TAX INFORMATION BULLETIN

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TIB available on the Internet

The Tax Information Bulletins from December 1996 onwards are now available on the Internet. They're saved in PDF format, which you can read using freely-available software.

You can find Inland Revenue's website at:

www.ird.govt.nz

Because of the time needed to print and post the paper TIB, each issue will generally appear on our website several days before it appears in your mailbox.

Our website also contains other Inland Revenue information which you may find useful.

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.

Tags (security) - Depreciation Determination DEP21

In TIB Volume Eight, No.6 (October 1996) we published a draft general depreciation determination for security tags and security systems used in the retail sector as part of the electronic security systems used to help prevent shoplifting.

We received a submission suggesting that further investigation was required into the proposed rate for the security systems. Because of this the Commissioner has now issued the determination to cover the security tags only. It may be cited as "Determination DEP21: Tax Depreciation Rates General Determination Number 21".

The determination is reproduced below. The new depreciation rate is based on the estimated useful life set out in the determination below and a residual value of 13.5% of cost.

General Depreciation Determination DEP21

This determination may be cited as "Determination DEP21: Tax Depreciation Rates General Determination Number 21".

1. Application

This determination applies to taxpayers who own the asset class 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 "Shops" industry category the general asset class, estimated useful life, and diminishing value and straight-line depreciation rate listed below:

Shops	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Tags (security)	3	50	40

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 20th day of December 1996.

Jeff Tyler
Assistant General Manager (Adjudication & Rulings)

Plant trolleys - draft depreciation determination

We have been advised that there is currently no general depreciation rate for plant trolleys. These trolleys are used in the horticultural industry and are leased to growers for use in the selection of plants in nurseries and subsequent transport to retail outlets.

The Commissioner proposes to issue a general depreciation determination which will insert a new asset class "Plant Trolleys" with an estimated useful life of 5 years and a general depreciation rate of 33% D.V. and 24% S.L., under the "Agriculture, Horticulture and Aquaculture" Industry Category.

The draft determination is reproduced below. The proposed new depreciation rate is based on the estimated useful live ("EUL") set out in the draft determination below and a residual value of 13.5%.

Exposure Draft - General Depreciation Determination DEPX

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

1. Application

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

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

2. Determination

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

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

Agriculture, Horticulture and Aquaculture	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Plant Trolleys	5	33	24

3. Interpretation

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

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

Assistant General Manager
Adjudication & Rulings
National Office
Inland Revenue Department
PO Box 2198
WELLINGTON

We need to receive your submission by 28 February 1997 if we are to take it into account in finalising this determination.

Filing United States tax returns - new regulations

Introduction

The United States Internal Revenue Service has set new regulations for foreign persons who are filing a United States tax return or refund claim.

Any foreign person who is filing a US tax return or refund claim must have an Individual Taxpayer Identification Number (ITIN). All previously issued temporary numbers became invalid on 1 January 1997.

When you include an ITIN on any US tax returns you file after 31 December 1996, your return will be processed more promptly and you will receive any refund due more quickly.

Key features

Any non-US individual who does not have and cannot get a US Social Security number, and who meets any of the following conditions, must get a US ITIN:

1. The individual is required to file a US tax return
2. The individual is claimed as a dependent of a US person on his or her US tax return
3. The individual is the spouse of a US person who elects to file a joint US tax return
4. The individual is claimed as a spouse for an exemption on a US tax return
5. The individual is filing a US tax return only to claim a refund

These people need not apply for an ITIN:

- US citizens
- Anyone who already has or can get a US Social Security number

ITINs are for tax purposes only and do not entitle the recipient to Social Security Benefits. Non-US citizens who gain approval to work in the United States will still be entitled to receive a Social Security number.

To get an ITIN, fill in a Form W-7 and file it with two forms of positive identification. For information on where to get Form W-7, what identification is acceptable and how to file the form, contact the US Consulate in Auckland - phone (09) 303 2724.

You can also contact the Internal Revenue Service's phone enquiry line in Sydney (00 61 2 9373 9194). Calls are answered on Tuesdays and Thursdays, 8.30 am to 4.00 pm (Australian time); at other times messages can be left on the machine. Alternately, you can download Form W-7 from the IRS World Wide Web site at http://www.irs.ustreas.gov.

The IRS needs approximately six weeks to process an ITIN application, plus postage time from Philadelphia (where applications are processed) to you.

Application date

The new regulations apply from 1 January 1997. The US Internal Revenue Service will continue to accept returns without an ITIN, but refunds will be frozen until the individual taxpayer has obtained an ITIN.

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.

Lease surrender payments - income tax treatment

Public Ruling - BR Pub 97/1

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

Taxation Law

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

This Ruling applies in respect of sections BB 4 (a) and CE 1 (1)(e) of the Income Tax Act 1994.

The Arrangement to which this Ruling applies

The Arrangement is the receipt of a lease surrender payment by a landlord from a tenant when the landlord, who is in the business of leasing property, agrees to accept the early termination of the lease. For the purposes of this Ruling, and for the avoidance of doubt, the term "business of leasing" has the same meaning as the term "business of renting", and means the business of letting property for a rent. The business of leasing property need not be the sole activity nor the principal activity of the person, however it must be sufficient to of itself amount to a business.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- Section BB 4 (a) includes within a taxpayer's assessable income all profits or gains from any business.
- A lease surrender payment received by a landlord in the business of leasing property is assessable income as a profit or gain from any business.
- A lease surrender payment is not assessable income under section CE 1 (1)(e).

The period for which this Ruling applies

This Ruling will apply to payments received by such a landlord between 1 March 1997 and 30 September 1997.

This Ruling is signed by me on the 14th day of January 1997.

Martin Smith
General Manager (Adjudication & Rulings)

Lease surrender payments - income tax treatment

Public Ruling - BR Pub 97/1A

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

Taxation Law

All legislative references are to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996 unless otherwise stated.

This Ruling applies in respect of sections CD 3 and CE 1 (1)(e) of the Income Tax Act 1994.

The Arrangement to which this Ruling applies

The Arrangement is the receipt of a lease surrender payment by a landlord from a tenant when the landlord, who is in the business of leasing property, agrees to accept the early termination of the lease. For the purposes of this Ruling, and for the avoidance of doubt, the term "business of leasing" has the same meaning as the term "business of renting", and means the business of letting property for a rent. The business of leasing property need not be the sole activity nor the principal activity of the person, however it must be sufficient to of itself amount to a business.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- Section CD 3 includes within a taxpayer's gross income any amount derived from any business.
- A lease surrender payment received by a landlord in the business of leasing property is gross income as an amount derived from any business.
- A lease surrender payment is not gross income under section CE 1 (1)(e).

The period for which this Ruling applies

This Ruling will apply to payments received by such a landlord between 1 March 1997 and 31 March 2000.

This Ruling is signed by me on the 14th day of January 1997.

Martin Smith
General Manager (Adjudication & Rulings)

Commentary on Public Rulings BR Pub 97/1 and 97/1A

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Rulings BR Pub 97/1 and 97/1A.

The Taxation (Core Provisions) Act 1996 amended a large number of sections in the Income Tax Act 1994. It has done this, in the main, by repealing those provisions and replacing them with new amended provisions. The new provisions take effect from the start of each taxpayer's 1997-98 income year (i.e. from 1 April 1997 for standard balance date taxpayers).

Given that the repealed provisions will no longer apply from the start of each taxpayer's 1997-98 income year, the Commissioner has produced two Rulings. BR Pub 97/1 applies for the period from 1 March 1997 to 30 September 1997.

BR Pub 97/1A applies for the period from 1 March 1997 to 31 March 2000.

For example, if a taxpayer has a standard balance date, i.e. 31 March 1997, BR Pub 97/1 will apply to that taxpayer for the period from 1 March 1997 to 31 March 1997. From 1 April 1997 the new provisions take effect

and BR Pub 97/1A will apply to that taxpayer for the period from 1 April 1997 to 31 March 2000.

The commentary refers to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996. In particular, it refers to section CD 3 (previously section BB 4 (a)) and to the concept of "gross income" (previously in the context of these rulings "assessable income").

Legislation

Cross-reference table

Income Tax Act 1994[1]	Income Tax Act 1994[2]	Income Tax Act 1976
CD 3	BB 4 (a)	65(2)(a)
CE 1 (1)(e)	CE 1 (1)(e)	65(2)(g)

1. as amended by the Taxation (Core Provisions) Act 1996
2. prior to amendment by the Taxation (Core Provisions) Act 1996

Under section CD 3 any amount derived from any business is included in the gross income of any person.

Section CE 1 (1)(e) includes within a person's gross income:

> All rents, fines, premiums, or other revenues (including payment for or in respect of the goodwill of any business, or the benefit of any statutory licence or privilege) derived by the owner of land from any lease, licence, or easement affecting the land, or from the grant of any right of taking the profits of the land.

Surrender payment as gross income

For a receipt to be "gross income" under section CD 3 it must be "derived from any business". To be "gross income" derived from any business, the courts have found that the amount must be a revenue amount. If the amount is a capital amount it will not be gross income of the landlord, as it will not be derived "from any business".

Gross income of a landlord

If a landlord is in the business of leasing property, the receipt by the landlord of a lease surrender payment is an amount derived from the landlord's business, and as such is a revenue receipt taxable under section CD 3. The receipt of a lease surrender payment, in the hands of a landlord in the business of leasing, is an act performed in what is truly the carrying on, or carrying out, of a business. It is not a capital receipt. This is an application of the general principle in *Californian Copper Syndicate v Harris* (1904) 5 TC 159 and adopted in other cases.

In *Californian Copper Syndicate* the taxpayer bought a mining concession for the purpose of exploiting it so that the syndicate could resell it at a profit. The syndicate never intended to work the property to derive income from mining operations. Although the transaction was an isolated transaction, nevertheless the profit was income as an act done in what is truly the carrying on of a business. The judgment in *Californian Copper Syndicate* draws a distinction between an act done in what is truly the carrying on of a business (revenue and gross income) and the mere realisation or change of investment (capital and not gross income).

Case law on lease surrender payments

There are no New Zealand authorities and few decisions from other analogous jurisdictions on the income tax treatment of the receipt of a lease surrender payment. However, support for the Commissioner's view comes from the United Kingdom case of *Greyhound Racing Association (Liverpool) Ltd v Cooper* (1936) 20 TC 373 and a series of Canadian cases such as *Monart Corporation v Minister of National Revenue* [1967] CTC 263. In both cases amounts paid to a landlord for early cancellation of a lease were assessable.

In *Greyhound Racing Association (Liverpool) Ltd* a lease surrender payment paid by a licensee was assessable income in the hands of the licensor. The licensor had a lease of a greyhound racing track. The lease was for 14 years. The licensor licensed use of the track to another company for nine years. Two years into the term of the licence the licensee went into voluntary liquidation and paid the licensor a surrender payment to terminate the licence. A new licence was executed as part of the settlement with a new company. The surrender payment was based on the difference between the old rent and the new rent over the term of the new licence agreement. The Commissioner assessed the licensor for the sum of the surrender payment. The licensor appealed.

The assessment was confirmed by Lawrence J who was of the view that use of the track did not create a new capital asset, and that the only asset in existence was the track and equipment. Use of that asset did not realise the original capital asset. His Honour's view was that (page 378):

> The sum of £15,640 was nothing more than a lump sum payment in place of future rents similar to the payments in question in *Short Bros Ltd v Commissioners of Inland Revenue*, 12 TC 955, and similar cases.

In *Monart* the taxpayer owned a large building in Montreal, Canada. A tenant occupying 10% of the lettable floor area of the building gave notice of its intention to end its tenancy, notwithstanding that the lease had six years to run. The taxpayer accepted a payment of $75,000 to cancel the lease for the remaining six years of its term. The amount was assessed as income of the taxpayer. The taxpayer objected, claiming the payment was to compensate for a diminution in value of the building as a result of the tenant leaving, such a diminution being a capital loss. The Court found that the receipt was assessable income of the taxpayer. It found that:

- The amount was paid to the taxpayer for damages suffered due to the early termination of the lease, and such a termination was a normal incident in the

activities of a landlord in the business of renting properties; and

- The lease rights surrendered by the taxpayer did not represent a loss of an enduring asset, and the taxpayer's method of conducting business was designed to cope with such a loss as a normal incident of the business; and
- The compensation was received in substitution for future profits surrendered.

The *Monart* decision was the latest of a series of Canadian cases that found lease surrender payments to be assessable. Included in the series of cases were *Hill and Hill v MNR* (1960) 24 Tax ABC 382 (payments for cancellations of leases assessable to the recipient landlord); *Grader v MNR* [1962] CTC 128 (monthly payments for the cancellation of a lease of theatre premises assessable to the recipient landlord); and *Industrial Leaseholds Limited v MNR* (1966) 40 Tax ABC 350 (payment for the early cancellation of a lease assessable to the recipient landlord).

In the *Hill and Hill* case the Tax Appeal Board adopted the distinction proposed by Lord President Cooper in *CIR v Fleming & Co (Machinery) Ltd* [1952] SLT 147; (1951) 33 TC 57; between:

(a) the cancellation of a contract which affects the profit-making structure of the recipient of compensation and involves the loss by him of an enduring trading asset [a capital receipt]; and

(b) the cancellation of a contract which does not affect the recipient's trading structure nor deprive him of any enduring trading asset, but leaves him free to devote his energies and organisation released by the cancellation of the contract to replacing the contract which has been lost by other like contracts [an income receipt].

The Board was of the view that the receipt of a lease surrender fell within the second category and hence was an income receipt. (*Fleming* is discussed below under the heading "case law on termination of agency contracts".)

In the *Industrial Leaseholds* case, the landlord owned only one building which was rented to one company for a term of 20 years. After five years the tenant wanted to terminate the lease and paid the landlord $7,525 for accepting the lease surrender. The Tax Appeal Board adopted the *Fleming* distinction, and concluded that the payment was of a revenue nature, coming within the second category set down in *Fleming*. At page 358 of the case the Board said that the payment was not related to "extraordinary commercial contracts" of the type in *Van den Berghs Ltd v Clark* [1935] AC 431. (*Van den Berghs* was a case of the same type as *CIR v Thomas Borthwick* (1992) 14 NZTC 9,101 (CA). *Thomas Borthwick* is discussed below under the heading "Case law where a receipt was not assessable").

The conclusion that a landlord's receipt of a lease surrender payment is assessable to the landlord is not inconsistent with the non-deductibility of such surrender payments established in the Court of Appeal case of *CIR v McKenzies NZ Ltd* (1988) 10 NZTC 5,233. In that case a tenant paid money to the landlord of one of the buildings it rented, to accept a surrender of the lease. The Court found the payment was not deductible because it was a capital expense. The character of a payment for assessability and deductibility purposes has to be tested in the hands of each taxpayer, and a symmetrical result is not guaranteed; see for example *Christchurch Press Company Ltd v CIR* (1993) 15 NZTC 10,206. For a tenant, a lease surrender payment will often be non-deductible for the reasons set out in *McKenzies*. For a landlord in the business of leasing property, a lease surrender payment will be assessable as a business profit.

Case law on termination of agency contracts

Some guidance on the question of whether a lease surrender payment is a capital or revenue receipt may also be gained from considering cases concerning compensation for termination of agency contracts. Indeed, in the Canadian lease surrender payment cases discussed above, agency cases such as *Fleming* were applied by the courts. There is an analogy between receiving a lease surrender payment (compensation for terminating a lease) and receiving compensation for termination of an agency contract.

In *Kelsall Parsons & Co v CIR* [1938] SC 238; (1938) 21 TC 608 the taxpayers carried on business as commission agents for the sale in Scotland of the products of various manufacturers, and entered agency agreements for that purpose. One particular agency was cancelled two years into a three year term. The taxpayers were paid £1,500 compensation. The taxpayer argued the sum was a capital amount, whereas the Commissioners argued the sum was a revenue amount. The Court of Session (First Division) agreed with the Commissioners that the sum was a revenue amount.

At page 619 of the Tax Cases report, Lord President Normand said:

It was a normal incident of a business such as that of the Appellants that the contracts might be modified, altered or discharged from time to time,...In parting with the benefit of the contract, moreover, the Appellants were not parting with something which could be described as an enduring asset of the business. The contract would have been terminated in any event as at the 30th September, 1935.

The judge concluded, at page 621:

In my opinion the agency agreements entered into by the Appellants, so far from being a fixed framework, are rather to be regarded as temporary and variable elements of the Appellant's profit-making enterprise.

Lord Fleming was of the view that (page 622):

One would suppose that it would be an ordinary incident of their business that such agreements might be altered or terminated from time to time.

In the same way, a lease is not a fixed asset of the landlord, but a temporary and variable element of the landlord's profit-making enterprise. It is an ordinary incident of their business that such agreements might be altered or terminated from time to time.

In *Fleming* the taxpayers had been agents of a company in respect of Scottish sales for over 45 years. The agency was terminated in 1948, and the taxpayer was paid a sum of compensation. To decide whether the receipt was a capital or revenue receipt, Lord President Cooper proposed to classify cases according to whether it involved (page 61 of the Tax Cases report):

(a) the cancellation of a contract which affects the profit-making structure of the recipient of compensation and involves the loss by him of an enduring trading asset [a capital receipt]; and

(b) the cancellation of a contract which does not affect the recipient's trading structure nor deprive him of any enduring trading asset, but leaves him free to devote his energies and organisation released by the cancellation of the contract to replacing the contract which has been lost by other like contracts [an income receipt].

The appropriate classification for a lease surrender payment is paragraph (b). The cancellation and surrender of the lease leaves the landlord free to devote energy and organisation to replacing the cancelled lease with a new lease.

In *Fleming* Lord Russell distinguished between a case where the rights and advantages surrendered are such as to destroy or materially cripple the whole structure of the taxpayer's profit-making apparatus [capital receipt], or whether the benefit does not represent the loss of an enduring asset [income receipt] (page 63 of the Tax Cases report). Applying this test again favours a lease surrender payment being a revenue receipt, as cancelling a lease does not destroy or materially cripple the landlord's business, but leaves the landlord with the asset and the need to lease it out again.

In *Wiseburgh v Domville (Inspector of Taxes)* [1956] 1 All ER 754 (CA) the taxpayer was a manufacturer's agent. One agency was terminated for which a sum of £4,000 was paid as compensation. In deciding the sum was a revenue receipt and assessable Lord Evershed MR accepted (page 759) that the loss of the agency was an incident of the taxpayer's business, it did not destroy the business, and was not the loss of an enduring capital asset. The same analysis can be applied to a lease surrender payment received on cancellation of a lease.

Case law where a receipt was not assessable

In *CIR v City Motor Service Limited; CIR v Napier Motors Limited* [1969] NZLR 1010, the Court of Appeal interpreted the words "from any business" in a predecessor section to CD 3. Turner J said, at page 1017:

I think I do no more than reach his [the lower court judge's] conclusion using other words when I say that in my opinion in the words "from the business" of the company something more is meant than merely "as a result of the fact that the company was carrying on this business". I think that *from the business* must mean *from the current operations of the business*. The distinction between capital accretions and revenue operations runs all through the law of income tax.

However, as discussed above, landlords who derive lease surrender payments do so not from the mere fact that they have a business, but from the current operations of the business, that is, from the leasing activities they carry on. That is, it is an ordinary incident of the business activity of the landlord.

This conclusion is not inconsistent with either of the two cases discussed next. In these two cases the relevant court found certain payments to be capital, but each case is distinguishable from the case of a landlord receiving a lease surrender payment.

In *Westfield Limited v FCT* 91 ATC 4234, the taxpayer was a company in the business of designing, constructing, letting, and managing shopping malls. It purchased some land which it subsequently sold, making a large profit. The Federal Commissioner sought to assess the profit as income. The Full Federal Court found it was not income as the profit was not a profit in the course of the taxpayer's ordinary carrying on of its business. The Court expressed its decision to be an application of the principle in *FCT v The Myer Emporium Ltd* 87 ATC 4,363. At page 4242 the Court said:

In a case where the transaction, which gives rise to the profit, is itself a part of the ordinary business (e.g. a profit on the sale of shares made by a share trader), the identification of the business activity itself will stamp the transaction as one having a profit-making purpose. Similarly, where the transaction is an ordinary incident of the business activity of the taxpayer, albeit not directly its main business activity, the same can be said. The profit-making purpose can be inferred from the association of the transaction of purchase and sale with that business activity...**It can not be said, in the present case, that resale of land was part of the ordinary business activity at all, or, for that matter, a necessary incident of that business activity. That business activity was relevantly the construction of shopping centres, their leasing or management, either on the appellant's own land, on the land of others, or on joint venture land**. (Emphasis added.)

Westfield differs from the lease surrender situation because the Full Federal Court found that the transaction that gave rise to the profit was outside the ordinary course of business, whereas with a landlord the derivation of a lease surrender payment is within the ordinary ambit of the landlord's business, being the leasing of property. The cases discussed under the heading "case law on lease surrender payments" provide support for receipt of a lease surrender payment being within the ordinary course of the landlord's business, as do the cases discussed above under the heading "case law on termination of agency contracts".

In *Thomas Borthwick*, the taxpayer gave up a valuable asset (a marketing contract) in return for payment of a cash settlement amount. The amount was found to be a capital receipt and non-assessable. The Court of Appeal considered that the marketing contract formed part of the capital structure of the taxpayer's business. It was the framework which provided the means of making profits from a particular area. Without the contract they could not run a part of their business. This is distinguishable from a landlord letting a property, as the lease

over the property, on extinguishment, does not lead to a loss of business structure, but just a loss of a particular use of the business structure. Although the lease no longer exists, the lease asset does and the landlord can lease the asset to a new tenant. In terms of the test quoted above from *Fleming* the *Thomas Borthwick* case falls into paragraph (a), whereas the lease cancellation and surrender payment situation falls into paragraph (b).

A case deciding that a lease surrender payment was not assessable was the Australian decision in *Case U99* 87 ATC 602. The lessee of business premises paid the lessor a sum to cancel the lease. The Commissioner treated the sum as assessable income. The lessor objected. The Administrative Appeals Tribunal upheld the objection and found that the sum was a capital amount. Relevant factors were:

- There was no discussion between the parties on how the lease surrender sum was calculated;
- It was not part of the taxpayer's business to trade in leaseholds;
- The property of the lessor was difficult to lease after the existing lease was cancelled; and
- The lessee received an advantage from ridding itself of an onerous asset (the lease).

In view of the authorities discussed above, we do not believe *Case U99* is good authority in New Zealand.

Submissions received

Some submissions received by Inland Revenue on an exposure draft of this item have disagreed with the interpretation set out above. In particular, some commentators have argued that a lease surrender payment has a capital character and should not be treated as assessable income of the landlord. These commentators argue that the *Thomas Borthwick* principle applies to such a payment and that it is an extinguishment of a valuable asset and hence capital. Alternatively, they argue in terms of the *California Copper* principle that the receipt of a lease surrender payment is not a receipt in the ordinary course of the landlord's business. *Case U99* was also mentioned in support of the submission favouring a capital character.

For the reasons discussed in some detail above the Commissioner does not accept these alternative views and considers that the ruling and commentary more correctly represent the proper interpretation of the law.

Example 1

Landlord A owns a number of commercial properties, and is in the business of leasing them. She leases one building to Tenant. Landlord A and Tenant execute a lease for 15 years at a rental of $50,000 per annum: the rental being reviewable every five years. The lease provides for one right of renewal for a further 15-year period.

Five years into the lease Tenant's business outgrows Landlord A's building. Tenant moves the business to another property. Tenant offers to pay Landlord A $200,000 if she will accept a surrender of the lease by Tenant, and the cancellation of all Tenant's obligations under the lease. Landlord A agrees, the lease is cancelled, and Tenant pays Landlord A the $200,000.

Under section CD 3, the amount is gross income of Landlord A.

Section CE 1 (1)(e)

In the case of a lease surrender payment section CE 1 (1)(e) potentially applies. That section includes "premiums or other revenues" derived by a land owner "from any lease" within the landowner's gross income. The words "premiums or other revenues" are potentially wide enough to include a lease surrender payment. However, in the Commissioner's view, the words "from any lease" imply that the premiums or other revenues arise from a lease that will continue in existence after the payment is made. The words do not cover a situation where the lease is terminated on payment of the surrender payment. Accordingly, section CE 1 (1)(e) does not apply. There is support for this view in obiter dicta of Richardson J in *McKenzies* at page 5,235, where His Honour said that premiums paid or received on the surrender of a lease are not dealt with in a predecessor section to section CE 1 (1)(e).

When a landlord's activity amounts to a business

The leading case on the test and criteria for whether a business exists is *Grieve v CIR* (1984) 6 NZTC 61,682. In *Grieve*, Justice Richardson noted there were two factors in deciding if there was a business: first, whether the taxpayer had an intention to make a profit; second, the nature of the activities carried on. He went on to set out the following factors relevant to the inquiry as to whether a taxpayer is in business:

- The nature of the taxpayer's activities.
- The period over which the taxpayer engages in the activity.
- The scope of the taxpayer's operations.
- The volume of transactions undertaken.
- The commitment of time, money, and effort by the taxpayer.
- The pattern of activity.
- The financial results achieved by the activity.

Ultimately, whether a landlord is in business is a question of fact. In seeking to determine whether a landlord is in business the Commissioner uses the criteria identified above from the *Grieve* decision. (More recently the question of whether a business existed or not arose in *Slater v CIR* (1996) 17 NZTC 12,453. The High Court examined, discussed, and approved *Grieve* and the tests proposed in that case.)

A taxpayer who is in doubt as to whether or not a leasing activity amounts to a business should contact a

tax adviser or the local Inland Revenue office.

Case law on whether a landlord's activity amounts to a business

There are a number of cases on whether the leasing of property for rents amounts to a business.

In *L D Nathan Group Properties Ltd v CIR* (1980) 4 NZTC 61,602 the taxpayer was the property owning subsidiary of the group. Davison CJ said that the deriving of rents by a company such as the taxpayer was income from a business. This confirms the approach in *Smith v Anderson* (1880) 15 Ch D 258, *CIT v Hanover Agencies Limited* [1967] 1 All ER 954 (PC), and *American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue* [1978] 3 All ER 1185 (PC) that companies involved in leasing will readily be held to be in the business of property leasing. However, this classification is not limited to company taxpayers. For example, in *Case F111* the taxpayer owned two houses and a block of five flats. She collected the rents, interviewed tenants and did some of the maintenance and repair work. The TRA was of the view that the taxpayer was in business as a landlord.

From these cases, it would appear that ownership of a number of buildings is likely to mean the taxpayer is in the business of property leasing. Owning just one building can also mean the taxpayer is in the business of property leasing if the requirements of the building mean the landlord is actively and regularly involved with the property (for example, negotiating new leases, maintenance, renovations etc.). It is also possible that owning a single building will not mean the landlord is in the business of property leasing (for example, when the landlord does not need to have much involvement with the day to day running of the property, or there are rarely new lessees, maintenance, or renovation work). It is interesting to note that the cases suggest that the threshold to be a business is lower when the landlord is a company than when the landlord is an individual or individuals.

There are two Australian cases discussed below which found the renting of property did not amount to a business. To the extent these cases are inconsistent with the cases discussed above, they should be ignored as these authorities, being Privy Council and New Zealand High Court and TRA cases, are more persuasive authorities in a New Zealand court.

In *Case 24* (1944) 11 TBRD 85 the taxpayer owned three properties which returned rental income of over £10,000. The taxpayer employed a manager who collected and banked rents, attended to repairs and supervised them, and controlled the caretaker and cleaners. However, the taxpayer personally carried out the management of his rent-producing properties and directed policy, attending to the financial arrangements and made decisions regarding repairs. He employed an accountant to prepare accounts. The Board of Review (in a 2-1 decision) found that the taxpayer did not have a business of renting property. In light of subsequent case law, particularly *Case F111* in New Zealand, this decision must be doubted.

In *Kennedy Holdings & Property Management Pty Ltd v FCT* 92 ATC 4918 the taxpayer co-owned a building which it rented out. It paid its lessee a sum of money to surrender the lease and sought to deduct the sum. The deduction was denied by the Commissioner, and the Federal Court (NSW) upheld the Commissioner's assessment. The Court found the taxpayer was not carrying on a business. At page 4, 921 Hill J said:

> The applicant and its co-owner own one property which they lease out and from which they derive rental income. The freehold held in co-ownership is, in such circumstances, the income producing entity, structure or organisation for the earning of the rental income of the co-owners. The freehold is the profit-making structure.

Again, there must be some doubt as to the persuasiveness of this case in New Zealand. However, it may be seen as an example of a case where a company owning one building, in respect of which it is not required to undertake a lot of work, is not in the business of renting property, as suggested above. It also raises the possibility that a company may own a building for the purposes of renting, and yet not be in the business of leasing property, contrary to some of the trends identified above.

Example 2

Landlord B is retired and owns two properties, a family home and another house which is rented to an architect for use as an office. The rent from the rental property is direct credited to Landlord B's bank account. Landlord B has no day to day involvement with the tenant or the building, and only very rarely needs to arrange for repairs and maintenance to be carried out. The tenant has tenanted the building for five years, and has a further five-year lease over the building. Landlord B is not in the business of renting as, in terms of the *Grieve* tests, the scope of her operations, the volume of transactions undertaken, the commitment of time, money, and effort by the taxpayer, the pattern of the activity, and so on, all do not suggest her renting amounts to a business.

Example 3

Landlord C is in full-time employment but also owns six houses which he rents out to tenants. Prior to renting out a house, Landlord C totally renovates it. Thereafter, Landlord C carries out any repairs that may be required. He undertakes advertising for new tenants, collection of rents, and associated duties. Landlord C is in the business of renting on the strength of both *Case F111* and the *Grieve* test. Unlike Landlord B, the nature of Landlord C's activities, the scope of the operations, the volume of transactions undertaken, and the commitment of time, money, and effort all suggest a business exists.

Colonial Mutual Life Assurance Society Ltd - demutualisation process does not of itself create tax liability for shareholders

Product Ruling - BR Prd 96/37

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

Taxation Laws

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

This Ruling applies in respect of section BB 4 (a), (c) and (d) of the Income Tax Act 1994.

The Arrangement to which this Ruling applies

The Arrangement is the demutualisation of the Colonial Mutual Life Assurance Society Ltd ("Colonial") whereby policyholders of Colonial receive shares and options in Colonial Limited.

Policyholders will be asked to vote on a proposal under which Colonial will demutualise. If demutualisation is approved, policyholders will receive shares and options in Colonial Limited in exchange for relinquishment of their membership rights in Colonial. The Directors of Colonial will fix an "implementation date" at which time shares and options will be issued by Colonial Limited to policyholders of Colonial. This is expected to occur in December 1996. Policyholders will relinquish their membership rights in Colonial prior to the time the shares and options are issued. These membership rights principally include:

- The right to attend, speak and vote at meetings of Colonial; and
- A contingent right to receive a share of any surplus assets on a winding up of Colonial.

These rights:

- Are not represented by a separate chose in action, such as a share; and
- Are embedded in the insurance policies which are held by policyholders; and
- Cannot be separately traded by policyholders.

Specifically, the Arrangement will be implemented by the following steps:

- Policyholders will vote and agree to a Scheme of Arrangement to demutualise Colonial;
- In December 1996 the Scheme of Arrangement to demutualise Colonial will be approved by the Supreme Court of Victoria;
- In accordance with the Scheme of Arrangement:
  - Colonial's Articles of Association will be amended permitting Colonial to issue shares and options;
  - Colonial's Articles of Association will also be amended resulting in extinguishment of the policyholders' ownership rights;
  - Colonial will issue 100% of its share capital to Colonial Holding Company (Number 2) Pty Limited;
  - Colonial Holding Company (Number 2) Pty Limited will issue all shares in itself to Colonial Holding Company Pty Limited;
  - Colonial Holding Company Pty Limited will issue all shares in itself to Colonial Limited;

  - Colonial Limited will issue shares and options to policyholders, or to the Colonial Foundation Trust on behalf of unconfirmed members;
  - Policyholders who wish to receive cash rather than shares will have the shares sold on their behalf by Colonial at the time of listing;
- Listing will occur in Australia and New Zealand as early as practicable in 1997. Listing will occur after the shares and options are issued to eligible policyholders or the Colonial Foundation Trust.

Demutualisation will proceed without any action by policyholders, apart from their agreement to the demutualisation proposal by way of vote.

Assumptions made by the Commissioner

This Ruling is based on the assumption that:

- The proposed demutualisation proceeds in a manner that is not materially different to the Arrangement as described above.

How the Taxation Laws apply to the Arrangement

Subject in all respects to the assumptions above, the Taxation Laws apply to the Arrangement as follows:

The demutualisation process (being the vote and agreement by Colonial policyholders to the Scheme of Arrangement and the steps that follow from this as set out in the description of arrangement above that result in the issue of Colonial Limited shares and options to the policyholders or to the Colonial Foundation Trust) will not **of itself**:

- Mean that shares and options received by policyholders will be acquired for the purpose of sale or other disposition as contemplated by the second limb of section BB 4 (c).
- Constitute an undertaking or scheme entered into or devised for the purpose of making a profit as contemplated by the third limb of section BB 4 (c).
- Be sufficient to constitute a business for the purposes of section BB 4 (a) or the first limb of section BB 4 (c).
- Mean that shares and options, or proceeds from the sale of shares and options, will be income derived from any other source under section BB 4 (d).
- Alter the account on which membership rights are held by policyholders. That is, the demutualisation process will not, of itself, mean that membership rights held by a policyholder on capital account prior to the demutualisation will become a revenue account item as a result of the demutualisation potentially giving rise to assessable income under section BB 4 (a), (c), or (d).

This Ruling sets out how the Commissioner will apply the specified Taxation Laws in relation to the demutualisation process itself and should not be taken, in any way, as a ruling on:

- The assessability of any income arising from the conversion of membership rights for shares and options in Colonial Limited; or
- The assessability of any proceeds from the sale of any shares and options in Colonial Limited.

The answer to either of the above issues will depend on the facts of any particular case.

The period for which this Ruling applies

This Ruling will apply for the period 2 December 1996 to 31 March 1999.

This Ruling is signed by me on the 2nd day of December 1996.

Martin Smith
General Manager (Adjudication & Rulings)

Colonial Mutual Life Assurance Society Ltd demutualisation - issue of shares and options does not constitute a claim

Product Ruling - BR Prd 96/38

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

Taxation Laws

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

This Ruling applies in respect of the definition of "claim" in section OB 1 and the life insurance rules as defined in section OZ 1 (1).

The Arrangement to which this Ruling applies

The Arrangement is the demutualisation of the Colonial Mutual Life Assurance Society Ltd ("Colonial") whereby policyholders of Colonial receive shares and options in Colonial Limited.

Policyholders will be asked to vote on a proposal under which Colonial will demutualise. If demutualisation is approved, policyholders will receive shares and options in Colonial Limited in exchange for relinquishment of their membership rights in Colonial. The Directors of Colonial will fix an "implementation date" at which time shares and options will be issued by Colonial Limited to policyholders of Colonial. This is expected to occur in December 1996. Policyholders will relinquish their membership rights in Colonial prior to the time the shares and options are issued. These membership rights principally include:

- The right to attend, speak and vote at meetings of Colonial; and
- A contingent right to receive a share of any surplus assets on a winding up of Colonial.

These rights:

- Are not represented by a separate chose in action, such as a share; and
- Are embedded in the insurance policies which are held by policyholders; and
- Cannot be separately traded by policyholders.

Specifically, the Arrangement will be implemented by the following steps:

- Policyholders will vote and agree to a Scheme of Arrangement to demutualise Colonial;
- In December 1996 the Scheme of Arrangement to demutualise Colonial will be approved by the Supreme Court of Victoria;
- In accordance with the Scheme of Arrangement:
  - Colonial's Articles of Association will be amended permitting Colonial to issue shares and options;

  - Colonial's Articles of Association will also be amended resulting in extinguishment of the policyholders' ownership rights;
  - Colonial will issue 100% of its share capital to Colonial Holding Company (Number 2) Pty Limited;
  - Colonial Holding Company (Number 2) Pty Limited will issue all shares in itself to Colonial Holding Company Pty Limited;
  - Colonial Holding Company Pty Limited will issue all shares in itself to Colonial Limited;
  - Colonial Limited will issue shares and options to policyholders, or to the Colonial Foundation Trust on behalf of unconfirmed members;
  - Policyholders who wish to receive cash rather than shares will have the shares sold on their behalf by Colonial at the time of listing;
- Listing will occur in Australia and New Zealand as early as practicable in 1997. Listing will occur after the shares and options are issued to eligible policyholders or the Colonial Foundation Trust.

Demutualisation will proceed without any action by policyholders, apart from their agreement to the demutualisation proposal by way of vote.

Assumptions made by the Commissioner

This Ruling is based on the assumptions that:

- The proposed demutualisation proceeds in a manner that is not materially different to the Arrangement as described above; and
- Colonial Limited will not be a "life insurer" as defined in section OB 1 at the time of issuing the shares and options to policyholders.

How the Taxation Laws apply to the Arrangement

Subject in all respects to the assumptions above, the Taxation Laws apply to the Arrangement as follows:

The issue of the shares and options in Colonial Limited to those policyholders eligible to receive the shares and options, or to the Colonial Foundation Trust on behalf of policyholders eligible to receive the shares and options, as a result of the demutualisation does not constitute a "claim" as defined in section OB 1.

The period for which this Ruling applies

This Ruling will apply for the period 2 December 1996 to 31 March 1999.

This Ruling is signed by me on the 2nd day of December 1996.

Martin Smith
General Manager (Adjudication & Rulings)

Colonial Mutual Life Assurance Society Ltd demutualisation - issue of shares and options not assessable as a dividend

Product Ruling - BR Prd 96/39

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

Taxation Laws

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

This Ruling applies in respect of section CF 1 of the Income Tax Act 1994.

The Arrangement to which this Ruling applies

The Arrangement is the demutualisation of the Colonial Mutual Life Assurance Society Ltd ("Colonial") whereby policyholders of Colonial receive shares and options in Colonial Limited.

Policyholders will be asked to vote on a proposal under which Colonial will demutualise. If demutualisation is approved, policyholders will receive shares and options in Colonial Limited in exchange for relinquishment of their membership rights in Colonial. The Directors of Colonial will fix an "implementation date" at which time shares and options will be issued by Colonial Limited to policyholders of Colonial. This is expected to occur in December 1996. Policyholders will relinquish their membership rights in Colonial prior to the time the shares and options are issued. These membership rights principally include:

- The right to attend, speak and vote at meetings of Colonial; and
- A contingent right to receive a share of any surplus assets on a winding up of Colonial.

These rights:

- Are not represented by a separate chose in action, such as a share; and
- Are embedded in the insurance policies which are held by policyholders; and
- Cannot be separately traded by policyholders.

Specifically, the Arrangement will be implemented by the following steps:

- Policyholders will vote and agree to a Scheme of Arrangement to demutualise Colonial;
- In December 1996 the Scheme of Arrangement to demutualise Colonial will be approved by the Supreme Court of Victoria;
- In accordance with the Scheme of Arrangement:
  - Colonial's Articles of Association will be amended permitting Colonial to issue shares and options;
  - Colonial's Articles of Association will also be amended resulting in extinguishment of the policyholders' ownership rights;
  - Colonial will issue 100% of its share capital to Colonial Holding Company (Number 2) Pty Limited;
  - Colonial Holding Company (Number 2) Pty Limited will issue all shares in itself to Colonial Holding Company Pty Limited;
  - Colonial Holding Company Pty Limited will issue all shares in itself to Colonial Limited;
  - Colonial Limited will issue shares and options to policyholders, or to the Colonial Foundation Trust on behalf of unconfirmed members;
  - Policyholders who wish to receive cash rather than shares will have the shares sold on their behalf by Colonial at the time of listing;
- Listing will occur in Australia and New Zealand as early as practicable in 1997. Listing will occur after the shares and options are issued to eligible policyholders or the Colonial Foundation Trust.

Demutualisation will proceed without any action by policyholders, apart from their agreement to the demutualisation proposal by way of vote.

Assumptions made by the Commissioner

This Ruling is based on the assumptions that:

- The proposed demutualisation proceeds in a manner that is not materially different to the Arrangement as described above; and
- The policyholders will relinquish their membership rights in Colonial prior to Colonial Limited issuing shares and options in itself to policyholders.

How the Taxation Laws apply to the Arrangement

Subject in all respects to the assumptions above, the Taxation Laws apply to the Arrangement as follows:

The issue of shares and options in Colonial Limited to those policyholders eligible to receive shares and options as a result of the demutualisation will not be assessable as a dividend under section CF 1.

The period for which this Ruling applies

This Ruling will apply for the period 2 December 1996 to 31 March 1999.

This Ruling is signed by me on the 2nd day of December 1996.

Martin Smith
General Manager (Adjudication & Rulings)

Non-binding tax statement to Colonial policyholders

This non-binding statement is issued by the Commissioner in order to clarify how income arising from the demutualisation of Colonial may be assessable in the hands of policyholders. It is included with the above product rulings at the request of Colonial.

There will be no tax consequences for most policyholders upon the receipt of shares on the demutualisation of Colonial.

In particular, shares received as part of the demutualisation process and the proceeds of the first sale of those shares, or alternatively the receipt of the cash value of the share entitlement in respect of a policy, will not ordinarily generate assessable income in the hands of a policyholder if:

- the policy was taken out for personal or family reasons. This includes the assignee of such a policy where the assignee is a relative or family trust; or
- the policy was taken out over the life or well-being of an employee or business principal of the business (corporate or otherwise); or
- the policy was taken out to protect personal earnings or business income in the event of disablement or trauma of an individual; or
- the policy was taken out over the life or well-being of a member, or a group of members, of a New Zealand registered superannuation scheme by the trustees of the scheme. The on-distribution of shares by trustees to members will not give rise to taxable income in the members' hands; or
- the policy is an accident and disability or trauma policy taken out for the purposes of providing a lump sum, or non-earnings related payment in the event of the disablement or trauma of an individual.

However, there may be tax consequences for those policyholders whose business activities mean that they deal in insurance policies or are otherwise ordinarily taxable on such receipts, or any policyholders who demonstrate that they acquired shares for the purpose of sale or other disposal.

In addition, if a person acquires further shares with the purpose of resale, any profit on the sale of those shares will be taxable.

The views expressed in this non-binding statement represent the Commissioner's policy in relation to the demutualisation of Colonial. Relevant policyholders should note that the treatment of the shares issued (or their cash equivalent) will not affect the tax status of the proceeds of any claim paid under a policy.

MJ Carr
National Manager, Corporates
20 June 1996

Colonial Mutual Life Assurance Society Ltd demutualisation - extinguishment of former rights does not constitute a gift

Product Ruling - BR Prd 96/45

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

Taxation Laws

All legislative references are to the Estate and Gift Duties Act 1968 unless otherwise stated.

This Ruling applies in respect of section 61, section 63, and the definitions of "gift" and "disposition of property" in section 2(2) of the Estate and Gift Duties Act 1968.

The Arrangement to which this Ruling applies

The Arrangement is the demutualisation of the Colonial Mutual Life Assurance Society Ltd ("Colonial") whereby policyholders of Colonial receive shares and options (both securities hereinafter referred to as "shares") in Colonial Limited.

Policyholders will be asked to vote on a proposal under which Colonial will demutualise. If demutualisation is approved, policyholders will receive shares in Colonial Limited in exchange for relinquishment of their membership rights in Colonial. The Directors of Colonial will fix an "implementation date" at which time shares will be issued by Colonial Limited to policyholders of Colonial. This is expected to occur in December 1996. Policyholders will relinquish their membership rights in Colonial prior to the time the shares are issued. These membership rights principally include:

- The right to attend, speak and vote at meetings of Colonial; and
- A contingent right to receive a share of any surplus assets on a winding up of Colonial.

These rights:

- Are not represented by a separate chose in action, such as a share; and
- Are embedded in the insurance policies which are held by policyholders; and
- Cannot be separately traded by policyholders.

Specifically, the Arrangement will be implemented by the following steps:

- Policyholders will vote and agree to a Scheme of Arrangement to demutualise Colonial;
- In December 1996 the Scheme of Arrangement to demutualise Colonial will be approved by the Supreme Court of Victoria;
- In accordance with the Scheme of Arrangement:
  - Colonial's Articles of Association will be amended permitting Colonial to issue shares;
  - Colonial's Articles of Association will also be amended resulting in extinguishment of the policyholders' ownership rights;
  - Colonial will then issue 100% of its share capital to Colonial Holding Company (Number 2) Pty Limited;
  - Colonial Holding Company (Number 2) Pty Limited will issue all shares in itself to Colonial Holding Company Pty Limited;

  - Colonial Holding Company Pty Limited will issue all shares in itself to Colonial Limited;
  - Colonial Limited will issue shares to policyholders, or to the Colonial Foundation Trust on behalf of unconfirmed members;
  - Policyholders who wish to receive cash rather than shares will have the shares sold on their behalf by Colonial at the time of listing;
- Listing will occur in Australia and New Zealand as early as practicable in 1997. Listing will occur after shares are issued to eligible policyholders or the Colonial Foundation Trust.

Demutualisation will proceed without any action by policyholders, apart from their agreement to the demutualisation proposal by way of vote.

Assumptions made by the Commissioner

This Ruling is based on the assumption that:

- The proposed demutualisation proceeds in a manner that is not materially different to the Arrangement as described above.

How the Taxation Laws apply to the Arrangement

Subject in all respects to the assumptions above, the Taxation Laws apply to the Arrangement as follows:

- The voting by Colonial policyholders and the subsequent extinguishment of their voting rights and other ownership or proprietary rights, will not constitute a "disposition of property" as defined in section 2(2). Therefore, the voting and subsequent extinguishment will not be a "gift" as defined in section 2(2) and cannot be a dutiable gift by the policyholders to any person under section 63.

The period for which this Ruling applies

This Ruling will apply for the period 18 December 1996 to 31 March 1999.

This Ruling is signed by me on the 18th day of December 1996.

Martin Smith
General Manager (Adjudication & Rulings)

DB Group Ltd's share cancellation - payments to shareholders do not constitute a dividend

Product Ruling - BR Prd 96/43

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

Taxation Laws

All legislative references are to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996 unless otherwise stated.

This Ruling applies in respect of sections CF 2 (1) and CF 3 (1)(b).

The Arrangement to which this Ruling applies

The Arrangement is the cancellation of three of every four fully paid shares in DB Group Limited ("DB Group"). For every share cancelled $0.60 will be distributed to shareholders.

The Arrangement is also a reduction to DB Group's share premium account of $278,034,000 and a matching credit to the accumulated losses account.

The shares to be cancelled are ordinary and fully paid shares and the cancellation will not alter the proportionate voting interest of any shareholder in DB Group.

DB Group will distribute $181,500,000 which is $0.60 for every ordinary and fully paid share cancelled.

The dividend payments since 1985 are:

Financial Year	Interim	Final
1985	2,571,000	3,334,000
1986	3,333,000	4,075,000
1987	9,481,000	10,872,000
1988	10,245,000	19,596,000
1989	19,971,000	24,896,000
1990	14,180,000	17,295,000
1991	14,707,000	17,746,000
1992	-	-
1993	-	-
1994	-	-
1995		6,089,000
1996	6,089,000	February 1997

A special dividend of $338,428,000 was paid in June 1989.

Difficult trading conditions and large amounts of debt were the reason why no dividend payments were made from 1992 to 1994, and only a final dividend was paid during 1995.

DB Group intends to continue paying both an interim and a final dividend each year.

The next dividend is due to be paid in February 1997. The company expects the amount will be $8,067,000.

The board of DB Group does not contemplate any issue of shares following the capital reduction.

The purpose of the cancellation is to return excess cash, that has built up through the sale of a number of assets, to shareholders. This excess cash is surplus to DB Group's present and likely future requirements. The purpose of the cancellation is also to give the company a debt to equity ratio and a share capital which is more commercially desirable.

The following are the facts for the purposes of determining the available subscribed capital per share cancelled.

Available subscribed capital - Variable a

DB Group existed before 1 July 1994.

Transitional capital amount - Variable j

The aggregate amount of capital paid up before 1 July 1994 is 150,837,492.

Amounts paid up by way of bonus issue after 31 March 1982 and before 1 October 1988 are:

April 1984	2,420,017
August 1985	4,115,878
November 1986	487,674
April 1987	724,154
August 1987	3,873
August 1987	1,716
November 1987	267,712
April 1988	1,219,381
April 1988	100,976
June 1988	753
September 1988	22,231,485
September 1988	2,034,529

The cancellation will occur after April 1997 and before August 1997.

Therefore, the following bonus issues occurred more than 10 years before the cancellation:

April 1984	2,420,017
August 1985	4,115,878
November 1986	487,674
April 1987	724,154

No bonus issues during the period 31 March 1982 and before 1 October 1988 were paid up by way of application of any amount of qualifying share premium.

Two bonus issues were made after 1 October 1988. The amounts of paid up capital are:

December 1988	15
April 1989	2,237,573

The bonus issue of April 1989 was a taxable bonus issue.

The total amount to be excluded from the aggregate amount of paid up capital is 25,860,440.

Variable j for the purpose of determining transitional capital amount is 124,977,052.

Transitional capital amount - Variable k

The total amount of share premium paid to the company before 1 July 1994 is 407,087,000.

No amounts of share premium were applied to pay up share capital in the company.

The total amounts of share premium which arose with respect to the issue of shares in one company as consideration for the acquisition of shares in any other company 312,893,369.

Variable k is 94,193,631

Transitional capital amount - Variable l

The number of shares ever issued before 30 June 1994 is 307,674,321.

Transitional capital amount - Variable m

The number of shares on issue at the close of 30 June 1994 is 307,674,321.

Transitional capital amount

The transitional capital amount is 219,170,683

Available subscribed capital - Variable b

The aggregate amount of consideration received by the company on or after 1 July 1994 and before the time of the cancellation for the issue of shares is 84,436,913. None of this consideration was received in any of the circumstances listed in paragraphs (b)(v) to (b)(xii) of the definition of available subscribed capital in section OB 1.

No further shares will be issued before the cancellation.

Available subscribed capital - Variable c

There have been no amounts distributed upon the acquisition, redemption, or cancellation of shares on or after 1 July 1994. No amounts will be distributed upon the acquisition, redemption, or cancellation of shares before the cancellation.

Available subscribed capital per share cancelled

The available subscribed capital is 219,170,683 + 84,436,913 - 0 which is 303,607,596.

The number of shares to be cancelled is 302,508,836.

The available subscribed capital per share cancelled is $1.00. DB Group intends to distribute $0.60 for every ordinary and fully paid share cancelled.

Assumptions made by the Commissioner

This Ruling is based on the assumptions that:

- The amount distributed to shareholders ($181,500,000) will be more than 15 percent of the market value of all shares at the time that DB Group first notifies shareholders of the proposed cancellation.
- DB Group intends to continue paying both an interim and a final dividend each year.
- The next dividend will be paid in February 1997. The company expects the amount will be $8,067,000.
- The board of DB Group does not contemplate any issue further issue of shares.
- The cancellation will occur after 30 April 1997 and before 1 August 1997.
- No further shares will be issued before the cancellation.

How the Taxation Laws apply to the Arrangement

Subject in all respects to the assumptions above, the Taxation Laws apply to the Arrangement as follows:

- The distribution to shareholders of $0.60 for every ordinary and fully paid share cancelled is excluded from the term “dividends” under section CF 3 (1)(b).
- The reduction to the share premium account will not constitute “dividends” under section CF 2 (1).

The period for which this Ruling applies

This Ruling will apply for the period 1 April 1997 to 30 September 1997.

This Ruling is signed by me on the 10th day of December 1996.

Martin Smith
General Manager (Adjudication & Rulings)

Bay of Plenty Co-operative Fertiliser Co Ltd's offer to Southfert Co-operative Ltd's shareholders

Product Ruling - BR Prd 96/48

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

Taxation Laws

All legislative references are to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996 unless otherwise stated.

This Ruling applies in respect of section HH 3 (5), the definition of "beneficiary income" in section OB 1, section EH 1 and section EH 4.

The Arrangement to which this Ruling Applies

The Arrangement is that pursuant to the offer document dated 29 August 1996 ("Offer Document") to Southfert Co-operative Limited ("Southfert") shareholders, Bay of Plenty Co-operative Fertiliser Company Limited ("BOP") offers to purchase all the ordinary shares of $1.00 each of Southfert.

Each Southfert shareholder who accepts the above offer will receive as consideration for the Southfert shares sold to BOP:

- Initially, one fully paid BOP share for every two Southfert shares sold to BOP; and
- Additional fully paid BOP shares in the 1996/97, 1997/98 and 1998/99 seasons for each tonne of fertiliser purchased by the particular Southfert shareholder ("deferred consideration"). Instead of issuing the BOP shares in progressive stages, BOP will issue BOP shares in respect of the deferred consideration immediately to the Southfert/BOP Fertiliser Trust Company Limited ("Trustee") which will hold the BOP shares on trust ("the Trust") pending release to the Southfert shareholders in successive seasons. At the end of each of the three seasons following settlement, BOP will notify the Trustee of the amount of BOP shares which should be provided as deferred consideration, and the Trustee will transfer the relevant BOP shares to those persons.

If the Trustee has insufficient shares to satisfy the payment of the deferred consideration, BOP may issue further shares to the Trustee. Alternatively, BOP may issue shares directly to the Southfert shareholders or pay an amount of cash to the Southfert shareholders equal to the value of the BOP shares constituting deferred consideration which BOP or the Trustee is obliged to provide in terms of the offer.

Terms and conditions of BOP shares issued

The BOP shares initially issued to the Southfert shareholders will not be entitled to receive any distributions (as defined in section 2 of the Companies Act 1993), bonus issues, cash issues or any other benefit provided to BOP shareholders prior to 31 May 1999. However, the Southfert shareholders will be entitled to receive all rebates or other distributions based on the volume of trading between the holder of the share and BOP.

The BOP shares transferred to the Trust will be non-voting and not carry any rights to receive dividends, rebates or distributions of any nature whatsoever.

After 31 May 1999, all the BOP shares issued in respect of the Southfert shares (the BOP shares initially issued to the Southfert shareholders and the deferred

consideration) will become pari passu with all other ordinary BOP shares because they will carry the same rights as all other ordinary BOP shares.

Terms and conditions of the Trust

Pursuant to the trust deed dated 29 August 1996 between BOP and the Trustee, BOP will pay the expenses of the Trustee, although the Trustee will not be remunerated.

The Trust will not provide any consideration for the transfer of shares from BOP. It will also not receive any consideration when it distributes the BOP shares to the Southfert shareholders.

The Trust will not derive any gross income for the time it holds the BOP shares.

The Southfert shareholders will not have any rights or interests in the BOP shares held by the Trust except as expressly set out in clause 3 of the trust deed (which relates to the tonnage of fertiliser purchased).

BOP will not have any rights to, or interests in the BOP shares held by the Trust or any other asset of any nature held by the Trust.

If there are surplus BOP shares remaining in the Trust after the deferred consideration obligations have been discharged, those shares will be cancelled or extinguished for nil consideration to the Trustee.

Other facts of the Arrangement and relevant information are as set out in the:

- Offer Document dated 29 August 1996; and
- Trust deed dated 29 August 1996 between BOP and the Trustee; and
- Application for this product ruling dated 12 December 1996.

Assumptions made by the Commissioner

This Ruling is made on the assumptions that:

- The transactions between BOP and the Southfert shareholders are at arm's length; and
- BOP will provide a service for the benefit of the Trust at less than market value being the payment of the administration fees of the Trust; and
- BOP is a resident for New Zealand tax purposes; and
- The lowest price that BOP and the Southfert shareholders who accept BOP's offer would have agreed upon for the Southfert shares being sold, at the time that the agreement for sale and purchase of the Southfert shares is entered into on the basis of full payment to the Southfert shareholders at the time at which the Southfert shares are transferred to BOP, is equal to the value of all BOP shares which are required to be provided to those Southfert shareholders pursuant to the terms of the offer (the BOP shares initially issued to the Southfert shareholders and the deferred consideration).

How the Taxation Laws apply to the Arrangement

Subject in all respects to the assumptions above, the Taxation Laws apply to the Arrangement as follows:

- The distributions of BOP shares from the Trust to the Southfert shareholders (in their capacity as beneficiaries) will not be gross income pursuant to section HH 3 (5) and the definition of "beneficiary income" in section OB 1; and
- The price of the Southfert shares is the value of the BOP shares which are required to be provided by BOP under the terms of the offer (the BOP shares

initially issued to the Southfert shareholders and the deferred consideration); and

- No accrual expenditure or gross income under section EH 1 or EH 4 will arise to the Southfert shareholders from the "financial arrangement" (as defined in section OB 1) that is created by the Arrangement.

The period for which this Ruling applies

This Ruling will apply for the period from 5 December 1996 to 31 March 2000.

This Ruling is signed by me on the 20th day of December 1996.

Martin Smith
General Manager (Adjudication & Rulings)

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'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.

Challenging the validity of an assessment by judicial review proceedings

Case: New Zealand Wool Board v CIR - Court of Appeal

Keywords: *Validity of assessment, objection proceedings, judicial review*

Summary: This is an appeal against the High Court's decision to grant the Commissioner's application for a stay of judicial review proceedings. The Objector's appeal was successful. The orders made in the High Court were quashed and the Commissioner's application for a stay was dismissed.

Facts: The Objector invested $100 million in redeemable preference shares. In its income tax returns it treated the dividend income received as exempt from tax under section 63 of the Income Tax Act 1976. The Commissioner audited the Objector and amended its assessments for the 1990, 1991, 1992 and 1993 income tax years, having invoked section 99 of the Act. The Objector objected to the 1990 amended assessment, challenging both the validity of the assessment and the correctness of it. The Objector applied for judicial review in the High Court. The Commissioner applied to stay the judicial review proceedings until the objection process had been exhausted. This was granted by the High Court.

Decision: Richardson P, who gave the majority decision, recognised that if and when the objection becomes the subject of a case stated proceeding it may be appropriate to consolidate it with the judicial review proceedings and it should only be in exceptional cases that judicial review be heard separately and ahead of the objection proceedings. However the possibility of consolidation is hard to predict in this case because there has been no case stated proceeding yet. Also, there have been such long delays since the judicial review proceeding was filed and served (5 February 1996) that there is no justification for making the Objector defer its judicial review proceedings. The objection to the 1990 amended assessment was still being considered by the Commissioner which would lead to further delays still.

Accordingly, the Court of Appeal quashed the orders made in the High Court and the Commissioner's' application for a stay of the Objector's judicial review proceeding was dismissed.

Onus on taxpayer to show intelligible basis for apportionment

Case: Barron Fishing Limited v CIR

Keywords: *Apportionment*

Summary: A taxpayer who wishes to deduct part of a lump sum payment from his or her assessable income in any income year must provide sufficient evidence to estab-

lish that at least a minimum quantifiable sum is deductible under section 104 of the Income Tax Act 1976. To do this the taxpayer must put before the Court evidence from which the Court can reasonably assess the proportion of the sum which is deductible under section 104.

Facts: The Objector is a company engaged in the business of fishing. An agreement was reached between the Objector and another company, Townsend and Paul Limited ("TPL") that if the Objector could obtain permits for the vessel "the Westerner", the two companies should enter into a partnership. The Objector's principal shareholder obtained the permit on 16 May 1985 in his own name. The Objector and TPL agreed on 1 August 1985 that TPL would buy the Westerner and a quota entitlement for $325,000. The partnership deed was signed and dated 5 September 1985.

In early September 1986 the name on the permit was changed over to the partnership name. However in October 1986 the principal shareholder again had the fishing permit relating to the westerner issued in his own name. TPL brought proceedings to dissolve the partnership and the Objector offered to settle the dispute by making a lump sum unapportioned payment of $325,000 to TPL. This was accepted by TPL and a deed of settlement was signed on 18 March 1988, deeming the partnership dissolved as at 31 March 1987. The deed recorded that upon payment to it of $325,000, TPL was to transfer all interests in the assets of the partnership, including the interest in the Westerner and the fishing quota, to the Objector.

The Commissioner disallowed the objector's claim for a deduction of $318,848 paid to TPL under the deed of settlement.

Decision: Justice Doogue in the High Court followed the case of *Buckley and Young* stating that the taxpayer must be able to point to some intelligible basis upon which a positive finding can be made that a defined part of a total sum is deductible. The taxpayer must provide sufficient evidence to establish that at least a minimum quantifiable sum is deductible under section 104 of the Income Tax Act 1976. To do this the taxpayer must put before the Court evidence from which the Court can reasonably assess the proportion of the sum of $325,000 which is attributable to capital under section 106 (1)(a) of the Act, and the portion which is deductible under section 104.

There was insufficient evidence to enable the Court to enter into apportionment so the Court was unable to find that the $325,000 represented anything other than payment for the capital assets of the partnership. The Commissioner was correct in disallowing the Objector's claim for a deduction of $318,848 paid to TPL under the deed of settlement.

Assessability of a lump sum payment received upon leaving employment

Case: Case TRA 95/72

Keywords: *Employment income, long service payment*

Summary: The Objector had received a lump sum payment for long service upon leaving his employment with a bank. The TRA held the payment was of a type that the taxpayer would receive only on retiring from his or her employment. The payment is therefore not assessable under section 65(2)(b) of the Income Tax Act 1976.

Facts: The Objector was an employee with a bank for some 28 years. This employment was terminated on 17 July 1992 for health reasons. The Objector received a long term service payment under the terms of his employment contract which provided certain criteria for the receipt of the payment. The Objector received $35,170 as a long service payment. The bank deducted PAYE tax of $10,093.79, leaving the Objector with a net amount of $25,076.21. The Objector queried the

tax treatment of the lump sum with Inland Revenue, and was subsequently refunded the PAYE paid in by the bank. After reviewing the file again, Inland Revenue advised the Objector that the long service payment had been correctly taxed by the bank and that the payment was fully assessable.

Decision: Judge Willy relied on the recent decision in *Case TRA 95/82* which dealt with a virtually identical provision in a bank contract which he described as being "on all fours" with the contract in the present case. Judge Willy agrees that prima facie, the type of payment received by the Objector comes within the definition of "monetary remuneration" as defined in section 2 and therefore, prima facie, appears to be assessable under section 65(2)(b). However, the payment comes within the type of payment described in section 68(2) and is therefore deemed not to be assessable income unless it comes within one of the exceptions in section 68(2), the relevant one which is section 68(5)(d).

Section 68(5)(d) would only exclude the payment made to the Objector if it had been calculated with respect to any right or entitlement not dependent on the occurring of the retirement (whether that right or entitlement related to any accumulated leave of absence which the employee might have taken in respect of any past service of the employee). The payment in this case and *Case TRA 95/82* was dependent on the Objector's retirement but was not a right or entitlement at that time.

Accordingly the lump sum payment was a retirement payment from the continued contract for services. It was therefore not assessable income under section 65(2)(b) because it was deemed not to be assessable under section 68(2).

Assessability of lump sum payment received upon leaving employment

Case: Case TRA 95/10

Keywords: *Retiring leave, redundancy, monetary remuneration*

Summary: The Objector left employment with a company after nearly 44 years of service and received a lump sum payment. He contended that part of the payment was "retiring leave" and was deemed not to be assessable income under section 68(2) of the Income Tax Act 1976. The Court held there was an early retirement component to the lump sum payment which was severable from the redundancy aspect and, as it complied with the criteria of section 68(2), it was exempt from tax.

Facts: The Objector was employed as a security advisor for the company. He had been employed by that line of employers for nearly 44 years. In 1993 he was asked to take voluntary severance as his position was considered surplus to requirements. The Objector elected to take voluntary severance with early retirement. He was treated to a retirement dinner and received accolades for his long service. He received a lump sum payment on his departure on 8 October 1993. Part of that payment was identified as "retiring leave" and the Objector contends that portion should not be taxed as a redundancy payment.

Decision: Judge Barber agreed that the Income Tax Act uses the reason for termination of employment to determine whether the tax concession in section 68(2) for retirement is available and that the terminology used by the parties is not decisive. But the Objector in this case had made a deal with the company whereby he not only achieved the usual redundancy payment on the basis he was being made redundant, but he retained a retirement payment on the basis that he had been allowed to sever his employment ahead of redundancy as a voluntary redundancy combined with an early retirement package.

Judge Barber decided the early retirement payment was severable, in that context, from the redundancy aspect and it was exempt from tax accordingly under section 68(2).

Due dates reminder

February 1997

5 Large employers: PAYE deductions and deduction schedules for period ended 31 January 1997 due.

7 Provisional tax and/or Student Loan interim repayments: first 1998 instalment due for taxpayers with October balance dates.
Second 1997 instalment due for taxpayers with June balance dates.
Third 1997 instalment due for taxpayers with February balance dates.

1996 end of year payments due (income tax, Student Loans, ACC premiums) for taxpayers with balance dates in period March-September.

QCET payment due for companies with balance dates in period March-September, if election is to be effective from the 1997 year.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 February 1997 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 January 1997 due.

Gaming machine duty return and payment for month ended 31 January 1997 due.

RWT on interest deducted during January 1997 due for monthly payers.

RWT on dividends deducted during January 1997 due.

Non-resident withholding tax (or approved issuer levy) deducted during January 1997 due.

28 GST return and payment for period ended 31 January 1997 due.

March 1997

5 Large employers: PAYE deductions and deduction schedules for period ended 28 February 1997 due.

7 Provisional tax and/or Student Loan interim repayments: first 1998 instalment due for taxpayers with November balance dates.
Second 1997 instalment due for taxpayers with July balance dates.
Third 1997 instalment due for taxpayers with March balance dates.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 March 1997 due.

Small employers: PAYE deductions and deduction schedules for period ended 28 February 1997 due.

Gaming machine duty return and payment for month ended 28 February 1997 due.

RWT on interest deducted during February 1997 due for monthly payers.

RWT on dividends deducted during February 1997 due.

Non-resident withholding tax (or approved issuer levy) deducted during February 1997 due.

31 GST return and payment for period ended 28 February 1997 due.

Non-resident Student Loan repayments - fourth instalment of 1997 non-resident assessment due.