Example 1

Purchase of a motor vehicle: payment in arrears and 10% deposit

Calculation of a lowest price by buyer for section EH 4 using various rates and methods

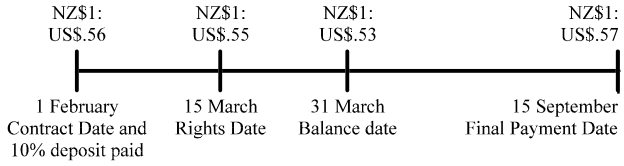
This is a simple example of a Foreign Currency ASAP with a deposit, payment in arrears, and no charge for the deferral of the payment. It shows the different results that will arise under the base price adjustment (section EH 4), using Rates C, D and E to calculate the core acquisition price. It also shows how Method E would apply to the calculation of income/expenditure from the arrangement.

1.1 On 1 February 1997 a NZ resident with a 31 March balance date agrees to purchase a motor vehicle from a US resident for US$14,000. The buyer pays a deposit of US$1,400 on 1 February 1997. The Rights Date will be 15 March 1997, when the vehicle is delivered to the buyer in Los Angeles. The final payment of US$12,600 does not have to be made until 15 September 1997. The price that the buyer would have had to pay for a cash sale is US$14,000. The car is acquired for business use.

1.2 The US$/NZ$ exchange rates for the various dates are:

1 February 1997	0.5600
15 March 1997	0.5500
31 March 1997	0.5300
15 September 1997	0.5700

1.3 This fact situation can be represented diagrammatically as follows:



Rate and Method C

1.4 If the buyer applies Rate C, the NZ$ Lowest Price will be the US$14,000 Lowest Price converted into NZ$ at the spot exchange rate on the Rights Date, ie.

$$\frac{\text{US\$14,000}}{.5500}$$

which is $25,454.

1.5 Leaving aside any income or expenditure that might be recognized by the buyer under the accrual rules in the 1997 year, the base price adjustment in the 1998 year would be:

$24,605 - $25,454 = ($849).

This would be income to the buyer.

Rate and Method D

1.6 If the buyer applies Rate D, the NZ$ Lowest Price will be the US$14,000 Lowest Price converted into NZ$ at the spot exchange rate on the Contract Date, ie.

$$\frac{\text{US\$14,000}}{.5600}$$

which is NZ$25,000.

1.7 Leaving aside any income or expenditure that might be recognized by the buyer under the accrual rules in the 1997 year, the base price adjustment in the 1998 year would be:

$24,605 - $25,000 = ($395).

This would be income to the buyer.

Rate and Method E

1.8 If the buyer applies Rate E to calculate the NZ$ Lowest Price, it must apply Method E to calculate its income/expenditure from the Foreign Currency ASAP in the 1997 year. Method E requires it to calculate the result of the formula:

a - b - c

where

'a' is the NZ$ value of the price. This is the total of:
- (a) US$1,400/.56 = $2,500;
- (b) US$12,600/.53 = $23,774. The buyer uses the spot rate on balance date to convert the final payment, because it is required to file its tax return for the 1997 tax year before the agreement is completed.

'a' is therefore $2,500 + $23,774 = $26,274;

'b' is the Lowest Price converted into NZ$ using the weighted average of the spot rates used to calculate 'a'. The weighted average is:

$$\frac{\text{US\$14,000}}{(\text{US\$1,400}/.56) + (\text{US\$12,600}/.53)}$$

which is .53285.

'b' is therefore US$14,000/.53285 = $26,274;

'c' is the unaccrued interest, treating the agreement as two US$ loans as follows:
- (a) a loan
  - (i) from the buyer to the seller;
  - (ii) advanced on 1 February 1997 (the Contract Date);

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(iii) of US$1,400;
(iv) repaid on 15 March 1997 (the Rights Date);
(v) with a payment of $1,400.

(b) a loan
(i) from the seller to the buyer;
(ii) advanced on 15 March 1997 (the Rights Date);
(iii) of US$12,600;
(iv) repaid on 15 September 1997 (the date of the second payment);
(v) with a repayment amount of US$12,600.

The buyer must calculate its income from this arrangement in US$, and then convert it into NZ$ using the same rate used to calculate 'a'. Because the US$ amount paid by the purchaser is the same as the US$ Lowest Price, the buyer has no unaccrued income or expenditure from the notional loans in the income year ended 31 March 1997.

1.9 The result of Method E is therefore $26,274 - $26,274 - 0 = 0. The buyer has no income or expenditure under section EH 1 in the 1997 year.

1.10 In the income year ended 31 March 1998, the buyer applies the base price adjustment in section EH 4. This will be calculated as follows:

a = all amounts of consideration paid by the issuer. This is the US$ price of the vehicle, converted into NZ$ at the Spot Rate when paid. This will be:

(i) in relation to the deposit, US$1,400/.56 = $2,500

(ii) in relation to the final payment, US$12,600/.57 = $22,105

giving a total of $24,605;

b = the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using the weighted average Spot Rate on the Payment Dates. The weighted average spot rate is:

$$\frac{\text{US\$14,000}}{\text{(US\$1,400/.56) + (US\$12,600/.57)}}$$

which is .5690. The acquisition price is therefore $24,605;

c = expenditure already recognized, of 0.

The base price adjustment is therefore $24,605 - $24,605 = 0.

Example 2

Payment in arrears; charge for deferral

Calculation of income by buyer under sections EH 1 and EH 4 using various methods and rates

This example involves deferred payment with a charge being made for the deferral. It shows how Rates and Methods A to D would apply to calculate the buyer's income/expenditure under sections EH 1 and EH 4.

2.1 On 1 February 1997 a US resident agrees to sell a quantity of plate glass to a NZ resident glass wholesaler for US$140,000. The parties agree that the price will be paid six months after the date the glass is landed in Auckland, which is expected to occur on 1 March. The glass will be at the seller's risk until it is landed in Auckland. The date it is landed will be the Rights Date. If payment were made at that time, the price would be US$130,000.

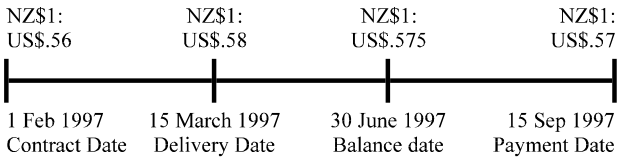
2.2 The glass is unloaded in Auckland on 15 March 1997. Therefore the term of the arrangement is 1 February 1997 to 15 September 1997 - 226 days. The purchaser's balance date is 30 June.

The US$/NZ$ spot and forward exchange rates for the various dates are

Date	Spot exchange rate	Forward rate to 1 Mar	Forward rate to 1 Sep	Forward rate to 15 Sep
1 Feb 1997	0.56	0.55	0.585	
15 Mar 1997	0.58	n/a	0.585	
30 Jun 1997	0.575	n/a	0.58	0.577
15 Sep 1997	0.57	n/a	n/a	

The purchaser is the "issuer" for the purposes of the qualified accruals rules.

2.3 This transaction can be represented diagrammatically as follows:



General

2.4 Whichever method the purchaser decides to use, it will have to treat itself as party to a notional foreign currency loan:

(a) from the seller to the buyer;
(b) advanced on 15 March (the Rights Date);
(c) of an amount equal to the Lowest Price of US$130,000;
(d) repaid on 15 September (the payment date);
(e) with a repayment amount of US$140,000.

Rate and Method A

2.5 If the purchaser applies section OB 7(1)(a) and calculates the Lowest Price of the glass using the forward rate on the Contract Date for delivery on

the expected Rights Date, it must apply Method A to calculate income/expenditure in the year ended 30 June 1997.

2.6 In calculating its income/expenditure in the year ended 30 June 1997 the purchaser first calculates its income from the notional foreign currency loan set out in paragraph 2.4. The purchaser uses Determination G9A.

2.7 Under Determination G9A, income or expenditure will be:

a + b - c - d

where

'a' is the value in NZ$ of the closing tax book value, using the spot rate at balance date; and

'b' is the sum of the value in NZ$ of all consideration given during the income year to or for the benefit of the purchaser in relation to the financial arrangement, using the spot rate when that consideration is given; and

'c' is the value in NZ$ of the opening tax book value, using the spot rate at the start of the year; and

'd' is the sum of the value in NZ$ of all consideration given during the income year by or on behalf of the person in relation to the financial arrangement, using the spot rate when that consideration is given.

2.8 The closing tax book value is calculated as follows:

e + f + g - h - i

where

'e' is -

(i) the opening tax book value at the beginning of the period, if the person was a party to the arrangement at that time; and

(ii) in every other case, nil; and

'f' is the sum of the US$ value of all consideration given during the income year by or on behalf of the purchaser in relation to the financial arrangement; and

'g' is the purchaser's US$ income in respect of the financial arrangement during the year; and

'h' is the sum of the US$ value of all consideration given during the income year to or for the benefit of the purchaser in relation to the financial arrangement; and

'i' is the US$ expenditure of the purchaser in relation to the financial arrangement.

2.9 In this case:

(a) 'e', 'f' and 'g' are zero;

(b) 'h' is the amount advanced under the notional loan, ie. US$130,000;

(c) to calculate 'i', the purchaser allocates the US$10,000 of expenditure over the period on a straight line basis. For the year ended 30 June 1997, this gives expenditure of:

(107/184) x US$10,000 = US$5,815.

The closing book value of the financial arrangement is therefore (US$135,815).

2.10 To calculate 'a' in the formula, the purchaser converts this closing tax book value into NZ$ using the spot rate on the balance date. This gives a figure of (US$135,815)/.5750 = ($236,200).

2.11 'b' in the formula is the amount advanced under the notional loan, converted into NZ$ at the spot rate on the Rights Date. This is US$130,000/.58 = $224,138.

2.12 'c' and 'd' in the formula are zero. The result of the formula in Determination G9A in the year ended 30 June 1997 is therefore ($236,200) + $224,138 = ($12,062). Because this is a negative amount, it is expenditure to the purchaser.

2.13 The second step requires the purchaser to calculate the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price converted using the spot rate on the Rights Date. This is US$130,000/.58 = $224,138;

'b' is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Rights Date, ie. 1 March. This is US$130,000/.55 = $236,364.

The result is therefore ($12,226). Since this is a negative amount and the taxpayer is the purchaser, it will be income to the purchaser.

2.14 The purchaser's income/expenditure for the 1997 year is therefore ($12,062) + $12,226 which gives income of $164.

2.15 In the 1998 income year, the purchaser applies the base price adjustment in section EH 4. This will be equal to:

a - (b + c)

where

'a' is all amounts of consideration paid by the purchaser. This is the US$ price of the glass, converted into NZ$ at the Spot Rate when paid. This is US$140,000/.57 = $245,614;

'b' is the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using Rate A, the Forward Rate on the Contract Date for delivery on the expected Rights Date, ie. US$130,000/.55 = $236,364;

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'c' is income already recognized, of $164.

The base price adjustment is therefore $9,086. Since this is a positive amount and the purchaser is the issuer of the Foreign Currency ASAP, this will be expenditure to the purchaser in the 1998 year.

2.16 Under section EH 8(2) of the Act, the acquisition price of $236,364 for the glass will also be its cost price for depreciation purposes.

Rate and Method B

2.17 If the purchaser applies section OB 7 (1)(b) and calculates the NZ$ Lowest Price of the glass using the forward rate on the Contract Date for delivery on the expected Settlement Date it must apply Method B to calculate income/expenditure in the year ended 30 June 1997.

2.18 In calculating its income/expenditure in the year ended 30 June 1997 the purchaser first calculates its income from the notional foreign currency loan set out in paragraph 2.4. However, in calculating this income or expenditure, it does not use determination G9A. Instead, it must treat the foreign currency loan as if it were in NZ$, and convert the resulting foreign currency income or expenditure into NZ$ using the spot rate on payment date (or year end, if payment date is after year end).

2.19 To calculate the foreign currency income/expenditure, the purchaser allocates the US$10,000 expenditure (ie. the difference between the Lowest Price and the price) over the period from 15 March to 15 September on a straight line basis. For the year ended 30 June 1997, this gives expenditure of:

(107/184) x US$10,000 = US$5,815.

2.20 The purchaser converts this amount into NZ$ using the spot rate at year end, which gives NZ$ expenditure of US$5,815/.575 = $10,113.

2.21 The second step requires the purchaser to calculate the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price converted using the forward rate on 30 June to 15 September (the expected Settlement Date on 30 June). This is US$130,000/.577 = $225,303;

'b' is the NZ$ value of the Lowest Price converted using the forward rate on 1 February (the Contract Date) to 1 September (the expected Settlement Date on 1 February). This is US$130,000/.585 = $222,222.

The result is $3,081. Since this is a positive amount and the taxpayer is the purchaser, it will be expenditure to the purchaser.

2.22 The purchaser's income/expenditure for the 1997 year is therefore ($10,113) + ($3,081) which gives expenditure of $13,194.

2.23 In the 1998 income year, the purchaser applies the base price adjustment in section EH 4. This will be calculated as follows:

'a' is all amounts of consideration paid by the purchaser. This is the US$ price of the glass, converted into NZ$ at the Spot Rate when paid. This is US$140,000/.57 = $245,614;

'b' is the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using Rate B, the Forward Rate on the Contract Date for delivery on the expected Settlement Date ie. US$130,000/.585 = $222,222;

'c' is expenditure already recognized, of $13,194.

The base price adjustment is therefore $10,198. Since this is a positive amount and the purchaser is the issuer of the Foreign Currency ASAP, this will be expenditure to the purchaser in the 1998 year.

2.24 Under section EH 8(2) of the Act, the acquisition price for the glass of $222,222 will also be its cost price for depreciation purposes.

Rate and Method C

2.25 If the purchaser applies Rate C, it will calculate the NZ$ value of the Lowest Price of the glass using the spot rate on the Rights Date, and must apply Method C to calculate its income/expenditure under section EH 1 from the contract in the year ended 30 June 1997.

2.26 In calculating its income/expenditure in the year ended 30 June 1997 the purchaser first calculates its income from the notional US$ loan set out in paragraph 2.4. The purchaser uses determination G9A to determine its income or expenditure from the loan. The calculations are set out in paragraphs 2.7 to 2.12, which will give it expenditure of $12,062 from the notional loan.

2.27 In the 1998 income year, the purchaser applies the base price adjustment in section EH 4. This will be calculated as follows:

'a' is all amounts of consideration paid by the purchaser. This is the US$ price of the glass, converted into NZ$ at the Spot Rate when paid. This is US$140,000/.57 = $245,614;

'b' is the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using Rate C, the spot rate on the Rights Date, ie. US$130,000/.58 = $224,138;

'c' is expenditure already recognized, of $12,062.

The base price adjustment is therefore $9,414. Since this is a positive amount and the purchaser is the issuer of the Foreign Currency ASAP, this will be expenditure to the purchaser in the 1998 year.

2.28 Under section EH 8(2) of the Act, the acquisition price of $224,138 for the glass will also be its cost price for tax purposes.

Rate and Method D

2.29 If the purchaser applies Rate D it will calculate the NZ$ value of the Lowest Price of the glass using the spot rate on the Contract Date, and must apply Method D to calculate income/expenditure under section EH 1 from the contract in the year ended 30 June 1997.

2.30 In calculating its income/expenditure in the year ended 30 June 1997 the purchaser first calculates its income from the notional US$ loan set out in paragraph 2.4. The purchaser uses determination G9A to determine its income or expenditure from the loan. The calculations are set out in paragraphs 2.7 to 2.12, which will give it expenditure of $12,062 from the notional loan.

2.31 The second step requires the purchaser to calculate the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price converted using the spot rate on the Rights Date. This is US$130,000/.58 which is $224,138;

'b' is the NZ$ value of the Lowest Price converted using the spot rate on the Contract Date. This is US$130,000/.56 = $232,143.

The result is ($8,005). Since this is a negative amount and the taxpayer is the purchaser, it will be income to the purchaser.

2.32 The purchaser's income/expenditure for the 1997 year is therefore ($12,062) + $8,005 which gives expenditure of $4,057.

2.33 In the 1998 income year, the purchaser applies the base price adjustment in section EH 4. This will be calculated as follows:

'a' is all amounts of consideration paid by the purchaser. This is the US$ price of the glass, converted into NZ$ at the Spot Rate when paid. This is US$140,000/.57 = $245,614;

'b' is the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using Rate D, the spot rate on the Contract Date, ie. US$130,000/.56 = $232,143;

'c' is expenditure already recognized, of $4,057.

The base price adjustment is therefore $9,414. Since this is a positive amount and the purchaser is the issuer of the Foreign Currency ASAP, this will be expenditure to the purchaser in the 1998 year.

2.34 Under section EH 8(2) of the Act, the acquisition price for the glass of $232,143 will also be its cost price for depreciation purposes.

Example 3
Sale of trading stock: payment in arrears
Calculation of income by seller under sections EH 1 and EH 4 using various rates and methods

This is an example of a contract with payment in arrears and no charge for the deferral. It shows how Rates and Methods A to D would apply to calculate a seller's income/expenditure under sections EH 1 and EH 4. Initially, it is on the basis that both delivery and payment are after balance date. Then the balance date is changed so that the delivery is before balance date.

3.1 On 15 October 1996 the taxpayer, a NZ wool exporter, agrees to sell 10,000 kg of wool for US$3 per kilo, delivered to a Japanese port specified by the buyer. On both the Contract Date and 31 March, the exporter reasonably expects that delivery will occur on 20 April 1997. US$3 is the price the parties would agree for payment on the delivery date. Payment is required 60 days after delivery. The exporter has a 31 March balance date.

3.2 The wool is actually delivered on 25 May 1997, and payment is made on 29 July 1997.

3.3 The US$/NZ$ exchange rates in the 1997 income year are as follows:

Date	Spot exchange rate	Forward rate to 20 April 1997	Forward rate to 20 June 1997
15 Oct 1996	0.585	0.605	0.62
31 Mar 1997	0.61	0.612	0.615
25 May 1997	0.635		
30 June 1997	0.645	n/a	0.58
29 July 1997	0.64	n/a	n/a

3.4 Diagrammatically, the transaction can be represented as follows:

General

3.5 Whichever method the exporter decides to use, it will have to treat itself as party to a notional foreign currency loan:

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(a) from the exporter to the buyer;

(b) advanced on 25 May 1997 (the Rights Date);

(c) of an amount equal to the Lowest Price of US$30,000;

(d) repaid on 29 July 1997 (the payment date);

(e) with a repayment amount of US$30,000.

Rate and Method A

3.6 If the exporter applies section OB 7(1)(a) and calculates the Lowest Price of the wool using the forward rate on the Contract Date for delivery on the expected Rights Date, it must apply Method A to calculate income/expenditure in the year ended 31 March 1997.

3.7 In calculating its income/expenditure in the year ended 31 March 1997 the exporter first calculates its income from the notional foreign currency loan set out in paragraph 3.5 above. As no amounts have been advanced under the loan at this date, there is no income or expenditure.

3.8 The second step requires the exporter to calculate the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price converted using the forward rate on the balance date for delivery of currency on the expected Rights Date, ie. 20 April 1997. This is US$30,000/.612 = $49,020;

'b' is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Rights Date, ie. 20 April 1997. This is US$30,000/.605 = $49,587.

The result is therefore ($567). Since this is a negative amount and the exporter is the seller, it will be expenditure to it. This will be the exporter's expenditure from the agreement for the year.

3.9 The exporter must perform a base price adjustment for the wool contract in the 1998 year. This will be equal to:

a - (b + c)

where

'a' is the NZ$ value of the price on the date of payment, ie. US$30,000/.64 = NZ$46,875;

'b' is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate A, the Forward Rate on 15 October 1996 (the Contract Date) for delivery on 20 April 1997 (the expected Rights Date). This is US$30,000/.605 which is NZ$49,587;

'c' is income/expenditure already recognized, which in this case is (NZ$567).

The base price adjustment is therefore ($2,145) which is an allowable deduction to the exporter. This amount is attributable to the fluctuation in the US$/NZ$ exchange rate between the balance date and the payment date. The exporter will be treated as having sold the wool for $49,587.

3.10 Suppose that the facts are the same except that the taxpayer had a 30 June balance date. The spot exchange rate on 30 June 1997 is NZ$1:US$0.645. With respect to the notional loan, made on 25 May, the taxpayer applies Determination G9A to calculate its income/expenditure for the 1997 year. Since there is no implied interest component, this will be equal to the NZ$ currency fluctuation, from delivery date to balance date, in the principal amount of US$30,000. This will be:

$$\frac{30,000}{.645} - \frac{30,000}{.635}$$

$$= 46,512 - 47, 244$$

$$= (\$732).$$

This will be expenditure to the taxpayer.

3.11 The second step requires the exporter to calculate the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price converted using the spot rate on the Rights Date, ie. 25 May. This is US$30,000/.635 = $47,244;

'b' is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Rights Date, ie. 20 April. This is US$30,000/.605 = $49,587.

The result is therefore ($2,343). Since this is a negative amount and the taxpayer is the seller, it will be expenditure to the seller.

3.12 The taxpayer's total expenditure from the wool contract for the 1997 year is therefore $3,075.

3.13 In the 1998 year the wool contract will mature, so a base price adjustment will have to be calculated. This will be equal to:

a - (b + c)

where

'a' is the amount received by the taxpayer. This is the US$ price received, on the day it is received, ie. US$30,000/.64 = $46,875;

'b' is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate A, the forward exchange rate on the Contract Date for delivery on the expected Rights Date, ie. it is NZ$49,587;

'c' is income/expenditure already recognised, which in this case is ($3,075).

The base price adjustment is therefore $363, which will be income to the taxpayer.

Rate and Method B

3.14 If the exporter applies section OB 7(1)(b) and calculates the NZ$ Lowest Price of the wool using the forward rate on the Contract Date for delivery on the Settlement Date it must apply Method B to calculate income/expenditure in the year ended 31 March 1997.

3.15 In calculating its income/expenditure in the year ended 31 March 1997 the exporter first calculates its income from the notional foreign currency loan described in paragraph 3.5. However, in calculating this income or expenditure, it does not use determination G9A. Instead, it must treat the foreign currency loan as if it were in NZ$, and convert the resulting foreign currency income or expenditure into NZ$ using the spot rate on Payment Date (or year end, if Payment Date is after year end).

3.16 As no amounts have been advanced under the loan at 31 March, there is no income or expenditure.

3.17 The second step requires the exporter to calculate the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price converted using the forward rate on 31 March for delivery of currency on the expected Settlement Date, ie. 20 June. This is US$30,000/.615 = $48,780;

'b' is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Settlement Date, ie. 20 June. This is US$30,000/.62 = $48,387.

The result is therefore $393. Since this is a positive amount and the taxpayer is the seller, it will be income to it. This will be the exporter's income from the agreement for the year.

3.18 The exporter must perform a base price adjustment for the wool contract in the 1998 year. This will be equal to:

a - (b + c)

where

'a' is the NZ$ value of the price on the date of payment, ie. US$30,000/.64 = NZ$46,875;

'b' is the acquisition price calculated by converting the US$ into NZ$ using Rate B, the Forward Rate on the Contract Date for delivery on the expected Settlement Date. This is US$30,000/.62 which is NZ$48,387;

'c' is income already recognized, which in this case is NZ$393.

The base price adjustment is therefore ($1,905) which is an allowable deduction to the exporter. The exporter will be treated as having sold the wool for $48,387.

3.19 Suppose that the facts are the same except that the exporter had a 30 June balance date. The spot exchange rate on 30 June is NZ$1:US$.645. With respect to the notional loan, made on 25 May, the exporter does not use Determination G9A. Instead, it must treat the foreign currency loan as if it were in NZ$, and convert the resulting foreign currency income or expenditure into NZ$ using the spot rate on payment date (or year end, if payment date is after year end). Since there is no US$ income from the notional loan, there will also be no NZ$ income using this method.

3.20 The second step required is for the exporter to calculate the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price converted using the forward rate on the balance date (now 30 June) for delivery of currency on the expected Settlement Date. Although the expected Settlement Date on the Contract Date was 20 June, the wool has been delivered late, and the expected Settlement Date is now 29 July. Assume that the forward rate from 30 June to 29 July is .61. 'a' is therefore US$30,000/.61 = $49,180;

'b' is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Settlement Date at that time, ie. 20 June. This is US$30,000/.62 = $48,387.

The result is therefore $793. Since this is a positive amount and the taxpayer is the seller, it will be income to it. The exporter's total income from the wool contract for the 1997 year is therefore $793.

3.21 In the 1998 year the wool contract will mature, so a base price adjustment will have to be calculated. This will be equal to:

a - (b + c)

where

'a' is the NZ$ value of the US$ price received, on the day it is received, ie. US$30,000/.64 = $46,875;

'b' is the acquisition price calculated by converting the US$30,000 into NZ$ using Rate B, the forward exchange rate on the Contract Date for delivery on the expected Settlement Date, ie. it is US$30,000/.62 = NZ$48,387.

'c' is income/expenditure already recognised, which in this case is $793.

The base price adjustment is therefore ($2,305), which is an allowable deduction to the taxpayer.

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Rate and Method C

3.22 If the exporter applies Rate C, it will calculate the NZ$ value of the Lowest Price of the wool using the spot rate on the Rights Date, and must apply Method C to calculate its income/expenditure under section EH 1 from the contract in the year ended 31 March 1997.

3.23 In calculating its income/expenditure in the year ended 30 June 1997, the exporter first calculates its income from the notional US$ loan, set out in paragraph 3.5. As no amounts have been advanced under the loan at 31 March, there is no income or expenditure in that year.

3.24 In the 1998 income year the exporter applies the base price adjustment in section EH 4 to the contract to sell the wool. This will be calculated as follows:

a = all amounts of consideration paid by the buyer. This is the US$ price of the wool, converted into NZ$ at the Spot Rate when paid. This is US$30,000/.64 = $46,875;

b = the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using Rate C (the spot rate on the Rights Date), ie. US$30,000/.635 = $47,244;

c = expenditure already recognized, of 0.

The base price adjustment is therefore ($369). Since this is a negative amount and the exporter is the holder of the Foreign Currency ASAP, this will be an allowable deduction to the exporter in the 1998 year.

3.25 Under section EH 8(2) of the Act, the acquisition price for the wool will also be its sale price for tax purposes.

3.26 Suppose that the facts are the same except that the exporter had a 30 June balance date. The spot exchange rate on 30 June is NZ$1:US$.645. With respect to the notional loan, made on 25 May, the exporter applies determination G9A to calculate its income/expenditure for the 1997 year. Since there is no implied interest component, this will be equal to the NZ$ currency fluctuation, from the Rights Date to balance date, in the NZ$ value of principal amount of US$30,000. This will be:

$$\frac{30{,}000}{.645} - \frac{30{,}000}{.635}$$

$$= 46{,}512 - 47{,}244$$

$$= (\$732).$$

This will be expenditure to the exporter in the 1997 year.

3.27 In the 1998 year the wool contract will mature, so a base price adjustment will have to be calculated. This will be equal to:

a - (b + c)

where

'a' is the amount received by the exporter. This is the US$ price received, on the day it is received, ie. US$30,000/.64 = $46,875;

'b' is the acquisition price calculated converting the Lowest Price into NZ$ using the spot rate on the Rights Date, ie. it is NZ$47,244;

'c' is income/expenditure already recognised, which in this case is ($732).

The base price adjustment is therefore $363, which will be income to the taxpayer.

Rate and Method D

3.28 If the exporter applies Rate D it will calculate the NZ$ value of the Lowest Price of the wool using the spot rate on the Contract Date, and must apply Method D to calculate income/expenditure in the year ended 31 March 1997.

3.29 In calculating its income/expenditure in the year ended 31 March 1997 the exporter first calculates its income from the notional US$ loan set out in paragraph 3.5. As no amounts have been advanced under the loan at 31 March, there is no income or expenditure in that year.

3.30 The second step requires the exporter to calculate the result of:

a - b

where

'a' is the NZ$ value of the Lowest Price using the spot rate on balance date. This is US$30,000/.61 which is $49,180;

'b' is the NZ$ value of the Lowest Price using the spot rate on Contract Date. This is US$30,000/.585 which is $51,282.

The result is therefore ($2,102). As this is negative and the exporter is the seller, this is expenditure to the exporter. This will be all of its expenditure in the 1997 year from the wool contract. This expenditure is solely attributable to the fluctuations in the US$/NZ$ spot exchange rate.

3.31 The exporter must perform a base price adjustment for the wool contract in the 1998 year. This will be equal to:

a - (b + c)

where

'a' is the NZ$ value of the price on the date of payment, ie. US$30,000/.64 = NZ$46,875;

'b' is the acquisition price. Because the exporter is using Rate D, this is calculated by converting the US$ into NZ$ using the exchange rate on the Contract Date, ie. it is US$30,000/.585 which is NZ$51,282;

'c' is income/expenditure already recognized, which in this case is (NZ$2,102).

The base price adjustment is therefore $2,305 which is an allowable deduction to the exporter. The exporter will be treated as having sold the wool for $51,282.

3.32 Suppose that the facts are the same except that the exporter had a 30 June balance date. The spot exchange rate on 30 June is NZ$1:US$.645. With respect to the notional loan, made on 25 May, the exporter applies Determination G9A to calculate its income/expenditure for the 1997 year. Since there is no implied interest component, this will be equal to the NZ$ currency fluctuation, from delivery date to balance date, in the principal amount of US$30,000. This will be:

$$\frac{30{,}000}{.645} - \frac{30{,}000}{.635}$$

= $46,512 - $47,244

= ($732)

This will be expenditure to the exporter.

3.33 The exporter will also have to make the adjustment a - b. In this case:

'a' is the NZ$ value of the Lowest Price converted using the spot rate on the Rights Date. This is US$30,000/.635 which is $47,244;

'b' is the NZ$ value of the Lowest Price converted using the spot rate on the Contract Date. This is US$30,000/.585 which is $51,282.

The result is therefore ($4,038). Since the exporter is the seller, and this amount is negative, it is expenditure.

3.34 The exporter's total expenditure from the wool contract for the 1997 year is therefore $4,770.

3.35 In the 1998 year the wool contract will mature, so a base price adjustment will have to be calculated. This will be equal to:

a - (b + c)

where

'a' is the amount received by the exporter. This is the US$ price received, on the day it is received, ie. US$30,000/.64 = $46,875;

'b' is the acquisition price. Because the exporter is using Rate D, the US$30,000 is converted into NZ$ using the exchange rate on the Contract Date, ie. it is US$30,000/.585 which is NZ$51,282;

'c' is income/expenditure already recognised, which in this case is ($4,770).

The base price adjustment is therefore $363, which will be income to the exporter.

Example 4

Further example of income calculation by seller under sections EH 1 and EH 4 using various rates and methods

This is an example with payments in advance and in arrears, and no difference between the actual price and a cash settlement price. It shows how Rates and Methods A to D would apply to calculate a seller's income/expenditure under sections EH 1 and EH 4.

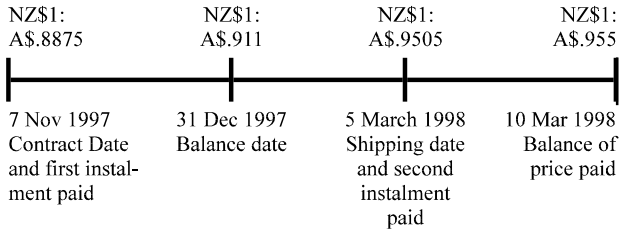
4.1 On 7 November 1997, a NZ furniture manufacturer with a December 31 balance date sells a consignment of pine furniture to an Australian purchaser for A$2,000,000. The furniture is to be shipped on a FOB basis, ie. the purchaser takes property in it once it is loaded on the vessel. A$150,000 is payable on 7 November, a further A$150,000 is payable once the furniture has been accepted by the shipper, and the remainder of the price is payable once the furniture is unloaded in Sydney, which is expected to be at the end of February.

4.2 Because the furniture is shipped FOB, the Rights Date is the date it is loaded, which is expected to be 20 February 1998. The parties agree that A$2,000,000 is the price they would have agreed on for the furniture on the basis of payment in full on 20 February.

4.3 The goods are in fact shipped on 5 March 1998, and arrive in Sydney on 10 March 1998. The A$/NZ$ Spot Rates on the relevant dates, and the resulting NZ$ spot values, are:

Date	Spot exchange rate	Forward rate to 20 February	Forward rate to 28 February
7 Nov 1997	0.8875	0.9205	0.9250
31 Dec 1997	0.9110	0.9300	0.9275
5 Mar 1998	0.9505	n/a	n/a
10 Mar 1998	0.9550	n/a	n/a

4.4 Diagrammatically, the transaction can be represented as follows:



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General

4.5 Whichever method the manufacturer decides to use, it will have to treat itself as party to two notional foreign currency loans, as follows:

4.5.1 A loan from the buyer to the seller:

(a) advanced on 7 November (the Contract Date);

(b) of A$150,000;

(c) repaid on 5 March 1998 (the Rights Date);

(d) with a repayment amount of A$150,000.

4.5.2 A loan from the seller to the buyer:

(a) advanced on 5 March (the Rights Date);

(b) of A$1.7m;

(c) repaid on 10 March 1998 (the Settlement Date);

(d) with a repayment amount of A$1.7m.

Rate and Method A

4.6 If the manufacturer applies section OB 7(1)(a) and calculates the Lowest Price of the furniture using the forward rate on the Contract Date for delivery on the Rights Date it must apply Method A to calculate income/expenditure in the year ended 31 December 1997.

4.7 In calculating its income/expenditure in the year ended 31 December 1997 the manufacturer first calculates its income from the notional foreign currency loan set out in paragraph 4.5.1 above. Applying the formula in Determination G9A, the furniture manufacturer's income/expenditure in the year ended 31 December 1997 will be calculated in accordance with the following formula:

a + b - c - d

where:

'a' is the value of NZ$ of the closing tax book value, using the spot rate at balance date; and

'b' is the sum of the value in NZ$ of all consideration given during the income year to or for the benefit of the person in relation to the financial arrangement, using the spot rate when that consideration is given; and

'c' the value in NZ$ of the opening tax book value, using the spot rate at the start of the year; and

'd' is the sum of the value in NZ$ of all consideration given during the income year by or on behalf of the person in relation to the financial arrangement, using the spot rate when that consideration is given.

4.8 The closing tax book value is calculated as follows:

e + f + g - h - i

where

'e' is the opening tax book value at the beginning of the year, if the person was a party to the arrangement at that time. This will be zero because the transaction was entered into during the year; and

'f' is the sum of the A$ value of all consideration given during the income year by or on behalf of the seller in relation to the notional loan. This will be zero for the year, since the manufacturer does not repay the loan until the 1998 year; and

'g' is the manufacturer's A$ income in respect of the loan during the year. This will be zero, since there is no difference between the A$ amounts lent and repaid; and

'h' is the sum of the A$ value of all consideration given during the income year to or for the benefit of the manufacturer in relation to the notional loan. This will be A$150,000; and

'i' is the A$ expenditure of the manufacturer in relation to the notional loan. This will be zero.

The closing tax book value is therefore (A$150,000).

4.9 To calculate 'a' in the formula, the manufacturer converts this closing tax book value into NZ$ using the spot rate on the balance date. This gives a figure of (A$150,000)/.911 = ($164,654).

4.10 'b' in the formula is the A$150,000 paid to the manufacturer during the income year, converted into NZ$ using the spot rate on the date of payment, ie. A$150,000/.8875, which is $169,014.

4.11 'c' and 'd' in the formula are both zero. The manufacturer therefore has income from the notional foreign currency loan in the year ended 31 December 1997 of $4,360.

4.12 The second step requires the manufacturer to calculate the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price converted using the forward rate on the balance date for exchange of currencies on the expected Rights Date, ie. 20 February. This is A$2,000,000/.9300 = $2,150,538;

'b' is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date for exchange of currencies on the expected Rights Date, ie. 20 February. This is A$2,000,000/.9205 = $2,172,732.

The result is therefore ($22,194). Since this is a negative amount and the manufacturer is the seller, it will be expenditure to the seller.

4.13 The manufacturer's income/expenditure for the year ended 31 December 1997 is therefore $4,360 + ($22,194) which gives expenditure of $17,834.

4.14 In the year ended 31 December 1998, the furniture manufacturer calculates a base price adjustment. This will be equal to:

a - (b + c)

where

'a' is the total of the amounts received by the manufacturer. This will be the total of

(a) A$150,000/.8875 = $169,014 (the payment on the Contract Date); plus

(b) A$150,000/.9505 = $157,812 (the payment on the shipment date); plus

(c) A$1,700,000/.955 = $1,780,105 (the final payment)

which gives a total of $2,106,931.

'b' is the acquisition price, calculated by converting the Lowest Price into NZ$ using Rate A, the forward rate on the Contract Date for delivery on the expected Rights Date, ie. it is $2,172,732 (A$2,000,000/.9205);

'c' which is income/expenditure already recognized will be ($17,834).

The base price adjustment will therefore be ($47,967). Since the furniture manufacturer is a holder of the Foreign Currency ASAP, and since the base price adjustment is a negative figure, this will be an allowable deduction to the furniture manufacturer.

4.15 The furniture will be treated as sold for NZ$2,172,732.

Method B

4.16 If the manufacturer applies section OB 7(1)(b) and calculates the Lowest Price of the furniture using the forward rate on the Contract Date for delivery on the Settlement Date it must apply Method B to calculate income/expenditure in the year ended 31 December 1997.

4.17 In calculating its income/expenditure in the year ended 31 December 1997 the manufacturer first calculates its income from the notional foreign currency loan described in paragraph 4.5.1. However, in calculating this income or expenditure, it does not use Determination G9A. Instead, it must treat the foreign currency loan as if it were in NZ$, and convert the resulting foreign currency income or expenditure into NZ$ using the spot rate on payment date (or year end, if payment date is after year end). Since there is no A$ income on the notional loan, there is also no NZ$ income.

4.18 The second step required is for the manufacturer to calculate the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price converted using the forward rate on the balance date for delivery of currency on the expected Settlement Date, ie. 20 February. This is A$2,000,000/.9275 = $2,156,334;

'b' is the NZ$ value of the Lowest Price converted using the forward rate on the Contract Date to the expected Settlement Date, ie. 20 February. This is A$2,000,000/.9250 = $2,162,162.

The result is therefore ($5,828). Since this is a negative amount and the taxpayer is the seller, it will be expenditure to it. This will be the manufacturer's expenditure from the agreement for the year.

4.19 In the 1998 year, the manufacturer calculates a base price adjustment. This will be:

a - (b + c)

where

'a' is the total of the amounts received by the manufacturer, which will be A$150,000/.8875 + A$150,000/.9505 + A$1,700,000/.955 which gives a total of $2,106,931;

'b' is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate B, the forward rate on the Contract Date for delivery on the Settlement Date, ie. it is A$2,000,000/.9250 = $2,162,162;

'c' which is income/expenditure already recognized will be ($5,828).

The base price adjustment will therefore be ($49,403). Since the furniture manufacturer is a holder of the Foreign Currency ASAP, and since the base price adjustment is a negative figure, this will be an allowable deduction to the furniture manufacturer.

4.20 The furniture will be treated as sold for NZ$2,162,162.

Rate and Method C

4.21 If the manufacturer applies Rate C, it will calculate the NZ$ value of the Lowest Price of the furniture using the spot rate on the Rights Date, and must apply Method C to calculate its income/expenditure under section EH 1 from the contract in the year ended 31 December 1997.

4.22 Under Method C, the manufacturer treats itself as being party to a notional A$ loan, as set out in paragraph 4.5.1. It applies Determination G9A to calculate its income/expenditure for the year ended 31 December 1997. It therefore undertakes the calculations set out in 4.7 to 4.11 above, and has income from the notional foreign currency loan in the year ended 31 December 1997 of $4,360.

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4.23 In the year ended 31 December 1998, the furniture manufacturer calculates a base price adjustment. This will be:

a - (b + c)

where

'a' is the total of the amounts received, ie. A$150,000/.8875 + A$150,000/.9505 + A$1,700,000/.955 which gives a total of $2,106,931;

'b' is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate C, ie. the spot rate on the Rights Date. This is A$2,000,000/.9505 = $2,104,156;

'c' is income/expenditure already recognized which will be $4,360.

The base price adjustment will therefore be ($1,585). Since the furniture manufacturer is a holder of the Foreign Currency ASAP, and since the base price adjustment is a negative figure, this will be an allowable deduction to the furniture manufacturer.

4.24 The furniture will be treated as sold for NZ$2,104,156.

Rate and Method D

4.25 If the manufacturer applies Rate D it will calculate the NZ$ value of the Lowest Price of the furniture using the spot rate on the Contract Date, and must apply Method D to calculate income/expenditure in the year ended 31 December 1997.

4.26 In calculating its income/expenditure in the year ended 31 March 1997 the manufacturer first calculates its income from the notional A$ loan set out in paragraph 4.5.1. It applies Determination G9A to calculate its income/expenditure for the year ended 31 December 1997. It therefore undertakes the calculations set out in 4.7 to 4.11 above, and has income from the notional foreign currency loan in the year ended 31 December 1997 of $4,360.

4.27 The furniture manufacturer must also take into account as income or expenditure the amount:

a - b

where

'a' is the NZ$ value of the Lowest Price calculated using the Spot Rate on the balance date. This is A$2,000,000/.9110 which is $2,195,390;

'b' is the NZ$ value of the Lowest Price calculated using the Spot Rate on the Contract Date. This is A$2,000,000/.8875 which is $2,253,521.

The result is therefore ($58,131). Since the furniture manufacturer is the seller, this will be expenditure to the seller.

4.28 The furniture manufacturer's expenditure from the contract for the year ended 31 December 1997 will therefore be $4,360 + ($58,131) = ($53,771).

4.29 In the 1998 year, the furniture manufacturer calculates a base price adjustment. This will be:

a - (b + c)

where

'a' is the total of the amounts received by the manufacturer, ie. A$150,000/.8875 + A$150,000/.9505 + A$1,700,000/.955 which gives a total of $2,106,931;

'b' is the acquisition price calculated by converting the Lowest Price into NZ$ using Rate D, the spot rate on the Contract Date of the Foreign Currency ASAP, will be $2,253,521;

'c' which is income/expenditure already recognized will be ($53,771).

The base price adjustment will therefore be ($92,819). Since the furniture manufacturer is a holder of the Foreign Currency ASAP, and since the base price adjustment is a negative figure, this will be an allowable deduction to the furniture manufacturer.

4.30 The furniture will be treated as sold for NZ$2,253,521.

Example 5

Purchase of a building: payment in arrears

Calculation of income by buyer under sections EH 1 and EH 4 using rate and method E

This is an example with payment in arrears, and a charge for the deferral. It shows how Rate and Method E would apply to calculate a buyer's income/expenditure under sections EH 1 and EH 4.

5.1 A commercial property is sold by a US resident to a NZ resident for US$1,400,000 on 1 February 1997. The parties agree that the price will be paid six months after the date possession passes, which is expected to occur in March, after the seller has undertaken certain repairs. They also agree that if payment were made on the date of possession, the price would have been US$1,300,000.

5.2 Possession of the property passes on 15 March 1997, which is the Rights Date. Therefore the term

of the agreement is 1 February 1997 to 15 September 1997 - 226 days.

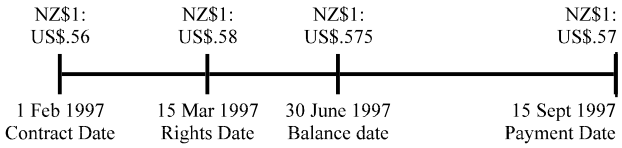
5.3 The purchaser's balance date is 30 June.

5.4 The US$/NZ$ spot exchange rates for the various dates are:

1 February 1997	0.5600
15 March 1997	0.5800
30 June 1997	0.5750
15 September 1997	0.5700

In this case the purchaser is the "issuer" for the purposes of the qualified accruals rules.

5.5 This fact situation can be represented diagrammatically as follows:



5.6 The purchaser is entitled to use Rate and Method E, and elects to do so. For the year ended 30 June 1997, it calculates its income using the formula:

a - b - c

where

'a' is the NZ$ value of the price. This is US$1,400,000/.57 = $2,456,140. Although the payment date is after the end of the relevant year, it is before the taxpayer is required to file its return for the year (for a 30 June year, 7 October - see section 37 of the Tax Administration Act 1994);

'b' is the NZ$ value of the Lowest Price, using the same exchange rate used to calculate 'a'. This is US$1,300,000/.57 = $2,280,702;

'c' is the unaccrued difference between the price and the Lowest Price, treating the agreement as a loan:

(i) from the seller to the buyer;

(ii) advanced on 15 March 1997 (the Rights Date);

(iii) of US$1,300,000;

(iv) repaid on 15 September 1997;

(v) with a repayment amount of US$1,400,000.

5.7 To calculate this unaccrued difference, the purchaser allocates the resulting US$100,000 of expenditure over the period using an available method under the qualified accruals rules. For a loan of less than one year's duration, a straight line basis is available, and the purchaser elects to use this.

5.8 For the period after the end of the year ended 30 June 1997, this gives expenditure of:

(77/184) x US$100,000 = US$41,848.

5.9 The purchaser converts this amount into NZ$ using the same spot rate used to calculate 'a'. This gives an unaccrued difference of:

US$41,848/.57 = $73,417.

5.10 The result of a - b - c is therefore $2,456,140 - $2,280,702 - $73,417 = $102,021. Because this is a positive amount, it will be expenditure for the purchaser.

5.11 For the year ended 30 June 1998, the purchaser applies the base price adjustment in section EH 4. This will be calculated as follows:

a = all amounts of consideration paid by the purchaser. This is the US$ price of the building, converted into NZ$ at the spot rate when paid. This will be US$1,400,000/.57 = $2,456,140;

b = the acquisition price, calculated converting the Lowest Price in US$ into NZ$ using the spot rate on the Payment Date. This is US$1,300,000/.57 = $2,280,702;

c = expenditure already recognized, of $102,021.

The base price adjustment is therefore $73,417, which will be expenditure to the purchaser in the 1998 year.

5.12 If the seller did not complete the repairs until July so that the purchaser did not take possession until after June, the buyer would have no expenditure under section EH 1 in the year ended 30 June 1997, since no payment under the notional loan contract would have been made during the 1997 year.

5.13 Under section EH 8(2) of the Act, the acquisition price of $2,280,702 for the building will also be its cost price for depreciation purposes.

Examples for Determination G29

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