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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.

Livestock values - 1999 national standard costs for specified livestock

The Commissioner of Inland Revenue has released a determination, reproduced below, setting the national standard costs for specified livestock for the 1998-99 income year.

These costs are used by livestock owners to value livestock on hand at the end of the income year where they have adopted the national standard cost (NSC) scheme to value any class of livestock.

The NSC scheme reflects the national average costs of production of various types and classes of livestock. Farmers using the scheme apply national standard costs to stock bred on the farm during the year and to immature animals on hand at the beginning of the year. Livestock they buy are valued at their purchase price. The average of these costs is used to find the closing value of livestock on hand.

Livestock – 1999 national standard costs

This determination may be cited as “The National Standard Costs for Specified Livestock Determination, 1999”.

This determination is made in terms of section EL 3A of the Income Tax Act 1994. It shall apply to any specified livestock on hand at the end of the 1998-99 income year, where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EL 3A of the Income Tax Act 1994, the national standard costs for specified livestock for the 1998-99 income year are as set out in the following table.

Type of livestock	Category of livestock	National standard cost $
Sheep	Rising 1 year	15.80
	Rising 2 year	9.90
Dairy cattle	Purchased bobby calves	115.00
	Rising 1 year	407.00
	Rising 2 year	63.90
Beef cattle	Rising 1 year	139.00
	Rising 2 year	82.10
	Rising 3 year male non-breeding cattle (all breeds)	82.10
Deer	Rising 1 year	53.60
	Rising 2 year	26.30
Goats (meat and fibre)	Rising 1 year	11.80
	Rising 2 year	7.90
Goats (dairy)	Rising 1 year	76.10
	Rising 2 year	13.60
Pigs	Weaners to 10 weeks of age	68.90
	Growing pigs 10 to 17 weeks of age	54.00

This determination is signed by me on the 26th day of January 1999.

Martin Smith
General Manager (Adjudication & Rulings)

Laser cutting machines

General Depreciation Determination DEP43

In Tax Information Bulletin Volume Ten, No.11 (November 1998) at page 25, we published a draft general depreciation determination for laser cutting machines used in the engineering industry.

No submissions were received on the draft determination, and the Commissioner has now issued the determination. It is reproduced below and may be cited as "Determination DEP43: Tax Depreciation Rates General Determination Number 43". The determination is based on the estimated useful life set out in the determination and a residual value of 13.5%.

General Depreciation Determination DEP43

This determination may be cited as "Determination DEP43: Tax Depreciation Rates General Determination Number 43".

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 1998/99 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 "Engineering (including automotive)" industry category the general asset class, estimated useful life, and diminishing value and straight-line depreciation rate listed below:

Engineering (including automotive)	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Cutting machines, laser	10	18	12.5

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 9th day of February 1999

John Mora
Assistant General Manager (Adjudication & Rulings)

Use of money interest rates from 8 March 1999

From 8 March 1999 the use of money interest rates on revenues and duties will decrease from 12.48% to 10.59% for underpayments and from 4.79% to 3.38% for overpayments.

Use of money interest rate compensate taxpayers or the Government when tax is over or underpaid. The rates are reviewed regularly to ensure they are consistent with market interest rates.

Interpretation guidelines

The items in this section of the TIB discuss the Commissioner's approach to the interpretation of a general area of law.

Interpretation guidelines are intended to clarify general points of interpretation that are causing, or may cause, difficulty for practitioners, taxpayers, and Inland Revenue. An interpretation guideline is Inland Revenue's opinion as to the better view of the law. That view is developed from an appreciation and assessment of the law on a particular topic, as gathered from leading cases.

Employee or independent contractor?

Background

This interpretation guideline will help taxpayers to determine correctly their employment status for tax purposes. It describes the common law tests developed by the courts for determining whether a person is an employee or an independent contractor.

This interpretation guideline replaces the policy statement entitled "Employee or independent contractor?" in Tax Information Bulletin Volume Four, No.7 (March 1993) at pages 2-4 which outlined the tests for determining whether a person is an employee or an independent contractor. That policy statement was published before the Court of Appeal overruling the Employment Court decision in *Cunningham v TNT Worldwide Express (NZ) Ltd* [1992] 3 ERNZ 1030. On the whole the previous statement contained the correct factors to consider, but it did not fully reflect the approach to this question currently taken by the courts.

This interpretation guideline is consistent with, and should be read in conjunction with, the policy statement in TIB Volume Five, No.1 (July 1993) at page 5 which discusses the implications of the Court of Appeal decision in *TNT Worldwide Express (NZ) Ltd v Cunningham* (1993) 15 NZTC 10,234 in relation to the employment status of courier drivers.

Relevance of employment status

A taxpayer's tax obligations differ according to his or her employment status, so it is important to know if he or she is an employee or not. The employment status of a person has the following consequences for tax purposes:

- Payments to employees from their employer are salary or wages, which must have PAYE deducted at source.
- Employees cannot register for or charge GST for services they supply as employees.
- Independent contractors:
  - may deduct certain expenses incurred in deriving assessable income;
  - must account to Inland Revenue for tax and ACC earner and employee premiums for themselves and any employees; and
  - must meet all the requirements of the Goods and Services Tax Act 1985 if the services they supply are in the course of a taxable activity, and they are registered (or liable to register) for GST.

It is not possible for taxpayers to alter their employment status (or the resulting tax implications) merely by calling themselves independent contractors when they are essentially still employees.

Types of employment arrangement

A person's employment status depends on whether his or her employment contract is a "contract of service" or a "contract for services". In *New Zealand Educational Institute v Director-General of Education* [1981] 1 NZLR 538, Somers J in giving the judgment of the Court of Appeal said at page 539:

> On many occasions over the years the Courts have had to decide whether the relationship between two persons was that of employer and employee or, as it used to be called, master and servant. The inquiry normally involved the distinction between a contract of service in which the relation was that of employer and employee and a contract for services in which the relation was that between employer and independent contractor. A decision in any particular case required an examination of the contract between the two – it might be expressed in words or it might be implicit from the circumstances.

Employees have a "contract of service" with their employer. Contracts of service evolved from the earlier concept of a master-servant relationship. Such a relationship required an employee to be continuously available for service and to accept a high degree of control by the employer.

A "contract for services" applies to the relationship between an independent contractor and a principal. It emphasises the nature of the services to be provided by a person rather than his or her availability to work as directed.

Either form of contract may include an unwritten agreement. A written contract is not necessary in determining the existence of any particular type of employment relationship. However, if there is a detailed written contract, it will form the basis for analysing the nature of the relationship the parties intended to have. Employment contracts often change as the relationship

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evolves (e.g. a person takes on more duties). Changes in regulations and work practices may also cause the employment status of some workers to change. The courts will consider how the parties actually work together when they determine the type of employment relationship the parties have.

Employment status and revenue law

Tax law relies on the terms "contract of service" and "contract for services", but does not define them. Therefore, their meanings depend on the contract law developed by the courts and any statutes that apply to a particular kind of work.

A person will have the same employment status for tax purposes as he or she has under the general law. Sometimes it is not easy to tell if a taxpayer is an employee or an independent contractor. Inland Revenue will use the current common law tests to determine a worker's status.

TNT Worldwide Express v Cunningham

A leading New Zealand case on the question of whether the relationship between two parties is one of employee and employer, or independent contractor and principal is the Court of Appeal decision in *TNT Worldwide Express*. In that case the Court gives guidance as to the appropriate focus of inquiry in deciding this question.

In *TNT Worldwide Express* the respondent was engaged by the appellant company, TNT, as an owner-driver to conduct a courier service for the company. The owner-driver:

- provided his own vehicle and was responsible for its maintenance and upkeep,
- was responsible for all his own tax and ACC payments,
- claimed deductions as if he were self-employed, and
- had a contract with TNT that said he was an independent contractor.

The company terminated the respondent's contract, and the respondent sought to invoke the personal grievance procedure under the Employment Contracts Act 1991.

The Employment Court held that an owner-driver courier for TNT was an employee and not self-employed. In reaching that conclusion, considerable emphasis was placed on the rigorous control which the company exercised over its owner-drivers. The Employment Court found that the company's actions showed that it treated the owner-driver as its employee. In particular, the Court found it significant that the company:

- imposed an obligation on the owner-driver to provide a licence, wear a uniform, and have the company's logo painted on the vehicle,
- exercised strong control over the volume, type, quality, and location of his work,
- supervised him closely,
- restricted him from carrying freight for anyone else,
- had all ownership rights over the business and goodwill, and
- could regulate his income (by controlling where and how much he worked).

The Court of Appeal's decision reversed that finding, holding that the written contract entered into by the parties created a genuine independent contractor relationship. The Court accepted that an owner-driver courier was an independent contractor rather than an employee where his or her contract with TNT:

- required him to provide his own vehicle, uniform, approved radio telephone, goods service licence under the Transport Act 1962, and insurance,
- paid him mainly on a per trip basis,
- made him responsible for employing any relief driver,
- referred to the courier as an independent contractor, and
- gave TNT very extensive control over his operations.

The Court acknowledged the extensive control exercised by TNT over the owner-driver, but concluded that the owner-driver accepted only that degree of control and supervision necessary for the efficient and profitable conduct of the business he was running on his own account as an independent contractor. Casey J cited (at page 697) the following statement of MacKenna J in *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 1 All ER 433 at page 447:

> A man does not cease to run a business on his own account because he agrees to run it efficiently or to accept another's superintendence.

The Court of Appeal said that when the contract is wholly in writing and it is not a sham, then the nature of the relationship intended by the parties is determined from the terms of that contract in the light of all the surrounding circumstances at the time it was made. Cooke P (as he then was) noted at page 10,235 that "it is necessary to consider all the terms of the agreement", and made the following observations at page 10,238:

> When the terms of a contract are fully set out in writing which is not a sham (and there is no suggestion of a sham in this case) the answer to the question of the nature of the contract must depend on an analysis of the rights and obligations so defined.
>
> …
>
> In the end, when the contract is wholly in writing, it is the true interpretation and effect of the written terms on which the case must turn.

Tests of the employment relationship

In cases where the nature of the relationship is unclear the courts have developed various tests to determine the type of contract that exists. Cases may not be clear-cut

and the tests may overlap. Therefore, the results of the various tests must be carefully weighed to find the predominant factors that will determine the relationship. In *TNT Worldwide Express*, the Court of Appeal cited (at page 10,248) a statement from page 382 of the judgment of the Privy Council in *Lee Ting Sang v Chung Chi-Keung* [1990] 2 AC 374:

> What then is the standard to apply? This has proved to be a most elusive question and despite a plethora of authorities the courts have not been able to devise a single test that will conclusively point to the distinction in all cases.

The Privy Council in *Lee Ting Sang* quoted with approval from the judgment of the English Cooke J in *Market Investigations Ltd v Minister of Social Security* [1968] 3 All ER 732, at page 185:

> No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of considerations which are relevant in determining the question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases.

Although there are no single tests or exhaustive lists that are appropriate, there are five broad factors or tests which are useful in determining this question. These are not alternative tests but are simply relevant factors to be considered. A discussion of the tests follows.

1. The control test

The control test looks at the degree of control the employer or principal exerts over the work an employee or contractor is to do and the manner in which it is to be done. The greater the extent to which the principal or employer specifies work content, hours and methods, and can supervise, regulate and/or dismiss a person, the more likely it is that the person will be an employee.

This test used to be considered as the deciding factor, but this is no longer the case. The Court of Appeal in *TNT Worldwide Express* emphasised that control is only one of several factors relevant to the interpretation of the contract. The Court endorsed the statement of Cooke J in *Market Investigations* (at page 185) that while control will always have to be considered, it can no longer be regarded as the sole factor in determining the relationship between the parties. The Court of Appeal in *TNT Worldwide Express* considered that this factor had been given too much weight by the Employment Court.

2. The independence test

This is the inverse of the control test. A high level of independence on the part of an employee or contractor is inconsistent with a high level of control by an employer or principal.

The following factors may indicate that a person has a high level of independence:

- work for other people or clients
- work from his or her own premises
- supply his or her own (specialised) tools or equipment
- have direct responsibility for the profits and risks of the business
- hire or fire whoever he or she wishes to help do the job
- advertise and invoice for the work
- supply the equipment, premises, and materials used
- pay or account for taxes and government and professional levies.

On the other hand, when some independent contractors perform work for a principal, they may agree not to work for a competitor or give away trade secrets. This alone will not make the worker an employee (it actually emphasises that the worker is usually entitled to work for others).

Also, the fact that a person is contracted to one party only does not, of itself, necessarily dictate a conclusion that their legal relationship is one of employment.

3. The organisation or integration test

In *Enterprise Cars Ltd v CIR* (1988) 10 NZTC 5,126, Sinclair J said that this test is really whether the person is part and parcel of the organisation and not whether the work itself is necessary for the running of the business.

According to this test, a job is likely to be done by an employee if it is:

- integral to the business organisation
- the type of work commonly done by "employees"
- continuous (not a "one-off" or accessory operation)
- for the benefit of the business rather than the worker.

4. Intention of the parties

This test looks at the intentions of each party to the agreement regarding the nature of the relationship. The description given to a relationship by the parties to the contract is a strong, but not conclusive indication of the type of relationship that exists. The fact that a written contract states that a person is an employee or an independent contractor may indicate the intention of the parties, but is not determinative. Holland J in the High Court in *Challenge Realty Limited and Ors v CIR* [1990] 3 NZLR 42 stated at pages 55-56:

> Obviously the Court's function in interpreting a contract is to determine the intentions of the parties. When, however, the question for determination is the legal relationship between the parties created by the contract, **the expressed intention of the parties will not be determinative of the question. It is nevertheless an important factor, and if after considering all factors the exact state of the relationship is a matter of some ambiguity, may be decisive** In the present cases before me Harcourts is the only one with a written agreement. Nevertheless I would conclude that in all cases it was the intention of the parties to create an agency relationship rather than an employer/employee relationship. The question remains as to whether that result has been achieved. (emphasis added)

Thus, if the actual circumstances point to an employment relationship, then simply labelling it an independent contract will not alter the actuality.

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In *TNT Worldwide Express*, a clause in the written contract which purported to override all other aspects of the agreement stated that the courier was an independent contractor. The Employment Court found that the actual conduct of the relationship showed that TNT imposed a high level of control and supervision of its staff that was inconsistent with any independence or initiative on their part. However, the Court of Appeal in reversing this decision concluded, after weighing all the circumstances, that the TNT standard form contract created a genuine independent contractor relationship.

If an employment contract treats a person as an employee, for example by paying him or her at regular intervals, at a set rate, and deducting PAYE, this may indicate that there is an employment relationship.

5. The fundamental test

In *Market Investigations*, the English Cooke J said that the fundamental test for distinguishing an employee and an independent contractor was as follows:

> Is the person who has engaged himself to perform these services performing them as a person in business on his own account? If the answer to that question is "yes", then the contract is a contract for services. If the answer is "no", then the contract is a contract of service. ... factors which may be of importance are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task.

This test was approved by the Privy Council in *Lee Ting Sang* and subsequently cited by four of the five judges in the Court of Appeal in *TNT Worldwide Express*.

The fundamental test is also sometimes described as the "business test" or the "economic reality test". In *Challenge*, the Court of Appeal stated at page 65:

> If it is helpful to look for a test or application in this case, apart from that of control, which is a key feature of the Act, we favour that suggested by Adrian Merritt, Lecturer in Industrial Law, University of New South Wales in his article "'Control' v 'Economic Reality': Defining the Contract of Employment" in (1982) 10 Australian Business Law Review 105 at p.118:
>
> > The issue that must be settled in today's cases is whether the worker is genuinely in business on his own account or whether he is "part and parcel of" - or "integrated into"- the enterprise of the person or organisation for whom work is performed. The test is, therefore, one of "economic reality".

This test looks at factors such as:

- whether the type of business or the nature of the job justifies or requires using an independent contractor
- the behaviour of the parties before and after entering into the contract
- if there is a time limit for completing a specific project
- whether the worker can be dismissed
- who is responsible for correcting sub-standard work
- who is legally liable if the job goes wrong.

Usually, an independent contractor agrees to be responsible for his or her work. He or she cannot usually be "dismissed", although the contract can be terminated if it is broken.

Summary

It must be emphasised that the "tests" outlined above are merely factors to be considered, rather than distinct tests, and it is important in each case to consider this question by balancing all the circumstances of the relationship between the parties. Often there will be competing factors that indicate differing conclusions as to whether someone is an employee or an independent contractor. In these circumstances, each of the tests described above should be applied to the facts of the case, and the resulting factors carefully and objectively weighed to determine the true nature of the relationship.

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.

Shortfall penalties - application where returns are amended before due date

Standard practice statement INV-570

Introduction

This Standard Practice Statement (SPS) outlines the Commissioner's practice when a taxpayer files a return taking an incorrect tax position and then seeks to amend the return before the due date for filing the return.

Application

This SPS applies for the period from 1 March 1999 to 31 March 2001. It applies to all amendments made to a return before due date, including amendments requested by phone call, letter, NOPA or by filing an amended return. It does **not** apply to **income tax** returns.

Background

The Tax Administration Act 1994 imposes shortfall penalties in all cases when a taxpayer breaches the standards defined in sections 141A to E and takes an incorrect tax position creating a tax shortfall. This applies even if the return is amended before the due date for filing the return.

If the incorrect tax position was not caused by a breach of the taxpayers' statutory obligations, shortfall penalties cannot be imposed.

Except for income tax, taxpayers take their tax position at the date when they file the return. This is the assessment date regardless of whether it is before the due date for filing the return. Therefore when taxpayers file an incorrect return they have taken an incorrect tax position at that date.

The definition of taxpayer's tax position is different for income tax. If a taxpayer alters the tax position taken in an income tax return before the earlier of the due date or when the assessment is issued, the amended return will be accepted as the taxpayer's tax position.

To date, in accordance with the legislation, Inland Revenue has been proposing shortfall penalties in some cases when the taxpayer has amended a return before the due date, with a 75% reduction for voluntary disclosure before notification of a pending tax audit or investigation. However, we are concerned that imposing shortfall penalties in these situations may discourage taxpayers from voluntarily disclosing an incorrect tax position. This would not be in keeping with the purpose of the penalty regime, which is to encourage taxpayers to voluntarily co-operate with Inland Revenue.

To encourage voluntary disclosure Inland Revenue will take a liberal approach. We will not impose shortfall penalties if a taxpayer independently and voluntarily files an amended return before due date. However, we reserve the right to impose shortfall penalties in all situations if we believe that the taxpayer's original tax position was not a genuine mistake or if the taxpayer repeatedly makes the same or similar mistake and files amendments to the returns before due date.

Practice

Inland Revenue will adopt the following approach:

If taxpayer amends return before due date and before IRD advises taxpayer of acceptance or non-acceptance of original tax position

In this situation the taxpayer has realised the mistake and has voluntarily notified IRD of the incorrect tax position. To impose shortfall penalties would discourage taxpayers from making such voluntarily disclosures in the future. The taxpayer has independently found and corrected the mistake before due date so Inland Revenue will not impose shortfall penalties.

Notification that the tax position has or has not been processed or accepted for processing will be the date the taxpayer or agent receives written advice or a statement of account, or the time of a telephone call advising of a pending tax audit or investigation.

If the exact time of the written advice/statement of account becomes crucial, it will be ascertained from the expected time for the mail to reach its destination as prescribed by section 14(2) of the Tax Administration Act 1994. This is in accordance with the Standard Practice Statement INV-250 on Voluntary Disclosure.

If taxpayer amends return before due date but after IRD advises taxpayer of acceptance of original tax position

In this situation the taxpayer has independently realised the mistake and chooses to file an amended return before the due date. Again to impose shortfall penalties in this situation would discourage this type of voluntary disclosure. Generally Inland Revenue would not impose shortfall penalties because the taxpayer has independently found and corrected the mistake before due date.

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If a refund is issued or the tax becomes due before the taxpayer files an amended return interest will be charged in accordance with Section 120.

Inland Revenue reserves the right to impose penalties if the amended return filed before due date is not correcting a genuine mistake. That is, the shortfall may be considered for penalties if we believe that the taxpayer intentionally attempted to overstate a benefit or understate tax by filing an incorrect first return. If we believe this may be the case we will need to request details as to why the shortfall occurred.

An example of the above would be if a vendor who has entered into a property transaction (for which an early return has been filed) omits to return the sale and then finds out that Inland Revenue is auditing the purchaser of the property. In this situation the vendor might quickly put in an amended return because they consider that IRD would check up on whether the vendor has returned the sale.

If taxpayer amends return before due date but after IRD advises taxpayer of pending audit/investigation

In this case the taxpayer did not amend the return until after Inland Revenue gave notice that the tax position was to be examined. Inland Revenue will consider shortfall penalties in this situation. To establish whether the shortfall was the result of a breach of sections 141A to E we will need to request details of how the shortfall occurred. If a penalty is warranted it will be reduced by 40% as a post-notification voluntary disclosure or 75% as a temporary shortfall.

If penalties were not imposed in these situations taxpayers would have an incentive to file early returns, overstating their benefit or understating their tax. If IRD does not accept the tax position taken the taxpayer could send in an amendment before the due date to avoid penalties. This does not encourage voluntary compliance first time. Consideration of a penalty in this instance prevents taxpayers abusing the opportunity to take a tax position beneficial to themselves before the due date.

If taxpayer repeatedly makes same/similar mistake then amends return before due date

Inland Revenue wants to continue to encourage taxpayers to take the correct tax position when filing their returns. Therefore in situations like this we may consider imposing a shortfall penalty.

This Standard Practice Statement was signed by me on 2 February 1999.

Tony Bouzaid
National Manager, Operations policy

GST returns – correcting minor errors

Clarification to Standard Practice Statement INV-490

In TIB Volume Ten, No.6 (June 1998) we published Standard Practice Statement INV-490 about correcting minor errors in GST returns. Briefly this statement set a maximum error amount (either $200 or $500 depending on whether the registered person's annual turnover is over $250,000) which could be corrected by the registered person in a later GST return without entering into the formal disputes resolution process.

Since then readers have asked whether this $200/$500 limit applies to the original return in which the error was made, or to the later return in which the error is corrected. This question becomes significant if errors are found in several earlier returns, and the registered person wants to correct them all in one later return.

The $200/$500 limit applies to the initial error(s) made in one return; it does not limit the value of error(s) that can be corrected in a later return. The following examples demonstrate how the limit applies and situations which are acceptable and not acceptable.

Example 1: One common error in several past returns - within threshold

Mrs Jones operates a large clothing warehouse. She permits staff to take supplies for private use in lieu of wages payable. She omitted to make adjustments for GST on fringe benefits when filing her two-monthly GST returns, but her accountant identified the oversight when preparing the end of year accounts.

Mrs Jones' staff take approximately $1,800 of goods per return period, so the GST adjustment for fringe benefits is approximately $200 per return period.

This qualifies as a minor error because Mrs Jones' annual turnover exceeds $250,000 and the return errors are less than $500 per period. She can make a $1,200 catch-up adjustment in the next GST return. She must keep details of the error with the current GST return work papers.

Example 2: One error exceeds threshold

ABC Limited operates a hotel/reception centre. ABC overlooked including $4,920 goods and services supplied and invoiced to a local club for a recent convention held at the centre. The company didn't identify the error until it received payment the following month, and asked if it could make an adjustment to the current return.

Although ABC Limited's annual turnover exceeds $250,000, the initial error is greater than $500 (1/9 of $4,920 = $546). The correction must be made to the original return as the value of the GST ABC Limited's error falls outside the concession in the Standard Practice Statement.

The company should notify the Commissioner, explaining the background leading to the error. The question of shortfall penalty will be considered as with any other voluntary disclosure. Interest will apply from return period the original liability arose.

Example 3: Various errors, test against return threshold

A registered person's accountant completing the income tax return identifies various return errors which result in GST short-paid in three return periods. The turnover is $200,000 per annum. They ask if an adjustment can be made in the current GST return period to correct these errors:

Dec 1997	$125
Feb 1998	$305
Jun 1998	$ 80
	$510

The December 1997 and June 1998 GST returns can be corrected by an adjustment in the current return period. The February 1998 error exceeds $200 so the registered person should notify the Commissioner, explaining the background leading to the error. The question of shortfall penalty will be considered as with any other voluntary disclosure. Interest will apply from the return period the original liability arose.

Averaging not permissible

Errors in different return periods cannot be averaged to fit within the policy concession. If the error in a single return period exceeds the $200 or $500 threshold (as applicable to $250,000 turnover) the registered person should notify the Commissioner, explaining the background leading to the error. The question of shortfall penalty will be considered as with any other voluntary disclosure. Interest will apply from return period the original liability arose.

Different limit from voluntary disclosures

Some readers have asked why Standard Practice Statement INV-490 does not allow registered persons to make adjustments to the value of $4,000, equivalent to the effective treatment of voluntary disclosures under the compliance and penalties rules.

Example of voluntary disclosure

Shortfall of tax	$3,999
Shortfall penalty at rate of 20%	$799
Less 75% reduction for disclosure	$199

Inland Revenue will generally not impose a shortfall penalty of less than $200. Reduction of a shortfall penalty for disclosure is considered on case by case basis. The shortfall penalty can be greater than 20% e.g. evasion 150%. However, this is a separate issue from the threshold for adjustment and consequential use of money interest.

Standard practice statement INV-490 allows registered persons to correct GST return errors without the need to notify the Commissioner or incur compliance costs (including use of money interest). It provides an administratively expedient way of solving minor errors without the encumbrances that follow the making of voluntary disclosures i.e. paperwork, consultation, examination of records and interest. For these reasons we do not plan to align the standard practice statement with the voluntary disclosure process, because the current concession is already reasonable.

In effect, standard practice statement INV-490 allows an adjustment up to $1,800 in taxable supplies per return period for small businesses and $4,500 for larger businesses.

Standard practice statement INV-490 will continue to apply until it is revoked or legislation change terminates its application.

General interest items

Interest, withholding taxes and approved issuer levy

In 1998 Inland Revenue's Banking and Finance Portfolio, Corporates, issued a questionnaire to selected financial institutions that pay interest to a significant number of depositors. We also reviewed the interest payment records of a number of corporates. The purpose of the questionnaire and reviews was to identify and correct common errors in applying resident withholding tax (RWT), non-resident withholding tax (NRWT) and approved issuer levy (AIL).

This article summarises the issues arising from the questionnaire responses and the review of records. We've published it to help interest payers correctly apply RWT, NRWT or AIL. It will also help recipients of interest to understand issues dealt with by interest payers which have a taxation impact on those recipients.

In this article *payer* means a person paying interest from which RWT or NRWT is deducted or AIL applied; *depositor* or *recipient* is the person who has invested with the payer and who is entitled to the interest being paid.

General

Resident and non-resident status

Part N of the Income Tax Act 1994 (the Act) sets out two separate sets of rules for NRWT and RWT. A payer's systems and procedures must be able to distinguish between New Zealand resident depositors and non-resident depositors, and then deduct the appropriate withholding taxes.

Obtaining customers' IRD numbers

Under section 27(1) of the Tax Administration Act 1994 (TAA), a recipient of resident withholding income which must have RWT deducted is required to supply his/her tax file number (IRD number) to the payer within 10 working days of receiving a written request from the payer. If the payer does not obtain the IRD number then the payer must deduct tax at the no-declaration rate. (This rate is 33 cents in the dollar until 31 March 2000; from 1 April 2000 it will be 45 cents in the dollar.)

Sections 52-54 of the TAA require the payer to provide the recipient's details, including IRD number, to the Commissioner. For the purposes of those sections only, the payer doesn't have to provide the IRD number if "*having made reasonable efforts to obtain the tax file number, is unable to do so*" (section 55, TAA).

The payer's procedures for obtaining the depositor's IRD number should amount to a "**reasonable effort**" to obtain the IRD number. The request on, say, a term deposit application form for the depositor's IRD number, may not amount to a reasonable effort if there is no follow up action with those depositors who did not provide their IRD numbers.

IRD number verification by modulus 11 check

A modulus 11 check is a mathematical calculation that any payer can run against the eight-digit IRD number supplied by a depositor to ensure the number is valid. Running this check will prevent invalid IRD numbers being loaded into the payer's systems and not being detected. Invalid IRD numbers may result in inappropriate RWT rates being applied and incorrect withholding taxes being deducted and accounted for to the Commissioner.

All payers should run the modulus 11 check regularly and ensure they have adequate controls to confirm that all IRD numbers supplied by depositors are valid. For details of this check see our booklet *E-File IR Electronic filing Payroll Specification Document April 1 1999 to March 31 2000* (also available from our website at http://www.ird.govt.nz/software/index.htm).

If an IRD number is not valid, payers must deduct RWT at the no-declaration rate.

An additional safeguard to ensure the correct IRD number is recorded in a payer's records is for the payer to confirm the IRD number by sighting, say, the depositor's Inland Revenue information card or other IRD documentation bearing the depositor's name and number.

Joint accounts

Section 25(9) of the TAA deals with tax deduction certificates when two or more people jointly derive resident withholding income. Basically, the joint account holders who receive resident withholding income can elect which account holder's name and IRD number will appear on the certificate. However, there are two points to note:

- If a person with a valid certificate of exemption holds a joint account with someone who does not have a valid certificate of exemption the payer must deduct RWT from all the interest paid. The person with the valid exemption certificate may then claim a tax refund when filing the annual tax return.
- If a non-resident and a resident have a joint account and the payer knows the proportions that relate to each person, NRWT and RWT can be deducted accordingly. If the proportions are not known, the payer should deduct RWT from all interest paid on that account. The non-resident may then claim a refund from Inland Revenue by filing an IR 3NR tax return (if they have an IRD number), or by filing an IR 15F (for RWT refund) if they do not have an IRD number.

All payers should ensure that their systems and procedures for joint accounts correctly record the RWT/NRWT deducted.

Payment of RWT or NRWT to Inland Revenue each month

Generally, the payment date for RWT or NRWT is on a monthly basis by the 20th of the month following the month the interest was paid. The respective payments must include all amounts due from **all** the payer's systems, sub-systems etc.

Because of the possible late payment penalties it is important that payers have adequate systems and procedures in place for paying RWT and NRWT to Inland Revenue by the due date.

Information provided to Inland Revenue each year

Payers must provide to Inland Revenue, both through the year and annually, the correct withholding tax details on the appropriate forms or in a format agreed by the Commissioner.

All payers' procedures and systems should reconcile the monthly information sent to Inland Revenue with the end of year reconciliation. If the monthly and annual figures cannot be reconciled the payer will need to provide an explanation to Inland Revenue. We view seriously failure to reconcile these records – it could lead to a review or audit of the payer's withholding tax records.

Payer instructions for RWT/NRWT/AIL

Inland Revenue expects all payers to maintain adequate records and (if appropriate) instruction manuals in respect of RWT/NRWT/AIL. This is good business practice as it will help payers to comply with the appropriate legislative requirements (e.g. section 26 of the TAA) and would be a factor in any consideration of a shortfall penalty e.g. for lack of reasonable care.

Resident withholding tax (RWT)

Expiry of certificate of exemption

Section NF 9(1) and (12) of the Act are very specific as to the various classes of persons that may apply for a certificate of exemption (COE). A COE applies only to the person named on the COE, not to, say, subsidiaries of or unit trusts related to that person.

To apply for a COE complete form IR 15E. It is important to complete the application under the correct category so it is processed as quickly as possible.

The COE is issued with a start date and an expiry date (if any) as well as the individual's IRD number. For example, an application under section NF 9(12) is usually limited to one year. If the criteria on which the COE was issued are adhered to, the COE is valid up to the expiry date specified unless it is cancelled earlier by the Commissioner.

All payers must deduct RWT at the appropriate rate once the expiry date of a COE has passed unless the depositor presents a new valid COE.

Cancellation of COE

A cancellation of a COE does not include the expiry of a COE merely because its term has expired. Section NF 11 of the Act provides for the cancellation of a COE either when a person ceases to meet the criteria for exemption as specified or when the Commissioner cancels it in the circumstances listed in section NF 11(2) of the Act.

The Commissioner is required by section NF 11(5) of the Act to publish quarterly in the *NZ Gazette* a list of all COEs that have been cancelled in the preceding three-month period. (This does not include expired certificates.) A COE ceases to be valid on the fifth working day after notice of its cancellation is published in the *NZ Gazette* (section NF 11(7) of the Act).

COE compliance

Before paying interest it is important that the payer checks that the COE has not expired. The payer must also check the *NZ Gazette* and update their database for COEs that have been cancelled.

If a payer doesn't record expiry dates or check the *NZ Gazette* for cancelled COEs, RWT would not be deducted when due. This would result in a deficiency of RWT payable to Inland Revenue, and the depositor would receive full interest income without deduction of RWT when that depositor no longer holds a valid COE.

Failure to deduct the correct RWT means the payer must make up the RWT shortfall, any late payment penalties, and possibly a shortfall penalty under the compliance and penalties rules (e.g. for lack of reasonable care). For details of the compliance and penalties rules see our guide, *Taxpayer obligations, interest and penalties (IR 240)* – available from the Inland Revenue website at http://www.ird.govt.nz/resource/publicat/index.htm or from IRD offices.

All payers should ensure that their systems and procedures properly record the expiry dates/cancellation of COEs against depositors' accounts and, that on expiry/cancellation of a COE, the correct RWT is deducted.

Netting off debit and credit interest

Some payers offer revolving credit type accounts that are basically current accounts with an approved overdraft limit. The general conditions of the account are:

- interest is paid by the payer on credit balances
- interest is paid by the depositor on debit balances
- the respective credit and debit interest amounts are calculated on a daily basis
- at the end of an agreed period (e.g. monthly, quarterly) the net amount of the two accruals is credited or debited to the depositor's account.

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RWT applies to the total credit interest before any offsetting of debit interest. The same applies when debit and credit balances from different accounts are offset. All payers should ensure that their system is applying RWT in this manner.

Negative interest on broken term deposits

Under section NF 2(1) of the Act when a payer pays resident withholding income "...that person shall, **at the time of making the payment**, make a deduction of tax..." (i.e. RWT) from the resident withholding income. In practice the RWT deduction is made at the same time as the interest is credited to the depositor's account.

Generally, when a depositor breaks a term deposit the payer recalculates interest on the deposit at a lower rate than would have applied if the deposit had run its full term. This change in interest rate can give rise to *negative interest*. Negative interest arises when, at the time of the break of a term deposit, there is insufficient interest payable to the depositor to offset any interest repayable by the depositor to the payer as a result of the depositor now earning a lower interest rate.

For RWT purposes the payer should not offset any negative interest paid by the depositor against gross interest previously paid/credited to the depositor's account.

Section NF 6(2) allows for the refund of any excess RWT deducted **due to an error on the part of the payer**. In those circumstances the payer "...may pay the excess to the recipient of the payment at any time on or before 31 March in the year the deduction was made...". However, the recalculation of interest on the breaking of a term deposit by a depositor is not an error on the part of the payer and so this provision does not apply.

This is an area that has caused confusion for some payers of interest. The following examples show the correct amounts subject to RWT and to be recorded on the RWT certificate given to the depositor and the Commissioner.

Example 1

A $10,000 term deposit is made with a bank on 1/1/X1 for three years at interest of 8% p.a., which will reduce to 6% p.a. if the term is broken. Interest is payable six-monthly on 30/6 and 31/12 of each year. RWT is deducted at 33%. Income year refers to year ending 31 March with 365 days per year.

The term deposit is fully broken after some interest is paid; but sufficient interest is payable at time of break to absorb interest to be recovered.

Interest payable on 30/6/X1 from start date 1/1/X1:

Interest payable	$400
RWT @ 33%	$132
Net deposit in the bank statement	$268

Break on 30/12/X1

Interest due (1/1/X1-30/12/X1)	
$^{364}/_{365}$ x .06% x 10,000	$598.35
Less interest paid to date	$400.00
Net interest payable to 30/12/X1	$198.35
Less RWT @33%	$ 65.45
Net deposit in the bank statement	$132.90

RWT certificate for year ended 31/3/X2 shows:

Gross interest	$598.35
RWT	$197.45

In this situation there is no negative interest paid by the depositor.

Example 2

Facts the same as in example 1, except that when the deposit is broken there is insufficient interest payable to absorb the interest to be recovered. This results in negative interest to be recovered by the bank from the depositor.

On 30/06/X1

Interest payable	$400
Less RWT	$132
Net deposit in bank statement	$268

On 31/12/X1

Interest payable	$400
Less RWT	$132
Net deposit in bank statement	$268

Break on 30/1/X2

Interest due (1/1/X1-30/1/X2)	
$^{395}/_{365}$ x .06% x 10,000	$649.32
Less gross interest paid	$800.00
Negative interest to be recovered	($150.68)

RWT Certificate for year ended 31/3/X2 shows:

Gross interest	$800
RWT	$264

The payer will need to advise the depositor separately of negative interest of $150.68. The depositor should consider this negative interest under the financial arrangement base price adjustment provisions in the accrual rules.

In this example there is an interest deductibility issue. The RWT certificate shows $800 gross interest for the year, and the depositor must show that gross income in his/her tax return for the year. In addition, the depositor must claim a deduction in his/her tax return for the interest recovered of $150.68. See Public Ruling BR Pub 97/9 in TIB Volume Nine, No.9, for details.

Section NF 6 of the Income Tax Act 1994 does not apply as the correct RWT was deducted from interest payments when made.

Example 3

A term deposit of $10,000 is made with a bank on 1/1/X1 for three years at 8% p.a. Interest is payable six-monthly on 30/6 and 31/12 of each year. On a partial break, interest reduces to 6% on the amount withdrawn from the start date to the date of break. The balance of the deposit continues at 8%.

RWT is deducted at 33%. Income year refers to year ending 31 March with 365 days per year.

The deposit is partially broken after some interest is paid, but there is sufficient interest payable at the time of the break to absorb interest to be recovered.

On 30/06/X1

Interest payable	$400
Less RWT @33%	$132
Net deposit in bank statement	$268

Partial break on 1/12/X1 – $6,000 is withdrawn. On 1/12/X1 interest on the amount withdrawn is:

Interest payable (1/1/X1-1/12/X1)	
$^{335}/_{365}$ x 0.06% x 6,000	$330.41
Less Interest paid (1/1/X1-30/6/X1)	
$^{181}/_{365}$ x 0.08% x 6,000	($238.03)
	$ 92.38
Less RWT	$ 30.49
Net deposit in bank statement	$ 61.89

As at 31/12/X1

Interest payable (1/7/X1-31/12/X1)	
$^{184}/_{365}$ x 0.08% x 4,000	$161.32
RWT @33%	$ 53.23
Net deposit in bank statement	$108.09

RWT certificate for the year ended 31/3/X2 shows:

Gross Interest (400+92.38+161.32)	$653.71
RWT	$215.72

In this situation there is no negative interest paid by the depositor.

Example 4

Facts the same as in example 3, except that at the time of the partial break there is insufficient interest payable to absorb interest to be recovered, and no further interest will be payable in the income year.

On 30/06/X1

Interest payable	$400
Less RWT	$132
Net deposit in bank statement	$268

On 31/12/X1

Interest payable	$400
Less RWT	$132
Net deposit in bank statement	$268

Break on 30/1/X2

Interest payable (1/1/X1-30/1/X2)	
$^{395}/_{365}$ x 0.06% x 6,000	$389.59
Less interest paid (1/1/X1-31/12/X1)	
$^{365}/_{365}$ x 0.08% x 6,000	($480.00)
Negative interest to be recovered	($90.41)

RWT certificate for the year ended 31/3/X2 shows:

Gross interest	$800
RWT	$264

The payer will need to advise the depositor separately of $90.41 negative interest for the year ended 31/3/X2. Although there is no requirement for the depositor to perform a financial arrangement base price adjustment until full maturity of the term deposit, deductibility of this $90.41 may need to be considered separately under section BD 2(1)(b).

There is an interest deductibility issue. The RWT certificate shows $800 gross interest, and the depositor must show that $800 interest in his/her tax return for the year ended 31/3/X2. The depositor may claim a deduction for the interest recovered of $90.41. However, the year the deduction can be claimed will depend on the particular circumstances – see Public Ruling BR Pub 97/9 in TIB Volume Nine, No.9.

Section NF 6 of the Income Tax Act 1994 does not apply as the correct RWT was deducted from interest payments when made.

Example 5

Facts the same as in example 4, except that the partial break occurs in a later income year. Insufficient interest is payable at the time of the break to absorb interest to be recovered, but further interest is payable in that income year.

On 30/06/X1

Interest payable	$400
Less RWT	$132
Net deposit in bank statement	$268

On 31/12/X1

Interest payable	$400
Less RWT	$132
Net deposit in bank statement	$268

RWT Certificate for year ended 31/3/X2 shows:

Gross interest	$800
RWT	$264

Break on 4/4/X2

Interest payable (1/1/X1- 4/04/X2)	
$^{459}/_{365}$ x 0.06% x 6,000	$452.71
Less interest paid (1/1/X1-31/12/X1)	
$^{365}/_{365}$ x 0.08% x 6,000	($480.00)
Negative interest to recover	($ 27.29)

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On 30/06/X2

Interest payable $^{181}/_{365}$ x 0.08% x 4,000	$158.68
Less RWT	$ 52.36
Net deposit in bank statement	$106.32

On 31/12/X2

Interest payable $^{184}/_{365}$ x 0.08% x 4,000	$161.32
Less RWT	$ 53.24
Net deposit in bank statement	$108.08

RWT certificate for year ended 31/3/X3 shows:

Gross interest	$320.00
RWT	$105.60

The payer will need to advise the depositor separately of negative interest of $27.29 arising in the year ended 31/3/X3. Although there is no requirement for the depositor to perform a financial arrangement base price adjustment until full maturity of the term deposit, deductibility of this $27.29 may need to be considered separately under section BD 2(1)(b).

The depositor must show the $800 gross interest in his/her tax return for the year ended 31/3/X2.

There is an interest deductibility issue in the year ended 31/3/X3. The RWT certificate must show $320 gross interest, and the depositor must show that $320 gross interest in his/her tax return for the year. The depositor may claim a deduction for the $27.29 interest repaid, but the year in which that deduction is to be claimed will depend on the circumstances – see Public Ruling BR Pub 97/9 in TIB Volume Nine, No.9 for details.

Section NF 6 of the ITA 1994 does not apply as the correct RWT was deducted from interest payable when made.

All payers should ensure that they are recording the correct term deposit interest information on all tax deduction certificates. Non-compliance could result in a deficiency in RWT being paid to Inland Revenue, which could incur a shortfall penalty under the compliance and penalties rules.

Prize draws in lieu of interest

Some payers have deposit accounts that not only pay interest on the deposit but also give the depositor a chance to win a prize draw (i.e. cash, goods or services).

RWT cannot be deducted from the prize won by a depositor or from any interest foregone by depositors who invest in such accounts. However, depending on the contract/conditions under which the deposit is made the depositor may be liable to return for tax purposes the value of any benefit from money advanced – section CE (1)(b). This would be in addition to the tax liability on any interest received. See Tax Information Bulletin Volume Two. No.3 for details.

Purchases of securities from residents

Resident withholding income includes interest paid on money lent, including redemption payments. Interest includes any return on money lent, excluding the repayment of the original capital. RWT should be deducted from the interest element of all redemption payments made by payers to New Zealand residents on the purchase or maturity of securities issued by the payer e.g., certificates of deposits and commercial bills.

Conversion of RWT deducted in foreign currencies

When converting any RWT deducted in foreign currency section NF 2(3)(b) of the Act states that,

> ...the amount of resident withholding tax deduction made by the first person [i.e. the payer] shall be converted into New Zealand currency **at the close of trading spot exchange rate on the first working day of the month succeeding the month** in which the resident withholding tax deduction is made. (emphasis added)

Payers should ensure that they are correctly converting RWT deductions made in a foreign currency. Tax deduction certificates should show the resident withholding income and the RWT in New Zealand dollars.

RWT tax deduction certificates

Section 25 of the TAA requires all payers who deduct RWT to issue tax deduction certificates in the prescribed form. These certificates must be issued to the recipients by 20 May following the end of the relevant year. Section 25(3) allows a recipient to request a tax deduction certificate from the payer **at any time** during the relevant year. All certificates issued must contain all the necessary information as specified in section 25(6). Note that for interest paid on or after 1 April 1999 additional information must be shown on the certificate.

Section 54 of the TAA requires all payers to provide to Inland Revenue details of all recipients of resident withholding income. This is generally done by filing the appropriate IR 15 forms or by an approved electronic format, by 31 May in the year after the RWT was deducted – section 51 TAA.

It is in the payer's interest to have adequate procedures and systems that ensure that:

- tax deduction certificates issued to recipients include all interest paid from all the payer's products, e.g. term deposits, saver accounts, etc
- total resident withholding income and RWT on the individual IR 15 certificates reconcile with the amounts shown on the annual reconciliation statement (IR 15S).

Further RWT information

For further RWT information please see our guide *RWT on Interest – Payer's Guide (IR 283)* – available from Inland Revenue offices or our website at http://www.ird.govt.nz/resource/publicat/index.htm .

Non-resident withholding tax

Calculation

Section NG 2 details the non-resident withholding tax (NRWT) rates to apply when a person derives non-resident withholding income that is liable for NRWT. However, those rates can be varied by double tax agreements that New Zealand has with various countries.

Payers' systems and procedures must be able to calculate and deduct NRWT at the correct rates set out in section NG 2 or the appropriate double tax agreement.

Purchases of securities from non-residents

Non-resident withholding income includes interest derived by a non-resident on money lent. NRWT at the appropriate rate should be deducted from the interest element of all redemption payments paid to non-residents on the purchase or maturity of securities issued by the payer.

Conversion of NRWT deducted in foreign currency

When NRWT is deducted in a foreign currency, the deduction should be converted into New Zealand dollars before payment to Inland Revenue. The legislation is silent on how/when the conversion should be made to New Zealand currency, but Inland Revenue's policy on this matter is that the conversion should be at the exchange rate which applied on the day the NRWT was deducted. The NRWT legislation calls for the NRWT deduction to be made at the time the non-resident withholding income is paid, and to be paid to Inland Revenue by the 20th of the following month.

Any payers who are not already complying with this method should seek advice from the Non-Resident Centre, Dunedin, phone 03 467 7020.

Interest payments to related parties overseas

If a payer conducts its business in New Zealand through a NZ resident company and pays interest to an overseas parent company (or to an overseas related party company), NRWT should be deducted from the interest payment. Approved issuer levy is not an option if the interest is paid to an associated person – section NG 2(1)(b)(i).

Further NRWT information

For further NRWT information see our guide *Non-Resident Withholding Tax – Payer's Guide (IR 291)* – available from IRD offices or our website at http://www.ird.govt.nz/resource/publicat/index.htm.

Approved issuer levy

Application

Two steps must take place before a payer pays approved issuer levy (AIL):

- Inland Revenue must have approved the payer as an approved issuer (Section NG 6 of the Act)
- The payer must have registered with Inland Revenue all the securities on which the zero rate of NRWT is to be applied (Section 86H, Stamp and Cheque Duties Act 1971).

To apply for registration contact the Inland Revenue Non-Residents Centre in Dunedin. Payers should ensure that the appropriate registration has been made for each security or class(es) of security.

Payment of AIL

Before the payment of interest, the payer and the non-resident deriving the interest must agree whether AIL applies. The agreement should be in writing to prevent later disputes, and cannot be made after the event.

AIL is a charge on the payer and so should not be deducted from the interest paid to the recipient. If the cost of the AIL is to be recovered from the recipient, it should be shown as a fee or a charge. If there is no agreement before payment that AIL will apply then NRWT should be deducted.

AIL cannot apply to the interest that is derived by a person who is an associated person of the payer. In such cases the NRWT rules apply.

Section 86K of the Stamp and Cheque Duties Act (SCD Act) 1971 requires the AIL to be paid monthly to Inland Revenue by the 20th of the month following the month interest was paid. If a payer fails to account for AIL by the due date to Inland Revenue, NRWT must be deducted by the payer in all cases (section 86I of the SCD Act and section NG 2(1) of the Income Tax Act). However, section 86M of the SCD Act provides for relief in cases when the payment was not made by due date due to circumstances beyond the payer's control.

It is important that all payers correctly calculate AIL and pay it to Inland Revenue by the due date. If NRWT has to be applied to interest payments on which AIL has not been accounted for by the due date, it may involve a significant increase in the payments required by the payer to Inland Revenue, including late payment penalties, shortfall penalties and use of money interest.

Further AIL information

For further information on AIL see our guide, *Approved Issuer Levy (IR 291A)* – available from IRD offices or our http://www.ird.govt.nz/resource/publicat/index.htm.

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.

Available subscribed capital – energy companies

Calculation for successors to electric power boards and municipal electricity departments

Summary

Under the Energy Companies Act 1992 ("the ECA") and establishment plans approved under that Act, the energy undertakings of:

- Electric power boards ("EPBs") were vested in successor energy companies, the successor energy companies issued shares, and the EPBs were dissolved.
- Municipal electricity departments ("MEDs") were transferred to successor energy companies and those successor energy companies issued shares.

For the purposes of determining the amount of available subscribed capital ("ASC") of the successor energy companies, this statement concludes that ASC arises from the issue of shares on the corporatisation of the successor energy companies to the EPBs or MEDs.

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

Background

ASC is generally the amount of capital contributed by shareholders to a company. In certain circumstances a distribution of ASC on the acquisition, redemption, or other cancellation of shares, or on the liquidation of a company, is excluded from the definition of "dividends" and may therefore be distributed tax-free to the shareholders.

The energy companies were generally corporatised because of the requirements of the ECA. There were a number of ways that new energy companies were formed. This interpretation statement applies to energy companies formed in any of the following ways:

- the corporatisation of an MED or MEDs
- the corporatisation of an EPB or EPBs
- the combined corporatisation of an EPB or EPBs and an MED or MEDs.

Because the effect of corporatisation on the level of ASC for shares issued on corporatisation was not clearly identified or specified, doubt has arisen as to whether such shares have given rise to any ASC. This interpretation statement concludes that in respect of the shares issued on corporatisation, ASC arises from their issue.

There are three different fact situations discussed in this item regarding the issue of shares by the new energy companies. These are:

- The recipient of the shares was the transferor of the energy undertaking. That is, a local authority transferred an MED to a new energy company in return for an issue of shares to the local authority.
- The recipient of the shares was not the transferor in circumstances where a local authority transferred an MED to a new energy company in return for an issue of shares to third party recipients.
- The recipient of the shares was not the transferor in circumstances where an EPB's undertaking was vested in a new energy company and an issue of shares was made to third party recipients.

Legislation

Section OB 1 defines ASC. The relevant portion of the definition states:

> "Available subscribed capital", in relation to a share in a company at any relevant time, means the amount calculated in accordance with the following formula in respect of all shares of the same class (referred to in this definition as the "specified class") as the share:
>
> a + b – c
>
> where –
>
> a is –
>
> (i) In the case of any company which existed before 1 July 1994, the transitional capital amount; and
>
> ...
>
> b is the aggregate amount of consideration received by the company on or after 1 July 1994 and before the relevant time in respect of the issue of all shares in the company of the specified class, including as consideration –
>
> (i) In the case of any bonus issue in lieu made on or after 1 July 1994, the amount of money or money's worth offered as an alternative to such bonus issue; and

(ii) In the case of any taxable bonus issue (other than a bonus issue in lieu) made on or after 1 July 1994, the amount of the dividend arising in respect of the taxable bonus issue; and

…

but not including –

(v) Any amount in respect of a bonus issue other than a bonus issue to which paragraph (i) or paragraph (ii) of this item b applies; or

...

c is the aggregate of amounts distributed – ...

The "transitional capital amount" ("TCA") is defined in section OB 1 as:

"Transitional capital amount", in relation to a share in a company at any relevant time, means the amount calculated in accordance with the following formula:

$$\frac{j + k}{l} \times m$$

where –

j is the aggregate amount of capital paid up before 1 July 1994 in respect of shares of the same class as the share (whenever issued and including the share), not being –

(i) An amount paid up by a bonus issue made after 31 March 1982 and before 1 October 1988, except where –

(A) The date of the acquisition, redemption, other cancellation, or liquidation falls more than 10 years after the date of the bonus issue; or

(B) The amount was paid up by way of application of any amount of qualifying share premium; or

(C) The relevant time is the time of liquidation of the company; or

(ii) An amount paid up by a bonus issue (other than a taxable bonus issue) made on or after 1 October 1988, except where the amount was paid up by way of application of any amount of qualifying share premium; and

k is the aggregate of qualifying share premium paid to the company before 1 July 1994 in respect of shares of that class (whenever issued and including the share), not being an amount subsequently (but before 1 July 1994) applied to pay up capital on shares in the company; and

l is the number of shares of that class (including the share) ever issued before the close of 30 June 1994; and

m is the number of shares of that class (including the share) on issue at the close of 30 June 1994:

"Bonus issue" is defined in section OB 1 as:

"Bonus issue", in relation to a company, means –

(a) The issue of shares in the company; or

(b) The giving of credit in respect of or forgiveness of the whole or part of the amount unpaid on any shares in the company –

where the company receives no consideration (other than an election by the shareholder not to receive money or money's worth as an alternative to the issue) for the issue, crediting, or forgiveness, except to the extent to which, in respect of any issue or crediting on or before 20 August 1985, such issue or crediting was excluded from the meaning of the term "bonus issue" in accordance with subsection (3) or subsection (4) of section 3 of the Income Tax Act 1976 as those subsections applied from time to time before their repeal by section 31(1) of the Income Tax Amendment Act (No.5) 1988:

The former definition of "bonus issue" in section 3(1) of the Income Tax Act 1976 read:

"Bonus issue" means a capitalisation of any amount available for capitalisation, being a capitalisation by way of –

(a) The allotment of fully paid-up or partly paid-up shares in the company; or

(b) The giving of credit in respect of the whole or part of the amount unpaid on any shares in the company, –

except to the extent to which, in respect of any such capitalisation completed on or before the 20th day of August 1985, such capitalisation was excluded from the meaning of the term "bonus issue" in accordance with subsection (3) or subsection (4) of this section as those subsections applied from time to time before their repeal by section 31(1) of the Income Tax Amendment Act (No.5) 1988:

"Qualifying share premium" ("QSP") is defined in section OB 1 as:

"Qualifying share premium" in relation to any company, means any premium paid (whether in money or money's worth) by any shareholder or former shareholder to the company in respect of the issue of share capital by the company at a premium, being a premium that –

(a) Was credited to a share premium account in the books of the company or, where the company has been taken over by another company or merged with another company, in the books of that other company; and

(b) Did not arise with respect to the issue of shares in one company as consideration for the acquisition of shares in any other company, whether by one transaction or a series of transactions:

Application of the legislation

ASC is calculated "in relation to a share in a company ... in respect of all shares ... of the same class as the share", and is generally a summation of consideration received and paid out in respect of those shares. The calculation therefore requires:

1. the **share** and **class of shares** to be determined.
2. the **consideration** received or paid out in respect of those shares to be ascertained.

Determining the "share" and the "class of shares" at issue

"Share" is defined in section OB 1 as including "any interest in the capital of a company". In relation to the calculation of ASC for the energy companies the concern is with the shares in the new energy companies.

Because ASC is calculated "in relation to" a share, it is important to determine the point at which the shares in the energy companies are created. Before this point there can be no transactions "in relation to" the share.

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The shares in the energy companies were issued on corporatisation under sections 32 and 33 of the ECA and under terms contained in an approved establishment plan. These shares were new shares. They were not a modified re-issue of shares in the energy trading operators ("ETOs"). ("ETOs" is a convenient way of describing both EPBs and MEDs.) Therefore, any transactions in relation to shares in the ETOs are not transactions in relation to shares issued on the corporatisation of the energy companies. The calculation of ASC in relation to a share issued on the corporatisation of the energy companies is, therefore, confined to transactions arising on or after a share's issue under the ECA and the approved establishment plan.

Furthermore, a "share" must be a share in "a company". The energy companies are clearly companies and their predecessor ETOs were also companies: in terms of the broad definition of that term contained in section OB 1 and/or because they were deemed to be companies by operation of section OC 2(5) (section OC 2 was the tax regime for ETOs). However, for the purposes of the definition of ASC the reference is to "a company". "A company" is clearly a reference to a single company, and this is reinforced by the references to "the company" in relation to each of parts "a", "b" and "c" of the calculation of ASC.

Since "a company" means a single company, the ETOs and their successor energy companies are clearly not "a company". They are separate companies. Accordingly, **in the absence of legislative intervention**, the calculation of ASC for the energy companies ordinarily would take no account of any matters relating to the ETOs.

However, there are two possible sources of legislative intervention that may be argued to cause the ETOs and their successor energy companies to be treated as a single company when calculating ASC:

1. The amalgamation provisions in the Act. However, these do not apply because there is no "amalgamation" as that term is defined in section OB 1. Consequently, the amalgamation provisions do not affect the analysis outlined above.
2. Sections 54 and 62 of the ECA deem the EPBs and the MEDs respectively to be "the same person" as their successor companies for the purposes of the Inland Revenue Acts. Since the ETOs and their successor energy companies are **deemed to be the same** person, the ETOs and their successor energy companies constitute "a company" for purposes of the ASC definition. It follows that transactions involving shares in an ETO may be relevant to the calculation of ASC in respect of a share in an energy company, if the shares in the ETO and the shares in the energy company are "shares of the same class ... as the share".

"Shares of the same class … as the share"

The section OB 1 definition of "Shares of the same class" commences:

> "Shares of the same class", in sections CF 3 to CF 5, section FC 4, and this section, in relation to shares of a company, means any 2 or more shares of the company where –
>
> (a) The shares carry the same right to exercise voting power...

The definition is concerned with any "2 or more shares [interests in the capital] of the company". Its purpose is to designate which shares can be considered together for the purpose of calculating the relevant ASC.

Shares "of" the company means that the shares to be compared must be currently existing shares in the company. We are concerned with comparing any shares in the ETOs with the shares in their successor energy companies. Even assuming that the ETOs had shares, the EPBs were deemed to be dissolved by operation of section 47(2)(a) of the ECA. Therefore, shares in the EPBs do not coexist with shares in their successor energy companies, and thus cannot be shares of the same class as shares in the successor energy company for these purposes.

The MEDs were entities created by statute and with perpetual existence. They were not owned by anyone and no one had any interest in their capital in the ordinary sense. However, section OC 2(5)(a) did deem the "elected members of the energy trading operator, in their collective capacity as such, ... to hold shares in the energy trading operator".

Therefore, while there may still be deemed shares in the MEDs, those shares cannot be shares of the same class as the shares in their successor energy companies because they do not carry the "same rights". The deemed shares in the MEDs carry no particular rights, while the shares in the successor energy companies carry very specific rights. None of the rights, if they exist, attached to deemed shares in the MEDs can therefore be called the "same rights" as those attaching to the shares in the energy companies (it is noted that this conclusion applies equally to all ETOs).

It follows that the class of shares relevant to the calculation of ASC in relation to a share issued by an energy company on its corporatisation, under the ECA and an approved establishment plan, is confined to shares of the same class issued on or after incorporation.

The class of shares having been determined to this extent, it is possible to turn to ascertaining the relevant **amounts of "consideration" received or paid out** for them.

Ascertaining the relevant amounts of TCA and "consideration" received in respect of the shares issued by the energy companies on their corporatisation

To ascertain the relevant amounts received or paid out in respect of the shares issued by the energy companies during the corporatisation process, being the "specified class" for purposes of the definition of ASC, it is necessary to apply the definition's calculation formula "a + b – c". As this interpretation statement is concerned solely with any amounts arising on the issue of the

shares, variable "c" (amounts distributed by the company) may be ignored for present purposes and this leaves variables "a" and "b" to be considered and determined.

Variable "a" of the ASC amount

Variable "a" of the formula is the TCA or nil, depending on whether the company existed before 1 July 1994. Most of the energy companies were established before 1 July 1994. It is therefore necessary to calculate the TCA for those energy companies that were so established. For those energy companies not established before 1 July 1994, "a" has a nil value.

The TCA is calculated according to the formula

$$\text{"}\frac{j + k}{l} \times m\text{"}$$

Variable "j" is the aggregate of capital paid up before 1 July 1994. Therefore, it is necessary to determine whether the shares in the energy companies were "paid up" when they were issued.

"Paid up" and "capital paid up" are not defined in the Act. However, the courts have considered the meaning of "fully paid up" in the context of shares. In *Bloomenthal v Ford* [1897] AC 156; [1895-9] All ER Rep 1845 (HL) Lord Halsbury LC stated (at page 1849 of the All ER Rep report):

> People who know anything about limited liability companies know that there is a certain liability upon their shares, and that from time to time the company calls up such and such a proportion of the money due upon those shares, and I should have thought that without being a lawyer, or discussing questions which have been raised in the courts, a person would ordinarily understand that fully paid-up shares mean shares upon which the whole amount that could be called had been called up. That is the meaning of "fully paid-up shares", and in strictness it is the only meaning.

The question is whether consideration was given, in money or money's worth, for the shares issued by the energy companies on their corporatisation such that they are "paid up".

Share recipient was the transferor of the ETO: Local authority transfer of an MED in return for shares issued to the local authority

In some cases the recipients of the shares issued by the energy companies on their corporatisation gave "money or money's worth" for those shares. In particular, for some local authority transferors of MEDs to new energy companies, the transfer was carried out pursuant to an agreement for sale and purchase, by which the transferor agreed to sell the ETO to the new energy company in consideration for an issue of shares to that transferor. In such cases the consideration given (the ETO) led to the issue of shares, and meant that the new company had an amount of paid up capital for the purposes of the definition of TCA.

Share recipients were not the transferors of the ETO: EPB's undertaking being vested in the new energy company, and shares being issued to third parties

In other circumstances the recipients of the shares did not themselves give money or money's worth for the issue of shares to them, but consideration was still given for the shares by the transferor of the ETO. There is no requirement in the definitions of ASC or TCA that consideration for the shares be given by the recipient. If a local authority transferred an ETO to an energy company and the shares issued by the energy company were received by third parties, and when an EPB transferred an ETO to an energy company and the shares issued by the energy company were received by third parties, there is still consideration provided to the new energy company sufficient to cause capital to be "paid up" for the purposes of the ASC and TCA definitions. This is discussed in more detail in the following paragraphs.

Sections 18, 22, 47, 48 and 56 of the ECA establish that the ETO transferred to the new energy company was consideration for the shares consequently issued by that particular company.

Section 18 dealt with establishment plans. Section 18(2) set out the required details to be included in an establishment plan. Amongst other things, such an establishment plan had to:

- identify with reasonable precision the energy undertaking that was to be vested
- value that energy undertaking
- contain a share allocation plan
- indicate whether or not any equity securities should be issued by the relevant energy company to any person **consequent upon** the vesting in the company of the relevant energy undertaking.

Section 22 of the ECA provided for the formation of a share allocation plan. Under section 22(1), the establishment plan should set out the recommendations as to the persons to whom the voting equity securities in the relevant energy company should be allocated **consequent upon** the vesting in that company of the relevant energy undertaking.

In both these sections of the ECA the use of the words **consequent upon** demonstrates that the issue of shares results from the receipt of the energy undertaking. The ordinary meaning of "consequent" supports this conclusion. *The Shorter Oxford English Dictionary* defines "consequent" as

- consequence
- following as an effect or result
- following as a logical conclusion; and
- the second part of a conditional proposition.

The word "consequence" is defined by the same dictionary to mean:

- a thing or circumstance which follows as an effect or result from something preceding;
- the action, or condition of so following; the relation of a result to its antecedent.

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Therefore, the use of the word "consequent" supports the conclusion that the issue of shares followed from, and as a result of, the vesting of the EPB's undertaking in the new energy company. That is, the statute provided that the vesting was the consideration for the issue of shares.

Sections 47 and 48 of the ECA provided certain rules for the transfer of EPBs to successor energy companies. Section 47(1) provided that on a date appointed by the Governor General by Order in Council, the undertaking of the EPB named in the Order was to vest in the EPB's successor company and all of the shares held by that EPB in the EPB's successor should vest in such persons as were specified in the Order, which should give effect to the provisions of the establishment plan.

Under section 48(1), every Order in Council made under section 47(1) would specify the kind, number, nominal value, and terms of any equity securities that were to be issued by the successor company **consequent upon** the vesting in it of the undertaking of the Board and the names of the persons to whom those equity securities were to be issued.

Again, both sections link the undertaking being vested in the new energy company and the shares being issued to those persons specified in the establishment plan and share allocation plan.

Share recipients were not the transferors of the ETO: Local authority transfer of a MED to a new energy company in return for shares being issued to third parties

Even for the transfer of MEDs to new energy companies, which do not have the same detailed rules as for EPBs, section 56 of the ECA still provided a link between the transfer of the undertaking and the issue of shares when those shares were issued to a third party.

Under section 56(1), the local authority would transfer its energy undertaking no later than 1 April 1993 to one or more energy companies. Under section 56(2), this transfer must be pursuant to an approved establishment plan. An approved establishment plan had to include a share allocation plan. The share allocation plan was to explain who was going to receive shares after the energy undertaking was transferred to the new energy company.

In this context section 18(2)(b), that required a valuation of the energy undertaking prior to transfer, is relevant. If there was no connection between the transfer of the undertaking and the issue of shares, it is difficult to see why any valuation would be necessary. However, if one considers that the transfer of the undertaking led to the issue of shares pursuant to a share allocation plan, then the use of a valuation becomes very relevant. The value of the undertaking would set the value of the share capital, and the amount of consideration provided for shares issued to subscribers, and would determine how many shares of a particular nominal value are to be issued, or whether shares are issued at a premium.

Summary of situations where the share recipients were not the transferors of the ETO

The sections discussed above mean that the transfer of an energy undertaking to a new energy company leads to the issue of the shares pursuant to the share allocation plan. That is, the transfer of the undertaking is consideration for the shares, sufficient to mean that paid up capital arises on the transfer. Those energy undertakings that were transferred were transferred as consideration for the issue of the shares to the subscribers.

In respect of EPBs this is also brought out under section 48(3)(a) which provides that the company shall, on the date specified in the Order in Council that vests the undertaking in the new company, issue to the person specified in the Order in that behalf, **and as fully paid up**, the shares specified.

Although the use of the word "as" could suggest that the shares are not really paid up, in this context this is not the appropriate interpretation. That is, in the interpretation of the ECA, the word "as" does not mean "as if something was that which it was not", which is the way the word "as" was interpreted in the statute in issue in *Styles v Treasurer of Middle Temple* (1899) 4 TC 123; 68 LJQB 1046 (CA). If this had been the intention of Parliament, it could have used the words "as if they were". Examples of recent legislation using such a formulation include section 42(3) of the Matrimonial Property Act 1976 ("as if it were a caveat") and section 176(4) of the Employment Contracts Act 1991 ("as if it were a collective employment contract"). Although the word "as" has a number of meanings (see *The Shorter Oxford English Dictionary* for examples), in this situation it most probably means "in the manner that" or "in the way that". It may be that the word is even superfluous and should be interpreted as having no meaning other than to make the legislation read better.

Section 48(3)(a) envisages that the shares issued to the subscribers are fully paid up, the consideration for paying up the shares being the provision of the energy undertaking. Section 48(1)'s use of the word "consequent" underlines the point. In the context of shares issued under the Companies Act 1955 (which had a par value) and taken together with the requirement in an establishment plan to value the undertaking, the requirement that shares be issued as fully paid up means that at the very least the par value of the shares issued must equal the value of the undertaking. The valuation sets the consideration given by the EPB to the new energy company for the paying up and issue of the shares.

It would be possible for the value of the undertaking to exceed the par value of the shares issued. In such a case the shares would be being issued at a premium. However, it is clearly envisaged in the Act that the amount of share capital issued will not be greater than the value of the undertaking. In those circumstances the shares would only be partly paid up, and shareholders would potentially be liable to further calls by the company.

Turning to variable "k" of the TCA, the exclusion cannot apply because any capital raised on the incorporation of the energy companies would be the only capital available at the time the original shares in the energy companies were issued. That capital could not have been "subsequently applied" at that time, and this interpretation statement is only concerned with ASC arising from the initial issue of shares by the energy companies on their corporatisation. The question is, therefore, whether any QSP was paid to the energy companies before 1 July 1994 in respect of their issues of shares on corporatisation.

The definition of QSP refers to any "premium paid ... in respect of the issue of share capital ... at a premium". Some energy company share issues were, according to the terms of issue, made at a premium. Accordingly, where such an issue was made at a premium there will be an amount for item "k" of TCA.

Conclusions in relation to the TCA

The better view is that ETOs were provided as consideration for the issue of the shares on the basis of the scheme of the ECA, the Vesting Orders, and for local authorities and MEDs the terms of the relevant Agreements for Sale and Purchase. This means that the shares issued by energy companies established before 1 July 1994 on their corporatisation were issued "paid up", and in some circumstances a premium was "paid" in respect of them. As a result, a TCA arises from the initial issues of shares by energy companies established before 1 July 1994.

Variable "b" of the ASC amount for those energy companies established on or after 1 July 1994

This interpretation statement is only concerned with ASC arising in relation to the initial issues of shares by the energy companies. Therefore, this part of the discussion is only relevant to initial issues of energy company shares made on corporatisation on or after 1 July 1994.

Variable "b" is concerned with the aggregate "consideration" received for shares of the specified class. "Consideration" is not defined for this purpose and thus it is necessary to consider the common law meaning. Lord Dunedin said of consideration in *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] AC 847 at 855:

> I am content to adopt from a work of Sir Frederick Pollock ... the following words as to consideration: "An act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable."

The common law meaning of "consideration" may be seen as having a contract law focus and be referring only to the consideration passing between contracting parties. This would not cover all the circumstances surrounding the creation of the energy companies, where some shareholders were not contracting parties with the energy companies but were gratuitous recipients of shares. However, there is case law that suggests that consideration can have a wider meaning where the context so requires, such that the focus is on the receipt of consideration by the energy company, rather than on the provision of consideration by shareholders; *Central and District Properties Ltd v IRC* [1966] 2 All ER 433 (HL) and *Shop and Store Developments Ltd v IRC* [1967] 1 All ER 42; [1966] TR 357 (HL). This is consistent with variable "b" which refers to "consideration received" by the company, the focus being on the company's receipt of consideration not the shareholders' provision of consideration. The context surrounding the creation of the energy companies (discussed above in respect of variable "a") also supports a wider interpretation of "consideration" in variable "b" consistent with this case law.

It is then a factual question whether consideration is received as the price for shares and, as with ascertaining whether shares are paid up, this is generally to be determined from the terms on which the shares were issued.

Apart from reflecting differences of terminology arising from the enactment of the Companies Act 1993, the terms of issue of the initial share issues made by energy companies established on or after 1 July 1994 were no different from those for energy companies established before that date. Accordingly, for the same reasons as discussed above for pre-1 July 1994 energy companies, consideration was provided either by the share recipients or by third parties, and hence the energy companies did receive consideration for the issue of shares.

It follows that the initial share issues made by energy companies established on or after 1 July 1994 were issued for consideration, giving rise to an amount for item "b" of ASC.

Bonus issues

Amounts in respect of bonus issues are generally excluded from variables "a" (TCA) and "b" of ASC.

"Bonus issue" is defined in section OB 1, and before that it was defined in section 3(1) of the Income Tax Act 1976. Whichever definition is applied to energy companies established before 1 July 1994, the issue of shares on corporatisation of those companies did not amount to bonus issues. In terms of the Income Tax Act 1976 definition, there is no bonus issue because there were no capitalisations of amounts available for capitalisation. As a new company, there were no such amounts available (for example, there were no retained earnings or capital revaluation reserves to capitalise). In terms of the section OB 1 definition, there is no bonus issue because the energy companies received consideration for the issue of shares, as discussed earlier in this statement.

For post-1 July 1994 energy companies, the section OB 1 definition does not apply because, as discussed above, the energy companies received consideration for the issue of shares.

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Conclusions

Consideration was provided to energy companies for the issue of shares in those companies, sufficient to mean there was "capital paid up" or "consideration received" for the purposes of the ASC definition. Accordingly, items "a" or "b" of the ASC definition are positive amounts reflecting the value of the energy undertaking transferred to, or vested in, the new energy companies.

For a local authority transferor of an MED to a new energy company, where that local authority was also the recipient of the shares in the new energy company, the MED was clearly given as consideration for the issue of the shares.

For a local authority transferor of an MED to a new energy company, where third parties were the recipients of the shares in the new energy company, the MED was given as the consideration for the issue of the shares. Although the point is not so clear as in the case where the MED was the recipient of the shares, the terms of the relevant provisions of the ECA support this conclusion.

If an EPB's undertaking was vested in a new energy company, where third parties were the recipients of the shares in the new energy company, the vesting of the undertaking was consideration for the issue of the shares. Although the point is not as clear as transfers involving MEDs, the terms of the relevant provisions of the ECA support this conclusion.

In no case did the share issues amount to bonus issues.

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.

PAYE refund to payer or insurance agent

TRA 98/10

Decision date: 29 January 1999
Act: Income Tax Act 1976
Keywords: PAYE refund, right to funds

Summary

Judge Barber held that the Department had acted correctly in refunding the $24,626.86 to a company rather than crediting it to the taxpayer's 1997 income tax account, or paying or crediting it to the taxpayer in any way.

Facts

The taxpayer entered into an agreement with a life insurance company ("the company") in July 1996, by which he became a life agent of the company. By means of a Special Agreement the company agreed to advance to the taxpayer the sum of $74,626.86 as compensation for loss of income and client base associated with the taxpayer joining the company. In the Special Agreement the company was described as the "Lender" and the taxpayer was described as the "Borrower".

Consistent with the terms of the Special Agreement referring to the advance as "taxable earnings", the company deducted a sum of $24,626.86 which it paid to Inland Revenue as PAYE. As such, the taxpayer received a net amount of $50,000 from the company.

Later the relationship between the taxpayer and the company began to sour. The company attempted to terminate the Special Agreement and seek repayment of the advance of $74,626.86.

In the end the advance between the company and the taxpayer was restructured by virtue of a Loan Agreement dated 17 January 1997; the effect being that the company agreed to loan the taxpayer the amount of $74,626.86. The company purported to terminate the Loan Agreement about two weeks later and sought to recover the full amount of $74,626.86 from the taxpayer.

The PAYE of $24,626.86 was received by Inland Revenue before the end of the 1997 income year as it was paid by the company as part of its routine PAYE and withholding payments. There was some confusion within the company as to whether or not the amount had been paid to Inland Revenue. In spite of this uncertainty the company issued a PAYE deduction certificate to the taxpayer on 26 March 1997, which included the $24,626.86 in the total PAYE deductions and the $74,626.86 in the total gross earnings.

When his contract with the company was terminated the taxpayer was in early and constant communication with Inland Revenue seeking to have the $24,626.86 forthwith repaid to him. The company also wanted the money back because on further consideration it felt that its payment to the taxpayer was capital in character or, if not, the $24,626.86 had been paid before it became due as tax because, as at July 1996, the $50,000 paid by the company to the taxpayer was a loan.

After considering the options Inland Revenue refunded the $24,626.86 to the company. Subsequently the taxpayer went through the disputes resolution process and issued a notice of claim in the TRA seeking to recover the $24,626.86 from Inland Revenue. He claimed that the money belonged to him and so should have been credited to him and not refunded to the company.

Decision

His Honour found that the payment in issue should never have been made to Inland Revenue and, when that was understood, Inland Revenue was obliged to return it to the payer (the company); and that Inland Revenue never had any authority to credit the disputed payment to the taxpayer's account or anything of that kind and it never did so.

His Honour stated at page 5 of the decision:

> "There can be no doubt from the documentation that, at all material times, there was nothing more than a loan of $50,000

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between [the company] and the taxpayer. In due course that loan was to change its character to net income and the consequential tax liability was, by agreement between the claimant and the life company, to be payable by the life company. In fact the life company had anticipated that liability and made the potential tax payment of $24,626.86 in July 1996. This was well ahead of any need to do so and, in fact, due to subsequent facts whereby the loan never converted to income, it was unnecessary to have ever done so. It is self-evident that a loan cannot be income of any kind, so that the advance by the life company of a loan to the claimant could not be or require a source deduction payment."

Judge Barber also found that the company did not link the payment to the taxpayer but simply added it in to a global payment to Inland Revenue representing source deductions for all its employees. As the payment was made in this way it did not create any obligation on Inland Revenue to pay the money to the taxpayer. There was no transferring by Inland Revenue of funds from one taxpayer's account to another. Inland Revenue received an excessive payment from the company and, when it had ascertained the amount of the excess, it repaid that excess to the payer. There was a simple overpayment by the company so that Inland Revenue was required to return it to the payer. The money was never in the taxpayer's "account" with Inland Revenue.

Due dates reminder

March 1999

5 Large employers: PAYE deductions and deduction schedules for period ended 28 February 1999 due.

7 Provisional tax and/or Student Loan interim repayments: first 2000 instalment due for taxpayers with November balance dates.

Second 1999 instalment due for taxpayers with July balance dates.

Third 1999 instalment due for taxpayers with March balance dates.

(We will accept payments received or posted on Monday 8 March 1999 as in time for 7 March.)

20 Large employers: PAYE deductions and deduction schedules for period ended 15 March 1999 due.

Small employers: PAYE deductions and deduction schedules for period ended 28 February 1999 due.

Gaming machine duty return and payment for month ended 28 February 1999 due.

RWT on interest deducted during February 1999 due for monthly payers.

RWT on dividends deducted during February 1999 due.

Non-resident withholding tax (or approved issuer levy) deducted during February 1999 due.

(We will accept payments received or posted on Monday 22 March 1999 as in time for 20 March.)

31 GST return and payment for period ended 28 February 1999 due.

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

April 1999

5 Large employers: PAYE deductions and deduction schedules for period ended 31 March 1999 due.

7 Provisional tax and/or Student Loan interim repayments: first 2000 instalment due for taxpayers with December balance dates.

Second 1999 instalment due for taxpayers with August balance dates.

Third 1999 instalment due for taxpayers with April balance dates.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 April 1999 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 March 1999 due.

All employers: All IR 12 and IR 13 certificates for year ended 31 March 1999 must be completed, and yellow copies given to workers.

FBT return and payment for quarter ended 31 March 1999 due.

Gaming machine duty return and payment for month ended 31 March 1999 due.

RWT on interest deducted during March 1999 due for monthly payers.

RWT on interest deducted 1 October 1998 to 31 March 1999 due for six-monthly payers.

RWT on dividends deducted during March 1999 due.

Non-resident withholding tax (or approved issuer levy) deducted during March 1999 due.

30 GST return and payment for period ended 31 March 1999 due.

Binding rulings, interpretation statements, standard practice statements: your chance to comment before we finalise them

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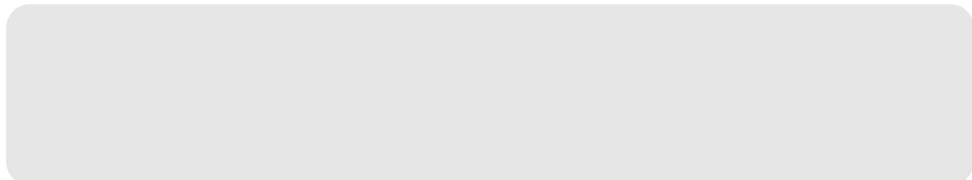

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