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Inland Revenue
Te Tari Taake

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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 item is available for review/comment this month, having a deadline of 31 August 2001. Please see page 57 for details on how to obtain a copy:

Ref.	Draft type	Description
PU2956	Public ruling	Payments made by parents or guardians of students to state schools – GST treatment

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).

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FEDERAL INSURANCE CONTRIBUTIONS ACT (FICA) – FRINGE BENEFIT TAX (FBT) LIABILITY

PUBLIC RULING – BR Pub 01/05

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of sections CI 1(e), CI 1(g) and CI 1(h).

The Arrangement to which this Ruling applies

The Arrangement is the deduction of FICA contributions and the paying of these along with the employer contribution, to the United States Federal Government in accordance with the Federal Insurance Contribution Act, by any New Zealand resident employer who is required to do so due to employing a citizen or citizens of the United States of America.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Moneys paid to FICA are not subject to FBT under section CI 1(g), as the contributions are not made to a "superannuation scheme" as defined in section OB 1.
- Moneys paid to FICA are not subject to FBT under section CI 1(h), as no benefit is received by the employee in the quarter or income year within the meaning of the FBT rules.
- Moneys paid to FICA are not subject to FBT under section CI 1(e), as the FICA scheme has not been approved by the Commissioner for the purposes of section CB 5, and FICA is not a "sick, accident or death benefit fund" as defined in section CB 5(2).

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 July 2001 to 30 June 2004.

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

Martin Smith

General Manager (Adjudication & Rulings)

COMMENTARY ON PUBLIC RULING BR PUB 01/05

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 01/05 ("the Ruling").

Background

If a United States Citizen is employed in New Zealand, under the Federal Insurance Contributions Act (FICA) of the United States of America, employers and employees may be required to contribute a stated percentage of taxable wages paid to the FICA scheme. The employee portion of the FICA contribution must be withheld and paid from each payment of taxable wages, and in addition the employer must pay the employer portion.

The FICA establishes two funds. The first is old age, survivors, and disability insurance (OASDI). The second is hospital insurance (HI). The current rate of contribution to the FICA scheme is 7.65%, made up of 6.2% for OASDI and 1.45% for the HI portion. This OASDI/HI rate of 7.65% is imposed on both the employer and the employee, so the employer contribution together with the employee's withheld amount result in a combined rate of 15.3%.

Legislation

The relevant meaning of "fringe benefit" is defined in section CI 1 as follows:

> In the FBT rules, "fringe benefit", in relation to an employee and to any quarter or (where fringe benefit tax is payable on an income year basis under section ND 4) income year, means any benefit that consists of –
>
> …
>
> (e) In relation to an employer of an employee, any contribution to any sick, accident, or death benefit fund which has been approved by the Commissioner for the purposes of
> CB 5:
>
> …
>
> (g) Any contribution in relation to an employer of an employee, to any superannuation scheme:
>
> (h) Any benefit of any other kind whatever, received or enjoyed by the employee in the quarter or (where fringe benefit tax is payable on an income year basis under section ND 4) income year, -

The relevant meaning of "superannuation scheme" is defined in section OB 1 as follows:

> "Superannuation scheme" means-
>
> …
>
> (c) Any arrangement constituted under an Act of the Parliament of New Zealand, other than the Social Security Act 1964, principally for the purpose of providing retirement benefits to natural persons; or any similar arrangement constituted under the legislation of any country, territory, state, or local authority outside New Zealand;–
>
> and where the superannuation scheme is a trust, any reference in this Act to a superannuation scheme includes a reference to the trustees of that scheme:

Application of the legislation

The substantive issue is whether the employer is required to pay fringe benefit tax (FBT) on any part of the contributions made to the FICA scheme.

The employee contribution is required to be withheld from the employee's gross income by the employer and is therefore not considered to be a fringe benefit provided by the employer, as it is expenditure on account of the employee.

The employer contribution is required to be paid over and above the employee's gross salary or wages. An issue arises as to whether FBT applies to the employer contribution, as this is a payment by an employer in relation to an employee.

Section CI 1(g)

Section CI 1(g) concerns whether contributions are made to a "superannuation scheme", as defined in section OB 1, and therefore attract FBT.

Under subsection (c) of that definition, "superannuation scheme" includes:

> any arrangement constituted under an Act of the Parliament of New Zealand, other than the Social Security Act 1964, principally for the purpose of providing retirement benefits to natural persons; or any similar arrangement constituted under the legislation of any country, territory, state, or local authority outside New Zealand.

Therefore, to come within the "superannuation scheme" definition, an arrangement constituted under the legislation of any country or state outside New Zealand, such as FICA, must be similar to an arrangement constituted under New Zealand legislation that has the principal purpose of providing retirement benefits.

Two basic or generic types of employee superannuation schemes exist: defined contribution schemes and defined benefit schemes. A defined contribution scheme is one where contributions are defined in advance, usually as a fixed percentage of an employee's salary, and benefits are determined by the amount of accumulated contributions plus income earned on those contributions. In such schemes the principle of allocated funding is employed, where contributions are invested as a common fund, but separate accounts are opened in respect of each member. Given that there is no beneficial entitlement to any particular amount that has been contributed to the FICA scheme (as the FICA scheme pays a statutorily fixed benefit on the basis of eventual eligibility as opposed to contributions made), it is considered that the FICA is not a sufficiently similar arrangement to a defined contribution scheme.

A defined benefit scheme is one that provides benefits based on a predetermined formula, usually relating the benefit level to the number of years of service and, in some cases, the average or recent levels of pay. Such schemes employ unallocated funding, and the employer contribution rate varies in order to meet the cost of providing the defined benefit. While FICA may *prima facie* appear similar to such a scheme in that it also employs unallocated funding and members contribute a fixed percentage of salary, it is considered the FICA is not sufficiently similar to a generic defined benefit scheme, as the employer's contribution and employee's contribution are matched and the rate is contained in statute. This statutorily imposed rate is fixed by the Federal Government of the United States, is involuntary, and an employer who fails to contribute the full amount as set down in statute may be liable for civil or criminal penalties.

It is therefore considered that FICA is not a sufficiently similar arrangement to either of these generic schemes (constituted under an Act of the Parliament of New Zealand principally for providing retirement benefits) to be regarded as a superannuation scheme as defined in section OB 1.

It is further concluded that the FICA is more similar to the New Zealand Social Security Act 1964, which is explicitly excluded from the definition of "superannuation scheme" as (on the words of the section) are similar arrangements constituted under the legislation of another country. Both schemes are tax funded and are the main government-provided retirement benefit schemes in the respective countries. In addition, both schemes form the basis of the social security systems in the respective countries, providing additional benefits such as those for sickness and disability. This conclusion takes FICA outside the definition of "superannuation scheme", so contributions to the FICA are not caught by section CI 1(h) as being liable to FBT.

Furthermore, contributions to FICA are more like a tax than a contribution to any superannuation scheme, as supported by the words of the Federal Insurance Contributions Act referring to the contributions as an "excise tax" (section 3111(a) and 3111(b)) and the penalties payable for non-payment of contributions that are the same as those for non-payment of federal income tax under the Internal Revenue Code. This view is also supported by an Australian decision, *Case 20* CTBR (NS) Vol. 7, 91 that by a majority held *employee* contributions under the FICA to be in the nature of an income tax, implying that the compulsory employer contribution is likewise more in the nature of a tax.

Section CI 1(h)

Section CI 1(h) includes as a fringe benefit "any benefit of any other kind whatever".

In addition, a fringe benefit under section CI 1(h) must be a benefit that is:

> used, enjoyed, or received, whether directly or indirectly, in relation to, in the course of, or by virtue of the employment of the employee… and which is provided or granted by the employer of the employee.

The Commissioner considers that the withholding of amounts from employees' wages or salaries provides no benefit. As to the employer's contribution, it is considered that in the absence of a beneficial entitlement to a matched contractual amount, no benefit is provided either.

It cannot be said that the employee receives a benefit at the point in time the employer makes a contribution to FICA, because it is a compulsory tax, goes into the Federal Government tax pool, and no beneficial sum is "belonging" to the employee. In addition, any eventual benefits from the FICA scheme do not satisfy the combination of requirements in section CI 1(h) to attract FBT liability.

It is a contingency whether the taxpayer ever receives any payment back from the Federal Government, as any benefit received depends on an individual meeting the eligibility requirements (entitlement to the old age benefit is based on reaching the age of 62 and being *fully* insured).

If an individual does receive a payment under the FICA scheme (paid as a monthly benefit), the person does so because of his or her United States citizenship and meeting the eligibility criteria etc. The person receives the government mandated amount, as opposed to a sum based on actual contributions made to the scheme.

So whilst eligibility in part is due to previous contributions made to FICA (and some of these are made by the employer), and this may be considered, "indirectly, in relation to, in the course of, or by virtue of the employment of the employee", if these words are of the widest import, overall, it is considered the nexus or connection between any eventual benefit and the employment of the employee is too remote (especially given that the only nexus is to eligibility at all, and not in any way connected to the quantum of any eventual benefit received).

Principally, the reason the benefit is received by the employee is not by virtue of the employee's employment, but because the employee is a United States citizen. Contributions to the scheme are not made voluntarily, but are compulsorily imposed by the Federal Government of the United States, and are not part of any employment contract or remuneration package.

Any amounts received by a United States citizen from FICA will be received from the Federal Government and not in the course of, or by virtue of, the employment relationship. Such a conclusion is consistent with the outcome of *Constable v FC of T* (1952) 86 CLR 402, where the High Court of Australia concluded that Constable only became entitled to payments under his scheme as a result of contingencies that had become absolute in the year in question, but that such an event did not give rise to an "allowance, gratuity, compensation, benefit […]" to the employee "in respect of, or for or in relation" to his employment.

Accordingly, no benefit is "received by the employee in the quarter or income year" when the employee is being paid, and no sufficient nexus exists between the employer's requirement to pay funds to the Federal Government of the United States and the ultimate benefit the employee may eventually receive from the government at a later date, if eligible under statute.

Section CI 1(e)

Section CI 1(e) includes as a fringe benefit:

> In relation to an employer of an employee, any contribution to any sick, accident, or death benefit fund which has been approved by the Commissioner for the purposes of section CB 5:

The Commissioner has not approved the FICA scheme for the purposes of section CB 5.

The term "sick, accident, or death benefit fund" is not defined for the purpose of section CI 1(e), but is defined in section CB 5(2) for the purpose of that section. Section CI (1)(e) and section CB 5(2) are interlinked, as section CI (1)(e) requires that a "sick, accident or death benefit fund" be approved by the Commissioner for the purposes of section CB 5. To be approved under section CB 5 such a fund must satisfy the section CB 5(2) definition.

The FICA scheme is not a "sick, accident, or death benefit fund" as that term is defined in section CB 5(2), as the FICA scheme is not established for the "benefit of the employees of any employer" as required by that definition. FICA is the funding scheme for the provision of United States social security benefits and there is no sufficient nexus between the employer's requirement to pay funds to FICA and any benefit the employee may eventually receive from the government at a later date, if eligible under statute.

Accordingly, any payments made to the FICA scheme are not considered to be subject to fringe benefit tax under section CI (1)(e).

MAORI TRUST BOARDS: DECLARATION OF TRUST FOR CHARITABLE PURPOSES MADE UNDER SECTION 24B OF THE MAORI TRUST BOARDS ACT 1955 – INCOME TAX CONSEQUENCES

PUBLIC RULING – BR Pub 01/07

Note (not part of ruling): This ruling is essentially the same as public ruling BR Pub 97/8 which was published in *TIB* Vol 9, No 8 (August 1997). BR Pub 97/8 applied up until 31 March 2001. Therefore this new ruling still relates to the charitable status of trusts established by Maori Trust Boards pursuant to the execution of a declaration of trust, under section 24B(1) of the Maori Trust Boards Act 1955. However, it should be noted that the reissue of BR Pub 97/8 is separate from the government discussion document on taxation issues relating to charities and non-profit bodies (Tax and Charities) which was released for public consultation on 14 June 2001, for comments by the end of July 2001.

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Law

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

This Ruling applies in respect of sections CB 4 (1)(c) and CB 4 (1)(e) of the Income Tax Act 1994.

The Arrangement to which this Ruling applies

This arrangement is the derivation of income by a trust established by a Maori Trust Board pursuant to the execution of a declaration of trust, under section 24B(1) of the Maori Trust Boards Act 1955, declaring that it stands possessed of any of its property upon trust for charitable purposes.

How the Taxation Law applies to the Arrangement

Where a Maori Trust Board executes a declaration of trust that it shall stand possessed of property for charitable purposes, under section 24B(1) of the Maori Trust Boards Act 1955, the income of such a trust is exempt from income tax under sections CB 4 (1)(c) or CB 4 (1)(e) of the Income Tax Act 1994 if:

- all of the purposes specified in the declaration of trust are purposes that are specified in sections 24 or 24A of the Maori Trust Boards Act 1955; and
- the Commissioner is satisfied that, with the exception of the charitable purpose requirement and the public benefit test, all other requirements of charitable status are met; and
- the declaration of trust has been submitted to and approved by the Commissioner of Inland Revenue, as required by section 24B(3) of the Maori Trust Boards Act 1955.

The period for which this Ruling applies

This Ruling applies to income derived by such a Maori Trust Board during income years falling within the period 1 April 2001 and 31 March 2006 (inclusive).

This Ruling is signed by me on the 9th day of July 2001.

Martin Smith

General Manager (Adjudication & Rulings)

COMMENTARY ON PUBLIC RULING BR PUB 01/07

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 01/07 ("the Ruling").

Background

Sections CB 4 (1)(c) and (e) of the Income Tax Act 1994 provide the following exemptions from income tax for income derived by a charitable trust:

- Under section CB 4 (1)(c), income derived by trustees in trust for charitable purposes or by any institution established exclusively for charitable purposes (except income to which section CB 4 (1)(e) applies).
- Under section CB 4 (1)(e), income derived from a business carried on by trustees in trust for charitable purposes or by any institution established exclusively for charitable purposes.

Neither exemption is available if any person is able to influence the amount of any private pecuniary benefit from the trust. The exemption under CB 4 (1)(e) only applies to the extent that the charitable purposes are limited to New Zealand.

Under section 24B of the Maori Trust Boards Act 1955, a Maori Trust Board may declare that it holds property in trust for charitable purposes. The income of the trust can only be applied for those purposes set out in sections 24 and 24A of that Act and which are specified in the declaration of trust. Section 24B deems the income of such a trust to be income derived by trustees in trust for charitable purposes for the purposes of the Income Tax Act 1994.

Income tax exemption – section CB 4 (1)(c) and (e)

Section CB 4 (1) provides an exemption from income tax for:

> …
>
> (c) Any amount derived by trustees in trust for charitable purposes or derived by any society or institution established exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual, except where the income so derived is income to which paragraph (e) applies:
>
> …
>
> (e) Any amount derived directly or indirectly from any business carried on by or on behalf of or for the benefit to trustees in trust for charitable purposes within New Zealand, or derived directly or indirectly from any business carried on by or on behalf of or for the benefit of any society or institution established exclusively for such purposes and not carried on for the private pecuniary profit of any individual.
>
> Provided that if those purposes are not limited to New Zealand the Commissioner may apportion the income in such manner as the Commissioner deems just and reasonable between those purposes within New Zealand and the like purposes out of New Zealand, and accordingly only a part of the amount may be exempt income:…

Maori Trust Boards Act 1955

Section 24B of the Maori Trust Boards Act 1955 states:

> (1) Any Board may from time to time, in its discretion, execute under its seal a declaration of trust declaring that it shall stand possessed of any of its property, whether real or personal, upon trust for charitable purposes.
>
> (2) Any income derived by the Board from any property to which the declaration relates shall be applied for such purposes referred to in section 24 or section 24A of this Act as may be specified in the declaration of trust; and, for the purposes of the Income Tax Act 1994, any such income shall be deemed to be income derived by trustees in trust for charitable purposes.
>
> (3) No declaration of trust under this section shall have any force or effect unless it has been approved by the Commissioner of Inland Revenue.

Sections 24 and 24A specify the purposes for which a Maori Trust Board may apply money.

Application of the Legislation

Charitable purposes

For a trust to be considered charitable for the purposes of the Income Tax Act, it must generally meet the common law requirements of charity. That is, a trust must be established for a **"charitable purpose"**, and must meet what is known as the **"public benefit test"**.

The term "charitable purpose" is defined in the Income Tax Act, as:

> …includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community:

The Court of Appeal noted in *Molloy v CIR* (1981) 5 NZTC 61,070 that the definition of charitable purpose in the Income Tax Act does not have the effect of enlarging or altering the ordinary, general law, meaning of charity. This means that it is necessary to refer to general law to determine whether any specific taxpayer, or activity, is charitable. In *Commrs of IT v Pemsel* [1891] AC 531, p.583, Lord Macnaghten determined that all charitable purposes fall within four classes of charity (known as the "Pemsel Heads"), namely:

- the advancement of religion;
- the relief of poverty;
- the advancement of education; and
- any other matter beneficial to the community.

In addition to falling within one of the "Pemsel Heads", with the exception of a trust for the relief of poverty, to be charitable in law a trust must be established for **the benefit of the community or a sufficiently important class of the community**, rather than for the benefit of private individuals. This requirement, which is in addition to the objects of the charity falling within one of the four heads listed above, is known as the public benefit test.

The public benefit test has been endorsed and further developed by a large body of case law, including *Verge v Somerville* [1924] All ER 121, *Oppenheim v Tobacco Securities Trust Company Limited* [1951] 1 All ER 31, *Davies v Perpetual Trustee Co. (Ltd.)* [1959] 2 All ER 128 and *New Zealand Society of Accountants v CIR* [1986] 1 NZLR 148.

Section 24B of the Maori Trust Boards Act 1955

Section 24B of the Maori Trust Boards Act 1955 was inserted into that Act by section 3 of the Maori Trust Boards Amendment Act 1962. Section 24B permits the establishment of charitable trusts by Maori Trust Boards, and provides a concessionary tax treatment of the income of such trusts.

There are two possible interpretations of the meaning of section 24B of the Maori Trust Boards Act:

- The first interpretation is that a declaration can only be made under section 24B(1) if the purposes of the trust are exclusively **charitable**, i.e. "charitable" being interpreted as the common law meaning of the term. Although section 24B(2) only requires that the income of the trust must be applied for purposes referred to in section 24 and 24A, it follows from this approach that, as the trust must be also charitable, the income can only be applied for section 24 and 24A purposes that are themselves charitable. Such income would therefore be exempt under the provisions of the Income Tax Act.
- The second interpretation is that the income of a section 24B trust can be applied for **any** of the purposes referred to in section 24 or 24A – whether those purposes are charitable under general law or not. However, this approach proceeds upon the basis that any income derived by the trust is **deemed** by section 24B(2), to the extent that it is applied for purposes specified in sections 24 and/or 24A, to be income derived in trust for charitable purposes for the purposes of the Income Tax Act, and therefore exempt from income tax. This is irrespective of whether the purpose is a purpose that would generally be considered charitable in law.

The background papers relating to the introduction of section 24B, including *Hansard*, indicate that the new section was intended to remedy the concern, at the time, that trusts established by Maori Trust Boards were not considered charitable in terms of both the common law and the income tax legislation.

This view of the law was confirmed by the Court in *Arawa Maori Trust Board v Commissioner of Inland Revenue* (1961) 10 MCD 391. In that case Donne S M ruled that a trust established by the Arawa Maori Trust Board was not charitable because:

- Many of the purposes specified in section 24 of the Maori Trust Boards Act 1955 were not charitable purposes under the general law; and
- The trust failed the public benefit test because it was for the benefit of a group of persons determined by their bloodline, or whakapapa. The Court determined that such a group of people did not satisfy the public benefit test.

Analysis

The Commissioner believes the better view of the law to be that contained in the second interpretation, as set out above, and that the first interpretation was not what was intended by Parliament.

As has been noted, at the time that section 24B was enacted, it was strongly arguable, taking into account the Court decision in *Arawa*, that a trust that benefits a specific tribe or iwi, or the members of such a tribe or iwi, cannot be charitable at common law because it will not meet the requirements of the public benefit test. Therefore, it would be arguable that any trust established under section 24B could not be charitable, irrespective of the purposes for which it was established, because Maori Trust Boards are acknowledged by the Maori Trust Boards Act to be for the benefit of iwi and hapu determined on the basis of whakapapa.

This would give rise to a situation where, despite the enactment of section 24B, trusts established by Maori Trust Boards would possibly continue to be denied charitable status, and the amendment would have no effective operation. Clearly, this cannot have been the intention of Parliament.

Taking this into account, and after considering the available background documents, the Minister's statement (as recorded in *Hansard*) and the Commissioner of Inland Revenue's practice immediately following the enactment of section 24B, the Commissioner believes that the second interpretation is the correct view of the law.

Under this interpretation, section 24B(1) allows a Maori Trust Board to declare that it holds property in trust for charitable purposes, and authorises the Trust Board to settle some of the Trust's assets to a charitable trust.

Section 24B(2) contains two limbs. The first limb states:

> Any income derived by the Board from any property to which the declaration relates shall be applied for such purposes referred to in section 24 or section 24A of this Act as may be specified in the declaration of trust; …

The Commissioner considers that this limb limits the purposes for which the income of a charitable trust can be applied to those purposes that are referred to in sections 24 and 24A. The purposes for which the income is to be applied must be specified in the declaration of trust.

As previously noted, many of the purposes referred to in sections 24 and 24A may not be charitable purposes under common law. In addition, any trust established by a Trust Board is only allowed to apply its income for the benefit of the Trust Board's beneficiaries, which are restricted, by the Maori Trust Boards Act, to the members of specified iwi. Such a requirement could mean that a trust would fail the public benefit test applied under the common law.

However, the second limb of section 24B(2) **deems** the income of the trust to be "income derived by trustees in trust for charitable purposes". The second limb states:

> and, for the purposes of the Income Tax Act 1994, any such income shall be deemed to be income derived by trustees in trust for charitable purposes.

Therefore, the effect of this section is to deem the income of the trust, even though it is established for purposes that may not be charitable in general law, to be "income derived by trustees in trust for charitable purposes" for the purposes of the Income Tax Act 1994. This means that the requirements of sections CB 4 (1)(c) and (e) of the Income Tax Act 1994, to the extent that those sections only apply to "income derived by trustees in trust for charitable purposes", have been satisfied. It is, therefore, not necessary for such a trust to satisfy the common law requirements of "charitable purpose" and the "public benefit test".

However, it should be noted that section 24B(2) of the Maori Trust Boards Act only modifies the requirements of the Income Tax Act. It does not apply for any other purposes.

Therefore, whatever may be the position of such a trust under common law and irrespective of whether the public benefit test would be failed in other contexts, the Commissioner is satisfied that in this provision Parliament intended for a trust established under section 24B to be treated as being a charitable trust for income tax purposes. The income of such a trust is therefore treated as having been derived for charitable purposes and as such is exempt from income tax under sections CB 4 (1)(c) or (e) of the Income Tax Act 1994.

Nevertheless, before that exemption can be applied, the requirements of section 24B(3) must be satisfied. That section requires a declaration of trust under section 24B(1) to be approved by the Commissioner of Inland Revenue before it will take effect. The Commissioner must still be satisfied that the constituting documents of the trust meet the legal requirements of a charitable trust, other than the public benefit test discussed above.

Approval of charitable trust

As has been outlined earlier in this commentary, section 24B(2) of the Maori Trusts Board Act 1955 modifies the general law requirements of a trust established under subsection (1) to the extent that the trust is not required to satisfy the meaning of "charitable purpose" in section OB 1 of the Income Tax Act 1994 or the public benefit test. However, before such a trust will be approved by the Commissioner under section 24B(3) as wholly exempt from tax, the trust must still meet the other criteria of a charitable trust.

For example, the Commissioner must also be satisfied that the declaration of trust provides that:

- the charitable activities are restricted to New Zealand;
- the rules of the trust cannot be changed in order to allow the income of the trust to be applied to purposes that are not specified in sections 24 or 24A of the Maori Trust Boards Act, or to otherwise affect the charitable nature of the trust;
- no person is able to derive a personal pecuniary profit from the trust;
- trustees are unable to materially influence their remuneration;
- professional services provided by trustees to the trust are provided at commercial rates and that conflicts of interest are avoided; and
- upon winding up, any remaining trust assets must be applied for charitable purposes.

This is not an exhaustive list of all matters that the Commissioner will consider when deciding whether or not a trust is charitable, and therefore entitled to the tax exemptions under sections CB 4 (1)(c) and (e).

When a section 24B trust has previously obtained the approval of the Commissioner, as required by section 24B(3) of the Maori Trust Boards Act, that approval will continue to apply. Approval given by the Commissioner under section 24B(3) cannot be revoked. However, continued tax exemption in respect of the income of the trust is dependent on the trust continuing to apply its income for the purposes specified in the declaration.

Comments on technical submissions received prior to the previous public ruling being issued

When a draft public binding ruling on this subject was first made available for public comment, a number of submissions were received that disagreed with the views expressed in that draft ruling. In particular, those submissions noted that the Commissioner did not appear to have taken into account the use of a deeming provision in section 24B. That view, that the deeming provision effectively creates a charitable trust where one would not exist under general charitable law, was incorporated into the previous ruling and has been included in this ruling.

A number of commentators also disagreed with the Court decision in *Arawa* and the general position of trusts for the benefit of iwi under the public benefit test. That issue was referred to in the commentary to the previous ruling, and is referred to in this commentary in so far as it is relevant to the issue being considered. While the Commissioner did consider the position of such trusts generally in an interpretation paper (IP3168) which went out for public consultation in January 2000 that matter has been put on hold pending the outcome of the recently released government discussion document on taxation issues relating to charities and non-profit bodies.

A submission was also received that argued that the Commissioner was not legally able to issue a binding ruling on the effect of a declaration made under a provision of an Act other than one of the Inland Revenue Acts. The Commissioner was, and is, of the view that he is able to issue this Ruling because it relates to the consequences of such a declaration under the income tax law and, in particular, to the application of sections CB 4 (1)(c) and CB 4 (1)(e) of the Income Tax Act 1994.

In the context of the previous ruling, Te Runanga O Ngai Tahu asked for the ruling to be expanded to deal specifically with its specific circumstances. The Ngai Tahu Trust Board executed a declaration of trust pursuant to section 24B in 1975. That Trust Board was dissolved by the Te Runanga O Ngai Tahu Act 1996, which also established the Runanga. All of the assets and liabilities of the former trust board were vested in the new Runanga. Section 30(1)(c) of the Te Runanga O Ngai Tahu Act provides:

> **30. Taxes and duties**—(1) For the purposes of the Inland Revenue Acts (as defined in section 3(1) of the Tax Administration Act 1994) and any other enactment that imposes or provides for the collection of any tax, levy, or other charge,—
>
> (c) Notwithstanding the dissolution of the Ngaitahu Maori Trust Board by this Act, any income derived by Te Runanga o Ngai Tahu from any property to which a declaration of trust made by the Ngaitahu Maori Trust Board under section 24B of the Maori Trust Boards Act 1955 and dated the 24th day of March 1975 relates shall, if applied for the purposes specified in the declaration, be deemed, for the purposes of the Income Tax Act 1994, to be income derived by Te Runanga o Ngai Tahu in trust for charitable purposes.

The Commissioner remains of the view that, notwithstanding the fact that the Trust Board has been dissolved and no longer exists, section 30(1)(c) provides that any income derived from property that was subject to the original declaration, to the extent that it is applied for the purposes specified in the declaration, shall be treated for tax purposes as being derived in trust for charitable purposes. This means that the income of the trust created under section 24B of the Maori Trust Boards Act will continue to be exempt for tax purposes.

Similar provisions may apply to other section 24B trusts established by Trust Boards that have since been dissolved.

Application of this Ruling

Section 91DA(1)(d) of the Tax Administration Act 1994 requires the Commissioner to state the period for which a public binding ruling applies. The Commissioner has determined that this public ruling will apply to income derived by approved trusts during income years falling within the period 1 April 2001 to 31 March 2006, inclusive.

Examples

Example 1

A Maori Trust Board executes a declaration of trust under section 24B of the Maori Trust Boards Act 1955. The declaration provides that the trust will hold certain assets upon trust for charitable purposes. The declaration specifies that the income of the trust will be applied by making grants to reimburse any dental costs incurred by any of the beneficiaries, being members of the iwi.

The declaration is submitted to the Commissioner who is satisfied that the purpose for which the trust's income will be applied is a purpose specified in section 24 of the Maori Trust Boards Act (*section 24(2)(a)(iii) "The promotion of health … by providing, subsidising, or making grants for medical, nursing, or dental services"*) and that there are adequate provisions in the Trust Deed to prevent the Trust's income and assets from being used for other purposes.

The Commissioner will therefore approve the declaration and the income of the trust will be exempt from income tax under sections CB 4 (1)(c) and CB 4 (1)(e) of the Income Tax Act 1994.

Example 2

A Maori Trust makes a declaration under section 24B for the same purpose as described in Example 1. The Commissioner is satisfied that the purpose for which the Trust's income is to be applied is a purpose that is specified in either section 24 or section 24A of the Maori Trust Boards Act.

However, it is found that the declaration does not prohibit the trustees from materially influencing the amount of remuneration that they receive. The declaration also does not provide for the disbursement of assets, upon winding up, to other charitable entities or purposes.

The Commissioner will therefore decline approval until such time as the declaration is amended in such a manner to satisfy the Commissioner's requirements.

PRODUCT RULING – BR PRD 01/05

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 ASB NZ Shares Trust.

Taxation Law

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

This Ruling applies in respect of sections CF 2 (1)(i) and CF 3 (1)(b).

The Arrangement to which this Ruling applies

The Arrangement is the establishment and continued operation of a trust to be known as the ASB NZ Shares Trust (the "Trust") in accordance with a master deed dated 17 October 1997, an establishment deed dated 17 October 1997, and a variation of master deed dated 17 October 1997. The Trust was established as a unit trust under the Unit Trusts Act 1960 and is a "unit trust" as defined in section OB 1 of the Income Tax Act.

Further details of the arrangement are set out in the paragraphs below.

1 The trustee of the Trust is Trustees Executors and Agency Company of New Zealand Limited (the "Trustee"). The Trustee is registered as a Trustee company under the Trustee Companies Act 1967. The manager of the Trust is ASB Investment Services limited, a subsidiary of ASB Bank Limited. The beneficial interests in the Trust are divided into units. Each unit confers an equal interest in the Trust but does not confer any interest in any particular investment of the Trust.

2 The Trust acts as a special purpose vehicle to hold units in the AMP Investments' Tracker Fund (the "AMP Tracker Fund"). Pursuant to the Master Deed and Establishment Deed, the Trust is only authorised to invest contributions from Members in the AMP Tracker Fund or in cash investments. Cash investments are authorised solely for the purposes of meeting liquidity and administrative requirements and must otherwise be invested in AMP Tracker Fund units as soon as practicably possible.

3 Units in the AMP Tracker Fund will only be sold or redeemed by the Trust in order to redeem the units of a member of the Trust. Units in the Trust will only be redeemed in whole and cannot be redeemed in part. Units redeemed must be cancelled. Units in the Trust will be issued on the basis that the ordering rule (subparagraph CF 3 (1)(b)(iv)(B)) applies.

4 The AMP Tracker Fund will make taxable distributions to the Trust from any dividends received by the AMP Tracker Fund either on receipt or quarterly depending on the size of the Trust's investment. The Trust must either re-invest any distribution in AMP Tracker Fund units or make a distribution. The Trust will ordinarily distribute such part, as is determined by the manager, of its net income 6-monthly to unit holders and that net income will be calculated taking into account all costs, charges and expenses due.

Conditions stipulated by the Commissioner

This Ruling is based on the conditions that:

(a) There is no arrangement between the Trustee and any unit holder for the redemption of units in substitution for dividends.

(b) The Trust is an "unlisted trust" and a "widely held trust" in terms of the definition of those terms in section CF 3 (14).

(c) The Trust will not redeem units as part of a pro rata cancellation of units.

(d) The Trust will not be quoted on the official list of a recognised exchange.

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:

- The income distributed to unit holders annually will be treated as a dividend pursuant to section CF 2 (1)(i).
- The entire amount paid to unit holders on the redemption of the units will be excluded from the definition of dividend by section CF 3 (1)(b) to the extent that that amount does not exceed the available subscribed capital per share cancelled.

This Ruling expressly does not consider any potential for application of section BG 1 or section GB 1 (3).

The period or income year for which this Ruling applies

This Ruling will apply for the period from 1 April 2001 to 30 June 2001.

This Ruling is signed by me on this 14th day of May 2001.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/06

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 ASB World Shares Trust.

Taxation Law

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

This Ruling applies in respect of sections CF 2 (1)(i) and CF 3 (1)(b).

The Arrangement to which this Ruling applies

The Arrangement is the establishment and continued operation of the ASB World Shares Trust (the "Trust") in accordance with a master deed dated 17 October 1997, an establishment deed dated 17 October 1997, and a variation of master deed dated 17 October 1997. The Trust was established as a unit trust under the Unit Trusts Act 1960 and is a "unit trust' as defined in section OB 1 of the Income Tax Act.

Further details of the arrangement are set out in the paragraphs below.

1 The trustee of the Trust is the Trustees Executors and Agency Company of New Zealand Limited (the "Trustee"). The Trustee is registered as a Trustee company under the Trustee Companies Act 1967. The manager of the Trust is ASB Investment Services Limited, a subsidiary of ASB Bank Limited. The beneficial interests in the Trust are divided into units. Each unit confers an equal interest in the Trust but does not confer any interest in any particular investment of the Trust.

2 The Trust acts as a special purpose vehicle to hold units in the AMP Investments' World Index Fund (the "WINZ Fund"). Pursuant to the Master Deed and Establishment Deed, the Trust is only authorised to invest contributions from Members in the WINZ Fund, a fixed 50% after tax foreign currency hedge or in cash investments. Cash investments are authorised solely for the purposes of meeting liquidity and administrative requirements and must otherwise be invested in WINZ Fund units and the foreign currency hedge as soon as practicably possible.

3 Units in the WINZ Fund will not be redeemed and will only be sold to the WINZ Fund manager. Further, units in the WINZ Fund will only be sold in order to redeem the units of a member of the Trust or in order to meet the Trust's payment obligations under the hedging arrangement in the event of a temporary insufficiency of cash. Units in the Trust will only be redeemed in whole and cannot be redeemed in part.

4 The WINZ Fund will make taxable distributions to the Trust from any income received by the WINZ Fund semi-annually within 20 days from the end of June and December in each year. The Trust must either re-invest any distribution in WINZ Fund units or make a distribution. The Trust will ordinarily distribute such part, as is determined by the manager, of its net income 6-monthly to unit holders and that net income will be calculated taking into account all costs, charges and expenses due.

Conditions stipulated by the Commissioner

This Ruling is based on the conditions that:

(a) There is no arrangement between the Trustee and any unit holder for the redemption of units in substitution for dividends.

(b) The Trust is an "unlisted trust" and a "widely held trust" in terms of the definition of those terms in section CF 3 (14).

(c) The Trust will not redeem Trust units as part of a pro rata cancellation of units.

(d) The Trust will not be quoted on the official list of a recognised exchange.

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:

- The income distributed to unit holders annually will be treated as a dividend pursuant to section CF 2 (1)(i).
- The amount paid to unit holders on the redemption of the units will be excluded from the definition of dividend by section CF 3 (1)(b) to the extent that that amount does not exceed the available subscribed capital per share cancelled.

This Ruling expressly does not consider any potential for application of section BG 1 or section GB 1 (3).

The period or income year for which this Ruling applies

This Ruling will apply for the period from 1 April 2001 to 30 June 2001.

This Ruling is signed by me on this 14th day of May 2001.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/10

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 Tortis-International Fund.

Taxation Laws

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

This Ruling applies in respect of sections CF 3(1)(b) and CF 3(1)(c).

The Arrangement to which this Ruling applies

The Arrangement is the establishment and continued operation of a unit trust known as Tortis-INTL pursuant to a Deed of Trust dated 16 December 1996 and amended on 18 February 1997 and 31 July 2000 (the "trust deed").

Further details of the arrangement are set out in the paragraphs below.

1 Tortis-INTL is a New Zealand tax resident. The trustee of Tortis-INTL is the Public Trustee. The manager of Tortis-INTL is Tower Managed Funds Investments Limited. Tortis-INTL has been established as a unit trust in terms of the Unit Trusts Act 1960 and meets the definition of a "unit trust" contained in section OB 1.

2 Tortis-INTL is an open fund and new investors are able to subscribe for units from time to time. The beneficial interest in Tortis-INTL is divided into units. Each unit confers an equal interest in Tortis-INTL (other than a fractional unit which will confer a proportionate interest) but does not confer any interest in any particular part of the fund or any particular investment of the fund.

3 Tortis-INTL will act as an investment fund to hold a portfolio of shares. The composition of that portfolio will be determined as follows. Tortis-INTL will track international share markets using only the countries included in the Morgan Stanley Capital International Index ("MSCI") which are also specified in Part A of Schedule 3 (known as grey list countries), and at the time of their inclusion in the grey list, the market capitalisation of MSCI companies in that country amount to at least 2% of market capitalisation of the Tower Global Index. Currently there are six of these countries being all of those currently specified in Part A of Schedule 3 (excluding Norway). Shares will be held only where the companies are subject to tax in terms of the proviso to section CG 13(1) or are resident and subject to tax in the country in terms of section CG 15(2)(b). The trust deed does not permit Tortis-INTL to hold shares in foreign entities specified in Part B of Schedule 4. The MSCI adjusted in this way is known as the Tower Global Index.

4 If any of the countries included in the Tower Global Index leave the grey list then securities held in companies resident in that country will be immediately divested. If any company in which Tortis-INTL holds shares ceases to be resident in a grey list country, then shares held in that company will be immediately divested.

5 With the exception of transactions relating to the cash pool, index sampling or financial derivatives (these matters are explained below), Tortis-INTL will only enter into transactions that give effect to the investment policy to replicate the Tower Global Index. The tracking of the Tower Global Index will not involve consideration of profitability, yield, or any other return based features. The only other situations when shares will be bought and sold by Tortis-INTL is where it is necessary to fund the redemption or repurchase of units in Tortis-INTL (or restore liquidity to the cash pool to enable Tortis-INTL to fund the redemption of units) or for sampling.

6 The tracking of the Tower Global Index will be undertaken by State Street Global Advisors, Australia Limited ("State Street").

7 Changes to the constituent stocks within the MSCI are made during the last week of the month unless corporate actions such as takeovers/mergers effected prior to this period require stocks to be added or removed earlier. Following adjustments to the MSCI the Tower Global Index will be adjusted in the appropriate proportion as soon as practicable. This will only require Tortis-INTL to buy and sell stocks to replicate these adjustments. No sales or purchases will be made as a result of changes in the market capitalisation of a particular stock in the MSCI arising as a consequence of actual or anticipated price fluctuations.

8 The approach of Tortis-INTL is to replicate the Tower Global Index. Initially, due to the small size of the portfolio when it was launched, State Street used index sampling to match the Tower Global Index. The sampling process entailed investing across the countries and industries contained in the Tower Global Index on the basis of market capitalisation, based on information from a computer model. The computer model was non-discretionary and selected stocks based purely on market capitalisation and industry membership. No stock forecasting techniques were incorporated in the model. Sampling did not take into account the individual, actual historical or forecast performance of any particular company within the Tower Global Index. As Tortis-INTL grew and more units were purchased new stocks were added until the Tower Global Index was replicated. This approach was self rebalancing and did not require stocks to be bought or sold as a result of individual price changes.

9 Due to the large number of companies in the Tower Global Index Tortis-INTL invests incoming funds, that are not of sufficient size to constitute effective replication of the index, in financial derivatives relating to the Tower Global Index. This is the only basis on which investments in financial derivatives occurs. As soon as sufficient funds are accumulated relevant financial derivatives are closed out and an acquisition of further shares, which replicate the Tower Global Index, is made. It is anticipated, depending on the size of the fund, that between 2% and 5% of the total fund will be invested in financial derivatives.

10 Tortis-INTL permits investors to exit by redeeming units or by repurchase of units by the manager. These are the only methods of exit offered by Tortis-INTL as it is not intended to list Tortis-INTL on a stock exchange. Moneys to fund redemption come from a debt pool of approximately 5% of the fund and not, except in extraordinary circumstances, from partial realisation of the share portfolio. In the unlikely event that Tortis-INTL needs to realise part of the share portfolio to fund redemptions, that realisation would occur in accordance with the weighting of the Tower Global Index. Any sale by Tortis-INTL would be calculated at such a level as to restore liquidity to the debt pool. Tortis-INTL will only invest the debt pool in bank deposits with banks registered under the Reserve Bank Act 1989 or other debt obligations or in the Tower First Rate Account.

11 Investors wishing to subscribe for units above a certain prescribed level may do so by transferring to Tortis-INTL an appropriately weighted basket of securities, and will receive units in Tortis-INTL in exchange. Equally, investors holding units in excess of a prescribed level will be able to redeem the units (both in the ordinary course of events and upon liquidation) in consideration for a transfer by Tortis-INTL to them of an appropriately weighted basket of securities, rather than by cash payment.

12 Unit prices may be published in newspapers and Tortis-INTL will have an Internet site which will be used principally to publish prices at which the manager will repurchase or redeem units, and as a means for transferring units only by purchase from the manager, and redemption or repurchase by the manager.

The MSCI World Index

13. The Tower Global Index is a customised version of the MSCI World Index.

14. The fundamental objective of the MSCI World Index is as follows (taken from the *MSCI Methodology and Index Policy* document, published by MSCI in March 1998, at page 3):

> MSCI Indices are constructed to provide benchmarks that accurately represent the opportunities available to the institutional investor. While an all-share-index (all listed companies at their full market cap weight) represents the theoretical opportunity set available to the global investor, this is not a fair performance benchmark in practice, since it cannot be fully replicated due to illiquidity of either shares or volume. Thus, MSCI creates indices which capture the spirit of an all-share index, but are actually subsets of shares which are truly replicable.

15. The rules for determining which companies will be included in the MSCI World Index are set out below (taken from the *MSCI Methodology and Index Policy* document):

> MSCI produces a world index which currently (31 May 2000) comprises 22 countries and over 1,300 stocks. Each country included in the MSCI World Index is represented by a separate index which forms part of the larger Index. The index for each country is referred to as a MSCI Country Index.
>
> In constructing the MSCI Country Indices MSCI uses a five-step process.
>
> **MSCI Country Index Selection Criteria:**
>
> 1. Define the total market.
> 2. Sort the market by industry groups and target 60% for inclusion.
> 3. Select stocks with good liquidity and free float.
> 4. Avoid cross-ownership.
> 5. Apply the full market capitalization weight to each stock.

1. **Define the total market**: The initial research for the MSCI Indices covers the full breadth of each equity market in the universe. Country specialists track the evolution of both listed and unlisted shares of domestically listed companies in 51 markets that, combined, account for over 90% of the world's total market capitalization. Based in Geneva, these teams of country specialists collect data on shares, pricing, ownership, float and liquidity for effectively all companies worldwide. Sources for this information include local stock exchanges and brokerage firms, newspapers ad company contacts. All of the companies within this research coverage are eligible for inclusion in the MSCI Indices except non-domiciled companies, investment trusts and mutual funds.

2. **Sort the total market by industry groups and target 60% for inclusion**: Once information on the total country market capitalization is analyzed, 60% of the capitalization of each industry group, and thus 60% of the entire market, is targeted for inclusion in each MSCI country index. This process ensures that the index reflects the industry characteristics of the overall market, and permits the construction of accurate regional and composite industry indices.

With the uniform target of capturing 60% of the each country's total market capitalization, each country carries its proportional weight in the regional and composite indices. A 60% target has been found sufficient to maintain a high level of tracking while still providing for an investable universe across all countries (the "highest common denominator" which can be captured, while still having an investable index in each country).

3. **Select stocks with good liquidity and free float**: A goal of the MSCI index construction process is to select the most liquid stocks within each industry group, all other things being equal, since liquidity is necessary but not the sole determinant for inclusion in the index. Liquidity is monitored by monthly average trading value over time in order to determine normal levels of volume, excluding temporary peaks and troughs. A stock's liquidity is significant not only in absolute terms, but also relative to its market capitalization and to average liquidity for the country and the industry as a whole. Liquidity is not used as an absolute measure to select constituents because: An absolute minimum level of liquidity would be arbitrary and would have different meanings in different markets.

Liquidity is partly a function of the cyclicality of markets and industries. Limiting index constituents to only the most liquid stocks would introduce a bias against those stocks and sectors that are temporarily out of favor with investors. An inflexible rule might also dictate a pattern of constituent additions and deletions that would introduce unnecessary turnover in the index.

The free float (percentage of shares freely tradable) of every security in the market is monitored and an estimate is calculated, and low float may exclude a stock from consideration in the index. In the developed markets and some emerging markets, "low" float is considered under approximately 25%, as estimated by the country specialists at CIPSA in Geneva. However, in many emerging market countries, the average float is below 25%, so float is measured relative to the stock's own industry and country.

But float can be a difficult number to determine. In some markets, reliable data sources are generally not available; in other markets, information on smaller and less prominent issues can be subject to error and time lags. Additionally, government ownership and corporate share crossholdings can change over time and are not always made public. The precise definition of "float" also tends to differ depending on the data source. Thus, evaluations of float run the risk of penalizing those markets that have higher standards for company disclosure, regardless of the actual degree of availability of shares. As with liquidity, sufficient float is an important consideration, not an inflexible rule.

4. **Avoid cross-ownership**: Cross-ownership occurs when one company has a significant ownership stake in another company, and both are included in the index. Substantial cross-ownership can skew industry weights, distort country-level valuations (such as Price/ Earnings and Price/Book Value) and overstate a country's true market size.

An integral part of the index construction process is to identify corporate share crossholdings in order to avoid or minimize cross-ownership in the MSCI Indices. Country analysts in Geneva separate cross-ownership stakes into two categories. The first consists of stakes which are considered immaterial. In these cases, such cross-ownership does not represent something significant in terms of having distortionary effects on the index even if both companies are included. The second category is stakes which could materially distort an industry- or country-level index by significantly overstating the index's market capitalization if both companies are included. Other ownership stakes (such as government, family, other institutional holdings) are also included in the estimated free float.

5. **Apply the full market capitalization weight to each stock**: All standard MSCI indices are weighted by each company's full market capitalization (both listed and unlisted shares). This approach has the advantage of objectivity—the number of shares outstanding is consistently defined for companies around the world and is a readily obtainable figure. This approach also minimizes turnover. MSCI does not adjust share weights for either free float or cross-holdings. The most serious consequence of float limitations is illiquidity, which can be monitored objectively. Full market capitalization weighting is favored to float-weighting schemes for both theoretical and practical reasons:

- It is impossible to judge whether a position which is currently in firm hands might be available in the future.
- The quality and timeliness of information on float varies from market to market. Adjustments penalize those markets with the highest standards of company information disclosure.
- Float adjustments incur index turnover as the float of a company changes. However, the precision of a float-adjusted index may not yield a more "investable" index. For instance, when the float of a stock increases from 55% to 60%, it may not be necessarily 5% more investable on a practical basis. In fact, it was probably fully replicable at a full market cap weight and the increase in turnover did not result in a "better" index, only an increase in transaction costs.

- Float adjustments on a country level may not result in materially different country weights from market capitalization weights.

[Weighting stocks at their full market capitalisation, as described below in the fifth selection criterion, is slowly being phased out by MSCI: first by its extension of the partial inclusion policy to all new additions to its indices (as of 31 July 2000) and second, by the change in its index construction methodology to a free float-adjustment methodology. However, currently stocks which were already part of the index as at 31 July 2000 are included at their full market capitalisation.]

Partial Inclusion Policy

Since the normal MSCI index policy is to include index constituents at 100% of market capitalization, large issues with low float—a characteristic of many privatizations—pose a dilemma for index construction. Including such companies at full market cap weight can overwhelm an index and overstate the true size of market opportunities; yet excluding them also results in an incomplete picture of the market. A company is included or excluded on a case-by-case basis, where the contributing factors include the expected change in float (especially for first-time government privatizations), stability of the liquidity and importance of the company in its local economy.

A growing number of very sizable companies have been or will be brought to market with modest tranches initially made available to the public. By virtue of their size and visibility, these companies are obvious candidates for inclusion in a portfolio. To reflect this new market trend, MSCI index construction rules do allow for the possibility of including a company at a portion of its total market capitalization. This occurs only in exceptional cases when very large companies come to market with very modest initial float.

In July 31 2000 the policy on partial inclusions was amended. MSCI has extended the application of its policy on partial inclusion of companies to all new additions to the MSCI indices. This amendment will simplify the partial inclusion policy, providing consistent treatment for all new index additions. Previously, the policy was targeted only at new constituents with very large market capitalizations. This amendment does not affect existing constituents in the MSCI indices.

Following this amendment, all companies with a float below 40%, that are to be added to the MSCI Standard or Extended indices, regardless of size, will be included at a fraction of their total market capitalization using a Market Cap Factor (MCF). The MCF will be determined using MSCI's current schedule as shown below:

% Float equal or exceeding*	10	15	20	25	30	35	40
% Market Cap Factor (MCF)	20	30	40	50	60	80	100

* Over-allotment option is not included in the case of IPOs, privatizations and similar public offerings.

Structural Changes

In changing the constituents of the MSCI Indices, accurate representation is balanced with minimizing turnover. An index must represent the current state of an evolving marketplace while at the same time minimizing turnover, which is costly as well as inconvenient for investment managers. Restructuring an index involves a balancing of constituent additions and deletions. The primary concern when considering additions and deletions is the continuity of the indices. Of secondary concern are the turnover costs associated with these changes.

There are two broad categories of changes to the MSCI Indices: structural changes and market-driven changes.

Structural changes reflect the evolution of a market due, for example, to a change in industry composition or regulations. Industry restructurings generally take place every 18 to 24 months for any given country. However, the structural change to the country index may occur on only four dates throughout the year: as of the close of the last business day of February, May, August and November. MSCI index additions and deletions are announced two weeks in advance. There are absolute firewalls on any price-sensitive decision until there is a public announcement. These changes are communicated to subscribers both electronically and by fax. They are simultaneously posted on public Reuters pages (starting on MSCIA) and public Bloomberg pages (MSCN). The Reuters and Bloomberg MSCI pages are updated by Capital International Perspective, S.A. in Geneva. The pages include the security names, the action to be taken and, when necessary, the context of the change.

A more detailed announcement service is available for a fee (and provides the weightings, shares outstanding, security identifiers and industry classification).

During the examination of each country index, the market cap and business function coverage of each industry group is measured against the underlying market. The investability (free float, cross-ownership, long- and short-term trading volume and turnover) of each constituent is also monitored. In the event that an industry is over- or under-covered, or that there are stocks in the index which are no longer investable (here both long-term and short-term liquidity is examined), or a large privatization has altered the capitalization of the market, a structural change may be necessary.

The MSCI indices reflect the opportunity set to the global investor on an ongoing basis—and should thus mirror the fundamental changes in the market's structure, and correspond to the situation of the average institutional investor. These structural changes are designed and timed to minimize turnover to the indices. If possible, several unrelated changes to a country index are grouped together, minimizing disruption.

Structural Change Additions: As markets grow because of privatizations, investor interest, or the relaxation of regulations, index additions (with or without corresponding deletions) may be needed to bring industry representations up to the 60% target. Companies are considered not only with respect to their broad industry, but also with respect to their sub-sector, in order to represent if possible a broader range of economic activity.

Structural Change Deletions: The indices must represent the full-investment cycle, including bear as well as bull markets. Out-of-favor stocks may exhibit declining price, market capitalization, and/or liquidity, and yet continue to be good representatives of their industry. Deleting constituents because their liquidity has declined introduces a bias against out-of-favor companies or industries, especially those in the trough of a business cycle. For this reason, low liquidity is never an automatic trigger for deleting a company from the index.

Companies may be deleted because they have diversified away from their industry classification, because the industry has evolved in a different direction from the company's thrust, or because a better industry representative exists (either a new issue or an existing company). In addition, in order not to exceed the 60% target coverage of industries and countries, adding new index companies may entail corresponding deletions.

Market-driven Changes

Market-driven changes consist of new issues, mergers, acquisitions, bankruptcies, and other similar corporate events. These changes are announced and implemented as they occur.

Additions - New Issues: New issues may not be automatically eligible for immediate inclusion in the MSCI Indices. Many factors must be considered, such as market capitalization, float and liquidity. Some new issues undergo a seasoning period of six to twelve months between index restructurings until a trading pattern and volume are established. After that time, they are eligible for inclusion, subject to the standard selection criteria discussed.

However, sometimes a new issue, usually a privatization, comes to market and substantially changes the country's industry profile. In this case, where even temporarily excluding it would distort the characteristics of the market, it may be immediately included in the MSCI Indices. An example is YPF, Argentina's privatized oil company, which at USD 3.04 billion is Latin America's largest privatization to date. In these cases, however, an announcement is made in the first few days of official trading for the security, since the country specialists do not want to influence the primary placement of the issue.

In other cases, a large new issue may not be included even in the normal process of restructuring, despite substantial size and liquidity. The primary reasons for non-inclusion of a large new issue are as follows:

- A large stock, if it has low float and is also illiquid, can overwhelm an index and over-represent the true opportunities in the market.
- The index may be at the limit of industry representation—including the new issue would seriously over-weight an industry in the index.
- In some cases, it is necessary to defer inclusion of a new issue until the next opportunity for index restructuring.

Deletions - Suspended Companies: In the case of suspension for bankruptcy or near bankruptcy, the suspended company is deleted at the smallest price (unit or fraction of the currency) at which a security could have traded in a given market.

More complex are the cases where the suspension is due to a major restructuring, which results in the company being ineligible (at least for an important period of time) for normal listing and trading on the stock exchange. The MSCI policy is to remove these companies from the index only after there is little likelihood the company will return to normal trading. In this situation, the key issue is determining the price at which the company can be removed from the index. Unofficial market prices may be used as a base to determine that exit price. In exceptional circumstances, average indicative prices from reliable sources may be used.

Mergers & Acquisitions: Any case of mergers and acquisitions, or capital restructuring, which can affect a company within the MSCI universe is monitored. Depending on whether the active companies are, or are not, constituents of the MSCI Indices, a number of factors must be considered. If either the acquiring or the acquired firm is a constituent of the index, the first consideration is the impact of the acquisition on the index. The second consideration involves structural changes to the index. When a non-constituent company acquires a constituent company, either the acquiring company can replace the constituent company in the index, or another company altogether may be chosen as a better representative of the industry. If two medium-sized, non-constituent companies merge, the merged company may also be considered for inclusion in the indices. However, this change would occur only through a structural review.

Spin-Offs: A spin-off is the distribution to existing shareholders of a part of the company's business through the issuance of shares in the newly-established company. The decision to include the newly-established company in the index is based on several factors including estimated market value, market capitalization, and float. The market value of the spin-off is estimated through a consensus of industry analysts, grey market prices, and statistics on revenues and earnings.

Performance of stocks

The methodology for determining which stocks are to be included in the relevant country indices does not involve any exercise of predicting whether a company is likely to be particularly profitable or unprofitable or whether the company's securities are likely to increase in value or decrease in value. Performance is not an issue. MSCI is solely focused on ensuring that a consistent methodology is used in preparing the indices, which maximises the utility of the indices as a recognised world-wide benchmark of stock market movement and avoids unnecessary turnover of index stocks.

Upcoming MSCI Changes

16. In addition to the process stated above, there are also upcoming changes which alter the way in which the MSCI World Index will select its constituent company securities. The MSCI will adjust all its equity indices for free float and increase the target market representation of its Standard Index series from 60% to 85%. The combined changes will be implemented in two separate phases. The first phase will be implemented as of the close of 30 November 2001 and the second phase will be implemented as of

the close of 31 May 2002. MSCI plans to publish index constituents and their Inclusion Factors on or before 30 June 2001, and will begin calculating a provisional index series based on the enhanced methodology shortly thereafter.

17. The change in index construction methodology to a "free float-adjustment" methodology is described in the *MSCI Announcement*, dated 10 December 2000 ("the *Announcement*"), as follows:

> MSCI calculates the free float of an equity security as its total number of shares outstanding less shareholdings classified as strategic and shares otherwise restricted from trading by international investors. Examples of shares excluded from free float are stakes held by governments, corporations, controlling shareholders and their families, the company's management, and shares subject to foreign ownership restrictions.
>
> Under this enhanced index construction methodology, MSCI will free float-adjust constituent weights using an adjustment factor, which will be referred to as the Inclusion Factor. This Inclusion Factor is equal to a constituent's estimated free float rounded-up to the closest 5%. For example, a constituent with an estimated free float of 23.2% will be included in the index at 25% of its total market capitalization, while a constituent with an estimated free float of 78.6%, will be included in the index with an Inclusion Factor of 0.80. Where the foreign ownership limit is more restrictive than the free float, and if there are no foreign strategic investors, a constituent's Inclusion Factor will be equal to its exact foreign ownership limit, rounded to the nearest percentage point.
>
> Securities with a free float below 15% will not typically be eligible for inclusion in the MSCI equity indices. However, in exceptional cases where including such a security would significantly improve the index's ability to accurately represent the investment opportunities in that country or industry, the security may be included in the MSCI indices with an Inclusion Factor equal to its estimated free float rounded to the closest percentage point. For example, a very large company with an estimated free float of 11.4%, if included in the index, would be included with an Inclusion Factor of 0.11.
>
> In order to account for other types of restrictions on foreign equity investment, such as the investor qualification and quota approval system prevailing today in Taiwan, the enhanced MSCI methodology provides for an additional investability factor, referred to as the Limited Investability Factor. The application of this Limited Investability Factor would permit a more accurate comparison of markets with more complex and subtle restrictions to the investment process with markets where investment limitations can be appropriately reflected in security specific Inclusion Factors.
>
> MSCI will review constituents' Inclusion Factors at the time of regular country index rebalancings. In addition, MSCI will allow for changes in a security's Inclusion Factor in response to significant market-driven corporate events, as the events become effective.

18. To determine whether a shareholding is strategic or non-strategic, the following guidelines are used:

> **Shareholding classification guidelines**
>
> MSCI primarily classifies shareholdings as strategic or non-strategic based on a categorization of investor types.
>
> - **Strategic shareholders:** The following investor types are generally considered as strategic and their shareholdings in a company are not included in that company's equity capital to determine its free float:
> - **Governments:** Shares owned by governments and affiliated entities. Please refer to the specific guidelines described below for government agencies and government-related investment funds.
> - **Corporations:** Shares owned by corporations, including treasury shares owned by the company itself, except when the treasury shares are excluded from the number of shares outstanding. Please refer to specific guidelines for banks.
> - **Management and Board Members:** Shares owned by members of the company's management or Board of Directors, including shares owned by individuals or families that are related to or closely affiliated with members of the company's management, Board of Directors, or founding members deemed to be insiders.
> - **Employee Stock Ownership Plans (ESOPs):** Shares owned in ESOPs during the lockup period.
>
> **Non-Strategic shareholders:** The following investor types are generally considered as non-strategic and their shareholdings in a company are included in that company's equity capital to determine its free float:
>
> - **Individuals:** Shares owned by individuals, excluding shares owned by individuals or families that are related to or closely affiliated with members of the company's management, Board of Directors or founding members deemed to be insiders, and, excluding those shareholdings held by individuals whose significant size suggests that they are strategic in nature.
> - **Investment funds, mutual funds or unit trusts:** Shares owned in investment funds, mutual funds and unit trusts, including shares owned in passively managed funds.
> - **Pension funds:** Shares owned in employee pension funds, excluding shares of the employing company, its subsidiaries or affiliates.
> - **Insurance companies:** In principle, the investment objective of portfolio holdings of insurance companies is non-strategic. When there are reasons to believe that an insurance company's shareholding is strategic, it will not be included in free float.
> - **Social security funds:** Shares owned in social security funds, unless the fund's management is deemed to exert influence over the management of the company.
> - **Venture capital funds:** Shares owned in venture capital funds, unless a specific investment is deemed to be strategic in nature.

19. If the above guidelines are not sufficient, the additional guidelines described below are used:

In the event that the above categories should not appropriately capture the nature of a specific shareholding, its classification as strategic or non-strategic will be determined based on a more extensive analysis. In particular, the following guidelines will be followed:

- **Banks.** Shareholdings by banks are considered as strategic, excluding, when identifiable, specific shareholdings that are deemed to be non-strategic.
- **Nominees or trustees:** Shareholdings registered in the name of a nominee or trustee are classified as strategic or non-strategic based on an analysis of who is the ultimate beneficial owner of the shares, according to the above definitions.
- **Government agencies and government-related investment funds:** Shareholdings of government agencies and government-related investment funds are classified based on an analysis of the objective of the investment.
- **Shares placed in IPOs with special incentives:** Shares that are placed in an IPO and that include meaningful incentives to hold the shares for a specific period of time, are classified as strategic until those incentives expire.
- **ADRs and GDRs:** Shares that are deposited to back the issuance of ADRs and GDRs are classified as non-strategic, unless it is established that a specific stake held in ADRs or GDRs is strategic in nature.

20. Other shares (other than those which are classified as "strategic") may also be excluded from the free float. These shares, described above as "shares otherwise restricted" from the free float, are described as follows:

- **Limits on share ownership for foreigners:** Limits on the proportion of a security's share capital that is authorized for purchase by non-domestic investors. Where they exist, these foreign share-ownership limits are generally set by law, government regulations, or company by-laws.
- **Other foreign investment restrictions:** Investment restrictions, other than those described above, which materially limit the ability of international investors to freely invest in a particular equity market. There is typically no simple way to account for these limitations in a benchmark, as these restrictions tend to be more subtle and complex, and may affect different market participants in different ways.

21. The MSCI calculates the free float-adjustment construction methodology in the following manner:

Calculation of a security's free float-adjusted market capitalization

As a general rule, MSCI calculates the free float of a security as its total number of shares outstanding less shareholdings classified as strategic and shares otherwise restricted from trading by international investors. However, the determination of the corresponding free float-adjusted market capitalization is dependent on the nature of the limitations on free float.

In all cases, the calculation is based solely on publicly available shareholding information obtained from multiple information sources. For each security, all available shareholdings are considered where public data is available, regardless of size.

- **Calculation in the case of a security which is not subject to a foreign ownership limit or other foreign investment restrictions**
- Strategic shareholding (%) =

  Number of shares classified as strategic
  Total number of shares outstanding
- Free float (%) = 100% - Strategic shareholding (%)
- For constituents with free float greater than or equal to 15%, the security's Inclusion Factor is equal to its estimated free float, rounded-up to the closest 5%.
- Securities with free float less than 15% are typically not eligible for inclusion in the indices. However, in exceptional cases, where including such a security would significantly improve the index's ability to accurately represent the investment opportunities in that country or industry, the security may be included in the indices with an Inclusion Factor equal to its estimated free float rounded to the closest 1%.
- Free float-adjusted market capitalization = Inclusion Factor * total market capitalization
- **Calculation in the case of a security which is subject to a foreign ownership limit**
- Foreign strategic shareholding (%) =

  Number of shares held by foreign strategic investors
  Total number of shares outstanding
- Free float available to foreign investors (%) is equal to the lesser of:
  - the free float, calculated as: 100% - strategic shareholding (including both foreign and domestic strategic shareholders) (%)
  - the foreign ownership limit less the foreign strategic shareholding (%)
- For constituents whose free float available to foreign investors is greater than or equal to 15%, the security's Inclusion Factor is equal to the lesser of:
  - the estimated free float available to foreign investors rounded-up to the closest 5%;
  - the foreign ownership limit rounded to the closest 1%.
- Securities with a free float available to foreign investors of less than 15% are typically not eligible for inclusion in the indices. However, in exceptional cases, where including such a security would significantly improve the index's ability to accurately represent the investment opportunities in that country or industry the security may be included in the indices with an Inclusion Factor equal to its estimated free float available to foreign investors rounded to the closest 1%.
- Free float-adjusted market capitalization = Inclusion Factor * total market capitalization
- **In the case of a security which is subject to other foreign investment restrictions**

In the case where other foreign investment restrictions exist, which materially limit the ability of international investors to freely invest in equity markets, an additional Limited Investability Factor may be applied. There is typically no simple way to account for these types of investability limitations in a benchmark as they tend to be subtle and complex, and may affect different market participants in different ways. Therefore, where warranted, the Limited Investability Factor will be determined based on an extensive case-by-case analysis.

22. The change in target representation, as described in the *Announcement*, will occur as follows:

In conjunction with the free float-adjustment of its indices, MSCI will increase the target market representation in the MSCI Standard Index series from 60% of total market capitalization to 85% of free float-adjusted market capitalization within each industry group within each country. Given trends such as increased market concentration, the increase in coverage will provide greater diversification and representation of investment opportunities in the indices. Broader coverage is also expected to decrease ongoing turnover in the MSCI indices.

MSCI research shows that the increase to a target market representation of 85% can be achieved with the addition of a reasonable number of relatively liquid and sizeable constituents in most countries. In the countries where this is not possible, the country index will remain below the target market representation of 85%.

23. The "phase in" periods, also detailed in the *Announcement*, for the changes are as follows:

Publication of Constituent Data and Implementation

In order to assist market participants in understanding and preparing for these changes, MSCI plans to publish, on or before June 30, 2001, the list of index constituents and their Inclusion Factors under the enhanced methodology for each of the MSCI Standard country indices. In addition, shortly thereafter, MSCI will begin publishing a provisional index series to measure the performance of the MSCI countries and main regions based on the enhanced methodology. The provisional series, together with the constituents and their Inclusion Factors, also may be used by clients who wish to measure their performance against such an index, ahead of MSCI's official implementation schedule.

In order to best transition the indices to the enhanced methodology, the combined changes will be implemented in two separate phases: as of the close of November 30, 2001, and as of the close of May 31, 2002. The changes in each phase will simultaneously affect all MSCI Standard country indices and will include changes resulting from both the free float-adjustment and the increase in coverage. In the first phase, approximately half of the total change resulting from the free float-adjustment will be implemented for all existing index constituents and, simultaneously, all the new constituents resulting from the increase in coverage to 85% will be added at approximately half of their free float-adjusted market capitalization.

More specifically, in the first phase, the market capitalization of all existing index constituents will be adjusted by an interim Inclusion Factor equal to the simple average of the current proportion of market capitalization included in the index prior to the change and their final Inclusion Factor. This average will be rounded up to the closest 5% (or closest 1% if below 15%). For example, in the first phase, two constituents with free floats of 23.2% and 78.6%, respectively, currently included in the index at their full market capitalization weights, will have their market capitalization adjusted by interim Inclusion Factors of 0.65 and 0.90, respectively. These interim Inclusion Factors are calculated as (25%+100%)/2 = 62.5%, rounded-up to 65%, and (80%+100%)/2 = 90%, respectively.

Simultaneously, all the new constituents resulting from the increase in coverage to 85% will be added to the indices in the first phase with interim Inclusion Factors equal to half of their final Inclusion Factors rounded-up to the closest 5% (or 1% if below 15%). For example, in the first phase, two new constituents with free floats of 23.2% and 78.6%, respectively, will be included in the indices with their market capitalization adjusted by Inclusion Factors of 0.13 (25%/2 = 12.5%, rounded-up to 13%) and 0.40 (80%/2 = 40%), respectively.

In the second and final phase, the remaining adjustment to market capitalization of all constituent securities will be implemented.

Index Rebalancings and Market Events during the Transition Period

During the transition period, from December 11, 2000 through May 31, 2002, MSCI will maintain its schedule of regular quarterly index rebalancings for its Standard Index series. To minimize changes not related to the transition, MSCI will seek to coordinate all changes in the Standard indices with the target index under the enhanced methodology (i.e., the provisional series when available.) In addition, MSCI will only consider very significant changes in the equity markets when performing its quarterly index reviews.

All new additions of companies resulting from IPO's and regular quarterly rebalancings will be included with their final Inclusion Factors.

Also, during the transition period, important new market capitalization additions resulting from mergers, acquisitions and similar corporate events, in principle will be made in proportion to the free float of the additional market capitalization entering the index. For example, when a company - with a current inclusion factor of 40% - issues new shares for the acquisition of assets entirely in firm hands for the equivalent of 25% of its current share capital, the resulting inclusion factor will be derived from the following calculation: [(100 x 40%) + (25 x 0%)] / 125 = 32%, which will be rounded up to 35%.

24. Further details of the Arrangement are as described in and applicable to Binding Ruling Prd 96/34.

Conditions stipulated by the Commissioner

This Ruling is subject to the following conditions:

(a) any cancellation of units by Tortis-INTL will be in whole but not in part; and

(b) Tortis-INTL will either have not less than 100 unit holders, or any lesser number of unit holders will be due to unusual or temporary circumstances (including the recent establishment of the trust); and

(c) the units will be issued on terms such that their redemption is subject to section CF 3(1)(b)(iv)(B); and

(d) in relation to amounts paid as consideration for a cancellation upon liquidation, the recipient will not be a person that is related to Tortis-INTL within the meaning of section CF 3(12); and

(e) at the date of redemption there is no arrangement for the units redeemed to be replaced by the subsequent issue of new units where the arrangement is intended to effect a substitution for the payment of dividends; and

(f) index sampling will only take place in the initial stages of Tortis-INTL but not after the time that the fund reaches a size of NZ$60 million; and

(g) financial derivatives will be used only to equitise relatively small balances anticipated to be less than 5% of the total fund. These derivatives will not be shares and will not be options to buy shares. They will be financial arrangements. Any gain on them will be assessable for income tax purposes and likewise any loss will be deductible; and

(h) Tortis-INTL and any company in the Tower group of companies will not be a "wholly owned group" as that term is defined in section IG 1(3); and

(i) In relation to the application of section CG 1(a), none of the features listed in Part B of Schedule 3 will be applied by any relevant company (shares of which are acquired) and

(j) Section CG 6 will apply to Tortis-INTL.

How the Taxation Laws apply to the Applicant and the Arrangement

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

- If a unit holder redeems units in Tortis-INTL (whether for cash or an appropriately weighted parcel of shares in the Index companies), section CF 3 (1)(b) will apply and the distribution made by Tortis-INTL will not be a dividend to the extent that the amount distributed does not exceed the "available subscribed capital per share cancelled", as that term applies to Tortis-INTL. The Commissioner is satisfied that in terms of section CF 3 (1)(b)(iii) the distribution is not in lieu of the payment of dividends. The procedure of publicising buy-back and redemption prices on the Internet does not constitute a "recognised exchange" in terms of the definition of that phrase in section OB 1.
- If Tortis-INTL is liquidated section CF 3 (1)(c) will apply. The amount distributed to unit holders will not be a dividend to the extent that it does not exceed the aggregate of the "available subscribed capital per share cancelled" and the "excess return amount" as those terms apply to Tortis-INTL. The excess return amount will include gains on shares sold by Tortis-INTL.

The period or income year for which this Ruling applies

This Ruling will apply for the period from 1 April 2001 until 30 June 2001.

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

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/11

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 Tortis-NZ Fund.

Taxation Laws

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

This Ruling applies in respect of sections CF 3 (1)(b) and CF 3 (1)(c).

The Arrangement to which this Ruling applies

The Arrangement is the establishment and continued operation of the Fund under the terms of the Deed of Trust, dated 1 November 1996 to act as an investment fund to hold a portfolio of shares that match the composition and weighting of the NZSE30 Selection Capital Index ("the Index").

Further details of the arrangement are set out in the paragraphs below.

1 The trustee of the Fund is the Public Trustee. The manager of the Fund is Tower Managed Funds Limited. The Fund has been established as a unit trust in terms of the Unit Trusts Act 1960 and meets the definition of a "unit trust" contained in section OB 1. The beneficial interest in the Fund is divided into units. Each unit (other than a fractional unit, which will confer a proportional interest in the Fund) confers an equal interest in the Fund but does not confer any interest in any particular part of the Fund or any investment in the Fund.

2 Approximately 95% of the amount invested in the Fund is used to invest in a portfolio of shares. The investment policy of the Fund is to invest in Index Companies in a manner that replicates the Index (apart from the transactions relating to the cash pool) and only enter into transactions that give effect to that policy.

3 Apart from shares acquired to establish and grow the Fund according to its terms, shares are bought and sold by the Fund in only two limited situations, namely where it is necessary to (i) reflect movements in the Index in terms of composition and weighting; and (ii) fund the redemption of units in the Fund (or restore liquidity to the cash pool to enable the Fund to fund the redemption of units).

4 In the event that the Fund will have to realise part of the share portfolio to fund redemptions, that realisation will occur in accordance with the weighting of the Index.

5 Approximately 5% of the Fund is invested in a cash pool. This part of the investment will provide a readily realisable pool of funds from which to pay liabilities and fund redemptions. The Fund only invests the cash pool in bank deposits with a bank registered under the Reserve Bank Act 1989, any debt obligations or in the Tower First Rate Account.

6 Apart from shares acquired to establish and grow the Fund and the investment of the cash pool, any powers of investment or divestment by the trustee under the Deed of Trust are exercised for the purposes of (i) reflecting movements in the Index in terms of composition and weighting; or (ii) funding the redemption of units in the Fund (or to restore liquidity to the cash pool to enable the Fund to fund the redemption of units).

7 Cash dividends received by the Fund (less any tax payable on them not covered by imputation credits) are passed on to the investors twice annually or retained by the Fund in order to restore liquidity to the cash pool.

8 Investors are able to subscribe for units in the Fund by making a cash payment. It will be possible for investors to transfer to the Fund a parcel of shares in the Index companies (as specified by the Manager) proportionate to the numbers and classes of shares of the Index companies included in the Index.

9 Investors are able to redeem their units at any time by giving notice, in the form of a repurchase request, to the manager. Their units will be redeemed in cash at a price equal to the net assets of the Fund at the time divided by the number of units on issue.

10 It is possible for the manager to purchase the units from the unit holders as an alternative to redemption. Where units are repurchased the manager will pay the unit holder a price equal to the net assets of the Fund at the time divided by the number of units on issue.

11 Instead of redeeming or repurchasing the units for cash the unit holder may request the trustee to transfer to the unit holder a parcel of shares in the Index companies proportionate to the numbers and classes of shares of the Index companies included in the Index.

Where the unit holder receives a transfer of shares the market value of the shares per unit will be equal to net assets of the Fund at the time divided by the number of units on issue.

12 The issuing of units and their redemption will be effected directly by the Fund. Unit prices may be published in newspapers and the Fund will have an Internet site through which visitors to the site will be able to request the purchase, redemption or buy-back of units. No units are or will be otherwise quoted on the official list of any "recognised exchange" as defined in section OB 1.

13 Any cancellation of units will only be effected in order to allow unit holders to exit the Fund or decrease their holding in the Fund. Units will also be cancelled in the event that the Fund is liquidated.

14 Apart from on liquidation of the Fund, any cancellation of units will be in response to the activities of a particular unit holder, and not all the unit holders of the Fund.

15 Further details of the Arrangement are as described in and applicable to Binding Ruling Prd 96/34.

Conditions stipulated by the Commissioner

This Ruling is subject to the following conditions:

(a) Any cancellation of units by the Fund will be in whole but not in part.

(b) The Fund will have either not less than 100 unit holders, or any lesser number of unit holders will be due to unusual or temporary circumstances (including the recent establishment of the trust).

(c) In relation to amounts paid as consideration for a cancellation upon liquidation, the recipient will not be a non-resident company that is related to the Fund within the meaning of section CF 3 (12).

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 a unit holder redeems units in the Fund (whether for cash or an appropriately weighted parcel of shares in the Index companies), section CF 3 (1)(b) will apply and the distribution made by the Fund will not be a dividend to the extent that the amount distributed does not exceed the "available subscribed capital per share cancelled", as that term applies to the Fund. The Commissioner is satisfied that, in terms of section CF 3 (1)(b)(iii), the distribution is not in lieu of the payment of dividends.
- If the Fund is liquidated, section CF 3 (1)(c) will apply. The amount distributed to unit holders will not be a dividend to the extent that it does not exceed the aggregate of the "available subscribed capital per share cancelled" and the "excess return amount", as those terms apply to the Fund. The excess return amount will include gains on shares sold by the Fund.

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 2001 until 30 June 2001.

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

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/14

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 Infrastructure Auckland.

Taxation Law

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

This Ruling applies in respect of:

- Section 2
- Section 3A
- Section 5(1)
- Section 5(6D)
- Section 8(1)
- Section 10(2)
- Section 20(3)

The Arrangement to which this Ruling applies

The Arrangement is the making of grants by Infrastructure Auckland ("IA") on the basis of applications from potential recipients to carry out specific transport or stormwater infrastructure projects within the Auckland region. Further details of the Arrangement are set out in the paragraphs below.

Background

1. IA is a body corporate which was established pursuant to the Local Government Amendment Act 1998, and the Infrastructure Auckland Deed.

2. Section 707ZZK(1) of the Local Government Act 1974 provides that the principal function of Infrastructure Auckland is to contribute funds, by way of grants, in respect of projects, or parts of projects, undertaken in the Auckland Region for the purpose of providing:

   (a) Land transport; or

   (b) Any passenger service; or

   (c) Any passenger transport operation; or

   (d) Stormwater infrastructure;

   where the projects or parts of projects generate benefits to the community generally in addition to any benefits that accrue to any identifiable persons or groups of persons.

3. IA's asset base has been originally derived from the Auckland Regional Council (the "ARC"). In 1992 the assets and liabilities of the ARC were transferred to the Auckland Regional Services Trust ("ARST") under Part XLIVB of the Local Government Act 1974 ("LGA"). However, ARST did not inherit all the functions of the ARC and its primary role was to manage its assets, reduce the liabilities and dispose of specified assets as required under the provisions of the LGA.

4. In 1998 the government decided that the assets held by ARST should be applied for developing the Infrastructure of the Auckland region and it was decided to create IA to facilitate this decision. Pursuant to section 707ZZZL of the LGA, on 1 October 1998 the assets and liabilities of ARST were transferred to IA, with the following exceptions:

   - $10 million was paid to the ARC for the purposes of regional parks;
   - $10 million was paid to the territorial authorities of the Auckland region to be applied to significant projects in the Auckland region in the area of arts and culture;
   - the assets and liabilities of ARST in relation to the Pikes Point walkway were transferred to the Auckland City Council;
   - the shares in Watercare Services Limited were divided between the territorial authorities of the Auckland region.

The Making of Grants

5. Section 707ZZL(1) of the LGA provides that any local authority which, or other person who, intends to undertake within the Auckland Region a project in respect of which IA may make a grant in the exercise of its functions under section 707ZZK(1) may apply to IA for such a grant.

6. IA, in deciding whether or not to contribute funds to projects or parts of projects or components of projects in the exercise of its principal function under section 707ZZK, must be guided by the criteria specified in clause 5.2 of the Infrastructure Auckland Deed, which provides:

   5.2 Criteria: The criteria, in relation to each such project, are as follows:

   (a) The extent to which the project generates benefits to the community generally in addition to those that accrue to any identifiable persons or groups of persons; and

(b) The extent to which the benefits generated to the community generally by the project exceed the costs (including the external costs) of the project by a margin greater than the assessed risk that the project will not deliver its intended net benefits; and

(c) Whether the project satisfies the requirements of clause 4.1; and

(d) The extent to which the project contributes and gives effect to any Auckland Regional Land Transport Strategy or the Auckland regional growth strategy or any regional policy statement or proposed regional policy statement adopted under the Resource Management Act 1991 or any regional stormwater strategy as adopted by the Regional Growth Forum; and

(e) The principle that the costs of the project, including the external costs, should be

(i) Allocated in a manner that is consistent with economic efficiency; and

(ii) Where practicable, recovered from those persons or groups of persons who—

- benefit from the project; or
- contributed to such costs; and

in a manner that matches the extent to which those persons or groups of persons benefit from the project or contributed to such costs; and

(f) The extent to which the project will be in the best interests of the inhabitants of the Auckland Region; and

(g) The extent to which the project provides the greatest benefit to the greatest number of people in the Auckland Region; and

(h) The extent to which the project provides for a geographical spread of public benefits across the Auckland Region; and

(i) The degree to which the project may improve economic performance in the Auckland Region; and

(j) The degree to which the project may contribute to regional environmental outcomes; and

(k) The degree of urgency for the project.

7. Clause 4.1 of the Infrastructure Auckland Deed sets out further matters which IA must have regard to in making grants. It states:

Infrastructure Auckland must ensure that grants it makes under section 707ZZK(1)—

(a) Are made primarily for the purpose of funding the capital components of projects; and

(b) Are not inconsistent with any Auckland Regional Land Transport Strategy or the Auckland regional growth strategy or any regional policy statement or proposed regional policy statement under the Resource Management Act 1991; and

(c) Are made having regard to Transfund New Zealand's funding policies; and

(d) Are not for services for which funding has already been identified. (As required by section 707ZZZA(1)(c))

8. The vast majority of the grants made by IA have been made (and will continue to be made) to local authorities and commercial transport operators who carry on taxable activities and must account for GST in respect of supplies they make.

Terms and Conditions attaching to Grants

9. The grants IA makes are usually subject to terms and conditions.

10. IA has a broad discretion, pursuant to section 707ZZL of the LGA, to make grants subject to such terms and conditions as IA sees fit.

11. However, in practice, there are three broad categories under which IA will impose conditions in relation to a grant. These are:

(a) Conditions which do no more than ensure the efficient and proper application of the grant funds, consistent with section 707ZZK(1) and 707ZZL(2) of the LGA, as well as other relevant statutory requirements, being one or more of the following conditions:

(i) The grant recipient carrying out the project as stated in the grant application;

(ii) The grant recipient obtaining any additional funding required to carry out the grant project (to the extent that the grant made by IA does not provide sufficient funding);

(iii) The grant recipient obtaining all relevant statutory and regulatory consents in respect of the project, such as resource consents, building consents, local body and regulatory authority approvals;

(iv) The grant recipient obtaining all relevant board and shareholder approvals;

(v) The grant recipient entering into the principal contracts required to complete the relevant project;

(vi) The grant recipient establishing an appropriate entity to hold assets and/ or carry out the project;

(vii) The grant recipient completing any due diligence or further enquiry (if appropriate) for the purpose of ensuring the feasibility of the project;

(viii) The grant recipient obtaining any property rights that are necessary for the project; and

(ix) The grant recipient providing regular reports to IA at specified intervals including information on the progress of the project and costs, adverse events that have arisen, and the outcome of the project following its completion.

(b) Conditions that ensure that the benefit of the grant is obtained by the Auckland people and region; provided that in any such case any benefit connected with any specified person or group of persons is incidental to and/or a necessary and unavoidable result of generating benefits to the community generally in the Auckland Region, being one or more of the following conditions:

(i) The grant recipient allowing competitors to use assets that are funded by grants;

(ii) The grant recipient allowing general public access to certain assets;

(iii) The grant recipient informing the public of the existence of the services assets or improvements (as the case may be) arising from the grant project; and

(iv) The grant recipient acknowledging the contribution of IA to the funding of the grant project.

(c) Conditions that are contingent on the occurrence of some future event that would alter the assumptions inherent in making the grant, being one or more of the following conditions:

(i) The grant recipient agreeing not to sell or dispose of its interest in assets acquired or approved as part of a project in respect of which a grant has been made unless authorised by IA;

(ii) A condition providing that, if assets are disposed of, those assets must continue to be used in a manner that will deliver benefits to the Auckland Region generally, whether by reason of being transferred to a local authority, a subsidiary of a local authority, a competitor or otherwise;

(iii) Rights to grants provided by IA may not be assigned;

(iv) The grant applicant maintaining the project for the life of the asset in accordance with sound business practice;

(v) A right for IA to cancel a grant and require repayment of amounts paid in respect of the grant if;

- the grant recipient cannot complete the project by the specified date; or
- the specified purpose for which the grant was made cannot be achieved; or
- the grant was made in reliance on information that was incorrect or misleading; or
- there are variations to the project to which the grant funds were applied that are not authorised by IA;

(vi) The grant recipient ensuring that any assets created as a result of the grant project remain available to be used for the benefit of the Auckland Region where the grant recipient disposes of its ownership of the assets or ceases to use them for the purposes for which the grant was made; and

(vii) The grant recipient obtaining IA's consent prior to moving certain assets to another physical location or changing the ownership of such assets.

Membership of IA

12. IA is required to be operated by up to seven "members" who are appointed in accordance with the Infrastructure Auckland Deed. The members are responsible for the appointment of the Chief Executive Officer.

13. The members are appointed by a body known as the Electoral College. The Electoral College is established pursuant to the LGA and its function is set out in section 707ZZT, which provides:

(1) The functions of the Electoral College are—

(a) To appoint, in accordance with this Act and the Infrastructure Auckland deed, members of Infrastructure Auckland:

(b) To appoint, in accordance with this Act and the Infrastructure Auckland deed, the chairperson of Infrastructure Auckland:

(c) To discharge, in accordance with this Act and the Infrastructure Auckland deed, its duties in relation to Infrastructure Auckland's statement of corporate intent:

(d) To monitor the performance of Infrastructure Auckland:

(e) To consult with the Minister from time to time about amendments to the Infrastructure Auckland deed:

(f) To carry out such other functions as are conferred on it by this Act or any other Act.

14. The Electoral College has eight members with each of the Manukau City Council, the Auckland City Council, the Waitakere City Council, the North Shore City Council, the Papakura District Council, the Rodney District Council, the Franklin District Council and the Auckland Regional Council being entitled to appoint one member.

Central Government Involvement with IA

15. The Minister of Local Government ("the Minister") has a minor degree of involvement with IA.

16. The Minister has been required to prepare and sign the Infrastructure Auckland Deed. In addition the Infrastructure Auckland Deed may be amended from time to time by Order in Council made on the recommendation of the Minister after consultation with the Electoral College.

17. Pursuant to clause 46.1 of the Infrastructure Auckland Deed, the Minister, in consultation with the Electoral College, must, in the period of 12 months ending with the close of 30 September 2008, conduct a review of the activities and future of IA for the purpose of determining whether there is a continuing need for IA to make grants under section 707ZZK(1).

18. In all other material respects, IA is totally divorced from central government involvement.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) No direct benefit to IA will arise in respect of grants made by IA except for a market rate return to compensate IA for temporary loss of use of funds where circumstances arise which necessitate repayment of a grant previously made.

b) Any benefit resulting from any project in respect of which a grant is made which arises to specified or identified persons or groups of persons is incidental to IA's overall purpose of providing a benefit to the Auckland Region generally.

c) No direct benefit will arise to any member or employee of IA from any project in respect of which a grant is made except in that member or employee's capacity as a member of the community generally living in the Auckland Region.

d) This ruling only applies in respect of grants made subject to no conditions, or subject to one or more of the conditions listed in paragraphs 11(a), 11(b), or 11(c) of the Arrangement, and will not apply in respect of any grant which contains conditions which are not listed in paragraphs 11(a), 11(b), or 11(c).

e) The criteria specified in clause 5.2 of the Infrastructure Auckland Deed are the sole criteria that IA will use in determining whether to offer a grant.

How the Taxation Law applies to the Arrangement

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

- The grant payments that the grant recipients receive from IA will not be deemed to be consideration for a supply of goods or services pursuant to section 5(6D).
- The grant recipients will not be required to account for GST pursuant to section 8(1) in respect of the grant payments they receive from IA.

The period or income year for which this Ruling applies

This Ruling will apply for the period from 1 October 1998 to 4 May 2004.

This Ruling is signed by me on the 4th day of May 2001.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/15

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 Truck Leasing Limited trading as Esanda Fleet Partners ("Esanda").

Taxation Laws

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

This Ruling applies in respect of sections BG 1, CI 3(1), GC 15, GC 17, and Schedule 2, Part A clause 1(c).

The Arrangement to which this Ruling applies

The Arrangement is the leasing of motor vehicles by Esanda under Multi-lease agreements to employers who provide the motor vehicles to employees for their private use. The Multi-lease agreements involve a motor vehicle lease with a term of one year, with the possibility of entering into two further terms of one year each. Further details of the Arrangement are set out in the paragraphs below.

1. Esanda conducts a fleet leasing business. One of the options offered to customers is a motor vehicle lease with a term of one year, with the possibility of entering into two further terms of one year each ("Multi-lease").

2. The arrangement for which this ruling is sought is the lease (using the Multi-lease product) of a motor vehicle from Esanda to an employer and the provision of that motor vehicle by the employer to an employee for their private use and enjoyment. The lease from Esanda to the employer is made under the terms and conditions contained in the Master Lease Agreement and Agreement to Lease (copies of which were provided with the application dated 14 December 2000). The Master Lease Agreement states that the agreement is between the lessee and Mutual Leasing Limited.

3. Mutual Leasing Limited amalgamated with Truck Leasing Limited on 2 October 2000 and therefore now operates under the name of Truck Leasing Limited. As part of Esanda's contractual obligations under the arrangement, it is required to advise employers of the market valuation of the vehicles.

4. The leases are operating leases rather than finance leases for income tax purposes.

5. Employers find the Multi-lease product appealing because of its flexibility. There are no penalties payable as a result of a customer choosing not to take up a further lease of the vehicle concerned. At the expiry of each 12-month period, lease obligations have been met under the Multi-lease product.

6. By comparison, Esanda imposes a significant potential penalty for early termination under its three year lease (under clause 28 of the Master Lease Agreement, Esanda can determine the amount of the penalty).

7. The flexibility provided by the Multi-lease is particularly valuable when employers are unsure of the number of employees for whom they will require vehicles or are unsure of the type of vehicle the employees may wish to have available. As a result, the employers prefer short lease terms so that they are not required to continue either renting vehicles that they do not require or pay significant penalties for early termination.

8. The leasing of the motor vehicles by Esanda to customers/lessees (being, for the purposes of this ruling, the employers) comprises the following steps:

(a) Initial lease enquiry

This is the initial contact from the potential customer inquiring about leasing vehicles from Esanda.

(b) Marketing response

This involves the initial meeting and consideration of promotional material.

(c) Lease proposal

Esanda provides the customer with a "Lease Proposal". This is not a contractual document. It is a strategic/informative document that sets out the general basis for the services that Esanda can provide to customers, as lessees.

(d) Credit Application

The lessee's credit application is completed and assessed.

(e) Motor Vehicle Leasing Terms and Conditions

When a lessee commences dealings with Esanda, Esanda then provides the lessee with the Motor Vehicle Leasing Terms and Conditions.

This is the Master Lease Agreement ("MLA") which sets out the general terms and conditions for motor vehicles to be subsequently leased from Esanda. There is no specific reference to actual vehicles in the MLA.

(f) Vehicle Order

The lessee then completes a "Vehicle Order" which details their precise requirements, for example the vehicle, term, kilometres, and relevant monthly lease rental etc. The Vehicle Order also incorporates the conditions in the MLA.

The Vehicle Order is completed prior to the commencement of each new lease and reflects the details for that lease only.

(g) Acceptance

Esanda then confirms acceptance with the lessee.

(h) Agreement to Lease

Esanda and the lessee then enter into an "Agreement to Lease". The terms and conditions set out in the MLA are incorporated into this lease agreement. In a contractual sense, the lease of each vehicle is clearly created by the offer and acceptance of each specific Agreement to Lease. The actual motor vehicle is then delivered to the lessee.

Under each and every Agreement to Lease entered into between Esanda and a particular lessee, the following will apply:

- The term of the lease is 12 months.
- There will be no provision for automatic renewal of the term of the lease.
- There will be no option conferred on the lessee to renew, extend or vary the term of the lease.
- There will be no provision for an incentive to the lessee if it takes up a further lease of the vehicle.
- There will be no penalty on the lessee if it does not take up a further lease of the vehicle.

(i) Procedure at end of lease

As standard practice, Esanda advises the lessee of the status of the lease at least three months prior to the expiration of the 12-month lease term. Esanda is then able to determine whether the lessee wishes to lease the vehicle for a further lease term of 12 months. If not, the vehicle is returned to Esanda upon expiry of the lease. If the lessee wishes to retain the vehicle, a new lease is entered into for a further 12-month period. This new 12-month lease is assigned a separate and distinct number or record in Esanda's computer system, which is used to manage vehicles leased using its Multi-lease product. In all cases, the old record for the previous 12-month lease is noted as having terminated. In addition, a new Agreement to Lease is executed for the further 12-month lease. Again, the general conditions set out in the MLA are incorporated into that new Agreement to Lease.

The rental rates for the second and third periods are lower than the first. The rates reduce as the depreciated value of the vehicle reduces. If the customer does not renew, it does not get the benefit of reduced rates. However, there is no obligation on Esanda to provide vehicles for subsequent 12-month leases and no obligation on customers to enter into a subsequent 12-month lease.

(j) Valuation of Vehicles

As noted above, Esanda is required to advise lessees of the market value of the vehicle at the commencement of each 12-month lease period. The market value assessment takes into account the type of car and its condition and mileage. Esanda advises employers/lessees of the market valuation of the vehicles, and also provides market value forecasts for subsequent periods for indicative purposes only. Market values are routinely reviewed prior to the commencement of subsequent leases to ensure that the forecasts are accurate.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The motor vehicles leased by the employers under this Arrangement are leased for the private use or enjoyment of the employees or made available for the private use or enjoyment of the employees.

b) Any rental rate for a subsequent lease period is the same rental rate that would be offered to any other customer for that particular vehicle and lease period (taking into account the customer credit rating, customer fleet size, kilometre allowances, and general service components of the lease including vehicle maintenance) irrespective of whether a previous lease for that vehicle was entered into by that customer.

c) There is no other documentation, agreements, or contracts that concern or affect the terms of the leases entered into under this Arrangement apart from the MLA, the Vehicle Order, and the Agreement to Lease.

d) There is no contract, agreement, arrangement, plan, undertaking or understanding (whether formal or informal, and whether intended to be legally unenforceable or not) that any party will, or will if requested, renew, extend or vary the term of the lease.

e) There is no contract, agreement, arrangement, plan, undertaking or understanding (whether formal or informal, and whether intended to be legally unenforceable or not) at the time of entering into any lease under this Arrangement, that the parties will enter into a further lease in respect of the vehicle.

f) There is no contract, agreement, arrangement, plan, undertaking or understanding (whether formal or informal, and whether intended to be legally unenforceable or not) at the time of entering into any lease under this Arrangement, that there will be penalties for choosing not to enter into a further lease in respect of the vehicle.

g) All calculations, factors, and/or projections which are taken into account in formulating the rental rates applying to each lease are not in any way based on a lease of the relevant motor vehicle for more than 12 months.

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:

- The market value of a motor vehicle under this Arrangement, for the purposes of calculating the fringe benefit value of that vehicle under section CI 3(1) and Schedule 2, Part A clause 1(c), is determined on the date on which each new 12-month lease commences.
- Sections GC 15 and GC 17 do not apply to the Arrangement.
- Section BG 1 does not apply to negate or vary the conclusions above.

The period or income year for which this Ruling applies

This Ruling will apply from the date this Ruling is signed until 3rd May 2004.

This Ruling is signed by me on the 4th day of May 2001.

Martin Smith

General Manager (Adjudication & Rulings)

NEW LEGISLATION

2000–2001 DEEMED RATE OF RETURN FOR FOREIGN INVESTMENT FUND RULES

The deemed rate of return used for the foreign investment fund (FIF) rules of the Income Tax Act 1994 has been set at 10.29% for the 2000–2001 income year, down from 10.74% for the previous year. The rate will apply to all types of investments, including interests in superannuation schemes and life insurance policies.

The FIF rules tax the income earned by foreign entities on behalf of New Zealand residents, and apply to investments that are not subject to the controlled foreign company rules.

The deemed rate of return method is one of four methods for calculating FIF income or loss. The rate for future income years will continue to be set annually.

The regulations setting the rate—the Income Tax (Deemed Rate of Return, 2000–01 Income Year) Regulations 2001—were made by Order in Council on 25 June 2001.

INTERPRETATION STATEMENTS

This section of the *Tax Information Bulletin* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

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

FINANCIAL PLANNING FEES – GST TREATMENT

This statement sets out the Commissioner's view on the GST treatment of services provided in relation to financial planning fees charged by financial advisers to plan, implement, and monitor an investment portfolio for their investor clients. This interpretation statement replaces Public Ruling BR Pub 95/11 that appeared in *Tax Information Bulletin* Vol 7, No 7 (January 1996). The Public Ruling ceased to apply from 31 March 1999.

There are seven categories of financial planning fees, which are based on the process of obtaining an initial financial plan, the subsequent monitoring of that plan, and any following adjustments or alterations to the plan. The question of the GST treatment hinges on the actual nature of the services provided rather than the label applied to those services.

The following table summarises the GST treatment of services provided in relation to the various categories of financial planning fees that are charged by financial advisers. The table is a general guide only and should be read in conjunction with the more detailed explanations of each particular category contained in this interpretation statement.

Fee Category	Services Subject to GST
Initial planning fees	Yes
Implementation fees	No
Administration fees	No
Monitoring fees	Yes
Evaluation fees	Yes
Re-planning fees	Yes
Switching fees	No

Introduction

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

This statement considers the GST treatment under sections 3 and 14, of a range of services provided by financial advisers for financial planning fees charged to investors. In this regard, the actual nature of the services provided is important and will determine the liability to GST of the financial planning fees paid for those services.

The services will be exempt from GST under section 14 (exempt supplies) if:

- the activities undertaken involve the supply of "financial services" in terms of section 3; or
- the services are not in themselves "financial services", but are supplied together with a supply of "financial services", and those other services are reasonably incidental and necessary to that supply of financial services, and are not otherwise specifically excluded from being exempt supplies.

Activities that involve the provision of advice are generally excluded from the meaning of "financial services".

Background

An investor who seeks advice from a financial adviser will be charged for the services provided. Whether these fees are exempt supplies or subject to GST will depend on the nature of the services provided.

When an initial financial plan has been devised, agreed to by the investor and implemented by the adviser, that is not necessarily the end of the matter. Usually systems are in place that require the adviser's continued involvement. Most financial advisers offer a continuing monitoring service that is generally part of an overall advisory package. The investments are sometimes (but not always) placed in the care of a custodian (commonly for security reasons) who may have also been involved in the acquisition of the investments. The income derived from the investments may pass to the adviser or custodian where it is placed in a trust account before being able to be drawn upon by the investor. The maintenance of these trust accounts by the adviser usually incurs costs that are charged to the investor. As part of the service, the adviser may monitor the portfolio to ensure that the aims of the investor are continually met. For this service the investor will often pay further fees. From time to time as part of this monitoring service the adviser can recommend changes to the investment mix. If the investor accepts these recommendations to change investments, further fees are incurred which may include switching fees.

It is the Commissioner's view that public ruling BR Pub 95/11 has been useful in respect of the GST treatment of the financial planning fees. However, despite the issue of the ruling there has been occasional uncertainty on how the ruling should be applied. Although some of these were discussed within the commentary definitions of the three categories identified, participants in the financial planning industry may have had difficulty in applying the ruling. It seemed logical to extend and further define the present three categories to make it easier for advisers and others in the financial planning industry to decide whether or not the planning fees were subject to GST. Similar issues arose and the same approach was taken in relation to the previous income tax public rulings (Public Rulings BR Pub 95/10 and 10A) that dealt with the income tax deductibility of financial planning fees charged to investors.

Financial advisers charge for a number of services provided to their clients, sometimes using different names for these component services. The GST tax treatment of the fees depends not on the name given to the service, but on the nature of the service. To determine the correct tax treatment of a service, it is important to identify the exact service a financial adviser provides.

The adoption of the expanded categorisation of fees in this statement is intended to make it easier for financial advisers and others to determine how fees charged and the services provided will be treated for GST purposes. The categories correspond to the process usually followed when an investor seeks the assistance of a financial adviser.

Fee categories

The fees charged by financial advisers vary from one adviser to another, but generally they can be separated into a number of categories. Financial planners give the fees charged various names, but the crucial point that determines the GST treatment is for what service(s) the fee is actually paid. The nature of the service provided will determine whether the fees paid are for a supply of a "financial service" and thus an exempt supply, or otherwise qualify as a supply of services exempt from GST.

The fees can be summarised as:

(a) *Initial planning fees*: Fees charged in relation to services provided by the adviser for the initial interview where the investor and the adviser discuss the investor's investment goals, savings objectives, cash requirements, and life and general insurance requirements. The adviser then prepares a draft portfolio plan for the investor. Further interviews, discussions, and adjustments to the draft plan may follow until it is acceptable to the investor.

(b) *Implementation fees*: All fees for services associated with implementing the draft plan devised in (a). They will include any one-off up-front fees paid to or made in respect of services or charges to advisers, administrators, executors, fund managers, etc., to purchase or acquire the investments. They include payments to custodians on implementation of the plan or charges by fund managers for entry into the investments.

(c) *Administration fees*: This fee category is generally described by advisers as "annual on-going" fees. They are charged by the adviser to cover the costs of maintaining records of the investor's transactions with the adviser. This category also includes charges relating to the handling of cash for the investor, such as the withdrawal and deposit in the investor's account with an administrator, bank charges, and other administration fees. Also included are any fees or commissions charged by the adviser for collecting income from the investments and arranging for this to be paid to or credited to the investor's account with the adviser or to the investor's own bank account.

(d) *Monitoring fees*: Annual charges for monitoring and reporting to the investor on the performance of the portfolio (including the performance of the fund managers and the adviser) in terms of the investor's goals, and relaying this information to the investor. The adviser will prepare these reports from time to time.

(e) *Evaluation fees*: Any fees for services relating to an evaluation of an existing portfolio. Typically, these arise where an investor has an existing portfolio of investments and either seeks a financial adviser's advice for the first time, or seeks confirmation that the portfolio's performance is matching the goals originally set by either the investor, or with the assistance of a financial adviser at the initial planning stage. This is a more detailed examination of performance of the portfolio than simply monitoring performance and reporting to the client. It may or may not result in a recommendation from the adviser to make changes to investments within the portfolio to maintain the investor's aims.

(f) *Re-planning fees*: Fees for services relating to the re-planning of a portfolio sometimes arising from category (e) services due to changes to the investor's objectives. This could entail minor changes, or the complete restructuring of investments and a change in investment strategy. Re-planning fees do not necessarily refer to advice supplied by the same adviser. They could be for advice by an adviser to a new client who had previously managed his or her own portfolio or had previously engaged a different adviser. Included in this category are any other fees as described in *Initial planning fees* at (a), when there has been a complete restructuring of investments.

(g) *Switching fees*: Fees related to the costs involved in selling existing investments and/or purchasing new investments arising from a recommendation by the adviser as a result of category (e) or category (f) services. The fees will be charged by the adviser for changing investments within the portfolio. Also included are any fees relating to the withdrawal in whole or in part from an existing portfolio.

If financial planners charge a global fee (that includes fees for more than one of the above categories), it will be necessary for that fee to be apportioned between the categories, based on the particular services provided for the fee, to ensure the fees are correctly treated for GST purposes.

A similar apportionment exercise needs to be undertaken in the case of "performance fees", where an investor may have the option of being able to elect to pay a performance fee instead of fees for some or all of the categories noted above. Performance fees are a form of global fee paid to advisers, based on how well the portfolio of investments selected by the adviser and agreed to by the investor is performing against some pre-determined measure.

The calculation of the seven categories of fees noted above might be based on a standard fee structure, hours of work put in by the adviser, the amount of the investments made by the investor, or a combination of those. Performance fees on the other hand, are calculated under some pre-determined formula based on how well the investor's portfolio, as recommended by the adviser, performs over a period of time. These fees could include a standard amount, plus a percentage based on the extent to which the level of growth or return from the portfolio exceeds previously agreed targets, or the fee could be based solely on a percentage of the returns/agreed targets.

Irrespective of the name given to the fee, or the basis of calculation, the GST treatment of the fees will be determined having regard to the services performed in establishing, administering, and altering the investor's portfolio, based on the seven categories of services mentioned above. It may be that in certain cases the performance fee is paid in respect of all seven categories of services, while in other instances the fee may be only for services coming within some of the categories, e.g. the administration and monitoring fee categories. In view of this, in determining the GST treatment it is not the description (label) the adviser attaches to the fee charged that is relevant, rather it is what service (s) the fee is actually paid for. Performance fees are in reality no different to any other global or multi-service fee charged by an adviser. How the amount is apportioned among the categories of services is a question of fact to be determined in the circumstances of the particular case.

Issues

The question considered in this statement is: in what circumstances will the Commissioner treat the services provided in respect of financial planning fees as an exempt supply of services under section 14 of the Goods and Services Tax Act 1985? This will be determined by:

- The nature of the service provided for the fees charged, and whether these fees are in respect of a "financial service" in terms of section 3.
- In the event that the fees are not in respect of a financial service, whether the services are reasonably incidental and necessary to that supply of financial services. This is subject to the services supplied for those other fees not otherwise being specifically excluded from being exempt supplies.

Legislation

The legislation relevant to this statement is contained in sections 3 and 14. Section 14 provides a GST exemption for certain supplies, including the supply of financial services, and section 3 defines the term "financial services" for the purposes of the Act.

Paragraph (a) of section 14(1) is relevant for the purposes of this statement and provides:

> The following supplies of goods and services shall be exempt from tax:
>
> (a) The supply of any financial services (together with the supply of any other goods and services, supplied by the supplier of those financial services, which are reasonably incidental and necessary to that supply of financial services), not being¾
>
> (i) A supply of financial services which, but for this paragraph, would be charged with tax at the rate of zero percent pursuant to section 11A of this Act; or
>
> (ii) A supply of goods and services which (although being part of a supply of goods and services which, but for this subparagraph, would be an exempt supply under this paragraph) is not in itself, as between the supplier of that first-mentioned supply and the recipient, a supply of financial services in respect of which this paragraph applies:

The parts of the section 3 definition of "financial services" that are relevant for the purposes of this statement are as follows:

> (1) For the purposes of this Act, the term "financial services" means any one or more of the following activities:
>
> (a) The exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise):
>
> ….
>
> (c) The issue, allotment, drawing, acceptance, endorsement, or transfer of ownership of a debt security:
>
> (d) The issue, allotment, or transfer of ownership of an equity security or a participatory security:
>
> ….
>
> (ka) The payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security, equity security, participatory security, credit contract, contract of life insurance, superannuation scheme, or futures contract:
>
> (l) Agreeing to do, or arranging, any of the activities specified in paragraphs (a) to (ka) of this subsection, other than advising thereon.

Analysis

General requirements of the legislation affecting financial services

In order to determine whether particular services supplied are exempt, it is necessary that the supplies fall into the criteria stipulated in section 14. Section 14(1)(a) requires that there must be either a supply of a financial service or the supply of a good or a service that is "reasonably incidental and necessary" to the supply of a financial service provided by the same supplier.

This raises two interpretation matters:

- What are financial services; and
- What does "reasonably incidental and necessary" mean?

What are financial services?

Section 3 defines "financial services". In terms of the issues raised by this statement concerning the treatment of financial planning fees, the relevant subparagraphs of section 3(1) are:

> (1) For the purposes of this Act, the term "financial services" means any one or more of the following activities:
>
> (a) The exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise):
>
> ….
>
> (c) The issue, allotment, drawing, acceptance, endorsement, or transfer of ownership of a debt security:
>
> (d) The issue, allotment, or transfer of ownership of an equity security or a participatory security:
>
> ….
>
> (ka) The payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security, equity security, participatory security, credit contract, contract of life insurance, superannuation scheme, or futures contract:
>
> (l) Agreeing to do, or arranging, any of the activities specified in paragraphs (a) to (ka) of this subsection, other than advising thereon. [*Emphasis added*]

The parts of section 3(1) under consideration raise two further interpretative matters: the meanings to be ascribed to the words "arranging" and "advising" as used in paragraph (l). A number of the supplies of services under consideration involve financial advisers providing various levels of advice or arranging for another organisation to implement an investor's financial plan (place investments, etc.) and/or to collect income from the investments and arrange payment or crediting to the investor. A preliminary issue is the position under section 3(1)(l) of persons or organisations who may act as intermediaries between the investor and the person actually undertaking the activities specified in paragraphs (a), (c), (d) or (ka) of section 3(1).

Intermediaries and section 3(1)(l)

The agreeing to do or arranging any of the activities listed in section 3(1) in terms of paragraph (l), encompasses the activities of brokers or intermediaries who arrange for the provision of financial services, such as mortgage, superannuation and life insurance brokers. This finding was concluded in Product Ruling BR Prd 96/30 issued by Inland Revenue in respect of section 3(1)(l) (*Tax Information Bulletin* Vol 8, No 8, November 1996).

The adviser often does not actually undertake the activities in section 3(1)(a) to (ka), but is authorised to arrange the activities to be undertaken for and on behalf of another (the investor). In this situation the adviser is acting as an intermediary. In other words, the financial adviser itself does not implement the plan but acts on behalf of its clients and gets someone else to implement the plan. This factor does not take the intermediary's actions outside the ambit of section 3(1)(l).

Similarly, where a custodian is involved, it is the custodian who usually implements the financial plan on instruction from the financial adviser. Even though there is another intermediary besides the financial adviser, the fees incurred for the activities undertaken by the custodian are still within the ambit of section 3(1)(l).

Meaning of "arranging" used in section 3(1)(l)

The term "arranging" is not defined in the Act. However, in ordinary use "arranging" is capable of being given a wide or a narrow interpretation.

A wide interpretation would include every step that could result in a financial service being provided to the client, independently of whether a service is actually provided or of any intention of a service being provided. This would include promotions and marketing which do not necessarily lead to any service being provided or research into any areas to which investment may be expanded in the future.

By comparison, a narrow meaning requires a nexus or a close linkage to the provision of the actual financial service to the client. These activities would include brokerage activities or filling out forms for a client. The activities are for a specific purpose, and it is highly probable that the supply of a financial service will occur following those activities. For example, the general monitoring of the debt securities market would not be arranging the issue of a debt security, despite the monitoring being required for the making of a prudent investment.

Although the courts have not specifically discussed the term "advising" in the context of section 3(1)(l), there are cases that indicate that a narrow interpretation such as outlined above should be applied. Davison CJ in *Databank Systems Limited v CIR* (1987) 9 NZTC 6,213 (HC) indicated that an appropriate meaning would be "cause to occur". This suggests that there is also an element of certainty that the financial service will be provided to the client. Equally, Lord Templeman in *CIR v Databank Systems Limited* (1990) 12 NZTC 7,227 (PC) indicated that the exemption did not extend to activities which merely resulted in the supply of financial services thus rejecting the wide interpretation of "arranging". These two judgments indicate the need for a close connection between the activity undertaken and the financial service supplied to the ultimate recipient (the investor) in order for that activity to be the arranging of the financial service.

Databank (PC) also illustrates the principle that it is the actual arranging activity being undertaken that is paramount and not the overall nature of the activity comprising the services being supplied to the ultimate recipient. Both the *Databank* (PC) and *Turakina Maori Girls College Board of Trustees v CIR* (1993) 15 NZTC 1,032 (CA) decisions demonstrate the importance of dissecting the transaction involved to determine precisely what activity is being undertaken in order to establish whether a financial service is being provided.

In summary, while the New Zealand courts have not directly considered what constitutes arranging in terms of section 3(1)(l), they have provided some determinative guidelines in establishing the application of arranging. That is, "arranging" is to be interpreted in a narrow sense, and that when considering what is inclusive of arranging, it is important to dissect the transaction involved to determine precisely what activity is being undertaken, and not be swayed by the overall nature of the activity that the recipient or supplier may be involved with. This is in order to establish whether it is a financial service that is being provided (*Databank* (PC), *Turakina Maori Girls College* and *Case Q10* (1993) 15 NZTC 5,061).

Putting this into the context of section 3(1)(l), "arranging" must have a direct connection to the specific supply of the financial service. It is not enough that the arranging may have caused the supply of that financial service, what is necessary is that the activity of arranging intentionally causes the provision of a financial service as defined in section 3(1)(a) to (ka).

This interpretation is consistent with how the courts in the United Kingdom have defined the term "making of arrangements" (*Hargreaves Landsdown Asset Management v C & E Commrs* [1995] BVC 896*, Dogbreeders Associates v C of CE* (1989) VATTR 317 and *Donald Ford v The Commissioners* (1987) VATTR 130) and how Revenue Canada has defined the term "arranging" in its policy statement (Ruling No. 11783-2).

In order to establish whether there is an activity of arranging pursuant to section 3(1)(l), it is therefore necessary to establish the following criteria:

- The service to which the arranging relates is a financial service as defined by section 3(1)(a) to (ka) (*Databank* (PC)); and
- The activity is a precursor to the provision of a financial service which the intended recipient of that financial service has already decided to use or to obtain. "Arranging activities" that arise before a decision is made to proceed by the intended recipient, are considered too far removed and the provision of the financial service too uncertain. Therefore, provision of the financial service being arranged must not be subject to another person's overriding decision on whether to proceed. The "arranging" activity is tainted by the financial service's character as it is closely connected and has the purpose of organising the provision of that financial service or causing it to occur (*Dogbreeders Associates*, *Databank* (HC)); and
- The activity undertaken is to intentionally cause the provision of the financial service. This does not mean that no arranging has taken place if the financial service is cancelled or does not proceed. As long as the requisite activity is undertaken with the specific intention of causing the provision of a financial service to a recipient, then it will meet the test of "arranging" (*Databank* (HC), *Dogbreeders Associates* and *Donald Ford*).

Meaning of "advising thereon" used in section 3(1)(l)

Section 3(1)(l) expressly excludes the activity of "advising thereon" from the concept of arranging a financial service, and therefore the "financial services" definition. If a service is advisory, then it is not an exempt supply under section 14(1)(a).

The courts in New Zealand (and overseas) have not considered the words "advising thereon". However, the word "advice" has been considered. In *JR Moodie Co Ltd v Minister of National Revenue* [1950] 2 DLR 145 Rand J (at p.148) stated:

> The word "advice" in ordinary parlance means primarily the expression of counsel or opinion, favourable or unfavourable, as to action, but it may chiefly in commercial usage signify information or intelligence.

The *Concise Oxford Dictionary* suggests two types of advising (being consistent with the *Moodie* decision). Advising that involves a degree of counsel or recommendation, and advising that merely involves notification; the dissemination of information.

In one sense, the exclusion for "advising thereon" from the paragraph (l) activity of "agreeing to do, or arranging" other financial services activities, could be said not to apply to the mere provision of information to a client in order for that client to decide where the funds should be invested.

However, it is possible to argue that the reference to "advising thereon" is in fact capable of wider meaning and also excludes (from financial services) the provision of information.

To assist in settling this point it is necessary to consider the meaning of the word "thereon". Comparing the meaning of "thereon" with the word "thereof" may also assist in determining the meaning to be applied to the phrase "advising thereon".

The *Concise Oxford Dictionary* (8^{th} ed.), for example, includes the following definitions:

> **thereof** *adv. formal* of that or it.
>
> **thereon** *adv. archaic* on that or it (of motion or position).
>
> **on** … 14. concerning or about …

In the context in which the phrase "advising thereon" is used in section 3(1)(l), it is considered that it bears the more limited of the two possible meanings. That is, the exclusion for "advising thereon" requires more than mere notification of or the dissemination of information regarding the activities in section 3(1)(a) to (ka). Rather it excludes activities involving a degree of interpretation of information, counsel or opinion relating to those activities.

However, in the case of the information and reporting services provided by financial advisers or planners, many such services may well incorporate a range of the varying levels of advice. Given that, careful consideration will be necessary by advisers and planners to determine whether their particular services are, or are not, subject to the exclusion for "advising" on the activities specified in section 3(1)(a) to (ka).

Even if an activity is not "advising", it does not mean that it will automatically be a financial service or a supply of services exempt from GST. The requirement that the activity be itself a financial service or the arranging of a financial service, or "reasonably incidental and necessary" to a supply of an associated financial service (discussed below) must still be met.

Meaning of "reasonably incidental and necessary" in section 14(1)(a)

As referred to earlier in this statement, the supply of services that are "reasonably incidental and necessary" to the supply of any financial service and supplied by the same supplier, are also exempt supplies under section 14(1)(a).

The Act does not define the term "reasonably incidental and necessary" and there are no cases on the meaning of this particular phrase. Therefore, it is necessary to consider the ordinary usage of the component parts of this phrase. The Act does however import an element of *reasonableness* to both "incidental" and "necessary", by the inclusion of the word "reasonably" in the phrase "reasonably incidental and necessary" itself. Most of the cases are fact-specific in their interpretations and indicate that what is "necessary" or "incidental" is largely a question to be decided on the particular facts of each case. The following summarises those interpretations.

It can be reasoned that the phrase "reasonably incidental and necessary" is designed to measure two separate although related things:

- Firstly, the level of association or connection between the type of financial services supplied and the type of other goods and services supplied which are under consideration, viz "incidental" (or "reasonably incidental"); and
- Secondly, how essential or "necessary" the other goods or services are for that supply of financial services to occur.

Were that not the case there would have been no need to include both elements in the phrase, as simply including the narrower of the two conjunctive tests would have been all that was needed. Parliament could not have enacted a provision that leads to absurdity or an incongruous result, requiring a lesser degree of connection ("reasonably incidental") but at the same time be essential ("necessary") for the supply of the financial service to occur. It is therefore considered that "reasonably" applies to both "incidental" and "necessary".

"Reasonably incidental"

A number of cases have suggested that incidental means ancillary or consequential or provided in subordinate conjunction with something else. From these cases, the word "incidental" suggests that the service must be an associated service that is secondary to and that depends on a financial service as the main or primary service. It must be a consequence of a financial service or provided in conjunction with one of the financial services in section 3(1).

The meaning of the words "reasonably incidental" is something more than that which has a mere casual, accidental, or fortuitous connection with the other item. It also means something more than an item that may only possibly or sometimes be associated with the other item. From the cases, the words suggest a service that it is reasonable to expect will be supplied or offered with the financial service.

In the context of section 14(1)(a) a service that is "reasonably incidental" to the supply of a financial service is an associated service:

- That is ancillary to (*C and E Commissioners v CH Beazer (Holdings) plc* (1989) 4 BVC 121 and *C and E Commissioners v Wellington Private Hospital Ltd* (CA) [1997] BVC 251), or occurs or is provided in subordinate conjunction with (*Department of Health and Social Security v Envoy Farmers* [1976] 1 WLR 1,018, *Canadian National Railway v Harris* [1946] 2 DLR 545, *CH Beazer (Holdings)*, and *Wellington Private Hospital*), the financial service (i.e. is a service that is secondary to and dependent on the financial service as the primary service, and provided in combination or conjunction with that financial service); (see also *Mindell v Canadian Northern Shield Insurance* (1990) 43 CCLI 191, *Re Fahy's Will Trusts* [1962] 1 All ER 73, *AG v Pontypridd Urban District Council* [1906] 2 Ch 257); and
- That it is reasonable to expect the supplier to provide in the course of undertaking the supply of the financial service (*CIR v Databank Systems Ltd* (1990) 12 NZTC 7,227 (PC)).

Something is not "reasonably incidental" if it is merely desirable or profitable (*Hazell v Hammersmith and Fulham London Borough Council* [1991] 1 All ER 545), or convenient or advantageously provided with the financial service rather than by necessary implication being incidental or accessory to it (*AG v Manchester Corporation* [1906] 1 Ch 643).

[Reasonably] "necessary"

The word "necessary" narrows the meaning of the phrase "reasonably incidental and necessary". The word "necessary" can be interpreted as having a wide or a narrow meaning. The *Concise Oxford Dictionary* definition imparts an ingredient of being essential to the activity being performed. However, there is an issue in terms of how essential the performance is in relation to the fulfilment of a specific activity.

The case law is fact specific on this point and it is the actual context in which the term "necessary" appears that indicates in broad terms the degree of essentiality that the term "necessary" is designed to effect.

For example, in *Re an Inquiry under the Company Securities (Insider Dealing) Act 1985* [1988] 1 All ER 203 at 208, Lord Griffiths stated that "necessary" has a meaning that lies somewhere between "indispensable" on the one hand, and "useful" or "expedient" on the other, and suggested "really needed" as the meaning.

In *Europa Oil (NZ) Ltd (No2) v CIR* (1974) 1 NZTC 61,169 the New Zealand Court of Appeal considered the meaning of the word "necessarily" in the context of deductions required to be "necessarily incurred" under the income tax general deductions provision. McCarthy P in the leading judgment, disagreed with the High Court of Australia's interpretation of "necessarily" in *Ronpibon Tin NL & Tongkah Compound NL v FCT* (1949) 78 CLR 47 and held that there was no justification for watering-down the usual meaning of the word. The Court of Appeal commented further on the meaning of "necessarily" in its subsequent decision, *Europa Oil (NZ) Ltd (No.2) v CIR* (1974) 1 NZTC 61,238, stating that the word did not merely mean "clearly appropriate or adapted for" as was suggested in *Ronpibon Tin*.

The Court of Appeal has therefore rejected a wider meaning for the word.

The degree of necessity required for a non-financial service to be "reasonably incidental and necessary" to a financial service, on the basis of the context that "necessary" arises in section 14(1)(a), and also based on the comments of McCarthy P in *Europa Oil (No.2)*, can be taken to mean that the provision of the service must be seen from the surrounding circumstances to be needed or required for the provision of a financial service stipulated in section 3(1).

The meaning to be applied to the word "necessary" (qualified by "reasonably") and the phrase "reasonably incidental and necessary" must also be considered in the context in which the words appear in the Act. That is, as an extension to an exemption, when the prima facie position under the Act is that all supplies are taxable unless made expressly exempt. This also indicates that the words should not be interpreted too widely.

Summary – "reasonably incidental and necessary"

In summary, for an additional non-financial service to be "reasonably incidental and necessary" to the provision of a financial service, it must be an associated service that:

- Is of a type that it is reasonable to expect the supplier to provide in the course of undertaking the supply of the financial service, and that is secondary to and dependent on the financial service as the primary service, and supplied together with or as a consequence of that financial service; and
- Can be seen from the surrounding circumstances to be needed or required for the supply of the financial service to the recipient.

Apportionment of global fees

Before discussing how the above legislative principles relating to the GST treatment of financial services apply, it is necessary to determine how global fees are to be apportioned.

Where a global or combined fee is charged for several supplies of services, some of which are exempt supplies and some of which are standard-rated services, section 10(18) requires an apportionment of the fee between the taxable and exempt supplies: *CIR v Smiths City Group Limited* (1992) 14 NZTC 9,140. Under section 10(18), if a taxable supply is not the only supply to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.

This interpretation statement has categorised the component parts of financial planning fees based on the process of obtaining an initial financial plan, subsequent monitoring of the plan, and any following adjustments or alterations to that plan. It is considered that if fees are charged by financial advisers on the basis of the description of these categories, then determining what amount is subject to GST will be on a more objective basis than the previous public ruling. In the event that a financial planner charges a global fee (e.g. performance fees) for some or all of the different supplies of services provided, an apportionment of that global fee, based on the categories discussed in this statement, will be required. The amount allocated to each category will be a question of fact in each case.

As noted earlier, the label given to such a supply is not necessarily determinative of the nature of the supply. It is a question of fact what services are provided for the fee, and it is the actual services provided that will determine the GST treatment.

Appropriate apportionment methods

The object of any apportionment is to identify the part of the consideration that is "properly attributable" to the taxable supply in question. The answer can only depend on the circumstances of the particular case and must be fair and reasonable and not be arbitrary or based on mere speculation: *Ronpibon Tin NL v FC of T; Tongkah NL v FC of T* (1949) 78 CLR 47; 8 ATD 431; *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271.

The onus will be on the adviser to show that a defined part of the consideration is properly attributable to something other than a taxable supply, although absolute precision or scientific calculation of an amount is not required as long as there is some intelligible basis supporting the conclusion: *Buckley & Young*.

Depending on the facts of the case, an appropriate method of apportioning the global fee may be to apply a "time apportionment method" using the adviser's time spent carrying out the activity of each category of service provided. In apportioning such a global fee any clearly identifiable direct expenses (those that clearly relate to a specific category) not specified separately from the global fee, would usually first be deducted and put to that category. The remaining global fee would then be apportioned on the basis of the time spent carrying out the activity of each category of service provided (the *time apportionment method*).

GST treatment of the particular services in the new categories

Having discussed the legislative principles relating to the GST treatment of financial services generally, those principles will now be applied in relation to the seven separate financial planning fees categories.

Initial planning fees

These fees relate to services provided by the adviser from the initial interview stage up to the finalisation of the portfolio plan for the investor. Events leading up to this point may include the preparation of a draft plan, subsequent discussions with the investor, and adjustments to the draft until it is acceptable to the investor.

Initial planning services do not come within any of paragraphs (a) to (ka) of the definition of "financial services" in section 3(1) and in particular paragraphs (a), (c), (d) or (ka), which are the only ones in this group relevant to this statement. The only possibility is paragraph (l).

In relation to paragraph (l), it is unlikely that initial planning services in this category would fall within the narrow interpretation of "arranging" as set out earlier in this statement. In many cases where an investor seeks initial planning services, it is not until the adviser completes the portfolio plan and it is approved and adopted by the investor that a final decision to invest is likely to be made. Activities undertaken before a decision to invest or a positive intention of entering into the transaction would appear too far removed and the provision of the financial service is too uncertain (not that it is essential for actual provision of a financial service to be the outcome).

Initial planning services in the circumstances outlined would not be an arranging service that is tainted by the character of any other financial service the advisers may provide, as it is not closely connected to nor has the purpose of organising the provision of that financial service. To that extent, therefore, such initial planning activities would not come within the initial section 3(1)(l) requirement that they involve "agreeing to do or arranging" any of the paragraph (a) to (ka) activities. If that happens such activities have failed the first test, and the fact that they may also be excluded from being financial services by virtue of the subsequent "advising" criterion in paragraph (l) is of little relevance.

Situations may exist where planning services meet the first requirement of agreeing to do or arranging. However, even if meeting the "arranging" requirement in paragraph (l), initial planning services will fall squarely within the ordinary meaning of "advising" and thus the general exclusion for advising activities in paragraph (l). In this connection, the preparation of the portfolio plan will certainly involve to a significant degree the provision of advice and suggestions or recommendations by the adviser.

Initial planning services provided by advisers are not reasonably incidental and necessary to any supply of financial services on the basis outlined earlier in this statement. Services that are reasonably incidental and necessary to the supply of any financial service (i.e. a supply coming within section 3(1)(a) to (l)) are also exempt supplies under section 14(1)(a). As outlined in the next section, where an adviser arranges implementation of an investment plan, once adopted by the investor those implementation services are generally financial services.

However, the initial planning services are not an additional subordinate service arising out of, or provided in conjunction with and ancillary to, any implementation of that advice (i.e. a supply of financial services). The existence of the initial planning services is not dependent on the supply of those implementation services. Initial planning services are therefore not reasonably incidental and necessary to the supply by the adviser of any financial services.

Initial planning services' fees are subject to GST. They do not constitute financial services under any of paragraphs (a) to (ka) of section 3(1), nor do these activities as undertaken by advisers generally constitute the "agreeing to do or arranging" of any of the paragraph (a) to (ka) activities in terms of paragraph (l). The initial planning services do involve advisers in "advising" the investor on an investment programme, and therefore come within the specific exclusion from the definition of a financial service in section 3(1)(l).

Implementation fees

This category relates to all fees for services associated with implementing the initial investment plan devised in the preceding section. They will include any one-off, up-front fees paid to or made in respect of services or charges to advisers, administrators, executors, fund managers, etc., to purchase or acquire the investments.

The fees include payments to custodians on implementation of the plan or charges by fund managers for entry into the investments.

These services are provided in relation to the placement of investments. The role played by the adviser in relation to the services may vary. In some cases the adviser may directly undertake the purchase or acquisition of investments whether they be debt securities, equity securities, or participatory securities. However, usually the adviser will engage another organisation (e.g. a broker) to implement the investment plan on the adviser's instructions and place investments on behalf of the investor. This other organisation is often referred to as the "custodian".

As previously noted, the use of one or more intermediaries does not prevent the services provided by them from being financial services in terms of section 3(1)(l).

To the extent that the adviser may directly undertake the purchase or acquisition of investments in the form of a debt security, equity security or participatory security, those implementation services constitute financial services in terms of section 3(1)(c), (d), and/or possibly paragraph (l). As such they are, therefore, exempt supplies. The activity of transferring ownership of such securities is itself a financial service under paragraphs (c) or (d).

On the other hand, the implementation of the investor's investment plan by the adviser organising the placement of the investments constitutes the arranging of that transfer of ownership activities in terms of paragraph (l). Such organising the placement of investments comes within the meaning of "arranging" as outlined earlier in this statement.

In situations where a custodian implements the plan and acquires the particular investments on the instruction of the financial adviser, the fees charged by the adviser to the investor are also for an exempt supply of arranging financial services in terms of section 3(1)(l). The arranging service is tainted by the financial service's character, as it is closely connected to and has the purpose of organising the provision of that financial service or causing it to occur.

If the adviser uses a custodian (or other person or organisation) to place investments and passes on any of that person's charges for this service to the investor as a disbursement, no GST consequences will arise for the adviser if the adviser is acting as the investor's agent.

Section 60(2) deems a taxable supply of goods and services made to an agent on behalf of a principal to be a supply made to the principal. Under this section, a supply of services that the adviser receives as agent for a client investor is deemed to be supplied to the investor client, not to the adviser. If the adviser pays for the supply and the client investor reimburses the adviser for that payment, the reimbursement is not consideration for a supply of services by the adviser. The adviser does not have to account for GST output or input tax on the supply.

The discussion on the GST consequences of disbursements was outlined in the item "Disbursements by professional firms on behalf of clients – GST" on page 5 of *Tax Information Bulletin* Vol 6, No 1 (July 1994).

Where the adviser incurs custodian's charges in the capacity of principal, and on-charges the investor as part of an "implementation fee", no GST output tax is payable by the adviser so long as the services supplied by the adviser in respect of that implementation fee are themselves still financial services. In this respect it is not the name given to the fee that determines the GST treatment but the actual nature of the services provided.

NB. Whether the adviser is acting in the capacity of principal (or agent of the investor) will be established based on the facts. That is, the nature of the contract or arrangements between the parties.

Implementation services will be financial services under section 3(1)(c), (d), and/or (l), and as such they are exempt supplies under section 14(1)(a).

Administration fees

These fees are generally described by advisers as "annual on-going" fees. They are charged by the adviser in respect of services provided in, and to cover costs of, maintaining records of the investor's transactions with the adviser. They are also in respect of services and charges relating to the handling of cash for the investor, such as the withdrawal and deposit in the investor's account with an administrator, bank charges, and other administration fees. Any fees or commissions charged by the adviser for collecting income from the investments and arranging these to be paid to or credited to the investor's account with the adviser or to the investor's bank account are also included.

The different activities or services described as falling within the administration fees category are addressed individually.

Income collection and distribution

Fees or commissions charged by the adviser for collecting income from the investments and arranging these to be paid to or credited to the investor's account with the adviser or to the investor's bank account, may generally be accepted as falling within the wording of section 3(1)(ka). That is, "the payment or collection of any amount of interest, principal, dividend, or other amount".

This is on the basis that the amounts concerned relate to investments in a debt security, equity security, participatory security, credit contract, contract of life insurance, superannuation scheme, or futures contract.

Alternatively, if part of the activities performed by the adviser in collecting investment income and arranging payment or crediting to the investor's account (as described in this fees category) do not fall entirely within section 3(1)(ka), then they usually constitute financial services within paragraph (l). That is, the activities would fall within "arranging" one of the activities specified in the earlier paragraphs of section 3(1). This is on the basis that the particular service involved actively carrying out a service prior to the actual payment of an amount in respect of the investment. There is a direct nexus between the adviser doing this and the actual payment of an amount in respect of the investments, which is a financial service within paragraph (ka) of section 3(1).

If a person other than the adviser (e.g. custodian or investment administrator) performs the income collection and distribution activities under consideration in this part of the statement, those activities would generally be financial services in terms of either section 3(1)(ka) and/or (l).

Cash handling services and charges

Services and charges relating to the handling of cash for the investor, such as the withdrawal and deposit in the investor's account with an administrator, bank charges, etc., are also considered initially under section 3(1)(ka) and/or (l). This is on the basis that the "investor's cash" referred to relates to money either arising from investment income, investment sales or withdrawals, or provided by the investor to make initial, additional or new investments. Furthermore, the same person or organisation undertakes both the cash handling services and the associated income collection and distribution services or investment placement services (or the arranging of such services), whether it is the adviser or administrator, etc.

Subject to the money concerned relating to investments of the type specified in paragraph (ka), the activities referred to can be considered to come within the wording in the paragraph:

> … payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of …

To the extent that it could be argued that part of the cash handling activities referred to may not directly involve "payment or collection of … or other amount whatever", it is considered they could come within section 3(1)(l) as being involved with the arranging of such activities. A direct nexus exists between the adviser or administrator doing this and the actual payment of an amount in respect of the investments.

On the other hand, it could be argued that the cash handling activities are not always a precursor to the payment or collection of the investor's interest, principal, dividend or other amount or "cause that collection or payment to occur" and are therefore not "arranging".

However, even if the cash handling activities referred to do not constitute arranging, they would still qualify as an exempt supply under section 14(1)(a). That is on the grounds that they are "reasonably incidental and necessary" to the *Income collection and distribution* services element of the administration fees already stated to be a financial service.

Without the cash handling services and investor accounts, the adviser or administrator would be unable to undertake the financial service of collecting and processing distributions for investors; those distributions being placed in each investor's "cash holding account". Maintaining such investors' accounts is essential to the adviser or administrator being able to supply the service of income collection and distribution for investors. Consequently, cash handling activities are regarded as being reasonably incidental and necessary to the *Income collection and distribution* services element of the administration services that are a financial service supplied by the same person.

On that basis, to the extent there is doubt as to these services qualifying as financial services under section 3(1)(ka) and/or (l), they would still qualify as an exempt supply in terms of section 14(1)(a). That is, they are reasonably incidental and necessary to the *Income collection and distribution* services element of the administration fees already stated to be a financial service.

Maintaining records of the investor's transactions with the adviser

To the extent that these activities relate to records of cash transactions between the adviser and investor, the reasoning and conclusions outlined in the previous section will apply equally here. This is on the basis that both the records maintenance activity and the associated income collection and distribution services and/or investment placement services (or the arranging of such activities), to which the cash transactions relate, are undertaken by the same person or company, whether it is adviser or administrator, etc. Where this occurs, this part of the administration fee activities will constitute an exempt supply. That will be either by virtue of being a financial service under section 3(1)(ka) and/or (l) or a supply of a service that under section 14(1)(a) is reasonably incidental and necessary to those other supplies making up the administration fee services as described (which in themselves are financial supplies supplied by the same person or company).

The position may be somewhat different where the maintaining of transaction records' activity referred to is undertaken by someone other than the person or company maintaining and operating the investor's investment cash account (or carrying out income collection and distribution or investment placement services). In that situation, the maintaining of transaction records could not be a supply of services that are reasonably incidental and necessary to another supply of services that are financial services as required by section 14(1)(a).

If the transaction records relate to the placing of investments and/or implementation of an investment plan (the undertaking or arranging of which it is considered is a financial service under section 3(1)(c), (d) and/or (l)), then (subject to the above comments) the keeping of such records is reasonably incidental and necessary to those other services. The keeping of such records would be essential as opposed to merely being a desirable adjunct to such activities.

Summary

Based on the activities making up the administration fee category being as described, the services provided in relation to administration fees constitute exempt supplies either:

- by virtue of being financial services coming within one of the paragraphs in section 3(1); or
- by being reasonably incidental and necessary to the supply of those financial services in terms of section 14(1)(a).

Monitoring fees

Monitoring fees are the annual charges for services provided in monitoring and reporting to the investor on the performance of the portfolio (including the performance of the fund managers and the adviser) in terms of the investor's goals. The adviser will from time to time prepare reports on the portfolio's performance and relay this information to the investor.

Earlier in this statement, it was concluded that the context in which the word "advising" is used in the phrase "advising thereon" in section 3(1)(l) indicates the more limited of two possible meanings. That is, the exclusion for advising thereon requires more than mere notification of or the dissemination of information regarding the financial service activities in section 3(1)(a) to (ka). Rather it excludes activities involving a degree of interpretation of information, counsel or opinion relating to those activities.

Based on the description of monitoring services outlined, such services will not usually be subject to the "advising thereon" exclusion from financial services within the terms of section 3(1)(l). However, as indicated earlier, some information and reporting services provided by financial advisers or planners may well incorporate levels of advice that fall inside the meaning attributed to the exclusion for advising on the activities specified in section 3(1)(a) to (ka). Careful consideration will, therefore, be necessary to determine whether particular services are, or are not, subject to the exclusion.

As discussed, even if an activity is not "advising" it does not mean that it will automatically be a supply of services that is exempt from GST. The requirement that the activity itself be a financial service or the arranging of a financial service, or reasonably incidental and necessary to a supply of an associated financial service still has to be met.

Based on the earlier criteria in this statement for satisfying the "agreeing to do, or arranging" requirements in section 3(1)(l), the monitoring services do not meet those tests. Neither are monitoring services reasonably incidental and necessary to another supply of services which is itself a financial service.

On this basis, monitoring fees will be regarded as not constituting a financial service in terms of section 3(1) or an exempt supply in terms of section 14(1)(a) and are therefore subject to GST.

Evaluation fees

This category includes fees relating to services involving subsequent evaluations of the portfolio's performance, where the investor generally seeks confirmation that an already established portfolio is matching the goals set by either the investor or at the initial planning stage. This is a more detailed examination of performance of the portfolio than simply monitoring performance and reporting to the client. It may or may not result in a recommendation from the adviser to make changes to investments within the portfolio to maintain the aims established in the initial planning stage.

Evaluation fees arise where the investor already has an existing portfolio and seeks advice to make changes to the income producing structure but not to the aims or goals of that structure.

The services covered by these fees can be compared with and are similar in nature to some of those provided under the *Initial planning fee* category discussed earlier, in particular the provision of advice relating to future investment options and preparation of an investment plan. As such the GST treatment of evaluation fees is reasonably clear and is in line with that applying to *Initial planning fee* services. That is, the services do not come within any of paragraphs (a) to (ka) of the definition of "financial services" in section 3(1) and in particular paragraphs (a), (c), (d) or (ka), which are the only ones in this group relevant to this statement. The only possibility is paragraph (l).

However, to the extent that these evaluation fee services do happen to involve agreeing to do, or arranging any of the activities specified in section 3(1)(a) to (ka), the services would fall squarely within the "advising" exclusion in section 3(1)(l). Evaluation fees are therefore subject to GST.

Re-planning fees

The category includes fees relating to services involving a re-planning of a portfolio sometimes arising from *Evaluation fees* services due to changes to the investor's objectives. This could be a minor change or a complete restructuring of investments and a change in investment strategy. Re-planning fees do not necessarily refer to advice supplied by the same adviser. The fees could be for advice by an adviser to a new client who had previously managed his or her own portfolio or had previously engaged a different adviser. The category could include any other fees for services as described in *Initial planning fees* above, when a complete restructuring of investments has occurred.

As the name suggests, a re-planning could involve the restructuring of the current portfolio to meet the investor's existing or changed investment goals and usually includes recommendations or suggestions for future investment.

The services covered by these fees are very similar to those in the *Evaluation fees* category above, except that re-planning fees arise when there is a change in the investor's investment objectives. The distinction is that *Evaluation fees* relate to looking at performance against original objectives whereas re-planning fees involve looking at new objectives and what changes are needed to achieve that. The services covered by re-planning fees do not include those relating to actual implementation of changes, which will come within the *Switching fees* category below. The GST treatment for services in the re-planning fee category is therefore the same as for *Evaluation fees* and the analysis is in line with that applying to *Initial planning fee* services.

That is, the services do not come within any of paragraphs (a) to (ka) of the definition of "financial services" in section 3(1) and in particular paragraphs (a), (c), (d) or (ka), which are the only ones in this group relevant to this statement. The only possibility is paragraph (l). However, to the extent that these services do happen to involve agreeing to do, or arranging any of the activities specified in section 3(1)(a) to (ka), the services would fall squarely within the "advising" exclusion in section 3(1)(l). Re-planning fees are therefore subject to GST.

Switching fees

These fees relate to the costs involved in selling existing investments and/or purchasing new investments arising from a recommendation by the adviser as a result of services suppled in relation to the two preceding fee categories (*Evaluation fees* and *Re-planning fees*). The fees will be charged by the adviser for services provided in changing investments within the portfolio, and will include any fees for services relating to the withdrawal in whole or in part from the then existing portfolio.

The services provided for these fees have close similarities to those in the *Implementation fees* category, and in fact will include many that are the same. In particular up-front fees paid to or made in respect of services or charges to advisers, administrators, executors, fund managers, etc., to purchase or acquire the new investments will arise in both the implementation fees and switching fees categories. The same can be said for payments to custodians (on implementation of any amended plan), or charges by fund managers for entry into new investments.

Section 3(1) will apply to services in the switching fees category, in the same way as it applied to those services in the implementation fees category. The analysis relating to the application of the law to these services is the same.

The activity of transferring ownership of debt, equity, or participatory securities is a financial service under section 3(1)(c) or (d). To the extent that the adviser directly undertakes the sale or purchase of such securities as part of a switching of investments exercise, those switching services constitute financial services in terms of section 3(1)(c), (d) and/or paragraph (l). As such they are, therefore, exempt supplies.

If a custodian implements an amended plan and switches or changes the particular investments on the instruction of the financial adviser, the fees charged by the adviser to the investor are also for an exempt supply of arranging financial services in terms of section 3(1)(l). This is in line with the conclusions drawn earlier as to the meaning of "arranging".

Examples

These examples are included to assist in explaining the application of the law.

Example 1

Financial Adviser prepares an initial portfolio plan, and charges Investor $2,000 for it. Investor decides to accept the plan, and asks Financial Adviser to arrange with Custodian for its implementation. Financial Adviser asks, on Investor's behalf and as Investor's agent, for Custodian to implement the plan. Custodian's fee is charged to Investor by an invoice sent to Financial Adviser. Financial Adviser passes the invoice on to Investor. Custodian's fee is $1,500, additional to the $2,000 charged by Financial Adviser.

The $2,000 Financial Adviser charges Investor is for a taxable supply of initial planning services. The advice falls either outside the agreeing to do or arranging requirement, or within the "advising" exclusion, in paragraph (l) of the section 3(1) definition of "financial services". Financial Adviser must account for GST output tax on the supply.

Passing on Custodian's invoice to Investor has no GST implications for Financial Adviser, because Financial Adviser is simply the agent of Investor. Custodian's services are exempt supplies of implementation services and no GST output tax needs to be returned by Custodian.

Example 2

Six months after implementing the plan, Financial Adviser passes on to Investor dividend income collected on Investor's behalf. Financial Adviser also conducts an evaluation of the investment portfolio's performance. Financial Adviser charges a small commission of $50 for collecting the dividend income and $250 for the evaluation service.

The $50 charge for collecting dividends is consideration for an exempt supply under section 3(1)(ka). Financial Adviser does not need to return GST on the amount. The $250 for the portfolio review is an evaluation service and as such is within the "advising" exclusion in section 3(1)(l) and therefore subject to GST. Financial Adviser must return GST output tax on this amount.

Example 3

Financial Adviser has prepared a portfolio plan (involving debt, equity, and participatory securities within the meaning of section 3) that Investor asks Financial Adviser as agent to arrange with Custodian to implement. Financial Adviser maintains a record of transactions between Investor, Financial Adviser and Custodian relating to investment purchases and placement, sales/withdrawals and collection, and distribution of investment income to Investor.

Financial Adviser undertakes collection and distribution of investment income and operates a cash account for Investor through which movement of funds is recorded.

Financial Adviser charges an annual on-going fee of $500 for the record administration and maintaining the account for Investor, plus an income collection and distribution commission of 5% of the investment income collected.

The 5% commission for collecting investment income is an exempt supply, being in respect of a financial service under section 3(1)(ka).

The annual on-going fee of $500 for services in administering Investor's records and cash account is not in respect of a financial service under any of the paragraphs of section 3(1). However, those services would be regarded as being reasonably incidental and necessary to the financial service of payment or collection of interest, dividends, principal (section 3(1)) and/or to an extent, the arranging of the investment placement portfolio implementation financial service (section 3(1)(l)), and thus would be an exempt supply under section 14(1)(a).

Financial Adviser does not need to return GST on either of these fee amounts.

Comments on technical submissions received

Some comments received in the course of producing this item suggested that the phrase "reasonably incidental and necessary" appearing in section 14(1)(a) should be interpreted as meaning *highly expedient* and that other narrower meanings for the phrase given in the draft item, such as *an integral part of*, were inconsistent with that wider meaning. These comments led us to review the cases used to determine the meaning of the phrase "reasonably incidental and necessary". That review concluded that the previous range of meanings given for the phrase was too wide. The cases, in particular *Databank*, *Re an Inquiry*, and *Europa Oil (No.2)*, together with the context in which the provision incorporating the phrase appears in the Act, show that the meaning of the phrase "reasonably incidental and necessary" is not as wide as the words *highly expedient* suggest. The cases and legislative context also indicate that the meaning of the phrase is not as narrow as the words *an integral part of* suggests. The Commissioner's view of the meaning of the phrase is as set out earlier in the interpretation statement, and is considered to describe more clearly now what the cases have interpreted as the goods and services that come within the phrase "reasonably incidental and necessary".

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.

DETERMINATION: AMOUNT OF A SPECIFIED WITHHOLDING PAYMENT (BEING HONORARIA PAID TO SCHOOL TRUSTEES) THAT SHALL BE REGARDED AS EXPENDITURE INCURRED IN PRODUCTION OF PAYMENT

Introduction

This Determination sets out the amount regarded as expenditure incurred in the production of specified withholding payments when those payments are honoraria paid to school trustees.

Section NC 2 of the Income Tax Act 1994 requires anyone who makes a source deduction payment to deduct tax when making it.

Under section OB 2 (1) of the Income Tax Act 1994 a withholding payment is included in the definition of "source deduction payments". Consequently, any person who makes a withholding payment must deduct tax from it at the time it is made, unless an exemption applies.

Honoraria paid to school trustees come within the definition of "withholding payment" in the Income Tax (Withholding Payment) Regulations 1979. The regulations require withholding tax of 33% to be deducted from honoraria.

Regulation 7 of the Income Tax (Withholding Payments) Regulations 1979 allows the Commissioner to determine an amount or proportion of any specified withholding payment that is considered to be expenditure incurred in the production of that payment. If the Commissioner has made such a determination, the person paying the specified withholding payment is only required to deduct tax from the amount that exceeds this threshold.

Application

This Determination applies to payments made to school trustees (honoraria) for each board meeting attended, up to a maximum of 11 meetings a year. It applies:

– to honoraria paid on or after 1 April 2001, and

– until the Commissioner varies or revokes this determination.

Interpretation

In this Determination, unless the context otherwise requires, expressions have the same meaning as in the Income Tax (Withholding Payment) Regulations 1979 and sections **NC 2** and **OB 2(1)** of the Income Tax Act 1994.

Determination

When any trustee receives honoraria for attendance at a board meeting, the sum of $55 per member, or $75 for the chair, shall be regarded as expenditure incurred in the production of the payment. The maximum annual amount of the specified withholding payment shall not exceed $605 per member, or $825 for the chair.

However, if the trustee receives any reimbursement (in addition to honoraria) for expenditure incurred to attend that meeting, the amount exempted under this determination ($55 or $75 for the chair) shall be reduced by the amount of that additional reimbursement.

This Determination is made by me, acting under delegated authority from the Commissioner of Inland Revenue under section 7 of the Tax Administration Act 1994.

This Determination is signed on the 13 July 2001.

Raju Budhia

(Acting) National Manager Technical Standards

Examples

Example 1

The chair receives honoraria of $75 a meeting. No payment is made in respect of any expenditure incurred, for example, travel. The payer does not have to deduct withholding tax because the total payment does not exceed $75.

Example 2

The chair receives a total payment of $95, made up of an honorarium of $70 and reimbursement of travel expenses of $25. The payer must deduct withholding tax from $20 (honorarium of $70 reduced by the difference between the exemption allowed under the determination ($75) and the additional reimbursement ($25)).

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 WAIVER OF TIME BAR FOR ASSESSMENT EFFECTIVE

Case:	*CIR v Vela Fishing Limited*
Decision date:	3 July 2001
Acts:	Tax Administration Act 1994, Income Tax Act 1976

Summary

The CIR was successful in his appeal from the High Court decision of Penlington J reported at [2001] 1 NZLR 437; (2000) 19 NZTC 15,885.

Facts

The taxpayer was subject to an audit. In February 1998 the 31 March time bar was approaching for the 1991 year. The taxpayer signed a waiver under section 108B of the Tax Administration Act 1994 ("TAA"), extending time to 30 September 1998. Inland Revenue reassessed on 30 September. The taxpayer then contended that the waiver was ineffective, because it applied only to time bars established under the TAA and not to time bars which existed under earlier legislation (the Income Tax Act 1976). Therefore, the taxpayer said that the assessment was out of time.

Decision

The Court held that section 227(4) TAA required the reference to the 1994 time bar provision (section 108 TAA) in section 108B (the provision authorising waivers) also to be read as a reference to the 1976 time bar provision (section 25 Income Tax Act 1976). Therefore, the waiver extended the period for the CIR to assess in this case. The Court said:

> "The question, then, is whether there is correspondence in that broad sense in relation to the times, circumstances or purposes as regards the continuing operation of s25. We have no hesitation in holding it to be a corresponding provision to the new s108. It has the same character and function. It pre-supposes the amendment of assessments within the time limit. During the four years the amendment function will be exercised as the statute provides. That is intended in each case and s25 and the new s108 are intended to produce that result. The altering of assessments during the 4 year period is something which is "to be done under or for the purposes of, that corresponding provision".

APPLICATION FOR JUDICIAL REVIEW; APPLICATION FOR LEAVE TO PROCEED

Case: *Floorlines (NZ) Ltd and W A Duncan v CIR*

Decision date: 19 June 2001

Act: Judicature Amendment Act 1972

Keywords: *Judicial review, delay, striking-out, leave to proceed*

Summary

Chambers J struck out Floorlines (NZ) Ltd's judicial review application but granted Mr Duncan leave to proceed.

Facts

The Commissioner assessed Mr Duncan, and one of his companies, Floorlines (NZ) Limited ("Floorlines"), for tax on undisclosed income in the years 1967–1978. The investigation was prolonged and revealed many anomalies in the way company profits were accounted for. As it became apparent that substantial amounts had been diverted to various staff "welfare" funds, and then to Mr Duncan, the Commissioner issued section 400 notices to recover tax from him and his companies. The assessments were amended a number of times as the ongoing investigation revealed further facts. Mr Duncan objected to the assessments and penalties and the matter went before Thorpe J in the late 1970s. After cross-examination of Mr Duncan, Thorpe J indicated that he had not made out his case and that he should reconsider his position. Mr Duncan then withdrew his objection and the matter went no further.

In 1990 Mr Duncan instructed new counsel who initiated the present judicial review proceedings on the basis that the assessments were "irrational" and "arbitrary". Various judicial conferences followed at which the judges directed Mr Duncan to apply to have Floorlines reinstated to the register of companies. Floorlines had been struck off in 1990 upon the Commissioner's application and has not since been reinstated.

Counsel for the applicants moved in mid-2000 for leave of the court to continue the proceeding under Rule 426A of the High Court Rules. The Commissioner counter-applied to have the matters struck out under High Court Rules 477 (no reasonable cause of action) and 478 (inordinate delay/prejudice).

Decision

His Honour, Chambers J, dealt with the standing of Floorlines first. He held that, as the company had been struck off, it would need to apply for reinstatement but, in any event, that was not to delay Mr Duncan's proceeding against the Commissioner. Only if it were reinstated could a separate application for review be entertained. In the meantime its present application was to be struck out.

On the Rule 478 matter, his Honour held that there was no evidence to exculpate the applicants. There had in fact been inordinate delay and it was inexcusable. His Honour noted, however, that as the review could proceed on affidavit evidence only, there was no prejudice to the Commissioner and the matter should proceed.

Under Rule 477, the Commissioner submitted that the review application was without merit, and the claim so untenable it could not succeed. His Honour noted:

> "I do not know whether Mr Duncan will be able to substantiate the allegations he has made. If they are true, however, then at least some of them may be the stuff of judicial review. It may be that Mr Duncan could have taken these points when he followed the statutory objection route ... It is common ground, however, that he did not then take these points."

However, the fact that Mr Duncan (and Floorlines) had withdrawn their objections rather than having a court decide the issues, meant that the Commissioner could not rely on issue/cause of action estoppel or the extended doctrine of *res judicata*. His Honour held that the Commissioner had not established that judicial review was hopeless on the established facts.

His Honour struck out the Floorlines claim and made orders that:

- Mr Duncan was to file a separate statement of claim on his own behalf, containing no new allegations.
- The new statement was to be simplified and the prayers for "ancillary orders" were to be deleted.
- The Commissioner may oppose any "fresh prejudice" the amended statement of claim may raise.
- Mr Duncan must seek the Commissioner's approval to file two affidavits in support. If that is not given (the Commissioner has only viewed drafts at this time), leave of the Court must be obtained.

As to costs, his Honour said:

> "While the Commissioner was unsuccessful in having Mr Duncan's proceeding dismissed, I do not think it would be appropriate for the Commissioner to have to pay costs to Mr Duncan. Mr Duncan has been guilty of inordinate and inexcusable delay. He is permitted to continue his proceeding but that is an indulgence."

REGULAR FEATURES

DUE DATES REMINDER

August 2001

6 **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

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

31 **GST return and payment due**

September 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

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

28 **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 ruling	*Comment deadline*
☐	**PU2956:** Payments made by parents or guardians of students to state schools – GST treatment.	31 August 2001

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