tax - prescribed interest rate lowered to 10.4%

The prescribed interest rate used to calculate the fringe benefit value of low interest employment-related loans has been lowered to 10.4% for the quarter starting on 1 January 1996. This rate will continue to apply to subsequent quarters until any further adjustment is made.

The prescribed interest rate was previously 10.6% for the quarter that started on 1 October 1995. The reduction reflects the recent fall in market rates.

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

"Injurious affection" - assessability of a payment

Section BB 4 (section 65, Income Tax Act 1976) - Receipt of capital payment: Telecom has requested permission from a farmer to lay underground telecommunication cabling across her land. To allow this to happen, and to provide continuing access to the cable, Telecom has asked for an easement over the land. While no payment is made for the easement, the agreement between the parties provides for the payment of a set amount as compensation for any "injurious affection" caused by Telecom in carrying out any work relating to the easement. The farmer has asked whether the payment is assessable income.

A common type of easement is one granted to allow access over a front neighbour's property to a back section. In this case the easement is a right of way over another person's land. The easement allows Telecom to lay the cable through a portion of the farmer's land, as well as providing access for repairs and maintenance. However, the payment is to "compensate for any injurious affection caused by Telecom in carrying out work related to the easement".

The term "injurious affection" refers to any ancillary damage that is, or may be, caused to land or buildings as a result of the work that is being undertaken.

Such a payment is of a capital nature. In most cases capital receipts are not treated as assessable income and as such are not taxable. In this case, the payment is not taxable income.

Wages - deductibility when taxpayer runs a non-business venture

Section BB 7 (section 104, Income Tax Act 1976) - Expenditure or loss incurred in production of assessable income: A taxpayer is considered by Inland Revenue to be involved in a farming venture that is not a business. Recently, under the Task Force Green scheme, the taxpayer engaged a person to clear gorse on her property. She has asked whether the payment of wages makes her an employer, and whether she can claim a deduction against income for the wages paid.

Section OB 1 (section 2, Income Tax Act 1976) defines an "employer" as a person who pays or is liable to pay a source deduction payment. A source deduction payment includes salary and wages. This means that the payment made by the taxpayer is a source deduction payment, and on that basis alone would make her an employer. As an employer, the taxpayer will be required to deduct PAYE and ACC premiums from the employee's payments, and to account for the deductions to Inland Revenue.

Section BB 7 states:

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

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

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

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

This means that if the taxpayer were receiving assessable income in any income year from the farming venture, or were carrying on a business, the wages could be claimed as an expense. Inland Revenue has ruled that the farming venture is not a business. The taxpayer is not receiving assessable income from the farming venture, nor is she carrying on a business. The wages cannot be claimed as an expense against any other income.

The payment received from Task Force Green to pay the wages is income received by the farming venture, and would, if the farming venture were a business, be offset against wages paid. As Inland Revenue has determined that the farming venture is not a business for tax purposes, the payment is not part of the taxpayer's assessable income. She is not required to include the payment received as income.

Child Support payments - whether included as assessable income for income tax purposes

Section CB 9 (section 61(15), Income Tax Act 1976) - Other exempt income: A taxpayer has asked whether the Child Support payments that he receives should be included in his income tax return as assessable income.

Under section CB 9 (a), income from either of the following sources is exempt from tax:

- Payments in the nature of alimony or maintenance made to that person out of money belonging to the spouse or former spouse of that person.
- Payments of Child Support or spousal maintenance within the meaning of those expressions in the Child Support Act 1991.

Section 2 of the Child Support Act 1991 defines "Child Support" as any payment required to be made under that Act by any person towards the support of a qualifying child, whether under a formula assessment, voluntary agreement, or order of the Court.

Child Support payments are exempt from tax, but anyone who is applying for Family Support must still show any Child Support payments that are to be received, or have been received, on the Family Support application and declaration form. This is because Child Support payments are taken into account when calculating any Family Support entitlement.

In this case, the Child Support falls within the above definition. Accordingly we told the taxpayer that the Child Support payments he receives are exempt from income tax, and need not be included in his income tax return.

Low income rebate for retired person who is not a New Zealand superannuitant

Section KC 1 (section 50D, Income Tax Act 1976) - Low income rebate: A taxpayer decided to retire from employment in 1994. His only income source for the 1995-96 income year was from interest. As the taxpayer was only aged 55 at the time of retirement, he was not entitled to receive New Zealand superannuation.

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The taxpayer has been told that as a retired person he is eligible to claim the low income rebate. His total income earned for the year ended 31 March 1996 was $8,500.

Section KC 1 allows an income tax rebate to a natural person in either of these circumstances:

- If the taxpayer is a New Zealand superannuitant and has assessable income in the income year of less than $9,500. The rebate is an amount equal to 9 cents for each complete dollar of that assessable income.
- If the taxpayer is not a New Zealand superannuitant and has assessable income in the income year of less than $9,500. In this situation the taxpayer will only be allowed the rebate to the extent that such assessable income does not comprise interest, dividends, royalties, rents, or income derived from the beneficial interest in a trust.

A New Zealand superannuitant is a person who receives New Zealand superannuation in the income year in question. New Zealand superannuation itself is administered by the New Zealand Income Support Service.

In this case, the taxpayer may have retired from employment and earned under $9,500 for the year, but the rebate entitlement will be nil, as his only income source is from interest. Section KC 1 (1)(b) excludes interest income from the rebate calculation.

PAYE deduction certificates and computer payroll systems

Section NC 8 (6) (section 344(8), Income Tax Act 1976) - Continuation of tax code: A company has obtained the Commissioner's consent under section 48 of the Tax Administration Act 1994 (section 354, Income Tax Act 1976) to submit computer-generated employee tax details to Inland Revenue. The company's manager has asked whether the company's employees must still complete IR 12 PAYE deduction certificates each year.

In the past, employers had to obtain a completed IR 12 from each employee, each year. However, from 1 April 1995 employers who operate a computer payroll system no longer need to have an IR 12 completed by existing staff. Instead, the employer continues to use the tax code that applied to each employee in the past year. To this end, the employer must keep the latest IR 12 on file as proof that tax is being deducted at the correct rate.

The only employees who must complete an IR 12 are new employees and employees wanting to change tax codes. Employees who used a special tax code in the past year will have to apply each year if they wish to continue using a special tax code.

Tax free allowances - recording details on tax deduction certificates

Section NC 15 (section 353, Income Tax Act 1976) - Payment of tax deductions to Commissioner: An employer has asked if she must show details of tax free allowances paid to her employees on their IR 12 tax deduction certificates.

Section NC 15 (1)(d) (section 353(1)(b), Income Tax Act 1976) requires an employer to deliver tax deduction certificates to each employee. A copy of the certificate is also forwarded to Inland Revenue when the reconciliation is filed by the employer.

The tax deduction certificate must be in a format authorised by the Commissioner, and the employer must show all the following information:

- total amount of source deduction payments
- total amount of tax deductions
- the combined tax and earner premium deductions
- other information as may be prescribed.

Inland Revenue's IR 12 tax deduction certificate requires that the total tax free allowances paid to an employee must be separately shown on the IR 12.

In this case, as the employer has paid tax free allowances, she must show the total amount paid on the appropriate employees' IR 12 tax deduction certificates.

Adverse event income equalisation scheme deposit - forms to be completed

Section OB 1 (section 185A, Income Tax Act 1976): A taxpayer believes she is eligible to deposit an amount to the adverse event income equalisation scheme. She has asked what forms she needs to complete for Inland Revenue, and what details are to be given in the statutory declaration.

Section OB 1 defines a "self-assessed adverse event" as meaning any:

(a) Fire, flood, drought, or other natural event; or

(b) Sickness or disease among livestock -

that materially affects the business of the taxpayer and in respect of which the taxpayer has made and furnished to the Commissioner a statutory declaration describing the relevant event or occurrence and specifying how the taxpayer's business is affected by that event or occurrence.

Inland Revenue requires an adverse event income equalisation deposit form (IR 139), which includes the statutory declaration, to be completed.

Tax Administration Act 1994

Request to extend an income year

Section 33 (section 76, Income Tax Act 1976) - Annual income tax returns by taxpayers: A trust was formed on 20 February 1995, and started business on 20 March 1995. The trust's adviser has asked Inland Revenue if the trust may file a nil income tax return for the year ending 31 March 1995, and include the period 20 - 31 March 1995 in its return for the year ending 31 March 1996.

Section 33 requires every taxpayer to file a return in the prescribed form setting out details of assessable income derived during the preceding year.

"Taxpayer" is defined in section OB 1 (section 2, Income Tax Act 1976) as:

a person chargeable with income tax, whether on the person's own account or as the agent or trustee of any other person, and includes-

(a) The executor or administrator of a deceased taxpayer...

Section 42(1) (section 10(1), Income Tax Act 1976) states:

When income is derived by 2 or more persons jointly, whether as partners, trustees, or otherwise,-

(a) In the case of trustees, they shall make a return of that income, and shall be jointly assessable on that income.

The Commissioner has no discretion to allow a return to be filed for an extended year, except when he has given his consent for a change of balance date under section 38 (section 15, Income Tax Act 1976) and consequential adjustments to a normal 12-month return are required under section 39 (section 16, Income Tax Act 1976).

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We told the trust's adviser that the trust must file a return for the period 20-31 March 1995 by 7 July 1995 (as no extension of time arrangement has been made in this particular case) in accordance with section 37(1)(c) (section 17(2)(c), Income Tax Act 1976).

Student Loan repayment deductions - relief from late payment penalties imposed

Section 182 (section 413, Income Tax Act 1976) - Relief from penalty: An employer incurred a 10% penalty for making a late payment of Student Loan deductions to Inland Revenue. The employer has paid the penalty, but wonders under what circumstances relief from it might be available. He has also asked whether remission will be considered now that the penalty has been paid.

When a borrower notifies an employer that Student Loan deductions are to be made from wages, section 19 of the Student Loan Scheme Act 1992 requires the employer to make the deductions at the appropriate deduction rate. The deductions are forwarded to Inland Revenue, along with the PAYE deductions for the same period, and are then credited to the borrower's account.

If an employer fails to forward the full amount of repayment deductions to Inland Revenue, or makes a late payment of the deductions, a late payment penalty is imposed on the employer under section 140 (section 370, Income Tax Act 1976). A 10% penalty is added to the outstanding balance, with a further 10% penalty being added for every six months that the balance remains outstanding.

Section 182 allows the Commissioner to remit in full or in part any late payment penalty if he considers it equitable to do so. A taxpayer must apply in writing for such a remission.

In considering whether a penalty should be remitted, the circumstances of each individual case are taken into account. Any mitigating circumstances, such as whether the late payment was a genuine oversight, and the taxpayer's previous compliance record, are taken into account.

A penalty may still be remitted even if it has been paid. At the taxpayer's discretion, any resulting excess can be either credited to another period or refunded.

Goods and Services Tax Act 1985

Suspensory loans and GST

Section 5(6D) - Payment in the nature of a grant or subsidy: A GST registered person has received a grant from the Crown for $20,000 in the form of a suspensory loan in August 1995. The loan will be used to develop a market for a device she has invented. As part of the loan application, the taxpayer was required to submit a "sales budget" for the following twelve months. If the projected sales are achieved, the loan will be written off by the Crown at the end of the twelve months. The taxpayer has asked if she must account for GST on the loan.

Section 5(6D) states that:

...where any payment in the nature of a grant or subsidy is made on behalf of the Crown or by any public authority to-

(a) Any person (not being a public authority) in relation to or in respect of that person's taxable activity; or

(b) Any person for the benefit and on behalf of another person in relation to or in respect of that other person's taxable activity, -

that payment shall be deemed to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made in the course or furtherance of that person's taxable activity.

Section 5(6E)(a) defines the term "payment in the nature of a grant or subsidy" to include:

(i) Any suspensory loan or advance, when the loan or advance becomes non-repayable by reason of its conditions for non-repayment being satisfied...

Under section 5(6D), when a grant or subsidy is paid by the Crown or a public authority to a person in respect of that person's taxable activity, the payment is to be treated as consideration for a supply of goods and services in the course of a taxable activity. A suspensory loan which is non-repayable is deemed by section 5(6E) to be a payment in the nature of a grant or subsidy from the time the non-repayment conditions of the loan have been met.

If the recipient of the payment is registered or liable to be registered for GST, and the non-repayment conditions of the loan have been met, he or she must account to Inland Revenue for one-ninth of the payment as GST output tax when notification is received from the Crown that the loan is written off. If the payment is made to a person who is not GST registered (or liable to be registered), that person does not have to account for GST.

In this case, the recipient has received a suspensory loan which has a non-repayable contingency when certain conditions are being met. Accordingly, she has been advised that if the non-repayment conditions of the loan are met, the payment will become subject to GST at the time she receives notification from the Crown. If the non-repayment conditions are not met and the suspensory loan becomes payable, the payment will not be subject to GST.

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.

Land sale on winding up proposed business not a taxable activity

Rating: • • •

Case: TRA Nos 95/75 and 93/76

Act: Goods and Services Tax Act 1985 - sections 6, 51(1)(c)

Keywords: *subdivision, taxable activity, liability to register*

Summary: The objectors were not carrying on a taxable activity by selling four sections because the sales were made to wind up a project to build a rest home. The sales of the four sections were not part of any land development or property dealing activity.

Following on from this finding, the Taxation Review Authority held that section 51(1)(c) exonerated the objectors from any need to register or from any deemed registration.

Facts: The objectors are the trustees of two family trusts which together purchased a 16 lot residential subdivision in 1984. Twelve of the subdivided lots were sold by the objectors prior to the introduction of GST on 1 October 1986. The objectors intended to use the remaining four sections for building a rest home. However, the rest home was never built and in 1988 and 1989 the objectors sold the remaining four sections.

The Commissioner assessed the objectors for GST on the final four property sales. The Commissioner contended that the objectors were carrying on a taxable activity because the sales of the four sections were part of a continuous and regular activity.

A second issue was whether the provisions of section 51(1)(c) precluded the objectors from liability to be registered under the Act. The objectors contended that section 51(1)(c) applied because the remaining four sections were sold solely as a consequence of the objectors' cessation of any taxable activity.

Decision: Judge Barber held that at the time of each sale of the remaining four sections the objectors were not carrying on the taxable activity of selling sections to third parties.

Judge Barber held that the objectors' property sale activity ceased after the sale of the first 12 sections and that the objectors were holding the remaining four sections for the development of a rest home business. He said there was no nexus between the initial sales of 12 sections and the subsequent sale of the remaining four sections other than a common purchase origin. The four sections were not sold as part of any land development or property dealing business, but to wind up the rest home project.

On the second issue, Judge Barber held that section 51(1)(c) exonerated the objectors from any need to register or from any deemed registration. This was because the four sections were sold solely as a consequence of the trustees deciding to abort their rest home enterprise and not as part of any land development or property dealing activity.

Comment: Inland Revenue is not appealing this decision.

Management fees paid to parent company - deductibility

Rating: • • •

Case: Lockwood Buildings Limited v CIR HC Auckland M 455/95

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

Keywords: *deductibility, management fee, capital or revenue expenditure*

Summary: Management fees paid by a subsidiary company to its holding company were deductible expenses. The question of deductibility was not affected by the fact that the fees were paid to a holding company or that the fees were not calculated by the holding company in direct reference to services performed.

Facts: The case concerned the deductibility of a management fee paid by the objector, Lockwood Buildings Limited (Lockwood Buildings), to its holding company, La Grouw Corporation Limited (La Grouw Corporation).

La Grouw Corporation was a holding company for Lockwood Holdings and thirteen other companies. In 1990 Lockwood Holdings and the other subsidiary companies divested their financial and management functions to La Grouw Corporation.

Services provided by La Grouw Corporation for Lockwood Buildings included investigating the possible acquisition of timber mills and State forests. These investigations were carried out so that Lockwood Buildings would be assured of receiving a steady supply of timber for its day to day business. A timber mill was purchased by Lockwood Buildings in 1990.

Lockwood Buildings paid La Grouw Corporation $1.2 million for management fees in the 1990 income year and $701,821 in the 1991 income year. La Grouw Corporation calculated the amount of fees payable by each subsidiary on the basis of the profits made by each subsidiary rather than calculating the fee in relation to the actual services performed for that subsidiary. In the 1990 income year Lockwood Buildings was the only subsidiary which paid La Grouw Corporation for management fees while in the 1991 income year three other subsidiaries also paid a management fee to La Grouw Corporation.

The Commissioner contended that $119,280 of the management fees paid by Lockwood Buildings represented capital expenditure and was not deductible under section 106(1)(a). The Commissioner argued that this proportion of the management fee was expenditure relating to the acquisition of forestry assets incurred for the benefit of Lockwood Buildings.

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Lockwood Buildings argued that the expenses were wholly deductible as this case was no different from any purchase of services, the fee for which includes a number of components including the cost to the supplier of providing those services.

Decision: The High Court held that the payments of the management fees by Lockwood Buildings to La Grouw Corporation were wholly deductible under section 104(a). The management fees were not capital expenditure under section 106(1)(a).

Justice Williams reviewed previous cases concerning the deductibility of expenses. The main factors he considered were:

- the occasion which gave rise to the expenditure
- whether the expenditure was of a once and for all nature producing enduring assets or lasting advantages
- whether the expenditure was a recurrent part of the cost of the objector's ordinary business operations
- whether the expenditure was fixed or circulating capital or money expended on the structure of the business
- how the payment of the management fees would be treated according to the principles of commercial accounting.

Applying these tests, the Court found that the management fees were not capital expenditure. The occasion giving rise to the expenditure was the divesting of management and financial functions by Lockwood Buildings to La Grouw Corporation. The management fees paid to La Grouw Corporation were for services provided of negotiating contracts and ensuring it had access to a supply of timber. The payment of management fees was part of a decision by Lockwood Buildings to enhance its ability to trade profitably. No assets were acquired by Lockwood Buildings as a result of its payment of the management fees.

It was immaterial that those services were provided by the objector's parent company or that the fee was not calculated strictly in accordance with the services provided.

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

Penal tax charged - whether amount excessive

Rating: • • • •

Case: TRA No. 94/80

Act: Income Tax Act 1976 - sections 420 and 423 (Tax Administration Act - sections 186 and 190)

Keywords: *penal tax*

Summary: The Commissioner made an assessment for penal tax calculated as 110% of deficient tax. The issue was whether the tax charged was excessive. The TRA reduced the Commissioner's assessment from $32,080 to $20,000.

Facts: The taxpayer was prosecuted for the years 1985, 1986, 1987 and 1989 for wilfully making false returns of income. The Commissioner assessed him for penal tax amounting to $32,080 (110% of the deficient tax) for those years as well as for the years 1988 and 1990. The taxpayer was found to have suppressed income he received from hunting, interest and dividends. The Commissioner imposed penal tax for the two additional years (1988 and 1990) because, although there was no tax payable in those years due to losses suffered on the share market, there was evasion of tax which "is or may become chargeable" under section 420.

The Commissioner took into account the large amount of deficient tax, the depositing of income in a foreign bank account and bank accounts under false names in arriving at the quantum of penal tax. Regard was also had to past penal tax cases where 100% penal tax had been upheld where deficient tax had been much less than in this case.

The taxpayer advised he undertook hunting as a hobby and referred to the freak prices in the 1980s "as a temporary chance thing". The use of fictitious names in local and foreign banks accounts was to keep his finances secret from his estranged wife. He considered the penal tax charged to be excessive due to the fact that he did not consider at the time that the hunting proceeds and the investment income therefrom to be taxable income. His normal business was as a retailer which he said was in order.

Decision: The TRA placed more credibility on the taxpayer's explanations than did the Commissioner. Also, in referring to the 1988 and 1990 years when the taxpayer incurred share trading losses, the TRA said that tax cannot become chargeable if there is no taxable income. The Authority said this should have been taken into account when considering whether the penal tax charged was excessive under section 423(1).

The TRA found that the penal tax charged was excessive and should be reduced from $32,080 to $20,000.

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

Regular employee unloading containers under contract - employment status

Rating: • • •

Case: TRA No. 94/47

Act: Income Tax Act 1976 - section 104 (Income Tax Act 1994 - BB 7)

Keywords: *independent contractor, employee*

Summary: The taxpayer contracted to undertake a job for his employer which was completely separate from that of his normal employment. The TRA found that the taxpayer was engaged as an independent contractor and consequently ruled that certain expenditure incurred by the taxpayer should be allowed as a deduction.

Facts: The objector was employed as a carpet mender by a leading carpet manufacturer. He tendered in the name of a trading partnership for a contract unloading containers at one of his employer's bulk stores. The parties agreed upon a price of $260 "per container unloaded", the work on which was to be carried out outside the objector's regular work hours with the manufacturer. The objector used the manufacturer's fork lift trucks but provided his own trolleys, bulk cutters, locks, and lighting equipment. The manufacturer stipulated that the containers be unloaded within eight days of delivery to the bulk store although the partners could unload the containers using whatever method they chose. There was no provision for holiday or sickness pay in respect of the unloading.

Inland Revenue required the objector to be treated as an employee of the manufacturer in respect of the unloading work. Inland Revenue also disallowed expenditure claimed for protective clothing, safety shoes and mileage. The objector contended he was on a contract basis with the manufacturer.

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Decision: The TRA looked at the various tests set down by case law, i.e., the control, integration, fundamental, and intention tests. It considered that the work that the objector undertook was completely separate from his normal job with the manufacturer. It did not consider that the degree of control the manufacturer had over the objector was significant. The TRA said it was quite reasonable for the manufacturer to place an eight day deadline on the work.

The unloading work could not be considered to be integrated into the objector's other work with the manufacturer nor as overtime or extended employment work. The partners used most of their own equipment and could carry out the job on their terms. The same reasoning applies in relation to the fundamental test, i.e., (Is the objector in business on his own account?).

The TRA considered that the manufacturer could not have intended retaining the partnership for unloading work on an employer/employee basis. It also did not consider that the objector and his partners thought that their unloading activity had any direct connection with their work at the carpet factory. The TRA said that although the work undertaken by the partnership did not achieve a return on investment or require particularly sound management, this was peculiar to a lot of contract work.

On the basis of the application of the above tests, the Authority found that the partnership undertook the unloading services as an independent contractor. Therefore, the objector was entitled to a deduction for the protective clothing, the safety footwear, and half the amount claimed for mileage.

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

Real estate salesperson - employment status

Rating: •

Case: TRA No. 92/159

Act: Income Tax Act 1976 - section 105 (Income Tax Act 1994 - section DE 1)

Keywords: *employment status, deduction for expenses*

Summary: The Taxation Review Authority found that the real estate salesperson was an employee and not an independent contractor. The taxpayer was therefore unable to deduct expenses.

Facts: The taxpayer was a real estate salesperson in the 1991 tax year. He incurred expenses in earning his income as a real estate salesperson. The taxpayer asked the Court to rule that he was an independent contractor and therefore able to claim the expenses. The Commissioner disputed that the taxpayer was an independent contractor on the grounds of the decision of the Court of Appeal in *Challenge Realty v CIR* (1990) 12 NZTC 7, 214: (1990) 3 NZLR 42.

Decision: Judge Barber held that the objector, under the then statute law, was an employee. *Challenge* agreed that certain factors pointed to an independent contractor relationship. These included no holiday pay, sick leave, or superannuation, lack of supervision, no fixed hours of work, provision of own cars. However, it was established that all contracts negotiated by a salesperson were in fact and in law the contract of the licensed real estate agent. In all circumstances the Court of Appeal found the salespersons to be employees. As an employee, under section 105, the taxpayer in this case was unable to claim a deduction for expenses incurred in earning his assessable income.

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

House built to run camping ground business - GST input deduction

Rating: •

Case: TRA 95/44

Act: Goods and Services Tax Act 1985 - section 2

Keywords: *input tax, principal purpose, taxable activity*

Summary: The Taxation Review Authority found that the objector erected a house for the principal purpose of running a camping ground business. He was therefore entitled to claim a GST input tax deduction on the costs of the house.

Facts: The objector partnership ran a camping ground business. As part of the agreement with the Department of Conservation, any manager of the camping ground had to ensure that there was 24 hour daily supervision. DOC effectively said that this could not be achieved unless a manager lived on site in suitable accommodation. The Commissioner contended that the principal purpose for building the house was to provide private accommodation for the objectors and their family.

Decision: The TRA held that the full input tax deductions were available because the principal purpose of the house was to operate the camping ground, which is one of making taxable supplies. The TRA acknowledged that there was a duality of purpose of providing private accommodation and the taxable supply of camping ground services, but the principal purpose was that of providing taxable supplies. In reaching this conclusion, the TRA took into account the fact that the objectors owned other residences in the nearby town, and the fact that they chose to live on the camp site supported the view that the need to live on site was for management purposes rather than for private accommodation purposes.

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

The TIB is always printed in a multiple of four 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 - how to get one and how to pay one back (SL 5) - 1996: *We've published this booklet jointly with the Ministry of Education, to tell students everything they need to know about getting a loan and paying it back.*

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.*

Visitor's Tax Guide - (IR 294) - Nov 1995: *A summary of New Zealand's tax laws and an explanation of how they apply to various types of visitors to this country.*

Business and employers

ACC premium rates - Mar 1996: *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.*

Electronic payments to Inland Revenue (IR 87A) - May 1995: *Explains how employers and other people who make frequent payments to Inland Revenue can have these payments automatically deducted from their bank accounts.*

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.*

Taxes and the taxi industry (IR 272) Feb 1996: *An explanation of how income tax and GST apply to taxi owners, drivers, and owner-operators.*

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 companies that receive dividends from overseas companies. This booklet also deals with the attributed repatriation and underlying foreign tax credit rules.*

Foreign investment funds (IR 275B) - Oct 1994: *Information for taxpayers who have overseas investments, but who don't have a controlling interest in the overseas entity.*

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 custodian's guide (CS 71B) - Nov 1995: *Information for parents who take care of children for whom Child Support is payable.*

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 liable parent's guide (CS 71A) - Nov 1995: *Information for parents who live apart from their children.*

Child Support administrative reviews (CS 69A) - Jul 1994: *How to apply for a review of the amount of Child Support you receive or pay, if you think it should be changed.*

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 - how the formula works (CS 68) - 1996: *Explains the components of the formula and gives up-to-date rates.*

What to do if you have a problem when you're dealing with us (CS 287) - May 1995: *Explains how our Problem Resolution Service can help if our normal services haven't resolved your Child Support problems.*

Due dates reminder

April 1996

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

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

(We will accept payments received on Monday 8 April as in time for 7 April.)

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

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

Employers: yellow copies of IR 12 and IR 13 certificates for year ended 31 March 1996 to be given to employees.

FBT return and payment due for quarter ended 31 March 1996.

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

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

RWT on interest deducted 1 October 1995 to 31 March 1996 due for six-monthly payers.

RWT on dividends deducted during March 1996 due.

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

30 GST return and payment for period ended 31 March 1996 due.

May 1996

5 Large employers: PAYE deductions and deduction schedules for period ended 30 April 1996 due.

(We will accept payments received on Monday 6 May as in time for 5 May.)

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

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

Small employers: PAYE deductions and deduction schedules for period ended 30 April 1996 due.

Gaming machine duty return and payment for month ended 30 April 1996 due.

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

RWT on dividends deducted during April 1996 due.

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

31 GST return and payment for period ended 30 April 1996 due.

FBT annual liable return (1 April 1995-31 March 1996) and payment due for employers who elected to pay FBT on an annual basis.

PAYE/ACC: 1996 PAYE and earner premium reconciliation (IR 68P) and 1996 ACC employer premium calculation (IR 68A) due, and 1996 ACC employer premium to be paid.

RWT on interest: annual reconciliation statement (IR 15S) due.

RWT on dividends: specified dividend reconciliation (IR 17S or IR 17SA) due.

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

This page shows the draft public binding rulings and policy statements that we now have available for your review. To give us your comments on any of these draft rulings, please tick the appropriate boxes, fill in your name and address, and return this page to us at the address below. We will send you a copy of the draft.

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

Name ______________________________

Address ______________________________

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	Ruling	Comment Deadline
☐	**3190**: Whether section CD 1 (4)(a)(i) and Section CD 1 (7)(a) Income Tax exemptions apply to non-individuals	26/4/96

INLAND REVENUE
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Manager (Rulings)
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Inland Revenue Department
P O Box 2198
WELLINGTON

Attention Public Rulings Consultation

Contents continued - questions and legal case notes

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Legal decisions - case notes (pages 34-39)

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