TAX INFORMATION BULLETIN

Volume Eleven, No.6 July 1999

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ISSN 0114-7161

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New Legislation

Taxation (Accrual Rules and Other Remedial Matters) Bill

The Taxation (Accrual Rules and Other Remedial Matters) Bill was introduced into Parliament in November 1998 and passed in May 1999. The main feature of the new legislation is its reform of the accrual rules in the Income Tax Act 1994. Also included are improvements to the binding rulings system, and a wide range of other amendments. The latter include changes that clarify the law or reinforce its policy intent, revenue protection measures, and remedial legislative amendments.

Enactment of the legislation has resulted in amendments primarily to the Income Tax Act 1994, the Tax Administration Act 1994, the Goods and Services Tax Act 1985, and the Student Loan Scheme Act 1992. Minor amendments have been made to the Estate and Gift Duties Act 1968, Income Tax Act 1976, Taxation (Simplification and Other Remedial Matters) Act 1998, and Taxation (Tax Credits, Trading Stock, and Other Remedial Matters) Act 1998.

The bill was divided into the following Acts:

- Taxation (Accrual Rules and Other Remedial Matters) Act 1999 - 99/59
- Student Loan Scheme Amendment (No.5) Act - 99/60.

The new legislation is described in detail in this *Tax Information Bulletin.*

THE TAXATION OF FINANCIAL ARRANGEMENTS

Subpart EH

Introduction

The accrual rules in Subpart EH of the Income Tax Act 1994, which govern the taxation of financial arrangements, have been reformed. These amendments give effect to some of the changes outlined in the Government discussion document *The Taxation of Financial Arrangements*, released in December 1997. The aim of the changes is to resolve problems, anomalies and inadequacies in the rules that have been identified over recent years. The basic policy objectives underlying the rules have not changed.

Most of the amendments are aimed at simplification and clarification of the law. They should improve the administration and application of the accrual rules and make them more workable.

Background

Before the accrual rules were introduced, in 1986, the law permitted taxpayers to defer, or effectively eliminate, their income tax liabilities by bringing forward deductions or deferring income. This was a major threat to the integrity of the tax base.

The main purpose of the accrual rules is to standardise the timing of income and expenditure associated with financial arrangements. This provides a better measure of income, reducing economic distortions and opportunities for tax avoidance. The rules that were introduced were consistent with accrual methods used in financial markets and, where appropriate, reflected accounting treatment.

The introduction of the accrual rules was foreshadowed in the Minister of Finance's Budget speech of 31 July 1986. Since the announcement the rules have been subject to several consultative processes. The first, on the introduction of the accrual rules, began with the release of the *Government's Consultative Document on Accrual Tax Treatment of Income and Expenditure* in October 1986. The consultative document contains the basic scheme of the present accrual rules. However, the consultative committee appointed by the Government was concerned that it would be easy to avoid the basic scheme of the accrual rules by using non-traditional debt instruments. As such, the committee widened the scope of the original scheme proposed in the consultative document to include a wider range of commercial dealings.

In the early 1990s, the Consultative Committee on the Taxation of Income from Capital (the Valabh Committee) reviewed the operation of the accrual rules and pointed to a number of areas that need further review. Some of the issues raised by the Valabh Committee were examined in a recent discussion document, *The Taxation of Financial Arrangements*, published in December 1997.

The discussion document recognised that although the policy objectives of the accrual rules are sound, the rules are complex and in some cases difficult to apply. The discussion document thus outlined proposals for the simplification of the accrual rules and clarifying areas of uncertainties in the operation of the accrual rules. Most of these proposals have been incorporated in the legislation.

Key features

The main amendments clarify the boundaries of the accrual rules and simplify the operation of the rules.

- The definition of "financial arrangement", which governs the type of arrangements that are within the accrual rules, has been clarified, and the list of "excepted financial arrangements", which excludes certain arrangements from the rules,
has been expanded.
- The holder/issuer distinction has been removed. The old accruals rules distinguish between holders (usually lenders) and issuers (usually borrowers). This distinction is arbitrary for some financial arrangements and thus encourages taxpayers to structure their transactions to take advantage of the concessions provided to the holders under the old rules.
- The removal of the holder/issuer distinction has in turn led to a number of major changes:
    - The base price adjustment has been standardised and the allowable deduction available under the base price adjustment to holders of financial arrangements has been removed.
    - The cash basis concession has been extended to all parties to financial arrangements, and the thresholds under which the cash basis rules apply have been raised.
- The debt remission rules remain in place. "Debt parking" rules and rules for remissions amongst members of consolidated groups have been introduced to close down avoidance opportunities.
- The treatment of assignments of income and defeasances of debt has been clarified.
- The tax treatment of trade credits and agreements for the sale and purchase of property has been rationalised. Even though trade credits and agreements for the sale and purchase of property are similar types of financial arrangements, they were treated differently under the old rules. Furthermore, agreements for the sale and purchase of services were not within the scope of the accrual rules. These inconsistencies have been removed, thus simplifying the tax treatment of these types of financial arrangements.
- The exception for debts forgiven in consideration of natural love and affection to trusts set up primarily to benefit family members and charities has been clarified.
- Leases with financing characteristics have been brought within the accrual rules.
- A transfer of a financial arrangement is now deemed to occur on the death of a party to a financial arrangement and on the distribution of the arrangement to a beneficiary under a will or on intestacy. A base price adjustment is carried out for the deceased person's financial arrangements (not for the other party to the financial arrangement).
- The disclosure requirements have been repealed.

Application date

The new accrual rules generally apply only to financial arrangements entered into on or after 20 May 1999 (the date of enactment). Financial arrangements entered into before 20 May 1999 are still subject to the accruals rules in place before the enactment of this latest legislation.

The accrual rules are now set out in two divisions. The old accruals rules, contained in Division 1, apply to financial arrangements entered into before 20 May 1999. Definitions unique to the operation of the old accruals rules, such as "core acquisition price", "holder", and "issuer", have been moved to section EH 14.

The amended accrual rules are set out in Division 2, inserted after section EH 18, and contain the amended accrual rules. These rules generally apply to financial arrangements entered into on or after 20 May 1999.

Special application dates

Although the majority of the new rules apply only to financial arrangements entered into from the date of enactment, there are several exceptions to the general application date.

The following additions to the list of excepted financial arrangements apply from the income year beginning 1 April 1985, when the accrual rules came into effect, unless a taxpayer has taken a contrary position in tax returns already filed:

- providing on-demand loans interest free and denominated in New Zealand dollars;

- employment contracts;
- interests in group investment funds;
- interests in joint ventures;
- interests in partnerships;
- travellers cheques; and
- warranties over goods or services.

Hire purchases of livestock or bloodstock have been added to the definition of "excepted financial arrangement" from 1 April 1993. Earlier legislation had made hire purchase agreements entered into after 1 April 1993 subject to the accruals rules, but the treatment of hire purchases of livestock and bloodstock was unclear. This amendment clarifies that hire purchases of livestock or bloodstock are outside the scope of the accruals rules.

Other exceptions to the general application date relate to transfers of debts at a substantial discount to an associate of the debtor, and the disclosure requirements. These amendments apply from 20 May 1999, regardless of when taxpayers entered into the financial arrangements.

Detailed analysis

DIVISION 1

Subpart EH contains the provisions relating to the taxation of financial arrangements. The Subpart has been broken down into two divisions. Division 1 contains the current accrual rules that have been re-enacted with minor modifications to reflect the new legislative style. These modifications include subsection headings and a list of defined terms at the end of each section. The rules are self-contained and apply to financial arrangements entered into before 20 May 1999.

A number of changes have been introduced to ensure that the rules in Division 1 are self-contained. Terms that are not used in Division 2 (such as "acquisition price" and "qualified accruals rules") continue to be relevant in Division 1. These terms have been moved from section OB 1 to section EH 14. Provisions that relate only to the current accrual rules, such as sections OB 7 and GD 11, have also been moved into Division 1 (sections EH 15 and EH 16 respectively).

Minor remedial amendments

Two remedial amendments have been made. Section EH 3(7)(a) refers to "trustee income or beneficiary income under the trust rules and sections HI 1 to HI 5". Sections HI 1 to HI 5 deal with Maori Authorities. The "and" between "trust rules" and "sections HI 1 to HI 5" has been replaced with "or". The section is meant to exclude trusts, as well as Maori Authorities, from the cash basis concession. Therefore the two provisions should not be inter-related.

Section EH 4(6)(a)(ii) applies if a person is released from an obligation to make a payment under a financial arrangement by operation of any of the Inland Revenue Acts. The purpose of the section is to ensure no remission income arises. Section EH 4(6)(a)(iii) applies if a person is released from an obligation to make a payment under a social assistance suspensory loan. There was an "and" between these subparagraphs. The provision in subparagraph (ii) has application beyond debts associated with loans from the Government for social assistance purposes. The two provisions are not, therefore, related. The "and" has been replaced with an "or".

Thresholds

Under section EH 1(3), if a person is a holder or issuer of financial arrangements, and the total value of those financial arrangements does not exceed $1,500,000, the person may use the straight line method to allocate income or expenditure to income years. This threshold has been increased from $1,000,000. Under section EH 3, if a person's gross income from financial arrangements does not exceed $70,000 or the total value of financial arrangements does not exceed $600,000 and the deferral test in section EH 3(1)(b) is not breached, the person is a cash basis person.

Following the latest amendments, in determining whether these thresholds have been breached a person must take into account financial arrangements to which Division 2 applies.

Natural love and affection

The "natural love and affection" rules have been amended to deal with uncertainty in the legislation. These amendments apply to both Division 1 and Division 2 financial arrangements and are contained in sections EH 5 and EH 53 respectively.

Section EH 5 applies to debts forgiven in consideration of natural love and affection from 20 May 1999. The exception applies if a natural person forgives a debt to a trust that is established primarily to benefit natural persons for whom the creditor has "natural love and affection", or charities (qualifying beneficiaries). This test requires an examination of the trust deed and all the circumstances surrounding the establishment of the trust in order to ascertain whether a particular trust qualifies under the exception. A discretionary trust, or a trust with a power of appointment, does not automatically fail to qualify under the exemption.

In addition, given that the policy underlying the "natural love and affection" exception is to exempt genuine gifts, the ambit of the exception has been specifically widened to include charities. The provisions recognise that debt forgiven to trusts that have charities as beneficiaries are as much gifts as debt forgiven to trusts that have family beneficiaries.

The trustee is taxed on any distribution to a non-qualifying beneficiary to the extent that the distribution is equal to or less than the debt forgiven to the trust. Future distributions to such beneficiaries are taxed to the extent that debt forgiven to the trust has not already been taken into account in calculating taxable distributions under these provisions. This ensures that an amount equal to the debt forgiven to the trust is taxed if it is ever distributed to a non-qualifying beneficiary.

Transfer of financial arrangement to associate of the debtor

A new section EH 7 has been inserted into Division 1 to reflect the debt parking rules. This section contains the provision relating to the transfer of a debt at a substantial discount to an associate of the debtor. This provision applies to transfers of debts on or after 20 May 1999 regardless of when the financial arrangement is entered into.

The provision applies if the debt is sold to a person associated with the debtor for 80% or less of the market value of the debt. Section EH 7(6) deems a new interest-free loan to have been extended by the associate to the debtor for the amount paid for the debt.

Consolidated groups

Previously, debts remitted between members of a consolidated group did not normally result in income for a debtor because the consolidation rules treat a group of companies comprehensively as one economic entity and one taxpayer. However, because this treatment of remission income was a concession to the general remission rules, the consolidation rules could be used to avoid the remission provision.

An amendment has been made to section HB 2(1)(a) to prevent taxpayers using the consolidation rules to avoid remission income. Amounts remitted amongst members of a consolidated group are exempt from remission income only if the financial arrangement was held by members of the same group at all times during the term of the arrangement. This amendment applies to events or transfers that occur on or after 20 May 1999 irrespective of when the arrangement was entered into.

Definition of excepted financial arrangement

Additions have been made to the definition of "excepted financial arrangement" in Division 1. These additions have been backdated, and they clarify the original intent of the rules and bring the law into line with the existing practice of both taxpayers and Inland Revenue.

Under section EH 13, taxpayers can elect to treat some excepted financial arrangements as financial arrangements if they entered into them between the date their last return of income was filed and the enactment of this legislation (20 May 1999). For example, a taxpayer who filed her 1997-98 tax return on 7 June 1998 and then entered into an employment contract before 20 May 1999 may elect to treat the employment contract as a financial arrangement, although the legislation adds employment contracts to the definition of excepted financial arrangement from 1986. This election is aimed at ensuring business decisions entered into on the basis of the legislation at that time are not compromised by the amendment. A person elects to treat the excepted financial arrangement as a financial arrangement by returning the income derived and the expenditure incurred from the elected financial arrangements under the accruals rules in Division 1 in their return of income.

Transitional adjustment

Division 1 applies to financial arrangements entered into before 20 May 1999. Taxpayers have the option of electing to move all financial arrangements onto the new rules. They will perform the transitional adjustment and include the resulting income or expenditure in their return for the year of election (section EH 17). However, if the arrangement is not subject to the accrual rules in Division 2, because, for example, it is a small variable principal debt instrument, section EH 17(9) requires the taxpayer to treat the arrangement as transferred at market value. The taxpayer must, therefore, do a base price adjustment under Division 1.

Once a taxpayer has elected to apply the accrual rules in Division 2 to financial arrangements entered into before 20 May 1999 (those to which the accruals rules in Division 1 would normally apply) there is no provision for the taxpayer to revoke that election and apply the accrual rules in Division 1.

Therefore, when the financial arrangement matures or is sold, for example, the base price adjustment in Division 2 (section EH 47) would be performed.

Terminology in other provisions of the Act

References in other provisions of the Act have been changed to reflect the new terms used in Division 2 of Subpart EH. For example, references to "holder" and "issuer" have generally been changed to "party", and references to "acquisition price" changed to "consideration". If consequential amendments are made, section EH 18 ensures that the amended provisions apply, in respect of a financial arrangement entered into before the date of enactment, as though the consequential amendments had not been made.

For example, section CE 1(1)(c) has been amended by this legislation. If a person is a holder or an issuer of a Division 1 financial arrangement, section CE 1(1)(c) should be read as it was before the amendment.

If, at a later date, it is necessary to amend a provision of the Income Tax Act outside of Subpart EH, section EH 18 will need to be amended for Division 1 financial arrangements in a manner similar to that set out in section EH 18(2) and (3). That is, an exception is created and the legislation then describes how the exception applies to Division 1 financial arrangements.

DIVISION 2

Rewrite style

As well as implementing policy changes, the accrual rules in Division 2 have been rewritten in "plain language" and are set out in the drafting style being used to rewrite the Income Tax Act. The new drafting style minimises complexity, repetition and the use of redundant words. Wherever possible, the accrual rules adopt words that are commonly used. To assist readers, descriptive subsection headings have been included and a list of terms used in the section and defined in section OB 1 have been included at the end of each section. Flowcharts and readers' notes have also been included in the legislation, although they are interpretational aids only.

Amounts arising under the accrual rules are treated as income derived or expenditure incurred. The term "income derived" is used in the accrual rules to refer to income arising from applying the spreading methods (including by way of a transitional adjustment calculation under section EH 17 or section EH 44), the cash basis adjustment or the base price adjustment. Section CE 1(1)(c) includes the "income derived under the accrual rules" in gross income.

Scope of the accrual rules

Purpose provision

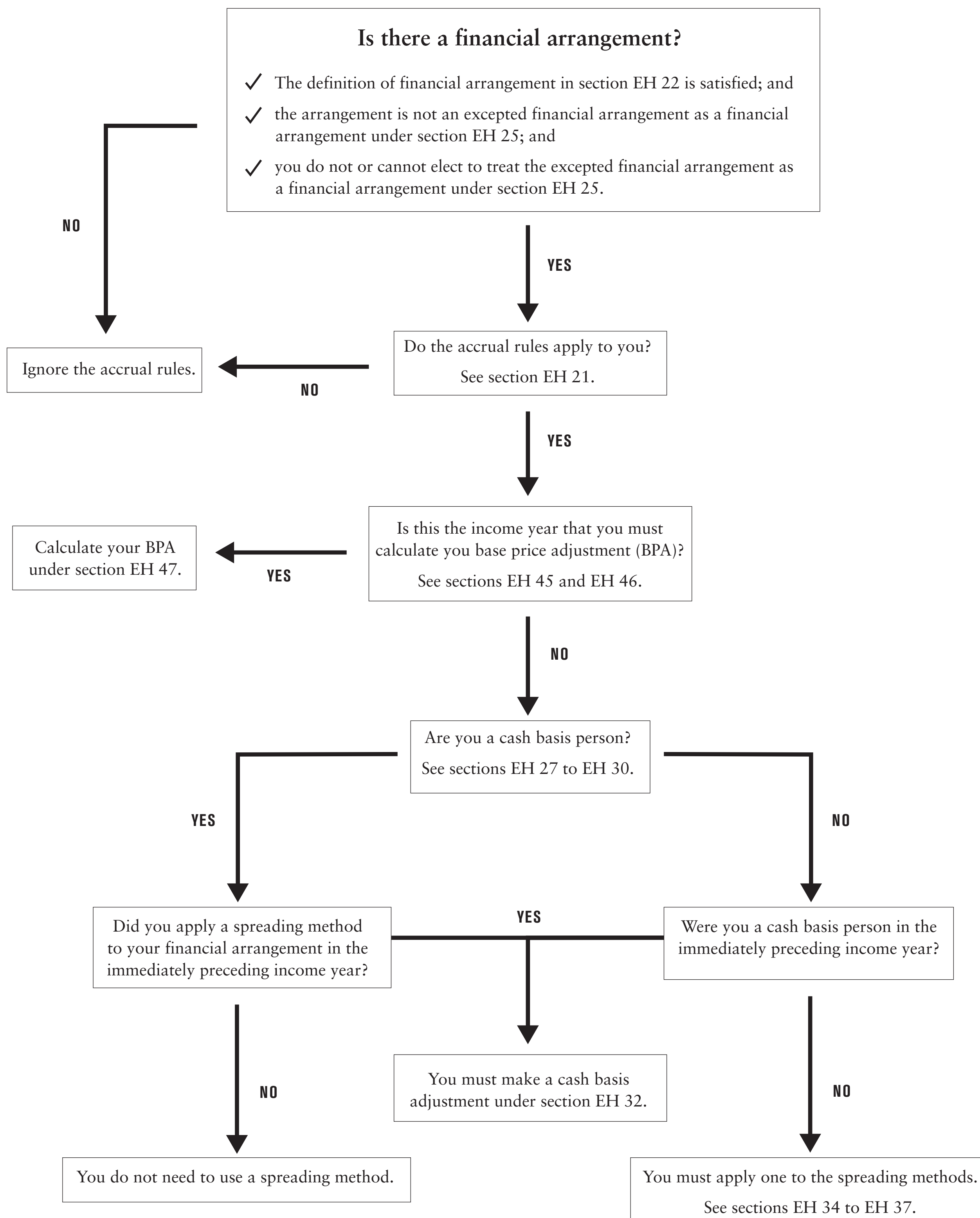
A purpose provision (section EH 20) has been included at the beginning of the new accrual rules. The provision aims to assist taxpayers and other users of the legislation to understand the general intent of the accrual rules, which is to allocate a fair and reasonable amount of income or expenditure from a financial arrangement over its term and so prevent deferring income and advancing expenditure.

The purpose provision guides taxpayers in choosing a spreading method in situations where the accrual rules do not prescribe one. Under those circumstances, taxpayers are required to use a method in accordance with the purpose provision. The provision may also assist in the resolution of any unforeseen ambiguities.

When do the accrual rules apply?

The accrual rules apply to every arrangement that is a financial arrangement as defined under the accrual rules. No major changes have been made to the rules governing the persons to whom the accrual rules apply. The only exceptions to this are certain arrangements that are explicitly excluded from the operation of the rules (excepted financial arrangements). Figure 1, which has been included in the legislation, also illustrates that there are circumstances under which a person who is a party to a financial arrangement (not being an excepted financial arrangement) need not comply fully with the accrual rules. These are the circumstances if the person is a cash basis person.

FIGURE 1: WHETHER THE ACCRUAL RULES AND THE SPREADING PROVISIONS APPLY



This flowchart illustrates the process a person should follow to determine whether the accrual rules and the spreading methods apply.

Definition of "financial arrangement"

Definitions are generally found in section OB 1. However, the definitions of "financial arrangement", "excepted financial arrangement" and "consideration" have been moved into Subpart EH because they are fundamental to the application of the accrual rules.

Section EH 22 defines "financial arrangement". The definition sets the outer boundary of the accrual rules. It is cast in wide terms to include debt instruments, debt substitutes and derivatives. A wide definition is necessary because of the range of financial instruments and derivatives available in the marketplace, many of which are substitutable for debt.

The definition has been redrafted, however, to improve its clarity and to make some minor amendments relating to terminology. Debts created by operation of law have been included within the definition of "financial arrangement". This change is intended to clarify that a financial arrangement can be created without agreement between the parties to the financial arrangement.

Elements of a financial arrangement

The definition "financial arrangement" contains five important elements, all of which must be present for an arrangement to be a financial arrangement. A financial arrangement is:

1. an arrangement, whereby
2. a person receives money in consideration for
3. a person providing money
4. to any person
5. at a future time or contingent upon an event.

An arrangement satisfies the definition if it satisfies all these criteria. For example, an agreement for the sale and purchase of property with deferred settlement is a financial arrangement because it is an arrangement whereby the purchaser receives money (the property) in consideration for the purchaser providing money (instalment payments for the property) to the vendor at a future time. On the other hand, an instantaneous sale or purchase of property is not a financial arrangement because the fifth element (the futurity) is absent.

Subparagraph (iii) of the old definition of "financial arrangement" includes a specific list of arrangements, such as sell-back and buy-back agreements and debt defeasances and assignments of income. The inclusion of a specific list bypasses the tests set out in the definition of financial arrangement. This subparagraph has been excluded from the new definition because arrangements that fall within the scope of the subparagraph are already within the scope of the general definition.

The bracketed words "that may include a debt or debt instrument or an excepted financial arrangement" in section EH 22(1)(b) imply that a financial arrangement may consist of more than one arrangement. The notion of a composite financial arrangement and the tax treatment of composites are dealt with in section EH 23 (and discussed in more detail below).

Assignments and defeasances

Section OB 1 defines "legal defeasance" as:

> a defeasance in which the release of a party to the financial arrangement from the primary obligation of the financial arrangement is either:
>
> (a) acknowledged formally by the creditor; or
>
> (b) acknowledged formally by a duly appointed trustee or agent of the creditor; or
>
> (c) established by legal judgement.

Section EH 22(2) excludes from the definition of "financial arrangement" partial or complete legal defeasances and absolute assignments, not only of financial arrangements but also of excepted financial arrangements. An absolute assignment or legal defeasance merely terminates existing rights or obligations for the assignor or the defeasor. Therefore this type of arrangement does not create new financial arrangements for those parties to the arrangement, although the exclusion does not prevent the assignee or defeasance counter party from becoming a party to a financial arrangement.

Nor do the specific exclusions affect arrangements other than absolute assignments and legal defeasances. Whether these other arrangements, such as in-substance defeasances, are subject to the accrual rules depends on whether they satisfy the tests set out in the general definition of financial arrangement.

Section EH 22(3) is a specific exception to subsection (2). Under subsection (3), if some or all of the consideration for the assignment or defeasance is deferred the assignment or defeasance is subject to the accrual rules. For example, the original debtor (the defeasor) could enter into a defeasance agreement with a counter party to defease the debtor's obligations, but the agreement may provide for a settlement of the defeasance agreement at a later date. If the creditor duly acknowledges the release of the debtor (defeasor) from obligations under the original debt, the defeasance becomes a legal defeasance but with a deferred settlement. A defeasance arrangement with deferred settlement possesses all the characteristics of a financial arrangement.

Composite financial arrangements

A consequence of the broad definition of "financial arrangement" is that groups of inter-related financial arrangements, which may not be financial arrangements separately, may fall within the definition. Inter-related arrangements are those in which there is a degree of interdependency between the transactions. It is therefore appropriate that they be covered by the rules if they have the same effect as debt instruments or debt substitutes.

The Court has noted, in *CIR v Dewavrin Segard (NZ) Ltd*, that two or more arrangements will be treated as a composite arrangement only if they are inter-dependent. In considering whether a wool contract and its related foreign currency hedge are part of a composite arrangement, Gault J commented that:

> In our view, even assuming the matching of wool contracts and hedging foreign exchange contracts, the argument is unconvincing. The wool purchaser is not a party to the foreign exchange contract and likely will not even know of it. The bank is not a party to a wool contract. The consideration in each contract moves to and from a party that has no connection with the other contract so there is no interaction or interdependence.

This implies that for two or more arrangements to be taken as part of a composite arrangement there must be some inter-dependence, not only in terms of the parties involved in the arrangements but also in terms of the consideration passing under each arrangement.

Section EH 2 of the old accruals rules deal with the calculation of income or expenditure in respect of composite financial arrangements. The provision requires that when a composite financial arrangement includes an excepted financial arrangement the amounts "solely attributable" to the excepted financial arrangement are excluded from the accrual rules. Income or expenditure is generally "solely attributable" to an excepted financial arrangement if it could have been expected to arise, or be incurred, without the support of the wider financial arrangement.

The words "solely attributable" should not be interpreted strictly. If a gain or loss is attributable to an excepted financial arrangement, it is "solely attributable" unless that gain or loss was also attributable to a financial arrangement. A gain or loss which is solely attributable to an excepted financial arrangement remains solely attributable to the excepted financial arrangement even if a non-excepted financial arrangement (such as a loan) was a necessary precondition for that gain or loss to be derived or incurred. Using an example from Glazebrook and Oliver[1], A lends money to B, in consideration for which B subscribes for shares in C. B pays interest to A under the loan and receives dividends from the shares in C. Under the accrual rules, the financial arrangement consisted only of the loan between A and B, the shares in C being attributable to an excepted financial arrangement. The shares subscription and all benefits flowing from it (including the dividends) are "solely attributable" to the excepted financial arrangement and thus are not taken into account in the accrual calculation.

There may, however, be other arrangements (such as a buy-back agreement) that can give rise to items which are attributable to those arrangements and therefore not "solely attributable" to an excepted financial arrangement. For example, assume that A sells shares to B for $100 and A agrees to buy them back in one year's time for $120. The $20 gain to B (and the $20 loss to A) could be said to be attributable to the shares (an excepted financial arrangement). However, that gain (or loss) was secured not by any change in share value but by the agreement to sell at a certain price and repurchase at another, higher price. The gain (or loss) was thus also attributable to the initial buy and sell agreement, which is a financial arrangement. Thus the gain (or loss) is not "solely attributable" to an excepted financial arrangement and should be included in the accrual calculation.

The discussion document *The Taxation of Financial Arrangements*, proposed that the operation of section EH 2 be clarified. Submissions on the discussion document expressed concern, however, that the proposed clarification would create a new concept and add uncertainties to the existing provision. For this reason the proposed amendment was withdrawn and the provision has been re-enacted as section EH 23 with only two minor changes.

The "solely attributable" rule has been amended so that it does not apply to arrangements that are excepted financial arrangements for compliance cost reasons only. In other words, these excepted financial arrangements are outside the accrual rules on their own but when used within a wider financial arrangement they are subject to the accrual rules. Those excepted financial arrangements are small variable principle debt instruments, short-term agreements for sales and purchase of property or services, short-term options, private or domestic purpose options over property, private or domestic purpose agreements for sales and purchase of property or services, private or domestic foreign currency loans to cash basis debtors, small prepayments for goods and services and travellers' cheques.

[1] Susan Glazebrook and Robin Oliver The New Zealand Accrual Regime—a practical guide (CCH, Auckland, 1989) 54

An amendment has also been made to ensure the "lowest price" concession[2] for agreements for the sale and purchase of property or services does not apply if it is part of a wider financial arrangement. A wider financial arrangement containing a group of inter-related arrangements cannot be properly characterised as an agreement for the sale and purchase of property or services (even though some of the constituent arrangements may be). Therefore the lowest price concession should not apply. This amendment has been achieved in the definition of "consideration" in section EH 48(4).

Definition of excepted financial arrangement

A consequence of the wide definition of "financial arrangement" is that it is necessary to exclude some types of arrangements from the rules. Although these arrangements are prima facie within the definition of "financial arrangement", they are excluded because of the need to maintain the debt/ equity boundary, for compliance cost reasons or because some transactions are subject to other rules set out in the Income Tax Act 1994.

Section EH 24 lists these "excepted financial arrangements". The list of excepted financial arrangements has been expanded to better reflect the original policy intention of the accrual rules and for compliance cost reasons. It has been made clear that interests in group investment funds, partnerships and joint ventures, employment contracts, warranties over goods or services, interest-free loans and hire purchase agreements for livestock and bloodstock are not arrangements that are subject to the accrual rules.

The list of excepted financial arrangements has also been extended to cover small prepayments, small variable principal debt instruments, travellers' cheques, private or domestic foreign exchange borrowings by a cash basis person and private or domestic agreements for the sale and purchase of property or services. These arrangements have been excluded for compliance cost reasons.

Three types of arrangements have been excluded from the accrual rules if the arrangements were entered into for a private or domestic purpose: loans in foreign currency for the borrower if the borrower is a cash basis person and uses the loan for a private or domestic purpose; an option to acquire, sell, or dispose of property, other than an interest in a financial arrangement for a person who becomes a party to the option for a private or a domestic purpose only; and a private or domestic agreement for the sale and purchase of property or services. If the arrangement ceases to be used for a private or domestic purpose it should be subject to the accrual rules. Section EH 24(3) provides for this by treating the arrangement as being issued for an arm's length price at the time the arrangement ceases to be applied for a private or domestic purpose.

A number of changes have also been made to the list of excepted financial arrangements to rationalise the tax treatment of trade credits and agreements for the sale and purchase of property. Short-term agreements for the sale and purchase of property or services are also excluded from the accrual rules for compliance cost reasons. Under the new accrual rules the measurement periods for short-term agreements for the sale and purchase of property or services and short-term options have also been rationalised.

Under Division 2 the definition of "excepted financial arrangement" excludes leases other than finance leases. A new set of rules has been introduced from 20 May 1999 under which leases with financing characteristics (finance leases) are within the scope of the accrual rules. It is therefore necessary to exclude operating leases (leases that are not finance leases) from the scope of the accrual rules.

Election to treat excepted financial arrangements as financial arrangements

Under the old accruals rules, taxpayers can elect to treat certain classes of short-term agreements for the sale and purchase of property as financial arrangements. Under the new accrual rules, the option to elect has been extended to prepayments for property or services of less than $50,000, short-term options, travellers' cheques and variable principal debt instruments of less than $50,000 (section EH 25). Nevertheless, unlike the election for short-term agreements for the sale and purchase of property or services which can be made for classes of short-term agreements (section EH 25(3)), when electing to treat the excepted financial arrangements listed above as financial arrangements the election must be made in respect of all such financial arrangements. For example, a taxpayer who has interests in several short-term options and several travellers' cheques wishes to treat the travellers' cheques as financial arrangements. The taxpayer can elect to treat all travellers' cheques as financial arrangements and continue to treat the short-term options as excepted financial arrangements.

A taxpayer elects by returning the income or expenditure in respect of the arrangement on an accrual basis in the income year that the election is made (section EH 25(4)). Under Division 1 the

[2] The "lowest price" provision in the definition of "consideration" ensures that increase in the value of property that are the subject of the agreements for the sale and purchase of property, for example, are not included as interest income under the accrual rules.

election is made by giving notice to the Commissioner. This requirement has been omitted from Division 2 in order to reduce compliance costs. The election can only be revoked, however, by giving notice to the Commissioner (section EH 25(6)). Once notice has been given the revocation applies to excepted financial arrangements entered into in the year following the income year in which notice is given.

Relationship between accrual rules and other provisions in the Act

Section EH 10 governs the relationship between the accruals rules and the rest of the Income Tax Act 1994. It is not clear, however, how the accruals rules relate to the rest of the Act under that provision. Section EH 26 of the new accrual rules clarifies that the accrual rules determine the amount and the timing of income and expenditure relating to financial arrangements, while the core provisions of the Act determine the assessability or deductibility of income or expenditure.

Nor is it clear whether section EH 10(1) under the old accruals rules precludes the transfer pricing provisions from applying. Under the new accrual rules it has been made clear in section EH 48(1) that the transfer pricing rules (sections GD 13(3) and GD 13(4)) are intended to have overriding effect to determine the amount of consideration paid or received in applicable cross-border financial arrangements.

Cash basis concession

Under the old accruals rules, if a natural person is a holder of financial arrangements and if the value of those financial arrangements falls under the thresholds, the person is given a partial exemption from the accrual rules for compliance cost reasons. This concession allows the person to calculate income from financial arrangements on a cash basis rather than applying one of the spreading methods under the accrual rules. The person is still required to perform a base price adjustment when the financial arrangements are sold or mature.

Under the old rules, a cash basis concession is available only to holders of financial arrangements. With the removal of the holder/issuer distinction, under the new accrual rules the cash basis concession has been extended to all parties to a financial arrangement who are natural persons (sections EH 27 to EH 32).

Thresholds

The three thresholds for the cash basis concession have been amended to reflect the extension of the concession to any person who is a party to a financial arrangement. The concession is available to a natural person if the person meets the deferral threshold and at least one of the following thresholds:

- if in that income year the absolute value of the person's income or expenditure, calculated under the accrual rules, from the financial arrangements is less than $100,000, or
- on every day in the income year the absolute value of each of the person's financial arrangements added together have a total value of not more than $1,000,000.

"Absolute value" is defined in section OB 13.[3]

Example

A person is a party to two financial arrangements. Using the yield to maturity method, the income from one financial arrangement is $50,000 and the expenditure from the other financial arrangement is $20,000. The absolute value of the person's income and expenditure is $70,000. The income and expenditure threshold is not breached. If the deferral threshold is not breached the person will be a cash basis person.

Another person also has two financial arrangements. Using the straight line method, the income from one arrangement is $60,000 and the expenditure from the other financial arrangement is $50,000. The absolute value of the person's income and expenditure is $110,000. The income and expenditure threshold is breached.

Deferral test

If a person satisfies one or both of these tests, to qualify as a cash basis person the person must also meet the deferral threshold (section EH 27(2)). A breach of the deferral test occurs if the person creates a deferral of income or an acceleration of expenditure of $40,000 or more in aggregate. The deferral test has been retained because of concerns over the deferral of income and the acceleration of expenditure. The threshold has been increased from $20,000 under the old accruals rules to $40,000 under the new accrual rules.

The formula in section EH 27(4) sets out how the amount deferred is calculated. It compares the income calculated under the accrual rules with the income calculated on a cash basis, and the expenditure

[3] "Absolute value", in sections CG 11(5) and EH 27(1) means the value irrespective of whether the value's sign is positive or negative

calculated on a cash basis with the expenditure calculated on an accrual basis. The calculation is made for all financial arrangements to which the person is a party at the end of the income year. The amount of deferral for each financial arrangement is calculated from the date the person becomes a party to the financial arrangement until the end of the income year in which the person seeks the cash basis concession. If the deferral across all financial arrangements is more than $40,000 the threshold is breached.

In determining whether any of the cash basis person thresholds have been breached the financial arrangements to which Division 1 applies must be taken into account.

Other aspects of the cash basis concession remain largely the same even though the concession has been amended to reflect the removal of the holder/ issuer distinction.

Special cash basis rules

Persons can be cash basis persons if they satisfy the thresholds described earlier. Nevertheless, the legislation provides for circumstances where the value of financial arrangements and expenditure incurred and income derived under the financial arrangements may be disregarded in determining whether a person qualifies for the cash basis concession. These special rules relate to circumstances where the person is a trustee (section EH 28), a trustee of a deceased cash basis person's estate (section EH 29) or a partner in a partnership (section EH 30).

The special rules have remained largely the same. Changes have been made to take into account the rewrite style and to provide for the removal of the holder/issuer distinction.

Election to apply the spreading rules

Under the old accruals rules, cash basis holders cannot elect to apply a spreading method.

Under the new accrual rules, section EH 31 provides that cash basis persons may elect to use a spreading method to calculate income or expenditure in respect of the financial arrangements to which they are a party. A cash basis person cannot, however, elect to apply a spreading method to a financial arrangement in the year the person is required, under section EH 45, to perform a base price adjustment.

The election must be made for all financial arrangements the person is a party to at the time of the election and any financial arrangements entered into in subsequent years. The person must continue to use the spreading method for those financial arrangements until the financial arrangements mature. There is no provision for the election to be revoked.

In the year a cash basis adjustment is performed the resulting income or expenditure for each financial arrangement from that adjustment is returned in that year.

If a person becomes a cash basis person, in that year the person can elect to use a spreading method by continuing to apply the spreading method and no cash basis adjustment is required.

Becoming or ceasing to be a cash basis person

Becoming a cash basis person, or ceasing to be one, requires a cash basis adjustment, as set out in section EH 32. Taxpayers must make an adjustment for all financial arrangements to which they are a party, apart from those arrangements that are already subject to the new method. For example, if a person was a cash basis person and breached one of the thresholds, the person is required to perform a cash basis adjustment for all financial arrangements apart from those that were already subject to one of the spreading methods.

The adjustment compares the income or expenditure that would have resulted had the new method been applied from the time the person became a party to the financial arrangement, with the income or expenditure that did result from using the old method. The result of the cash basis adjustment is the person's income or expenditure from the financial arrangement in that year.

Base price adjustment

The base price adjustment is a "wash-up" calculation that is performed when a financial arrangement is sold, matures, is remitted or transferred. The old accruals rules contain a separate base price adjustment for cash basis holders. Under the new accrual rules the new base price adjustment, in section EH 47, applies to both accrual and cash basis taxpayers.

Core accrual rules

Spreading methods

If a person is required to comply with the accrual rules, the purpose provision (section EH 20) requires the person to allocate a fair and reasonable amount of income or expenditure to each income year over the term of the financial arrangement. The only exception is in the income year in which the base price adjustment calculation is required (section EH 33(1)).

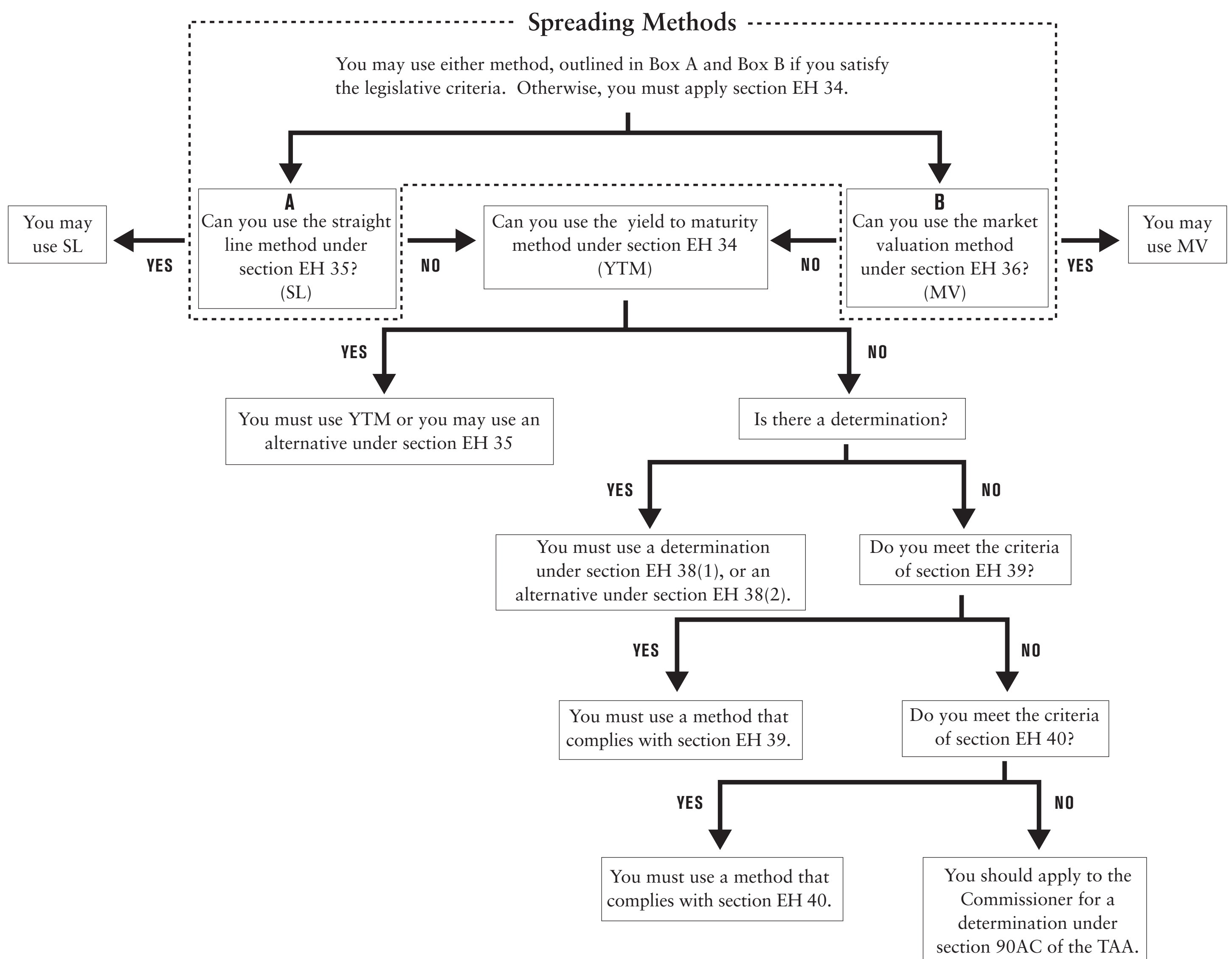
To determine the amount to be allocated, section EH 33(2) requires a person to take into account:

- all consideration paid or to be paid to or by the person for the financial arrangement;
- an amount remitted or to be remitted by the person or by law under the financial arrangement; and
- an amount that would have been payable to the person if it had not been remitted by law.

The amount to be allocated at the beginning of the term of the financial arrangement is the expected income or expenditure for the financial arrangement. The wording in section EH 33(2) is consistent with the wording of base price adjustment, to ensure that these are comparable amounts.

The main spreading methods are set out in sections EH 34 to EH 40. The flowchart in Figure 2 has been included in the legislation to illustrate the process that should be followed to determine which spreading method to use.

FIGURE 2: WHICH SPREADING METHOD TO USE



This flowchart illustrates the process a person should follow to determine which spreading method to use.

Yield to maturity
Under section EH 34(1), the primary method of spreading income or expenditure under a financial arrangement is the yield to maturity method (YTM). While YTM is not defined in the legislation, Determination G3 sets out how YTM is applied to financial arrangements, and Determination G1 sets out how the resulting income or expenditure is allocated to income years.

The power of the Commissioner to issue determinations under the new accrual rules is set out in section 90AC of the Tax Administration Act 1994. Until new determinations are issued under this section, however, all the existing determinations issued under section 90, or under sections 64B to 64M of the Income Tax Act 1976, continue to apply in principle to all financial arrangements subject to the new accrual rules.

YTM can be applied to a financial arrangement only if expected cash flows and payment dates for the financial arrangement are certain. Examples of circumstances where YTM cannot be applied are for financial arrangements with variable rates and when terms and conditions of a financial arrangement are varied.

Section EH 34(2) provides that a person may use an alternative method to YTM if the method:

- has regard to the principles of accrual accounting, and
- conforms with commercially acceptable practice, and
- is consistently applied by the person to the same or similar financial arrangements for financial reporting purposes (unless section EH 42 applies), and
- results in allocated amounts that are not materially different from those that would have been allocated using YTM.

Materiality is discussed in *Tax Information Bulletin* Volume 3, No. 1 July 1991.

Method prescribed by determination
If YTM cannot be applied to a financial arrangement the Commissioner can issue a determination setting out the appropriate accrual method. Section EH 38(1) deals with determination methods and section EH 38(2) with alternatives available to taxpayers. This type of determination is binding on the taxpayer.

For example, Determination G26 provides for a method of spreading income or expenditure under a variable rate financial arrangement. This determination was issued under section 90 of the Tax Administration Act 1994 because YTM could not be applied to this type of financial arrangements. Under the new accrual rules, Determination G26 will be applied, in principle, as if it has been issued under section 90AC until a new determination is issued under section 90AC(1)(d).

Under section EH 38(2) a person may use an alternative method to the method prescribed by the Commissioner in a determination if the method:

- has regard to the principles of accrual accounting,
- conforms with commercially acceptable practice,
- is consistently applied by the person to the same or similar financial arrangements for financial reporting purposes (unless section EH 42 applies), and
- results in allocated amounts that are not materially different from those that would be allocated using the method prescribed in the determination.

In the absence of a determination
If YTM cannot be applied, and there is no relevant determination, section EH 39 requires a person to apply a method that:

- conforms with commercially acceptable practice,
- results in an amount being allocated to each income year in accordance with the purpose provision, and
- is consistently applied by the person to the same or similar financial arrangements for financial reporting purposes.

The last requirement implies that this method is applicable only if the person prepares financial accounts and reports the income or expenditure in relation to financial arrangements for financial reporting purposes.

Default method
Submissions on proposals in the discussion document *The Taxation of Financial Arrangements* pointed out that a person who does not comply with the requirements in section EH 39 will have no relevant spreading method and will need to apply to the Commissioner for a specific method of spreading.

To alleviate the compliance cost concerns, a specific default method has been provided (section EH 40). A person who does not prepare financial accounts or who does not include income or expenditure of certain financial arrangements for financial reporting purposes has to use a method to calculate income or expenditure for tax purposes that conforms with commercially acceptable practice.

The method must also allocate a fair and reasonable amount to each income year over the term of the financial arrangement in accordance with the purpose of the accrual rules.

However, if a person uses different methods to account for income or expenditure under the same or similar financial arrangements for financial reporting purposes, section EH 39 may not be applicable. The new default method also does not apply because being a person that prepares financial accounts, the person does not satisfy the requirements of section EH 40. It is therefore necessary to apply to the Commissioner because, in the absence of a prescribed method, it is important that only one method is used for tax purposes to determine income or expenditure for the same or similar financial arrangements. Because there are no accounting standards on the method of determining income or expenditure, it is possible that several methods could be used to account for the same or similar financial arrangements for financial reporting purposes, and not all of those methods are acceptable for tax purposes.

Straight line method

Instead of applying YTM a person may apply a straight line method under section EH 35. The straight line method is available to a person who is a party to a small parcel of financial arrangements and is aimed at reducing compliance costs. The straight line method can be used if the person is a party to financial arrangements that have a total value of $1,500,000 or less. In determining whether the value of financial arrangements is $1,500,000 or less a person must take into account all financial arrangements to which Division 1 applies (section EH 35(5)).

The straight line method spreads the income or expenditure under a financial arrangement on a straight line basis over the term of a financial arrangement.

Market valuation method

Under section EH 36, a person who has a business that includes dealing in financial arrangements may apply the market valuation method of accrual for the financial arrangements in which the person deals. From a policy perspective, it is necessary to restrict the availability of the market valuation method because of the need to limit bad debt deductions. Under the market valuation method, any decrease in market prices (including that attributable to decrease in credit worthiness) is recognised as expenditure. A decrease in credit worthiness, however, is generally not recognised as expenditure under the bad debt deduction rules, except for dealers.

Under the new accrual rules, it has been clarified (by using the word “includes”) that a person who runs a business and has to buy and sell financial arrangements as part of that business may apply the market valuation method.

A person who is a party to forward contracts for foreign exchange, futures and exchange-traded option may also apply the market valuation method of accrual to those financial arrangements. These financial arrangements do not have any principal values, so the question of a bad debt deduction is not a consideration for them.

Under the old accruals rules, the market valuation method can only be used if Inland Revenue has approved a market in that instrument. This requirement has been relaxed so that the market valuation method may also be used if taxpayers can show that the market value used is reliable. The objective criteria that should be considered in determining whether markets are reliable include, but are not limited to, the following:

- the number of participants in the market or having access to the market;
- the frequency of trading in the market;
- the existence of an appropriate regulatory body;
- the existence of industry standards regulating trading practices; and
- the accessibility of sources of information to market participants.

Because the over-riding requirement is that taxpayers must show that the market value used is reliable, the absence of some of these factors does not necessarily mean that market valuation method could not be adopted. Taxpayers can also use information from a related market if there is an inadequate, or no, direct market in the instrument.

Taxpayers who adopt the market valuation method are required to maintain records to show the reliability of the market from which the valuation is obtained (section 22A(1) of the Tax Administration Act 1994).

Consistency requirements and change of spreading method

Taxpayers must use a method of calculating income or expenditure consistently for the same or similar financial arrangements. Taxpayers are generally required to apply the same spreading method to a financial arrangement for its entire term (section EH 41).

Section EH 42 contains an exception to the general rules that the same spreading method be applied consistently to the same or similar financial arrangements.

Under section EH 43, taxpayers are able to change method only if there is a good commercial reason for doing so. Those who change methods are required by section 22A(2) of the Tax Administration Act 1994 to keep a record of the reason for the change. Taxpayers changing methods must do a transitional adjustment, under section EH 44, in the year of change. Changing methods is not permitted, however, if the financial arrangement is subject to either the market valuation or the straight line method. Those methods must be applied to financial arrangements consistently until the financial arrangement is subject to the base price adjustment.

Base price adjustment

The base price adjustment is a "wash-up" calculation that is generally performed when a financial arrangement is sold, matures, is remitted or transferred.

Timing of the base price adjustment
Section EH 45 sets out the events that require a base price adjustment. In addition to the sale, transfer, maturity or remission of a financial arrangement, the new accrual rules set out special circumstances in which a base price adjustment is required. These circumstances include:

- a non-resident leaving the tax base;
- a debtor whose debt is sold to an associate at a discount;
- an in-kind, or in specie, distribution of a financial arrangement by a company in liquidation; and
- for an assignor or defeasor, an absolute assignment or legal defeasance of a debt.

Dispositions on the death of a taxpayer
Under the old accruals rules, there is uncertainty as to if and when a base price adjustment should be done on the death of a party to a financial arrangement. The new accrual rules (section EH 45(5)) ensure that a transfer of a financial arrangement necessitating a base price adjustment occur:

- on the death of a party to a financial arrangement; and
- on the distribution of a financial arrangement to a beneficiary under a will or on intestacy.

Exceptions from performing a base price adjustment
Taxpayers are required to carry out a base price adjustment when they cease to be New Zealand residents. To ease compliance burdens on them, temporary residents who are cash basis persons are excluded from the requirement to perform a base price adjustment if they become non-resident for tax purposes within three years. The time limit test for this exemption is aligned with the test for temporary residents in the foreign investment fund rules. That is, a resident who becomes a non-resident is exempt from the base price adjustment upon departure if the person leaves on or before the first day of the fourth income year succeeding the income year in which the person initially obtain tax residence. This relief applies only to financial arrangements to which they were a party before first becoming a New Zealand resident (section EH 46(1)).

Section EH 4(9)(d) of the old accruals rules requires persons who become non-resident to carry out a base price adjustment for any financial arrangement to which they are a party. This also applies if they continue to carry on a business in New Zealand through a fixed establishment. In the new accrual rules a base price adjustment is not necessary if a New Zealand resident becomes non-resident and the financial arrangement relates to a business carried on by the person through a fixed establishment in New Zealand (section EH 46(2)).

Under subsection EH 46(3) taxpayers who are a party to a debt that has been legally defeased, and are not the defeasor, do not have to carry out a base price adjustment. This is because their rights to receive payments under the financial arrangement defeased have not been terminated. Only the party that is obliged to make the payments has changed.

A legal defeasance may be used to renegotiate the terms of a debt because the original debtor is unable to meet the obligation. Under this situation, there is more than just a change in the party that is obliged to make the payment even from the perspective of the creditor. The original debt has been terminated and there is a new debt between the creditor and the new debtor. It is thus necessary to restrict the exemption from the base price adjustment to legal defeasances if the only change is the party that will meet the existing obligations under the financial arrangement.

Base price adjustment formula
The amendments to the base price adjustment in section EH 47 and the new definition of "consideration" in section EH 48 are intended to standardise and simplify the base price adjustment calculation.

The old accruals rules contain a separate base price adjustment for cash basis holders. Under the new accrual rules, the base price adjustment applies to both accrual and cash basis taxpayers because the holder/issuer distinction has been removed.

Other policy changes reflected in the amended base price adjustment calculation include:

- the inclusion of amounts remitted by operation of law in the variable "amounts remitted"; and
- amendments to allow for the effect of debt parking arrangements.

The new base price adjustment formula is:

consideration — income + expenditure + amounts remitted

where -

consideration is the consideration paid or payable to the person less the consideration paid or payable by the person;

income is (a) the income derived by the person from the financial arrangement in previous income years, and

(b) dividends within the meaning of section CF 2(1)(b) or section CF 2(1)(k), and

(c) gross income derived under section DC 2(1);

expenditure is expenditure incurred by the person under the financial arrangement in previous income years;

amounts remitted is an amount that is not included in the consideration paid or payable to the person, because it has been remitted

(a) by the person, or

(b) by law.

Example

A commercial property is sold for $1,500,000 under a sale and purchase agreement, subject to certain planning consents being obtained.

A deposit of $150,000 is paid on 20 December 1999, when the agreement is entered into. The balance of $1,350,000 is payable in two equal instalments due 3 and 6 months after the date of possession.

Under the agreement, possession passes to the purchaser on the date the sale becomes unconditional; the purchaser has no other prior rights. On 3 March 2000 the planning consents are obtained and the sale becomes unconditional.

The purchaser's balance date is 31 March.

For the purpose of recognising the expenditure incurred in the 1999 and 2000 income year of this agreement for the sale and purchase of property, the taxpayer may apply Determination G17B. By applying that Determination, the taxpayer will determine the value of the property passing under the agreement. The value of the property is determined, on the basis of discounted cash flows, to be $1,435,999. This is part of the "consideration" of the agreement for the sale and purchase of property. The other form of consideration is the cash payment of $1,500,000.

Determination G17B, in turn, relies on Determination G3 (alternatively, G11A could be used) and Determination G1A to allocate an amount of expenditure to the 1999 income year. The expenditure allocated to the 1999 income year in accordance with those Determinations is $12,916.

On the maturity of the financial arrangement, in the 2000 income year, a base price adjustment is calculated. The base price adjustment formula is:

consideration — income + expenditure + amounts remitted

where -

consideration = the consideration paid to the person less the consideration paid by the person

= (the present value of the property transferred to the person) less (the cash payment made by the person)

= $1,435,999 - $1,500,000

= –$64,001

income	=	(the income derived by the person from the financial arrangement in previous income years), and (dividends within the meaning of section CF 2(1)(b) or section CF 2(1)(k)) and (gross income derived under section DC 2(1))
	=	0
expenditure	=	expenditure incurred in previous income years
	=	$12,916
amounts remitted	=	an amount not included in the consideration paid or payable to the person, because it has been remitted by the person, or by law.
	=	0

The result of the base price adjustment is -$51,085. This amount is expenditure incurred in the 2000 income year.

Assessability and deductibility of accrual income or expenditure

The main amendment to the base price adjustment, with the removal of the holder/issuer distinction, is the removal of the automatic deduction (a deduction not subject to a nexus or business test) currently available to holders of financial arrangements if the result of the base price adjustment calculation is negative.

This automatic deduction for holders has been removed because it:

- is consistent with the rewrite of the Income Tax Act 1994, which separates the timing rules from assessability and deduction provisions;
- means that both parties to a financial arrangement are treated in a manner consistent with the rest of the Act (that is, the person receiving the interest has to return it but the person paying the interest may or may not be able to deduct it); and
- reduces incentives on taxpayers to structure transactions to take advantage of the right to an automatic deduction.

A negative result arising from the base price adjustment calculation is expenditure incurred and subject to the core deductibility tests. A positive amount is income derived. This continues to be treated as income under section CE 1(1)(c).

Two additional tests have been introduced to overcome the unintended effects of the base price adjustment.

- If the outcome of the base price adjustment is negative (expenditure) and the amount arises because of an overstatement of income derived in previous income years, the amount is deductible regardless of the core deductibility tests.
- If the outcome of the base price adjustment is positive (income) and the amount arises because of expenditure incurred in prior years but the expenditure was not allowed as a deduction, the amount is not be treated as income under the base price adjustment.

Definition of "consideration"

Like the definitions of "financial arrangement" and "excepted financial arrangement", the definition of "consideration" has been included in Subpart EH (section EH 48) because it is core to the operation of the accrual rules.

The definition of "consideration" has been introduced to replace "acquisition price", "core acquisition price" and "amount of all consideration". The primary objective of this change is to simplify the calculation of amounts that are spread under the accrual rules (section EH 33) and to simplify base price adjustment. The definition of "consideration" has also incorporated a number of minor policy changes. These include:

- the extension of the consideration rules to cover finance leases;
- the exclusion of income or expenditure associated with non-contingent fees;
- the exclusion from the lowest price concession for an agreement for the sale and purchase of property or services if that agreement is part of a wider financial arrangement; and
- the provision that market value is the appropriate consideration to be used in the accrual rules when a financial arrangement is transferred by way of distribution in specie or treated as being transferred on the death of a party to a financial arrangement and on the distribution of a financial arrangement to a beneficiary under a will or on intestacy.

Forgiveness of debt

The accrual rules treat debts that do not have to be repaid as income if they are forgiven. Forgiveness is a benefit to the person who is no longer required to discharge its obligations. The forgiveness of debt rules also act as a clawback for deductions previously taken by taxpayers. This legislation has now been made more robust to ensure that taxpayers cannot structure transactions to avoid recognising forgiveness of debt income.

Natural love and affection

The accrual rules treat debts that do not have to be repaid as income to the debtor. An exception is made, however, if a natural person forgives a debt in consideration of "natural love and affection". If a debt is forgiven in these circumstances the amount forgiven is treated as if it had been paid for the purposes of the accrual rules, so is not assessable as income.

This exception was previously contained in section EH 4(6). It was uncertain how this provision applied to debt that was forgiven by a creditor to a family trust in consideration of the creditor's "natural love and affection" for the beneficiaries of the trust. In particular, it was not clear whether the creditor was required to have "natural love and affection" for all of the trust's beneficiaries. This created uncertainty for:

- trusts where the trustee has the power to appoint beneficiaries for whom the creditor does not have "natural love and affection",
- discretionary trusts with a class of discretionary beneficiaries amongst whom there is an entity for whom the creditor could not have "natural love and affection",
- trusts that include a charity as a beneficiary.

To address these uncertainties the "natural love and affection" rules have been amended. The amendments apply to Division 1 and Division 2 financial arrangements and are contained in sections EH 5 and EH 52 respectively.

They provide that the "natural love and affection" exception applies if a natural person forgives a debt to a trust that is established primarily to benefit natural persons for whom the creditor has "natural love and affection" or charities (qualifying beneficiaries). This test requires an examination of the trust deed and all the circumstances surrounding the establishment of the trust in order to ascertain whether a particular trust qualifies under the exception. It ensures that a discretionary trust, or a trust with a power of appointment, will not automatically fail to qualify under the exemption.

In addition, given that the policy underlying the "natural love and affection" exception is to exempt genuine gifts, the ambit of the exception has been specifically widened to include charities. The provisions recognise that debt forgiven to trusts that have charities as beneficiaries are as much gifts as debt forgiven to trusts that have family beneficiaries.

The amendments also contain a rule that taxes the trustee on any distribution to a non-qualifying beneficiary to the extent that the distribution is equal to or less than the debt forgiven to the trust. Future distributions to such beneficiaries are taxed to the extent that debt forgiven to the trust has not already been taken into account in calculating taxable distributions under these provisions. This rule ensures that an amount equal to the debt forgiven to the trust is taxed if it is ever distributed to a non-qualifying beneficiary.

There is also a new record-keeping requirement for trustees of trusts qualifying under the exemption. Section 22B of the Tax Administration Act 1994 requires the trustee to keep records of amounts of debt forgiven to the trust, and amounts distributed to the trust's beneficiaries for the life of the trust. This provision is necessary in order to calculate accurately the extent to which distributions to non-qualifying beneficiaries are taxable.

Example

In year 1 a father establishes a family trust to benefit his two daughters. The trust deed gives the trustee the power to appoint other beneficiaries - including non-qualifying beneficiaries.

In year 1 the father transfers the family home to the trust for its market value of $50,000. A debt is created between the trust and the father for $50,000. The father forgives the debt progressively in years 1 and 2.

In each of the years 1 - 7 he makes regular cash gifts of $25,000 to the trust. In year 5 the trustee exercises the power of appointment, appoints the father's family company as a beneficiary and distributes $40,000 to the company. The trustee also distributes $25,000 to each of the daughters in the same year. In year 7 the trustee distributes $20,000 to the family company and $20,000 to each of the daughters.

Year	Debt forgiveness to trust	Other distributions to trust	Distributions to non-qualifying beneficiaries	Distributions to qualifying beneficiaries	Trust's assets and funds at year-end
1	$25,000	$25,000 (cash gift from settlor)	$0	$0	$25,000 equity in the house $25,000 cash
2	$25,000	$25,000 (cash gift from settlor)	$0	$0	$50,000 - house $50,000 cash
3	$0	$25,000 (cash gift from settlor)	$0	$0	$50,000 - house $75,000 cash
4	$0	$25,000 (cash gift from settlor)	$0	$0	$50,000 - house $100,000 cash
5	$0	$25,000 (cash gift from settlor)	$50,000	$40,000	$50,000 - house $35,000 cash
6	$0	$25,000 (cash gift from settlor)	$0	$0	$50,000 - house $60,000 cash
7	$0	$25,000 (cash gift from settlor)	$40,000	$20,000	$50,000 - house $25,000 cash

The father establishes the trust primarily to benefit his daughters. Thus, the $50,000 debt that he forgives to the trust in years 1 and 2 is treated as if it is paid under the accrual rules and is, therefore, not taxable to the trust.

The distributions to the daughters in years 5 and 7 are distributions to qualifying beneficiaries, so are not taxable under the new rules.

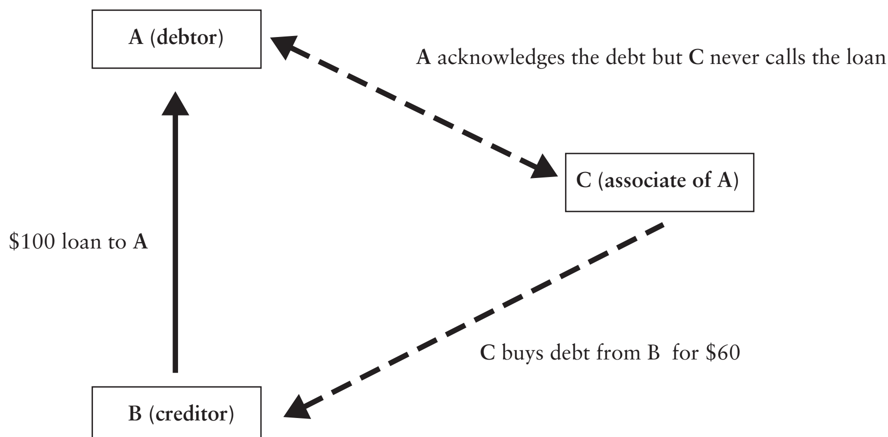
The distribution of $40,000 to the family company in year 5 is taxable to the trust in its entirety. This is because the family company is a non-qualifying beneficiary and the trust has received the benefit of $50,000 debt forgiveness in years 1 and 2.

The distribution of $20,000 to the family company in year 7 is taxable to the extent of $10,000. This is because only $10,000 of the $50,000 past debt forgiveness has not already been taken into account in calculating taxable distributions under these provisions.

Transfers of debts to associates

Figure 3 shows an example of how a debt could be sold or transferred to an associate of the debtor to circumvent the debt remission rules. In the example, A owes money that it cannot repay to B. Rather than forgiving the debt (which would give rise to remission income for A) B sells the debt, at a discount, to an associate of A (in this case C).

FIGURE 3: DEBT PARKING



B has received $60 for A's debt and extinguished its rights under the arrangement. Had this money come direct from A (as full and final settlement of the debt) remission income of $40 would have arisen to A. However, because C is an arm's length party from B, no remission income arises under current law. The difference between this type of arrangement and the sale or assignment of the debt from B to an unrelated third party is that, although A's debt under the arrangement is still outstanding, A no longer expects to have to repay the loan.

Section EH 53 deals with transfers of debts to persons associated with the debtor. If a creditor sells a debt to an associate of the debtor at a discount of 20% or more of the market value of the debt (adjusted for changes in value that are attributable to decreases in creditworthiness), the debt is treated as being forgiven by the creditor. Both the original creditor and debtor will carry out a base price adjustment, and a new financial arrangement will be created between the debtor and the debtor's associate. For the purpose of the base price adjustment the debtor will be treated as paying the discounted price (in the example $60). The debtor's associate is treated as providing an interest-free loan of $60 to the debtor, so there is no income or expenditure to spread under the new financial arrangement. Under the new financial arrangement, if the debtor repays an amount in excess of the amount the debtor's associates paid the original creditor, the excess is an allowable deduction to the debtor and gross income to the debtor's associate.

Amounts remitted

When taxpayers perform a base price adjustment they must take into account any amount they have remitted. This ensures that the amount they remitted does not contribute to a negative outcome under the base price adjustment, since a negative outcome may be deductible for tax purposes. The amounts remitted through operation of law are now explicitly included in the base price adjustment.

Allowable deductions - bad debts

Section EH 54 largely replicates section EH 6 of the old accruals rules. It has been extended to allow bad debt deductions for dealers or providers of goods and services when credit is extended under an agreement for the sale and purchase of property or services.

The latest review of the accrual rules did not specifically address issues associated with the treatment of bad debts arising from financial arrangements. Bad debt deductions were, however, reviewed in 1993, and the subsequent Income Tax Amendment Act (No. 3) 1993 confirmed that the accrual rules operate as a code for deduction of bad debts arising from financial arrangements, and that deductions between associates were inappropriate.

The prohibition against the deduction of associated person bad debts was part of the accruals rules when first enacted. At that time it was considered that the non-arm's length relationship between the borrower and the lender could create avoidance opportunities if bad debt deductions were permitted.

The Valabh Committee recommended in 1992 that the accrual rules be modified to allow persons in the business of lending money deductions for losses of principal in respect of loans to associated persons. The Government did not accept the recommendation to change the rules for several reasons:

- It would make it easier for business lenders to capitalise their subsidiaries with debt instead of equity, thereby allowing any losses from the investment to be deductible while gains would not be included in income.
- The common law test as to whether a loan that goes bad was on revenue account (meaning a bad debt deduction would be allowed) or on capital account (meaning no bad debt deduction would be allowed) is difficult to apply in practice.
- A change could also provide scope for taxpayers to claim double deductions.

Security arrangements

Sections EH 55 and EH 56 consolidate the provisions relating to security arrangements.

The discussion document *The Taxation of Financial Arrangements* proposed removing certain types of security arrangements from the accrual rules. These proposals were not included in the recent legislation, but will be consulted on further and any necessary amendments included in a future tax bill.

Agreements for the sale and purchase of property or services

The rules applying to trade credits have been integrated with the rules for agreements for the sale and purchase of property. They have also been extended to apply to the provision of services.

The integration has been done by widening the definition of "property" for the purpose of the accrual rules. This results in the rules for agreements for the sale and purchase of property or services covering all agreements in which the subject is property, except if the property is foreign exchange or financial arrangements. The provisions in the old rules relating to trade credits are not included in the new rules.

As a result of the integration, the bad debt provisions have been extended to taxpayers in the business of dealing in the goods or services that are the subject of the agreements for the sale and purchase of property or services.

In addition, there is only one excepted financial arrangement for short-term agreements for the sale and purchase of property or services. The measurement period to determine short-term agreements for the sale and purchase of property or services runs from the date the contract was entered into. If the date of contract cannot be determined with reasonable certainty, the measurement period runs from the earlier of the date the purchaser makes payment to the vendor or the date the first right in the property is transferred or any services are performed. The same measurement rule applies to short-term options.

Interest accumulation rules have been included in the definition of "consideration" to enable the accrual rules to apply if payment is made before the property is transferred.

The rules for agreements for the sale and purchase of property were intended to deal with actual transfers of property. They were not intended to apply if the property concerned is being used only as a pricing index. If there is a cash settlement option in a property agreement it indicates this is an indication that the property is being used as a pricing index. The agreement should then be treated as a forward contract. The rules for an agreement for the sale and purchase of property or services apply only if the agreement is to be settled by physical delivery of property or the performance of services.

It has been made clear that an agreement for the sale and purchase of property or services that provides for a cash settlement option is a forward contract, and a futures contract is a forward contract traded on a recognised futures exchange.

The treatment of fees

Because the fees of a financial arrangement affect the cost of funds, they should be taken into account as consideration in calculating income or expenditure. Under the old accruals rules, the treatment of fees incurred in relation to a financial arrangement is dependent upon whether the fees are contingent or non-contingent. Contingent fees must be spread over the term of the financial arrangement, while non-contingent fees up to 2% of the core acquisition price do not have to be spread.

This threshold has been removed from the new accrual rules so that all non-contingent fees are outside the ambit of the accrual rules because they are not readily substitutable with interest.

Unlike non-contingent fees, contingent fees, by their very nature, are substitutable for interest and so are spread.

The treatment of fees has been reflected in the definition of "consideration" in section EH 48. "Non-contingent fee" is defined in section OB 1 as a fee for services provided in relation to a person becoming a party to a financial arrangement that is payable whether or not the arrangement proceeds. Each fee will need to be considered on a case-by-case basis. For example, depending on the circumstances, brokerage fees can be either contingent or non-contingent; if the brokerage is payable on applications received, and is non-refundable, it is non-contingent, whereas if it is payable on applications accepted it is contingent.

Finance leases

All leases were previously excepted financial arrangements. Under sections FC 6 to FC 8 the specified lease rules treated certain leases in a similar manner to a sale of the lease asset financed by a "loan" from the lessor to the lessee.

As set out in the discussion document *The Taxation of Financial Arrangements*, specified leases are essentially financing arrangements and similar to deferred property settlements. Therefore leases with financing characteristics have been included within the scope of the accrual rules.

Leases entered into on or after 20 May 1999 (the date of enactment) that have financing characteristics are known as "finance leases". The definition of "excepted financial arrangement" has been amended to exclude leases, other than finance leases, from the accrual rules. The definition of "specified lease" has also been amended so that the definition applies only to leases entered into before 20 May 1999.

The definition of "finance lease" is narrower than the definition of "specified lease". "Finance lease" is defined in section OB 1. A lease of personal property (other than bloodstock and livestock) is a finance lease if, under the lease, any of the following criteria are met:

- The lease provides for the lease asset to transfer to the lessee at the end of the lease term.
- The lessee or associate has the option to acquire the lease asset for an amount that is substantially lower than the market value of the lease asset on the date of acquisition.
- The lease term is longer than 75 percent of the useful life of the lease asset.

Rules similar to those governing the tax treatment of hire purchase agreements have been introduced to deal with finance leases. As with the hire purchase rules the finance lease rules, other than those dealing with the spreading of the interest income or expenditure, are contained in Subpart FC.

Leases entered into on or after 20 May 1999 that are not finance leases are known as operating leases. Section EO 2A deals with deductions available to lessees under operating leases.

Special rules for finance leases

Under section FC 8A, the leasing of an asset under a finance lease is treated as a sale of the lease asset from the lessor to the lessee. The lessor is then treated as providing a loan to the lessee equal to the *lessor's disposition value*. The lessee is then treated as using that loan to purchase the asset for the *lessee's acquisition cost*. The result of the deemed sale is that any profit from the sale is recognised by the lessor in the year of sale, and the lessee is entitled to claim depreciation if appropriate. The lessor is explicitly denied a deduction for depreciation (section FC 8B(1)).

Section FC 8B(2) ensures that if title of the lease asset transfers to the lessee at the termination of the lease, the transfer of title does not result in any tax consequences. In other words, the lessee is treated as purchasing the lease asset at the time of the deemed sale, not when title eventually passes.

If, at the end of the lease term, the lease asset is not purchased by the lessee but instead returned to the lessor the lease asset is treated as being sold to the lessor. The consideration for the transfer is the guaranteed residual value (GRV). GRV is defined in section OB 1 as an amount equal to the value of the lease asset as agreed in the lease by the lessor and the lessee being an amount the receipt of which by the lessor is guaranteed by the lessee. If there is no GRV the lease asset is treated as being sold for no value.

Section FC 8C deals with early terminations of leases. If a lease is terminated early, the lease asset is treated as being sold to the lessor for the amount by which the outstanding balance of the loan exceeds any additional payment made as a result of early termination. "Outstanding balance" is defined in section OB 1 as including principal, interest, and penalties owing by the lessee to the lessor on the date that the lease is terminated.

Both sections FC 8B(3) and FC 8C(1) apply despite the requirements of section EG 19(7) of the depreciation rules. Section EG 19(7) enables the Commissioner to treat property sold, in certain circumstances, at its market value at the time of sale. This is not appropriate in relation to finance leases because such leases are treated as financing transactions, and the deemed sale price is treated as part of that transaction.

Section FC 8D deals with the sale of lease assets by the lessor following expiry of the lease. If an asset is sold for more or less than the guaranteed residual value, and a payment is made to or by the lessee, an adjustment is made to the deemed sale price, under the finance lease rules, to ensure that the value of the asset transferred (be it higher or lower than the guaranteed residual value) is reflected in the financing transaction.

One of the main practical problems encountered under the specified lease rules is that, in some cases, it is only with the benefit of hindsight that it can be ascertained whether a lease is a specified lease. One of the aims of the definition of "finance lease" is certainty. When taxpayers enter into a lease they should generally be able to ascertain whether the lease is a finance lease or an operating lease. Paragraphs (a) and (b) of the definition are drafted so that it is clear from the outset whether these factors will be characteristics of the lease. Under paragraph (c), however, it is possible that with the benefit of hindsight a person could determine that a lease is a finance lease. For example, if there are two or more consecutive or successive leases of the same lease asset to the same lessee and the Commissioner treats those leases as one lease, and the lease is for 75% or more of the asset's estimated useful life, and the second, or subsequent lease, was not contemplated when the first lease was entered into, it is only with the benefit of hindsight that the taxpayer can determine that the lease is a finance lease. Sections FC 8H and FC 8I are aimed at such leases and allow taxpayers to make an adjustment in the income year in which they determine that their lease is a finance lease.

Finance leases and the accrual rules

The new finance lease rules and the amendment to the definition of "excepted financial arrangement" to exclude operating leases mean that:

- The interest element of a finance lease is recognised as income or expenditure over the term of the agreement using the yield to maturity or alternative accrual methods.
- On termination or expiry of the lease there is a base price adjustment to ensure that all income or expenditure is recognised.

Example 1

On 1 April 2000 a person leases a floodlight system, the lease is for three years, and the Commissioner has determined that the estimated useful life of the floodlight system is also three years. The lessee's acquisition cost is $100,000 (neither the lessee nor the lessor incurred any costs in preparing or installing the lease asset for use). The lease payments are payable annually in one instalment of $32,000. The lessor and the lessee have agreed a guaranteed residual value of $30,000. Their balance dates are both 31 March.

Lessee

Interest spread on a YTM basis:

31 March 2001	11,069.01
31 March 2002	8,752.16
	19,821.17

Base price adjustment

consideration — income + expenditure + amounts remitted

consideration = $100,000 (the loan) - (($32,000 x 3 years) (the lease payments) + $30,000 (the return of the lease asset - valued at the GRV under section FC 8B(3)(a)))
= -$26,000

income = 0

expenditure = $11,069.01 + $8,752.16 (interest on a YTM basis as set out above)
= $19,821.17

amounts remitted = 0

The result of the base price adjustment is -$6,178.83 (negative therefore expenditure).

Depreciation on lease asset

Tax book value $100,000
Depreciation at 50% diminishing value

31 March 2001	$50,000
31 March 2002	$25,000
Tax book value	$25,000
Treated as sold for	$30,000
Gain on sale	$5,000

Overall summary

Expenditure for year 1	Interest	11,069.01
	Depreciation	50,000.00
		61,069.01
Expenditure for year 2	Interest	8,752.16
	Depreciation	25,000.00
		33,752.16
Expenditure for year 3	BPA	6,178.83
		101,000.00
	Less gain on sale	5,000.00
		96,000.00

Lessor

consideration — income + expenditure + amounts remitted

consideration = (($42,000 x 3 years) (the lease payments) + $30,000 (the return of the lease asset - under section FC 8B(3)(a))) - $100,000 (the loan)
= $26,000

income = $11,069.01 + $8,752.16 (interest on a YTM basis as set out above)
= $19,821.17

expenditure = 0

amounts remitted = 0

The result of the base price adjustment is $6,178.83 (positive, therefore income).

Overall summary

Income for year 1	Interest	11,069.01
Income for year 2	Interest	8,752.16
Income for year 3	BPA	6,178.83
Principal repayment		100,000.00
		126,000.00

Example 2

A variation on example 1 - the lease agreement requires that when the lease asset is returned to the lessor at the end of the lease the lessor has to sell it. If the proceeds of the sale are more than $30,000 the lessor will return the excess to the lessee, and if the sale proceeds are less than $30,000 the lessee will make up any shortfall. At the end of the lease the lessor sells the floodlight system for $24,000, and the lessee pays the lessor $6,000.

Lessee

Interest spread on a YTM basis:

31 March 2001	11,069.01
31 March 2002	8,752.16
	19,821.17

Base price adjustment

consideration — income + expenditure + amounts remitted

consideration = $100,000 (the loan) - (($32,000 x 3 years) (the lease payments) + $24,000 (the return of the lease asset - valued as the GRV less the GRV payment under section FC 8D(1)(b)) + $6,000 (the GRV payment)
= -$26,000

income = 0

expenditure = $11,069.01 + $8,752.16 (interest on a YTM basis as set out above)
= $19,821.17

amounts remitted = 0

The result of the base price adjustment is -$6,178.83 (negative, therefore expenditure).

Depreciation on lease asset

Tax book value	$25,000
Treated as sold for	$24,000
Loss on sale	$ 1,000

Overall summary

Expenditure for year 1	Interest	11,069.01
	Depreciation	50,000.00
		61,069.01
Expenditure for year 2	Interest	8,752.16
	Depreciation	25,000.00
		33,752.16
Expenditure for year 3	BPA	6,178.83
	Loss on sale	1,000.00
		102,000.00

Lessor

consideration — income + expenditure + amounts remitted

consideration = (($42,000 x 3 years) (the lease payments) + $30,000 (the return of the lease asset - valued as the GRV less the GRV payment under section FC 8D(1)(b)) + $6,000 (the GRV payment)) - $100,000 (the loan)
= $26,000

income = $11,069.01 + $8,752.16 (interest on a YTM basis as set out above)
= $19,821.17

expenditure = 0

amounts remitted = 0

The result of the base price adjustment is $6,178.83 (positive, therefore income).

Overall summary

Income for year 1	Interest	11,069.01
Income for year 2	Interest	8,752.16
Income for year 3	BPA	6,178.83
Principal repayment		100,000.00
		126,000.00

Finance leases and withholding taxes

Resident withholding tax (RWT)

Under section FC 8F, the lessor's income from the loan under the finance lease is treated as interest. Interest payable under a finance lease is included in the definition of "exempt interest" for the purposes of the RWT rules. Under section NF 1(2), the RWT rules do not apply to exempt interest. Therefore the interest component of a finance lease payment is not subject to RWT.

Non-resident withholding taxes (NRWT)

The accrual rules do not apply to the calculation of non-resident withholding income (section EH 21(2)(a)), so they have no effect on NRWT. Section FC 8F deems income derived by the lessor, from the deemed loan, to be interest. This section ensures that the interest component of a lease payment is subject to withholding tax. Therefore non-resident withholding tax or approved issuer levy must be deducted in relation to actual payments made rather than the "interest" spread under the accrual rules.

Other amendments

Branch equivalent income

An amendment to the branch equivalent income calculation (section CG 11(5)) clarifies the amount a controlled foreign company must use to value the "consideration" for a financial arrangement. The section applies if there was no attributed foreign income or loss in the previous accounting period. The consideration for the arrangement is relevant for calculating the amount of income or expenditure and the base price adjustment in all years that the company is a party to the arrangement (provided the company remains subject to the controlled foreign company rules). The consideration is the market value or the absolute value of the formula in CG 11(5)(b). "Absolute value" is defined in section OB 1 as the value irrespective of whether the value's sign is positive or negative.

Section CG 11(5)(a) has been repealed, since it does not give the appropriate result. The section provided that the acquisition price of a financial arrangement was the value of that arrangement at the end of the immediately preceding period. This means the acquisition price would fluctuate from year to year because the value of the arrangement changes and would give an incorrect result in the year the base price adjustment applied.

Commercial bills

Section CE 3(1)(b), relating to commercial bills, has been repealed. A specific anti-avoidance rule (section GC 14A) has been introduced to act as a deterrent to taxpayers entering into arrangements with the purpose of avoiding non-resident withholding tax or approved issuer levy.

The provision is designed to prevent non-residents avoiding non-resident withholding tax on redemption payments by disposing of the bills to a resident immediately before maturity of the bills. The provision does this by making a resident liable for tax on the redemption payment.

Hire purchase rules

A new section (section FC 10(6A)) has been inserted into the hire purchase rules. The section treats the income of a lessor from the loan under a hire purchase agreement as interest. This amendment clarifies the relationship between the accrual rules and interest for the purpose of the withholding tax rules.

Non-market transactions

Section GD 11 is aimed at transactions that attempt to defeat the intent and application of the accrual rules. The requirement that there be a connection between the parties has been removed, and the section has been extended to apply if an arrangement is issued, acquired, varied, sold or otherwise transferred.

Consequential amendments

A substantial number of consequential amendments have been made to remove terms such as "holder" and "issuer". These changes are not intended to affect the way the taxation law applies.

Amendments to the Tax Administration Act 1994

Record-keeping

A new section 22A has been inserted. This section requires taxpayers to keep:

- Sufficient records to verify market prices if they use the market valuation method to work out income or expenditure in any year. Under the old rules, taxpayers can use the market valuation method only if the Commissioner has approved the market. Markets will still be approved by the Commissioner, which will help to minimise compliance costs.
- Records showing why spreading methods have been changed. It is not intended that taxpayers be able to switch method from year to year simply because another accrual method provides more favourable tax outcomes. If, however, there are valid reasons for change (for example, a company is taken over and the new owner has different accounting policies (it will be allowed.

The new section 22B requires trustees who qualify under the natural love and affection exemption to keep records of amounts of debt forgiven to the trust, and amounts distributed to the trust's beneficiaries for the life of the trust.

Disclosure of financial arrangements

The disclosure requirements for inter-related financial arrangement contained in section 60 of the Tax Administration Act 1994 have been repealed. This change affects both Division 1 and Division 2 financial arrangements. This amendment is aimed at reducing the costs of complying with the accrual rules.

Commissioner's determination-making powers

Extensions to the Commissioner's determination-making powers have been made to:

- enable the consideration for the transfer of property to be calculated if there are substantial prepayments (accumulation provisions); and
- allow the Commissioner to determine the consideration for which a finance lease asset is transferred if it is inappropriate to use the cash price.

In the latter case, the determination would refer to "discounted value". This may occur, for example, if the payment terms are more favourable to the lessee than outright acquisition of the asset.

Determinations

Owing to the structure of the accrual rules, two sets of determinations will govern the tax treatment of various types of financial arrangements. The existing determinations issued under section 90 of the Tax Administration Act 1994 will govern the tax treatment of financial arrangements entered into before the date of enactment. A new provision, section 90A, has been inserted into the Tax Administration Act 1994 to allow the Commissioner to issue determinations that will govern the tax treatment of new financial arrangements.

Until the new determinations are issued, however, determinations issued under section 90 will apply, in principle, to financial arrangements entered into on or after 20 May 1999. For example, two determinations have been issued under section 90 to govern the tax treatment of trade credits and deferred property settlements. The determinations will continue to apply, in principle, to agreements for the sale and purchase of property or services under the new rules, even though trade credits and deferred property settlements will be treated in the same way under the new rules. These determinations will continue to apply until a new determination for agreements for the sale and purchase of property or services is issued under section 90A of the Tax Administration Act 1994.

COMPARATIVE TABLE OF AMENDMENTS TO THE ACCRUAL RULES IN THE TAXATION (ACCRUAL RULES AND OTHER REMEDIAL MATTERS) ACT 1999

As inserted by Taxation (Accrual Rules and Other Remedial Matters) Act 1999	Corresponding sections in Income Tax Act 1994 prior to amendment
Division One	
EH A1	New
EH A2	New
EH 1	EH 1 - EH 1(3) and (4) amended
EH 2	EH 2
EH 3	EH 3 - EH 3(1) amended
EH 4	EH 4 - EH 4(1), EH 4(9)(c) amended
EH 5	New
EH 6	EH 5
EH 7	New
EH 8EH 12	EH 6 - EH 10
EH 13	New
EH 14	OB 1 definition re-enacted
EH 15	OB 7 re-enacted
EH 16	GD 11 re-enacted
EH 17	New
EH 18	New
Division Two	
EH 19(1)	New
EH 19(2)	Proviso EH 9(b) and EH 9(c)
EH 19(3)	EH 9(b) and (c) amended
EH 20	New
EH 21(1)	New
EH 21(2) (a)	EH 9(e)(ii)
(b)	EH 9(f)
(c)	EH 9(f)
EH 21(3)	EH 9(e)(i)
EH 21(4)	EH 9(e)(i) reversed
EH 21(5)	New
EH 22(1)	OB 1 definition amended
(2)	New
(3)	New
(4)	OB 1 definition amended
EH 23(1)	EH 2 amended
(2)	New
EH 24(1) (a), (c), (d), (f), (l), (n), (p), (q), (r), (s)	OB 1 definition
(b), (e), (g), (h), (j),	New
(k), (m), (t), (u), (v) (i), (o)	OB 1 definition amended
(2)	New
(3)	New
EH 25	EH 10 extended and amended
EH 26	EH 8
EH 27(1)—(7)	EH 3(1) amended
(8)	EH 3(2)(b)
EH 28(1)	EH 3(6) amended
(2)	EH 3(6) amended
(3)	EH 3(6) amended
(4)	EH 3(7) amended
EH 29	EH 3(8)
EH 30	EH 3(9) amended
EH 31	New

As inserted by Taxation (Accrual Rules and Other Remedial Matters) Act 1999	Corresponding sections in Income Tax Act 1994 prior to amendment
Division Two continued	
EH 32	EH 3(4) and (5) amalgamated
EH 33 (1) and (2)	EH 1(1) amended
(3)	New
(4)	EH 1(8)
EH 34	EH 1(2)
EH 35	EH 1(3) and EH 1(4)(a) amended
EH 36	EH 1(6) amended
EH 37	New
EH 38	EH 1(5)(a)
EH 39	EH 1 (5)(b)
EH 40	New
EH 41	New
EH 42	EH 1(7) amended
EH 43	New
EH 44	EH 1(4)(b) extended and amended
EH 45 (1)	EH 4(1), EH 4(9)(c), EH 4(9)(d) amended
(2)	OB 1 definition - maturity
(3)—(6)	New
EH 46 (1)—(3)	New
EH 47 (1)	EH 4(1), EH 4(2) amalgamated and amended
(2)	EH 4(3) amended
(3)	New
(4)	New
EH 48	OB 1 definition - acquisition price amended
EH 49 (1) and (2)	GD 11(3)
(3)—(5)	EH 4(5)
EH 50	GD11(2)
EH 51	EH 4(7)
EH 52	EH 4(6) amended
EH 53	New
EH 54 (1)	EH 5(4)
(2)	EH 5(1)
(3) and (4)	EH 5(2)
EH 55 (1)	EH 5(3)
(2)	EH 5(5)
EH 56	EH 4(8)
EH 57	EH 6 (1) - (3)
EH 58	New
EH 59	EH 4(9)(ba)
22A	New
22B	New
44A	New
90AA	New
90AB	90(3)
90AC (1) and (2)	90(1)
(3)	90(2)
(4)	Proviso 90(1)
(5)	90(1)(d)
(6)	90(6)
90AD (1)	90(7)
(2)	90(8)
(3)	90(9)
90AE	Proviso 90(6)

Other changes to the Income Tax Act 1994

AVERAGING OF TAX-FREE ALLOWANCES

(Section CB 12(3))

Introduction

The legislation on the averaging of tax-free allowances has been relaxed. As a result, employers may base these allowances upon fair and reasonable estimates of work-related expenditure likely to be incurred by employees for related periods.

Background

The Income Tax Act 1994 allows employers to calculate average tax-free allowances payable to employees. The legislation is intended to provide employers with the low-cost alternative of paying an average tax-free allowance, rather than having to reimburse each individual item of employee work-related expenditure.

Employers use a variety of methods to determine the amounts of employee work-related expenditure to be reimbursed by way of average tax-free allowances. In general, average tax-free allowances paid by employers are reasonable estimates of actual work-related expenditure. However, an Inland Revenue review of the law identified that a strict interpretation of the legislation did not allow for employers to take this approach.

The legislation required employers to carry out extensive employee surveys and use mathematical formulae to calculate the average tax-free payment they made to each employee. If it had been strictly followed, the legislation would have posed serious difficulties for employers. Even when information concerning total employee work- related expenditure was available (and in many cases, it may not have been), the legislation's compilation and calculation requirements imposed a very heavy compliance cost burden upon employers.

The legislation has been amended by removal of its exacting survey and calculation requirements. Instead it now allows employers to base averages upon fair and reasonable estimates of work-related expenditure likely to be incurred by employees for related periods.

Key features

Section CB 12(3), which governs the averaging of tax-free allowances, has been replaced by a new provision which allows employers to base average tax-free allowances upon fair and reasonable estimates of work related expenditure likely to be incurred by employees for related periods.

Application date

The amendment applies from 1 April 1999.

GST TO BE INCLUDED AS PART OF THE COST OF A FRINGE BENEFIT

(Sections CI 2, CI 3 and OB 1)

Introduction

GST is to be taken into account in valuing all fringe benefits, except when the good or service is exempt from GST.

Background

Fringe benefit tax (FBT) was introduced in 1985 to reverse the effect of certain court decisions which established that non-cash benefits that could not be converted to cash were not subject to income tax. FBT was essential to support the PAYE system and to protect the revenue base, since employers were switching from providing monetary remuneration to remuneration in kind. FBT also increases the equity of the tax system, since equity requires that all forms of remuneration, including non-cash benefits, are taxed consistently. Also, because the incidence of non-cash benefits tends to increase with income, not taxing fringe benefits was eroding the progressive nature of the tax system.

In the *Atlas Copco* case the cost price of a motor vehicle was held to be GST-exclusive if the business could claim a GST input credit. The law was later amended so that the cost price for motor vehicles was GST-inclusive. The policy intention was that the value of fringe benefits would be calculated on a GST-inclusive value . The amendment did not cover other goods or services that employers may provide to their employees at a discount or for free.

Key features

The FBT rules have been amended to provide that the calculation of the value of a fringe benefit is GST-inclusive if the employer is a registered person who can claim input tax in relation to the fringe benefit provided or the good or service provided is subject to GST. This involved amendments to the terms "amount", "cost", "price", "fee", and "sale at retail" in sections CI 2 and CI 3. Consequential amendments were also made to the terms "input tax" and "registered person".

This measure will not affect all fringe benefits; only those that include a GST element will have an increase in the value of the benefit. It will not increase the cost of providing subsidised loans to employees because this is an exempt activity for GST purposes.

The benefits affected are the goods and services an employer produces and provides to employees at a subsidised price or at no cost. Also affected are the goods and services an employer purchases and provides at a subsidised price or at no cost to employees.

Example of impact of amendment

An employer wishes to provide a fishing rod, cost $100 (including GST) to an employee. This table illustrates the various ways to achieve this, presuming the employee's marginal tax rate is 33%.

Description of cost	FBT (old rules)	Additional salary	FBT (new rules)
Cost excluding GST	$89		$89
Cost including GST	$100		$100
Cost price of rod (under FBT rules)	$89		$100
GST output tax based on cost price of rod for FBT purposes	$10		$11
Cash bonus paid		$149	
Less income tax @ 33%		$49	
Bonus paid after tax		$100	
Fringe benefit tax	$44		$49
Total cost to employer	**$143**	**$149**	**$149**
Total tax revenue	**$54**	**$60**	**$60**
Collected	FBT plus GST on rod	Income tax plus GST on rod	FBT plus GST on rod

The example shows that by calculating the cost price on a GST-exclusive basis, less than the appropriate level of tax was paid, and employers could lower their overall tax bill by providing fringe benefits rather than paying equivalent wages. In the example, the saving to the employer was $6 on the $100 rod. This result was not intended, from a policy perspective, because the total cost to the employer and the total revenue collected should be the same regardless of the way employers pay their employees.

Application date

This measure applies to fringe benefits provided on or after 1 April 1999.

GUARANTEE FEES PAID TO NON-RESIDENTS

(Sections CN 4, OB 1)

Introduction

Guarantee fees paid to non-residents will attract withholding tax of 3.3% if the payer and recipient are associated persons, or a "more than incidental" purpose or effect of the guarantee is to reduce the amount of interest on a financial arrangement. As a result, these guarantee fees will be taxed in the same way that insurance premiums paid to non-resident insurers are taxed.

Background

Section CN 4 generally provides that a non-resident insurer (one without a fixed establishment in New Zealand) deriving insurance premiums from New Zealand is subject to a 3.3% tax on the amount of the gross premiums. The person paying the premium is required to deduct the amount of this tax from the premium and pay it to the Commissioner.

Section OE 4(1)(o) stipulates the type of insurance premiums that are deemed to be derived from New Zealand.

The definition of "insurance" applying for the purposes of sections CN 4 (including its precursors) and OE 4 has always included a reference to guarantee against risk.

Key features

Section CN 4 and associated definitions in section OB 1 have been amended to ensure that certain guarantee fees paid to non-residents are subject to the withholding tax treatment under section CN 4. The amendments are intended to protect the New Zealand tax base.

Two types of guarantee fees paid to non-residents are subject to withholding tax treatment under section CN 4.

The first is any guarantee fee payable directly or indirectly or by one or more transactions by a person who is associated with the non-resident deriving the guarantee fee. The definition of "associated persons" in section OD 8(3) applies for this purpose. Also, "payable" is defined to include an amount distributed, credited or dealt with in the interest of or on behalf of a person.

The second type is a guarantee fee payable to an unassociated non-resident in respect of money lent if a "more than incidental" purpose or effect of the guarantee is that the guarantee fee is in substitution for interest. Only this type of guarantee fee paid to an unassociated non-resident is subject to section CN 4. This would generally not include fees paid on normal trade and commercial financing transactions such as letters of credit and performance bonds.

Furthermore, the reduction in interest must be a "more than incidental" purpose or effect of the guarantee. "Incidental" in this context means naturally flowing from, or a normal result of, the guarantee. If a reduction in interest is not incidental in this sense, the guarantee fee may be subject to section CN 4. The fact that the payment of a guarantee fee to an unassociated non-resident acting at arm's length results in a lower rate of interest does not of itself mean that the fee is subject to section CN 4.

The main amendments are:

- The definition of "insurance" in section OB 1, applying for purposes of sections CN 4, GD 13, OE 4 and associated definitions in section OB 1, has been amended to include a separate reference to a guarantee against risk. This guarantee reference applies if the person deriving the guarantee fee is associated with the payer, or a non-incidental purpose or effect of the guarantee is that the guarantee fee is in substitution for interest.
- A new definition of "insured person" has been inserted into section OB 1 and applies for the purposes of sections CN 4 and OE 4. An insured person is defined as a person who incurs a premium for a contract of insurance, regardless of whether the person is also the one who can make a claim under the contract.
- The definition of "premium" in section OB 1, applying for purposes of sections CN 4 and OE 4, has been amended to include a specific reference to a guarantee fee.

An example of the amendment's application would be to a guarantee fee (including any establishment fee) paid by a New Zealand resident company to a non-resident parent company (or another non-resident associate) in consideration for the non-resident parent guaranteeing the repayment of a loan made by a lender to the New Zealand company. The guarantee fee would be subject to the withholding tax treatment under section CN 4.

The amendments also confirm that guarantee fees come within the insurance exclusion provision in the business profits articles in New Zealand's double tax agreements.

Application date

The amendments apply from 17 November 1998 (the date of introduction of the bill) in relation to guarantee fees paid to associated persons. In the case of guarantee fees paid to unassociated persons, the amendments apply from 20 May 1999 (the date of enactment).

LIMITING DEDUCTIONS UNDER CERTAIN ARRANGEMENTS

(Sections EO 4A, EO 4B, DM 1A, DM 1B, Income Tax Act 1994)

(Section 44AA, Tax Administration Act 1994)

Introduction

Amendments counter a weakness in the tax law in relation to expenditure on films and petroleum mining exploration. They remove the taxation benefits of certain arrangements, but do not affect the ordinary deductibility of expenditure on films and petroleum mining exploration.

Background

Investors were previously able to enter into arrangements (usually through a group of companies) to claim, in effect, two deductions for one amount of expenditure. Such arrangements are complex, but in essence involve investors claiming one deduction for expenditure on films or petroleum mining exploration and a second deduction in relation to the disposal of property under the same arrangement.

Key features

The principal new sections inserted are EO 4A and DM 1A. In general, both sections follow the same form and, as such, the description that follows applies to both. These sections apply to situations in which expenditure is incurred on films or on petroleum mining exploration under an arrangement, and property is disposed for consideration under the same arrangement. The amount of the deduction for such expenditure is reduced by reference to the amount of consideration received for the property. However, the tax treatment of the consideration received for the property is not affected.

More specifically, subsection (2) provides that these sections apply in relation to a person and an arrangement if:

- the person incurs film or petroleum mining exploration expenditure under the arrangement; and
- the person or an associated person disposes of property (for example, shares) under the same arrangement or a right given under that arrangement; and
- the consideration received for the property is not income relating to a film or petroleum exploration.

If the criteria in subsection (2) are satisfied, adjustments may be required under subsections (3) and (4). If adjustments are required, special returns must be filed under section 44AA of the Tax Administration Act 1994.

A special return must be filed if a taxpayer's income or loss for an income year is either directly or indirectly affected by reduced deductions. A company may be indirectly affected, for instance, if it belongs to a group of companies and has previously utilised a loss resulting from an arrangement of the kind in question. Sections EO 4B and DM 1B allow the Commissioner to assess taxpayers outside the time bar. Use of money interest may apply when adjustments are made.

Sections EO 4A and DM 1A are best illustrated by example.

Example A: receipts exceed expenditure

A person in year 1 incurs $50 expenditure and in year 2 derives $70 as consideration for property disposed of under an arrangement.

Applying the formula in subsection (3) "a - (b - c)" in year 1, item 'a', the amount of the expenditure that would be deductible in that income year, is $50. Item 'b', the total amount of consideration for the property derived before or during year 1, is $0. Item 'c', the lesser of item 'b' and the total amount of expenditure that would be deductible in earlier income years, is also $0. So:

	a - (b - c)
Year 1:	50 - (0 - 0) = 50

$50 is therefore the amount allowed as a deduction in year 1.

In year 2 item 'a' is nil. Item 'b', the total amount of the consideration for the property derived before or during that income year, is $70. Item 'c', the lesser of item 'b' and the total amount of expenditure that would be deductible in earlier income years (year 1), is $50.

	a - (b - c)
Year 2:	0 - (70 - 50) = -20

The deduction allowed in year 2 is equal to the greater of nil and the amount given by the formula. As the amount given by the formula is negative, the deduction allowed in year 2 is nil.

As consideration is also derived in year 2, subsection (4) applies. In the formula "a - b" item 'a', the amount of expenditure deducted in earlier income years, is $50. Item 'b', the total amount of consideration derived before or during year 2, is $70:

	a - b
Year 2:	50-70 = -20

Subsection (4) reduces a person's deductions in earlier income years to equal the greater of nil and the amount given by the formula, -20 in this example. Accordingly, in year 2 the $50 deduction in year 1 (the earlier income year) is reduced to nil.

Example B: expenditure exceeds receipts

A person incurs $100 expenditure of which $50 is deductible in year 1 and $50 in year 2. In year 2, $70 is derived as consideration for the disposition of property. The treatment of the $50 of expenditure deductible in year 1 follows that of the example above, giving:

	a - (b - c)
Year 1:	50-(0 - 0) = 50

Applying subsection (3) for year 2, item 'a', the amount of expenditure that would be deductible in year 2, is $50. Item 'b', the total amount of consideration derived before or during year 2, is $70. Item 'c', the lesser of item 'b' and the total amount of expenditure that would be deductible in earlier income years, is the $50 deductible in year 1.

	a - (b - c)
Year 2:	50-(70-50) = 30

Subsection (4) also applies in year 2 to limit the deduction in year 1. Under the formula "a - b", item 'a', the amount of expenditure deducted in earlier income years, is $50 and item 'b', the total consideration derived before or during year 2, is $70.

	a - b
Year 2:	50 - 70 = -20

As in example A , the deduction for year 1 is reduced to nil. At the end of Year 2 a $30 deduction is allowed.

Example C: first in, first out - the order in which deductions are reduced

This example is a variation on example B to illustrate subsection (5). As in example B, $50 of expenditure is deductible in both year 1 and year 2. Now, however, $70 consideration is derived in year 3 instead of year 2.

Applying subsection (3) as before:

	a - (b - c)
Year 1	50-(0 - 0) = 50
Year 2	50-(0 - 0) = 50
Year 3	0-(70-70) = 0

Applying subsection (4) in year 3, when consideration is derived:

a - b

100 - 70 = 30

Subsection (4) reduces the total amount of the person's deductions in earlier income years so that the total of those deductions is 30. The order in which deductions are disallowed is provided for in subsection (5). As such, deductions are disallowed in the same order as they would have been deductible, that is, on a first in, first out basis. The deduction for year 1 is first reduced to zero before the deduction for year 2 is reduced by $20 to allow the total deduction of $30.

Application

These provisions apply to expenditure incurred from 17 November 1998, the date of introduction of the bill.

TRADING STOCK - VARIANCES

(Sections EE 5(3) and (4) and EE 15)

Introduction

The trading stock legislation has been amended to provide more flexibility and reduce compliance costs for taxpayers who use a budgeted or standard cost method of allocating costs to trading stock.

Background

As introduced into Parliament, the amending legislation replaced section EE 5(4) to correct the following deficiencies:

- The entire variance was included in gross income, rather than the part of the variance allocated to closing stock.
- The provision did not allow for variances that arise because less is spent on trading stock than was budgeted.

The replacement provision, as introduced, provided that the portion of a current year variance that related to closing stock must be taken into account in calculating the value of closing stock in the year in which the variance arises. Variances arising in a previous year were not to be taken into account in calculating the value of the closing stock.

This provision was itself replaced during the Select Committee process. A submission to the Committee argued that there should be more flexibility with regard to the inclusion of a previous year's variances in the value of closing stock. If taxpayers included them for financial reporting purposes, they should be able to do so for tax purposes. The trading stock legislation has been amended to allow this flexibility.

Key features

- Sections EE 5(3) and (4) have been replaced by a new section EE 5(3) which applies if, for financial reporting purposes, taxpayers use a budgeted or standard cost method of allocating costs to trading stock.
- New section EE 5(3) provides that a taxpayer must allocate any variance between the costs of production included in its financial statements for the year, and the actual costs of production for the year, by pro-rating the variance between the cost of stock sold and the closing value of the stock.
- The provision does not prevent taxpayers from carrying forward previous year variances (that is, including them in the value of closing stock for the following year) if they do so for financial reporting purposes. The flexibility to do this will reduce compliance costs for such taxpayers.
- Previous year variances that are not carried forward for financial reporting purposes are not required to be carried forward for tax purposes because they will be deducted as part of the opening stock under section EE 2(4).
- Section EE 15(1)(e) has been amended to clarify that the income year in which companies need to have years that end with the same balance date is the year in which the trading stock is valued, not the year in which the return is filed.

Application dates

The new section EE 5(3), and the amendment to section EE 15(1)(e), take effect from the 1998-99 income year. Section EE 5(4) is repealed with effect from 2 October 1997, which is the earliest date on which it could have applied.

Example

A Co values trading stock for financial reporting purposes using a budgeted cost method of cost allocation. In the 2000-2001 year the taxpayer produced the number of units budgeted for (100,000), but at $10.50 per unit rather than the $10 per unit budgeted for. The actual costs of producing the trading stock therefore differ from the costs used in calculating the value of trading stock under FRS 4.

A Co is required to allocate the variance between the costs used for financial reporting purposes and the actual costs between the cost of trading stock sold during the year and the closing stock. However, A Co is not required to carry forward the remaining portion of the variance in calculating the closing value of trading stock in the 2001-2002 year. The taxpayer obtains a deduction for this portion of the variance in the 2001-2002 year because it is included in the opening value of the stock in that year.

1. Calculate variance

Production costs used for financial reporting purposes - 100,000 units @ $10 per unit	$1,000,000
Actual production costs - 100,000 units @ $10.50 per unit	$1,050,000
Variance	$50,000

2. *Allocate variance*

The variance is pro-rated between the cost of goods sold and the cost of closing stock.

Cost of trading stock sold =

90,000/100,000 x $1,050,000 = $945,000

Cost of closing stock =

10,000/100,000 x $1,050,000 = $105,000

Portion of variance allocated to closing stock =

$$\text{Variance} \times \frac{\text{cost of closing stock}}{\text{cost of stock sold + cost of closing stock}}$$

$50,000 x $105,000/$1,050,000=

$50,000 x 10% = $5,000

Value of closing stock =

FRS 4 + remaining portion of the variance

= $100,000 (10,000 @ $10 per unit) + $5,000
= $105,000

The value of opening stock for the 2001-2002 year is $105,000. The taxpayer therefore obtains a deduction for the remaining portion of the variance in that year. It is not required to be carried over into the value of the closing stock for that year.

In this example, the variance is allocated only between the goods produced in the 2000-2001 year. It would also be acceptable to allocate the variance over the goods produced in an earlier year and sold in the 2000-2001 year (that is, to pro-rate the variance between opening stock + the cost of goods produced and sold in that year, and closing stock).

LOW INCOME REBATE

(Section KC 1(2))

The term "absentee" in section KC 1(2) has been replaced with "non resident" to correct an error in the legislation. Section KC 1(2) referred to a taxpayer who is an absentee for part of an income year. Because an absentee is a person who is not resident for any part of an income year, the term "non-resident" should have been used.

The amendment applies to the 1999-2000 and subsequent income years.

CHARITABLE ORGANISATIONS - ADDITIONS

(Section KC 5(1))

The Bangladesh Flood Appeal Trust has been granted charitable donee status from the 1998-99 income year.

The Humanitarian Aid Account of Mission Without Borders (NZ) has been granted charitable donee status from the 1999-2000 income year.

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

Changes to the Tax Administration Act 1994

APPLICATION OF SHORTFALL PENALTIES TO DUTIES

(Section 3)

Introduction

The definition of "return period" has been amended to clarify that it covers tax returns provided for a particular transaction or transactions but not tied to a particular period.

Background

Section 141 requires a tax shortfall calculation each time a taxpayer incurs a shortfall penalty. A shortfall penalty is a penalty imposed on a taxpayer under any of sections 141A to 141K for taking an incorrect tax position or for doing or failing to do anything specified or described in those sections. "Tax shortfall" is a defined term, and the definition sets out how the tax shortfall is to be calculated. A shortfall penalty is imposed for the return period to which the tax return relates.

It could previously have been argued that taxes such as cheque duty had no return period because the returns relate to one-off transactions, so shortfall penalties could not be imposed. Furthermore, without a return period the various offsetting provisions in section 141 could not apply.

Key features

The definition of "return period" in section 3 has been amended to provide that the return period in relation to a tax return that relates to transactions is the day on which the tax return is due. For example, cheque duty is a transaction tax, so the tax return for cheque duty has no period to which it relates. This amendment provides a return period for these taxes so that various offsetting provisions in section 141 can apply and shortfall penalties can be imposed, since the requirements of section 141(3) are now met. Section 141(3) requires a shortfall penalty to be imposed in relation to a return period, a tax type and a tax position.

Application date

This provision applies on or after 1 April 1999.

LATE PAYMENT PENALTY

(Section 3)

The definition of "late payment penalty" in section 3 has been expanded to cover late payment penalties regardless of the period to which they relate, allowing application of the current remission provisions to these penalties.

The remission provisions contained in the Tax Administration Act are intended to cover late payment penalties regardless of the period to which they relate. This prevents the situation where one taxpayer might gain remission under the current rules, while another is denied remission in identical circumstances, except that the late payment penalty involved related to an earlier period and was considered under the previous rules.

Key features

The period-based restrictions previously contained in the late payment penalty definition have been removed.

Application date

This amendment applies from 1 April 1997.

ARRANGEMENTS FOR EXTENSIONS OF TIME

(Sections 3 and 37 and MC 1, NC 2 and NC 17)

Introduction

Several amendments have been made to the provisions relating to the extension of time arrangements for furnishing income tax returns. The provision allowing the Commissioner to cancel an extension of time arrangement has been amended to make it clear that the Commissioner can cancel an arrangement previously granted if tax agents do not meet their return filing percentage obligations. It has also been made clear that such cancellation may apply to one or more returns rather than being required in relation to all tax returns.

The term "linked to a tax agent", which allows taxpayers so linked to have the extended terminal tax due date 7 April for standard and late balance dates, is being limited to agents with extension of time arrangements.

Background

The Tax Administration Act 1994 was recently amended to provide that taxpayers with an agent who have an extension of time arrangements would have a terminal tax date of two months after the general terminal tax dates. These measures address additional policy issues arising from the terminal tax date change.

Key features

Section 37(4A) has been amended to make it clear that the Commissioner has the power to cancel tax agents' extension of time arrangements during an income year if they do not meet their return filing percentages. Further, a new provision was inserted to make clear that the Commissioner also has the option of cancelling an extension of time arrangement granted to an agent in relation to one or more returns rather than all returns.

The definition of "linked to a tax agent" in section OB 1 of the Income Tax Act 1994 has been amended to refer to tax agents with an extension of time arrangement. Clients of a tax agent without an extension of time arrangement do not require the later terminal tax date because their returns are due on 7 June and 7 July following the end of the income year.

Consequential amendments have been made to sections MC 1, NC 2 and NC 17 to reflect these amendments.

Application date

The measures will apply from 20 May 1999, the date of enactment.

BINDING RULINGS

(Sections 3, 91C, 91DA, 91DB, 91DC, 91DD, 91DE, 91E, 91EA, 91EB, 91EC, 91EH, 91EI, 91EJ, 91F, 91FA, 91FB, 91FC, 91FH, 91FI, 91FJ, 91G, 91GA, 91GAB, 91GAC, 91GAD, 91GAE, 91GB, 91GBA, 91GC, 91GD,91I, 91J and 138E)

Introduction

The post-implementation review of the binding rulings system has led to a number of changes to the binding rulings legislation. Some are minor technical changes, while other amendments reflect more significant policy changes.

Background

The binding rulings legislation, enacted by amendment to the Tax Administration Act 1994, took effect from 1 April 1995. The primary aim of binding rulings is to give taxpayers certainty about the way the Commissioner will apply tax law to particular transactions.

A post-implementation review of the binding rulings system identified a number of areas that could be improved. This has resulted in a number of changes to the binding rulings legislation.

Key features

- Binding rulings continue to apply after a legislative change if that change does not materially affect the ruling. Taxpayers wishing determine whether a ruling is still valid can apply for a status ruling.
- Binding rulings continue to apply if an assumption used in the ruling proves to be incorrect if the assumption is not material to the ruling.
- Product rulings will not be published until two months after the applicant receives the ruling.
- Product rulings, status rulings on product rulings, and public rulings will be published in an Inland Revenue publication.
- It has been clarified that binding rulings are not disputable decisions and cannot be challenged through the dispute resolution process.
- Private binding rulings are now permitted on recurring arrangements. This will improve certainty for taxpayers that regularly enter into similar transactions.

Application dates

The amendments are generally effective from the date of enactment, 20 May 1999. There are, however, two exceptions:

- The amendments to section 91I that give the Commissioner the power to waive fees that are payable applies retrospectively from 1 April 1995.
- The amendments to section 91J that allow the Commissioner to refuse to issue a ruling to an applicant with an outstanding debt relating to an earlier ruling's application apply on or after 1 June 1999.

Detailed analysis

Continuation of binding rulings after legislative change

Section 91G stated that a ruling terminated if the taxation law on which the ruling was given was repealed. This occurred even if the provision was replaced with a substantially similar provision that did not alter the tax treatment of the arrangement. This meant that rulings had to be re-issued, which resulted in compliance and administrative costs. This defeated the purpose of binding rulings, which was to provide certainty.

The policy rationale of section 91G was that the intent of Parliament should always take precedence over a binding ruling. Binding rulings were to terminate, therefore, following a change to the legislation that materially affected that ruling. Immaterial changes were not intended to terminate binding rulings. This intent was not adequately reflected in the legislation, however. Therefore section 91G has been redrafted to ensure that only material changes to a taxation law affect the status of a binding ruling.

This change means that taxpayers are now responsible for monitoring the rulings they have obtained. In some cases, however, the effect of a change in the law on a ruling may not be clear to taxpayers. To overcome this problem the Commissioner is now able to issue rulings on the effect of legislative change on an existing ruling. These are known as "status rulings" and are provided for by the new sections 91GA, 91GAB, 91GAC, 91GAD, 91GAE, 91GB, 91GBA, and 91GC, and amendments to sections 91I and 3. This service is charged for at the regular rate.

Scope of product rulings

Product rulings are Inland Revenue's interpretation of how the taxation law applies to a particular product rather than how it applies to a person or class of persons in relation to an arrangement.

The ruling, therefore, defines the product and specifies the tax treatment. It applies to taxpayers whose identities and tax attributes are not known to Inland Revenue.

It was not intended that product rulings should state how the law applied to a person or class of persons. However, the legislation in this area was ambiguous. In practice, Inland Revenue has issued product rulings that include comment on the tax treatment of unknown parties.

Section 91FC has therefore been clarified so that product rulings can be issued on the way the taxation law applies to the unknown parties to products. This applies only if the tax characteristics of the persons entering into the arrangement do not affect the content of the ruling.

Effect of incorrect assumptions

The rulings legislation allows the Commissioner to set out the facts and assumptions on which rulings are based. However, the legislation did not provide a materiality threshold in relation to incorrect assumptions contained in binding rulings. Assumptions are generally made about future events. Thus, if an assumption proved incorrect the whole binding ruling was invalid, despite the fact that the incorrect assumption may not have been relevant to the remainder of the ruling.

Therefore sections 91EB and 91FB have been amended so that a ruling does not apply if it contains assumptions about future events or facts that prove to be materially incorrect.

These sections, however, provide that the ruling does not apply if the Commissioner stipulates a condition that is not satisfied. Conditions stipulated by the Commissioner are not subject to a materiality threshold.

Arrangement not seriously contemplated

The Commissioner is required to make rulings only on arrangements that are seriously contemplated. It was not clear, however, at what point an arrangement that is the subject of the binding ruling has to be "seriously contemplated". It could be the time of application or the time the ruling is to be issued, or at all times before the ruling is issued.

Section 91E has been amended to clarify that an arrangement that is the subject of a binding ruling must be "seriously contemplated" at the time of application or at any time before the ruling is issued. This ensures that Inland Revenue will be able to stop work on an application if, after the application has been received, it becomes apparent that the arrangement is no longer seriously contemplated.

This approach does not prevent minor amendments being made to an arrangement whilst a ruling application is being considered.

Timing of publication of product rulings

Section 91FH clarifies that Inland Revenue must publish all product rulings (in a departmental publication). The previous legislation was unclear on this point, and the practice was for product rulings to be published only if the taxpayer had specifically approved publication.

The policy underlying this change is that product rulings may affect many people, and it is in the public interest for taxpayers to be aware of Inland Revenue's interpretation of the law.

Under section 91FH Inland Revenue must wait two months after a product ruling is issued before publication is permitted. This is because the publication of rulings could limit the competitive advantage that a new product generates. Introducing this time period means that there is now a suitable compromise between the public's interest in gaining information and an applicant's right to benefit from the development of new products.

However, the provision allows the Commissioner to publish the product ruling earlier if the applicant requests earlier publication.

Vehicle for publication of rulings

Sections 91DA and 91FH have been amended, and a new section 91GBA introduced to require that Inland Revenue publish product rulings, status rulings on product rulings, and public rulings in Inland Revenue publications. Tax-orientated publications such as the *Tax Information Bulletin* are an effective means by which these rulings can reach the appropriate audience. These publications are widely available, both in hard copy and on the Internet.

Binding rulings and disputable decisions

Section 138E has been amended to make it clear that binding rulings are not disputable decisions. The policy underlying the binding rulings system was that no separate appeal rights to the courts were to be provided. It should not be possible, therefore, to challenge rulings through the dispute resolution process.

Recurring arrangements

Sections 91E(1) and 91EC have been amended so that private rulings will be permitted on recurring arrangements. This extension of the scope of binding rulings will increase certainty for taxpayers who enter a series of arrangements that are each identical in nature except for the parties that enter them. An example of a recurring arrangement is the retail sale of televisions on hire purchase.

Taxpayers entering into recurring arrangements previously had two options. The first was to request a private ruling for each arrangement. Although this provided certainty to applicants, it was costly from both a compliance and administrative perspective. The second option was to request a product ruling on the basis that not all parties to the arrangement would be known at the time of application. The problem with this approach was that the product ruling provided only an interpretation of how the law applied to the arrangement, not how the law applied to a person in relation to the arrangement.

The focus of a product ruling is on the tax treatment of a particular transaction rather than on the applicant. The amendment is intended to permit a private ruling to be obtained covering the applicant's treatment under all the transactions that are the subject of the recurring arrangements.

Extension of binding product rulings

Section 91FI, which allowed extensions to product rulings, has been repealed. Experience has shown that extending a product ruling has no advantages over making a fresh application for a ruling.

Conflicting rulings

The provisions in section 91DB(2), 91EA(2) and 91FA(2) dealing with conflicting binding rulings are unnecessary and have been repealed. Where conflicting rulings exist, the taxpayer has the choice of which ruling to apply.

Content of a binding ruling

Sections 91DA, 91EH and 91FH have been amended to include an explicit requirement to state in a binding ruling how the taxation law applies to an arrangement (and an applicant for private rulings). This reflects current practice.

Duration of a binding ruling

Sections 91DA, 91DC, 91DD, 91DE, 91E, 91EB, 91EH, 91EI, 91F, 91FB, 91FH, and 91FJ have been clarified to make it explicit that binding rulings can be issued for income years as well as for specific periods. This reflects current practice.

Minor mistakes in binding rulings

The new section 91GD provides that rulings issued with typographical errors and minor mistakes can, with the consent of the taxpayer, be corrected without the need to withdraw the original ruling and reissue a new ruling.

Disclosure requirements for private binding rulings

Section 91EJ required holders of private rulings to disclose to Inland Revenue, using forms IR115 and IR115A, whether they had complied with the content of a ruling and whether any material changes to the arrangement identified in the ruling had occurred.

In order to reduce compliance costs for taxpayers section 91EJ has been repealed.

Prospective applicants

The application provisions in section 91EC have been amended to allow for applications to be made on behalf of applicants not yet in existence (for example, an arrangement to be entered into by a yet to be incorporated company). This reflects commercial reality and current practice.

Identification of applicants in product rulings

The amended section 91FH(1) requires applicants for product rulings to be identified in the ruling. This is consistent with the original policy intent and current practice.

Incorrect rulings

Sections 91DC, 91EA and 91FA have been amended to make it clear that a binding ruling has not been applied if a taxpayer has filed a return on the basis of a ruling and has then issued a notice of proposed adjustment (NOPA) within the specified time period. The issuance of the NOPA effectively retracts the ruling, and the Commissioner will not, in these circumstances, be bound to apply it.

Tax due and payable

Section 91E(4)(d)(i) provided that the Commissioner could not make a ruling when the matter on which the binding ruling was sought concerned tax that was due and payable. This had the potential to cause problems because of the operation of provisional and other tax credit regimes. In relation to provisional tax, for example, although the tax is due and payable in three instalments throughout the year, it has not been assessed at the date it is paid. The instalment acts as a tax credit until the actual income tax liability has been determined.

The provision was not intended to prevent rulings being made in relation to taxpayers who had, for instance, provisional tax payments due and payable. This would substantially limit the ability of the Commissioner to rule on completed transactions.

Section 91E(4)(d)(i) has therefore been amended to clarify that all provisional taxpayers may apply for binding rulings, even though the matter may concern a provisional tax payment.

Audit undertaken

Section 91E(4)(g) provides that once an audit encompassing an arrangement that is the subject of an application for a binding ruling has been undertaken, the Commissioner cannot make a ruling on that arrangement. This restriction applies because the binding rulings system should not overlap with the dispute resolution process.

It was unclear from this section what constituted an "audit". Therefore the section has been clarified so that all types of audit activity carried out by Inland Revenue come within the scope of the provisions.

Private rulings and the dispute resolution process

The policy intent behind the binding rulings legislation is that it should not overlap with existing dispute resolution procedures. Section 91E(4) has therefore been clarified so that a binding ruling cannot be sought on an arrangement that is within the scope of a NOPA.

Outstanding money owing

Amendments to sections 91E(3), 91F(3) and the enactment of a new section 91J allow the Commissioner to decline to rule if an applicant has outstanding debts relating to earlier binding ruling applications.

EXTENSION OF TIME BAR

(Section 108B)

Introduction

The amended legislation puts it beyond doubt that waivers relating to tax periods before 1 October 1996 are legally valid if entered into on or after 17 November 1998.

Background

The disputes resolution process allows taxpayers to sign a waiver to extend by six months the four-year period that generally applies to amended assessments. This was a recommendation of the Organisational Review of the Inland Revenue Department and was designed to allow taxpayers and Inland Revenue extra time, if needed, before the issue of a re-assessment. Section 108B of the Tax Administration Act 1994 was introduced in 1996 to provide that taxpayers could do this.

As originally proposed, the amendment applied to all waivers. However, the majority of members of the parliamentary select committee that considered the bill were concerned that if it transpired that

Inland Revenue was incorrect and waivers already entered into for tax periods before 1 October 1996 were invalid, the amendment would have retrospective effect. Therefore the amendment does not apply to waivers signed and delivered to the Commissioner before 17 November 1998.

Key feature

The amendment to section 108B puts it beyond doubt that waivers relating to tax periods ending before 1 October 1996 are legally valid, although it applies only to waivers signed and delivered on or after 17 November 1998 (the date of the bill's introduction). Waivers entered into before 17 November 1998 continue to be governed by the unamended legislation. Inland Revenue's view remains that such waivers are valid.

Application date

The amendment applies to waivers signed and delivered on or after 17 November 1998.

TAX IN DISPUTE AND USE OF MONEY INTEREST RULES

(Sections 120 AA, 124 A(1), 128 (5-6) and 138I (4-5))

Introduction

Amendments to the rules on tax in dispute and use of money interest confirm their application to disputes begun after the rules came into effect but for income years that predate their introduction.

Other amendments confirm that these provisions apply regardless of section 1(2), which provides that the Tax Administration Act 1994 applies only to tax on income derived on the 1995-96 and subsequent income years.

Background

There has been doubt as to the application of the current tax in dispute and use of money interest rules to periods before the Tax Administration Act 1994 took effect.

The amendments clarify the application of the rules to those periods.

Key features

- Section 120AA has been inserted to provide that if the Commissioner is required to refund the qualifying tax in dispute paid, or the taxpayer to pay deferrable tax, the old use of money interest rules in sections 120 and 139 of the Income Tax Act 1994, and their predecessors, sections 34A and 398 of the Income Tax Act 1976, will still apply. The dispute must have begun before 20 May 1999, and the taxpayer must have indicated to Inland Revenue before that date his or her view that the old rules applied.

Application date

This amendment applies from 1 April 1997

- Section 124 A(1) has been replaced, to provide that despite section 1(2), Part VIII of the Act relating to objections, applies to assessments or reassessments issued after 1 April 1995 and before 1 October 1996, regardless of the income year to which they relate.

Application date

This amendment applies from 1 October 1996

- The addition of sections 128(5) and 138I (4) ensures that the use of money interest rules, introduced as part of the compliance and penalty legislation, apply from 1 April 1997 to calculate the interest payable on deferrable and non-deferrable tax. This is irrespective of whether the dispute relates to an income year before the 1997-98 income year.
- Also, sections 128(6) and 138I (5) provide that if a dispute relates to 1995-96 or an earlier income year and begins on or after 1 April 1997, the use of money interest rules will apply from the beginning of that dispute rather than the original due date.

Application date

The amendments apply from 20 May 1999.

PROVISIONAL TAX AND USE OF MONEY INTEREST

(Sections 120L and 183CA)

Introduction

Taxpayers will be allowed to specify the provisional tax instalment to which a payment applies. If they do not do so, Inland Revenue must apply the payment to the instalment to which it considers it relates. The amendment applies to the 1998-99 and subsequent years. Use of this provision prevents a payment automatically being applied to an earlier underpaid provisional instalment, effectively causing use of money interest to compound.

A supporting refund provision has been introduced to deal with cases where interest on underpayments has compounded for the 1997-98 income year. If interest has been charged on underpaid provisional tax and is more than would have applied had the changes applied for the 1997-98 income year, Inland Revenue will refund the difference.

Background

It could previously be argued that the use-of-money interest provisions required payments towards a provisional tax instalment to be first applied to meeting accumulated interest in relation to earlier instalments, with any residual amount going towards the tax liability itself.

This approach is generally suitable because it ensures that interest does not compound, which would increase the complexity of the calculations, both for taxpayers and Inland Revenue, and increase the overall amount owed. But for provisional tax, which usually has three payments due in relation to one income tax return, the general statutory rule of applying payments to interest first in cases of underpayment actually causes compounding of interest. Payments made on the second and third provisional tax instalment dates are first applied to meet any outstanding interest, rather than the provisional tax due.

The policy intent was that payments apply first to provisional tax, with the residual amount, if any, applying to interest outstanding. The legislation has been clarified to confirm that policy intent.

Not originally part of the bill, this matter was raised in submissions and later included in the bill on the recommendation of the Finance and Expenditure Committee.

Key features

- Under section 120L, use of money interest on underpaid provisional tax instalments for the 1998-99 income year will be computed on a simple basis. If a provisional tax instalment is short paid, the next provisional tax instalment is not applied against the shortfall and resultant use of money interest, unless the taxpayer specifies that treatment. This ensures that the legislation is consistent with the original and agreed policy intention that use of money interest should not compound.
- Under section 183CA, taxpayers must apply to the Commissioner for a refund. They may request a use of money interest recalculation by way of an IR 960 form (an adjustment request) or a letter giving their name, IRD number and the relevant income year.

In early September 1999 Inland Revenue will attempt to identify all taxpayers due refunds of more than $20 for the 1998/99 income year. Until this date some refunds will be issued with interest calculated on a compounding basis. Any assessment with interest calculated on a compounding basis before early September 1999 exceeding $20 will be corrected.

Application date

The amendment is effective from the 1998-99 income year. The remission provision applies to the 1997-98 income year.

How the changes will be implemented

1998-99 tax year

The legislative changes require Inland Revenue for the 1998-99 tax year and future tax years to apply payments of provisional tax instalments to the period to which it considers the payment relates. Interest charged on underpaid provisional tax instalments will be calculated on a "simple" basis, which means that if an instalment is underpaid the next instalment is not applied against the shortfall and resultant interest unless the taxpayer requests this to be done. Taxpayers can specify a particular provisional tax instalment to which a payment is to be applied.

Inland Revenue will have the necessary computer changes in place by early September to calculate interest on a "simple" basis and will send a statement of account with details of the use of money interest adjustment to affected taxpayers.

Inland Revenue will check all assessments issued for the 1998-99 income year and recalculate interest in accordance with the amended legislation. If a taxpayer has paid additional interest Inland Revenue will automatically refund amounts greater than $20. Smaller amounts will be transferred to the current income tax year if the account is in credit.

For tax assessments for the 1998-99 year received before September, interest will continue to be calculated on a compounding basis.

Taxpayers who have paid additional interest and who would like a refund before September can request an adjustment by using the adjustment request form IR 960 or by letter, giving their name, IRD number and the relevant income year.

Taxpayers who believe their interest has been miscalculated or have not received a statement of account by the end of September can request an adjustment by using the IR 960 or by letter.

1997-98 income year

The legislative change specifies taxpayers must apply in writing to receive an adjustment to use of money interest for the 1997-98 tax year. To minimise compliance costs, however, the computer changes in September will also check assessments issued for the 1997-98 tax year.

Amounts of more than $20 will be refunded. Smaller amounts will be credited towards provisional tax due for the 1999-2000 tax year.

Taxpayers who believe their interest has been miscalculated or who have not received a statement of account should write to Inland Revenue with details or complete the IR 960 form.

Notices of proposed adjustment

Some taxpayers have issued notices of proposed adjustment requested recalculation of interest calculated on a compounding basis. These have now been overtaken by the legislative change. These taxpayers should now write to Inland Revenue advising that they intend to withdraw their filed request for an adjustment as a result of the legislative change and await the adjustment to occur in September.

Late payment charges

The difference in the calculation of use of money interest will not attract the application of either shortfall penalties or a late payment penalty because use of money interest is not “tax” for the purposes of the Tax Administration Act 1994.

REMISSION PROVISIONS

(Section 174, 174AA and 3)

Introduction

The remission provisions in Part XI apply regardless of whether the remission relates to a penalty imposed in the 1994-95 or earlier income years.

Background

The compliance and penalty legislation introduced new remission provisions that provided clear rules for remitting civil penalties (other than shortfall penalties). It was intended that the remission provisions would apply to remissions relating to the 1994-95 income year and earlier years. However, as a result of the application of section 1(2), which states that the Tax Administration Act applies only to tax on income derived in the 1995-96 and subsequent years, this did not occur. This amendment ensures that taxpayers in similar positions receive similar remission treatment.

Key features

A new section 174 provides that despite section 1(2), an application for remission of penalties must be considered under Part XI of the Act, regardless of whether the remission relates to a penalty imposed in the 1994-95 or earlier income years.

The former section 174, relating to the power of the Commissioner in respect of small amounts of refunds or tax payable, has been replaced with section174AA.

The definition of “late payment penalty” in section 3 has been expanded to cover late payment penalties regardless of the period to which they relate, allowing application of the current remission provisions to those penalties.

Application date

The amendments apply from 20 May 1999.

NON-RECOVERY OF SMALL AMOUNTS OF CIVIL PENALTIES

(Section 174)

Introduction

The $20 threshold below which the Commissioner may not recover outstanding tax has been extended to cover late payment penalties, shortfall penalties and late filing penalties. This has been achieved by removing a provision that prevents this threshold applying to civil penalties.

Background

The restriction on writing off small amounts of civil penalties was carried over from the previous legislation and stemmed from a concern that those who have not complied in some way should not benefit from having small amounts of their tax liability remitted. In practice, the provision imposed both compliance and administrative costs, with little revenue benefit to offset those costs.

The amendment provides a direct compliance cost benefit to taxpayers in this circumstance as well as reducing administration costs.

Key features

Section 174 is being amended to allow the Commissioner to choose not to recover all tax debts under $20 regardless of their nature. This means the Commissioner may now choose not to recover civil penalties, as previously required.

Application date

The amendment applies from 20 May 1999.

TAX RECOVERY AGREEMENTS

(Part XA Tax Administration Act 1994)
(Section BH 1 Income Tax Act 1994)

Introduction

Several amendments have been made to the Income Tax Act 1994 and the Tax Administration Act 1994 to enable tax recovery agreements made with other countries to have effect in New Zealand. Tax recovery agreements provide a mechanism by which participating countries can call on each other's tax administration to recover tax from absconding debtors.

Background

Tax recovery agreements are becoming common internationally. Globalisation has prompted a rapid increase in international co-operation in economic and fiscal matters, including co-operation in tax administration. The OECD has recommended that Member countries consider adoption of tax recovery agreements, and is now developing a model agreement for likely inclusion in the OECD Model Tax Convention.

It is expected that the New Zealand Government will enter into a tax recovery agreement only if the participating foreign state meets certain fundamental requirements. For example, it will need to have a system for the assessment and collection of tax that is acceptable to New Zealand and have a legal system that gives appropriate recognition to due process concerns.

New Zealand will maintain a close working relationship with the competent authority of the foreign state. Therefore should complications arise at any stage of the collection process, the competent authorities will be able to develop a resolution that conforms to the requirements of the empowering legislation and the relevant agreement.

Key features

A new Part XA, entitled "Tax Recovery Agreements", has been inserted into the Tax Administration Act 1994, and section BH 1 of the Income Tax Act 1994 has been amended. These amendments, together with several minor consequential changes, permit tax recovery agreements to be given force of law in New Zealand by way of Order in Council, and provide a further legislative framework for the operation of those agreements.

They enable the Commissioner to exercise his usual powers of collection in relation to foreign tax claims that are the subject of a tax recovery agreement, or request the other state to collect outstanding New Zealand tax. The amendments also allow tax recovery provisions to be included within new or existing double tax agreements (DTAs).

Practical application of a recovery agreement will be a straightforward process of debt collection. A typical case where New Zealand is called upon to collect foreign tax will proceed as follows:

1. New Zealand will receive a request for assistance in recovery, accompanied by relevant documentation, from a foreign state with which New Zealand has a relevant agreement.
2. New Zealand will review the request to ensure that it complies with the provisions of the agreement and the empowering legislation.
3. New Zealand will pursue recovery action, in the same way it would were the claim a New Zealand tax debt.
4. Following recovery (assuming the action is successful) the recovered amount will be paid over to the foreign state.

Almost all of the key matters covered by the legislation are included within the new Part XA of the Tax Administration Act 1994:

- Application of Part XA

  Section 173A provides that Part XA applies to tax recovery agreements negotiated between the government of a territory outside New Zealand and the government of New Zealand.

- Definitions

  Section 173B contains several new definitions relevant to Part XA. These include "contested tax", used in section 173G, which stipulates certain limitations on recovery action concerning contestability and age of tax claims. Section 173B also includes a definition of "tax recovery agreement" and "competent authority".

- Empowerment

  Section 173C provides that tax recovery agreements may be given effect by Order in Council, in a similar manner to section BH 1 of the Income Tax Act 1994 in relation to DTAs. However, whereas DTAs override anything in the Income Tax Act 1994 or any other enactment, section 173C provides that the extent to which tax recovery agreements override domestic law will be limited, in their application, by the provisions of Part XA.

- Taxes that may be recovered

  Section 173D provides that recoverable taxes are limited to those that are imposed by the laws of New Zealand and the other country, and are prescribed in the relevant tax recovery agreement.

- Essential documentation requirements

  A new section 173E stipulates the documentation that must accompany requests for assistance in recovery. This will include, for example, written particulars of the amount of the tax claim; the extent, if any, to which the requesting party considers that the tax claim is uncontested; a declaration that the request meets the terms of the relevant agreement; and a certified or notarized copy of the instrument permitting enforcement in the other country.

  Other documentation may be required under each agreement, although section 173E lists the essential documents that would be expected to accompany each request for assistance in recovery.

- Enforcement powers

  Section 173F provides that the Commissioner may exercise his usual powers of collection in carrying out recovery action under a tax recovery agreement. However, New Zealand use of money interest and penalties will not apply.

- Limitations on assistance in recovery

  Section 173G sets out limitations on the recovery of foreign tax by the Commissioner that concern the age of tax claims and whether they are contested.

  Under a tax recovery agreement the Commissioner will generally be obliged to collect uncontested tax claims (subject to the conditions of each individual treaty and the boundaries set out in the empowering legislation). The Commissioner will not, however, be obliged to collect a contested tax claim.

  Nevertheless, even if a tax claim is contested, in certain circumstances the Commissioner may choose to carry out recovery action - for example, when it appears the taxpayer is about to leave New Zealand or to re-locate or hide assets in an attempt to prevent recovery action. The Commissioner may do this only after consulting with the other country.

The section provides that, to be recoverable under a tax recovery agreement, a tax claim must not have been outstanding as an uncontested tax liability longer than six years before the entry into force of the relevant agreement.

The section also provides that the Commissioner is not obliged to comply with a request for assistance that has been made after a period of 15 years from the date that the tax claim first became uncontested. The rationale for this rule, which is modelled on a draft OECD proposal, is that a 15-year period provides a balance between providing sufficient time for disputes to be settled domestically before foreign assistance is required, and allowing a requested state to avoid the obligation to collect unacceptably old debt.

- Process when objection raised

  Section 173H provides a process that taxpayers may follow if they believe recovery action should not be taken.

  They may present their case to the New Zealand competent authority and request that the competent authority of the other state be informed. The New Zealand competent authority must then, without undue delay, endeavour to resolve the matter with them or the other competent authority. This approach replicates the mutual agreement procedure that is usually included in tax treaties.

- Right of Appeal

  A new section 173I provides a taxpayer who believes that recovery action should not be taken with a right of appeal to the District Court.

- Commissioner's Certificate

  A new section 173J provides that, if the Commissioner determines assistance in recovery of a foreign tax claim may be given, he may produce and sign a certificate stating that the request complies with Part XA. In proceedings relating to recovery of the tax claim the certificate will be, in the absence of proof to the contrary, sufficient evidence of the matters certified.

Tax recovery agreements may be negotiated on a stand alone basis, or as part of new or existing DTAs. The amendment to section BH1 of the Income Tax Act 1994 extends the purpose of a DTA to include giving assistance in the recovery of tax claims. This is to allow for tax recovery provisions to be included within DTAs. However, whereas DTAs override anything in the Income Tax Act 1994 or any other enactment, any DTA which contains a tax recovery agreement will be subject to the conditions set out in Part XA.

Other, consequential, amendments include deeming the meaning of "tax" and "income tax" to include taxes prescribed in a tax recovery agreement, and the insertion of a definition of the term "contested act of assistance", used in sections 173H and 173I.

Application date

The amendments apply from 20 May 1999, the date of enactment.

Although the amendments will enable tax recovery agreements to have effect, New Zealand's first such agreement (negotiated with the Netherlands) is not expected to enter into force until late 1999.

Changes to other Acts

GST ON OVERSEAS MAIL DELIVERY IN NEW ZEALAND

(Section 11(2)(caa) of the GST Act)

Introduction

Delivery services fees charged to an overseas postal organisation by a supplier of postal services in New Zealand have been zero-rated.

Background

Postal services in New Zealand were not zero-rated previously because of the connection of the services with moveable personal property in New Zealand (that is, the mail). This meant that postal services were treated differently from other delivery services in respect of goods entering New Zealand.

Agreements between international postal authorities treat the delivery of overseas mail as a service provided to the sender. As such, taxing the fees charged for delivering overseas mail in New Zealand would be against the intention of the Goods and Services Tax Act 1985, since consumption of the delivery service is considered to occur outside New Zealand.

Key feature

A new paragraph in section 11(2) specifically zero-rates delivery service fees charged to overseas postal organisations for the delivery of overseas mail in New Zealand.

Application date

The amendment applies from 1 April 1999.

MINOR REMEDIAL AMENDMENTS

(Sections 30, 41 and 56 of the Student Loan Scheme Act 1992)

The Student Loan Scheme Act 1992 has been amended to:

- Ensure that the terminal repayments of borrowers with a tax agent are due at the same time as their terminal income tax. This amendment follows that made last year to the Income Tax Act 1994 which extended the terminal tax due date for taxpayers with an agent who has an extension of time arrangement by two months.
- Correct two drafting errors made in the Student Loan Scheme Amendment Act (No. 2) 1998 in relation to the interest write-off and refund provisions.

Application dates

The amendment to the payment dates applies from the 1997-98 income year.

The corrections apply from the original application dates contained in the Student Loan Scheme Amendment Act (No. 2) 1998.

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.

Draft general depreciation determination on growing trays

In Tax Information Bulletin Volume Eleven, No.4 (April 1999), we published a draft general depreciation determination for plastic growing trays used for producing forestry seedlings.

After considering a submission received on the draft, we felt it inappropriate to issue a general depreciation determination based on that draft.

If we consider that a general depreciation determination for growing trays should still be issued, a revised draft will be published for comment.

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.

Correction to previous case note

In the previous edition of the Tax Information Bulletin, Vol 11, No5 we published case note TRA Number 98/11. Decision Number 009/99 "Whether property was sold as a going concern". That case note contained factual errors in the last two sentences of the Facts section. Those sentences should have read:

> "The purchaser claimed a GST input of $16,666.67. The Commissioner took the view that the sale of the property should have attracted GST and reassessed the objectors with the amount paid out to the purchaser."

We apologise for any inconvenience caused by the errors.

GST - registration threshold and whether Commissioner can amend deemed registration date

Case: Iona Farm Limited v CIR

Decision date: 10 June 1999

Act: Goods and Services Tax Act 1985

Keywords: GST, sales to self, registration threshold, deemed registration

Summary

The High Court found in favour of the Commissioner upholding the decision of the Taxation Review Authority.

Facts

Iona Farm was leased by the Objector to Mr B from 1965 to 1991 and then to a farming partnership of Mr B and his son. The son purchased the farm from the Objector pursuant to an agreement which was dated 11 July 1994 but was purported to be effective as of 1 April 1993. The vendor Objector was not registered for GST purposes and the rental it had been charging to the partnership was well below the GST registration threshold.

The son registered for GST purposes with effect from 1 May 1994 and claimed a second hand goods input of $98,333.33.

The Commissioner obtained a valuation of the open market rental of the property, which showed that the value was substantially in excess of the registration threshold. The Commissioner registered the objector and assessed output tax on the supply of the farm to the son.

The Commissioner originally established a deemed registration of the Objector for GST as from 1 February 1994 and later amended the date of registration to 1 October 1986. This was in response to a letter from the Objector, which advised that the sale took place on 1 April 1993 and not 11 July 1994 as the sale and purchase agreement represented.

The Objector challenged the GST assessment on the grounds that the open market rental for the farm did not exceed the GST registration threshold and secondly, because it was not lawful for the Commissioner to change the date of the GST registration having already identified one date as the deemed registration date.

Decision

Citing *Trustees Executors and Agency Co of New Zealand v CIR* (1997) 18 NZTC 13,076 Justice Young stated that where a lease imposes on the lessee an obligation to meet liabilities which are

properly regarded as those of the lessor the cost of meeting such liabilities are held to be part of the value of the supply.

His Honour went on to say that the present situation where the underlying obligation was created by the lease was a more difficult type of case.

Justice Young held that the question should be determined by allowing the situation to be controlled by the way in which the lease is drafted. On this basis, the "goods" supplied must be regarded as the leasehold estate actually conferred by the lessor on the lessee. In the present case, the goods supplied were the leasehold estate created by the 1964 lease with all its advantages and disadvantages. The disadvantages included an obligation to eradicate weeds. Therefore the value of supply represented the market value of that leasehold interest. Accordingly, the inquiry in the present case under s 10(2) must be in terms of the open market value of the lease allowing for the obligations of the tenant as to weed and pest eradication. To come to the correct valuation a deduction for weed control costs should not be taken off the stock unit price.

In relation to the section 51(4) issue, Justice Young stated that there is nothing in section 51(4) which suggests that the powers conferred by that section can only be exercised once. When the Commissioner fixed the second deemed registration date this action was within the scope of the section. His Honour held further that the Commissioner had made an error and that section 25(j) of the Acts Interpretation Act 1924 provided that the Commissioner could re-exercise his powers in that circumstance.

Whether establishment fees paid to financial advisor were capital or revenue

Case: TRA Number 96/92. Decision Number 010/99

Decision date: 11 June 1999

Act: Income Tax Act 1976

Keywords: Establishment fees, capital v revenue costs

Summary

Judge Barber found that the establishment fees were revenue in nature and that the Commissioner had acted incorrectly in treating payment of the $1,292.00 as a capital payment.

Facts

The Objector was a qualified social worker who ran a small importing business and also received income from rents and interest. The Objector paid an establishment fee to a financial advisor, for the restructuring of her investments of $30,000. The financial advisor gave the Objector a wide range of advice about investment in bonds, trusts, unit trusts, overseas investments and the like. There was also consideration of superannuation arrangements and life insurance with a focus on investment and a mix of equities. At the outset, the bulk of the Objector's $30,000 investment portfolio was in fixed interest bank securities. The point of investing through the financial advisor was to save the Objector time.

The Commissioner disallowed the deduction of the establishment fee on the grounds that it was a capital expense.

Decision

Judge Barber held that at all material times the Objector had an investment portfolio comprising of a series of carefully considered bank term deposits of varying durations and interest rates. These were regularly rolled over after negotiations by the objector with her bankers (and competitor bankers) regarding interest rates and terms and after consideration of alternative investment areas. The time came when the objector felt she would widen her investment criteria for her existing portfolio so she took advice from a financial advisor. The financial advisor designed a restructuring of her portfolio and gave her written advice on the type of new investments she should take up in place of her existing investments.

Judge Barber stated that the Objector expanded her investment horizons after taking written advice from her financial advisor. She then allowed her $30,000 bank deposits investment portfolio to be reconstructed using not only her previous investment methods, but also other areas of investment - most of which she had herself considered previously but decided to be inappropriate at that time. Judge Barber stated that in simple terms, the issue here was whether the objector reviewed her $30,000 existing portfolio of bank deposits, or whether there was a complete reconstruction of her portfolio. Judge Barber held that the objector was an active investor.

Judge Barber aligned the present case with *CIR v North* 20/03/99, No. AP 21/99, Auckland Registry, Justice Williams and stated that the present Objector's investment aims did not alter fundamentally - the change was to her mix of investments.

Whether late objection application properly declined

Case: Bernard Joseph Wood v CIR - Judicial Review

Decision date: 9 June 1999

Act: Judicature Act 1908

Keywords: Judicial Review proceedings

Summary

The application for review was dismissed

Facts

In October 1994 the Plaintiff wrote to the Commissioner requesting that late objections forthe 1984-1993 income years be accepted. The Commissioner declined.

The decision of the Commissioner addressed the application in two steps.

The first dealt with the taxpayer's explanation for the lateness of his objection to the assessments, which had accepted the Plaintiff's position in relation to his assessable income at face value. It was considered the delay was not adequately explained or reasonable.

The second step was to consider the merits and whether, as a matter of fairness, the late objection should be accepted. It was decided that, prima facie, the claim had merit but that it was not unfair to decline the application to object out of time.

Decision

The Court found that it could not be said that there was a clear entitlement to a deduction for losses incurred on the sale of shares, and, secondly, the Commissioner did consider the merits of the taxpayer's entitlement to a deduction in such circumstances.

The Court held that the Commissioner did take into account the taxpayer's assertion, both through his accountants and through his solicitors, that he was unaware of the proper tax treatment of his profits and losses from his share transactions. The Commissioner regarded that consideration as outweighed by other considerations.

The Court also found that the Commissioner had considered the issue of fairness in some detail and dismissed the challenge to the decision of the Commissioner.

Whether settlement sum assessable income

Case: Jeffery Burgess Sayer v CIR

Decision date: 8 June 1999

Act: Income Tax Act 1976

Keywords: Settlement payment, in respect of or in relation to employment, apportionment

Summary

The High Court held that a settlement sum received by the Objector subsequent to an Employment Court Award was assessable income. The receipt, although derived from an assignment of legal rights, had sufficient nexus with the employment of the Objector.

Facts

The Objector obtained judgment in the Employment Court against a former employer for wrongful termination of employment. The judgment awarded $62,000 for loss of earnings and $50,000 for humiliation. The employer company was by then in liquidation and the judgment debt was unsatisfied. The Objector commenced and then settled proceedings against directors and shareholders of the parent company of the former employer for $100,000.

The Commissioner advised the Objector that he proposed to assess $50,000 of the amount received as compensation for loss of earnings.

An objection was disallowed and the Objector requested a case be stated to the High Court.

Decision

As to the first issue of whether any part of the sum received by the Objector was assessable income, his Honour Justice Doogue held that it was. The Objector was forced by the liquidation of his former employer to seek other means of recovering the debt arising from the Employment Court judgment. These steps included the taking of proceedings against the employer's shareholders and directors. At the time of settlement the Objector claimed he was owed over $130,000 by the former employer. There was no evidence before the Court that this enlarged amount was in any way due to claims other than the settlement of the employment dispute.

His Honour held that authorities such as *Marac, Buckley & Young, Smythe, Reid and NZ Forest Research Institute* did not assist the Objector.

The essence of such decisions was that the true nature of the transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and not on the broad substance of the transaction. His Honour found that the Deed of Settlement itself was fatal to the Objector's claim as it specifically apportioned all but $1 of the settlement sum to the assignment of the employment-related claim.

"If the Deed had been silent about the consideration for the assignment of the company claim, the position of the Objector would undoubtedly be strong under this head, but when the deed is specific as to the consideration for the assignment ... the position is otherwise. The Court cannot go behind the Objector's own document and state that the deed was in consideration of the settlement of proceedings against the directors and shareholders of the company when all but one dollar of the consideration was applied to the assignment of the company claim."

The Objector also challenged the apportionment by the Commissioner of $50,000 of the settlement sum as monetary remuneration. He cited the Australian authorities of *McLaurin v FCT and Allsop v FCT*; both decisions of the Full Court of the High Court of Australia. His Honour distinguished both cases on the basis that, although settlement sums were arrived at with reference to calculations of the payer as to constituent losses, the final settlements were lump sums accepted in full satisfaction of the entirety of the appellant's claims.

In the Objector's case, there was no evidence to suggest there was any claim for unliquidated damages against the company. All but one dollar of the sum received was referable to 'all claims' against the employer. There was no evidence before the Court of any other possible claim the Objector was able to bring against the employer. As such, the sum received represented liquidated damages claims against the company at that time. The Court held that the Commissioner's apportionment of that sum into assessable and non-assessable components was consistent with the proportioning of the original judgment amounts.

Fringe Benefit Tax - whether company vehicle was available for private use

Case:	Yes Accounting Services Limited v CIR
Decision date:	17 June 1999
Act:	Income Tax Act 1976
Keywords:	Meaning of availability, Fringe benefit

Summary

The High Court confirmed the decision of the Taxation Review Authority which found in favour of the Objector regarding the availability of a motor vehicle for the private use and enjoyment of shareholder employees.

Facts

The Objector is a private company which provides accountancy services. The sole shareholders and directors are a husband and wife. The Objector owns a Ford Fairmont motor vehicle, which was used exclusively for the purposes of the company at all relevant times. A logbook maintained by the company verified sole business use. The husband and wife personally owned another vehicle, which they used for their private purposes.

The wife, acting as secretary for the company wrote a letter to her husband sometime in 1991, but backdated it to 21 November 1989, stating to him that the Ford Fairmont is not available for private purpose in order to ensure that FBT is not payable.

In the Taxation Review Authority, Judge Willy found that from the outset the company policy was that the Fairmont would not be used for private purposes. His Honour was also satisfied that it never had been so used. Therefore, the decision was that the vehicle can not be available for private use if the company policy forbids that use and providing it is not in fact used for private purposes.

Decision

Justice Anderson found in favour of the Objector stating that he was satisfied that there was an adequate evidential basis for the TRA to find that, regardless of the backdating of the restriction letter, from the outset the company policy was that the

vehicle would not be used for private purposes and the company and the husband and wife (as employees) fully appreciated and respected the policy.

His Honour made some useful obiter comments that could be of assistance to the Commissioner in future cases. His Honour stated that it would have been preferable if the directors of the company had, in that capacity, passed a directors' resolution from the beginning and if the husband and wife, in their capacity as employees, had in writing acknowledged and agreed to be bound by that direction. In this case, however, there is no suggestion other of than a bona fide treatment of the vehicle by the husband and wife in their various capacities.

His Honour also stated that he found compelling the Objector's submission that the word "so" in sub clause (b) of section 336N(1) invests "availability" with connotations of permission by the proprietor of the motor vehicle i.e. lawful availability. In Anderson J's opinion it is untenable that a person could be liable for FBT because the circumstances would not prevent the tortious or criminal conversion of a motor vehicle by a dishonest employee.

His Honour also stated that the meaning of "availability" is affected by its legislative context which in this case is the whole of the definition of "fringe benefit".

At page 7 of the decision His Honour stated:

> ""Availability" for the purposes of assessment of fringe benefit tax connotes a situation which the owner, lessor, or hirer of a motor vehicle has permitted. In any particular case whether such a situation exists will depend on the particular facts which may include the reality of a situation whatever the purported documentation might be."

Disposal of proceedings; Disputant's claim struck out

Case:	TRA Number 97/86. Decision Number 012/99
Decision date:	18 June 1999
Act:	Income Tax Act 1976

Facts

The Disputant is a film production company. The Commissioner issued a NOPA in 1997 following a full review of the Disputant's Income Tax, GST and FBT affairs. Substantial adjustments were proposed for the Disputant's 1991 - 1993 income tax returns and GST periods from 1992 - 1997. FBT adjustments were proposed for quarters from 1993-1996. Some of the adjustments were agreed to by the Disputant in March 1997. The issues were: expenditure disallowed, disputed revaluations, depreciation disallowed and/or overclaimed, income not returned, penalties non-deductible, GST output tax understated and input tax overstated, and FBT on a motor vehicle and an overdrawn shareholder's current account. Total tax in dispute exceeded $580,000.

Decision

The case came on for hearing on 20 July 1998. The Disputant advised the Authority by letter that it would not participate in, nor be represented at the hearing. The Commissioner sought an order dismissing the challenge and Judge Willy reserved his decision.

Judge Willy stated in a brief judgment:

> "Because the procedure used in this case was not that of the usual case stated, I reserved the question of the appropriate way of disposing of the proceeding.
>
> In the circumstances I consider that the proper order is to strike out the objector's statement of claim and to affirm the Commissioner [sic] assessments of 27 March 1997."

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.

Late Filing Penalty

Introduction

This Standard Practice Statement states the Commissioner's practice on the charging of late filing penalties in instances where returns or Employer Monthly Schedules have not been filed by the due date.

The passing of the Tax Administration Amendment Act (No 2) 1996 provided for a new penalty regime, including a penalty for late filing of certain return types. Prior to this, avenues available for pursuing overdue returns were restricted to the issue of default assessments and prosecution for failure to furnish in selected cases. The late filing penalty provisions were enacted by Parliament to provide an incentive for taxpayers to voluntarily comply with their filing obligations.

Application

This Standard Practice Statement applies from 1 August 1999.

Legislation

Under section 139A of the Tax Administration Act 1994 (TAA), the late filing penalty applies to:

- Income tax returns for the 1997/1998 and subsequent years,
- ACC premium statements and PAYE reconciliation statements for 1997/1998 and subsequent years,
- ACC residual claims levy statements from the 1998/1999 year, and
- Employer Monthly Schedules from 1 April 1999.

With the exception of Employer Monthly Schedules, the Commissioner must give at least 30 days notice before charging a late filing penalty. The Commissioner may do this by written notice, or by public notification. If the outstanding return is filed within the 30-day period, (or an extension of time is granted to file an income tax return), the penalty will not be charged.

The Amount of the late filing penalty is prescribed in Section 139A (3), as follows:

1. *Income tax returns:*

Amount of Net Income	*Late Filing Penalty*
Less than $100,000	$50
From $100,000 to $1,000,000	$250
Greater than $1,000,000	$500

2. *ACC premium statements, PAYE and ACC earner premium reconciliation statements, ACC residual claims levy statements and Employer Monthly Schedules:*

The late filing penalty is $250 per statement or schedule.

Commissioner's practice for charging the late filing penalty

The Commissioner's practice is that the late filing penalty is charged on the following:

- income tax returns for individuals (IR 3 and IR 5)
- income tax returns for companies (IR 4),
- PAYE and ACC earner premium reconciliation statements (IR 68P)
- ACC employer premium statements and ACC residual claims levy statements (IR 68A), and
- Employer Monthly Schedules (IR 348 and IR 349).

The late filing penalty will be charged in the following circumstances:

1. *Income tax returns* When 30 days notice of imposition of the penalty has been given and:

   a) The return is not filed by the due date, and is not subject to an extension of time arrangement (EOT).

   b) The return is subject to an individual extension of time arrangement, and is not filed by the date agreed to when the EOT was granted.

   c) A client is removed from the A list of an agent, resulting in the loss of EOT for the return, and the return is not filed by the date specified when the extension of time was withdrawn.

d) An extension of time arrangement is withdrawn from a client of an agent, and the return is not filed by the date specified when the extension of time was withdrawn.

e) An extension of time arrangement is withdrawn from all clients of an agent, and the returns are not filed by the date specified when the extension of time was withdrawn.

f) The return is for a client of an agent with EOT and is not filed by the 31st of March of the year immediately following the income year to which the return applies.

The amount of the penalty for outstanding income tax returns is determined from the taxpayer's previous year's net income.

If Inland Revenue has no information on which to base the late filing penalty, the minimum penalty of $50 is charged, and when the return is received the amount of penalty is checked and amended if necessary. If the original late filing penalty is reversed and an amended one charged, time will be given to pay any additional penalty. The minimum penalty remains payable if the return is subsequently filed and shows a loss.

2. *PAYE and ACC earner premium reconciliation statements, ACC employer premium statements and ACC residual claims levy statements* When 30 days notice of imposition of the penalty has been given and:

a) The reconciliation or statement has not been filed by 31 May of the year to which the statement relates, or

b) The employer has ceased employing and the reconciliation or statement has not been filed by the date required.

3. *Employer Monthly Schedules*

When the schedule has not been filed by the due date.

Commissioner's practice for reversal or remission of the penalty

The Commissioner's practice is that the late filing penalty may be **reversed** if:

- The return was filed before the date the late filing penalty was charged, but had not been 'lodged' by Inland Revenue, or
- The tax return or Employer Monthly Schedule was not required to be filed, or
- The taxpayer was a client of an agent with EOT and the link had not been updated because of error or delay by Inland Revenue, or
- The taxpayer is a client of an agent, had previously been denied an EOT because of outstanding returns, and the outstanding returns were filed by the due date for the current year and the taxpayer is subsequently granted EOT for the current year, or
- Although registered as an employer, the tax-payer did not pay any salary or wages, (applies to Employer Monthly Schedules, PAYE and ACC earner premium reconciliation statements (IR68P) and ACC statements (IR68A)).

The Commissioner's practice is that the late filing penalty may be **remitted** if the legislative criteria of either (a) reasonable cause or, (b) highest net revenue over time, are met. (Sections 183A and 183D of the TAA). Remissions under these sections are covered in Standard Practice Statement RDC-2.

The Commissioner's practice is that the late filing penalty will not be remitted if:

- The taxpayer has EOT as a client of an agent, but the agent had not notified us before the late filing penalty was charged.
- The taxpayer gains EOT as a client of an agent, or gains an individual extension oftime arrangement, after the late filing penalty is charged.

Summary

In summary the practice for the late filing penalty is as follows:

- The Commissioner will give 30 days notice of the intention to impose the late filing penalty for outstanding income tax returns, PAYE and ACC earner premium reconciliation statements, ACC premium statements and ACC residual claims levy statements.
- The late filing penalty will be charged on identified outstanding IR 3, IR 4, and IR 5 income tax returns, the PAYE and ACC earner premium reconciliation statements (IR 68P), ACC premium statements and ACC residual claims levy statements (IR 68A), and Employer Monthly Schedules (IR 348 and IR 349).
- The amount of the late filing penalty is prescribed in Section 139A (3) of the Tax Administration Act 1994
- The penalty can only be remitted if the legislative criteria of reasonable cause or highest net revenue over time are met. (Sections 183A and 183D of the Tax Administration Act 1994)

This Standard Practice Statement was signed by me on 18 June 1999.

Michael Rapson
Manager, Technical Standards

Disputes Resolution - Content standards for Notice of Proposed Adjustment and Notice of Response

Introduction

This Standard Practice Statement sets out the Commissioner's practice applied to the content standards for Notices of Proposed Adjustment and Notices of Response

Application

This Standard Practice Statement applies from 1 August 1999.

Background

The Disputes Resolution rules introduced an open, "all cards on the table" approach to tax disputes, with the aim of resolving tax disputes fairly, quickly and efficiently. The process requires the exchange of certain information between the Commissioner and a taxpayer, and begins when one party issues a Notice of Proposed Adjustment ("NOPA") to the other. If the recipient of the NOPA disagrees with the proposed adjustment, that party must reject any or all of the proposed adjustments within a two month response period by issuing a Notice of Response ("NOR"). If a NOR is not issued within that timeframe and there are no exceptional circumstances as defined in the Tax Administration Act 1994 the NOPA recipient is deemed to have accepted the proposed adjustments in the NOPA.

There has been some confusion about what information must be in the NOPA and NOR. This has lead to claims that a NOPA or NOR was invalid because of alleged information shortcomings, and on occasion resulted in the deemed acceptance of proposed adjustments because the response period expired before alleged deficiencies could be made good. This is a critical outcome for a taxpayer; deemed acceptance finalises the dispute and the taxpayer no longer has the right to challenge the Commissioner before the Courts.

The Commissioner does not consider deemed acceptance in these circumstances appropriate or in keeping with the stated aims of the disputes resolution rules. To remove some of the misconceptions and help taxpayers who wish to dispute assessments or proposed adjustments, this standard practice statement sets out the relevant tax laws, the Commissioner's practice on applying those laws, and associated practical issues.

Legislation

All legislative references are to the Tax Administration Act 1994 ("the Act").

Section 89F gives a list of content headings for a NOPA, and section 89G(2) gives a similar list for a NOR. Both sections incorporate a standard which governs the content headings and acts as a guide to the amount and quality of the information required. These are guidelines, so they are flexible and permit NOPA and NOR to have a wide variance in content, style and detail, with the result that the amount and quality of information they contain can vary considerably and still comply with the law.

When information provided under the content headings is full and complete (i.e. of a high quality) problems and misunderstandings are unlikely to arise. They are more likely to occur when information content is minimal or of a lesser quality.

From 1 April 1999, the tax laws which govern the content of a NOPA and a NOR are as follows:

NOPA

89F A notice of proposed adjustment must be in the prescribed form and contain, with sufficient detail to reasonably inform the recipient, -

(a) The items in a disputable decision or a tax return that the issuer of the notice proposes should be adjusted; and

(b) The tax laws on which the adjustments are based; and

(c) An outline of the facts giving rise to the adjustments; and

(d) The legal issues arising in respect of the adjustments; and

(e) The propositions of law relied on or distinguished in respect of the adjustments.

NOR

89G(2) A response notice must, with sufficient detail to reasonably inform the recipient,-

(a) Specify the items in the notice of proposed adjustment that the issuer of the response notice considers to be in error; and

(b) Specify the tax laws on which the issuer of the response notice relies; and

(c) Outline the facts contained in the notice of proposed adjustment that the issuer of the response notice considers to be in error; and

(d) Outline any further facts on which the issuer of the response notice relies; and

(e) Outline any additional legal issues that the issuer of the response notice considers arise in respect of the notice of proposed adjustment; and

(f) State the propositions of law relied upon in respect of the response notice.

Commissioner's Approach

The standard for NOPA content is defined by the wording "must ... contain, with sufficient detail to reasonably inform the recipient" which precedes and governs the required content list. The same standard, only this time without the word "contain", precedes and governs the required content list for the NOR.

Essentially, each standard requires a NOPA or NOR issuer to provide enough factual and relevant details for the recipient of the notice to understand why a tax adjustment or determination is proposed or rejected. Case law when applied to the words "sufficient detail to reasonably inform" indicates that the circumstances and background to a dispute must be taken into account. These include any information already available or known to the recipient of a NOPA or NOR.

Previously it was suggested that NOPA and NOR content should have enough detail to inform a reader who lacked prior knowledge of the disputed issue. This viewpoint overlooked an important factor in the disputes resolution process, i.e. that the Commissioner and a specific taxpayer (whether or not through a tax agent or legal advisor) are always the issuer and recipient of a NOPA and a NOR. (Which party is the issuer and which is the recipient depends on who began the process.) In most instances, before this there will have been some form of interaction between the two; e.g. the taxpayer will have issued a NOPA following receipt of the Commissioner's assessment of a return filed by the taxpayer, or a determination such as tax residency status. If the Commissioner has issued the NOPA, this is likely to have followed a GST audit, income tax or other investigation involving the taxpayer.

However the dispute started any earlier interaction between Commissioner and taxpayer would be evidence that both parties had entered the disputes resolution process with an awareness of the issues in dispute. These and other circumstances, including whether the taxpayer is represented by a tax agent or legal advisor, should be considered when the standards of sections 89F and 89G(2) are applied to the content of NOPA and NOR.

The Commissioner believes he has a statutory obligation to inform taxpayers fully which goes beyond that required by sections 89F and 89G(2). In keeping with that wider obligation, Inland Revenue will always attempt to issue NOPA and NOR which are complete, fully detailed and of a high standard. A frank and complete exchange of information by both parties is implicit in the spirit and intent of the disputes resolution process. Inland Revenue therefore expects that taxpayers, their tax agents and legal advisors, will to the best of their ability also issue complete and fully detailed NOPA and NOR.

The disputes resolution process was neither intended nor designed to be unduly difficult or costly for taxpayers who want to dispute a tax matter. However, the reality is that some taxpayers may struggle with the requirements, particularly if they do not have professional assistance. While Inland Revenue encourages taxpayers to issue NOPA and NOR with a high standard of information content, it would be unrealistic to expect this in every instance.

The issuer of a NOPA or a NOR is not bound by or restricted to the content of that notice. However, it must contain sufficient relevant information to satisfy the legislative requirement that it "reasonably inform" the intended recipient. Although Inland Revenue prefers and encourages a high standard of NOPA and NOR content, mere brevity and lack of precision do not nullify a notice which directs the attention of the recipient to the necessary information. The following examples show how this can be achieved:

Content standard for taxpayer-generated NOPA

From 1 April 1999 section 89F requires taxpayers (including tax agents and legal advisors) to use an IR 210 Cover Sheet when issuing a NOPA. Inland Revenue recommends using the full IR 210 to complete the NOPA, as this form covers each of the content headings listed in section 89F. Using the full form is optional; taxpayers may instead complete the NOPA by way of a letter or typewritten sheets attached to the IR 210 cover sheet.

Whichever option is used the NOPA should include all available relevant information In keeping with the aim and spirit of the disputes resolution process, this should be as complete and detailed as is possible. Following the format of the IR 210 form by listing each content heading and responding to each in turn will ensure that nothing is omitted.

Some examples of how to inform the Commissioner and satisfy the requirements of tax law follow. Note that the examples are not exclusive and that other possibilities exist:

(a) *The items in a disputable decision or a tax return that the issuer of the notice proposes should be adjusted*

Inland Revenue needs to know the type and amount of each proposed adjustment as well as the tax return period involved. Reference should be as specific as possible e.g. "Increase 1998 travel expenditure by $1,500 to $4,365"; "1999 Repairs and Maintenance understated by $3,615"; or "Outputs overstated by $5,000 June/July 1998". Directing Inland Revenue to an earlier letter which clearly sets out information about the type and

amount of proposed adjustment is also acceptable, e.g. "Determination of Loss (date)"; or "See my/your letter (date)".

(b) The tax laws on which the adjustments are based

Wherever possible, identify the particular tax laws relating to the proposed adjustment. A taxpayer who does not have access to a copy of the tax laws through a tax agent, legal advisor, Citizens Advice Bureau, or local library etc. can ask Inland Revenue for help. Should our help be sought, then subject to the information supplied by the taxpayer, Inland Revenue may suggest certain tax laws could apply and will provide a photocopy of these. Any decision about application and use of a particular tax law in the context of their NOPA or NOR remains with the taxpayer.

However, a general reference such as "The Income Tax Act" or "The Goods and Services Tax Act" is also acceptable if it is clear from the type of proposed adjustment and overall content of the NOPA that certain tax laws will be involved, e.g. a dispute involving depreciation in year of sale (1998) must involve section EG 1(2) of the Income Tax Act 1994. In some instances, reference to the content of a disputed income tax or GST return may also direct the Commissioner's attention to the relevant tax laws.

(c) An outline of the facts giving rise to the adjustments

In practice most taxpayers tend to provide more rather than less information under this heading. Inland Revenue encourages and prefers this approach, as it helps us to understand the taxpayer's point of view and ensures that we have the correct facts. The law requires an "outline" i.e. a description omitting details. This can be in the form of a brief statement e.g. "The four wheel drive was purchased for use only in my plumbing business" or "I am able to claim 100% depreciation and expenses because the mower was bought for the factory lawns". When the adjustment item has been discussed in previous correspondence, reference to this by date(s) or a statement such as "For the reasons previously given, the Commissioner was wrong in fact and in law to treat profit from the sale of 24 Red Dwarf Drive, Galaxy, as 1998 taxable income" is also acceptable.

(d) The legal issues arising in respect of the adjustments

These are the questions to be decided and answered about the matters in dispute. There may only be one legal issue in a dispute or there may be several. The questions can take any form, and be simply put, e.g. "Am I able to claim 100% of expenses and depreciation for the four wheel drive?" Also acceptable is a statement such as "Tax law allows me to claim 100% of four wheel drive expenses and depreciation".

Often, the information provided under headings (a), (b) and (c) will indicate what the legal issues are.

(e) The propositions of law relied on or distinguished in respect of the adjustments

Under this heading, statements are made about how the law supports the proposed adjustments in the particular situation. The statements have more value when made not merely as a statement of opinion, but supported by reasoning and authority such as tax laws or case law i.e. Court decisions about how the law should be applied. Although other authorities can be used to illustrate support or acceptance for the taxpayer's view, e.g. IRD rulings, TIB articles, etc. they carry less weight. "Distinguished" means showing why a particular tax law or Court decision which would usually apply, does not in these particular circumstances. Within the disputes resolution process a proposition of law includes any or all of the following:

- reference to tax laws, e.g. "Section DH 1(2) of the Income Tax Act 1994 allows 100% expenditure and depreciation deduction for business vehicles", "Section BD 2(1)(b)(ii) of the Income Tax Act 1994 applies", or "See tax laws"
- case law (Court decisions) e.g. "Case N8 (1991) 13 NZTC 3,052"
- publications, e.g. "TIB Volume Nine, No.8 at page 12"
- IRD rulings, public or policy statements, etc.
- a simple statement e.g. "The four wheel drive is a business vehicle, and its repairs and maintenance costs are deductible"

Inland Revenue encourages taxpayers to identify and include relevant propositions of law in their NOPA, although we realise that this may not always be possible. If no specific propositions of law are included, we will treat the tax laws referred to in the NOPA as being the propositions of law on which the taxpayer has relied.

Content standard for taxpayer-generated NOR

Preparing a NOR involves more precise attention to information detail than preparing a NOPA. Inland Revenue recommends using an IR 210A when preparing a NOR, to ensure that each content heading listed in section 89G(2) is considered. Use of this form is optional; taxpayers may complete a NOR by way of a letter or typewritten sheets. Whichever option is used, all available relevant information should be included in the NOR. In keeping with the aim and spirit of the disputes resolution process, this should be as complete and detailed as is possible. Following the format of the IR 210A by listing each content heading and responding to each in turn will ensure that nothing is omitted.

Some examples of how to provide sufficient information to inform the Commissioner and comply with tax law follow. Note that the examples are not exclusive and other possibilities exist:

(a) Specify the items in the notice of proposed adjustment that the issuer of the response notice considers to be in error

Although it can be helpful to do so, a NOR issuer is not required to say why an item is in error (disputed) under this heading. The information supplied elsewhere in the NOR should explain why the item is disputed.

The word "specify" in the heading means each disputed item must be identified. There are several ways of doing this. If the taxpayer disagrees with all the proposed adjustments in the NOPA, a statement such as "The proposed adjustments are wrong" will make this clear. If one or more of a number of proposed adjustments are disagreed with, each must be identified, e.g. "Items a, c, e, and f are wrong", or "Proposed adjustment amounts of $6,259.00, $3,400.00 and $1,321.00 are incorrect".

When the disagreed adjustments include several which can be combined together under a recognisable description, (e.g. adjustments which obviously all relate to vehicle repairs and maintenance) a statement such as "Repairs and maintenance items totalling $5,690.00" with separate identification of the other disputed adjustments is acceptable.

(b) Specify the tax laws on which the issuer of the response notice relies

The word "specify" again requires the NOR issuer to identify the tax laws relied on. Frequently these will be the same tax laws as the Commissioner has relied on in his NOPA, although the two parties disagree about how they should apply in the particular circumstances. When this occurs, a reference to the NOPA with a comment such as "See NOPA" or "As stated by the Commissioner" is sufficient.

A NOR issuer may consider tax laws other than those quoted in the Commissioner's NOPA apply. In this situation the Commissioner must be given at least the relevant Parts of the Act, section references, or enough information under this heading or elsewhere in the NOR for him to be able to identify the tax laws the issuer has relied on.

(c) Outline the facts contained in the notice of proposed adjustment that the issuer of the response notice considers to be in error

The NOR issuer is not required to say under this heading why any fact may be in error (although this would be helpful) merely to identify those which are. The information supplied under the next heading (d) should explain why a NOPA fact is disputed.

Only an outline is needed; directing the Commissioner's attention to the relevant paragraph, page number, or any other recognisable feature is one way to indicate which facts are in error. If none of the facts in the NOPA are in error, writing "Facts agreed" makes this clear, and is preferable to leaving that section of the IR 210A NOR blank.

(d) Outline any further facts on which the issuer of the response notice relies

The NOR issuer should show here any facts to be considered which were not included in the NOPA. The Commissioner needs to know why any NOPA fact is disputed. He also needs to be told about facts he has overlooked or did not know when the NOPA was prepared, as additional information or new information may be all that is needed to resolve the dispute. As in the NOPA examples, this can take several forms, including a brief statement; e.g. "The four wheel drive was used only in my plumbing business. I have two other cars available for private use". Reference to correspondence in which the additional facts were discussed, or interviews and meetings where proceedings were tape-recorded and/or a subsequent transcript agreed, would also be adequate. (Dates should be given in each instance.)

If facts were correctly stated in the NOPA and there are no additional facts to be taken into account, no entry is needed under this heading. However writing "none" or "not applicable" clarifies this to the Commissioner.

(e) Outline any additional legal issues that the issuer of the response notice considers arise in respect of the notice of proposed adjustment

As with a NOPA, these are the questions that need to be answered about the matters in dispute. A NOR issuer may consider there are legal issues over and above those in the NOPA as a result of additional facts not considered by the Commissioner, or the application of tax laws on which the Commissioner has not relied.

Because only an outline is required, the information provided about additional facts and tax laws can make the Commissioner aware of further legal issues. If a question is asked or a statement made in everyday language e.g. "Am I allowed a deduction under section BD 2(1)(b) for factory floor repairs? or "Can I claim the cost of driveway repairs as home office expenses?" it will alert the Commissioner to any additional legal issues.

(f) State the propositions of law relied upon in respect of the response notice

As with a NOPA, a simple statement or reference to tax laws, Court decisions, publications or IRD rulings and statements that the taxpayer considers support rejection of the proposed adjustments is required. If the taxpayer relies on the Commissioner's propositions of law, statements such as "See NOPA" or "Refer Commissioner's propositions of law" clarify this.

If this section of the IR 210A is left blank, any reference in the NOR to tax laws will be treated as a reference to the propositions of law on which the taxpayer is relying.

General

The examples give some guidance on the nature and quantity of information to include in a NOPA or NOR for it to comply with the standards required by the law. They are not exclusive; other possibilities exist and at all times regard must be had for the circumstances surrounding the dispute. Inland Revenue recommends that where possible, taxpayers seek professional guidance with the preparation of these notices.

As demonstrated by the examples Inland Revenue intends to apply as broad an interpretation to the content of taxpayer-generated NOPA and NOR as the standards permit. Where necessary, we will ask taxpayers to clarify or expand aspects of their notice by providing additional information. Inland Revenue considers that this approach has a basis in case law and is consistent with the aims of the disputes resolution rules.

Similarly, when the response period remaining permits we will ask taxpayers to provide any information needed to bring their document to the relevant minimum content standard. In this situation, the information must be written and issued to Inland Revenue prior to the end of the notice response period, otherwise the taxpayer will not have issued a NOPA or a NOR. To avoid the possibility of taxpayers finding they have run out of time before essential information can be provided, we recommend the issue of NOPA and NOR earlier rather than later in the response period.

Only in the exceptional circumstances defined in section 89K(3) can the Commissioner accept a late notice as having been given within the response period.

Note that the requirements for the third document of the disputes resolution process - the statement of position (SOP) described in section 89M - are much more formal and restrictive than those of section 89F for the NOPA and section 89G(2) for the NOR. Where Inland Revenue has issued a Disclosure Notice, and the outcome of the process is unfavourable to the taxpayer who challenges the Commissioner's position before the Courts, both taxpayer and Commissioner will be limited by section 138G(1) to the contents of their respective SOP. Only in very unusual circumstances will the Courts allow the introduction of additional evidence, issues, or propositions of law not previously contained in the SOP.

When Commissioner and taxpayer have exchanged and rejected NOPA and NOR, and it seems likely the dispute will proceed to adjudication (the final stage of the disputes resolution process) Inland Revenue strongly urges taxpayers to seek professional assistance before attempting to prepare an SOP.

This Standard Practice Statement was signed by me on 12 June 1999.

Michael Rapson
Manager, *Technical Standards*

Due dates reminder

August 1999

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

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

Second 2000 instalment due for taxpayers with December balance dates.

Third 1999 instalment due for taxpayers with August balance dates.

1999 income tax returns due to be filed for all non-IR 5 taxpayers with April balance dates.

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

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

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

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

RWT on dividends deducted during July 1999 due.

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

31 GST return and payment for period ended 31 July 1999 due.

September 1999

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

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

Second 2000 instalment due for taxpayers with January balance dates.

Third 1999 instalment due for taxpayers with September balance dates.

1999 end of year payments due (income tax, Student Loans, ACC premiums) for taxpayers with October balance dates.

1999 income tax returns due to be filed for all non-IR 5 taxpayers with May balance dates.

QCET payment due for companies with October balance dates, if election is to be effective from the 2000 year.

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

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

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

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

RWT on dividends deducted during August 1999 due.

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

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

Non-resident Student Loan repayments - second 2000 instalment due.

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

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

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

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

Name ______________________________

Address ______________________________

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√	*Interpretation statements*	*Comment Deadline*
☐	**IS2215** Patents – income tax treatment	31 August 1999

√	*Standard practice statements*	*Comment Deadline*
☐	**ED0005** Taxpayer amendments to tax returns	31 August 1999
☐	**ED0006** Section 17 notices	31 August 1999

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

No envelope needed - simply fold, tape shut, stamp and post.

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WELLINGTON

IR 596

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