# TAX INFORMATION BULLETIN

**Vol 13, No 3** **March 2001**

## Contents



*This TIB has no appendix*

ISSN 0114-7161

Inland Revenue
*Te Tari Taake*

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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.

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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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### *Where to find us*

Our website is at

**www.ird.govt.nz**

It has other Inland Revenue information that 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 email us from our website.

# THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

Inland Revenue produces a number of statements and 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 30 April 2001:

| Ref. | Draft type | Description |
|---|---|---|
| PU3398 | Public ruling | Federal Insurance Contributions Act (FICA) – fringe benefit tax (FBT) liability. The arrangement is the deduction of FICA contributions from US citizen employees by a New Zealand employer, and the payment of those contributions together with the employer contribution to the United States Federal Government. |

The following draft items are available for review/comment this month, having a deadline of 31 May 2001:

| Ref. | Draft type | Description |
|---|---|---|
| PU0059 | Public Rulings | These nine rulings replace both public rulings BR Pub 96/1 and BR Pub 96/2A as some of the conclusions in those earlier rulings have changed as a result of the House of Lords decision in *Ingram v IRC* [1999] 1 All ER 297. |
| IP3502 | Issues paper | Interest deductibility in certain arrangements. This paper deals with the issues of whether interest is deductible in certain arrangements where the borrowed funds on which interest is payable is not directly used in an income earning activity or business. Follows on from a previous issues paper (IRRUIP3) and details the Commissioner's proposed new approach. |

Please see page 25 for details on how to obtain copies.

# 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 *Adjudication & Rulings, a guide to Binding Rulings (IR 715)* or the article on page 1 of *Tax Information Bulletin* Vol 6, No 12 (May 1995) or Vol 7, No 2 (August 1995).

You can download these publications free of charge from our website at **www.ird.govt.nz**

# PRODUCT RULING - BR PRD 01/01

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 Russell Investment Management Limited ("RIML").

## Taxation Laws

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

This Ruling applies in respect of sections CG 1, CG 4, CG 6, CG 7, CG 13, CG 15, CF 3, and the definitions of "accounting period", "non taxable bonus issue" and "income interest of 10% or greater" in section OB 1.

## The Arrangement to which this Ruling applies

The Arrangement is the investment by New Zealand resident investors in the Russell International Bond Fund - $A Hedged ("RIBF"), an Australian resident unit trust. The RIBF is a Fund established under the umbrella trust deed of the Russell Multi- Manager Unit Trust ("RMMUT"), dated 21 November 1997. The operation of the RIBF and the RMMUT governed by the New Zealand Amended Russell Multi-Manager Unit Trust Constitution, in the form provided to Rulings with a covering letter dated 20 November 2000 and lodged with the Australian Securities and Investments Commission on 1 December 2000. The prospectus in respect of the RIBF and other Funds established under the RMMUT was lodged with the Australian Securities and Investments Commission on 25 September 1999. Further details of the Arrangement are set out in the paragraphs below.

1. The manager and trustee of the RIBF has been changed to the responsible entity as a result of a change to Australian legislation. The responsible entity is RIML, an Australian resident company. The centre of management and control of the RIBF is in Australia.
2. RIML, in its capacity as responsible entity of RIBF, will at all times during the accounting periods covered by this Ruling be liable to income tax in Australia by reason of domicile, residence, place of incorporation or place of management in Australia.
3. The RIBF commenced on 1 December 1997 and terminates on 30 November 2077.
4. The investment objective of the RIBF, as set out in the prospectus, is to provide investors with exposure to a portfolio of international fixed income securities.
5. The prospectus provides for two classes of units, Class A and Class B. The prospectus provides that:
   - unitholders in Class A units may elect to have their income entitlements in respect of a Fund reinvested in Class A units in that Fund.
   - the income entitlements of Class B units of a Fund will be automatically reinvested in additional Class B units in that Fund.
   - the policy of compulsory reinvestment of income entitlements in respect of Class B units may be varied by the responsible entity at its discretion.

6. The prospectus provides that each unit in a Fund entitles an investor to an equal interest in that Fund, but does not confer any interest in any particular asset of a Fund or the right to interfere with the management of a Fund. Specifically investors do not have:

   - any entitlement to or any entitlement to acquire any shares in a foreign company held by the RIBF;
   - any entitlement to or any entitlement to acquire a right to vote in respect of a foreign company in which the RIBF holds shares;
   - any entitlement to or any entitlement to acquire a right to receive, or to have dealt with on their behalf, any income of any company in which the RIBF holds shares;
   - any entitlement to or any entitlement to acquire a right to receive, or have dealt with on their behalf, any assets of any company in which the RIBF holds shares.

7. All transactions between the investors and the RIBF will occur at market value.

8. The New Zealand Amended Russell Multi-Manager Unit Trust Constitution contains the following relevant clauses:

   Clause 4.1:

   The beneficial interest in each Fund will be divided into Units. Subject to the terms of issue that attach to any Unit or class of Units, every Unit confers an equal interest in the relevant Fund but not an interest in any particular part of that Fund.

   Clause 7.1:

   A Unit Holder is entitled to a beneficial interest in the relevant Trust Fund but may not:

   (a) interfere with the exercise of the Responsible Entity's powers; or

   (b) exercise any rights in respect of any investment or require the transfer of any property.

   Clause 15.1:

   (a) The Distributable Income of a Fund for a Distribution Period will be determined by the Responsible Entity having regard to:

      (i) the Accounting Income of that Fund;

      (ii) the Tax Income of that Fund;

      (iii) any amount held in a reserve or previously provided for; and

      (iv) the portion of the Tax Income of that Fund attributable to franking or foreign tax credits or similar deemed assessable amounts.

      …

   Clause 15.4:

   The Distributable Income of a Fund for a Distribution Period must be distributed by the Responsible Entity to the relevant Unit Holders no later than the applicable Distribution Date.

   Clause 15.5:

   Subject to clause 15.6 and the terms of issue of any Units, the Distributable Income of a Fund for each Distribution Period, to the extent to which it has not been dealt with under clause 11.11, after payment of, or providing for, all taxes will be distributed to registered Unit Holders in that Fund at the close of business on the last day of the Distribution Period, in proportion to the number of Units of which they are registered holders at such date.

   Clause 15.6:

   (a) Under the terms of issue of any Units, the Responsible Entity may invite or require Unit Holders in a Fund to reinvest any or all of the amount which they would otherwise receive as a distribution under Clause 15.5 by way of application for additional Units in that Fund or another Fund. The terms of any such invitation or requirement will be determined by the Responsible Entity. Any invitation or requirement may be withdrawn or varied by the Responsible Entity.

   (b) Units so applied for will be deemed to have been issued on such date and time as the Responsible Entity determines following the Distribution Period in respect of which the Distributable Income has accrued or such other date determined by the Responsible Entity. Units will be issued at a price determined in accordance with Clause 4.2.

## Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) For New Zealand tax purposes the RIBF is a unit trust as defined in section OB 1.

b) Tresponsible entity of the RIBF will calculate its income liable to income tax without applying any features of the taxation law of Australia specified in Part B of Schedule 3 of the Income Tax Act 1994.

c) Where the terms of issue of the units require the investor to apply for additional units in the RIBF rather than cash distributions of the RIBF's distributable income, the trustee of the RIBF will not elect pursuant to section CF 8 that the issue of additional units will be a taxable bonus issue.

## How the Taxation Laws apply to the Arrangement

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

- If the RIBF is a Controlled Foreign Company ("CFC") as defined in section CG 4:
  - A New Zealand resident investor will not be required to return attributed foreign income or loss from the RIBF pursuant to section CG 1 by virtue of section CG 13(1); and
  - Subject to section CG 6(1)(a), an investor with an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the RIBF will be required to return Foreign Investment Fund ("FIF") income or loss of the RIBF pursuant to section CG 1, attributed to the investor pursuant to section CG 7(5).
- A New Zealand resident investor that does not have an "income interest of 10% or greater" (as defined in section OB 1) in the RIBF is not required to return FIF income or loss pursuant to section CG 7(5). If the RIBF is a CFC as defined in section CG 4 (the first tier CFC) and the RIBF has "qualified control interests" (as defined in section CG 4(6)) in another foreign company (the underlying foreign company) and as a consequence the underlying foreign company is a CFC as defined in section CG 4:
  - Subject to section CG 6(1)(a) and section CG 13, where an investor in the RIBF has an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the underlying CFC, the investor will be required to return attributed foreign income or loss of the underlying CFC pursuant to section CG 1; and
  - Subject to section CG 6(1)(a), where an investor in the RIBF has an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the underlying CFC, the investor will be required to return FIF income or loss of the underlying CFC pursuant to section CG 1, attributed to the investor pursuant to section CG 7(5).
  - Where an investor in the RIBF does not have an "income interest of 10% or greater" (as defined in section OB 1) in the underlying CFC, FIF income or loss of the underlying CFC will not be attributed to the investor pursuant to section CG 7(5) and the investor will not be required to return FIF income or loss of the underlying CFC pursuant to section CG 1.

  If the underlying foreign company is a CFC and has "qualified control interests" (as defined in section CG 4(6)) in another foreign company, and as a consequence the other foreign company is a CFC as defined in section CG 4, and so on down the chain of CFCs, the above three rulings shall also apply on the basis that any other foreign company is the underlying foreign company.
- If the RIBF is not a CFC *or* the RIBF is a CFC and the investor does not have an "income interest of 10% or greater" (as defined in section OB 1) in the RIBF for any "accounting period" (as defined in section OB 1), a New Zealand resident investor's interest in the RIBF will not constitute an investment in a FIF by virtue of the exemption contained in section CG 15(2)(b).
- Where the terms of issue of the units require the investor to apply for additional units in the RIBF rather than cash distributions of the RIBF's distributable income, the issue of additional units will constitute a non-taxable bonus issue to the investor and accordingly will be excluded from the definition of a dividend pursuant to section CF 3(1)(a).

## The period or income year for which this Ruling applies

This Ruling will apply for the period 11 January 2001 to 31 March 2005.

This Ruling is signed by me on the 11th day of January 2001.

**Martin Smith**

General Manager (Adjudication & Rulings)

# PRODUCT RULING - BR PRD 01/02

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 Russell Investment Management Limited ("RIML").

## Taxation Laws

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

This Ruling applies in respect of sections CG 1, CG 4, CG 6, CG 7, CG 13, CG 15, CF 3, and the definitions of "accounting period", "non taxable bonus issue" and "income interest of 10% or greater" in section OB 1.

## The Arrangement to which this Ruling applies

The Arrangement is the investment by New Zealand resident investors in the Russell International Shares Fund ("RISF"), an Australian resident unit trust. The RISF is a Fund established under the umbrella trust deed of the Russell Multi-Manager Unit Trust ("RMMUT"), dated 21 November 1997. The operation of the RISF and the RMMUT is governed by the New Zealand Amended Russell Multi Manager Unit Trust Constitution, in the form provided to Rulings with a covering letter dated 20 November 2000 and lodged with the Australian Securities and Investments Commission on 1 December 2000. The prospectus in respect of the RISF and other Funds established under the RMMUT was lodged with the Australian Securities and Investments Commission on 25 September 1999. Further details of the Arrangement are set out in the paragraphs below.

1. The manager and trustee of the RISF has been changed to the responsible entity as a result of a change to Australian legislation. The responsible entity is RIML, an Australian resident company. The centre of management and control of the RISF is in Australia.

2. RIML, in its capacity as responsible entity of RISF, will at all times during the accounting periods covered by this Ruling be liable to income tax in Australia by reason of domicile, residence, place of incorporation or place of management in Australia.

3. The RISF commenced on 1 December 1997 and terminates on 30 November 2077.

4. The investment objective of the RISF, as set out in the prospectus, is to provide investors with exposure to a highly diversified portfolio of international equities.

5. The prospectus provides for two classes of units, Class A and Class B. The prospectus provides that:

   - unitholders in Class A units may elect to have their income entitlements in respect of a Fund reinvested in Class A units in that Fund.
   - the income entitlements of Class B units of a Fund will be automatically reinvested in additional Class B units in that Fund.
   - the policy of compulsory reinvestment of income entitlements in respect of Class B units may be varied by the responsible entity at its discretion.

6. The prospectus provides that each unit in a Fund entitles an investor to an equal interest in that Fund, but does not confer any interest in any particular asset of a Fund or the right to interfere with the management of a Fund. Specifically investors do not have:

   - any entitlement to or any entitlement to acquire any shares in a foreign company held by the RISF;
   - any entitlement to or any entitlement to acquire a right to vote in respect of a foreign company in which the RISF holds shares;
   - any entitlement to or any entitlement to acquire a right to receive, or to have dealt with on their behalf, any income of any company in which the RISF holds shares;
   - any entitlement to or any entitlement to acquire a right to receive, or have dealt with on their behalf, any assets of any company in which the RISF holds shares.

7. All transactions between the investors and the RISF will occur at market value.

8. The New Zealand Amended Russell Multi Manager Unit Trust Constitution contains the following relevant clauses:

   Clause 4.1:

   The beneficial interest in each Fund will be divided into Units. Subject to the terms of issue that attach to any Unit or class of Units, every Unit confers an equal interest in the relevant Fund but not an interest in any particular part of that Fund.

Clause 7.1:

A Unit Holder is entitled to a beneficial interest in the relevant Trust Fund but may not:

(a) interfere with the exercise of the Responsible Entity's powers; or

(b) exercise any rights in respect of any investment or require the transfer of any property.

Clause 15.1:

(a) The Distributable Income of a Fund for a Distribution Period will be determined by the Responsible Entity having regard to:

(i) the Accounting Income of that Fund;

(ii) the Tax Income of that Fund;

(iii) any amount held in a reserve or previously provided for; and

(iv) the portion of the Tax Income of that Fund attributable to franking or foreign tax credits or similar deemed assessable amounts.

…

Clause 15.4:

The Distributable Income of a Fund for a Distribution Period must be distributed by the Responsible Entity to the relevant Unit Holders no later than the applicable Distribution Date.

Clause 15.5:

Subject to clause 15.6 and the terms of issue of any Units, the Distributable Income of a Fund for each Distribution Period, to the extent to which it has not been dealt with under clause 11.11, after payment of, or providing for, all taxes will be distributed to registered Unit Holders in that Fund at the close of business on the last day of the Distribution Period, in proportion to the number of Units of which they are registered holders at such date.

Clause 15.6:

(a) Under the terms of issue of any Units, the Responsible Entity may invite or require Unit Holders in a Fund to reinvest any or all of the amount which they would otherwise receive as a distribution under Clause 15.5 by way of application for additional Units in that Fund or another Fund. The terms of any such invitation or requirement will be determined by the Responsible Entity. Any invitation or requirement may be withdrawn or varied by the Responsible Entity.

(b) Units so applied for will be deemed to have been issued on such date and time as the Responsible Entity determines following the Distribution Period in respect of which the Distributable Income has accrued or such other date determined by the Responsible Entity. Units will be issued at a price determined in accordance with Clause 4.2.

## Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) For New Zealand tax purposes the RISF is a unit trust as defined in section OB 1.

b) The responsible entity of the RISF will calculate its income liable to income tax without applying any features of the taxation law of Australia specified in Part B of Schedule 3 of the Income Tax Act 1994.

c) Where the terms of issue of the units require the investor to apply for additional units in the RISF rather than cash distributions of the RISF's distributable income, the trustee of the RISF will not elect pursuant to section CF 8 that the issue of additional units will be a taxable bonus issue.

## How the Taxation Laws apply to the Arrangement

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

- If the RISF is a Controlled Foreign Company ("CFC") as defined in section CG 4:
  - A New Zealand resident investor will not be required to return attributed foreign income or loss from the RISF pursuant to section CG 1 by virtue of section CG 13(1); and
  - Subject to section CG 6(1)(a), investor with an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the RISF will be required to return Foreign Investment Fund ("FIF") income or loss of the RISF pursuant to section CG 1, attributed to the investor pursuant to section CG 7(5).
  - A New Zealand resident investor that does not have an "income interest of 10% or greater" (as defined in section OB 1) in the RISF is not required to return FIF income or loss pursuant to section CG 7(5).

- If the RISF is a CFC as defined in section CG 4 (the first tier CFC) and the RISF has "qualified control interests" (as defined in section CG 4(6)) in another foreign company (the underlying foreign company) and as a consequence the underlying foreign company is a CFC as defined in section CG 4:
  - Subject to section CG 6(1)(a) and section CG 13, where an investor in the RISF has an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the underlying CFC, the investor will be required to return attributed foreign income or loss of the underlying CFC pursuant to section CG 1; and
  - Subject to section CG 6(1)(a), where an investor in the RISF has an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the underlying CFC, the investor will be required to return FIF income or loss of the underlying CFC pursuant to section CG 1, attributed to the investor pursuant to section CG 7(5).
  - Where an investor in the RISF does not have an "income interest of 10% or greater" (as defined in section OB 1) in the underlying CFC, FIF income or loss of the underlying CFC will not be attributed to the investor pursuant to section CG 7(5) and the investor will not be required to return FIF income or loss of the underlying CFC pursuant to section CG 1.

  If the underlying foreign company is a CFC and has "qualified control interests" (as defined in section CG 4(6)) in another foreign company, and as a consequence the other foreign company is a CFC as defined in section CG 4, and so on down the chain of CFCs, the above three rulings shall also apply on the basis that any other foreign company is the underlying foreign company.
- If the RISF is not a CFC *or* the RISF is a CFC and the investor does not have an "income interest of 10% or greater" (as defined in section OB 1) in the RISF for any "accounting period" (as defined in section OB 1), a New Zealand resident investor's interest in the RISF will not constitute an investment in a FIF by virtue of the exemption contained in section CG 15(2)(b).
- Where the terms of issue of the units require the investor to apply for additional units in the RISF rather than cash distributions of the RISF's distributable income, the issue of additional units will constitute a non-taxable bonus issue to the investor and accordingly will be excluded from the definition of a dividend pursuant to section CF 3(1)(a).

## The period or income year for which this Ruling applies

This Ruling will apply for the period 11 January 2001 to 31 March 2005.

This Ruling is signed by me on the 11th day of January 2001.

**Martin Smith**

General Manager (Adjudication & Rulings)

# PRODUCT RULING - BR PRD 01/03

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 Russell Investment Management Limited ("RIML").

## Taxation Laws

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

This Ruling applies in respect of sections CG 1, CG 4, CG 6, CG 7, CG 13, CG 15, CF 3, and the definitions of "accounting period", "non taxable bonus issue" and "income interest of 10% or greater" in section OB 1.

## The Arrangement to which this Ruling applies

The Arrangement is the investment by New Zealand resident investors in the Russell World Bond Fund ("RWBF"), an Australian resident unit trust. The RWBF is a Fund established under the umbrella trust deed of the Russell Multi- Manager Unit Trust ("RMMUT"), dated 21 November 1997, and the Second Supplemental Deed for RMMUT, dated 15 June 1998. The operation of the RWBF and the RMMUT is governed by the New Zealand Amended Russell Multi-Manager Unit Trust Constitution, in the form provided to Rulings with a covering letter dated 20 November 2000 and lodged with the Australian Securities and Investments Commission on 1 December 2000. The prospectus in respect of the RWBF and other Funds established under the RMMUT was lodged with the Australian Securities and Investments Commission on 25 September 1999. The investment statement is dated 31 May 2000. Further details of the Arrangement are set out in the paragraphs below.

1. The manager and trustee of the RWBF has been changed to the responsible entity as a result of a change to Australian legislation. The responsible entity is RIML, an Australian resident company. The centre of management and control of the RWBF is in Australia.

2. RIML, in its capacity as responsible entity of the RWBF, will at all times during the accounting periods covered by this Ruling be liable to income tax in Australia by reason of domicile, residence, place of incorporation or place of management in Australia.

3. The RWBF commenced on 15 June 1998 and terminates on 14 June 2078.

4. The investment objective of the RWBF, as set out in the prospectus and the investment statement, is to provide investors with long term returns by investing in a portfolio of international, and New Zealand fixed income investments.

5. The prospectus provides for two classes of units, Class A and Class B. The prospectus provides that:

   - unitholders in Class A units may elect to have their income entitlements in respect of a Fund reinvested in Class A units in that Fund.
   - the income entitlements of Class B units of a Fund will be automatically reinvested in additional Class B units in that Fund.
   - the policy of compulsory reinvestment of income entitlements in respect of Class B units may be varied by the responsible entity at its discretion.

6. The investment statement only provides for investment in class B units. The investment statement states that distributions from class B units are compulsorily reinvested towards the purchase of further units, and cannot be received in cash unless the responsible entity exercises its discretion to alter the terms of issue to allow distributions.

7. The prospectus provides that each unit in a Fund entitles an investor to an equal interest in that Fund, but does not confer any interest in any particular asset of a Fund or the right to interfere with the management of a Fund. Specifically investors do not have:

   - any entitlement to or any entitlement to acquire any shares in a foreign company held by the RWBF;
   - any entitlement to or any entitlement to acquire a right to vote in respect of a foreign company in which the RWBF holds shares;
   - any entitlement to or any entitlement to acquire a right to receive, or to have dealt with on their behalf, any income of any company in which the RWBF holds shares;
   - any entitlement to or any entitlement to acquire a right to receive, or have dealt with on their behalf, any assets of any company in which the RWBF holds shares.

8. All transactions between the investors and the RWBF will occur at market value.

9. The New Zealand Amended Russell Multi-Manager Unit Trust Constitution contains the following relevant clauses:

Clause 4.1:

The beneficial interest in each Fund will be divided into Units. Subject to the terms of issue that attach to any Unit or class of Units, every Unit confers an equal interest in the relevant Fund but not an interest in any particular part of that Fund.

Clause 7.1:

A Unit Holder is entitled to a beneficial interest in the relevant Trust Fund but may not:

(a) interfere with the exercise of the Responsible Entity's powers; or

(b) exercise any rights in respect of any investment or require the transfer of any property.

Clause 15.1:

(a) The Distributable Income of a Fund for a Distribution Period will be determined by the Responsible Entity having regard to:

(i) the Accounting Income of that Fund;

(ii) the Tax Income of that Fund;

(iii) any amount held in a reserve or previously provided for; and

(iv) the portion of the Tax Income of that Fund attributable to franking or foreign tax credits or similar deemed assessable amounts.

…

Clause 15.4:

The Distributable Income of a Fund for a Distribution Period must be distributed by the Responsible Entity to the relevant Unit Holders no later than the applicable Distribution Date.

Clause 15.5:

Subject to clause 15.6 and the terms of issue of any Units, the Distributable Income of a Fund for each Distribution Period, to the extent to which it has not been dealt with under clause 11.11, after payment of, or providing for, all taxes will be distributed to registered Unit Holders in that Fund at the close of business on the last day of the Distribution Period, in proportion to the number of Units of which they are registered holders at such date.

Clause 15.6:

(a) Under the terms of issue of any Units, the Responsible Entity may invite or require Unit Holders in a Fund to reinvest any or all of the amount which they would otherwise receive as a distribution under Clause 15.5 by way of application for additional Units in that Fund or another Fund. The terms of any such invitation or requirement will be determined by the Responsible Entity. Any invitation or requirement may be withdrawn or varied by the Responsible Entity.

(b) Units so applied for will be deemed to have been issued on such date and time as the Responsible Entity determines following the Distribution Period in respect of which the Distributable Income has accrued or such other date determined by the Responsible Entity. Units will be issued at a price determined in accordance with Clause 4.2.

## Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) For New Zealand tax purposes the RWBF is a unit trust as defined in section OB 1.

b) The responsible entity of the RWBF will calculate its income liable to income tax without applying any features of the taxation law of Australia specified in Part B of Schedule 3 of the Income Tax Act 1994.

c) Where the terms of issue of the units require the investor to apply for additional units in the RWBF rather than cash distributions of the RWBF's distributable income, the trustee of the RWBF will not elect pursuant to section CF 8 that the issue of additional units will be a taxable bonus issue.

## How the Taxation Laws apply to the Arrangement

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

- If the RWBF is a Controlled Foreign Company ("CFC") as defined in section CG 4:
  - A New Zealand resident investor will not be required to return attributed foreign income or loss from the RWBF pursuant to section CG 1 by virtue of section CG 13(1); and
  - Subject to section CG 6(1)(a), an investor with an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the RWBF will be required to return Foreign Investment Fund ("FIF") income or loss of the RWBF pursuant to section CG 1, attributed to the investor pursuant to section CG 7(5).
  - A New Zealand resident investor that does not have an "income interest of 10% or greater" (as defined in section OB 1) in the RWBF is not required to return FIF income or loss pursuant to section CG 7(5).

- If the RWBF is a CFC as defined in section CG 4 (the first tier CFC) and the RWBF has "qualified control interests" (as defined in section CG 4(6)) in another foreign company (the underlying foreign company) and as a consequence the underlying foreign company is a CFC as defined in section CG 4:
  - Subject to section CG 6(1)(a) and section CG 13, where an investor in the RWBF has an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the underlying CFC, the investor will be required to return attributed foreign income or loss of the underlying CFC pursuant to section CG 1; and
  - Subject to section CG 6(1)(a), where an investor in the RWBF has an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the underlying CFC, the investor will be required to return FIF income or loss of the underlying CFC pursuant to section CG 1, attributed to the investor pursuant to section CG 7(5).
  - Where an investor in the RWBF does not have an "income interest of 10% or greater" (as defined in section OB 1) in the underlying CFC, FIF income or loss of the underlying CFC will not be attributed to the investor pursuant to section CG 7(5) and the investor will not be required to return FIF income or loss of the underlying CFC pursuant to section CG 1.

  If the underlying foreign company is a CFC and has "qualified control interests" (as defined in section CG 4(6)) in another foreign company, and as a consequence the other foreign company is a CFC as defined in section CG 4, and so on down the chain of CFCs, the above three rulings shall also apply on the basis that any other foreign company is the underlying foreign company.
- If the RWBF is not a CFC *or* the RWBF is a CFC and the investor does not have an "income interest of 10% or greater" (as defined in section OB 1) in the RWBF for any "accounting period" (as defined in section OB 1), a New Zealand resident investor's interest in the RWBF will not constitute an investment in a FIF by virtue of the exemption contained in section CG 15(2)(b).
- Where the terms of issue of the units require the investor to apply for additional units in the RWBF rather than cash distributions of the RWBF's distributable income, the issue of additional units will constitute a non-taxable bonus issue to the investor and accordingly will be excluded from the definition of a dividend pursuant to section CF 3(1)(a).

## The period or income year for which this Ruling applies

This Ruling will apply for the period 11 January 2001 to 31 March 2005.

This Ruling is signed by me on the 11th day of January 2001.

**Martin Smith**

General Manager (Adjudication & Rulings)

# PRODUCT RULING - BR PRD 01/04

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 Russell Investment Management Limited ("RIML").

## Taxation Laws

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

This Ruling applies in respect of sections CG 1, CG 4, CG 6, CG 7, CG 13, CG 15, CF 3, and the definitions of "accounting period", "non taxable bonus issue" and "income interest of 10% or greater" in section OB 1.

## The Arrangement to which this Ruling applies

The Arrangement is the investment by New Zealand resident investors in the Russell World Shares Fund ("RWSF"), an Australian resident unit trust. The RWSF is a Fund established under the umbrella trust deed of the Russell Multi- Manager Unit Trust ("RMMUT"), dated 21 November 1997, and the Second Supplemental Deed for RMMUT, dated 15 June 1998. The operation of the RWSF and the RMMUT is governed by the New Zealand Amended Russell Multi-Manager Unit Trust Constitution, in the form provided to Rulings with a covering letter dated 20 November 2000 and lodged with the Australian Securities and Investments Commission on 1 December 2000. The prospectus in respect of the RWSF and other Funds established under the RMMUT was lodged with the Australian Securities and Investments Commission on 25 September 1999. The investment statement is dated 31 May 2000. Further details of the Arrangement are set out in the paragraphs below.

1. The manager and trustee of the RWSF has been changed to the responsible entity as a result of a change to Australian legislation. The responsible entity is RIML, an Australian resident company. The centre of management and control of the RWSF is in Australia.

2. RIML, in its capacity as responsible entity of the RWSF, will at all times during the accounting periods covered by this Ruling be liable to income tax in Australia by reason of domicile, residence, place of incorporation or place of management in Australia.

3. The RWSF commenced on 15 June 1998 and terminates on 14 June 2078.

4. The investment objective of the RWSF, as set out in the prospectus and the investment statement, is to provide long term returns by investing in a highly diversified portfolio of international, Australian and New Zealand equities.

5. The prospectus provides for two classes of units, Class A and Class B. The prospectus provides that:

   · unitholders in Class A units may elect to have their income entitlements in respect of a Fund reinvested in Class A units in that Fund.

   · the income entitlements of Class B units of a Fund will be automatically reinvested in additional Class B units in that Fund.

   · the policy of compulsory reinvestment of income entitlements in respect of Class B units may be varied by the responsible entity at its discretion.

6. The investment statement only provides for investment in class B units. The investment statement states that distributions from class B units are compulsorily reinvested towards the purchase of further units, and cannot be received in cash unless the responsible entity exercises its discretion to alter the terms of issue to allow distributions.

7. The prospectus provides that each unit in a Fund entitles an investor to an equal interest in that Fund, but does not confer any interest in any particular asset of a Fund or the right to interfere with the management of a Fund. Specifically investors do not have:

   • any entitlement to or any entitlement to acquire any shares in a foreign company held by the RWSF;

   • any entitlement to or any entitlement to acquire a right to vote in respect of a foreign company in which the RWSF holds shares;

   • any entitlement to or any entitlement to acquire a right to receive, or to have dealt with on their behalf, any income of any company in which the RWSF holds shares;

   • any entitlement to or any entitlement to acquire a right to receive, or have dealt with on their behalf, any assets of any company in which the RWSF holds shares.

8. All transactions between the investors and the RWSF will occur at market value.

9. The New Zealand Amended Russell Multi-Manager Unit Trust Constitution contains the following relevant clauses:

Clause 4.1:

> The beneficial interest in each Fund will be divided into Units. Subject to the terms of issue that attach to any Unit or class of Units, every Unit confers an equal interest in the relevant Fund but not an interest in any particular part of that Fund.

Clause 7.1:

> A Unit Holder is entitled to a beneficial interest in the relevant Trust Fund but may not:
>
> (a) interfere with the exercise of the Responsible Entity's powers; or
>
> (b) exercise any rights in respect of any investment or require the transfer of any property.

Clause 15.1:

> (a) The Distributable Income of a Fund for a Distribution Period will be determined by the Responsible Entity having regard to:
>
> (i) the Accounting Income of that Fund;
>
> (ii) the Tax Income of that Fund;
>
> (iii) any amount held in a reserve or previously provided for; and
>
> (iv) the portion of the Tax Income of that Fund attributable to franking or foreign tax credits or similar deemed assessable amounts.
>
> …

Clause 15.4:

> The Distributable Income of a Fund for a Distribution Period must be distributed by the Responsible Entity to the relevant Unit Holders no later than the applicable Distribution Date.

Clause 15.5:

> Subject to clause 15.6 and the terms of issue of any Units, the Distributable Income of a Fund for each Distribution Period, to the extent to which it has not been dealt with under clause 11.11, after payment of, or providing for, all taxes will be distributed to registered Unit Holders in that Fund at the close of business on the last day of the Distribution Period, in proportion to the number of Units of which they are registered holders at such date.

Clause 15.6:

> (a) Under the terms of issue of any Units, the Responsible Entity may invite or require Unit Holders in a Fund to reinvest any or all of the amount which they would otherwise receive as a distribution under Clause 15.5 by way of application for additional Units in that Fund or another Fund. The terms of any such invitation or requirement will be determined by the Responsible Entity. Any invitation or requirement may be withdrawn or varied by the Responsible Entity.
>
> (b) Units so applied for will be deemed to have been issued on such date and time as the Responsible Entity determines following the Distribution Period in respect of which the Distributable Income has accrued or such other date determined by the Responsible Entity. Units will be issued at a price determined in accordance with Clause 4.2.

## Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) For New Zealand tax purposes the RWSF is a unit trust as defined in section OB 1.

b) The responsible entity of the RWSF will calculate its income liable to income tax without applying any features of the taxation law of Australia specified in Part B of Schedule 3 of the Income Tax Act 1994.

c) Where the terms of issue of the units require the investor to apply for additional units in the RWSF rather than cash distributions of the RWSF's distributable income, the trustee of the RWSF will not elect pursuant to section CF 8 that the issue of additional units will be a taxable bonus issue.

## How the Taxation Laws apply to the Arrangement

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

- If the RWSF is a Controlled Foreign Company ("CFC") as defined in section CG 4:
  - A New Zealand resident investor will not be required to return attributed foreign income or loss from the RWSF pursuant to section CG 1 by virtue of section CG 13(1); and
  - Subject to section CG 6(1)(a), an investor with an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the RWSF will be required to return Foreign Investment Fund ("FIF") income or loss of the RWSF pursuant to section CG 1, attributed to the investor pursuant to section CG 7(5).
  - A New Zealand resident investor that does not have an "income interest of 10% or greater" (as defined in section OB 1) in the RWSF is not required to return FIF income or loss pursuant to section CG 7(5).

- If the RWSF is a CFC as defined in section CG 4 (the first tier CFC) and the RWSF has "qualified control interests" (as defined in section CG 4(6)) in another foreign company (the underlying foreign company) and as a consequence the underlying foreign company is a CFC as defined in section CG 4:
  - Subject to section CG 6(1)(a) and section CG 13, where an investor in the RWSF has an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the underlying CFC, the investor will be required to return attributed foreign income or loss of the underlying CFC pursuant to section CG 1; and
  - Subject to section CG 6(1)(a), where an investor in the RWSF has an "income interest of 10% or greater" (as defined in section OB 1) for any "accounting period" (as defined in section OB 1) in the underlying CFC, the investor will be required to return FIF income or loss of the underlying CFC pursuant to section CG 1, attributed to the investor pursuant to section CG 7(5).
  - Where an investor in the RWSF does not have an "income interest of 10% or greater" (as defined in section OB 1) in the underlying CFC, FIF income or loss of the underlying CFC will not be attributed to the investor pursuant to section CG 7(5) and the investor will not be required to return FIF income or loss of the underlying CFC pursuant to section CG 1.

  If the underlying foreign company is a CFC and has "qualified control interests" (as defined in section CG 4(6)) in another foreign company, and as a consequence the other foreign company is a CFC as defined in section CG 4, and so on down the chain of CFCs, the above three rulings shall also apply on the basis that any other foreign company is the underlying foreign company.
- If the RWSF is not a CFC *or* the RWSF is a CFC and the investor does not have an "income interest of 10% or greater" (as defined in section OB 1) in the RWSF for any "accounting period" (as defined in section OB 1), a New Zealand resident investor's interest in the RWSF will not constitute an investment in a FIF by virtue of the exemption contained in section CG 15(2)(b).
- Where the terms of issue of the units require the investor to apply for additional units in the RWSF rather than cash distributions of the RWSF's distributable income, the issue of additional units will constitute a non-taxable bonus issue to the investor and accordingly will be excluded from the definition of a dividend pursuant to section CF 3(1)(a).

## The period or income year for which this Ruling applies

This Ruling will apply for the period 11 January 2001 to 31 March 2005.

This Ruling is signed by me on the 11th day of January 2001.

**Martin Smith**

General Manager (Adjudication & Rulings)

# 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.

# PARTNERSHIP INCOME – ACC RESIDUAL CLAIMS LEVY – CLASSIFICATION BY PARTNERS

## Introduction

This item deals with the way in which partners in a partnership are classified for ACC purposes. It replaces the item in *TIB* Vol 7, No 3 (September 1995).

With effect from 1 April 2001, partners are able to classify themselves for residual claims levy purposes on their share of partnership income according to the activity personally performed for the partnership. Previously, each partner was required to use the classification that reflected the business activity of the partnership regardless of the duties personally performed.

Where a partner is engaged in two or more business activities the existing rule still applies. The residual claims levy is calculated on *all* earnings derived from personal exertion at the rate for the business activity with the highest levy rate. A business activity accounting for 5% or less of the total self-employed earnings can be ignored in determining the appropriate classification.

Partners paid a regular wage or salary have earner premium deducted at source as a component part of the PAYE deductions. In terms of its employer responsibilities, the partnership is required to pay the residual claims levy on these earnings using the classification that reflects the *business activity of the partnership*.

## Background

The residual claims levy is payable by:

- Employers on earnings paid to their employees; and
- Self-employed people on their earnings as a self-employed person.

A person deriving a share of partnership profits is a self-employed person and calculates this levy in their IR 3 tax return.

## Legislation

The Accident Insurance Act 1998 defines "Earnings as a self-employed person" –

**20. "Earnings as a self-employed person"** - (1) "Earnings as a self-employed person", in relation to any person and any income year, -

(a) Means A minus B, A being the amount described in subsection (2) and B being the amount described in subsection (3); and

(b) Does not include any earnings as an employee or earnings as a shareholder-employee.

(2) A is the amount of gross income (if any)-

(a) That the person derives in the income year for the purposes of the Income Tax Act1994; and

(b) That is dependent on the person's personal exertions.

(3) B is all amounts allowable as deductions to the person for the purposes of the Income Tax Act 1994 because of the income derived in subsection (2).

The Accident Insurance (Residual Claims Levy) Regulations 2000 provides –

3 Interpretation

…

(2) In these regulations, activity-

(a) means a business, industry, profession, trade, or undertaking of an employer ,a self-employed person, or a private domestic worker; and

(b) includes ancillary or subservient functions relating to the activity, such as administration, management, marketing and distribution, technical support, maintenance, and product development; and

(c) in the case of a self-employed person, refers to the nature of his or her work rather than the context of business in which he or she is working.

…

6 **Classification of employees, self-employed persons, and private domestic workers engaged in 2 or more activities**

(1) An employee, a self-employed person, or a private domestic worker who is engaged in 2 or more activities must be classified in the classification unit for whichever of those activities attracts the highest levy rate under these regulations.

(2) If a particular activity accounts for 5% or less of the person's earnings for the year, then that activity need not be considered when determining the correct classification unit under this subclause.

…

## Application of legislation

The change in the law recognises that although the business activity is operated as a partnership, the partners are individuals and are recognised as single self-employed entities for both income tax and ACC purposes. With inter-spousal partnerships in particular, each partner often brings different skills or contributes in a different way for the collective benefit of the partnership's business. Notwithstanding that collective contribution, it is now recognised as appropriate to classify each partner according to the nature of the work personally performed rather than according to the business activity of the partnership.

This policy change first applies to the residual claims levy calculated in 2001 IR 3 tax returns.

Where a partner derives a share of earnings from two or more partnerships, or personally derives other self-employed income, the residual claims levy must be calculated on *all* shares of partnership earnings and other self-employed income using the relevant highest rated classification. The exception is that if a particular activity accounts for 5% or less of the person's self-employed earnings, then that activity can be ignored for the purposes of determining the appropriate classification.

It should be noted that the policy change does not affect the way a partnership must classify earnings that are approved salary or wages paid to a partner. In terms of its employer responsibilities, the partnership is required to pay the residual claims levy on those earnings using the classification that reflects *the business activity of the partnership*.

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### *Example 1*

Pierre and Susanna are partners in the Plumage TV Aerial Installation Partnership. Pierre does all the installation work and Susanna does all the bookwork and other administrative tasks.

In his 2001 IR 3 tax return, Pierre must classify himself for residual claims levy purposes using the most appropriate description—*Household Equipment Repair Services – Electrical and Electronic (Television antennae installing) 52610* at the rate of 38 cents.

Susanna on the other hand, can classify herself in her tax return according to the work she actually performs for the partnership. The most accurate description is *Business Administrative Services 78540* at the rate of 24 cents.

Susanna also derives a salary from the Plumage TV Aerial Installation Partnership. As the employer entity, the Partnership must pay the residual claims levy in the 2001 IR68A return using the classification that reflects its business, that is *Household Equipment Repair Services – Electrical and Electronic 52610*.

### *Example 2*

Susanna also has an interest in a contract grape-growing venture Over the Hill Vineyards Partnership, in which she actively participates in all of the vineyards operations. The classification unit description is *Grape Growing 01140* at a rate of 39 cents. Therefore, she must pay her residual claims levy at the higher rate of 39 cents on her *shares* of income from *both* partnerships.

### *Example 3*

If Susanna's share of income from the vineyard is 5% or less of her *total* partnership earnings, then the residual claims levy is calculated using the lower 24 cents rate.

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## Sleeping partners

A sleeping partner is a partner who has capital in a partnership and shares in its profits without taking any part in its management or day to day running.
A sleeping partner is not liable for the residual claims levy on their share of partnership income.

The share of partnership income of a sleeping partner is excluded from the definition of "Earnings as a self-employed person" as it is not dependent on the person's personal exertions.

# 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.

# UNSUCCESSFUL APPEAL AGAINST COMMISSIONER'S ASSESSMENTS

**Case:** *IR and PM Hyslop v CIR*

**Decision date:** 1 March 2001

**Act:** Income Tax Act 1976

## Summary

This was an appeal against the judgment of Chambers J reported as *CIR v Hyslop* (2000) 19 NZTC 15,560. That case in turn was a successful appeal by the CIR against the judgment of Barber DCJ reported as *Case T49* (1998) 18 NZTC 8,335.

## Facts

The 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 as a result of their attempt, in about September 1982, to gift capital to their children.

That case itself was in many ways a rerun of *Case M7* (1990) 12 NZTC 2,046 (Judge Bathgate) except that *M7* dealt with the objector's 1982 to 1984 financial years (inclusive), while *Case T49* deals with the years 1985 to 1989 inclusive. 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.

The Commissioner appealed. Chambers J found that the 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 of the Inland Revenue Department Act 1974 (now section 18 of the Taxation Review Authorities Act 1994) was clear—invalidity is a distinct ground of objection. 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) of the 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 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".

The taxpayers appealed further.

## Decision

The Court of Appeal found that the issue of whether the invalidity of the assessments was raised as a ground of objection and the consequences therefrom, was not raised in the Case Stated Appeal. Consequently Chambers J should not have considered and decided this issue.

The Court of Appeal also held that, assuming that the Commissioner had failed to give the taxpayer sufficient reasons for an assessment, that would not invalidate that assessment. The assessment remains valid despite deficient or no notice. Contrary Australian decisions were distinguished as being based on a materially different statutory scheme. However, failure to give sufficient reasons would give the taxpayers the opportunity to seek, and the Commissioner an obligation to provide, further particulars.

In any event, in the circumstances of this case, the Commissioner had given sufficient information as to the grounds of the assessments to the taxpayers.

Whether the assessments were in any event invalid because the Commissioner's delegate had not adequately turned his mind to making a proper assessment was not part of the Authority's decision, and so could not be raised by the taxpayers on appeal by way of case stated. Whether that ground can be pursued in the TRA will be a matter for the TRA.

# WHETHER THE TAXPAYERS' EXPENDITURE IN RELATION TO SPECIFIC QUARRIES WAS CAPITAL

| | |
|---|---|
| **Case:** | *Milburn New Zealand Ltd and Fraser Shingle Ltd v CIR* |
| **Decision date:** | 1 March 2001 |
| **Act:** | Income Tax Act 1976 |
| **Keywords:** | *Capital, Cost of minerals* |

## Summary

Wild J held that the expenditure was capital in nature.

## Facts

Milburn New Zealand Ltd ("Milburn") is a long-established company, which makes and sells cement, concrete and lime and quarries aggregates for its concrete business. Milburn's operations, which began in 1888, were until the late 1980s predominantly in the South Island. As demand for its products expanded in the North Island with its comparatively much larger population, Milburn expanded its business throughout the North Island. During the 1970s and early 1980s it established or expanded cement distribution facilities in most of the larger centres in the North Island. In the late 1970s Milburn set about increasing its cement sales by developing a fully (or vertically) integrated business in cement, readymixed concrete and building aggregates. Milburn's aim was to broaden the range of its business activities to "mine, mix and sell".

During the expansion period of the late 1980s to the mid-1990s Milburn investigated 48 different sites for aggregates, mostly in the North Island. These were generally existing quarries, mainly small. In most cases little effort was expended on investigation. Three other sites, Bombay Hills south of Auckland ("Bombay"), Alpha Creek near Westport ("Alpha Creek"), and Fraser Shingle's expenditure on an aggregate prospect on the Ngaruroro River in Hawkes Bay were at issue in this case.

It was common ground that the expenditure on all three sites was for the purpose of obtaining the necessary consents or licenses.

### *Bombay*

Investigation of the site as a potential hard rock (basalt) quarry to provide roading and concrete aggregates for the Auckland market began in August 1986. Planning consent and water rights were eventually granted by consent in May 1993.

### *Alpha Creek*

The site was investigated in 1989 as a replacement for Milburn's lime quarry on Cape Foulwind. Approval to apply for a mining licence was given by Milburn's board in November 1989.

### *Fraser Shingle*

In June 1988 Fraser Shingle was advised that the gravel extraction from the Ngaruroro River, from which Fraser Shingle obtained its aggregate, may in the future be restricted. This resulted in Fraser Shingle

investigating other sources of aggregate. Between approximately May 1989 to October 1991 investigation into an alternative site, followed by a planning application and hearing, took place. The planning application for the alternative site was unsuccessful.

## Decision

The expenditure was clearly capital, based on:

(a) The nature of the business of Milburn and Fraser Shingle.

(b) The importance of Bombay and Alpha Creek to Milburn's business and the Ngaruroro gravels to Fraser Shingle's business.

(c) The amount of the expenditure.

(d) Its sustained nature, that is the length of time over which the expenditure was incurred.

(e) The nature of the expenditure: all on the obtaining of consents necessary before production could begin.

(f) The combination (c) to (e) when contrasted with the amount, duration and nature of the expenditure on Milburn's 48 other prospects.

These six factors in combination indicated that the taxpayers, having investigated and evaluated the three sites, had made business decisions to expend money in developing the sites for commercial production. The first step, or one of the first steps, to that end was to apply for the necessary consents. The expenditure was a necessary part of the development of the three sites into quarries for the production of aggregate (or in the case of Alpha Creek, lime) for the use in the taxpayers' cement or concrete businesses.

The categorisation of the expenditure dependent upon the outcome has been firmly rejected in New Zealand. The deductibility of the outlay cannot be made to depend upon the success or failure of what the outlay was intended to achieve. His Honour, Wild J, noted that some Canadian cases take a different approach, but *L D Nathan* and *Waste Management* make it clear that they do not represent New Zealand law binding upon him.

Having found the expenditure was clearly capital it was strictly unnecessary to consider the *BP* tests, but his Honour did so in the event his view that the expenditure is capital is held to be wrong.

***The character of the advantage sought***

The expenditure was substantially to obtain the consents and licences necessary to develop the three sites into quarries for aggregate and lime for the taxpayers' cement and concrete businesses. The consents and licences were preferably viewed as inseparable from the quarries to which they related but even if they were viewed separately as assets in their own right, they are enduring and not recurrent in nature.

***Whether the expenditure was from fixed or circulating capital***

This test is considered not useful and disregarded.

***Whether the payments were once and for all and intended to create an enduring asset***

Whether viewed as an integral part of the quarries to which they related (the preferred view), or as assets in their own right, the consents and licences were enduring rather than transient in nature.

***How should expenditure be treated on ordinary accounting principles***

It was accepted that this test has more relevance in England than it does in New Zealand because, irrespective of financial accounting principles, in New Zealand section 104 prescribes what deductions are permissible for taxation purposes and, notwithstanding section 104, section 106 prohibits deductions of capital expenditure. The frequent need for a reconciliation between a company's financial accounts and its accounting for taxation purposes demonstrates that accounting principles and tax law sometimes diverge. Faced with two differing expert views his honour was not prepared to hold that either approach was wrong or the only correct one, though he did have a slight preference for the taxpayers' view. The correct accounting treatment was not determinative of the correct treatment for tax purposes. When two almost diametrically opposed accounting treatments are legitimately available, accounting principles cease to be a useful guide to tax treatment.

***Whether the expenditure is directed towards the structure through which the taxpayer earns its profit or towards the day-to-day carrying on of its business***

Expenditure on one of the steps toward developing quarries or aggregate resources for commercial production is capital, in that it is expended on assets which will produce income within the taxpayers' businesses.

## Deduction under section 74 (2)(b)

The issue between the parties is whether section 74(2)(b) is to be applied to the taxpayers' aggregate winning operations generally—allowing deduction of all costs associated with them—or only when and where costs can be matched with profits from identifiable "extractions". The first general, or "cross-the-board", basis was contended for by the taxpayers, the latter "site or quarry specific" approach by the Commissioner.

The Commissioner's approach was accepted. Section 74(2)(b) allows the deduction of capital costs of "land based" assets but only by way of reduction from the income earned from them. A deduction for the capital cost in relation to each quarry is allowed only in the years in which income is produced from the extraction of minerals from that quarry. The expenditure must be amortised over the life of the relevant asset.

# AMENDED ASSESSMENTS ISSUED UNDER SECTION 113 TAX ADMINISTRATION ACT 1994 IN RESPECT OF 1994 INCOME YEAR INVALID

| | |
|---|---|
| **Case:** | *TRA Number 010/00, 011/00 and 012/00. Decision Number 002/2001* |
| **Decision date:** | 9 March 2001 |
| **Act:** | Income Tax Act 1976, Tax Administration Act 1994 |
| **Keywords:** | *Validity of assessment* |

## Summary

The Commissioner was unsuccessful.

## Facts

There were three Disputants in this case. Two of these, A Company Limited and B Company Limited, were loss attributing qualifying companies ("LAQCs") and the remaining Disputant, C Company Limited, was a shareholder in B Company Limited.

The LAQCs claimed losses and, as a consequence, the shareholders claimed proportions of those losses. The claimed losses were disallowed by the Commissioner under section 99 of the Income Tax Act 1976 because the claimed expenses had not been incurred.

On 29 March 2000 the Commissioner issued amended assessments against A Company Limited and B Company Limited (the LAQCs), in respect of the 1994 income year, and against C Company Limited, in respect of the 1995 income year. The officer who made the assessments on the Commissioner's behalf had the delegated authority to make assessments under the Income Tax Act 1976 and the Tax Administration Act 1994, as well as other Revenue Acts. At the time of making the amended assessments, her evidence was that she did not consider whether she was making them under section 23 of the Income Tax Act 1976 or section 113 of the Tax Administration Act 1994, which are identical provisions.

The Notices of Amended Assessment were sent with covering letters. The covering letters, which were not prepared or signed by the assessing officer, stated that "it is now necessary to make an amended assessment under section 113 Tax Administration Act, 1994".

As a consequence the Disputants claimed that, in issuing the amended assessments, the Commissioner purported to exercise a power contained in section 113 of the Tax Administration Act 1994 which does not authorise him to issue assessments in respect of income years commencing prior to 1 April 1995. The Disputants claimed that the amended assessments were therefore a nullity.

## Decision

Despite the assessing officer's evidence that, at the time of making the assessment, she had not considered whether she was making it under section 23 of the Income Tax Act 1976 or section 113 of the Tax Administration Act 1994, the Authority was satisfied that "the officer at all times intended to rely upon the 1994 Act, considered she was right to do so and remains of that view down to the present time." The Commissioner had turned his mind to the wrong statutory provision and, therefore, not obeyed the statutory requirement for the exercise of his legal authority to make an assessment. The Authority held that the Tax Administration Act 1994 has no retrospective effect in relation to these assessments and, therefore, they were not lawful assessments and the Disputants must succeed.

The Commissioner had submitted that, even if the assessments had been purportedly made under the 1994 Act:

> By virtue of section 114 of the Tax Administration Act 1994 and section 26 of the Income Tax Act 1976, any failure to comply with any of the provisions of those Acts did not affect the validity of the assessments.
>
> The transitional provisions and savings in the Tax Administration Act 1994 operate to make the reference to the letters complained of, a reference to the 1976 Act. Section 227(4) of the Tax Administration Act 1994 provides that a reference in any document to a provision of that Act (here, section 113) shall be construed as including, in relation to the purposes to which the corresponding provision in the repealed enactment (section 23 of the Income Tax Act 1976) has or had effect, a reference to that corresponding provision.

These submissions were not addressed in the decision beyond the statements that the Interpretation Act 1999 does not validate the exercise of a power contained in legislation not in force at the time of the events to which the power relates. "To the contrary" said the Authority, "section 7 provides 'an enactment does not have retrospective effect.' ... Nothing in sections 2, 109A or 227(4) of the Tax Administration Act 1994 derogates from this simple requirement."

In relation to the C Company Limited section 89C issue, the Authority accepted the Commissioner's submission that by virtue of subsection (k) the provisions of section 89C (which requires that a NOPA be issued before an assessment) do not apply. Subsection (k) states an exception where the assessment corrects a tax position taken by the taxpayer as a consequence of an incorrect tax position taken by another taxpayer to whom a correct assessment is issued also. This conclusion did not affect the outcome of the case in relation to this Disputant.

# CORRECTION TO PREVIOUS ITEM

## AMOUNTS REMITTED TO BE GROSS INCOME

Section CE 4(1) Income Tax Act 1994 states:

> (1) Subject to section EZ 9(2), where the amount of any expenditure or loss incurred by a taxpayer has been allowed as a deduction for any income year, and subsequently the liability of the taxpayer in respect of that amount is remitted or cancelled in whole or in part, the amount so remitted or cancelled shall be deemed to be gross income for that income year.

The Commissioner is of the view that the words "that income year" refer to the income year in which the deduction was taken. This view is supported by section CE 4(3) which removes the time bar for amending an assessment when applying section CE 4.

This corrects the item in *Tax Information Bulletin* Vol 8, No 9 (November 1996), which states that the amount remitted is gross income in the year in which it is remitted or cancelled.

# REGULAR FEATURES

# DUE DATES REMINDER

## April 2001

5 **Employer deductions and Employer monthly schedule**

Large employers ($100,000 or more PAYE and SSCWT deductions per annum)

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

9 **End-of-year income tax**

7 April 2001, 2000 end-of-year income tax due for clients of agents with a March balance date

20 **Employer deductions**

Large employers ($100,000 or more PAYE and SSCWT deductions per annum)

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

**Employer deductions and Employer monthly schedule**

Small employers (less than $100,000 PAYE and SSCWT deductions per annum)

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

30 **GST return and payment due**

## May 2001

7 **Employer deductions and Employer monthly schedule**

Large employers ($100,000 or more PAYE and SSCWT deductions per annum)

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

21 **Employer deductions**

Large employers ($100,000 or more PAYE and SSCWT deductions per annum)

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

**Employer deductions and Employer monthly schedule**

Small employers (less than $100,000 PAYE and SSCWT deductions per annum)

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

31 **ACC due date for employers:**

- Annual 2001 *ACC residual claims levy statement (IR 68A)* and payment due

**FBT return and payment due**

**GST return and payment due**

*These dates are taken from Inland Revenue's* Smart business tax due date calendar 2001–2002

# 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:

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| | ***Public rulings*** | ***Comment deadline*** |
|---|---|---|
| ☐ | **PU3398:** Federal Insurance Contributions Act (FICA) – fringe benefit tax (FBT) liability | 30 April 2001 |
| ☐ | **PU0059:** Nine rulings dealing with the application of the Estate and Gift Duties Act 1968 and the Income Tax Act 1994 to nine different arrangements. These rulings replace BR Pub 96/1 and BR Pub 96/2A, as conclusions in those earlier rulings have changed as a result of the House of Lords decision in *Ingram v IRC* [1999] 1 All ER 297 | 31 May 2001 |

| | ***Issues papers*** | ***Comment deadline*** |
|---|---|---|
| ☐ | **IP3502:** Interest deductibility in certain arrangements | 31 May 2001 |

*Items are not generally available once the comment deadline has passed*

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