

TAX INFORMATION BULLETIN

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Inland Revenue
Te Tari Taake

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This Tax Information Bulletin is also available on the Internet, in two different formats:

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- This is the better format if you want to read the TIB on-screen (single column layout).
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- Individual TIB articles will print satisfactorily, but this is not the better format if you want to print out a whole TIB.
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Online TIB articles appear on our website as soon as they're finalised – even before the whole TIB for the month is finalised at mid-month. This means you can read the first of any month's TIB articles on our website in the last two weeks of the previous month.

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- This is the better format if you want to print out the whole TIB to use as a paper copy – the printout looks the same as this paper version.
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The printable TIB appears on our website at mid-month, at the same time as we send the paper copy to the printers. This means you can get a printable TIB from our website about two weeks before we can post you a paper copy.

Where to find us

Our website is at <http://www.ird.govt.nz>

It also includes other Inland Revenue information which you may find useful, including any draft binding rulings and interpretation statements that are available, and many of our information booklets.

If you find that you prefer the TIB from our website and no longer need a paper copy, please let us know so we can take you off our mailing list. You can e-mail us from our website.

THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

Inland Revenue produces a number of statements/rulings aimed at explaining how taxation law affects taxpayers and their agents.

Because we are keen to produce items that accurately and fairly reflect taxation legislation, and are useful in practical situations, your input into the process – as perhaps a “user” of that legislation – is highly valued.

The following draft items are available for review/comment this month, having a deadline of 29 February 2000. These are mostly the same items that we advertised in last month's TIB, but due to the high level of interest already shown and the additional time for comment, you may wish to obtain a copy. Please see page 17 for details on how to obtain a copy:

Ref.	Draft type	Description
ED0011	Standard Practice Statement	Tape recording Inland Revenue interviews. The draft Standard Practice Statement looks at the rules to be followed when Inland Revenue conducts an interview using audio recording equipment, rather than handwritten notes.
IS2228	Interpretation statement	Transferable term fishing quota – acquisition and conversion. The item considers whether the cost of acquiring a transferable term fishing quota (TTQ) is deductible and if it is depreciable property as defined in the Income Tax Act 1976. It further considers issues arising when a TTQ is converted to an individual term quota.
PU0066	Public ruling	Bad debts – writing off debts as bad for GST and income tax purposes. The draft ruling is essentially the same as public ruling 96/3A, but has an application period from 1 April 1999 to 31 March 2004. It looks at when a debt is considered bad, and what is required to write off a debt as bad.
PU3019	Public ruling	“Cost price of the motor vehicle” – meaning of the term for fringe benefit tax purposes. The draft ruling considers what should be included under the term “cost price of the motor vehicle”, where an employer who owns a vehicle makes provision of the vehicle to an employee for that employee's private use and enjoyment.

BINDING RULINGS

This section of the TIB contains binding rulings that the Commissioner of Inland Revenue has issued recently.

The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates tax liability based on it.

For full details of how binding rulings work, see our information booklet "Binding Rulings" (IR 115G) or the article on page 1 of TIB Volume Six, No.12 (May 1995) or Volume Seven, No.2 (August 1995). You can order these publications free of charge from any Inland Revenue office.

PRODUCT RULING – BR PRD 00/01

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Colonial Services (NZ) Limited.

Taxation Laws

This Ruling applies in respect of the following sections of the Income Tax Act 1994 and the Goods and Services Tax Act 1985:

- Income Tax Act 1994, sections BD 1, BD 2, EH 1-EH 10, HH 1(8), HH 3 to HH 8 and the definitions of "unit trust", "beneficiary income", "trustee income", "core acquisition price", "financial arrangement" and "unit holders" in section OB 1.
- Goods and Services Tax Act 1985, sections 3, 14 and 55(7) and the definition of "insurance" in section 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the establishment, administration and carrying on of Colonial Select Investor Service ("the Service") by Colonial Services (NZ) Limited ("CSNZL"). CSNZL is the agent of Investors in the Service and the Manager of the Service. Further details of the Arrangement are set out in the paragraphs below.

1. CSNZL launched the Service [previously known as "Navigator Select Investor Service"] during August 1998, and for that purpose obtained Product Ruling BR Prd 98/71. This Ruling replaces BR Prd 98/71 which is withdrawn.

2. The Service provides access for Investors to a range of investment products and fund managers with all reporting consolidated.
3. The Administrator of the Service is Jacques Martin New Zealand Limited ("JMNZL"). This Ruling applies only to those activities of the Administrator that are carried on in relation to the Service and are described in this Arrangement.
4. The Custodian and bare trustee of the Service, and the Nominee of the Investors, is the Public Trustee acting at all times through its nominee and wholly owned subsidiary, Navigator Nominees Limited ("NNL"), who may also act as the trustee of any superannuation scheme made available through the Service.
5. Investors are able to switch between investment options and make lump sum or regular contributions and withdrawals.
6. Investors are offered the choice of investing in:
 - (i) unit trusts (New Zealand, Australian and elsewhere);
 - (ii) group investment funds ("GIFs"); and
 - (iii) UK Investment Trusts.
7. Possibly in the future a master superannuation fund would be added. The superannuation fund will in turn offer a choice of investment in wholesale superannuation funds, GIFs and unit trusts. In addition, Investors may be offered the facility to invest in "direct" investment securities on a case by case basis including: participatory securities, interest bearing securities, and shares other than unit trusts, group investment funds and Investment Trusts.

8. The Manager will approve the various unit trusts, GIFs and the Investment Trusts selected by Jarden Morgan Investment Services Limited from time to time based on performance. Investors will be entitled to select their own “direct” investments if that option is offered to the Investors.
9. In addition to the various investment options, Investors may also elect to include supplementary insurance benefits such as life cover, total and permanent disablement, trauma cover and income cover.
10. Investors in the Service may be supplied with both life and non-life insurance cover through the Service.
11. Investors come to CSNZL to use the Service through their financial advisers. The Manager, the Administrator and the Custodian of the Service act only as directed by Investors and do not give any investment advice or make any investment decisions under delegated authority from the Investors. Jarden Morgan Investment Services Limited under contract to CSNZL selects the product mix of the Service and makes the asset allocation decisions of the premixed selection options.
12. Reporting to Investors under the Service is purely to provide information to Investors on details of their investments and income from their investments as well as to deliver an annual statement for taxation purposes. The reports do not constitute what is regarded in the industry as “monitoring” nor do they contain investment advice.
13. The Investors’ agent and Manager of the Service is CSNZL. The Manager of the Service is appointed as the Investors’ agent pursuant to an investment authority given under the Investor Information Document (“the IID”) to instruct the Custodian to acquire, dispose of, and receive the income from investments on behalf of the Investor.
14. The Administrator is charged under the Administration Agreement primarily with making and withdrawing from investments on behalf of Investors as well as collecting and processing the cash flows that arise from them. As an adjunct to that activity it must carry out the consequential administration, reporting and record keeping activities that make up the Service.
15. Investors under the IID appoint the Custodian to act as bare trustee and nominee in subscribing for and holding investments in safe custody in its name on their behalf. Investors undertake to be bound by the terms of the Custodian Agreement, and authorise the Manager to delegate its powers (including those delegated to it by the Custodian) to the Administrator.
16. The Custodian also establishes a trust account under the Cash Holding Account Agreement to facilitate all the cash flows of the Service. The administration and management of that account is delegated to the Manager who in turn delegates it to the Administrator.
17. An Investor who wishes to use the Service will be handed an IID, which will:
 - (i) Background the structure of the Service.
 - (ii) Explain in general terms the operation of the pertinent Administration, Custodian, Delegation and Cash Holding Account Agreements (together with the IID described in this Ruling as “the Agreements”) by which the Service is implemented.
 - (iii) Contain detachable application forms and an Investment Authority by which Investors can identify their investment selections.
18. An Investor wishing to use the Service will then make application and execute an Investment Authority under which the Investor will:
 - (i) Provide a declaration pursuant to which Investors will: authorise the Manager and Custodian to act as their agent and bare trustee/nominee respectively, be bound by the Custodian Agreement, and consent to the delegation of services to the Administrator.
 - (ii) Confirm the Investor’s receipt of investment statements for each option selected.
19. Investors in products other than the superannuation fund first pay their moneys into a Cash Holding Account of the Custodian run by the Administrator who records and identifies by Investor all deposits, investments, income, withdrawals, expenses, and tax information. From this account the Administrator as delegate of the Manager disperses funds into Investors’ various investment options. Interest and dividend income as well as sale proceeds and further investment moneys are all received into the Cash Holding Account which acts as a general clearing account for all funds received from or to be disbursed to Investors. Investors are required to maintain a minimum credit balance in this account.
20. Investors in the superannuation scheme (if made available) will become direct members of the scheme, and their investment choices are activated as members of the scheme.
21. Investors expressly acknowledge receipt of an investment statement (and at their option a prospectus) where one has been issued from their financial adviser for each product that they select, including the superannuation scheme (if made available).

22. The relevant documentation is:
- (i) The Administration Agreement, being an agreement between the Manager and the Administrator.
 - (ii) The Custodian Agreement, being an agreement between the Manager and the Custodian.
 - (iii) The Cash Holding Account Agreement between the Custodian and the Manager.
 - (iv) The IID (and the Investment Authority given under the IID by the Investor) between the Manager, the Investor and the Investor's financial adviser.
 - (v) The Delegation Agreement between the Manager and the Custodian.
23. The Investor undertakes in the IID to be bound by the three other agreements relevant to the Investor.
24. Title to investments is held by the Custodian, and the Cash Holding Account is also in the name of the Custodian.
25. The Administrator will operate the Cash Holding Account, record and trace all investments made by individual Investors, and report to them at regular intervals on the value of their investments, the income derived and any tax deductions made.
26. The Administrator under the Administration Agreement provides a means of recording each Investor's interest in the underlying products.
27. The Custodian Agreement at paragraph 2.1(e) expressly describes the pooling as aggregation for "administrative convenience". The pooling is subject to the proviso that adequate tracing be maintained at all times.
28. Taking into account the effect of delegations, the essence of the Agreements can be summarised as follows:
- (i) The Manager provides the entire facility and arranges for investments to be made, changed, or sold by instructing the Custodian as the Investor's agent.
 - (ii) The Custodian holds title to the investments and the Cash Holding Account as bare trustee for each Investor.
 - (iii) The Administrator makes, changes or sells the investments, pays and collects the resulting cash flows and attends to all consequential administration, processing, record keeping and reporting requirements of the Service.
29. The services rendered in respect of each fee charged in relation to the Service are:
- (i) Investment/Contribution fee:
 - Processing applications by Investors.
 - Arranging the acquisition of investments.
 - Providing four switches per annum.
 - Providing documentation.
 - (ii) Administration fee:
 - Keeping records of Investors and their portfolios.
 - Investor level transaction recording and tracing.
 - Maintaining a computer system that delivers the service requirements.
 - Allocating and processing distributions for Investors.
 - Reporting to Investors and preparation of Investor tax statements.
 - Executing proxies and voting rights of the Custodian.
 - Reporting to the Custodian.
 - Maintaining Investors' Cash Holding Accounts.
 - Responding to Investor queries about the Service.
 - (iii) Custodian fee:
 - Use of the Custodian's name as security holder. (The tasks of subscribing, safe custody and withdrawing from the investments are delegated to the Administrator, leaving the Custodian merely lending his or her name as security holder for the investment.)
 - (iv) Switching fee:
 - Processing investment switches.
 - (v) Expense fee:
 - Printing and distributing Investor information documentation, investment statements and prospectuses, excluding establishment expenses of the Service.
 - Audit, accounting and legal compliance services, excluding establishment expenses of the Service.
 - (vi) Regular withdrawal fee:
 - Direct crediting money to accounts for singular/regular withdrawals.
 - (vii) Withdrawal fee:
 - Processing withdrawal applications.
 - (viii) Adviser service fee:

- Supplying financial planning and portfolio monitoring services.
- (ix) Fund manager fee:
- On-going charging for management (investment and administration) of GIFs or unit trusts (where charged to the Investor by the Fund Manager or trustee) for:
 - Annual management costs.
 - On-going monitoring of the investments.
 - Purchasing and selling investments.
 - Maintaining computer system to record investments.
 - Receiving and processing distributions.
 - Reporting to Investors.
 - Reporting to trustee.
 - Responding to customer queries.
 - Acting as trustee.
 - Use of the trustee/statutory supervisor's name as security holder. (The tasks of subscribing, safe custody and withdrawing from the investments are delegated to the Manager, leaving the trustee/statutory supervisor merely lending his or her name as security holder for the investment.)
 - Maintaining register of Investors.
 - Accounting and legal fees excluding establishment expenses of the fund.
 - Preparing and distributing cheques and statements.
 - Printing stationary.
 - Cost of holding investor meetings.
 - Any other miscellaneous cost incurred in managing the funds.
 - Issuing expenses.
- (x) Brokerage fee:
- Brokerage paid to broker to arrange entry into listed trusts.
 - Brokerage paid to broker to arrange exit from listed trusts.
- (xi) Insurance cover:
- The supply of life insurance cover.
 - The supply of non-life insurance cover.
30. The way in which each fee is calculated is set out in the Agreements. The rates and methods used to calculate such fees may be varied from time to time.
- However, any type of fee not described above, charged in the future, will not be subject to this Ruling.
31. The adviser service fee, the fund manager fee and the brokerage fee are not charged by the Manager, Custodian or the Administrator of the Service. Investors through the Service pay these fees for services supplied to them through the Service by their adviser, fund managers and brokers. This Ruling does not consider the goods and services tax treatment of the adviser services fee, the fund manager fee and the brokerage fee paid by Investors.
32. In respect of the fees charged by fund managers, a separate contribution fee is ordinarily charged for set up costs. Due to the size of the investment through the Service, the fund managers have waived this fee for Investors through the Service.
- ### Assumption made by the Commissioner
- This Ruling is made subject to the following assumption:
- a) The Investors are resident in New Zealand under section OE 1 or OE 2 of the Income Tax Act 1994.
- ### Conditions stipulated by the Commissioner
- This Ruling is made subject to the following conditions:
- a) The final form of the Agreements will not differ materially from the draft Agreements received by Adjudication & Rulings on 16 March 1999 and 23 June 1999.
- b) Where an Investor is under a legal disability, the Manager, Administrator and the Custodian will not have or exercise the receipt, control, or disposition of any income derived by that investor, but may act on the instructions of whomsoever the law gives the capacity to act on behalf of that Investor. No additional powers accrue to the Manager, Administrator or the Custodian because of a lack of capacity of an Investor beneficiary so as to change the nature of the bare trust relationship.
- c) Except for the non-life insurance cover supplied to Investors through the Service, the investments and facilities available through the Service are any debt security, equity security, participatory security, credit contract, contract of life insurance, superannuation scheme, or futures contract referred to in section 3(1)(ka) of the Goods and Services Tax Act 1985.
- d) The fees described in this Ruling are charged only for the services listed under each fee in the Arrangement.

- e) The fees charged by the Administrator to the Manager under the Administration Agreement will be negotiated on an arm's length basis.
- f) The Manager, Custodian and the Administrator undertake no services that, either directly or indirectly through the selection of the product mix of the Service, involve planning an Investor's portfolio or advising on an Investor's portfolio or making investment decisions or recommendations for an Investor.
- g) Colonial makes goods and services tax returns as a group under the provisions of section 55 of the Goods and Services Tax Act 1985.
- h) The only activities carried on by the Administrator in relation to the Service are as described in the Arrangement to this Ruling.
- i) The Manager will only disapprove investments in "direct" investment securities (if that option is offered to Investors) if, and only if, the purchase of a particular share or investment on behalf of the customer will, in the reasonable and bona fide view of the Manager:
- Result in excessive costs to the Manager due to administrative complexity; or
 - Be unlawful or contrary to the Manager's own interests; or
 - Expose the Manager to use its own funds with respect to uncalled or partly paid shares.
- j) Any fee that is charged in relation to the Service is on an arm's length, stand alone commercial basis so as only to reflect the relevant services listed and will not be directly or indirectly related to or affected by any other services or fees.
- and not the Manager, the Administrator or the Custodian.
- All the fees listed in the Arrangement that are paid by an Investor who is liable to be assessed pursuant to sections CD 3, CD 4, or CD 5 in respect of gross income received from investments through the Service, are deductible to that Investor under section BD 2, except to the extent that the fees (not being either contingent upon implementation of a "financial arrangement" or non-contingent upon implementation of a "financial arrangement" but exceeding 2% of the "core acquisition price" of a "financial arrangement" as those terms are defined in the qualified accrual rules) are incurred in gaining or producing exempt income or an amount that is excluded from being gross income.
 - The following fees are not deductible to an Investor who is not liable to be assessed pursuant to sections CD 3, CD 4, or CD 5 in respect of gross income received from investments through the Service:
 - The investment/contribution fee.
 - The withdrawal fee.
 - The brokerage fee.
 - The switching fee.
 - The adviser service fee to the extent that it relates to planning services.
 - The following fees paid by an Investor who is not liable to be assessed pursuant to sections CD 3, CD 4, or CD 5 in respect of gross income received from investments through the Service, are deductible to that Investor under section BD 2 except to the extent that the fees (not being either contingent upon implementation of a "financial arrangement" or non-contingent upon implementation of a "financial arrangement" but exceeding 2% of the "core acquisition price" of a "financial arrangement" as those terms are defined in the qualified accrual rules) are incurred in gaining or producing exempt income or an amount that is excluded from being gross income:
 - The administration fee.
 - The custodian fee.
 - The expense fee.
 - The regular withdrawal fee.
 - The fund manager fee.
 - The adviser service fee to the extent that it relates to monitoring services.
 - The fees paid by the Manager in relation to the Service to the Administrator, or to any broker, agent, or associate of the Administrator, or to any independent research resource, are deductible under section BD 2 by the Manager.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any assumption or condition stated above, the Taxation Laws apply to the Arrangement as follows:

- The Service, to be launched to the public by CSNZL, as the Manager and the Investors' agent, JMNZL as the Administrator, and NNL as the Custodian of the Service pursuant to a bare trust, is not a "unit trust" as defined in section OB 1 and the Investors are not "unit holders" as also defined in section OB 1.
- As a consequence of Investors having direct ownership of their investment choices, the income from investments made by the Investors through the Service and held by the Custodian, will be gross income of the relevant Investor under section BD 1,

- GST is payable in respect of any fees charged for non-life insurance cover to Investors through the Service.
- Except for any fees charged for non-life insurance cover to Investors through the Service, the fees listed in the Arrangement in this Ruling that are charged by the Manager, the Custodian and the Administrator in relation to the Service are exempt from GST by reason of the application of section 14 of the Goods and Services Tax Act 1985.
- The representative member of the Colonial group is required to make a return of goods and services tax under section 55(7) of the Goods and Services Tax Act 1985 in respect of any fee charged for the Administrator's services supplied in relation to the Service, where Investors are supplied with non-life insurance cover through the Service.
- There is no requirement for the representative member of the Colonial group to make a return of goods and services tax under section 55(7) of the Goods and Services Tax Act 1985, in respect of the Administrator's services supplied in relation to the Service, except where Investors are supplied with non-life insurance cover through the Service.

The period or income year for which this Ruling applies

This Ruling will apply for the period 13 January 2000 until 31 March 2002.

This Ruling is signed by me on the 13th day of January 2000.

Martin Smith

General Manager (Adjudication & Rulings)

GENERAL INTEREST ITEMS

DOUBLE TAX AGREEMENT WITH INDIA AMENDED

New Zealand has a network of 26 Double Tax Agreements (DTAs) with its main trading and investment partners. These DTAs aim to reduce tax impediments to cross-border trade and investment and to assist tax administration. From time to time these DTAs need updating to address deficiencies that have been identified, or areas where the Government's policy positions may have changed.

On 17 December a Second Protocol entered into force, updating certain features of the DTA between New Zealand and India concluded in 1986. Specifically, the Second Protocol amends the Indian DTA by:

- reducing the maximum rates of tax on dividends (from 20% to 15%); interest (from 15% to 10%); and royalties and certain service fees (from 30% to 10%);
- revising the definition of 'India' to recognise the UN Convention on the Law of the Sea;
- clarifying that when a non-individual's place of effective management (which determines tax residence) cannot be determined, the competent authorities can settle the question by mutual agreement;
- clarifying that New Zealand and India may tax certain income from immovable property and from the alienation of property; and
- clarifying that the Non-discrimination Article will not affect the rate of tax imposed on branches of non-resident companies nor defeat the application of anti-avoidance provisions, thus preventing potential abuse of the Non-discrimination Article.

The provisions of the Second Protocol take effect:

- in New Zealand, from the income year beginning 1 April 2000; and
- in India, for any 'previous year' (as defined in the Income Tax Act 1961) beginning on or after 1 April 2000.

The full text of the protocol is available on the Inland Revenue Department website (<http://taxpolicy.ird.govt.nz/international/DTA/agreements/india2p.html>).

STUDENT LOAN SCHEME - REPAYMENT THRESHOLD FOR 2000-01

The student loan scheme repayment threshold for the 2000/01 income year will increase to \$14,768.

TRANSFER PRICING – DRAFT GUIDELINES

The appendix to this TIB contains the second of a series of draft guidelines on the application of New Zealand's transfer pricing rules. The first part, issued in October 1997 (TIB Vol 9, No.10), contained a general overview of the framework in which transfer pricing operates. This part deals with the remaining issues covered in the OECD guidelines issued to date, namely intangible property, intra-group services and cost contribution arrangements (CCAs). Subsequent guidelines will deal with advance pricing agreements (APAs) and the application to branches of section FB 2 of the Income Tax Act 1994.

Inland Revenue welcomes submissions on the material in the draft guidelines. Please make these by 31 March 2000, addressed to:

General Manager
Policy Advice Division
Inland Revenue Department
PO Box 2198
WELLINGTON

Inland Revenue fully endorses the OECD guidelines in relation to issues dealt with in this part of the guidelines. This part should be read, therefore, as supplementing the OECD guidelines, rather than superseding them. On matters not addressed in draft guidelines issued to date, Inland Revenue will continue to follow the OECD guidelines.

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.

WHETHER ASSESSMENT INVALID

Case:	I R & P M Hyslop v CIR
Decision date:	10 January 2000
Act:	Income Tax Act 1976
Keywords:	“Assessment”, “Notice of Assessment”

I have always been of the view that a fundamental part of the assessment process is to notify the objector, simultaneously with an assessment document or, perhaps, prior to that, of the reasons for assessment or reassessment. One would expect those reasons to be endorsed, briefly on the form of assessment or to be set out in a covering letter. In this case that did not happen, except that there was reference to reliance on the principles of *Case M7* ... In my view, the reasons for assessment should be endorsed on the assessment form or contained in a simultaneous covering letter... In my view, it is not good enough to assess a person without making clear the reasons for assessment.....

I find the assessment process in this case to have been invalid and ineffective. It is not redeemed by subsequent correspondence.”

Summary

Justice Chambers upheld the Commissioner’s appeal and referred the substantive issue back to the Taxation Review Authority.

Facts

This was an appeal from the TRA judgment of Barber DCJ reported as *Case T49* (1998) 18 NZTC 8,335. That case itself was in many ways a rerun of *Case M7* (1990) 12 NZTC 2,046 [also reported as *Case 84* (1990) 14 TRNZ 21; TRA No 88/9; Dec No 89/107] (Judge Bathgate) except that *M7* dealt with the 1982 to 1984 financial years (inclusive) of the objectors and *Case T49* deals with 1985 to 1989 inclusive. The essential tax issue was whether the husband and wife objectors (the husband being a pharmacist and the wife also a shareholder/director of their pharmacy company) successfully split some income among their children consequential to measures taken in about September 1982 to gift capital to their children.

However the Authority in *T49* found that it did not need to decide the substantive issues as it found in favour of the Objectors on the threshold submission that the Commissioner had failed to give adequate grounds for the assessments, thereby rendering those assessments invalid. Barber DCJ stated as follows:

“It is only necessary for me to deal with the threshold issue. It seems to me that the basis of the assessments could not have been clearly known to the objectors when they were reassessed on 13 March 1991 and when they formulated their objections.....

Decision

Chambers J found that the Taxation Review Authority had no basis on which to entertain this issue of validity, because invalidity of the assessments was not raised as a ground of objection. Section 36 Inland Revenue Department Act 1974 (now section 18 Taxation Review Authorities Act 1994) was clear. Invalidity is a distinct ground of objection: *CIR v Canterbury Frozen Meat Co Limited* (1994) 16 NZTC 11,150 at 11,159.

And while that finding was sufficient to enable the case to be decided in the Commissioner’s favour, the Authority also erred in finding that a failure by the Commissioner to give sufficient reasons for an assessment invalidates that assessment. Sections 26 and 29(1) Income Tax Act 1976 (sections 114 and 111 TAA 1994) make it clear that an assessment is quite different from the notice of assessment, and any failure or deficiency in the notice has no effect on the validity of the assessment. It is the consideration that has gone into an assessment by the Commissioner that determines validity, not the physical form (if any) upon which notice is given to the taxpayer.

Finally Chambers J found that the Authority erred in finding that the Commissioner had given insufficient information as to the grounds of assessment in this case. In the facts of this case a reasonable objective reader of *Case M7* would be able to deduce some reasonably clear legal principles and the Commissioner's application of those principles was well demonstrated in the working papers sent with the notices. The Commissioner did "nail his colours to the mast for the Hyslops to see".

WHETHER LEGAL EXPENSES INCURRED IN DEFENCE OF CRIMINAL CHARGES DEDUCTIBLE UNDER INCOME TAX ACT AND GOODS AND SERVICES TAX ACT

Case:	TRA Number 10/99 & 45/99. Decision Number 1/2000
Decision date:	11 January 2000
Act:	Income Tax Act, Goods and Services Tax Act
Keywords:	<i>deductibility of legal expenses</i>

Summary

Judge Barber found in favour of the Commissioner in all aspects of the case.

Facts

On 15 January 1995 the police searched the taxpayer's property and 170 cannabis plants were found. Subsequently the taxpayer pleaded guilty to two charges of cultivating cannabis, one of possessing cannabis for supply, and one of selling cannabis, a class C drug.

As a result of a plea bargain entered into with the Police, on 22 March 1995, the taxpayer was fined \$40,000, ordered to forfeit the sum of \$14,820.00 being cash found on his property and was sentenced to two years imprisonment.

The taxpayer claimed legal expenses of \$21,231 incurred in relation to the criminal prosecution against him for the cultivation, possession and sale of cannabis in his 1995 income tax return and GST return for the period ending 31 March 1995.

The Commissioner disallowed the deductions and a challenge was issued in the Taxation Review Authority by the taxpayer.

Decision

In terms of the GST input tax credit claim, Judge Barber stated that the GST Act makes it quite clear that, for the purposes of this case, the critical criterion is whether the goods and services were "acquired for the principal purpose of making taxable supplies". His Honour found from the evidence that the legal services in this case were acquired by the taxpayer for the purpose of minimising or avoiding any prison sentence and the size of sum to be forfeited to the Crown, and to protect the taxpayer's own home property and preserve it from the State. His Honour stated that there can be no doubt here that the plea bargain reduced the length of jail sentence imposed on the taxpayer.

Also of importance was Judge Barbers' finding that the facts indicated that the taxpayer's cannabis business did not operate after the taxpayer's arrest and that any subsequent sales (which were alleged to have occurred by the taxpayer after his arrest) were from stock remaining after business closure. His Honour also agreed with the Commissioner's position that if the taxpayer recommenced cannabis growing on release from prison, then that would be a new and separate business and not a continuance of the previous business which had closed by 3 March 1995. This finding also depended on the particular facts of the case.

The facts were overwhelmingly clear that the principal purpose of the taxpayer in acquiring the legal services was to achieve the best possible outcome in respect of the criminal charges laid against him. That purpose is quite indirect to the continuing of taxable supplies of cannabis and is too remote from that purpose to be an input to such an activity. In any event, that activity came to an end before the bulk of the legal services seem to have been supplied.

In regards to income tax deductibility, His Honour found that the legal expenses in defending the criminal charges were of a private and personal nature and related to the preservation of the taxpayer's personal liberty and assets. Such expenditure is not deductible under the Income Tax Act. Also such expenditure is not sufficiently connected with the taxpayer's income earning process of cannabis growing and dealing. It merely has an indirect connection. In any case the taxpayer's cannabis business had ceased at the time that the legal fees were incurred so there could not possibly be the required nexus between that expenditure and the cannabis business.

Regarding the final issue Judge Barber found for the Commissioner on a matter of credibility i.e. it is more likely that the taxpayer spent the proceeds from cannabis sales as they were earned rather than saved them.

REGULAR FEATURES

DUE DATES REMINDER

February 2000

- 7 IR 66N or IR 66W PAYE and schedules: large employers (\$100,000 or more PAYE and SSCWT deductions per annum)
 - schedules and payment due

Employer deductions: **large employers** (\$100,000 or more PAYE and SSCWT deductions per annum)

 - IR 345 or IR 346 *Employer deductions form* and payment due

Employer monthly schedule: **large employers** (\$100,000 or more PAYE and SSCWT deductions per annum)

 - IR 348 *Employer monthly schedule* due

- 21 Employer deductions: **large employers** (\$100,000 or more PAYE and SSCWT deductions per annum)
 - IR 345 or IR 346 *Employer deductions form* and payment due

Employer deductions and Employer monthly schedule: **small employers** (less than \$100,000 PAYE and SSCWT deductions per annum)

 - IR 345 or IR 346 *Employer deductions form* and payment due
 - IR 348 *Employer monthly schedule* due

- 29 GST return and payment due

March 2000

- 6 Employer deductions: **large employers** (\$100,000 or more PAYE and SSCWT deductions per annum)
 - IR 345 or IR 346 *Employer deductions form* and payment due

Employer monthly schedule: **large employers** (\$100,000 or more PAYE and SSCWT deductions per annum)

 - IR 348 *Employer monthly schedule* due

- 7 Provisional tax instalments due for people and organisations with a March balance date

- 20 Employer deductions: **large employers** (\$100,000 or more PAYE and SSCWT deductions per annum)
 - IR 345 or IR 346 *Employer deductions form* and payment due

Employer deductions and Employer monthly schedule: **small employers** (less than \$100,000 PAYE and SSCWT deductions per annum)

 - IR 345 or IR 346 *Employer deductions form* and payment due
 - IR 348 *Employer monthly schedule* due

- 31 GST return and payment due

YOUR CHANCE TO COMMENT ON DRAFT TAXATION ITEMS BEFORE THEY ARE FINALISED

This page shows the draft public binding rulings, interpretation statements, standard practice statements, and other items 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 _____

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Public rulings

Comment Deadline

- | | | |
|--------------------------|--|------------------|
| <input type="checkbox"/> | PU0066: Bad debts – writing off debts as bad for GST and income tax purposes | 29 February 2000 |
| <input type="checkbox"/> | PU3019: "Cost price of the motor vehicle" – meaning of the term for fringe benefit tax purposes | 29 February 2000 |

Interpretation statements

Comment Deadline

- | | | |
|--------------------------|---|------------------|
| <input type="checkbox"/> | IS2228: Transferable term fishing quota – acquisition and conversion | 29 February 2000 |
|--------------------------|---|------------------|

Standard Practice Statements

Comment Deadline

- | | | |
|--------------------------|---|------------------|
| <input type="checkbox"/> | ED0011: Tape recording Inland Revenue interviews | 29 February 2000 |
|--------------------------|---|------------------|

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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