Taxation (Remedial Provisions) No.2 Bill

This section of this TIB covers changes arising form the Taxation (Remedial Provisions) No.2 Bill which was introduced into Parliament in November 1997 and passed in March 1998. The bill was split into the following Acts:

- Taxation (Remedial Provisions) Act 1998 No 7
- Student Loan Scheme Amendment Act 1998 No 8

The bill amended the following principal Acts

- Income Tax Act 1994
- Tax Administration Act 1994
- Goods and Services Tax Act 1985

The amendments cover a variety of legislative changes ranging from tax simplification to protection of the revenue base.

Contents

Conduit tax reform

Introduction

The Taxation (Remedial Provisions) Act (No.2) 1997 implemented the new conduit tax rules. The new rules result in the controlled foreign companies (CFC) and foreign investment funds (FIF) rules generally no longer applying to income derived by New Zealand resident companies on behalf of their non-resident shareholders. The amendments aim to improve the coherence of New Zealand's international tax rules.

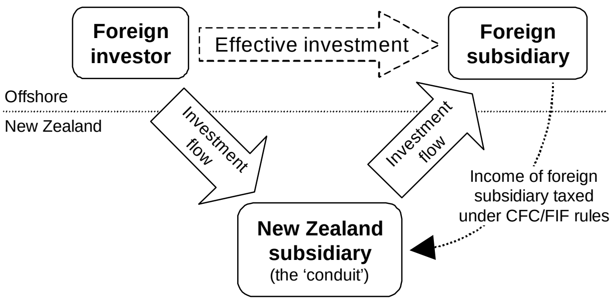
Background

In May last year, the Government issued a discussion document on conduit tax reform, which outlined the principles behind the reform and proposed a general reform mechanism. The reform package that has been enacted has remained broadly consistent with the mechanism outlined in the discussion document.

Conduit investment is investment by a non-resident into a foreign company that is made through an intermediary company resident in a third country.

A foreign investor who wishes to invest into a country other than New Zealand has two options. The first is to invest directly into that third country (or indirectly into that country through a country other than New Zealand). Because the income from the third country is then neither sourced in New Zealand nor derived by a New Zealand resident, it is generally accepted that New Zealand neither could nor should impose tax on the income.

The alternative option is to invest into a New Zealand subsidiary that in turn invests into the third country. This is illustrated in the following diagram.



In this case, New Zealand imposes tax on the worldwide income of the New Zealand subsidiary. This will include the income of the foreign subsidiary, even though the foreign subsidiary (and hence its income) is ultimately owned by the foreign investor. The term "conduit taxation" is used to refer to this taxation by New Zealand of the foreign income derived by a New Zealand company on behalf of its non-resident shareholders.

New Zealand's international tax rules aim to comprehensively tax New Zealand residents on their worldwide income as it accrues, whether that income is earned directly or indirectly through foreign entities. At the same time, the rules seek to tax non-residents on their New Zealand-sourced income.

Two key components in the rules for taxing New Zealand residents are the CFC and FIF rules, which attribute the income earned by foreign entities back to their New Zealand owners as if those owners had earned the income directly. One problem with this approach, however, is that if these New Zealand owners were companies, there was, before the enactment of conduit reform, no distinction between companies that were owned by residents and those owned by non-residents. To the extent that the companies were owned by non-residents, therefore, the international tax rules had the effect of taxing non-residents on their non-New Zealand-sourced income, a result that was outside the intended effect of the rules.

The taxation of conduit income – the foreign-sourced income earned by New Zealand companies on behalf of non-resident shareholders – was an unintended effect brought about by the interaction of a number of other policies. In addressing this effect, conduit tax reform has made New Zealand's international tax rules more coherent. Conduit tax reform preserves the taxation of resident investors on their worldwide income (the policy underpinning the international tax rules), while relieving tax on non-residents' foreign-sourced income.

Key features

- New subpart KH relieves the taxation of a New Zealand company on attributed foreign income derived from CFCs and FIF income calculated under the accounting profits and branch equivalent methods, to the extent the company is directly owned by non-resident shareholders.
- New subpart MI introduces the new "conduit tax relief" (CTR) account, a memorandum account that will record the amount of relief given to a company. This account is to ensure that the relief is passed to non-resident shareholders on whose behalf it is given.
- New subpart FH contains interest allocation rules to measure accurately the amount of conduit income derived by a New Zealand company. The rules apply only for the purposes of determining conduit tax relief. To minimise compliance costs, safe harbours ensure the rules apply only if a group has highly geared its New Zealand operations and a significant amount of conduit relief is involved.
- Sections OE 7 and OE 8 introduce special rules that enable:
  - holding companies wholly owned by a single non-resident to elect to be treated as non-resident for the purposes of determining the conduit relief of other companies in which they hold interests of 10% or greater; and

  - conduit tax relief to be given to and passed on from a lower-tier company in a 100% chain of companies, to the extent the top-tier company is owned by non-residents.

- The existing 15% rate of non-resident withholding tax (NRWT) on distributed income is retained.

Application date

The rules for determining relief from income tax on income derived from CFCs and FIF interests will apply from the start of the 1998/99 income year.

The rules for determining relief from dividend withholding payment (DWP) liabilities on foreign-sourced dividends will apply to dividends paid on or after 1 April 1998.

Amendments to the rules for maintaining memorandum accounts will apply generally from the start of the 1998/99 imputation year.

Overview of conduit tax reform

Introduction

In broad terms, conduit reform will reduce the tax payable by a New Zealand resident company in proportion to its non-resident shareholders when and to the extent that income is derived as:

- attributed foreign income from CFCs:
- FIF income calculated under the accounting profits and branch equivalent methods; and
- DWP liabilities on foreign-sourced dividends.

The first two sources of income referred to here are defined collectively in section OB 1 to be "foreign attributed income" (not to be confused with "attributed foreign income" derived under the CFC rules). The statutory term "foreign attributed income" will be used subsequently in this Tax Information Bulletin to refer to income of these types.

Because relief is given on behalf of non-resident shareholders, a mechanism is necessary to ensure this relief is passed on to those shareholders on whose behalf it is given. A new memorandum account (the conduit tax relief (CTR) account) has been introduced to track conduit relief.

The conduit relief mechanism operates at two different points in time.

First, relief is given to a New Zealand resident company when it derives foreign attributed income or a foreign-sourced dividend (conduit income).

Second, there are implications once the company distributes conduit income by way of dividend.

Ultimately, the amount of conduit relief is determined when a company distributes conduit income to its shareholders. In determining the amount of relief to be given when conduit income is derived, the percentage of non-resident shareholders of a company at that time is best seen as a proxy for the percentage of shareholders that will exist on distribution. If the percentage of shareholding changes, the credit allocation mechanism washes out the effect of the shareholding changes. This is discussed further in the separate article on the general conduit relief mechanism, later in this Tax Information Bulletin.

Elections

To be entitled to relief on conduit income as it is derived, companies must elect to maintain a CTR account, thereby becoming conduit tax relief companies.

Conduit relief is still available to companies not electing to be conduit tax relief companies. However, this relief will only be available when conduit income is distributed to non-resident shareholders, by way of a refund of DWP credits in excess of the non-residents' NRWT liabilities (repatriation-based relief). Further, the interest allocation rules will still apply to these companies in determining the amount of income subject to repatriation-based relief.

Basic mechanism

The basic conduit relief mechanism was illustrated by the example in paragraphs 4.2 to 4.7 of the discussion document, *The Taxation of Conduit Investment*, released in May 1997. The example was basic in the sense that it illustrated the key concepts of:

- Determining conduit relief when income is derived;
- Crediting the memorandum accounts; and
- Distributing conduit income.

However, it did not dwell on those aspects of the rules that make conduit reform complex, such as the effect of interest allocation rules, changes in shareholding between the time income is derived and distributed, foreign tax credits and branch equivalent tax account (BETA) offsets.

The example is reproduced here because it provides a good illustration of the essential relief mechanism. Subsequent discussion in this Tax Information Bulletin will deal with how more complex aspects of the rules' interface with the basic mechanism.

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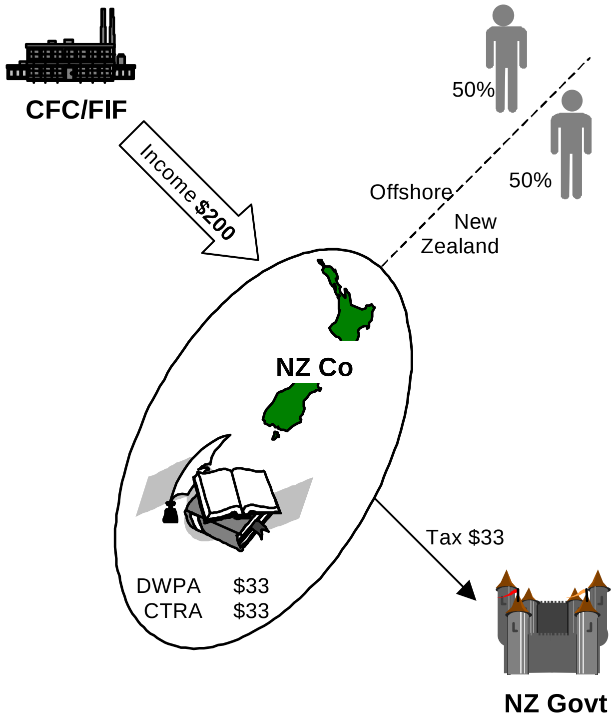
Example

The following example illustrates the operation of what can be referred to as a "current-based" relief mechanism. The mechanism is current-based in the sense that it provides relief as conduit income is derived by a New Zealand company (current), as contrasted to relief that is provided only when conduit income is distributed to non-resident shareholders ("repatriation-based" relief).

The example concerns a New Zealand company in which resident and non-resident shareholders each own 50% of the shares. The company earns $200 of attributed income from a CFC or FIF on which no foreign tax is paid.

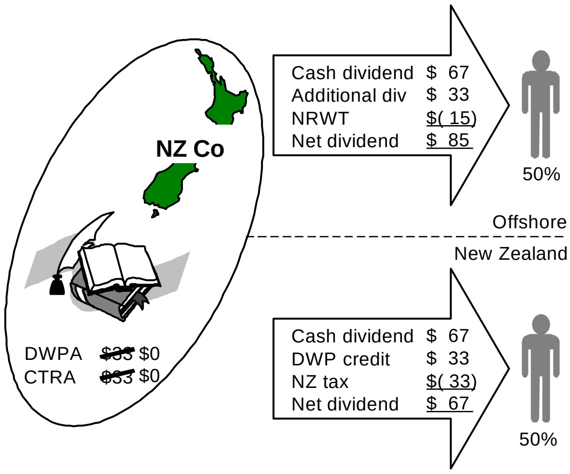


Under pre-conduit rules, the amount of New Zealand tax payable on the $200 of foreign income in the example would have been $66 (33% of $200). The payment of this tax would have given rise to a credit in NZ Co's imputation account of $66.

Following conduit reform, however, relief is given for 50% of the tax on the CFC or FIF income, based on the New Zealand company being 50% owned by non-resident shareholders. This gives a net New Zealand tax liability of $33. This amount will now be credited to the DWP account (instead of to the ICA, as previously), while the $33 of tax relieved will be credited to the CTR account.

The following diagram illustrates what happens under the proposed reform when the New Zealand company distributes its income to its shareholders.

The first point to note in the example is that the DWP credits are allocated to the resident shareholders, while the CTR credits are allocated to the non-resident shareholders. This is appropriate, as the tax has been paid on behalf of the resident shareholders (giving rise to the DWP credits), whereas the relief has been provided for the non-resident shareholders (giving rise to the CTR credits).



The second point is that the CTR credits attached to the dividends paid to the non-resident shareholders give rise to a requirement for the company to pay an additional dividend to those shareholders of the amount of the credits. This is to ensure that the benefits of the conduit relief are passed on to non-resident shareholders. The effect is that a cash dividend of $67 is paid to the resident shareholders, while $100 is paid to the non-resident shareholders. However, both resident and non-resident shareholders are liable for tax on $100 of dividend. (The DWP credit forms part of the taxable dividend of the resident shareholders.)

Following the imposition of tax on the dividends, the net effect is that the $100 of foreign income attributable to the resident shareholders has been taxed at 33%, while the $100 attributable to the non-resident shareholders has been taxed at 15% (the rate of NRWT).

Components of reform package

There are three main components to the reform package:

- The basic relief mechanism;
- Special holding company and 100% group rules; and
- Interest allocation rules.

A broad outline of these component parts follows. For a detailed explanation, however, reference should be made to the separate articles appearing later in this Tax Information Bulletin.

General relief mechanism

A general mechanism has been created to determine the amount of relief to which a New Zealand company will be entitled, and to track that relief until it is passed on to non-resident shareholders on whose behalf conduit relief is given. This basic mechanism was illustrated in the previous example.

Conduit relief will be available on a current basis only if the company elects to maintain a conduit tax relief account. Further, the amount of any relief will be reduced to the extent the interest allocation rules apply.

Holding companies and 100% groups

There are special rules for determining whether certain shareholders are non-resident for the purposes of determining the amount of conduit relief. The exceptions to the normal rules are:

- Companies wholly owned by a single non-resident (conduit tax relief holding companies) will be treated as if they were themselves non-residents in relation to certain companies in which they hold interests. There are further rules to determine which companies may elect to be conduit tax relief holding companies.
- New Zealand resident members of 100% chains of companies will be treated as non-resident to the extent that a non-resident has a direct interest in the top company in the chain, and the company at the bottom of the chain has an interest in a CFC or FIF.
- A non-resident will not be treated as a non-resident for conduit relief purposes if it is a CFC or the trustee of a non-qualifying trust.

Interest allocation rules

Interest allocation rules have been introduced to ensure that companies cannot allocate an excessive amount of debt to their New Zealand operations relative to CFCs and FIFs in which they hold interests, thereby generating an excessive amount of conduit relief.

If application of the interest allocation rules determine that the group of a New Zealand company has excessively debt geared their New Zealand operations relative to their non-grey list CFC and FIF interests, the amount of conduit relief to which members of the group are entitled will be reduced. The formula in section KH 1 for determining the amount of conduit relief reduces a company's foreign attributed income by the amount of any excess interest allocation, and determines conduit relief only on the net amount.

Thus, if a company has foreign attributed income of $1,000 but has an excess interest allocation of $400, relief will be provided only in relation to the net foreign attributed income of $600 ($1,000 – $400).

The fundamental test under the interest allocation rules is whether the New Zealand assets of a group are excessively debt funded relative to the assets of its CFC and FIF interests. If an excess interest allocation is identified in New Zealand, the excess is allocated against the conduit income of the group, thereby reducing the conduit relief to which members of the group are entitled.

To reduce compliance costs, two safe harbours have been introduced so that the rules apply only to groups that have high levels of debt in New Zealand and when a substantial amount of conduit relief is involved. To this end, the rules do not apply when:

- The debt percentage of a taxpayer's New Zealand group, as defined under the interest allocation rules, is less than 66%; or
- A taxpayer and all companies associated with the taxpayer are entitled to conduit relief for an income year of less than $50,000.

Because companies not electing to receive current-based relief can still obtain distribution-based relief, through the refundable nature of DWP credits, the interest allocation rules apply equally to such companies. In applying the $50,000 relief test when such companies are involved, the test is applied to the amount of conduit relief to which such companies would have been entitled had they elected to receive current-based relief.

It is expected that these safe harbours will make the interest allocation rules of no real consequence for all but a very small group of taxpayers with high levels of debt in their New Zealand operations, which are entitled to large amounts of conduit relief.

Non-conduit relief companies

Conduit tax reform also requires that some changes be made to existing rules, even for companies that do not elect to receive conduit tax relief.

If a company does not elect to maintain a CTR account, its shareholders will still be entitled to receive conduit relief on foreign attributed income once it is distributed. This can occur if the company still elects to maintain a DWP account. As for companies electing to receive current-based conduit relief, tax on foreign attributed income will be creditable to the DWP account (section ME 5(7)). However, the interest allocation rules will still apply in determining the amount able to be credited to the account.

General conduit relief mechanism

Introduction

As noted in the previous article, the conduit relief mechanism operates at two different points in time.

First, relief is given to a New Zealand resident company when it derives foreign attributed income or a foreign-sourced dividend (conduit income).

Second, there are implications once the company distributes conduit income by way of dividend.

Ultimately, the amount of conduit relief is determined when a company distributes conduit income to its shareholders. The percentage of non-resident shareholders when a New Zealand company derives conduit income could, therefore, be perceived as a proxy for the percentage of non-resident shareholders it will have when that income is distributed, and the amount of conduit relief ultimately determined.

This article focuses first on the rules that apply to determine the amount of relief to which a New Zealand

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company will be entitled when it derives foreign attributed income. It then proceeds to discuss the rules for determining relief on foreign-sourced dividends. Finally, it considers the implications when the company distributes conduit income (foreign attributed income and foreign-sourced dividends) by way of dividends.

Calculating relief when conduit income derived (section KH 1(2))

The amount of conduit relief on foreign attributed income is determined under the formula in section KH 1(2). The amount is calculated as:

NRS x ((TR x (FAI – FALO – EIA)) – FAC – BC)

This formula can be broken down into components, representing the process that is effectively followed for determining conduit relief:

- Tax is first determined on the company's foreign attributed income less any foreign attributed losses offset against that income and the amount of any interest expense allocated (TR x (FAI – FALO – EIA)) in the formula).
- The amount of tax is then reduced by any credit for tax paid by a CFC or FIF calculated under the branch equivalent method, and by any offset of BETA debits under section MF 5(4) (– FAC – BC in the formula).
- Finally, the net amount of tax is then reduced in proportion to the non-resident shareholders in the company.

Example

NZ Co is a New Zealand resident company, owned 40% by non-resident shareholders. It derives attributed foreign income of $100,000 from a CFC resident in Thailand (Thai Co). Foreign tax of $8,000 has been paid in respect of that income for which a CFC tax credit will arise.

For the purposes of this example, it is assumed that the interest allocation rules do not apply. NZ Co also has a nil balance in its BETA. Finally, NZ Co has income tax payable in respect of other income derived for the year.

For NZ Co, the relevant values for the variables are:

NRS	40%	Percentage of non-resident shareholders
TR	33%	Company tax rate
FAI	$100,000	Attributed foreign income from Thai Co
FALO	Nil	Foreign attributed loss offsets
EIA	Nil	Interest allocation – assumed to be nil
FAC	$8,000	CFC tax credit
BC	Nil	No debit balance in BETA

Applying these amounts into the formula in section KH 1(2) determines the amount of conduit relief as follows:

40% x ((33% x (100,000 – 0 – 0)) – 8,000 – 0) = $10,000

The tax payable by NZ Co on the attributed foreign income from Thai Co can be calculated as:

Attributed foreign income	100,000
Tax payable @33%	33,000
Less: CFC tax credit	(8,000)
Less: Conduit rebate (section KH 1(2))	(10,000)
Net New Zealand tax payable	15,000

Caveats to section KH 1(2) result

Section KH 2(3) contains two caveats on the result from applying the formula. Application of the formula cannot result in relief of less than nil (section KH 2(3)(a)) or for more than the company's net tax liability (before taking conduit relief into consideration) for the year (section KH 2(3)(b)).

This will have no application for NZ Co in the example above. Application of section KH 1(2) results in a rebate of more than nil, and NZ Co is known to have tax payable on other income, meaning the company's income tax liability for the year must be more than the conduit rebate.

Loss offsets

The formula for determining conduit relief calculates the rebate to which a company will be entitled after "foreign attributed loss offsets" (FALO in the formula).

The term "foreign attributed loss offsets" is defined in section OB 1 to include only attributed foreign losses (from CFCs) and FIF losses calculated under the branch equivalent or accounting profits methods. Thus, if a FIF loss calculated under the comparative value method or the deemed rate of return method is to be applied against FIF income calculated under the accounting profits method, that offset will not affect the calculation of amount of conduit relief to which the New Zealand company is entitled.

On a related issue, an amendment has been made to section DP 2 at Select Committee, dealing with the ability of companies with a FIF loss to offset that loss against other income to the extent that FIF income (other than that calculated under the branch equivalent method) has been returned in previous years. For the purposes of determining the extent to which a taxpayer may make such a loss offset, the amendment reduces the amount of FIF income calculated under the accounting profits method in previous years to the extent that conduit relief has eliminated the New Zealand income tax impost on that income.

Foreign tax credits

The calculation of the amount of conduit relief to which a company is entitled is determined with reference to the credits allowable to the company for taxes paid by a

CFC. Thus, if a CFC tax credit of say $500 were available in respect of attributed foreign income of $5,000, relief would only be available on the New Zealand tax liability net of the CFC tax credit, that is, on income tax payable of $1,150 ($5,000 x 33% – $500).

An amendment was made to section LC 4 at Select Committee. This amendment was a recognition that under the new Core Provisions approach in the Act, rebates (including conduit relief) are applied before a company's income tax liability is determined. Because conduit relief is determined based on tax credits that will be applied, an amendment was made to section LC 4 to ensure that CFC tax credits are still applied to the extent they are taken into consideration in determining conduit tax relief.

BETA offsets

The last variable in the formula is BETA debit offsets. If a company pays DWP on a foreign-sourced dividend it derives, a debit arises to its branch equivalent tax account (BETA). This debit can then be applied against the income tax liability arising on subsequent foreign attributed income.

As with foreign tax credits, BETA offsets are taken into account in determining the amount of conduit relief to which a taxpayer will be entitled. Thus, if a taxpayer has a BETA debit of say $300 and has foreign attributed income of $3,000 (with no foreign tax credit available), relief would only be available on the New Zealand tax liability net of the BETA offset, that is, on income tax payable of $690 ($3,000 x 33% – $300).

Determining percentage of non-resident shareholders (section KH 2)

Section KH 2 contains rules for determining what percentage of a company's shareholders are non-resident for the purposes of determining conduit relief on income derived under the CFC and FIF regimes.

The purpose of the measurement dates adopted is to:

- permit companies to measure their non-resident shareholders on a date they are already required to determine their non-resident shareholders for dividend purposes; and
- prevent the manipulation of different share classes to defeat the intent of the rules.

With this aim in mind, section KH 2(1)(a) establishes generally that the last day in the year on which the company pays a dividend to all shareholders as the date on which a measurement of non-resident shareholders is made for conduit relief purposes. This is because companies already have to determine the extent of their non-resident shareholders to apply the NRWT rules.

An amendment was made at Select Committee to further refine this rule. Publicly listed companies are able to use the Record Date for calculation of entitlement to dividends to determine the extent of their non-resident shareholding, rather than the date on which the dividend is actually paid (section KH 2(2)). This reflects that in practice, it is the Record date that determines who receives the dividends, not the payment date.

If the company has not paid a dividend to all shareholders in the income year, the measurement date defaults to the last day of the income year (section KH 2(1)(b)).

The requirement to pay dividends to **"all shareholders"** of a company to avoid having to apply the default end of income year measurement date (section KH 2(1)(b)) created potential problems for companies with multiple classes of shares. For example, dividends being paid on fixed rate shares at a different time to those paid on ordinary shares would cause a company to fail the test, even though fixed rate shares do not affect voting interests on which current-based relief is generally determined. Also Treasury stock would be included within the shareholding, but no dividend would be paid.

Consequently, further refinement was introduced into rules at Select Committee. Treasury stock is explicitly excluded from shares by section KH 2(6). Special deeming rules have also been introduced for multiple classes of shares.

If a company pays dividends in an income year to all shareholders of each class of share, section KH 2(4) treats the company as having paid a dividend to all shareholders on the last date on which dividends were paid. Further, the shareholding at the time the last dividend was paid to all shareholders of other classes is deemed to have remained constant for the rest of the year in calculating voting and market value interests.

The effect of this rule is best illustrated by way of an example.

Example

Multiclass Co has two classes of shares, with all shares having identical voting rights, regardless of class. Multiclass Co has 1,000 'A' shares on issue and 1,500 'B' shares on issue. Multiclass Co pays dividends in the income year on the following dates:

28 July	'A' shares	40% non-resident
27 November	'B' shares	30% non-resident
3 February	'A' shares	50% non-resident

Because dividends have been paid to all shareholders of each class in the income year, section KH 2(4) deems Multiclass Co to have paid a dividend to all shareholders on 3 February. Further, the shareholding of class 'B' shares is deemed to be the same at 3 February as it was when a dividend was paid to shareholders of the class on 27 November (section KH 2(5)).

The percentage of non-resident shareholders in Multiclass Co, based on voting interests, is calculated as 40%, that is:

$$\frac{(50\% \times 1{,}000) + (30\% \times 1{,}500)}{1{,}000 + 1{,}500}$$

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Special classes of shareholders

For the purposes of determining the extent of non-resident shareholders for conduit relief purposes, conduit tax relief holding companies and higher-tier companies in a 100% chain of companies are treated as also being non-resident (see the article on holding companies later in this Tax Information Bulletin).

However, a non-resident shareholder that is associated with the New Zealand resident company that is either a CFC or the trustee of a non-qualifying trust is not treated as being a non-resident shareholder (section OE 8(2)).

Crediting CTR account

Because conduit relief is given on behalf of non-resident shareholders, it is necessary to track that relief to ensure it is on-paid to them. To this end, a new memorandum account has been established, (the conduit tax relief (CTR) account) to record how relief is treated.

A credit arises to the CTR account for the amount of any conduit relief given (in the case of NZ Co, $10,000). A debit will arise to the account when that conduit relief is distributed.

New subpart MI contains rules relating to the maintenance of the new CTR memorandum account. It is necessary for a company to elect to maintain such an account under section MI 2 if it is to be entitled to conduit relief on foreign attributed income as it is derived.

The legislation for CTR accounts is modelled on the legislation in subpart MF relating to branch equivalent tax accounts (BETAs). BETAs prevent the double taxation of foreign attributed income and foreign-sourced dividends.

Crediting DWP account

As will be discussed in the second part of the example, the amount of conduit relief is ultimately determined once conduit income is distributed to shareholders. To ensure that this relief is correctly provided, it is necessary to be able to identify conduit income separately from other income. To achieve this, the application of the DWP account has been extended so that it now also records the amount of income tax payable on foreign attributed income.

Before conduit tax reform, NZ Co would have credited the $15,000 tax payable on its attributed foreign income from Thai Co to its imputation credit account. Following the reform, section ME 5(1)(o) now permits this tax to be credited to the DWP account.

It should be noted, however, that if there was an interest allocation against conduit income, the amount credited to the DWP account would not be the full amount of tax payable on the attributed foreign income.

Example

High Gearing Ltd derives foreign attributed income of $5,000. No foreign attributed losses, CFC tax credits or BETA offsets arise in respect of that income. An excess interest allocation is determined of $2,000.

High Gearing Ltd is 40% owned by non-residents.

The gross foreign attributed income is reduced by the amount of excess interest allocation before determining the amount of conduit relief. Thus, High Gearing Ltd's net foreign attributed income will be $3,000 ($5,000 – $2,000).

Tax payable on this net amount will be $990 ($3,000 x 33%) less 40% conduit relief. This results in relief of $396 (credited to the CTR account), with the $594 balance of the tax payable ($990 – $396) credited to the DWP account.

However, the actual tax payable on foreign attributed income will be $1,254 ($5,000 x 33% – $396). To the extent that this exceeds the amount credited to the DWP account ($594), a credit will arise to the company's imputation credit account ($1,254 – $594 = $660).

Thus the final result will be:

Tax payable on foreign attributed income	$1,254
Conduit relief	$ 396
Credit to CTR account	$ 396
Credit to DWP account	$ 594
Credit to ICA	$ 660

Time for crediting tax on foreign attributed income to DWP account

Because conduit relief on foreign attributed income is not determined until after the end of an income year, it is not possible to be certain at the time of paying provisional tax whether it is being paid in respect of foreign attributed income or other income. To resolve this, tax paid in relation to foreign attributed income will be credited to memorandum accounts as follows.

First, provisional tax payments will be credited to the ICA as they are made. This preserves the existing treatment of such payments.

Subsequently, when an income tax return is filed, identifying the amount of any conduit relief, a transfer is made from the ICA to the DWP account:

- On the last day of the imputation year corresponding with the income year, to the extent provisional tax payments have been made for the year on or before that date; and
- On the return filing date, to the extent that the amount of tax payable on net foreign attributed income (note that the amount of transfer depends on the application of section KH 1, requiring an adjustment for any interest expense allocated) exceeds provisional tax for the year.

For the purposes of the wash-up mechanism, section MI 6 provides that the retrospective crediting of the DWP and CTR accounts occurs before the wash-up mechanism is applied for the year.

Example

Slow Filing Ltd is a conduit tax relief company with a 31 March balance date. For its 1998/99 income year, it makes the following provisional tax payments:

7 July 1998	$15,000
7 November 1998	$15,000
7 March 1999	$20,000

Slow Filing Ltd also makes a voluntary tax payment of $20,000 on 31 May 1999.

On 31 August 2000, Slow Filing Ltd files its 1998/99 income tax return. On the shareholder measurement date for the year, the company is 40% owned by non-resident shareholders. Its return shows the company to be entitled to conduit relief of $40,000, and to have tax payable on net (post-interest allocation) foreign attributed income of $60,000.

Under section ME 5(1)(o), Slow Filing Limited is entitled to a transfer from its ICA to its DWP account of $60,000. This transfer is made as follows.

First, on 31 March 1999, a transfer is made for $50,000. This amount is the lesser of provisional tax for the year paid on or before that date or the income tax payable on net foreign attributed income for the income year (sections ME 5(2)(l)(i) and MG 4(2)(ba)). Note that this transfer is made at the end of the imputation year corresponding with the income year (1998/99), not the imputation year ending most recently before the income tax return is filed (1999/2000).

Second, on 31 August 2000 (the return filing date), a transfer is made for the $10,000 balance of the tax payable on net foreign attributed income. The return filing date is used, notwithstanding that Slow Filing Co has made a payment between the time the imputation year ended and the income tax return was filed.

(Note, however, that if Slow Filing Co had not yet paid the remaining $10,000, a transfer to the DWP account would still occur on the return filing date.)

The crediting of the CTR account for conduit relief is similarly divided between the last day of the relevant imputation year and the return filing date. Section MI 4(2)(a) credits the CTR account on each date in the same proportion that credits arise to Slow Filing Ltd's DWP account.

Thus on 31 March 1999, a credit will arise to the CTR account for $33,333 ($40,000 x 50,000/60,000), and a further credit will arise on 31 August 2000 for $6,667 ($40,000 – $33,333).

Transfers from DWP account to ICA

For companies that elect to be conduit tax relief account companies, it will no longer to be possible to make a transfer from the DWP account to the ICA (sections MG 7(1) and MG 11(1). This is because making such a transfer would, in principle, require part of the transfer to be made from the associated CTR account, with a corresponding repayment of conduit relief to the extent a transfer is made.

There is, however, no straightforward way to create an appropriate credit allocation mechanism to determine the extent the transfer to the ICA should be sourced from the DWP and CTR accounts respectively. To reduce complexity, therefore, transfers from the DWP account to the ICA can no longer be made by conduit tax relief companies.

This rule does not affect dividend withholding payment account companies that do not elect to receive current-based conduit relief.

Relief on DWP (section NH 7)

Section NH 7 introduces current-based conduit relief on foreign-sourced dividends subject to DWP. In a similar manner to relief on foreign attributed income, companies that have elected under section MI 2 to maintain a CTR account and be a conduit tax relief company are entitled to have their DWP liabilities reduced to the extent of their non-resident shareholders. The amount of DWP on which relief will be determined is the DWP liability after allowing for underlying foreign tax credits, foreign withholding taxes, BETA offsets and loss offsets.

Unlike relief on foreign attributed income, it is unrealistic to expect an adjustment for any interest expense allocated to be determined at the time any DWP is due for payment. Section NH 7 therefore does not require an interest allocation to be taken into consideration in determining the amount of relief when the DWP is paid.

However, the position is reviewed once interest allocation calculations are performed for the relevant income year. If an excess interest allocation is determined under section FH 5, and that excess is greater than the taxpayer's foreign attributed income group's net foreign attributed income for the year (foreign attributed income less loss offsets), then to the extent the excess allocation exceeds the group's net foreign attributed income, it will be allocated against DWP relief under section FH 8.

Details on the application of section FH 8 can be found in the article on interest allocation rules, later in this Tax Information Bulletin.

Summary of memorandum accounts

The amount of any tax reduction (whether income tax or DWP) will be credited to the CTR account. This is because the relief has been provided on behalf of the non-resident shareholders and needs to be identified for passing on to them at some time.

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Tax paid on foreign attributed income will be credited to the DWP account (instead of to the imputation credit account (ICA)). DWP paid on foreign-sourced dividends will still be credited to the DWP account. The effect will be to identify distributions as being from either foreign-sourced or New Zealand-sourced earnings of the company, depending on the type of credits attached.

Conduit relief mechanism on distribution

As noted previously, the amount of conduit relief is determined ultimately by the percentage of non-resident shareholders when conduit relief is distributed. Conduit reform has introduced, therefore, a new memorandum account to track conduit relief until it is distributed.

Distributions of conduit income will be identified through the attachment of DWP or CTR credits. DWP credits indicate that tax has been paid on conduit income, while CTR credits indicate the tax that has been relieved.

When a company receives conduit relief, a credit arises in its memorandum account. If the company then wants to distribute conduit income, it attaches a CTR credit to a dividend paid to a non-resident. Each dollar of CTR credits attached reflects a dollar of conduit tax relief given to the company. To pass the benefit of this relief to its non-resident shareholders, the company is required to pay an additional dividend equal to the amount of CTR credits attached (section LG 1). Thus, if a company pays a $67 cash dividend with $33 CTR credits attached, it is required to pay an additional dividends to the shareholder of $33, making a total cash dividend of $100.

To minimise compliance costs associated with an allocation mechanism, conduit tax relief companies will be able to attach CTR credits only to dividends paid to non-residents (section MI 7(1)). Dividends paid to resident shareholders will be required to have DWP credits attached (section MG 6(2)), in the same proportion as CTR credits are attached to dividends paid to non-resident shareholders.

Effect of CTR credits on credit allocation rules

In a similar manner to the foreign investor tax credit rules, section LG 1 introduces special rules to ensure that the additional dividend mechanism used in conduit reform does not contravene company law and trust deed requirements and credit allocation rules. Specifically:

- Section LG 1(3) ensures that the uncredited additional dividend does not affect the credit allocation rules;
- Section LG 1(4) ensures that the additional dividend paid only to non-resident shareholders does not breach company law or the company's articles of association or constitution; and
- Section LG 1(5) ensures that a trustee deriving an additional dividend on behalf of a non-resident beneficiary can pass on that additional dividend without contravening the terms of the trust.

Attaching ICA credits to dividends with CTR or DWP credits

There is no rule that prevents companies attaching imputation credits to a dividend at the same time as it attaches DWP or CTR credits. The total credits attached will, however, be subject to the credit allocation and benchmark dividend rules in sections MG 8 and MG 10. For the purposes of applying these rules, section MI 8 requires any CTR credit to be treated as if it were a DWP credit.

NRWT on distributed conduit income

Distributions of conduit income to non-resident shareholders are subject to NRWT of 15%. Section NG 2 has been amended to apply a 15% rate of NRWT to dividends paid to non-residents to the extent they have full CTR credits attached. The 15% NRWT rate will also apply to additional dividends paid in respect of the CTR credits.

The CTR credit does not form part of the dividend subject to NRWT.

Example of distribution mechanism

Returning to the example earlier in this article, NZ Co had 40% non-resident shareholding at the time it derived conduit income. It received conduit relief of $10,000, giving rise to a credit in its CTR account. A credit of $15,000 also arose to its DWP account for tax payable on foreign attributed income.

NZ Co has now decided that it wants to distribute some of its conduit income to its shareholders. However, at the time of distribution, non-residents own 60% of the company. NZ Co wants to pay fully credited cash dividends of $13,400.

Because 40% of the shareholders are resident, 40% of the cash dividends ($5,360) will be paid to them. Full DWP credits of $2,640 (5,360 x 33/67) will be attached to these dividends.

In relation to the non-resident shareholders, cash dividends of $8,040 will be paid. Full CTR credits of $3,960 (8,040 x 33/67) will need to be attached (if the company does not attach full CTR credits, an allocation deficit debit will arise under section MG 8, as modified by section MI 8). Additional dividends will also have to be paid to the shareholders of $3,960, equal to the amount of CTR credits attached to the dividends (section LG 1(2)).

The dividends paid to the non-resident shareholders will be subject to NRWT as follows:

Cash dividends	$ 8,040
Additional dividends	$ 3,960
Dividends subject to NRWT	$12,000
NRWT @ 15%	$ 1,800

The non-resident shareholders will then receive post-NRWT dividends of $10,200 (12,000 – 1,800).

Statement to shareholders

When a company attaches a CTR credit to a dividend to a non-resident shareholder, it is required to include the amount of the conduit tax relief credit and the amount of the additional dividend in the dividend statement provided to the shareholder (sections 29(1), 30A, Tax Administration Act 1994).

Wash-up mechanism

As indicated in the example, it is possible that a company's level of non-resident shareholding may change between the time conduit relief is given to the company and the time at which it is distributed. In this case, the company will still attach only DWP credits to dividends paid to residents and CTR credits to dividends paid to non-residents.

If the requirement to attach certain types of credits to certain types of shareholder results in either the CTR account or the DWP account having a debit balance at the end of the imputation year, section MI 6 allows for a wash-up adjustment to be made.

If the CTR account is in debit and the DWP account is in credit (indicating generally that the percentage of non-resident shareholders of the company has increased between the time conduit relief is provided and the time it is distributed), a transfer will be made from the DWP account to the CTR account for the lesser of the amount of the debit or the credit (section MI 6(1)). A payment will be made by Inland Revenue to the company for the amount of the transfer made (section MI 11).

If the DWP account is in debit and the CTR account is in credit (indicating generally that the percentage of non-resident shareholders of the company has decreased between the time conduit relief is provided and the time it is distributed), a transfer will be made from the CTR account to the DWP account for the lesser of the amount of the debit or the credit (section MI 6(2)). The company will be required to make a payment to Inland Revenue for the amount of the transfer made (section MI 10(4)).

Example

Changing Times Ltd had 40% non-resident shareholders at the time it derived conduit income of $10,000. As a result of determining the tax payable on its foreign attributed income, credits of $1,320 and $1,980 arose to its CTR and DWP accounts respectively. At the time of paying a dividend, no other entries had arisen to those memorandum accounts.

Changing Times Ltd has decided to pay fully credited dividends from conduit income to its shareholders. However, it now finds that its non-resident shareholders own 75% of the company.

Based on having an aggregate of $3,300 of CTR and DWP credits in its account, Changing Times Ltd is able to fully credit $6,700 of cash dividends ($3,300 x 67/33). Fully credited dividends are, therefore, paid as follows:

To resident shareholders:		
Cash dividend	$6,700 x 25%	$1,675
Full DWP credits	$1,675 x 33/67	$ 825
To non-resident shareholders:		
Cash dividend	$6,700 x 75%	$5,025
Full DWP credits	$5,025 x 33/67	$2,475

The cash flow of Changing Times Ltd will be as follows:

Cash dividend to residents	1,675
Cash dividend to non-residents	5,025
Additional dividend to non-residents:	2,475
Total dividends paid	9,175

After paying New Zealand tax of $1,980 (from which DWP credits arose) on foreign attributed income of $10,000, Changing Times Ltd's post-tax income was only $8,020. However, because of the requirement that the company attach only CTR credits (and not DWP credits) to dividends to non-resident shareholders, the company has had to pay out $9,175 to fully distribute its conduit income. Further, as a consequence of paying the dividends, the balances in its memorandum accounts will become the following:

CTR account: 1,320 CR – 2,475 DR = $1,155 DR
DWP account: 1,980 CR – 825 DR = $1,155 CR

Had the company been able to attach DWP credits to dividends paid to non-residents, it could have left both memorandum accounts with a nil balance and not been required to fund the additional dividend.

If the balances in the memorandum accounts of Changing Times Ltd remain the same at the end of the income year, a wash-up adjustment will result. A transfer will be made from the DWP account to the CTR account for $1,155, leaving both accounts with a nil balance. Changing Times Ltd will also receive a refund from Inland Revenue for the amount of credit transferred.

Transitional rule allowing DWP credits to pass to non-residents

A transitional rule will allow companies with existing DWP credits at the effective date of the reform to still allocate to non-resident shareholders their proportionate share of those credits until 31 March 2001. This is to reduce the cash flow consequences for companies that would otherwise be unable to make a timely distribution of existing DWP credits relating to tax paid on behalf of their non-resident shareholders. The rule overrides the normal requirement that DWP credits be attached only to dividends paid to resident shareholders.

The amount of DWP credits to which this rule can apply is defined in section MZ 4(4). Essentially, it is the aggregate of non-resident shareholders' share of:

- DWP credits existing at 31 March 1998; and
- DWP credits arising on foreign-sourced dividends derived by the company in the March 1998 quarter.

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This later rule recognises that while the DWP liability for this quarter is not payable until after 31 March 1998, no conduit relief can arise in respect of these dividends because they have been paid before the application date of the new relief rules.

Example

In an earlier example, NZ Co paid fully CTR credited dividends to non-resident shareholders of $8,040. It was also required to pay additional dividends of $3,960 in relation to those CTR credits.

NZ Co determines under section MZ 4(4) that it has transitional DWP credits of $4,000 available. It could, therefore, attach DWP credits to the dividends paid to non-resident shareholders, instead of CTR credits. NZ Co would then not be required to fund an additional dividend.

The dividends paid to the non-resident shareholders would then be subject to NRWT as follows:

Cash dividends	8,040
DWP credits	3,960
Dividends subject to NRWT	12,000
DWP credit	3,960
NRWT @ 15%	1,800
Refund of excess DWP credits	2,160
Cash dividends received by non-resident shareholders	8,040
Refund of excess DWP credits	2,160
Total receipt of non-resident shareholders	10,200

The non-resident shareholders obtain the same return as they did when CTR credits were attached to the dividends. However, NZ Co has not been required to fund additional dividends to achieve this result.

Breach of shareholder continuity between derivation of conduit income and its distribution

Special rules have been introduced to deal with breaches of shareholder continuity, which differ from the continuity rules applying to the existing imputation, DWP and BETA rules. Section MI 5(1)(d) defines a breach of continuity to have occurred if, at any time between the time conduit relief is given to the company and the time that relief is distributed, the percentage of resident shareholders of the company increases by 34 or more percentage points.

For example, if a company has 30% of its shareholders resident in New Zealand when conduit relief is received, and this increases to 70% at any time before distribution is to occur, the 40 percentage point increase in resident shareholders will represent a continuity breach.

Implications of breach of continuity

If a breach of continuity occurs, a debit arises to the company's CTR account to the extent of any credit balance in the account at that time. The company will also be required to repay to Inland Revenue the amount of that debit by the 20th day of the month following the quarter in which the breach of continuity occurs (section MI 10(1)(a)).

The payment is treated as a payment of DWP, but does not give rise to a credit in the company's DWP account (section MI 10(2)). This is broadly consistent with the result that would have been achieved if the company had not been a conduit tax relief company, paid DWP (which correspondingly is now paid in relation to the 34 percentage point breach), and subsequently had a breach of shareholder continuity giving rise to a debit in its DWP account.

Other debits to CTR account

A debit to the CTR account under section MI 5(1) will also occur if:

- there is an allocation debit resulting from excessive CTR credits being attached to a dividend (section MI 5(1)(c)); or
- section GC 22 applies if CTR credits are applied to gain a tax advantage (section MI 5(1)(d)).

As with a breach of shareholder continuity, the company will be required to pay to Inland Revenue by the 20th day of the month following the quarter in which the debit occurs an amount of DWP equal to the amount of that debit. Again, the payment will not give rise to a credit in the company's DWP account (section MI 10(2)).

Not crediting the DWP account for the payment made places the taxpayer in the same position it would have been in had it not received conduit tax relief, and a similar credit allocation with DWP credits instead of CTR credits occurred.

Finally, a debit will also arise to the CTR account if:

- a lower-tier company in a 100% chain ceases to be a member of that chain while having a credit balance in its CTR account (section MI 5(1)(f),(g)); or
- a company ceases to be a conduit tax relief company (section MI 5(1)(h)).

The company will again be required to pay to Inland Revenue by the 20th day of the month following the quarter in which the debit occurs an amount of DWP equal to the amount of that debit. However, the payment will now give rise to a credit in the company's DWP account. This is because had the company not elected to be a conduit tax relief company or a conduit tax relief group member, the payment of DWP on foreign attributed income would have given rise to a credit in its DWP account, and that credit would have been unaffected by the action giving rise to the debit to the CTR account.

Crediting the DWP account for the payment made creates a result consistent with what would have occurred had the company not utilised the conduit relief rules.

CTR and amalgamating companies

Section MI 13 introduces rules for amalgamating companies that maintain a CTR account.

If the amalgamated company also maintains a CTR account, the balances in the amalgamating companies' CTR accounts are transferred to the amalgamated company. The 34 percentage point continuity rule applies from the time any credit arose in the CTR account of the amalgamating company until distributed by the amalgamating company, as if the amalgamation had not occurred.

If the amalgamated company does not maintain a CTR account, the balance in the amalgamating companies' CTR at the date of amalgamation is transferred to the amalgamated company's ICA. The amalgamated company will then be required to pay to Inland Revenue an amount of DWP equal to the amount of the transfer. This payment will not give rise to a credit in either the ICA or DWP account of the amalgamated company.

BETA mechanism

The BETA mechanism remains largely unchanged from the way it operated before conduit reform. Tax payable on foreign attributed income gives rise to a credit in the BETA, which can be applied to meet the DWP liability on subsequent foreign-sourced dividends. Similarly, DWP deducted in respect of foreign-sourced dividends gives rise to a debit in the BETA, which can be applied to meet the income tax liability on subsequent foreign attributed income.

To operate correctly, the BETA mechanism works on the basis of tax payable (including any tax implicitly paid by way of loss offset) before determining conduit relief. This ensures that changes in shareholding, for example, do not affect the BETA mechanism's ability to ensure double taxation does not occur on the same ultimate source of income.

To achieve this effect in relation to conduit income, the BETA rules have been modified to ensure that:

- BETA credits and debits on foreign attributed income and foreign-sourced dividends respectively are determined before conduit relief is calculated (section MF 4(1)(a), (3)(a)); and
- BETA offsets are applied before calculating conduit relief (section MF 5(2)(a), (6)(c)).

Implications of reform for non-CTR companies

One of the anomalies identified in the development of conduit tax reform was that the net return to non-resident shareholders of New Zealand companies could be influenced by the order in which the company derived foreign attributed income and foreign-sourced dividends.

The BETA mechanism had the general effect of ensuring that New Zealand tax was imposed only on the form of income that was derived first. If a company derived a foreign-sourced dividend before foreign attributed income, the payment of the DWP impost would give rise to a credit in the company's DWP account, instead of to its ICA if the foreign attributed income were derived first. Because of their refundable nature, DWP provided a greater benefit to non-resident shareholders.

A key aspect of conduit reform for resolving this anomaly is the ability created for companies to credit the tax paid on net foreign attributed income (foreign attributed income less any excess interest allocation) to their DWP account.

This option also exists for non-conduit tax relief companies. If a company maintains a DWP account, the tax payable by the company on foreign attributed income is creditable to the DWP account under section ME 5(7).

The interest allocation rules in Subpart FH still apply in determining the amount to be credited to the DWP account.

However, given the $50,000 relief threshold for the interest allocation rules, it is not anticipated that companies not electing to be conduit tax relief companies will be affected by the rules. If companies do have enough potential conduit relief to be affected by the interest allocation rules, it is reasonable to expect them to elect into the full mechanism, so they can derive the benefits of current-based conduit relief. Alternatively, such companies may elect to cease to be a DWP account company under section MG 2(4).

Conduit reform: holding companies and 100% chains of companies

Background to holding company rules

Non-resident investors commonly use holding companies as vehicles through which to hold their New Zealand investments. A common structure is illustrated in the following diagram. Non-resident owns 100% of NZ Holding Co, which in turn has an investment in NZ Operating Co.

Legally, NZ Holding Co holds the interest in NZ Operating Co, but economically, the real owner is Non-resident.

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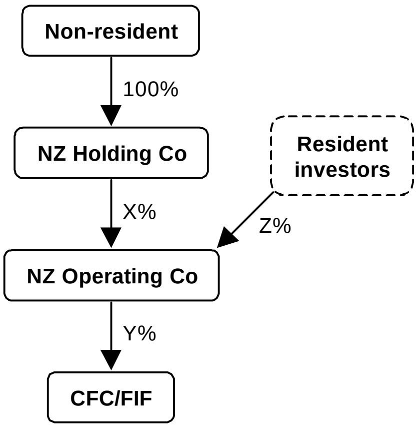
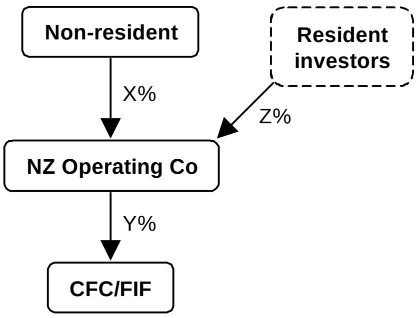


Because conduit tax relief generally arises only to the extent that non-residents hold direct interests in New Zealand companies with foreign investment, no relief would arise to NZ Operating Co for the above structure in the absence of special holding company rules.

One alternative is to require Non-resident to restructure its investment to hold its interest in Operating Co directly to obtain relief. The resulting structure, which is the economic equivalent of the ownership structure illustrated above, is illustrated in the following diagram.



There are several reasons, however, why this would have represented a poor policy approach:

- It could be expensive for Non-resident, and may disrupt a structure established for non-tax reasons.
- Non-resident may be unable to manage the timing of distributions from conduit income, and consequently its NRWT and home country tax liabilities. These liabilities could potentially claw back the benefit of any conduit relief given to Operating Co.
- If Operating Co did not pass on the benefits of conduit relief to Non-resident, but instead reinvested it, the benefits from that reinvestment would accrue to both Resident Investors and Non-resident. For Non-resident to fully capture the benefits of conduit relief (including any income accruing to the reinvested relief), it is necessary that the relief be on-paid and held on its account. However, NRWT acts as a deterrent to this distribution.

To resolve these concerns, special rules have been introduced that:

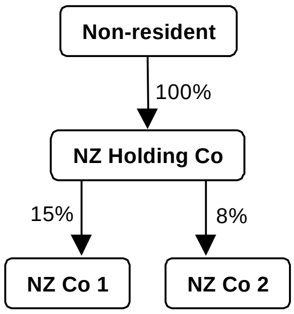
- allow New Zealand resident holding companies wholly owned by a single non-resident investor to be treated as if they were themselves non-resident (sections OE 7(1), (2) and OE 8(3)); and
- eliminate the tax impost on the dividend flow to the holding company (section CB 10(4) and (5)).

In determining whether a company is wholly owned by a single non-resident, a small shareholder that is effectively a nominee and exists to meet company law requirements will not be treated as a separate shareholder (section OE 7(1)(b)). NRWT of 15% will still be imposed when conduit income is passed on to the actual non-resident investor.

If special rules were introduced for all 100% owned holding companies, irrespective of the size of their investment into other New Zealand companies, an inappropriate incentive would be created for every non-resident to incur costs to hold their investments into New Zealand through special holding companies to qualify for conduit tax relief holding company treatment. To reduce this incentive, the special treatment of holding companies will apply only to the extent that they hold interests of 10% or greater in other New Zealand companies (section OE 7(1)(c)).

Example

The shareholding of NZ Holding Co and its interests in other New Zealand resident companies is as follows:



Because of the 10% ownership threshold, NZ Holding Co will be treated as a non-resident for conduit relief purposes only in relation to NZ Co 1.

In relation to NZ Co 2, NZ Holding Co will be treated the same way as any other New Zealand resident shareholder – its interest in the company will not give rise to any current-based conduit relief.

Restrictions on ownership of conduit tax relief holding companies

Several special rules targeting the ownership of conduit tax relief holding companies have been introduced to preserve the integrity of the rules.

First, consistent with the rules applying to direct interests in New Zealand companies held by non-residents, a CFC or a non-qualifying trust will not be treated as a non-resident shareholder. If a holding company has such a shareholder, it cannot be a conduit tax relief holding company (section OE 7(2)).

Second, because of the 10% ownership threshold required before a company can be a conduit tax relief holding company in relation to a conduit tax relief company, rules have been introduced to deal with the situation when ownership falls below this threshold. If this occurs, the election to be treated as a non-resident in relation to that conduit tax relief company will be revoked, and subsequent conduit income of the conduit tax relief company and dividends paid to the holding company will no longer qualify for preferred treatment. There will, however, be no consequence for any credits in the holding company's CTR account at the time it ceases to hold the requisite 10% interest (section MI 5(1)(e),(f) or (g) do not apply).

Dividend exemption

Dividends paid to a conduit tax relief holding company are exempt income "to the extent fully conduit tax relief credited" (section CB 10(4)).

The term "fully conduit tax relief credited" is defined in section OB 1. It is that portion of a cash dividend equal to the CTR tax credits attached, multiplied by 67/33. Thus if a $120 cash dividend is paid with $33 CTR credits attached, the dividend is fully conduit tax relief credited to the extent of $67 of the cash dividend ($33 x 67/33). The remaining $53 of the dividend is not conduit tax relief credited.

The additional dividend paid to a conduit tax relief holding company in respect of CTR credits attached is also exempt income (section CB 10(5)).

The CTR credit does not form part of the dividend, so is also not subject to tax.

Amendments to thin capitalisation rules

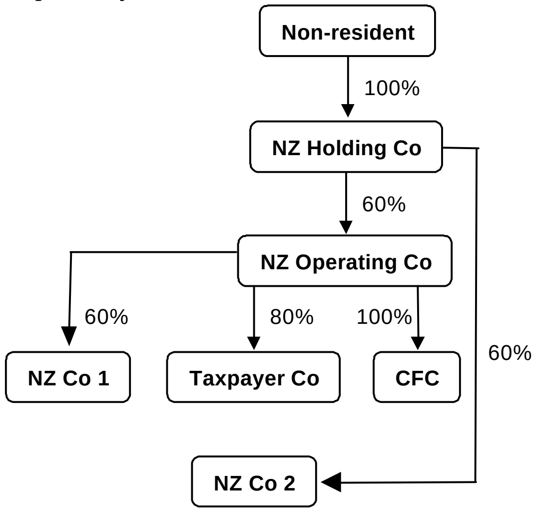
One of the most difficult policy problems under the thin capitalisation rules is the double counting of equity (and, therefore, assets) that would result if companies under common control were not required to consolidate. To some extent, the ability for companies not to group down a chain for interests of less than 66% leaves this double counting problem unaddressed.

Because the holding company rules are concessionary, new rules have been introduced that require generally that a holding company consolidate with any conduit tax relief companies in which it holds a direct interest of more than 50%, notwithstanding that it may have elected to group on the basis of a 66% election. This precludes the holding company from benefiting from both a double counting of assets through not consolidating with lower-tier interests and the special holding company rules.

Specifically, section FG 4(14E) modifies the thin capitalisation rules so that the 66% option no longer applies in relation to the direct interest held by a conduit tax relief holding company in any company to which it has forwarded an election (if the 66% option is elected under thin capitalisation, the lower "greater than 50%" option would apply to the direct interest held by the holding company, with the 66% option applying to all other links in the chain).

The effect of this rule is illustrated in the following diagram.

If NZ Holding Co, as the New Zealand parent of Taxpayer Co under the thin capitalisation rules, elected to apply the 66% grouping threshold, then NZ Holding Co would represent one New Zealand group for thin capitalisation purposes, NZ Operating Co and Taxpayer Co would represent a second group, while NZ Co 1 and NZ Co 2 would represent third and fourth groups respectively.



If NZ Holding Co is a conduit tax relief holding company in respect of NZ Operating Co, section FG 4(14E) will prevent the 66% grouping option applying to NZ Holding Co's interest in NZ Operating Co, because NZ Operating Co is a conduit tax relief company. NZ Holding Co, NZ Operating Co and Taxpayer Co would then become a single New Zealand group for thin capitalisation purposes. However, the 66% grouping election continues to apply other than to direct interests NZ Holding Co has in conduit tax relief companies, and NZ Co 1 and NZ Co 2 will continue to represent separate New Zealand groups for thin capitalisation purposes.

Section FG 4(14E) will not be applicable in every case. If dividends received by a conduit tax relief holding company are on-paid to its non-resident shareholder in the year of receipt (section FG 4(14F)), section FG 4(14E) will not apply. In applying this rule, however, any dividend not on-paid in earlier years will need to be on-paid before a subsequent dividend can be treated as being on-paid in the year of receipt.

The specific test for determining whether dividends have been on-paid refers to dividends to the extent fully CTR credited (as defined in section OB 1). Thus the focus is on relief passed through (as evidenced by credits attached to dividends), rather than the amount of dividends with any extent of conduit tax relief credits attached.

Special rules for 100% owned chains of companies (sections MI 5(1)(f), (g), OE 7(3) to (5) and OE 8)

Special rules have also been introduced for 100% chains of companies. These rules allow a lower-tier company in a chain of companies to qualify for conduit tax relief on account of the extent of non-resident shareholding in the top-tier company in the chain.

Dividends being passed up the 100% chain will be exempt from tax under existing section CB 10(2).

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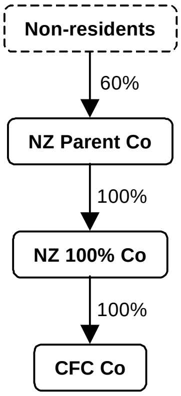
Example

The shareholding chain for a 100% New Zealand group is as follows:



Under the 100% group rules, NZ Parent Co will be treated as a non-resident in relation to NZ 100% Co, to the extent of the 60% interest held in NZ Parent Co by non-residents. As a consequence, NZ 100% Co will be entitled to 60% relief on conduit income derived from CFC Co.

Effective nominees

As with the rules for conduit tax relief holding companies, a small shareholder that is effectively a nominee and exists to meet company law requirements will be disregarded in determining whether 100% ownership exists (section OE 7(4)).

Conduit reform: interest allocation rules

Introduction

The interest allocation rules in new subpart FH aim to ensure that companies do not allocate an excessive amount of interest expense to their New Zealand operations, relative to their foreign interests for which conduit relief is to be provided. If an excessive interest allocation exists, the excess will be reallocated against conduit income, thereby reducing the amount of conduit relief to which the New Zealand company will be entitled.

The fundamental test for determining whether an excessive allocation exists will be a comparison of the debt level of a taxpayer's New Zealand group with that of CFC and FIF interests in which it holds an interest. An excessive allocation in New Zealand exists if the debt level of the New Zealand group exceeds that of its CFC and FIF interests.

The required calculations introduce potentially high compliance costs. To minimise these costs, two important safe harbours have been introduced. Their aim is to ensure that taxpayers are required to perform full calculations only if their New Zealand group has highly geared its New Zealand operations, and a significant amount of conduit relief is involved. To this end, the interest allocation rules will not apply if:

- the conduit relief to which the taxpayer, and companies associated with the taxpayer, are entitled for an income year does not exceed $50,000 (section FH 1(2)(a)); or

  (Note: If any company identified, including the taxpayer, is not a conduit tax relief company, the test applies to that company based on the relief to which it would have been entitled if it had elected to be a conduit tax relief company.)

- the "debt percentage" of the taxpayer's New Zealand group does not exceed 66% (section FH 1(2)(b)).

The New Zealand group is labelled as the "foreign attributed income group" in Subpart FH. This is to distinguish it from the "New Zealand group" under the thin capitalisation rules, since the two groups do not necessarily need to be identical. This commentary will, therefore, use the term "foreign attributed income group" to refer subsequently to the New Zealand group under the interest allocation rules.

Process for applying interest allocation rules

The flow chart on the right sets out an outline of the process to be followed in applying the interest allocation rules. The steps identified are annotated only in greatly summarised form. For a detailed explanation of each step in the process, reference should be made to the explanation that follows.

Non-applicability of interest allocation rules if total relief is less than $50,000

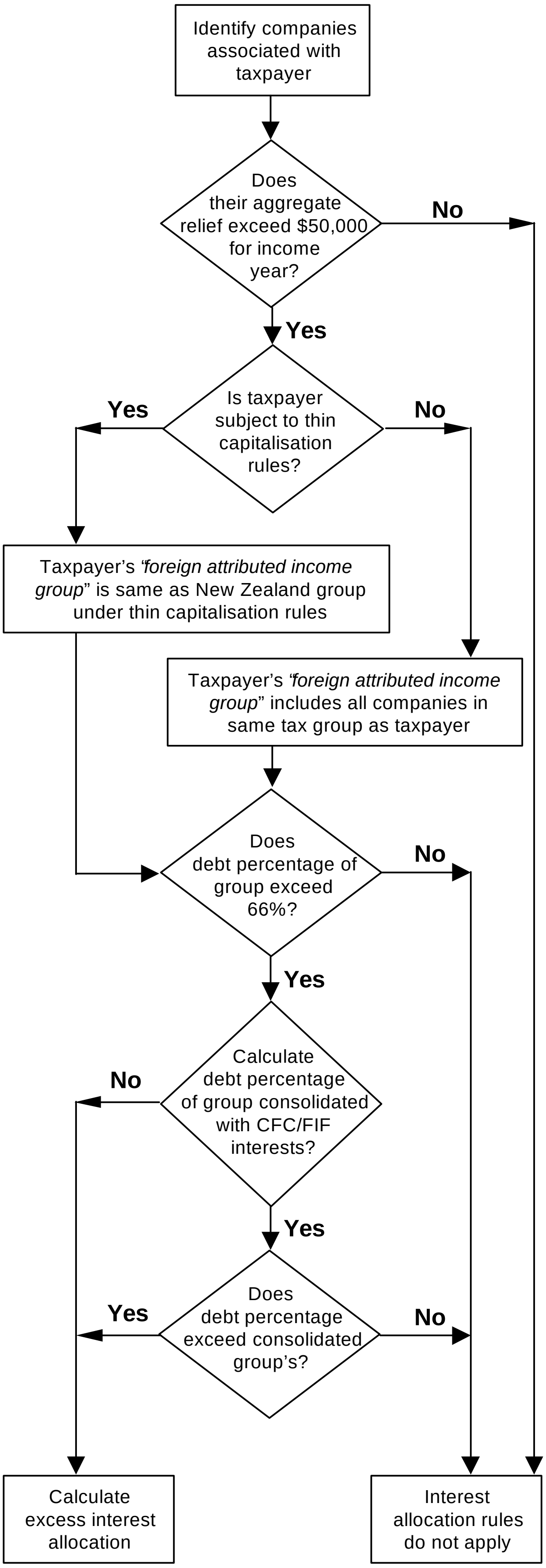
The interest allocation rules will not apply to a taxpayer if the aggregate amount of conduit relief to which the taxpayer and all companies associated with the taxpayer for an income year is less than $50,000.

Two points should be noted in applying this safe harbour.

First, the purpose of the test is to reduce compliance costs by allowing taxpayers to meet a safe harbour test without performing any interest allocation calculations. Consequently, the test is applied based on the amount of conduit tax relief to which a company would be entitled if there is no interest allocation.

Second, there is a special rule for companies that are not conduit tax relief companies but still maintain a DWP account. For each of those companies, the test applies based on the amount of conduit relief the company would have received if it were a conduit tax relief company (section FH 1(2)(a)(i) and (iii)).

Applying interest allocation rules



Example

Taxpayer Co is entitled to conduit relief for an income year of $30,000. Non-conduit Co is a company associated with Taxpayer Co that maintains a DWP account, but has not elected to be a conduit tax relief company.

Consequently, Non-conduit Co does not qualify for conduit relief. However, the company is 75% owned by non-resident shareholders and has received a foreign-sourced dividend in the income year of $100,000. No foreign withholding tax has been deducted and the company does not qualify for an underlying foreign tax credit.

Taxpayer Co would not qualify for exemption from the interest allocation rules under the $50,000 relief threshold. This is because Taxpayer Co's $30,000 relief, when aggregated with the $24,750 relief Non-conduit Co would have been entitled if it were a conduit tax relief company ($100,000 x 33% x 75%), exceeds the $50,000 threshold.

Scheme of rules if $50,000 relief safe harbour threshold breached

The central test around which the interest allocation rules are based is a comparison with the level of debt funding of a group against its New Zealand assets against the level of debt funding of CFCs and FIFs for which conduit relief is to be given.

The discussion immediately following explains the general framework that the rules follow. Understanding the framework should help to place some of the more detailed rules discussed subsequently in their proper context.

To achieve a meaningful comparison, the rules in sections FH 3 to FH 5 for determining the excess interest allocation, in principle, apply the following process:

1. The level of debt is calculated for a consolidated group, which includes members of the taxpayer's group in New Zealand, and CFCs and FIF calculated under the accounting profits or branch equivalent methods from which gross income is derived (referred to subsequently as "non-grey list" CFCs and FIFs) in which those members hold an interest.
2. The amount of consolidated assets for that group are also calculated.
3. The calculations from steps one and two are used to calculate the consolidated group's debt percentage. This represents the extent to which each dollar of assets is funded by debt.
4. The consolidated group's debt percentage is applied back to the assets of the New Zealand part of the group to determine the acceptable level of debt relative to those assets.

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(Note: Section FH 3(3) excludes from the assets of the foreign attributed income group any interest held by a member of that group in a CFC or FIF calculated under the accounting profits or branch equivalent methods from which gross income is derived ("non-grey list" CFCs and FIFs). This exclusion occurs to the extent non-residents hold interests in that group member.

These interests are consolidated out in the full calculations under section FH 4. The exclusion of assets under section FH 3(3) is necessary to get a meaningful comparison of debt levels between the non-conduit assets of the foreign attributed income group and the total assets of the consolidated group.)

A brief example illustrates this mechanism further.

Example

Taxpayer Co is the only member of a foreign attributed income group. It is owned 100% by non-resident shareholders. Its balance sheet is as follows:

Taxpayer Co

Equity	6,000	Shares in CFC	3,000
Debt	15,000	Other assets	18,000
	21,000		21,000

Taxpayer Co holds 100% of the shares in CFC. The balance sheet of CFC is as follows:

CFC

Equity	3,000	Assets	12,000
Debt	9,000		
	12,000		12,000

Performing a consolidation will result in the following consolidated balance sheet:

Consolidated group

Equity	6,000	Assets	30,000
Debt	24,000		
	30,000		30,000

Under step one of the process, the level of debt of the consolidated group is $24,000. Under step two, the assets of the consolidated group are $30,000. This gives a debt percentage under step 3 of 80% (24,000/30,000).

Applying this percentage in step four of the process, Taxpayer Co's assets of $18,000 (the equity investment in CFC is not treated as an asset) will be able to be funded to 80% debt before the interest allocation rules apply.

This leaves an acceptable debt level of $14,400 (18,000 x 80%) in Taxpayer Co. The excess interest allocation to Taxpayer Co would, therefore, be $600 (15,000 – 14,400).

66% safe harbour debt percentage

To reduce compliance costs, section FH 1(2)(b) introduces a second safe harbour, which is the 66% debt percentage. If the debt level of the New Zealand assets of the group is less than 66%, the interest allocation rules do not apply. (This safe harbour is replicated in paragraph (a) of variable CGDP in the formula in section FH 5)

In effect, what this rule does, in relation to the general scheme of the interest allocation rules, is to allow steps one to three of the process to default to 66%.

Thus, in practice, taxpayers will first complete step four of the process to determine whether this 66% threshold is breached. If it is, taxpayers can then proceed, if they wish, to perform the calculations under steps one to three of the process, to see if this permits a higher level of debt funding of the New Zealand assets.

The remainder of this commentary examines the interest allocation rules in the order in which they will be applied to taxpayers.

Determination of foreign attributed income group (New Zealand group)

If a taxpayer company does not qualify for the $50,000 relief safe harbour, the next step will be to identify its foreign attributed income group. In determining whether an excess interest allocation exists, the level of debt funding for that group will need to be determined.

The rules for determining a taxpayer's foreign attributed income group are contained in section FH 2.

The basis for determining the group depends on whether the taxpayer is subject to the thin capitalisation rules or not (that is, whether it is controlled by a single non-resident person).

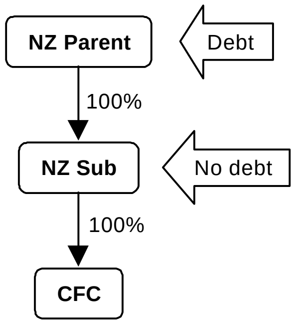
If the taxpayer is subject to the thin capitalisation rules, its foreign attributed income group under the interest allocation rules will be the same as the one determined under the existing thin capitalisation rules (Note: this will exclude the special grouping rules for holding companies in section FG 4(14E) and (14F)).

If the taxpayer is not subject to the thin capitalisation rules, its foreign attributed income group will consist of itself and any other company with which it has 66% common ownership. The key principle underlying the adoption of this threshold is the ability of group companies to transfer losses.

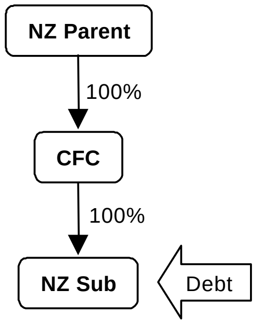
Rationale for using groups

As noted in the discussion document, it is necessary for interest allocation rules to apply in relation to a New Zealand group, rather than only to the taxpayer holding a direct interest in a CFC, to prevent a group of New Zealand companies being structured in a way that circumvents the interest allocation rules.

This problem is illustrated in the following two diagrams.



In the diagram above, rules that considered only the interest expense incurred by the company holding a direct interest in the CFC (NZ Sub) would not take into account interest expense incurred by other companies in the group (NZ Parent). Such rules would not be effective in determining the interest expense properly attributable to the income from the CFC because the loss grouping rules effectively allow the interest expense to be deducted anywhere in the group.



The situation illustrated in this second diagram, in which a CFC is interposed between the two New Zealand group companies, is similar. If reference were made only to the company holding a direct interest in the CFC, the interest incurred by NZ Sub would not be considered in determining the amount of NZ Parent's interest expense allocable to the income from the CFC. However, the loss grouping rules still enable NZ Parent to take advantage of the interest expense incurred by NZ Sub in determining its taxable income.

Consequently, if interest allocation rules are to be effective, they need to be defined in relation to the group of companies of which a taxpayer is a member.

Measurement of "debt level" of foreign attributed income group ("NZ foreign attributed income group debt percentage")

The rules for calculating the group debt percentage are similar to those used for calculating the value of a group's assets and debt under the thin capitalisation rules. Generally accepted accounting practices for consolidation are applied to the foreign attributed income group determined under section FH 2, eliminating intra-group transactions within that group (section FH 3(1)).

Section FH 3(3) contains the exception to the general rule of following a similar calculation approach to the one used under the thin capitalisation rules. Any interests held by a member of the foreign attributed income group in a CFC or FIF calculated under the accounting profits or branch equivalent methods from which gross income is derived ("non-grey list" CFCs and FIFs) are excluded from the assets of the group, to the extent non-residents hold interests in that group member.

Excluding interests in non-grey list CFCs and FIF interests effectively permits the assets of the group other than these excluded assets to be debt-funded at least to the extent of the 66% safe harbour threshold. To the extent that the debt percentage of the consolidated group (including non-grey list CFC and FIF interests) is higher than 66%, a higher level of debt funding is permitted in the foreign attributed income group.

Any debt in excess of 66% (or a higher amount calculated for the consolidated group) is then treated by the rules as relating to the non-resident's share of investment in non-grey list CFCs and FIFs, on which conduit relief is being provided. This represents interest expense for which an adjustment should, in principle, be made in determining the amount of conduit relief to which the company is entitled. How the interest expense allocation is performed is outlined below.

Comparison of New Zealand debt level with that of CFC and FIF interests

If taxpayers breach the 66% safe harbour, section FH 4 gives them the option of performing a consolidation calculation with their non-grey list CFC and FIF interests. This determines whether, based on their consolidated group, a threshold of higher than 66% is justified for determining the extent to which there is an excessive interest expense allocation to the foreign attributed income group (the "worldwide fungibility approach" is applied to determine whether the allocation of the "worldwide group" to its New Zealand operations exceeds the debt levels borne by the group as a whole).

If the taxpayer decides to calculate its "consolidated foreign attributed income group debt percentage" (including non-grey list CFC and FIF interests), section FH 4 requires the consolidation calculation to be made as follows:

- The assets and debt of the New Zealand members of the group will be determined as under section FH 3, except that all interests held in non-grey list CFCs and FIFs calculated under the accounting profits or branch equivalent methods are now excluded from the assets of the group (effect of section FH 4(8)).
- Full consolidation of assets and debt should be done for non-grey list CFC and FIF interests of 40% or greater (section FH 4(3)).
- For interests of between 5% and 40%, taxpayers will include the portion of the underlying interest's assets and debts owned by the taxpayer (section FH 4(4)). For example, if a New Zealand company held 10% of an underlying CFC or FIF, it would consolidate 10% of that interest's debt and assets into its group calculations.

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- Assets and debts for CFC and FIF interests should be consolidated using values from their existing financial statements (section FH 4(5)).

Non-grey list CFC and FIF interests of less than 5% are excluded from the calculations, and are not included as an asset of the consolidated group.

Example

NZ Group Co is the only company in its foreign attributed income group. Its balance sheet is as follows:

NZ Group Co

Equity	6,600	CFC Co	4,000
Debt	18,000	FIF Co 1	4,000
		FIF Co 2	600
		Other assets	16,000
	24,600		24,600

NZ Group Co owns 80% of CFC Co, 25% of FIF Co 1, and 3% of FIF Co 2.

The balance sheets of CFC Co, FIF Co 1 and FIF Co 2 are as follows:

CFC Co

Equity	5,000	Assets	13,000
Debt	8,000		
	13,000		13,000

FIF Co 1

Equity	16,000	Assets	24,000
Debt	8,000		
	24,000		24,000

FIF Co 2

Equity	20,000	Assets	60,000
Debt	40,000		
	60,000		60,000

The consolidated group debt percentage will be calculated as follows:

Consolidated debt:

NZ Group Co:		18,000
CFC Co:	8,000 x 100% =	8,000
FIF Co 1:	8,000 x 25% =	2,000
FIF Co 2:		0
		28,000

Consolidated assets:

NZ Group Co:		16,000
CFC Co:	13,000 x 100% =	13,000
FIF Co 1:	24,000 x 25% =	6,000
FIF Co 2:		0
		35,000

The consolidated group debt percentage will, therefore, be 80% (28,000/35,000).

Determination of group excess interest allocation

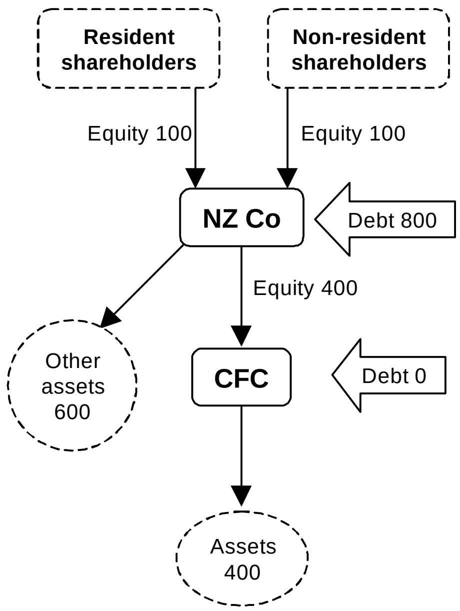
The rules for calculating whether a "group excess interest allocation amount" exists, and consequently whether interest expense must be allocated against conduit income, are contained in section FH 5. The formula in that section confirms that an interest allocation can occur only to the extent that the debt percentage of the foreign attributed income group exceeds 66%. If the debt percentage of the consolidated group (including relevant CFCs and FIFs) is higher than 66%, an interest allocation can only occur if, and to the extent that, the debt percentage of the foreign attributed income group exceeds that of the consolidated group.

Shorthand consolidation

Section FH 5 permits a further debt percentage to be applied in determining the extent to which an excess interest allocation exists. This alternative represents a shorthand debt percentage calculation for the consolidated group.

The example in the following diagram illustrates its effect.

In the diagram, NZ Co (the only member in the foreign attributed income group) is 80% funded by debt. The interest expense on the $800 debt in NZ Co is $80. Half of its shares are owned by non-residents. NZ Co applies 50% of its capital to an investment in CFC, with the balance funding other (non-conduit) assets.



The New Zealand foreign attributed income group debt percentage for NZ Co is calculated as:

$$\frac{800}{1{,}000 - (400 \times 50\%)} = 100\%$$

Prima facie, because this debt percentage exceeds 66%, NZ Co will be subject to an excess interest allocation for the amount of New Zealand debt in excess of this amount.

However, if Taxpayer Co were to perform a consolidation with CFC, the following consolidated balance sheet would result:

Consolidated group

Equity	200	Assets	1,000
Debt	800		
	1,000		1,000

This would give a consolidated debt percentage of 80% (800/1000). Because this debt percentage exceeds 66%, using this percentage would reduce the amount of excess interest expense determined for NZ Co.

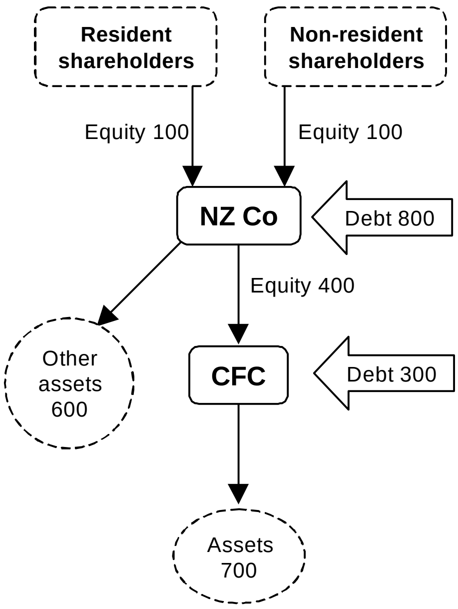
One concern expressed in submissions on the bill is that taxpayers may be reluctant to incur the compliance costs associated with a full consolidation with non-grey list interests. This is despite the fact that such a consolidation may result in a lower amount of excess interest expense being determined.

In response to this, the third limb added to variable CGDP in the formula in section FH 5 recognises that the scenario outlined above represents the worst-case mischief that the interest allocation rules were intended to address – a non-grey list entity owned 100% by a foreign attributed income group and fully equity funded. In practice, CFCs and FIF interests are likely to have debt levels that are greater than nil.

Section FH 5 allows, therefore, a shorthand consolidation with non-grey list entities based on the assumption that the entities in which they invest are owned 100% by a foreign attributed income group and fully equity funded. This ignores debt in the underlying CFCs and FIFs. Mechanically, all this requires to measure is to undo the adjustment in section FH 3(3) for non-grey list CFC and FIF interests.

In the example illustrated, the effect would be to compare the debt percentage of the foreign attributed income group (100%) with that of the consolidated group (80%). Applying these amounts in the formula in section FH 5 gives a $20 excess interest.

The implications of the rule are best illustrated by considering the original scenario, but with CFC now funding additional assets by acquiring debt funding of its own. This is illustrated in the following diagram.



In applying the shorthand test, the debt funding of the CFC is disregarded. As with the previous calculations, the consolidated assets will be $1,000 (the assets of NZ Co) and the consolidated debt will be $800 (the debt of NZ Co), giving a consolidated debt percentage of 80%. From this, it is clear that the shorthand consolidation internalises all data to the New Zealand group.

It is illustrative however, to consider what happens if a full consolidation is performed with CFC. In that case, the consolidated assets will be $1,300 ($600 + $700), the consolidated debt will be $1,100 ($800 + $300), giving a consolidated debt percentage of 84.6% ($1,100/$1,300). This is higher than the percentage calculated under the shorthand consolidation, and would lead to a lower excess interest allocation determination.

In summary, therefore, the shorthand consolidation is a low-compliance cost option of performing the full consolidation calculation which, although being in all but very obscure scenarios less beneficial to the taxpayer than a full consolidation, is nevertheless more favourable than the position if no consolidation is performed at all.

Application of excess interest allocation against foreign attributed income

If the application of the formula in section FH 5 determines that there is an excess interest allocation, the next question is how that should be applied.

The general rule is the excess is to be allocated against the net foreign attributed income (foreign attributed income less foreign attributed losses offset) derived by members of the group under sections FH 6 and FH 7. If the excess is greater than the net foreign attributed income, any surplus is then allocated under section FH 8 against dividends subject to DWP.

Determination of net foreign attributed income

The effect of the formula in section FH 6 is to determine what percentage the excess interest expense represents of the group's net foreign attributed income. Section FH 7 then determines that percentage of a group member's net foreign attributed income to be its share of the excess interest allocation. This amount is then substituted in the variable "EIA" in the formula in section KH 1(2) to determine the amount of conduit relief (if any) to which the member is entitled.

An amendment was made at Select Committee to clarify that the income base against which the excess interest expense is to be allocated is reduced by the income equivalent value of any BETA debit able to be offset against the income tax liability. This is because income tax is only really payable to the extent a BETA offset does not occur. It is not appropriate that interest expense is allocated against income on which no tax is payable because it has been paid in an alternative form.

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Example

Vice Versa Ltd derived a foreign-sourced dividend of $10,000 on 1 July 1998. No foreign withholding tax was deducted and the company had no entitlement for an underlying foreign tax credit. Vice Versa Ltd is the only company in its foreign attributed income group.

Because it had 60% non-resident shareholders, the DWP liability on the dividend was reduced by $1,980 ($3,300 x 60%) from $3,300 ($10,000 x 33%) to $1,320. A debit arose to the BETA for $3,300.

Vice Versa Ltd subsequently derived foreign attributed income of $15,000. Again, no foreign tax credit was available. Vice Versa Ltd continued to have 60% non-resident shareholders.

In applying the relief formula in section KH 1, variable BC, for BETA offsets, will be $3,300. Because there are no foreign tax credits, relief will, in the absence of an excess interest allocation, be determined as:

60% x ((33% x (15,000 – 0 – 0)) – 0 – 3,300) = $990

Tax will be payable of $660 ($15,000 x 33%, less $3,300 BETA debit, less $990 conduit relief).

Overall, therefore, Vice Versa Co will pay tax of $1,980 ($1,320 DWP plus $660 income tax), and receive conduit relief of $2,970 ($1,980 on DWP and $990 on foreign attributed income). Thus the pre-conduit relief tax base is $4,950 ($1,980 tax plus $2,970 relief).

As it turns out. Vice Versa Ltd has an excess interest allocation under section FH 5 of $12,000. This has a tax equivalent value of $3,960 ($12,000 x 33%). What the rules in sections FH 6 and FH 7 aim to achieve is to apply this tax equivalent value against the tax payable on conduit income. Thus in principle, the excess interest allocation is to be offset first against the pre-conduit relief income tax liability of $1,650 ($660 tax plus $990 relief), with the excess applied against the DWP liability.

Applying the formula in section FH 6 to Vice Versa Ltd, the company's excess interest allocation percentage would be determined as:

$$\frac{\$12{,}000 \text{ x } 33\%}{33\% \text{ x } (\$15{,}000 - 0) - \$3{,}300} = 240\%$$

Because this percentage exceeds 100%, the variable EIAP in section FH 7 will be 100%. This results in an excess interest allocation for Vice Versa Ltd under section FH 7 to be included in section KH 1(2) of:

$$\left(15{,}000 - 0 - \frac{\$3{,}300}{33\%}\right) \text{ x } 100\% = \$5{,}000$$

When this amount is applied back into section KH 1(2), conduit relief is determined to be exactly nil:

60% x ((33% x (15,000 – 0 – 5,000)) – 0 – 3,300)

The excess interest allocation of $7,000 ($12,000 – $5,000) will be applied against Vice Versa Ltd's DWP liability under section FH 8. The application of the rules in section FH 8 are discussed in the section that follows.

Application of excess interest allocation against DWP

If the amount of interest expense allocated to all members of the foreign attributed income group under section FH 7 is less than the amount calculated in applying section FH 5 in respect of the group, the difference is applied against foreign-sourced dividends derived by members of the group from which a DWP is required to be deducted using the formulae in section FH 7.

The first step is to convert the excess amount into its tax cash value, by multiplying the excess by the company tax rate. This tax cash value is then allocated against the DWP liabilities of the companies calculated before the provision of conduit tax relief.

To the extent that an allocation is made, the following results:

- An amount of gross income equal to the allocated tax cash value divided by the company tax rate is derived by the company under section FH 8(3).
- A debit will arise in the company's CTR account equal to the foreign dividend adjustment amount calculated under section FH 8(5) (section MI 5(1)(b)). This amount is determined by multiplying the amount of gross income by the company tax rate.

The reason for an additional amount of gross income under section FH 8(3) requires explanation. It traces back to the position that would have resulted had the company derived foreign attributed income subject to the interest allocation rules, and then used the BETA credit arising from that liability to meet the subsequent DWP liability. In that case, tax on the foreign attributed income would have been credited to the DWP account of the company under section ME 5(6) only to the extent of tax on the income net of the interest allocation. This gives a lower credit to the DWP account than if an equivalent gross dividend had been received.

The additional amount of gross income under section FH 8(3) addresses this inconsistency. It ensures that deriving dividends before foreign attributed income does not result in more favourable balances in the memorandum account of the company than if foreign attributed income were derived first (DWP credits in preference to ICA credits).

Example

The application of the rules in section NH 7 is illustrated by revisiting Vice Versa Ltd.

Recall that Vice Versa Ltd had an excess interest allocation unable to be applied under section FH 7 of $7,000. This is the surplus group excess interest allocation amount calculated under section FH 8(1).

The formula in section FH 8(2) then calculates the company's surplus group excess interest allocation percentage as:

$$\frac{\$7{,}000 \times 33\%}{\$3{,}300} = 70\%$$

Applying this percentage into the variable SGEIP in section FH 8(4) then enables the company's foreign dividend adjustment to be calculated as:

$$\frac{\$3{,}300 \times 70\%}{33\%} = \$7{,}000$$

Under section FH 8(3), the company is deemed to have derived an amount of gross income equal to this amount on the last day of its income year. A debit will also arise to its CTR account under section MI 5(1)(b) of $2,310 ($7,000 x 33%).

Detailed example of effect of excess interest allocation against DWP

A taxpayer's foreign attributed income group consists of three members, A Co, B Co and C Co. Following the application of section FH 7 (allocation of excess interest expense against foreign attributed income), a surplus group excess interest amount of $700 is determined under section FH 8(1).

The companies have 31 March balance dates, and have respective DWP liabilities for the year to 31 March 1999 as follows:

	A Co	B Co	C Co
Gross dividends derived	10,000	8,000	16,000
UFTC	5,000	0	4,000
Foreign withholding tax	1,000		2,400
DWP payable	0	2,640	200
BETA offsets		(640)	0
Loss offsets		(500)	0
	0	1,500	200
Conduit relief		(600)	(20)
Net DWP paid	0	900	180
Balance in CTR account	0	600 CR	20 CR
Balance in DWP account	0	900 CR	180 CR

B Co's average percentage of non-resident shareholders was 40%, while C Co's was 10%.

The first step is to convert the excess interest allocation to its tax cash value of $231 ($700 x 33%).

This tax cash value is then allocated against the net DWP liabilities of members of the group, determined before the provision of conduit relief. The relevant amounts are 'nil' for A Co, $1,500 for B Co and $200 for C Co.

Application of the formula in section FH 8(1) determines a surplus group excess interest allocation percentage of 13.59% ($^{231}/_{(1,500 + 200)}$). This percentage is then applied as follows:

A Co:	$0 x 13.59%	=	$ 0
B Co:	$1,500 x 13.59%	=	$204
C Co:	$200 x 13.59%	=	$ 27

In relation to B Co, the following would then result:

- Under section FH 8(3), an amount of gross income of $618 ($^{204}/_{0.33}$) would be derived on the last day of the 1998/99 income year.
- A debit will arise in the company's CTR account for $82 (equal to $618 x 33% x 40% average non-resident shareholding) under section MI 5(1)(b)).

As a consequence, B Co would have paid tax and have credits in its memorandum accounts as follows:

Total DWP paid	$900	= $ 900
Income tax paid	$618 x 33%	= $ 204
Balance in ICA	$618 x 33%	= $ 204
Balance in DWP account	$900	= $ 900
Balance in CTR Account	$600 – $82	= $ 518

Detailed interest allocation rules example

Introduction

The Commentary to the Taxation (Remedial Provisions) Bill (No.2) 1997 contained a detailed example of the application of the interest allocation rules. The purpose of that example was to illustrate the overall effect of the rules in their entirety, rather than only aspects of the rules which have been discussed elsewhere in this Tax Information Bulletin.

This section reproduces the example in the Commentary to the bill, but has been modified to take into account changes made to the bill at Select Committee.

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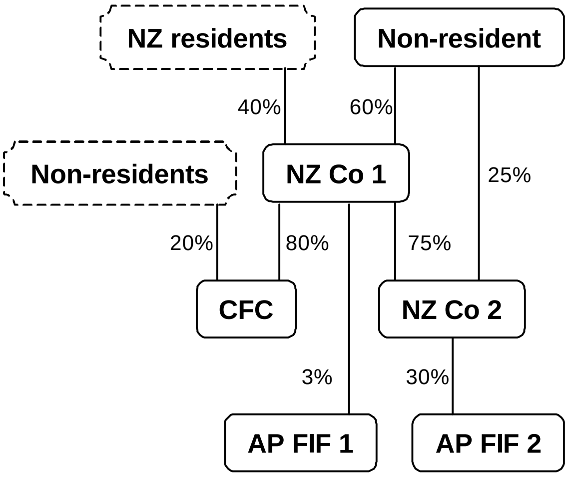
Example

The following example is designed to illustrate the effect of the interest allocation rules, and their interface with the formula for determining conduit relief in section KH 1. The structure is deliberately convoluted to illustrate the various interfaces in the rules. Calculations are to be performed for the income year ending 31 March 1999.



Relevant information and balance sheets for the various companies is as follows:

NZ Co 1

NZ Co 1's income year ended on 31 March 1999. Relevant amounts from its balance sheet at that date are as follows:

NZ Co 1

Share capital	100,000	Shares in CFC	400,000
Other shareholders' funds	546,800	Shares in AP FIF 1	3,000
Loan from NZ Co 2	800,000	Shares in NZ Co 2	15,000
Other "tax" debt	1,000,000	Other assets	1,828,800
Other "non-tax" debt	(200,000)		
	2,246,800		2,246,800

For the year to 31 March 1999, NZ Co 1 had the following relevant income and expenses:

FIF income from AP FIF 1	10,000
Attributed foreign income from CFC	60,000
Section LC 4 credits for tax paid by CFC	12,500
Interest paid to NZ Co 2	80,000
Other interest expense under section DD 1(b)	120,000

NZ Co 2

NZ Co 2's income year ended on 31 March 1999. Relevant amounts from its balance sheet at that date are as follows:

NZ Co 2

Share capital	20,000	Shares in AP FIF 2	60,000
Other shareholders' funds	180,000	Loan to NZ Co 1	800,000
Loan from CFC	200,000	Other assets	340,000
Other "tax" debt	700,000		
Other "non-tax" debt	100,000		
	1,200,000		1,200,000

For the year to 31 March 1999, NZ Co 2 had the following relevant income and expenses:

FIF income from AP FIF 2	6,231
Interest expense under section DD 1(b)	150,000

CFC

CFC's accounting period ended on 31 December 1998. Relevant amounts from its balance sheet at that date are as follows:

CFC

Share capital	500,000	Loan to NZ Co 2	200,000
Other shareholders' funds	356,200	Other assets	1,281,200
Liabilities	625,000		
	1,481,200		1,481,200

AP FIF 1

Because the total interests of members of the foreign attributed income group in AP FIF 1 is less than 5%, it is not included in the consolidated foreign attributed income group debt percentage calculations under section FH 4.

AP FIF 2

AP FIF 2 prepares its financial statements to 28 February 1999. Relevant amounts from its balance sheet at that date are as follows:

AP FIF 2

Share capital	200,000	Assets	500,000
Other shareholders' funds	150,000		
Liabilities	150,000		
	500,000		500,000

Step 1: Identify the foreign attributed income group (section FH 2)

Because NZ Co 1 and NZ Co 2 are both subject to the thin capitalisation rules, by virtue of a single non-resident person (Non-resident) holding in them an ownership interest of 50% or greater (section FG 2), the thin capitalisation rules apply to determine the foreign attributed income group. The group will consist, therefore, of NZ Co 1 and NZ Co 2.

Step 2: Calculate New Zealand foreign attributed income group debt percentage (section FH 3)

The New Zealand foreign attributed income group debt percentage is determined by applying the thin capitalisation rules in section FG 4(1) to (14D) to the foreign attributed income group (NZ Co 1 and NZ Co 2). The most significant factors to bear in mind here are that:

- Section FG 4(2) defines debt on the basis on financial arrangements that provide funds to the recipient and give rise to a deduction for "interest" expense. This differs from the concept of debt used in preparing financial statements.
- Assets are measured based on generally accepted accounting principles of New Zealand (section FG 4(3) to (4)).

Assets held by group members in non-grey list CFCs and FIFs calculated under the accounting profits and branch equivalent methods are also excluded from the asset base to the extent that non-residents hold a direct interest in the New Zealand company holding those CFC and FIF interests.

The asset and debt values for the foreign attributed income group comprising NZ Co 1 and NZ Co 2 are, therefore, calculated as follows.

Assets:	NZ Co 1's total assets	2,246,800
	NZ Co 2's total assets	1,200,000
Less:	NZ Co 1's equity in NZ Co 2	(15,000)
	60% of NZ Co 1's equity in CFC	(240,000)
	60% of NZ Co 1's equity in AP FIF 1	(1,800)
	25% of NZ Co 2's equity in AP FIF 2	(15,000)
	Loan from NZ Co 2 to NZ Co 1	(800,000)
	Total assets	2,375,000
Debt:	Other "tax" debt of NZ Co 1	1,000,000
	Other "tax" debt of NZ Co 2	700,000
	Loan from CFC to NZ Co 2	200,000
	Total debt	1,900,000

This results in a New Zealand foreign attributed income group debt percentage of 80% ($^{1,900,000}/_{2,375,000}$).

(Note: The thin capitalisation rules will not have any effect here, because the New Zealand group debt percentage for thin capitalisation purposes is only 72.2% ($^{1,900,000}/_{2,631,800}$).)

Step 3: Test whether the New Zealand foreign attributed income group debt percentage exceeds 66%

As the New Zealand foreign attributed income group debt percentage does exceed 66%, there is, *prima facie*, an adjustment to be made for an excess interest allocation under section FH 5. The group must now decide whether to pursue a consolidation including its CFC and FIF interests under section FH 4.

Shorthand consolidation

If NZ Co 1 and NZ Co 2 do not want to pursue a full consolidation with CFC, AP FIF 1 and AP FIF 2 under section FH 4, they could consider how the shorthand consolidation would determine their excess interest allocation.

In performing this calculation, the assets of the foreign attributed income group would not be adjusted to remove the non-resident shareholders' share of equity in non-grey list entities. The group's assets would be calculated as:

NZ Co 1's total assets	2,246,800
NZ Co 2's total assets	1,200,000
NZ Co 1's equity in NZ Co 2	(15,000)
Loan from NZ Co 2 to NZ Co 1	(800,000)
Group's total assets	2,631,800

The group's debt remains as 1,900,000, giving a consolidated group debt percentage of 72.2% ($^{1,900,000}/_{2,631,800}$).

As this percentage is higher than the 66% safe harbour percentage, the shorthand consolidation can make the group better off. If the company does not perform the calculation under section FH 4, section FH 5 can be applied to determine the group excess interest allocation amount using 72.2% as the threshold percentage, rather than the 66% safe harbour percentage (step 5 of the process).

Step 4: Calculate consolidated foreign attributed income group debt percentage (section FH 4)

If the taxpayer proceeds with a full consolidation with its group's offshore interests, the asset and debt values calculated at step 2 form the starting point for the further calculations. Adjustments are then made as required by section FH 4.

First, the assets of the foreign attributed income group are further reduced to the extent of resident shareholders' share of its CFC and FIF interests (section FH 3(3)):

Adjustment for NZ Co 1's equity in CFC:	
40% x 400,000 =	160,000
Adjustment for NZ Co 1's equity in AP FIF 1:	
40% x 3,000 =	1,200
Adjustment for NZ Co 2's equity in AP FIF 2:	
75% x 60,000 =	45,000
Total adjustment:	206,200

Second, consolidation with the CFC and FIF interests is performed following the rules in section FH 4(3) to (5). In doing this:

- 100% of the assets and debt of CFC are consolidated into the calculation;
- 30% of the assets and debt of AP FIF 2 are consolidated into the calculation;
- AP FIF 1's assets and debt are disregarded because the foreign attributed income group's interest is less than 5%.

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The asset and debt of the consolidated foreign attributed income group are, therefore, determined as follows:

Assets:	Foreign attributed income group's total assets	2,375,000
Less:	Adjustment for residents' share of CFC and FIF interests	(206,200)
Add:	100% of CFC's assets	1,481,200
Less:	Loan from CFC to NZ Co 2	(200,000)
Add:	30% of AP FIF 2's assets	150,000
	Total assets	3,600,000
Debt:	Foreign attributed income group's total debt	1,900,000
Less:	Loan from CFC to NZ Co 2	(200,000)
Add:	100% of CFC's debt	625,000
	30% of AP FIF 2's debt	45,000
	Total debt	2,370,000

This results in a consolidated foreign attributed income group debt percentage of 65.8% ($^{2,370,000}/_{3,600,000}$).

Because this percentage is less than 66%, the interest allocation rules continue to apply on the basis of the 66% safe harbour threshold (subject to any higher percentage calculated using the shorthand consolidation). The group is not forced to now apply the interest allocation rules on the basis of the lower 65.8% consolidated foreign attributed income group debt percentage (section FH 5).

Step 5: Determine excess interest allocation amount (section FH 5)

The first step in determining the excess interest allocation amount under section FH 5 is to identify the amount of interest for the foreign attributed income group that is deductible under section DD 1(b), less any interest paid on loans between members of the group.

In the example, this is calculated as follows:

Interest expense allowable to NZ Co 1 under section DD 1(b)	200,000
Interest expense allowable to NZ Co 2 under section DD 1(b)	150,000
Less: interest paid on intra-group loan from NZ Co 2 to NZ Co 1	(80,000)
Total relevant interest expense	270,000

This amount is then inserted into the formula in section FH 5 to determine a group excess interest allocation amount of:

$$270{,}000 \times \frac{(80\% - 72.2\%)}{80\%} = \$26{,}345^*$$

* 72.2% is a rounded number. The calculation has been made using the actual percentage, which is calculated as $1,900,000 ÷ $2,631,800.

(Note: Because the debt percentage calculated using the shorthand consolidation at step 3 exceeds the 66% safe harbour percentage and the consolidated group debt percentage (65.8%), this is the percentage applied in the section FH 5 formula.)

Step 6: Determine allocation of excess interest expense between group members

The next step in the process is to apply the excess interest allocation rules in section FH 6. As a starting point, this requires the amount of foreign attributed income to be identified to which relief may potentially apply.

In the example, this will be the following income:

NZ Co 1's attributed foreign income from CFC	60,000
NZ Co 1's FIF income from AP FIF 1	10,000
NZ Co 2's FIF income from AP FIF 2	6,231
Total foreign attributed income	76,231

Applying this amount to the formula in section FH 6, an excess interest allocation percentage of 34.56% is determined ($^{26,345}/_{76,231}$). The formula in section FH 7 then allocates 34.56c interest against each dollar of net foreign attributed income (in the formula, foreign attributed income less foreign attributed income losses offset).

The excess interest allocated to NZ Co 1 will, therefore, be $24,192 (70,000 x 34.56%). The excess interest allocated to NZ Co 2 will be $2,153 (6,231 x 34.56%).

Step 7: Determine amount of conduit relief

Because all of the interest expense has been allocated against foreign attributed income, it is not necessary to consider whether the rules in section FH 8 relating to the allocation of excess interest expense against DWP apply. This means that all that remains to be determined is the amount of conduit relief arising under section KH 1(2).

Application of the formula in section KH 1(2) will determine relief for NZ Co 1 as:

60% x ((33% x (70,000 – 0 – 24,192)) – 12,500 – 0)
= $1,570.

Application of the formula in section KH 1(2) will determine relief for NZ Co 2 as:

25% x ((33% x (6,321 – 2,153)) – 0 – 0) = $344.

Local authority trading enterprises

Sections CB 4, OB 1

Introduction

The amendment has removed the charitable and district improvement income tax exemptions for local authority trading enterprises (LATEs) and local authority income derived from LATEs.

Background

The Act provides that income derived by trustees in trust for charitable purposes, or derived from a business carried on by, on behalf of, or for the benefit of, trustees in trust for charitable purposes within New Zealand is exempt from tax. Charitable purpose is defined to include "the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community".

The commercial activities carried by most, if not all, LATEs could probably be considered beneficial to the community, so qualifying them for an income tax exemption. It is also likely that the commercial activities of LATEs would also qualify for the district improvement income tax exemption. This exemption is provided for societies or associations established substantially or primarily for the purpose of developing any city, borough or district, so as to attract trade, tourists or population, or to develop amenities for the general public.

These exemptions may also extend to certain income derived by local authorities. Income derived by local authorities is, generally speaking, exempt from income tax. However, this exemption does not include income derived from LATEs.

In 1989 the Government enacted legislation to ensure that LATEs and income derived by local authorities from LATEs were taxable. This was to ensure as much competitive neutrality with the private sector as possible. The ability of local authorities and LATEs to obtain a charitable or district improvement income tax exemption is clearly inconsistent with the policy intent of the 1989 legislation.

Key features

Section CB 4 has been amended to ensure that charitable income tax exemptions under subsections CB 4(1)(c) and (e) and the district improvement income tax exemption under subsection CB 4(1)(j) do not apply to LATEs and local authority income derived from LATEs.

Application date

The amendment applies from the 1999/00 income year.

Charitable organisations - addition

Section KC 5(1)

The New Zealand Viet Nam Health Trust has been granted charitable donee status.

From the 1998/99 income year, donations made to the Trust will entitle individual taxpayers to a rebate of 33 1/3 percent of the amount donated. The maximum rebate for all donations is $500 per annum. A company (other than a closely held company) will be entitled to a deduction from net income up to the amount prescribed by section DJ 4.

Terminal tax date

Sections MC 1, MC 2, NC 17, OB 1 Income Tax Act 1994
Sections 3, 37(4A) Tax Administration Act 1994

Introduction

The terminal tax date for taxpayers with a tax agent has been extended by two months. The new terminal tax date for taxpayers with a March to September balance date moves from 7 February to 7 April if they have an agent. The change is intended to reduce exposure to late payment penalties and use-of-money interest and reduce compliance costs.

The terminal tax date for taxpayers without an agent is not changed. For a standard or late balance date taxpayer, the terminal tax payment date remains 7 February.

The change in the terminal tax date will also apply to ACC premiums paid by self-employed taxpayers.

Background

At present, about 270,000 taxpayers have to consider making a terminal tax payment on 7 February, although their return of income and the calculation of the tax payable is not due until 31 March.

Taxpayers and their agents incur substantial compliance costs in preparing an income estimate to determine the amount of terminal tax that should be paid on 7 February. The Institute of Chartered Accountants of New

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Zealand has estimated the compliance cost associated with the current practice at $22 million.

The amendments deal with these compliance cost concerns by extending the terminal tax payment date for taxpayers whose tax return is prepared by a tax agent.

Key features

Section MC 1(2) has been amended to provide that the terminal tax of a provisional taxpayer is due and payable on the month specified in column E of Schedule 13 if the taxpayer has a tax agent, and on the month specified in column D of that schedule in any other case.

This amendment applies solely to the 1997/98 income year. Section MC 1(2) applies from the 1998/99 income year. A new subsection MC 1(4) is inserted to ensure that provision provides the required extension for returns prepared by agents. This subsection applies from the 1998/99 income year.

Schedule 13 has been amended by inserting a new column E which sets out the month for payment of terminal tax when a taxpayer has an agent.

Section MC 2(1) has been amended to provide that the terminal tax date of a non-resident company which does not have a fixed establishment in New Zealand is 7 April if the company has a tax agent.

Section MC 2(2) has been amended to provide that the terminal tax of any person is due on the month specified in column E of Schedule 13 if the person has a tax agent, and on the month specified in column D of that schedule in any other case. This amendment applies to the 1997/98 income year with the section inserted applying for 1998/99 and subsequent income years. Section MC 2(3) is inserted to ensure that provision applies correctly.

Section NC 17(2) has been amended to provide that the income tax payable by an employee under an assessment made in accordance with section NC 17(1) is due as follows:

- on 7 February;
- on 7 April, if the taxpayer's return of income to which the assessment relates was linked to a tax agent; or
- on an earlier date specified in the notice of assessment.

Section OB 1 of the Income Tax Act 1994 and section 3 of the Tax Administration Act 1994 have been amended by adding the definition of the term "tax agent". A tax agent is a person who prepares the annual returns for ten or more taxpayers and who:

- carries on a professional public practice; or
- carries on a business in which annual returns are prepared; or
- is the Maori Trustee.

Section OB 1 has also been amended to include the term "linked to a tax agent". This term which is used in sections MC 1, MC 2 and NC 17 is required to ensure that the proposed deferral of the terminal tax date applies to returns filed by agents or prepared by agents.

Section 37(4) of the Tax Administration Act has been redrafted to reflect the definition of the term "tax agent". An amendment is also made to clarify that the return being to referred to in the section is not the tax agent's return.

A new section 37(4A) has been inserted to provide that the Commissioner may refuse to extend a tax agent's time for filing a particular return or cancel an existing extension if the taxpayer has furnished a required return of income for a prior income year.

Application date

The amendment applies to the 1997/98 income and subsequent years except in the case of the provisions specified.

Provisional tax uplift factors

Section MB 2

Introduction

The amendment adjusts the provisional tax uplift factors to take into account the tax rate reductions for natural persons. With the tax rate reductions applying from 1 July 1998, the use of last year's tax liability to determine the amount of provisional tax payable this year would lead to natural persons overpaying their provisional tax if no adjustment were made.

Background

The provisional tax regime provides that taxpayers with significant income not subject to sufficient withholding tax must pay their tax in three instalments during the year on the basis of a prior year's tax liability plus an uplift factor or on the basis of an estimate of their tax liability.

With the tax rate reductions from 1 July 1998, using last year's tax liability to determine the amount of provisional tax payable this year would lead to natural persons overpaying their provisional tax. If no adjustment were made to the last year's payment basis, taxpayers would either overpay their tax or estimate their tax liability. To limit the number of cases in which this occurs an adjustment has been made to the provisional tax uplift factors to take into account the tax rate reductions for natural persons.

Key features

Section MB 2 has been amended so that:

- When a natural person's taxable income for the immediately preceding income year does not exceed $75,000, and the previous year's tax return has been filed, the person's provisional tax liability for the current year is 100% of last year's residual income tax.
- When a natural person's taxable income for the income year before the immediately preceding income year does not exceed $75,000, and the previous year's tax return has not been filed, the person's provisional tax liability for the current year is 105% of the residual income tax for the income year before the immediately preceding income year.

These adjustments do not apply to taxpayers who estimate their provisional tax liability or for whom the Commissioner determines liability.

Application date

The amendment applies to provisional tax instalments for the 1998/99 income year due on or after 7 July 1998.

Taxing extra employment income and secondary income

Sections NC 2, NC 8(1A)

Introduction

Before these amendments were made, the PAYE regime systematically under-deducted tax from the earnings of those taxpayers paying income tax at the top marginal tax rate of 33%. A number of amendments have being made to increase the PAYE scheme's flexibility and to reduce the likelihood of under-deduction.

These measures are consistent with the Government's overall objective of simplifying the tax system and they support further reductions in filing tax returns.

Background

The PAYE system provided that both extra employment income and secondary employment earnings were subject to a withholding tax rate of 24% (which reduces to 21% from 1 July 1998) unless an employee applied for a special tax code. Depending on an employee's annual income, he or she may have faced an annual tax debit because too little tax has been withheld from that extra employment income or secondary employment income. These measures have been introduced to avoid such debits arising, thereby improving the accuracy of the PAYE system. The changes also prevent employees with significant extra emoluments or secondary employment income being forced into the provisional tax system if their residual income tax exceeds $2,500.

Key features

Section NC 2(4) provides that employers will be required to apply a 33% withholding rate to extra employment income if the combined total of the extra income and the annualised value of the source deduction payments paid to the employee by the employer in the last four weeks exceed $38,000.

The provision applies only to the annualised value of the last four weeks paid to that employee by that employer. No payments by other employers or from other income sources are required to be included in the calculation.

Examples

Example 1: Employee paid weekly

An employee receives the following salary and extra emolument payments:

Pay day	Wage	Extra emolument
30 September 1998	$1,000	$0
7 October 1998	$1,000	$0
14 October 1998	$1,000	$0
21 October 1998	$1,000	$4,000

The total value of the source deduction payments paid to the employee in the last four weeks is $4,000. These payments represent an annual salary of $52,000 ($4,000 x 52 weeks ÷ 4 weeks). Adding the extra emolument of $4,000 provides an estimated annual salary of $56,000. As this expected salary exceeds $38,000 the employer is required to withhold at 33% from the $4,000 extra emolument payment.

Example 2: Employee paid monthly

An employee receives monthly payments comprising the following salary and extra emolument payments:

Pay day	Salary	Extra emolument
30 September 1998	$4,000	$1,000

The total value of the source deduction payments paid to the employee in the four weeks includes the payment of salary for September. This payment represents an annual salary of $48,000 ($4,000 x 12 months ÷ 1 month). Adding the extra emolument of $1,000 provides an estimated annual salary of $49,000. As this expected salary exceeds $38,000 the employer is required to withhold at 33% from the $4,000 extra emolument payment.

A new paragraph NC 8(1A) has been inserted. This allows employees, via a tax code declaration, to elect

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that a 33% deduction rate applies to any extra emolument payments.

Employees with more than one employer are able to request that a 33% withholding rate apply to secondary employment. This is done by way of electing a “SH” code which has been inserted as a paragraph (da) in subsection NC 8(1).

Clause 8 of Schedule 19 has been amended to provide that 33% is the withholding tax rate for extra employment income when either new sections NC 2(5) or NC 8(1A) applies. Similarly the schedule has been amended by inserting a new clause 5A which provides that 33% is the withholding tax rate for secondary employment earnings if an employee has elected the “SH” tax code.

Application date

The amendments apply to tax deductions from payments of salary or wages or extra employment income for pay periods ending on or after 1 July 1998.

Creating forestry right for oneself

Section OB 1

Introduction

The Income Tax Act 1994 has been amended to ensure that land owners do not incur a tax liability when they create forestry rights for themselves.

Background

A new section 2A has been inserted in the Forestry Rights Registration Act 1983 to allow land owners to create a forestry right for themselves. This amendment is contained the Statutes Amendment Bill (No.2), which at the time this TIB went to print was still before Parliament. A supporting amendment to the Income Tax Act was required to ensure that land owners do not incur a tax liability when they create a forestry right for themselves. The amendment solves a problem faced by many small forestry owners who want to sell their land but retain ownership of their trees.

Key features

Subparagraph (c)(i) of the section OB 1 definition of “sale or other disposition” has been amended to exclude a forestry right created for oneself. This amendment means that creating a forestry right does not result in a tax liability under section CJ 1.

Application date

The amendment applies from the 1997/98 and subsequent income years but will not take effect until the Statutes Amendment Bill (No.2) has been passed.

Overpayments arising under the student loan scheme

Section 56, Student Loan Scheme Act 1992

Introduction

An amendment has been made to the Student Loan Scheme Act 1992 to allow the Commissioner to offset an annual student loan overpayment against a borrower’s student loan balance, if the borrower has not indicated to Inland Revenue that he or she wishes the overpayment to be refunded. Borrowers are given six months from the date of the notice of assessment to apply for the whole, or part, of the overpayment to be refunded.

Background

Previously, if borrowers had paid more than their minimum repayment obligation for an income year, and they did not indicate to Inland Revenue that they wished the overpayment to be credited against their loan balance, the overpayment was refunded. A significant number of borrowers in this situation received refunds of payments that were intended to reduce their loan balance.

Key features

Section 56 has been amended to provide that if a borrower has not indicated how an overpayment is to be applied, it will be offset against his or her loan balance. Borrowers are given six months from the date of their notice of assessment to apply for the whole, or part, of the overpayment to be refunded.

Application date

The amendment applies to overpayments arising on or after 1 April 1998.

Cancellation of interest on student loan repayments

Section 60A, Student Loan Scheme Act 1992

Introduction

The amendment has added a new section 60A to the Student Loan Scheme Act 1992. The amendment provides for interest that has accrued subsequent to a borrower being notified of the amount of the student loan balance outstanding to be cancelled when the loan, and any interest that has accrued to the date of the notification, is paid in full within 15 days of the notification.

Background

Borrowers who fully repay their student loan during an income year may accrue small amounts of interest between the date they are notified by Inland Revenue of the total amount outstanding and the date on which they pay that amount. This often necessitates a further small payment.

Key features

If Inland Revenue notifies a borrower of the amount of his or her student loan, including any accrued interest, and the borrower pays this in full within 15 days, any interest accruing after the date of notification will be cancelled.

Application date

The amendment applies to notifications issued on or after 1 June 1998.

Return filing requirements

Section 33A Tax Administration Act 1994

Introduction

An amendment to the Tax Administration Act 1994 removes the requirement for student loan borrowers to file a tax return for an income year if their loan has been fully repaid during that income year.

Background

Student loan borrowers are required to file an annual tax return to establish their repayment obligation and any entitlement to a base interest write-off. If a borrower repays his or her loan during an income year, the only reason for requiring a return is to calculate any entitlement to a base interest write-off. The vast majority of borrowers do not receive a base interest write-off in the final year of repayment. Requiring a return in the final year of repayment imposes unnecessary compliance costs on borrowers who are not otherwise required to file a tax return.

Key features

An amendment to section 33A removes the requirement for student loan borrowers, who are not otherwise required to file a tax return, to file a tax return for an income year if their loan is fully repaid during that income year.

Borrowers entitled to a base interest write-off will still receive it, but only if they file a tax return. The IR 5 and IR 3 tax guides will contain a statement on the possibility of a base interest write-off and Inland Revenue will advise borrowers of this by letter when the loan is repaid.

Application date

The amendment applies from the 1998/99 income year.

National standard cost values and national average market values for specified livestock

Sections EL 3A, El 4, EL 8

Introduction

This amendment provides that the national standard cost values and the national average market values for specified livestock should be set by the Commissioner rather than by Order in Council The current release dates for these values cause undue pressure on both taxpayers and their agents in calculating tax payments. The new process will allow the values to be released approximately two weeks earlier than is currently the case.

Background

Section EL 4 provides for the Governor-General to declare, by Order in Council, the national standard costs for each category of specified livestock. Section EL 8 provides that the Governor-General may also, by Order in Council, declare a national average market value in relation to a class of specified livestock.

When the regime was introduced, the process of setting the values was seen as a potentially significant issue. However, the process has become routine, and is, in principle, no different from the way the Commissioner determines depreciation rates.

Given this and the fact that the delays involved in the current process are imposing a significant compliance

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costs on some taxpayers and their advisors, the Income Tax Act 1994 has been amended to allow the Commissioner to determine the values.

No change in consultation will occur with this proposal. In practice, more time may actually be made available for consultation, given the simpler process for promulgating the values themselves.

Key features

The existing section EL 4 has been split into a new section EL 3A (the Commissioner may issue a determination as to the national standard costs of livestock) and an amended section EL 4 which provides that the Commissioner may determine (as is currently the case) the methods by which livestock are to be valued under the national standard cost scheme.

Section EL 8 has been amended to provide that Commissioner may declare those values. A requirement that the Commissioner gazette those values has also been introduced.

Application date

The application date of these measures is date of enactment. The effect of this is that the national average market values for the 1997/98 income year will be set by Commissioner's determination.

Goods and Services Tax Act 1985: remedial amendments resulting from the Customs and Excise Act 1996

Reference amendments

Sections 1(2) and 2(1)

The reference to section 13 in subsection 1(2) of the Goods and Services Tax Act 1985 has been removed. Section 13 was repealed by the Customs and Excise Act 1996.

The reference in section 2(1), definition of "input tax" to the Customs Act 1966 is replaced with a reference to the Customs and Excise Act 1996.

These amendments bring the Goods and Services Tax Act 1985 in line with the changes resulting from the Customs and Excise Act 1996.

The amendments are deemed to apply from 1 October 1996, the application date of the Customs and Excise Act 1996.

"Directly in connection with"

Section 11(2)(ca)

The amendment restores the phrase "directly in connection with" in section 11(2)(ca) after the Customs and Excise Act 1996 replaced it with the phrase "in relation to".

The amendment will apply from 1 October 1996 (the application date of the Customs and Excise Act 1996). However, if registered persons have furnished returns before 18 November 1997, which pertain to taxable periods ending between 30 September 1996 and 18 November 1997, and have relied on the phrase "in relation to", the amendment applies from 18 November 1997.

Minor remedial issues

Introduction

A number of minor drafting amendments have been made to the newly enacted provisional tax regime and the compliance and penalty regime.

Background

These measures are minor drafting corrections or clarifications.

Key features

The definition of "instalment date" in section OB 1 of the Income Tax Act 1994 refers to all instalments being due on the 7th of the month, when instalments in January are due on the 15th of the month. The definition has been amended to include a reference to the 15th of the month, if the month is January.

Paragraph (b) of the definition of "first business day" in section OB 1 of the Income Tax Act has been amended by replacing the words "ceased to derive" with "derived".

Section 183H of the Tax Administration Act 1994 provides that taxpayers may request remission of liabilities in writing. The section has been amended to make clear that the provision applies to sections 183A and 183D of the Tax Administration Act.

Application date

The application date for the first two minor amendments is 1 October 1997 while the application date for the amendment to section 183H is the date of enactment.

Credit card transaction duty repealed

A supplementary Order paper to the bill amended the Stamp and Cheque Duties Act 1971, to repeal credit card transaction duty from 1 April 1998. It confirms that EFT-POS transactions and certain ATM withdrawals are not subject to the duty, and never have been. These amendments will bwe described in more detail in the May Tax Information Bulletin.

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.

Foreign currency amounts – conversion to NZ currency

The tables in this item list exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand currency under the controlled foreign company (CFC) and foreign investment fund (FIF) rules for the 12 months ending 31 March 1998. In the past we've published these rates in an annual IR 270G form. However, we now publish them six-monthly in the Tax Information Bulletin instead. The final IR 270G form was to 31 March 1997. The conversion rates for the first six months of each income year are published following the end of the September quarter, and the rates for the full 12 months rates at the end of each income year.

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown.

Table A

Use this table to convert foreign currency amounts to New Zealand dollars for:

- branch equivalent income or loss under the CFC or FIF rules under section CG 11(3) of the Income Tax Act 1994
- foreign tax credits calculated under the branch equivalent method for a CFC or FIF under section LC 4(1)(b) of the Income Tax Act 1994
- FIF income or loss calculated under the accounting profits, comparative value (except if Table B applies) or deemed rate of return methods under section CG 16(11) of the Income Tax Act 1994.

Key

x
y

x is the exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the next day on which they were quoted.

y is the average of the mid-month exchange rates for that month and the previous 11 months.

Example 1

A CFC resident in Hong Kong has an accounting period ending on 31 December 1997. Branch equivalent income for the period 1 January 1997 to 31 December 1997 is 200,000 Hong Kong dollars (HKD).

HKD 200,000 ÷ 5.1426 = NZ$38,890.83

A similar calculation would be needed for a FIF using the branch equivalent or accounting profits methods.

Example 2

A taxpayer with a 31 March balance date purchases shares in a Philippines company (which is a FIF) for 350,000 pesos on 7 December 1997. Using the comparative value or deemed rate of return methods, the cost is converted as follows:

PHP 350,000 ÷ 20.6183 = NZ$16,975.21

Alternatively, the exchange rate can be calculated by averaging the exchange rates "x" which apply to each complete month in the foreign company's accounting period.

Example 3

A CFC resident in Singapore was formed on 21 April 1997 and has a balance date of 30 November 1997. During this period, branch equivalent income of 500,000 Singapore dollars was derived.

(i) Calculating the average monthly exchange rate for the complete months May-November 1997:
(0.9963 + 0.9824 + 0.9586 + 0.9717 + 0.9563 + 0.9927 + 0.9834) ÷ 7 = 0.9773

(ii) Conversion to New Zealand currency:
SGD 500,000 ÷ 0.9773 = NZ$511,613.63

Table B

Table B lists the end of month exchange rates acceptable to Inland Revenue for the 12 month period ending 31 March 1998. Use this table for converting foreign currency amounts to New Zealand dollars for:

- items "a" (market value of the FIF interest on the last day of the income year) and "c" (market value of the FIF interest on the last day of the previous income year) of the comparative value formula
- foreign tax credits paid on the last day of any month calculated under the branch equivalent method for a CFC or FIF under section LC 4(1)(a) of the Income Tax Act 1994.

Example 4

A New Zealand resident with a balance date of 31 December 1997 held an interest in an FIF resident in Thailand. The market value of the FIF interest at 31 December 1997 (item "a" of the comparative value formula) was 500,000 Thailand baht (THB).

THB 500,000 ÷ 26.7376 = NZ$18,700.26

Note: If you need an exchange rate for a country or a day not listed in these tables, contact one of New Zealand's major trading banks. Round the exchange rate calculations to four decimal places wherever possible.

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Table A: Mid-month and 12 month cumulative average exchange rates

Country	Foreign Currency to NZ $		15 Apr 97 12 mth rate	15 May 97 12 mth rate	16 Jun 97 12 mth rate	15 Jul 97 12 mth rate	15 Aug 97 12 mth rate	15 Sep 97 12 mth rate
United States	Dollar	USD	0.6910 0.6935	0.6961 0.6942	0.6883 0.6954	0.6657 0.6937	0.6402 0.6900	0.6341 0.6850
United Kingdom	Pound	GBP	0.4262 0.4352	0.4225 0.4326	0.4208 0.4311	0.3942 0.4272	0.4025 0.4239	0.3945 0.4196
Australia	Dollar	AUD	0.8855 0.8795	0.8956 0.8826	0.9162 0.8881	0.9018 0.8915	0.8630 0.8902	0.8781 0.8904
Austria	Schilling	ATS	8.3931 7.6561	8.2653 7.7276	8.3705 7.8230	8.3673 7.9086	8.2521 8.0010	7.8909 8.0437
Bahrain	Dollar	BHD	0.2605 0.2613	0.2624 0.2616	0.2583 0.2620	0.2508 0.2613	0.2412 0.2599	0.2388 0.2580
Belgium	Franc	BEF	24.5941 22.4351	24.2815 22.6552	24.6017 22.9477	24.6360 23.2132	24.2580 23.4891	23.1720 23.6223
Canada	Dollar	CAD	0.9662 0.9446	0.9662 0.9467	0.9498 0.9493	0.9105 0.9470	0.8895 0.9427	0.8824 0.9371
China	Yuan	CNY	5.7192 5.7482	5.7601 5.7512	5.7010 5.7598	5.5124 5.7440	5.2931 5.7123	5.2483 5.6704
Denmark	Krone	DKK	4.5424 4.1768	4.4824 4.2114	4.5425 4.2600	4.5453 4.3041	4.4808 4.3498	4.2766 4.3698
European Community	Unit	XEU	0.6091 0.5682	0.6037 0.5718	0.6110 0.5776	0.6031 0.5819	0.5984 0.5867	0.5720 0.5883
Fiji	Dollar	FJD	0.9746 0.9675	0.9786 0.9695	0.9730 0.9722	0.9438 0.9710	0.9240 0.9680	0.9278 0.9650
Finland	Markka	FIM	3.5616 3.2762	3.5571 3.3010	3.5779 3.3370	3.5240 3.3655	3.5234 3.4053	3.3591 3.4214
France	Franc	FRF	4.0167 3.6884	3.9697 3.7213	4.0321 3.7674	4.0355 3.8094	3.9686 3.8501	3.7766 3.8671
French Polynesia	Franc	XPF	72.8279 66.9149	71.9875 67.5116	73.1636 68.3452	73.1285 69.0995	71.9482 69.8341	68.5027 70.1444
Germany	Deutschemark	DEM	1.1949 1.0911	1.1790 1.1013	1.1950 1.1152	1.1957 1.1279	1.1778 1.1410	1.1246 1.1473
Greece	Drachma	GRD	187.4440 171.5416	187.7064 173.2869	188.6238 175.4444	186.9641 177.3852	184.5894 179.2721	177.3789 180.1888
Hong Kong	Dollar	HKD	5.3518 5.3639	5.3822 5.3688	5.3258 5.3784	5.1553 5.3657	4.9580 5.3378	4.9084 5.3001
India	Rupee	INR	24.5707 24.3573	24.7120 24.4724	24.4316 24.5855	23.4658 24.5524	22.6475 24.4441	22.9062 24.3220
Indonesia	Rupiah	IDR	1,644.49 1,707.47	1,684.64 1,715.94	1,651.29 1,725.09	1,623.64 1,728.37	1,752.56 1,743.05	1,847.80 1,764.96
Ireland	Pound	IEP	0.4470 0.4319	0.4552 0.4332	0.4555 0.4357	0.4395 0.4366	0.4402 0.4380	0.4184 0.4370
Italy	Lira	ITL	1,172.40 1,087.44	1,159.74 1,095.01	1,172.33 1,106.03	1,158.55 1,115.12	1,149.02 1,124.44	1,098.07 1,127.68

Country	Foreign Currency to NZ $		15 Oct 97 12 mth rate	14 Nov 97 12 mth rate	15 Dec 97 12 mth rate	15 Jan 98 12 mth rate	16 Feb 98 12 mth rate	16 Mar 98 12 mth rate
United States	Dollar	USD	0.6449	0.6249	0.5960	0.5753	0.5818	0.5875
			0.6805	0.6732	0.6645	0.6540	0.6447	0.6355
United Kingdom	Pound	GBP	0.3976	0.3675	0.3608	0.3527	0.3543	0.3503
			0.4159	0.4109	0.4057	0.4001	0.3941	0.3870
Australia	Dollar	AUD	0.8748	0.8971	0.8980	0.8877	0.8659	0.8638
			0.8897	0.8895	0.8907	0.8898	0.8865	0.8856
Austria	Schilling	ATS	7.9093	7.5269	7.4012	7.3390	7.4159	7.4443
			8.0783	8.0779	8.0614	8.0193	7.9538	7.8813
Bahrain	Dollar	BHD	0.2426	0.2352	0.2247	0.2167	0.2191	0.2209
			0.2563	0.2535	0.2503	0.2463	0.2428	0.2392
Belgium	Franc	BEF	23.2616	22.1036	21.7944	21.5512	21.7640	21.9012
			23.7314	23.7351	23.6873	23.5703	23.3775	23.1599
Canada	Dollar	CAD	0.8908	0.8794	0.8456	0.8239	0.8392	0.8269
			0.9326	0.9269	0.9178	0.9076	0.8997	0.8892
China	Yuan	CNY	5.3444	5.1624	4.9276	4.7534	4.8101	4.8459
			5.6335	5.5723	5.4993	5.4111	5.3340	5.2565
Denmark	Krone	DKK	4.2920	8.5874	4.0254	3.9858	4.0242	4.0489
			4.3866	4.7594	4.7484	4.7261	4.6907	4.6528
European Community	Unit	XEU	0.5745	0.5428	0.5345	0.5295	0.5346	0.5359
			0.5898	0.5884	0.5860	0.5823	0.5767	0.5708
Fiji	Dollar	FJD	0.9335	0.9279	0.9089	0.8928	1.1016	1.1234
			0.9618	0.9573	0.9523	0.9454	0.9553	0.9675
Finland	Markka	FIM	3.3775	3.2309	3.1868	3.1649	3.2013	3.2202
			3.4375	3.4381	3.4338	3.4205	3.3989	3.3737
France	Franc	FRF	3.7846	3.5974	3.5408	3.5059	3.5402	3.5675
			3.8810	3.8788	3.8681	3.8459	3.8126	3.7780
French Polynesia	Franc	XPF	68.6347	65.2944	64.2298	63.5786	64.2480	64.7270
			70.3999	70.3610	70.1654	69.7618	69.1602	68.5226
Germany	Deutschemark	DEM	1.1293	1.0761	1.0584	1.0484	1.0579	1.0645
			1.1523	1.1525	1.1500	1.1441	1.1349	1.1251
Greece	Drachma	GRD	177.1737	168.8147	166.2377	164.8590	166.8856	177.1380
			181.0468	181.0291	180.5671	179.8079	178.5236	177.8179
Hong Kong	Dollar	HKD	4.9873	4.8271	4.6142	4.4526	4.5003	4.5373
			5.2654	5.2094	5.1426	5.0611	4.9889	4.9167
India	Rupee	INR	23.1619	22.6597	23.2989	22.8971	22.3431	22.9142
			24.2082	23.9954	23.8619	23.6814	23.4926	23.3341
Indonesia	Rupiah	IDR	2231.54	2104.29	2935.13	4215.47	5,155.13	5,486.25
			1817.09	1856.24	1965.21	2179.64	2,473.94	2,694.35
Ireland	Pound	IEP	0.4378	0.4119	0.4059	0.4183	0.4218	0.4248
			0.4375	0.4362	0.4349	0.4343	0.4330	0.4314
Italy	Lira	ITL	1101.91	1050.24	1035.88	1029.19	1,042.63	1,047.52
			1130.93	1128.55	1125.82	1121.09	1,112.21	1,101.46

table continued on page 36-37

Table A (cont'd): Mid-month and 12 month cumulative average exchange rates

Country	Foreign Currency to NZ $		15 Apr 97 12 mth rate	15 May 97 12 mth rate	16 Jun 97 12 mth rate	15 Jul 97 12 mth rate	15 Aug 97 12 mth rate	15 Sep 97 12 mth rate
Japan	Yen	JPY	87.3593	81.4940	78.9073	75.8296	75.4280	76.6920
			79.2470	79.9640	80.4206	80.4297	80.5508	80.5653
Kuwait	Dollar	KWD	0.2101	0.2109	0.2081	0.2012	0.1951	0.1929
			0.2085	0.2089	0.2094	0.2090	0.2082	0.2069
Malaysia	Ringgit	MYR	1.7307	1.7523	1.7263	1.7018	1.7763	1.8858
			1.7292	1.7323	1.7364	1.7360	1.7419	1.7549
Netherlands	Guilder	NLG	1.3415	1.3246	1.3427	1.3443	1.3251	1.2651
			1.2225	1.2347	1.2507	1.2651	1.2804	1.2879
Norway	Krone	NOK	4.8139	4.8767	4.9880	4.9774	4.8752	4.6173
			4.5421	4.5715	4.6206	4.6640	4.7041	4.7145
Pakistan	Rupee	PKR	27.5810	27.9351	27.6447	26.7853	25.8224	25.6168
			26.0719	26.4405	26.8189	27.0827	27.2280	27.2456
Papua New Guinea	Kina	PGK	0.9528	0.9624	0.9477	0.9204	0.8932	0.8979
			0.9150	0.9218	0.9295	0.9337	0.9344	0.9345
Philippines	Peso	PHP	18.0533	18.1990	17.9908	18.8951	18.6101	20.1879
			17.9575	17.9912	18.0675	18.1923	18.2671	18.4554
Portugal	Escudo	PTE	119.2839	118.4161	120.9286	120.5229	119.2244	114.1306
			110.4094	111.2543	112.5246	113.6460	114.8879	115.4923
Singapore	Dollar	SGD	0.9938	0.9963	0.9824	0.9586	0.9717	0.9563
			0.9782	0.9806	0.9836	0.9825	0.9830	0.9815
Solomon Islands	Dollar	SBD	2.4922	2.5237	2.4891	2.4261	2.3315	2.3090
			2.4766	2.4896	2.5026	2.5037	2.4977	2.4857
South Africa	Rand	ZAR	3.0707	3.1156	3.0924	3.0254	2.9919	2.9637
			3.1264	3.1408	3.1549	3.1552	3.1451	3.1328
Spain	Peseta	ESP	100.1278	99.1960	100.6729	100.3495	99.3774	94.6141
			91.5267	92.4923	93.6719	94.7445	95.8547	96.3889
Sri Lanka	Rupee	LKR	40.2207	40.5983	39.9968	38.6256	37.3157	37.4598
			38.6521	38.9680	39.2435	39.3755	39.3655	39.3072
Sweden	Krona	SEK	5.2779	5.2617	5.3352	5.1995	5.1324	4.8599
			4.8024	4.8548	4.9241	4.9747	5.0240	5.0443
Switzerland	Franc	CHF	1.0154	0.9990	0.9929	0.9827	0.9710	0.9301
			0.9146	0.9261	0.9386	0.9486	0.9605	0.9662
Thailand	Baht	THB	17.7692	17.7961	16.6305	19.5720	19.7839	21.9450
			17.4654	17.5255	17.5089	17.7083	17.9348	18.3169
Tonga	Pa'anga	TOP	0.8414	0.8517	0.8496	0.8327	0.8141	0.8153
			0.8444	0.8457	0.8476	0.8475	0.8453	0.8432
Vanuatu	Vatu	VUV	77.4649	78.2371	77.4905	75.7724	73.4260	73.5734
			76.6666	76.9103	77.1860	77.2210	77.0164	76.7915
Western Samoa	Tala	WST	1.6915	1.7039	1.6967	1.6645	1.6138	1.6305
			1.6760	1.6802	1.6852	1.6857	1.6825	1.6793

Country	Foreign Currency to NZ $		15 Oct 97 12 mth rate	14 Nov 97 12 mth rate	15 Dec 97 12 mth rate	15 Jan 98 12 mth rate	16 Feb 98 12 mth rate	16 Mar 98 12 mth rate
Japan	Yen	JPY	78.4345	78.7489	77.5808	75.3667	72.8209	74.9568
			80.6002	80.5659	80.3872	79.8319	78.7273	77.8016
Kuwait	Dollar	KWD	0.1955	0.1891	0.1817	0.1760	0.1772	0.1787
			0.2057	0.2038	0.2014	0.1985	0.1958	0.1930
Malaysia	Ringgit	MYR	1.9931	2.0624	2.2623	2.4706	2.2156	2.1683
			1.7753	1.7977	1.8393	1.9004	1.9419	1.9788
Netherlands	Guilder	NLG	1.2700	1.2086	1.1908	1.1793	1.1907	1.1988
			1.2940	1.2945	1.2922	1.2859	1.2759	1.2651
Norway	Krone	NOK	4.5402	4.3581	4.3345	4.3246	4.3935	4.4248
			4.7153	4.7039	4.6871	4.6744	4.6550	4.6270
Pakistan	Rupee	PKR	26.0209	27.4007	26.1437	25.2276	25.5039	25.7026
			27.2783	27.1960	27.0454	26.8073	26.6293	26.4487
Papua New Guinea	Kina	PGK	0.9126	0.9571	0.9936	1.0022	1.0448	1.0614
			0.9338	0.9348	0.9398	0.9450	0.9536	0.9622
Philippines	Peso	PHP	21.5122	20.9749	22.3777	24.3547	23.2485	23.0158
			18.7341	18.9395	19.2913	19.7931	20.2205	20.6183
Portugal	Escudo	PTE	114.8032	109.4598	108.2006	107.0433	108.2896	108.8777
			116.0648	116.1513	116.0408	115.6724	114.9195	114.0984
Singapore	Dollar	SGD	0.9927	0.9834	0.9807	0.9981	0.9606	0.9352
			0.9823	0.9814	0.9816	0.9828	0.9811	0.9758
Solomon Islands	Dollar	SBD	2.3429	2.3058	2.2138	2.5366	2.5789	2.6019
			2.4744	2.4360	2.4124	2.4145	2.4218	2.4293
South Africa	Rand	ZAR	3.0066	3.0150	2.9104	2.8398	2.8667	2.9089
			3.1197	3.0830	3.0501	3.0147	2.9991	2.9839
Spain	Peseta	ESP	94.9968	90.4296	89.1780	88.6138	89.4015	90.0983
			96.8523	96.8808	96.7252	96.3519	95.5861	94.7546
Sri Lanka	Rupee	LKR	38.2110	36.9962	36.4406	35.3194	35.4509	35.6851
			39.2468	39.0029	38.7526	38.3932	38.0491	37.6933
Sweden	Krona	SEK	4.8319	4.6802	4.6335	4.6075	4.7029	4.6350
			5.0640	5.0615	5.0494	5.0266	4.9936	4.9298
Switzerland	Franc	CHF	0.9421	0.8735	0.8560	0.8531	0.8504	0.8644
			0.9718	0.9690	0.9631	0.9538	0.9402	0.9275
Thailand	Baht	THB	22.8860	23.4651	26.6581	28.7442	26.3935	23.3322
			18.7634	19.2340	19.9880	20.9089	21.6240	22.0813
Tonga	Pa’anga	TOP	0.8169	0.8155	0.7980	0.7865	0.7791	0.7917
			0.8403	0.8367	0.8325	0.8269	0.8206	0.8160
Vanuatu	Vatu	VUV	74.1761	74.0876	72.2803	71.7595	70.6587	71.1237
			76.5439	76.1951	75.8165	75.3344	74.7181	74.1708
Western Samoa	Tala	WST	1.6493	1.6254	1.5955	1.5890	1.5729	1.5851
			1.6765	1.6702	1.6633	1.6548	1.6445	1.6348

Table B: End of month exchange rates

Country	Foreign Currency to NZ $		30 Apr 97	30 May 97	30 Jun 97	31 Jul 97	29 Aug 97	30 Sep 97
United States	Dollar	USD	0.6942	0.6898	0.6788	0.6499	0.6428	0.6367
United Kingdom	Pound	GBP	0.4252	0.4204	0.4080	0.3988	0.3973	0.3950
Australia	Dollar	AUD	0.8870	0.9005	0.9100	0.8721	0.8714	0.8842
Austria	Schilling	ATS	8.3795	8.1927	8.2500	8.3700	8.0944	7.8686
Bahrain	Dollar	BHD	0.2614	0.2599	0.2558	0.2448	0.2420	0.2399
Belgium	Franc	BEF	24.6155	24.0926	24.2447	24.5798	23.9440	23.0886
Canada	Dollar	CAD	0.9695	0.9513	0.9363	0.8969	0.8918	0.8801
China	Yuan	CNY	5.7447	5.7126	5.6161	5.3704	5.3172	5.2709
Denmark	Krone	DKK	4.5486	4.4465	4.4900	4.5369	4.3868	4.2617
European Community	Unit	XEU	0.6115	0.6001	0.6008	0.6042	0.5864	0.5372
Fiji	Dollar	FJD	0.9808	0.9692	0.9593	0.9338	0.9275	0.9310
Finland	Markka	FIM	3.5996	3.5195	3.5121	3.5376	3.4528	3.3418
France	Franc	FRF	4.0315	3.9502	3.9780	4.0182	3.8805	3.7615
French Polynesia	Franc	XPF	73.1334	71.6357	72.1007	72.8891	70.4076	68.2228
Germany	Deutschemark	DEM	1.1967	1.1695	1.1810	1.1929	1.1535	1.1213
Greece	Drachma	GRD	189.0817	187.2762	187.1873	186.0559	181.2796	176.6620
Hong Kong	Dollar	HKD	5.3743	5.3407	5.2578	5.0298	4.9771	4.9239
India	Rupee	INR	24.5177	24.4732	23.9994	22.9850	23.1249	22.7217
Indonesia	Rupiah	IDR	1,662.82	1,661.87	1,630.13	1,659.73	1,917.47	2,011.21
Ireland	Pound	IEP	0.4499	0.4551	0.4481	0.4436	0.4310	0.4347
Italy	Lira	ITL	1,183.58	1,158.89	1,151.33	1,160.17	1,127.14	1,095.97
Japan	Yen	JPY	88.0135	80.1596	77.7395	76.9402	76.4936	77.0771
Kuwait	Dollar	KWD	0.2109	0.2087	0.2057	0.1979	0.1954	0.1936
Malaysia	Ringgit	MYR	1.7400	1.7292	1.7097	1.7081	1.8738	2.0250
Netherlands	Guilder	NLG	1.3444	1.3156	1.3261	1.3416	1.2985	1.2608
Norway	Krone	NOK	4.9192	4.8628	4.9527	4.9386	4.7607	4.5055
Pakistan	Rupee	PKR	27.7728	27.6924	27.2490	26.2244	25.9656	25.7229
Papua New Guinea	Kina	PGK	0.9568	0.9502	0.9438	0.9048	0.9040	0.9171
Philippines	Peso	PHP	18.0408	18.0203	17.7443	18.7913	19.2823	21.4149
Portugal	Escudo	PTE	119.8323	118.4349	119.1516	120.3508	117.0699	114.0388
Singapore	Dollar	SGD	1.0007	0.9845	0.9687	0.9503	0.9808	0.9720
Solomon Islands	Dollar	SBD	2.5118	2.4958	2.4572	2.3677	2.3430	2.3153
South Africa	Rand	ZAR	3.0767	3.0757	3.0616	2.9787	3.0148	2.9622
Spain	Peseta	ESP	100.5052	98.8198	99.3820	100.3819	97.2099	94.4123
Sri Lanka	Rupee	LKR	40.7481	40.0344	39.4232	37.8338	37.5810	37.5971
Sweden	Krona	SEK	5.4297	5.3022	5.2401	5.1749	5.0144	4.8132
Switzerland	Franc	CHF	1.0181	0.9728	0.9883	0.9829	0.9535	0.9252
Thailand	Baht	THB	17.8329	17.3415	16.2690	20.1363	21.6784	22.1795
Tonga	Pa'anga	TOP	0.8458	0.8483	0.8407	0.8227	0.8155	0.8140
Vanuatu	Vatu	VUV	77.7945	77.6909	77.1761	74.7291	73.7444	74.2389
Western Samoa	Tala	WST	1.7035	1.6887	1.6892	1.6478	1.6401	1.6313

Country	Foreign Currency to NZ $		31 Oct 97	30 Nov 97	31 Dec 97	31 Jan 98	28 Feb 98	31 Mar 98
United States	Dollar	USD	0.6251	0.6154	0.5817	0.5866	0.5777	0.5524
United Kingdom	Pound	GBP	0.3748	0.3677	0.3512	0.3576	0.3511	0.3291
Australia	Dollar	AUD	0.8867	0.9062	0.8913	0.8702	0.8591	0.8318
Austria	Schilling	ATS	7.5662	7.6022	7.2836	7.4894	7.3269	7.1347
Bahrain	Dollar	BHD	0.2356	0.2319	0.2192	0.2211	0.2177	0.2081
Belgium	Franc	BEF	22.1321	22.3456	21.4116	22.0136	21.5193	20.9631
Canada	Dollar	CAD	0.8791	0.8756	0.8331	0.8593	0.8207	0.7850
China	Yuan	CNY	5.1668	5.0844	4.8061	4.8468	4.7735	4.5628
Denmark	Krone	DKK	4.0863	4.1288	3.9580	4.0730	3.9852	3.8839
European Community	Unit	XEU	0.5466	0.5474	0.5253	0.5410	0.5285	0.5130
Fiji	Dollar	FJD	0.9232	0.9211	0.8928	1.1062	1.1075	1.0625
Finland	Markka	FIM	3.2262	3.2740	3.1412	3.2346	3.1702	3.0904
France	Franc	FRF	3.6016	3.6323	3.4770	3.5798	3.5081	3.4149
French Polynesia	Franc	XPF	65.3479	65.8225	63.0869	65.0339	63.5879	61.8856
Germany	Deutschemark	DEM	1.0759	1.0861	1.0404	1.0715	1.0473	1.0203
Greece	Drachma	GRD	169.4077	169.8499	163.8336	169.1478	165.3969	175.8446
Hong Kong	Dollar	HKD	4.8278	4.7535	4.5053	4.5360	4.4703	4.2771
India	Rupee	INR	22.3742	23.4394	22.6984	22.3370	22.4579	21.6373
Indonesia	Rupiah	IDR	2,241.53	2,226.90	3,184.76	5,545.15	5,154.19	4,634.31
Ireland	Pound	IEP	0.4165	0.4154	0.4061	0.4267	0.4225	0.4051
Italy	Lira	ITL	1,054.06	1,061.89	1,020.85	1,054.93	1,030.09	1,004.28
Japan	Yen	JPY	75.2041	78.0565	75.6254	73.6536	73.4629	72.8870
Kuwait	Dollar	KWD	0.1892	0.1869	0.1772	0.1789	0.1762	0.1686
Malaysia	Ringgit	MYR	2.1395	2.1469	2.2532	2.5383	2.1271	1.9956
Netherlands	Guilder	NLG	1.2101	1.2220	1.1709	1.2050	1.1780	1.1488
Norway	Krone	NOK	4.3728	4.4300	4.2435	4.4461	4.3664	4.1876
Pakistan	Rupee	PKR	27.4184	26.9907	25.4762	25.7330	25.3371	24.4414
Papua New Guinea	Kina	PGK	0.9289	1.0034	1.0077	1.0355	1.0380	1.0866
Philippines	Peso	PHP	21.7191	21.1132	23.1779	24.9770	23.0930	20.5591
Portugal	Escudo	PTE	109.7517	110.6502	106.3410	109.3525	106.9438	104.4669
Singapore	Dollar	SGD	0.9833	0.9805	0.9732	1.0084	0.9353	0.8850
Solomon Islands	Dollar	SBD	2.3024	2.2750	2.5618	2.5901	2.5660	2.4191
South Africa	Rand	ZAR	3.0114	2.9764	2.8231	2.8825	2.8524	2.7675
Spain	Peseta	ESP	90.5784	91.5506	87.8062	90.5650	88.4749	86.3659
Sri Lanka	Rupee	LKR	36.8720	36.8578	35.7231	36.1102	35.0441	34.1316
Sweden	Krona	SEK	4.6823	4.7676	4.5785	4.7445	4.6331	4.3812
Switzerland	Franc	CHF	0.8760	0.8763	0.8455	0.8633	0.8468	0.8408
Thailand	Baht	THB	24.4801	24.0537	26.7376	31.1723	24.3575	21.0033
Tonga	Pa’anga	TOP	0.8109	0.8105	0.7877	0.7845	0.7820	0.7547
Vanuatu	Vatu	VUV	73.8276	73.3297	71.6093	72.1139	70.6252	73.3300
Western Samoa	Tala	WST	1.6095	1.6241	1.5707	1.5931	1.5637	1.5442

Computer Numerically Controlled (CNC) Drilling & Routing Machines

Depreciation Determination DEP33

In Tax Information Bulletin Volume Ten, No.2 (February 1998) we published a draft general depreciation determination for CNC Drilling & Routing machines, and invited readers to make submissions on the proposed depreciation rate. No submissions were received and the Commissioner has now issued the determination.

The determination is reproduced below and may be cited as "Determination DEP33: Tax Depreciation Rates Determination General Determination No.33". The determination is based on an estimated useful life (EUL) of 8 years and a residual value of 13.5%.

General Depreciation Determination DEP33

This determination may be cited as "Determination DEP33: Tax Depreciation Rates General Determination Number 33".

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 1997/98 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 "Timber & Joinery" industry category the general asset class, estimated useful life, and diminishing value and straight-line depreciation rate listed below:

Timber and Joinery	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Drilling and Routing Machine, CNC	8	22	15.5

3. Interpretation

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

This determination is signed by me on the 2nd day of April 1998.

Jeff Tyler
Assistant General Manager (Adjudication & Rulings)

Hydrogen Manufacturing Unit and Hydrocracker Catalysts

Draft general depreciation determination

We have been advised there is currently no general depreciation rate for hydrogen manufacturing unit (HMU) catalysts or hydrocracker catalysts (either rechargeable or non-rechargeable). These assets are used in the oil refining industry.

The Commissioner proposes to issue a general depreciation determination, applicable from the 1995/96 and subsequent income years, which inserts a new category into the "Oil and Gas Industry" industry category. The determination, reproduced below in draft form, will set out various depreciation rates for the assets based on their estimated useful lives (EUL).

General Depreciation Determination DEP[X]

This determination may be cited as "Determination DEP[x]: 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 "Oil and Gas Industry" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

Oil and Gas Industry	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Hydrogen Manufacturing Unit (HMU) Catalyst	5	33	24
Hydrocracker Catalyst – non-rechargeable	2	63.5	63.5
Hydrocracker Catalyst – rechargeable	4	40	30

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 new depreciation rates, please write to:

Assistant General Manager (Adjudication & Rulings)
Adjudication & Rulings
National Office
Inland Revenue Department
P O Box 2198
WELLINGTON

We need to receive your submission by 31 May 1998 if we are to take it into account in finalising the determination.

Woven reflective mulch

Draft general depreciation determination

We have been advised that there is currently no general depreciation rate for woven reflective mulch used in the agriculture, horticulture, and aquaculture industries. The mulch is a fabric which is placed under trees or vines to reflect solar radiation that would otherwise be absorbed into the ground. This increases the amount of light and heat available to those trees or vines, increasing crop production. Two types of the fabric are available: white woven film and aluminised woven plastic film. There is no need to differentiate between them for depreciation purposes.

The Commissioner proposes to issue a general depreciation determination, applicable from the 1997/98 income year, which will insert a new asset class into the "Agriculture, Horticulture and Aquaculture" industry category. The determination, reproduced below in draft form, will set a depreciation rate of 50% DV for this asset and is based on an estimated useful life of 3 years and a residual value of 13.5%.

General Depreciation Determination DEP[X]

This determination may be cited as "Determination DEP[x]: 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 1997/98 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 class, estimated useful life, and diminishing value and straight-line depreciation rate listed below:

Agriculture, Horticulture and Aquaculture	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Woven reflective mulch	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.

If you wish to make a submission on these new depreciation rates, please write to:

Assistant General Manager (Adjudication & Rulings)
Adjudication & Rulings
National Office
Inland Revenue Department
P O Box 2198
WELLINGTON

We need to receive your submission by 31 May 1998 if we are to take it into account in finalising the determination.

Interpretation statements

This section of the TIB contains interpretation statements issued by the Commissioner of Inland Revenue. These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

"Forestry": whether or not it is included in the section CD 1(7) definition of "farming or agricultural business"

Summary

This item states the Commissioner's view on whether "forestry" falls within the definition of "farming or agricultural business" in section CD 1(7) of the Income Tax Act 1994. Under this interpretation, the Commissioner accepts that "forestry" does fall within the above definition.

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

Background

The Commissioner's previous policy, dated January 1993, sets out the activities Inland Revenue considers are carried on for agricultural or farming purposes. It specifically did not include the growing of trees for the production of timber in the definition of agriculture and farming.

The following specified activities were considered to be carried on for farming and agricultural purposes: beekeeping, animal husbandry, dairy farming, grain and seed growing, market gardening, fruit growing, poultry farming, sharemilking, tobacco growing, and vegetable growing.

The following activities specifically did not qualify: dealing in livestock, leasing or bailing livestock by the bailor, aerial topdressing, growing trees for the production of timber, and providing services to persons carrying on a farming or agricultural business, e.g. services provided by agricultural contractors and seed cleaners.

Legislation

Section CD 1(2) includes in a taxpayer's gross income, any amounts derived from the sale or other disposition of any land in some seven categorised circumstances. Section CD 1(7) excludes from the gross income of a taxpayer any amount derived from the sale or disposition of land resulting from the division into two or more lots of a larger area of land occupied or used by the taxpayer, or spouse, "or by both of them, primarily and principally for the purposes of a farming or agricultural business".

The following requirements must **all** be satisfied before the exemption applies:

- The land sold must have resulted from the division into two or more lots of a larger area of land which, immediately before the division was occupied or used by the taxpayer, or spouse, or both, primarily or principally for the purpose of a farming or agricultural business that the relevant persons carried on.
- The Commissioner must be satisfied that the land sold is of such an area and nature that it is presently capable of being worked as an economic unit in a farming or agricultural business.
- The Commissioner must be satisfied, having regard to the circumstances in which the land was disposed of, that the land was disposed of primarily and principally for the purpose of it being utilised in a farming or agricultural business.

Application

The question of whether forestry is included in the expression "farming or agricultural business" has been considered by the courts in relation to other sections of the Act that use similar wording, but not directly in relation to section CD 1(7).

Earlier cases tended towards the view that forestry was not included in the definition of "farming and agriculture". In *Gilchrist* v *Lanarkshire Assessors* (1895) 35 Sc LR 663, the Court had to consider whether a greenhouse used for growing tomatoes was an erection or a structural improvement made or required for agricultural purposes. Lord Stormouth Darling said at page 665:

> Now that question must be solved by considering the meaning of the phrase in its ordinary acceptation. The appellant considers that a market garden is an agricultural subject because it effects the culture of the ground. No doubt it does but there are three main methods of utilising the soil, which are expressed by the terms agriculture, horticulture and forestry. These three things are distinguishable, and any one of them is not to be held as including any other without special provision to that effect.

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In *Horniblow* v *Napier* [1985] NZLR 105, the question was whether an orcharidist was a farmer for the purposes of the Transport Act 1949. Barrowclough CJ referred to the *Gilchrist* case and said at page 105:

> It might be very unsafe to accept as applicable to this country's special type of husbandry (I deliberately use a new and comprehensive word), a classification that was applicable in Scotland over fifty years ago. But it appears to me that that classification is adaptable to New Zealand conditions, and is a classification which is commonly accepted here. Agriculture is essentially the business of the farmer. That is recognised in the interpretation clause of the Transport Act 1949, where the phrase 'agriculture purpose' is defined 'as a purpose concerned directly with the management of a farm'. I would conclude that a farmer is one engaged in the first of the three methods of utilizing the soil referred to by Lord Stormonth Darling, and consequently that a person engaged in either of the two other methods is not a farmer. The viticulturist is in the second group comprising those who utilize the soil of a garden; and so also, is the fruitgrower or an orchardist. They are not properly referred to as farmers. The silviculturist is in the third group; and he too, is not properly referred to as a farmer.

In 1994, in the Court of Appeal decision of *Hill* v *CIR* (1994) 16 NZTC 11,037, Richardson J concluded that agriculture and farming might include forestry. The Court of Appeal considered whether forestry was included within the expression "farming or agricultural business" in terms of section 126 and 127 of the Income Tax Act 1976. In this case, Richardson J who delivered the judgment of the Court stated at page 11,046:

> "Farming" and "agricultural" are broad flexible words and the use of both expressions in the phrase on its face suggests that a broad approach casting a wide net was intended. But the particular meaning to be accorded to the words depends on the context in which they are used. In order to determine the intended application of the phrase in ss 126 and 127 it is also necessary to set the sections in context in the Income Tax Act as a whole.

After briefly considering the earlier cases, Richardson J stated at page 11,047:

> *Horniblow* v *Napier* and *Hill* v *Rothwell* were decided 40 years ago and *Gilchrist* is even more remote in time. But the classification in *Gilchrist* and the approach in *Re Walker and Township of Uxbridge* perhaps indicate that variable meanings and shades of meaning may attach to such expressions. At the same time it is apparent from any reference to standard dictionaries that in their ordinary sense the words have wide meanings. Thus the *Shorter Oxford English Dictionary* definitions are indicative of the potential breadth of the expression. Agriculture is defined as "the science and art of cultivating the soil; including the gathering in of the crops and the rearing of livestock; farming (in the widest sense)". Farming is "the business of cultivating land, raising stock etc" and a farm is "a tract of land held ... for the purpose of cultivation; sometimes specialised as dairy-, grass-, poultry-farm. Also a tract of water used as a preserve, e.g., fish, oyster, etc." Interestingly forestry is defined as "the science and art of forming and cultivating forests, management of growing timber". Closer to home the two Australian dictionaries, *The Macquarie Dictionary* and *Tasman Dictionary*, both define agriculture as "the cultivation of land, including crop-raising, forestry, stock raising, etc; farming.

Richardson J concluded that:

> Sufficient has been said to show that in New Zealand usage agricultural and farming may include forestry. But in determining the intended scope of the expression "farming or agricultural business on land in New Zealand" and so in deciding the intended reach of ss 126 and 127 it is necessary to consider the context ... In our view it is a necessary implication from ss 126 and 127 considered in their statutory setting that they did not apply to taxpayers engaged in the business of forestry.

Richardson J considered by way of necessary implication that sections 126 and 127 when they were considered in their statutory setting did not apply to taxpayers engaged in the business of forestry, because Parliament subsequently legislated specifically (in section 127A) to provide a similar deductibility regime for any taxpayer who carried on any forestry business. In doing so it allowed for the same range of expenses and followed the model of sections 126 and 127, which would, of course, have been unnecessary had those two provisions already applied to forestry. This did not, however, detract from his initial conclusion that the phrase "farming or agriculture" might include forestry on an ordinary meaning of the words.

Whilst not all dictionaries give a consistent indication, several other dictionary meanings also indicate that farming and agriculture include forestry: *Webster's International Dictionary*, Second Edition, gives a wide meaning to the word "agriculture":

> The art or science of cultivating the ground, and raising and harvesting crops, often including also feeding, breeding, and management of livestock; tillage, husbandry; farming; in a broader sense, the science and art of the production of plants and animals useful to man, including to a variable extent the preparation of these products for man's use and their disposal by marketing or otherwise. In this broad use it includes farming, horticulture, forestry, dairying, sugar making, etc.

Funk and Wagnall's *New Standard Dictionary* gives this definition of "agriculture":

> 1. The cultivation of the soil for food-products or any other useful or valuable growths of the field or garden; tillage; husbandry; also by extension, farming, including any industry practised by a cultivator of the soil in connection with such cultivation, as forestry, fruit-raising, breeding and rearing of stock, dairying, market-gardening, etc.

There is also overseas authority to support the approach that the phrase "farming or agriculture" includes forestry.

In Canada, forestry is considered to be a farming activity. "Farming" is defined in section 248 of the Canadian Income Tax Act 1994 to include the various activities of a person who is engaged in the business of earning income from the tillage of soil, the raising or exhibiting of livestock, the maintenance of horses for racing or exhibiting, the raising of poultry, the keeping of bees, fur farming, dairy farming, and fruit growing.

The definition is not exhaustive and it has been decided by the courts that farming also includes tree farming: *Her Majesty the Queen* v *Douglas C Matthews* 74 DTC 6193, [1974] CTC 230 (FCTD).

Revenue Canada's *Interpretation Bulletin IT–373R March 14 1985* relating to farm woodlots and tree farms states that proceeds from the sale of logs, lumber, poles or Christmas trees are income from farming.

It also states that a taxpayer who is not otherwise engaged in a lumbering or logging business and who undertakes the reforestation of an area of land with the objective of producing mature trees at a date that may be 40 or 50 years in the future, or even longer, is considered to be farming.

Possible alternative interpretations

Certain provisions in the Income Tax Act indicate that (for those provisions at least) Parliament had clearly intended "farming and agriculture" to not include forestry by having explicit separate treatments. The decision in *Hill* illustrates one such example, and others include the Income Equalisation provisions in sub-part EI of the Act, and sections DZ 2 and DZ 3. It could certainly be argued that this indicates it was Parliament's intention or understanding that forestry was not included in the phrase "farming and agriculture".

Whilst such an argument does have some merit, it is considered that the better approach is that expressed by Richardson J in *Hill*, that forestry does generally come within the phrase, unless the context of a particular provision indicates otherwise.

Accordingly, each provision needs to be examined separately, and whilst some (such as those discussed above) will result in a conclusion that forestry is not included, section CD 1 has no such contextual reasons to overturn the general proposition that forestry is included.

It might also be suggested that the use of the word "worked" in section CD 1(7) can be seen as suggesting a greater level of day to day activity than might be involved in small to medium scale forestry operations. However, the word "worked" is capable of a wide meaning ranging from the application of mental or physical effort for a purpose to cultivating land. The ordinary meaning of the word "worked" tends to suggest that there must be some form of physical activity, but does not necessarily require any particular activity level. Many activities that are clearly regarded as a "farming or agricultural business" do not demand day to day physical work on the part of the proprietor. The existing case law in New Zealand simply analyses as a whole the meaning of the phrase "worked as an economic unit as a farming or agricultural business" in section CD 1(7). It does not look at the meaning of each word in the phrase in isolation.

Conclusion

The words "farming or agriculture" in their ordinary usage may include forestry. The wording and context of section CD 1(7) do not prevent this interpretation. The New Zealand Court of Appeal case of *Hill* supports the interpretation that agriculture and farming may include forestry.

Several dictionary meanings of these words indicate that farming and agriculture can include forestry. Case law and a revenue interpretation bulletin in Canada also indicate that farming and agriculture can include forestry

The phrase "farming and agriculture" has a wider meaning now than it did many years ago as technology has advanced, and agricultural practices have changed over time. In New Zealand and in the previously mentioned overseas jurisdictions, the ordinary meaning of "farming and agriculture" may include forestry. In determining whether forestry is included in any phrase of the Income Tax Act, the context of the section must be examined. For the purposes of section CD 1(7), forestry is included in the phrase "agriculture and farming". There is nothing in the context of section CD 1(7) to indicate that forestry is not included.

Note that any claim for exemption under section CD 1(7) in respect of a forestry activity must not only satisfy paragraphs (a) and (c) ("farming or agricultural business"), but the land under consideration must also be "capable of being worked as an economic unit" as required by paragraph (b) of section CD 1(7).

Standard practice statements

These statements describe how the Commissioner will, in practice, exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

Tax payments – when received in time

Standard Practice Statement PRC-100

Recently there has been considerable comment about the received in time rules for tax payments.

This statement sets out the administrative rules which the Commissioner applies to tax payments when those various revenues are due.

We prefer customers to pay their tax by posting their cheque – it will be accepted as being received in time if it is mailed and postmarked on the due date.

Alternatively, payment may be made by cheque, EFT-POS or cash at any Inland Revenue Office – and will be accepted as being received in time if it is physically handed in to an Inland Revenue Office by the close of business hours on the due date – in most cases this is 4.30 pm.

These administrative rules apply to all tax types, including GST.

If a due date falls on a weekend or public holiday, the payment will be accepted as being in time if posted or handed in on the next business day. Note that this does not apply to GST payments because GST is due on the last **working** day of the relevant month.

There is one exception to that GST rule, and that is when the GST payment, which would normally be due on the last working day of December, is actually due on 15 January. If 15 January falls on a weekend then the payment will be accepted as being in time if posted or handed in to an Inland Revenue Office on the next business day.

Applications to keep records in Maori

Standard Practice Statement INV-470

Introduction

This standard practice statement advises that the Commissioner will generally approve applications to keep records in Maori, provided that:

- The taxpayer complies with the requirements of sections 24 and 25 of the Goods and Services Tax Act 1985 ("GST Act"); and
- Numbers are recorded using Arabic numerals. In order to accommodate the needs of third parties, Arabic numerals (i.e., 0, 1, 2, 3, 4, 5, 6, 7, 8, and 9) are to be used to record numbers.

This policy applies from 1 May 1998.

Background

Sections 75 of the GST Act, and 22, 26, and 32 of the Tax Administration Act ("TAA"), require taxpayers to keep and retain sufficient records in the English language to enable ready ascertainment by the Commissioner or his delegates, of their liability to tax. However, each of these sections provides discretion to the Commissioner who may, following a written application, allow records to be kept in an alternative language.

The legislative policy reason for the requirement to keep records in English is administrative convenience. It allows the Commissioner to readily ascertain a taxpayer's liability. However, a claim lodged with the Waitangi Tribunal under the Treaty of Waitangi Act prompted Inland Revenue to review its policy for exercising the discretion related to keeping records in a language other than English.

When considering a request from a taxpayer to keep records in Maori, Inland Revenue recognises that Maori is an official language of New Zealand. We also recognise that the choice of language for business dealings is not a matter for the Commissioner to determine. It is reasonable for persons whose business dealings are conducted in Maori to expect that Inland Revenue will be able to accommodate their language preference.

However, the revenue law obligations of third parties must also be considered. When base records such as invoices and receipts are maintained in Maori there may be some inconvenience to other persons. GST tax invoices and debit and credit notes raise a special problem. They are necessary for ascertaining the tax liability of the issuer and of a third party. They are, therefore, records covered by section 75(3) of the GST

Act (i.e., they must be maintained in English unless the Commissioner gives permission to use another language).

There are also explicit requirements for specific English phrases to be used in these documents. These phrases are:

- "tax invoice" (s.24 & 25, GST Act)
- "copy only" – on copy of lost tax invoice, credit or debit note (s.25, GST Act)
- "buyer created tax invoice – IRD approved" (s.24, GST Act)
- "modified tax invoice – IRD approved" (s.24, GST Act)
- "credit note" or "debit note" – on credit or debit notes (s.25, GST Act)

There is no discretion to allow the use of expressions in Maori (or any other language) to satisfy the requirements imposed in sections 24 and 25 of the GST Act (which state that specific words must be used).

The decision by the Commissioner and his delegates to allow the keeping of records in Maori, is the exercise of an administrative discretion provided by the Revenue Acts having regard to the form of tax invoices and taxpayer obligations as prescribed by legislation.

Policy

Applications

When any person applies in writing to keep records (e.g., invoices, receipts, cash books, and journals) for tax purposes in Maori, permission will usually be granted, provided all numbers are recorded using Arabic numerals. The application need not be in English, but must specify which records the taxpayer wishes to keep in Maori.

An application form in both English and Maori is available from Inland Revenue offices for use by persons wishing to take advantage of this policy. The use of these forms will simplify applications and assist IRD to readily identify requests and provide a more timely response.

A person may seek approval to keep only some records in Maori. In addition, where approval to keep certain records in Maori has been obtained, there is nothing to stop a person continuing to keep all or some of those records in English. This would extend to having an individual document completed partly in Maori and partly in English.

Approval process

The Commissioner has delegated his authority to approve applications to officer level. Authority to decline applications is confined to Team Leaders, Senior Investigators or Managers. Refusals will only be on the basis that those legislative requirements under the GST Act and TAA and the use of Arabic numerals are not satisfied.

The letter giving consent will advise:

- That the taxpayer must comply with the requirements of sections 24 and 25 of the GST Act in respect of the provision or creation of tax invoices and the issuing of debit and credit notes.
- That numbers must be recorded using Arabic numerals.
- The date from which those records can be kept in Maori (generally the date of the letter of approval).
- The approval is not a relaxation in the standard of record keeping [the requirements of sections 22 and 26 of the TAA and section 75 of the GST Act are not relaxed for this purpose].
- The approval does not mean IRD will communicate with taxpayers in Maori.

Further conditions

If permission is given to keep records in Maori, there is no relaxation in the standard of record keeping. The requirements of sections 22 and 26 of the TAA and section 75 of the GST Act are not relaxed for this purpose.

The law is silent on the question of the language to be used in completing any returns that a person may be required to provide to the Commissioner. The Commissioner will accept returns in the prescribed format, completed in the Maori language with numbers entered using Arabic numerals.

Impact on third parties

When base records such as invoices and receipts which have been completed in Maori are used by third parties to ascertain their tax liability, that third party need not also apply for permission to use records kept in Maori.

The balance of commercial convenience between buyers and sellers will determine what language is used in any particular case. Over time, the usual Maori expressions will become known within the community. Interpretation will, therefore, become less difficult.

Policy application date

This policy applies from 1 May 1998. It will apply to records coming into existence following approval of an application lodged with the Commissioner on or after that date.

Contact

Should you have questions about this policy, please contact the Maori Community Officer at your nearest Inland Revenue Service Centre or Branch Office.

Tony Bouzaid
National Manager, Operations Policy

see next page for examples

Examples

The following examples do not form part of the policy but are provided to indicate its general effect.

Example 1

A New Zealand resident GST registered person, who is fluent in English, operates a shop in Whangarei. The person is also fluent in Maori and has asked for approval to keep certain GST business records in Maori.

Approval would be granted, subject to the requirements that the registered person uses Arabic numerals and complies with the requirements of sections 24 and 25 of the GST Act.

Example 2

A New Zealand resident taxpayer, who regards English as their second language and has limited bookkeeping skills, operates a farm on the East Coast. The taxpayer is fluent in Maori and has asked for approval to keep all their business records in Maori.

Approval would be granted, subject to the requirements that they use Arabic numerals and comply with the requirements of sections 24 and 25 of the GST Act and sections 22 and 26 of the TAA. As in any other case, the taxpayer's records must be sufficient to allow the Commissioner to readily ascertain the taxpayer's tax liabilities.

Example 3

A large Maori incorporation is staffed by persons whose fluency in Maori and in English differs. For cultural and policy reasons the incorporation wishes to maintain its records in Maori to the greatest extent possible within the law. The taxpayer has asked for approval to keep all of its business records in Maori.

Approval would be granted, subject to the requirements that the taxpayer uses Arabic numerals and comply with the requirements of sections 24 and 25 of the GST Act and sections 22 and 26 (where applicable) of the TAA.

Example 4

A New Zealand resident private company runs a business teaching Te Reo Maori. The company seeks approval to issue GST tax invoices printed and completed entirely in Maori.

Approval would be granted, subject to the requirements that the taxpayer uses Arabic numerals and complies with the requirements of sections 24 and 25 of the GST Act and section 22 of the TAA.

Example 5

A New Zealand resident GST registered person receives a tax invoice completed in Maori. The person, who does not speak or understand Maori, contacts her local Inland Revenue office and asks the office to intervene and require the issuer of the invoice to replace it with one completed in English.

Provided the invoice has been completed in accordance with the requirement of section 24 of the GST Act and numbers are entered using Arabic numerals, the person would be advised that the document complies with our record keeping requirements in its present form. Any dispute over the language used in completing the invoice is a matter to be settled between the recipient of the invoice and the issuer.

Example 6

A New Zealand resident taxpayer makes a claim in their annual income tax return for the housekeeper rebate. This is in respect of payments made to a caregiver that cared for the taxpayer's child to enable the taxpayer to work. Upon being requested to supply a receipt to substantiate the housekeeper rebate claimed, the taxpayer supplies a receipt completed entirely in Maori, including the numbers for the amount paid written using Maori words.

The receipt would not be accepted as a satisfactory record to support the rebate claim because numbers for the amounts paid have not been entered using Arabic numerals.

Questions we've been asked

This section of the TIB sets out the answers to some day-to-day questions that people have asked. We have published these as they may be of general interest to readers.

These items are based on letters we've received. A general similarity to items in this package will not necessarily lead to the same tax result. Each case will depend on its own facts.

Income Tax Act 1994

Investment portfolio fees – deductibility

Section BD 2 – Allowable deductions: A taxpayer has asked if *Case T42* (1988) 18 NZTC 8,285 is inconsistent with the Commissioner's treatment of financial planning fee expenditure as set out in Public Ruling BR Pub 95/10A (TIB Volume Eight, No.10 (December 1996) at page 18).

In summary, that Public Ruling states that:

- Regard must be had to the difference between fees paid for planning an investment, implementing the purchase of that investment, and subsequently monitoring it.
- "Passive" investors cannot deduct fees paid to financial advisors for planning or implementation services, as they are considered to be capital in nature (although the qualified accruals rules may include some implementation fees in the base price adjustment calculation on the maturity of any financial arrangements purchased).
- "Passive" investors can deduct fees paid for the monitoring of existing investments, although section EF 1 may require the unexpired portion of such expenditure to be added to the taxpayer's gross income in any year.
- Speculative investors, and persons in the business of investing, can deduct all planning, implementation and monitoring fees when incurred, subject to the applicability of the qualified accruals rules and section EF 1 as mentioned above, and the trading stock provisions of section EE 1.

In *Case T42*, the taxpayers were a husband and wife who had a portfolio of investments that the husband had managed since 1986. In 1992, on receipt of a superannuation scheme lump sum, the taxpayers engaged a firm of investment advisors to manage their overall investments. The investment advisors charged a fee described as "portfolio establishment costs", and the question was whether or not this fee was a deductible expense. Willy DJ observed that the parties were in agreement as to how the law applied. At page 8,286 he stated:

> There is no argument about the law. The Commissioner accepts that if the fees were properly incurred in the course of the maintenance and monitoring of an established portfolio of investments then they are properly deductible. The objector accepts that if the fees are for the work involved in the establishment of a portfolio then they are non-deductible.

His Honour went on to find on the facts that the taxpayers had an existing investment portfolio, and the financial planning fees related to the monitoring of that investment portfolio, rather than any planning or implementation of a new one. Therefore, the expenditure was deductible under section BD 2. He stated at page 8,287:

> ...it is clear beyond any doubt that the payments in these cases were expended as part of a process by which the objectors earned their income from their investment portfolios. They would therefore be treated on the ordinary principles of commercial accounting as a debit to revenue not capital.

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...the objectors decided to recast their investments .... The plain fact is this objector had an established investment portfolio going back to 1986.

The Commissioner has lodged an appeal, but for the purposes of this discussion it is important to note that the decision in *Case T42* was a finding on the facts of that case. The application of the law is entirely consistent with Public Ruling BR Pub 95/10A, and the Commissioner does not intend to review or withdraw the Public Ruling as a result of this recent case.

Write-off of business assets

Section EG 12 (section 108K, Income Tax Act 1976) - Depreciation of depreciable property that can no longer be used: A taxpayer who wishes to write off some business assets that are no longer used in his business has asked:

- what details of the assets is he required to supply to Inland Revenue
- what factors Inland Revenue takes into account when considering a write-off application.

Under section EG 12(5), a taxpayer may apply to the Commissioner for a determination to deduct the remaining adjusted tax value of any depreciable property that can no longer be used.

Adjusted tax value in relation to any depreciable property is defined as:

bv (base value) – ad (aggregate deductions)

We advised the taxpayer that he must complete the form "Application for a deduction for an asset you no longer use" (IR 260D) when making such a request. All the following details must be provided:

- asset details such as description, industry / asset category, asset class, depreciation rate, date of purchase, purchase price, remaining adjusted tax value
- use of the asset by the business – the date when the asset stopped being used in the business, the reason why it is no longer used
- disposal of the asset – the estimated cost of selling or disposing of it including the basis of the estimate, estimated gross proceeds from sale or disposal of the asset including the basis for this estimate
- use of asset by any business – whether it is likely that the asset could be used in another business and if so, in what type of business and industry is it most likely to be used.

In considering such an application, the Commissioner must be satisfied:

- that the property is no longer used by the taxpayer, and neither the taxpayer nor a person associated with the taxpayer intends to use the asset in deriving gross income or in a business; and
- that the costs of disposing of the property would exceed any consideration that could be derived from the disposition of the property.

Only if the Commissioner is satisfied on these two points may the asset be written off.

Stamp and Cheque Duties Act 1971

Property transfer: differentiation between fixtures and chattels – stamp duty

Section 10 – Stamp duty payable: A taxpayer intends selling a commercial property and has asked for details of the stamp duty implications. She is aware that stamp duty is payable on the sale of the land and buildings, but is unsure of the position concerning items within the building: carpets, air-conditioning systems, a suspended ceiling, furniture (including built-in furniture), electric light fittings, partitions, a card access system, and refrigerators.

Under section 10, duty is payable on:

(a) Conveyances and leases of land; and…

“Land” is defined in section 2 as:

land within New Zealand, and includes –

(a) Buildings, appurtenances, and improvements; and…

An “appurtenance” to land includes a right of way or a similar right over someone’s land. Examples of “improvements” to land are drainage, fencing, and the construction of buildings, while improvements to a building are additions to the building (other than mere repairs).

Included in a building may be such items as lifts, sprinkler systems, ceilings, plumbing systems, carpets and vinyl flooring. Case law has established that when such items are an integral part of a building and are permanently affixed to the land or building, they lose their nature as chattels and become fixtures. As fixtures to the building they are part of the land and, therefore, are subject to inclusion in the value of land for assessing stamp duty. This is assuming that the owner of the building also owns the fixtures.

Stamp duty is not levied upon chattels (i.e. moveable possessions) as such. Items generally termed “chattels”, including stoves, tables, chairs, electric heaters, and curtains, are not subject to stamp duty as they would not be fixed to the building.

At times it can be difficult to differentiate between chattels and fixtures. However, the courts have found that it is the degree and the object of annexation to the land that is important in making this decision.

Case law has provided the following factors to be taken into account in deciding whether an object is a chattel or a fixture:

- **Whether the asset is a permanent improvement.** If the asset is for the permanent and substantial improvement of the land or building as evidenced by the degree of annexation to the property, this fact would lean heavily towards the asset being a fixture. On the other hand, if the asset is merely resting by its own weight on the property, thereby indicating a temporary use or for its more complete enjoyment and use as a chattel, this could be a determining factor in finding it to be a chattel. In *Feickert v Perpetual Trustees Estate and Agency Company of New Zealand Ltd* (1989) 1 NZ Conv C 190, 244, the High Court, in finding that such items as partitions, carpets, and light fittings were fixtures, looked at whether they formed part of the fabric of the building. For example, the Court noted that whereas carpet at one time was considered as more of a luxury item in commercial buildings, it has now become commonplace and is what a prospective tenant would expect to find. In *Case S68* (1996) 17 NZTC 7,422, the Taxation Review Authority reached a similar conclusion in respect of items such as vinyl floor coverings, suspended ceilings, light fittings, a roller door, and handrails.

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- **The intention, as evidenced by the circumstances of each case, in bringing the asset on to the land.** In approaching this issue, the courts have established it is the purpose for which the asset is used, as seen by the degree and object of annexation, which should be taken into account and not the subjective purpose of the person who placed it there. This factor is borne out in the Court of Appeal case *Lockwood Buildings Ltd v Trustbank Canterbury Ltd* [1995] 1 NZLR 22 where it was found that a show-home was a fixture and not a chattel. The Court followed rules set down in earlier cases in looking at the extent to which the show-home was fixed to the land. It looked like any ordinary house. This finding was not swayed by the possibility that an outside observer, realising it was a show-home, might question its permanency on the site. Its status, to anyone viewing it, was evident from its outward appearance. In other words, these matters should be examined objectively and not subjectively. This point was emphasised in a recent House of Lords case, *Elitestone Ltd v Morris* [1997] 2 All ER 513 at 524; 1 WLR 687.
- **Whether the asset can be removed without causing damage to it, the building, or the land.** In the *Feickert v Perpetual Trustees* case, the High Court found that partitions and a bench unit were fixtures – one of the factors being that they would have been damaged if removed.

No single factor should be considered alone in determining the issue of whether an item is a fixture or a chattel. Rather, all the factors are important in providing a picture of the degree and object of annexation of a particular item to the land, i.e. whether it is a chattel brought on to the land to continue as a chattel or whether it becomes a fixture.

In applying these criteria to the taxpayer, the furniture (excluding built-in furniture) and refrigerators are chattels. They are therefore not subject to stamp duty. These assets were not fixed to the building in any way and could easily be removed. They could not be regarded as permanent improvements to the building. The remaining assets, i.e., carpets, air-conditioning system, suspended ceiling, built-in furniture, electric light fittings, partitions, and card access system are considered to be fixtures and are therefore part of the building. They exhibit a sufficient degree of permanence to be considered as fixtures because of their integration within, and annexation to, the building, and the fact they could only be removed with some difficulty. It is considered that an outside person coming in and viewing these assets would see that they were of sufficient permanence as to rightly be fixtures. The taxpayer was therefore advised that the items would attract a liability for stamp duty when the property was sold, as they were part of the land.

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.

Joint bank accounts – whether Commissioner can attach under section 157

Case: ANZ Banking Group v CIR

Decision date: 4 March 1998

Act: Tax Administration Act 1994 - section 157

Keywords: *Attaching joint bank accounts*

Summary: Justice Ellis determined that the Commissioner could not attach a joint bank account as an asset belonging solely to the taxpayer using section 157 of the Tax Administration Act 1994.

Facts: The Commissioner assessed a taxpayer for income tax. The taxpayer and his wife have a joint account with the ANZ Bank.

The Commissioner served notice on the Bank under section 157 of the Tax Administration Act 1994 ("the Act") demanding payment of all monies in the joint account to service the tax payable.

The Bank refused payment and requested the matter be resolved under the Declaratory Judgments Act 1908.

Decision: Justice Ellis found that to override the wife's rights as joint account holder there needed to be explicit statutory provision, but no such provisions are contained in the Act. There is a presumption that half the money in the joint account belongs to the wife.

His Honour relied upon *Hirschorn v Evans*[1938] 2 KB 801 where the Court of Appeal found that in the absence of proof that an account belonged solely to the husband, a joint account could not be attached to answer a judgment against the husband.

Depreciation determinations issued since last update of IR 260 Depreciation booklet

This list shows the contents of all depreciation determinations we've issued since the last update of our Depreciation booklet (IR 260). We've published it so you can quickly check whether you need to review any determinations when calculating depreciation for tax purposes.

Some determinations cover a large number of assets which will concern relatively few taxpayers. For these determinations we've simply listed a cross-reference to the original TIB article rather than reproduce several pages of figures here.

This list is essentially a summary; if you're claiming depreciation on any of these assets we recommend that you refer to the original TIB article to make sure you get the full context of the determination, including the relevant industry categories.

Asset	Estimated useful life (years)	DV banded depreciation rate (%)	SL equivalent banded dep'n rate (%)	Determ-ination number	Appears in TIB
Aquariums	4	40	30	DEP22	9.2:1
Automotive tools *(various – see TIB article)*				DEP30	9.11:2
Bakery utensils (incl. pots and pans)	3	50	40	DEP30	9.11:2
Bedding (Hotels, Motels, etc, and medical/lab)	3	50	40	DEP30	9.11:3,4
Bedding (medical and medical laboratories)	3	50	40	DEP30a	10.3:5
Bin (wool storage, live bottom)	15.5	12	8	DEP11	7.3:20
Books, published annually or more frequently	2	63.5	63.5	DEP32	10.3:3
Books, other	10	18	12.5	DEP32	10.3:3
Bulkheads (insulated, removable)	4	40	30	DEP13	7.10:26
CCH Electronic NZ Essential Tax Package, designed for a specific tax year	1	100	100	PROV4	7.3:19
CCH Electronic NZ Master Tax Guide, designed for a specific tax year	1	100	100	PROV4	7.3:19
Combing machines (wool)	15.5	12	8	DEP11	7.3:20
Computer numerically-controlled drilling & routing machine (timber/joinery industry)	8	22	15	DEP33	10.4:40
Computer numerically-controlled tooling machine (timber/joinery industry)	8	22	15	DEP28	9.9:1
Containers (insulated, below 8m^3)	5	33	24	DEP13	7.10:26
Containers (shipping)	20	9.5	6.5	DEP13	7.10:26
Crown Health Enterprise assets *(half a page of various assets - see TIB article)*					6.5:7
Dance floor	20	9.5	6.5	DEP30	9.11:3
Drilling & routing machine, computer numerically-controlled (timber/joinery industry)	8	22	15	DEP33	10.4:40
Drilling machines (horizontal directional)	6.66	26	18	DEP24	9.3:3
Drilling machine components, underground (horizontal directional)	2	63.5	63.5	DEP24	9.3:3
Electronic article surveillance systems	5	33	24	DEP26	9.6:3
Engineering tools *(various – see TIB article)*				DEP30	9.11:2
Fastening guns (explosive)	3	50	40	DEP20	8.10:1
Firearms (Leisure industry category)	10	18	12.5	DEP20	8.10:1
Gas cylinders – LPG (incl. propane and butane)	8	22	15.5	DEP16	8.1:10
Gas cylinders – other	12.5	15	10	DEP16	8.1:10
Gill machines (wool)	20	9.5	6.5	DEP11	7.3:20
Golf ball placing machine and sensor	3	50	40	DEP10	7.3:18
Golf driving ranges, netting (for golf driving nets)	5	33	24	DEP10	7.3:18
Golf driving ranges, poles (for golf driving nets)	20	9.5	6.5	DEP10	7.3:18
Golf mats (stance and base, at golf driving/practice ranges)	2	63.5	63.5	DEP10	7.3:18
Hand soap dispensers	2	63.5	63.5	DEP7	6.7:16

Ink mixing systems, computerised	3	50	40	DEP27	9.8:2
"Kiwiplus" – kiwifruit packhouse software	1	100	100	PROV6	9.6:8
Lawnmowers (domestic type in use by lawnmowing contractors)	2	63.5	63.5	DEP15	7.13:22
Lawnmowers (non-domestic type in use by lawnmowing contractors	5	33	24	DEP15	7.13:22
Machine centre, CNC (timber/joinery industry)	8	22	15	DEP28	9.9:1
Marquees *(half a page of various assets – see TIB article)*				DEP18	8.6:8
Medical and medical laboratory equipment *(3 pages of various assets – see TIB article)*				DEP8	6.7:17
Mulchers (commercial)	4	40	30	DEP25	9.6:6
Newspapers		expense	expense	DEP32	10.3:3
Paintball firearms	2	63.5	63.5	DEP20	8.10:1
Pallet covers (insulated)	2	63.5	63.5	DEP13	7.10:26
Paper towel dispensers	2	63.5	63.5	DEP7	6.7:16
Pistols, Air (Leisure industry category)	10	18	12.5	DEP20	8.10:1
Plant trolleys	5	33	24	DEP23	9.3:2
Psychological testing sets	10	18	12.5	PROV2	6.10:6
Rams (hydraulic or pneumatic)	3	33	24	DEP30	9.11:3
Residential rental property chattels *(various – see TIB article)*				DEP30	9.11:3
Rifles, Air (Leisure industry category)	10	18	12.5	DEP20	8.10:1
Rifles (less than 10,000 rounds per year)	6.66	26	18	DEP20	8.10:1
Rifles (more than 10,000 rounds per year)	2	63.5	63.5	DEP20	8.10:1
Scaffolding (aluminium)	8	22	15.5	DEP19	8.8:3
Scaffolding (other than aluminium)	15.5	12	8	DEP19	8.8:3
Scientific and laboratory equipment (not medical laboratory equipment) *(2 pages of various assets – see TIB article)*				DEP8	6.7:17
Shop utensils (incl pots and pans)	3	50	40	DEP30	9.11:3
Shotguns (less than 50,000 rounds per year)	6.66	26	18	DEP20	8.10:1
Shotguns (more than 50,000 rounds per year)	2	63.5	63.5	DEP20	8.10:1
Skidoo	5	33	24	DEP30	9.11:3
Sound recordings (copyright in)	1	100	100	DEP31	10.3:2
Speed humps (metal)	5	33	24	PROV3	6.13:13
Stage	20	9.5	6.5	DEP30	9.11:3
Static delimbers (timber industry)	5	33	24	DEP9	6.11:16
Tags (security)	3	50	40	DEP21	9.1:1
Toilet roll dispensers	2	63.5	63.5	DEP7	6.7:16
Tomato graders	8	22	15.5	DEP14	7.13:23
Tooling machine, CNC (timber/joinery industry)	8	22	15	DEP28	9.9:1
Trailers (class TD – over 10 tonnes) – when rented for periods of one month or less	10	18	12.5	DEP29	9.11:1
Undersea maintenance equipment *(1 page of various assets – see TIB article)*				DEP17	8.2:9
Wintering pads (rubber)	6.66	26	18	PROV5	8.2:7
Yachts (international ocean-going)	6	15	10	DEP12	7.10:25
Yachts (other than international ocean-going)	15.5	12	8	DEP12	7.10:25

Booklets available from Inland Revenue

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

Some booklets could fall into more than one category, so you may wish to skim through the entire list and pick out the booklets that you need. To order any of these booklets, call the forms and stationery number listed under "Inland Revenue" in the blue pages at the front of your phone book. This is an automated service, and you'll need to have your IRD number handy when you call.

The TIB is always printed in a multiple of four pages. We will include an update of this list at the back of the TIB whenever we have enough free pages.

General information

Binding rulings (IR 115G) - Dec 1997: *Explains binding rulings, which commit Inland Revenue to a particular interpretation of the tax law once given.*

Cash assistance for your growing family (FS 4) - Mar 1997: *Information about Family Assistance and how to apply.*

Disputing a notice of proposed adjustment (IR 210K) - Oct 1996: *If we send you a notice to tell you we're going to adjust your tax liability, you can dispute the notice. This booklet explains the process you need to follow.*

Disputing an assessment (IR 210J) - Oct 1996: *Explains the process to follow if you want to dispute our assessment of your tax liability, or some other determination.*

How to tell if you need a special tax code (IR 23G): *Information about getting a special "flat rate" of tax deducted from your income, if the regular deduction rates don't suit your particular circumstances.*

If you disagree with us (IR 210Z) - Sep 1996: *This leaflet summarises the steps involved in disputing an assessment.*

Income from a Maori Authority (IR 286A) - Feb 1996: *For people who receive income from a Maori authority. Explains which tax return the individual owners or beneficiaries fill in and how to show the income.*

Independent Family Tax Credit (FS 3) - Sep 1996: *Introducing extra help for families, applying from 1 July 1996.*

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

Maori Community Officer Service (IR 286) - Apr 1996: *An introduction to Inland Revenue's Maori Community Officers and the services they provide.*

New Zealand tax residence (IR 292) - Jun 1997: *An explanation of who is a New Zealand resident for tax purposes.*

Overseas private pensions (IR 258A) - Oct 1996: *Explains the tax obligations for people who have interests in a private superannuation scheme or life insurance annuity policy that is outside New Zealand.*

Overseas social security pensions (IR 258) - Jun 1997: *Explains how to account for income tax in New Zealand if you receive a social security pension from overseas.*

Payments and gifts in the Maori community (IR 278) - April 1998: *A guide to payments in the Maori community - income tax, PAYE and GST consequences.*

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

Provisional tax (IR 289) - Jun 1997: *People whose end-of-year tax bill is $2,500 or more must generally pay provisional tax for the following year. This booklet explains what provisional tax is, and how and when it must be paid.*

Putting your tax affairs right (IR 282) - Jun 1997: *Explains the advantages of telling Inland Revenue if your tax affairs are not in order, before we find out in some other way. This book also sets out what will happen if someone knowingly evades tax, and gets caught.*

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

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

Self-employed or an employee? (IR 186) - Jun 1997: *Sets out Inland Revenue's tests for determining whether a person is a self-employed contractor or an employee. This determines what expenses the person can claim, and whether s/he must pay ACC premiums.*

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

Student Loans - how to get one and how to pay one back (SL 5) - 1998: *We've published this booklet jointly with the Ministry of Education, to tell students everything they need to know about getting a loan and paying it back.*

Superannuitants and surcharge (IR 259) - Jun 1997: *A guide to the surcharge for national superannuitants who also have other income.*

Tax facts for income-tested beneficiaries (IR 40C) - Aug 1997: *Vital information for anyone who receives an income-tested benefit and also has some other income.*

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

Taxpayer obligations, interest and penalties (IR 240) - Jan 1997: *A guide to the new laws dealing with interest, offences and penalties applying from 1 April 1997.*

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

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

Business and employers

ACC premium rates (ACC 450) - Mar 1998: *This book provides the rates of employer premium for employers and self-employed. The rates apply to earnings for the year ended 31 March 1998.*

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

Direct selling (IR 261) - Aug 1996: *Tax information for people who distribute for direct selling organisations.*

Electronic payments to Inland Revenue (IR 87A) - Sep 1997: *Explains how employers and other people who make frequent payments to Inland Revenue can have these payments automatically deducted from their bank accounts.*

Employer's guide (IR 184) - Feb 1998: *Explains the tax obligations of anyone who is employing staff, and explains how to meet these obligations. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.*

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

First-time employer's guide (IR 185) - April 1996: *Explains the tax obligations of being an employer. Written for people who are thinking of taking on staff for the first time.*

Fringe benefit tax guide (IR 409) - Jul 1997: *Explains fringe benefit tax obligations of anyone who is employing staff, or companies which have shareholder-employees. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.*

GST - do you need to register? (GST 605) - May 1997: *A basic introduction to goods and services tax, which will also tell you if you have to register for GST.*

GST guide (GST 600) - Dec 1997: *An in-depth guide which covers almost every aspect of GST. Everyone who registers for GST gets a copy of this booklet. It is quite expensive for us to print, so we ask that if you are only considering GST registration, you get the booklet "GST - do you need to register?" instead.*

IR 56 taxpayer handbook (IR 56B) - Mar 1998: *A booklet for part-time private domestic workers, embassy staff, nannies, overseas company reps and Deep Freeze base workers who make their own PAYE payments.*

Making payments (IR 87C) - Nov 1996: *How to fill in the various payment forms to make sure payments are processed quickly and accurately.*

PAYE deduction tables - 1999
- Weekly and fortnightly (IR 184X)
- Four-weekly and monthly (IR 184Y)
Tables that tell employers the correct amount of PAYE to deduct from their employees' wages from 1 April 1998.

Retiring allowances and redundancy payments (IR 277) - Aug 1997: *An explanation of the tax treatment of these types of payments.*

Smart Business (IR 120) - Jul 1996: *An introductory guide to tax obligations and record keeping, for businesses and non-profit organisations.*

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

Resident withholding tax and NRWT

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

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

Resident withholding tax on dividends (IR 284) - Feb 1998: *A guide for companies, telling them how to deduct RWT from the dividends that they pay to their shareholders.*

Resident withholding tax on interest (IR 283) - Jul 1996: *A guide to RWT for people and institutions which pay interest.*

Resident withholding tax on investments (IR 279) - Jun 1996: *An explanation of RWT for people who receive interest or dividends.*

Non-profit bodies

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

Clubs and societies (IR 254) - Feb 1998: *Explains the tax obligations which a club, society or other non-profit group must meet.*

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

Gaming machine duty (IR 680A) - Jun 1997: *An explanation of the duty which must be paid by groups which operate gaming machines.*

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

Company and international issues

Company amalgamations (IR 4AP) - Feb 1995: *Brief guidelines for companies considering amalgamation. Contains an IR 4AM amalgamation declaration form.*

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

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

Foreign dividend withholding payments (IR 274A) - Mar 1995: *Information for NZ companies that receive dividends from overseas companies. This booklet also deals with the attributed repatriation and underlying foreign tax credit rules.*

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

Imputation (IR 274) - Dec 1997: *A guide to dividend imputation for New Zealand companies.*

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

Child support booklets

A guide for parents who pay child support (CS 71A) - May 1997: *Information for parents who live apart from their children.*

Child support - a guide for custodians (CS 71B) - Nov 1997: *Information for parents who take care of children for whom child support is payable.*

Child support - a guide for prisoners (CS 288) - Mar 1998: *Information for prison inmates who have to pay child support..*

Child support administrative reviews - how to apply (CS 69A) - Feb 1998: *How to apply for a review of the amount of child support you receive or pay, if you have special circumstances.*

Child support administrative reviews - how to respond (CS 69B) - Apr 1997: *Information about the administrative review process, and how to respond if you are named in a review application.*

Child support and the Family Court (CS 51) - Apr 1997: *Explains what steps people need to take if they want to go to the Family Court about their child support .*

Child support - estimating your income (CS 107G) - Aug 1997: *Explains how to estimate your income so your child support liability reflects your current circumstances.*

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

Child support is working for children (CS 80) - Mar 1998: *Brief summary of how child support works, plus some statistics on number of child support customers and amount collected/paid.*

Problems with our child support service? (CS 287) - Jul 1997: *Explains how our Problem Resolution Service can help if our normal services haven't resolved your child support problems.*

Due dates reminder

May 1998

5 Large employers: PAYE deductions and deduction schedules for period ended 30 April 1998 due.

7 Provisional tax and/or Student Loan interim repayments: first 1999 instalment due for taxpayers with January balance dates.

Second 1998 instalment due for taxpayers with September balance dates.

Third 1998 instalment due for taxpayers with May balance dates.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 May 1998 due.

Small employers: PAYE deductions and deduction schedules for period ended 30 April 1998 due.

Gaming machine duty return and payment for month ended 30 April 1998 due.

RWT on interest deducted during April 1998 due for monthly payers.

RWT on dividends deducted during April 1998 due.

Non-resident withholding tax (or approved issuer levy) deducted during April 1998 due.

29 GST return and payment for period ended 30 April 1998 due.

31 All employers: 1998 PAYE and ACC reconciliation and calculation sheet (IR 68A and IR 68P) due to be filed, and 1998 ACC employer premium to be paid.

FBT - employers who elected to pay FBT on annual basis: annual liable return (1/4/97-31/3/98) and payment due.

RWT on interest: 1998 reconciliation (IR 15S) to be filed.

RWT on dividends: 1998 specified dividend reconciliation (IR 17S or IR 17SA) to be filed.

June 1998

5 Large employers: PAYE deductions and deduction schedules for period ended 31 May 1998 due.

7 Provisional tax and/or Student Loan interim repayments: first 1999 instalment due for taxpayers with February balance dates.

Second 1999 instalment due for taxpayers with October balance dates.

Third 1998 instalment due for taxpayers with June balance dates.

IR 5 tax returns due to be filed.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 June 1998 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 May 1998 due.

Gaming machine duty return and payment for month ended 31 May 1998 due.

RWT on interest deducted during May 1998 due for monthly payers.

RWT on dividends deducted during May 1998 due.

Non-resident withholding tax (or approved issuer levy) deducted during May 1998 due.

Imputation: Debit balances as at 31 March 1998 due to be paid.

FBT: Final day for "small" employers to elect to pay annually.

30 GST return and payment for period ended 31 May 1998 due.

Non-resident Student Loan repayments: first instalment of 1999 Student Loan non-resident assessment due.

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

This page shows the draft public binding rulings and interpretation statements that we now have available for your review. You can get a copy and give us your comments in three ways:

By post: Tick the drafts you want below, fill in your name and address, and return this page to the address below. We'll send you the drafts by return post. Please send any comments *in writing, to the address below*. We don't have facilities to deal with your comments by phone or at our local offices.

From our main offices: Pick up a copy from the counter at our office in Takapuna, Manukau, Hamilton, Wellington, Christchurch or Dunedin. You'll need to post your comments back to the address below; we don't have facilities to deal with them by phone or at our local offices.

On the Internet: Visit our web site at http://www.ird.govt.nz/rulings/ Under the "Adjudication & Rulings" heading, click on "Draft Rulings", then under the "Consultation Process" heading, click on the drafts that interest you. You can return your comments via the Internet.

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✓	*Interpretation statements*	*Comment Deadline*
☐	**9708**: Available subscribed capital – consequences of deemed reregistration	31 May 1998

We must receive your comments by the deadline shown if we are to take them into account in the finalised item

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IR 596

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