TAX INFORMATION BULLETIN

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CONTENTS

This month's opportunity for you to comment 3

Binding rulings

Product Ruling – BR Prd 01/28 4

Product Ruling – BR Prd 01/29 8

Product Ruling – BR Prd 01/30 12

Product Ruling – BR Prd 01/31 16

Product Ruling – BR Prd 01/32 18

Product Ruling – BR Prd 01/33 20

Taxability of payments under the Human Rights Act 1993 for humiliation, loss of dignity, and injury to feelings 22
Public Ruling – BR Pub 01/09

New legislation

Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001 30

Taxation (Annual Rates of Income Tax 2001-2002) Act 2001 59

Other Acts 60

Legal decisions – case notes

Whether legal expenses were incurred in carrying on of a business activity 66

Other items of interest

Finalised guidelines for the valuation of nursery stock 68

Correction to previous article 70

Regular features

Due dates reminder 73

Your chance to comment on draft taxation items before they are finalised 75

This TIB has no appendix

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Te Tari Taake

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This *Tax Information Bulletin* is also available on the internet, in PDF format. Our website is at:

www.ird.govt.nz

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

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

THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft item is available for review/comment this month, having a deadline of 3 December 2001.

Ref.	Draft type	Description
ED0026	Standard Practice Statement	Retention of business records by taxpayers

The following draft item is available for review/comment this month, having a deadline of 11 January 2002.

Ref.	Draft type	Description
PU3855	Public rulings	Fishing quota and secondhand goods

Please see page 75 for details on how to obtain copies.

BINDING RULINGS

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

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

For full details of how binding rulings work, see our information booklet *Adjudication & Rulings, a guide to Binding Rulings (IR 715)* or the article on page 1 of *Tax Information Bulletin* Vol 6, No 12 (May 1995) or Vol 7, No 2 (August 1995).

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

PRODUCT RULING – BR PRD 01/28

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 Custom Fleet (NZ) Limited.

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 Custom Fleet (NZ) Limited ("Custom Fleet") to employers ("Lessees") under its "Annual Lease" product, when the Lessees provide the motor vehicles to their employees for their private use and enjoyment. Further details of the Arrangement are set out in the paragraphs below.

1. Custom Fleet conducts a fleet leasing business. One of the options offered to customers is a motor vehicle lease with a Lease Term of 12 months, and the possibility of entering into three further leases, with Lease Terms of 12 months, 12 months and 9 months respectively. This option is referred to as an Annual Lease.

2. The lease from Custom Fleet to the Lessee is made under the terms and conditions contained in the Fleet Lease Agreement and Guarantee ("FLA"), the Vehicle Order, and the Vehicle Schedule (copies of which were received by the Rulings Unit on 11 July 2001).

3. There are no penalties payable as a result of a Lessee choosing not to take up a further lease of the vehicle concerned upon the expiry of a Lease Term. By comparison, if a customer terminated a 45-month lease after 12 months, Custom Fleet would be entitled to impose a significant penalty for that early termination under the clause 10 of the FLA.

4. Custom Fleet expects Lessees to find the Annual Lease product appealing because of this absence of penalties and the flexibility it provides Lessees.

5. The leasing of the motor vehicles by Custom Fleet to Lessees comprises the following steps:

   (a) Initial lease enquiry

   This is the initial contact from the potential Lessee enquiring about leasing vehicles from Custom Fleet.

   (b) Marketing response

   This includes the initial meeting between Custom Fleet and the Lessee and the distribution of promotional material.

   (c) Lease quote

   Custom Fleet provides the Lessee with a Lease Quote. This is not a contractual document. It provides an example of the terms and conditions on which Custom Fleet can provide particular vehicles to the Lessee.

   (d) Credit application

   If the Lessee wishes to proceed, they make a credit application and this is assessed by Custom Fleet.

(e) Motor Vehicle Leasing Terms and Conditions

Custom Fleet provides the Lessee with the FLA. This document sets out the general terms and conditions for motor vehicles to be subsequently leased from Custom Fleet. There is no specific reference to actual vehicles in the FLA.

(f) Vehicle Order

The Lessee then completes (and delivers to Custom Fleet) a Vehicle Order which details their precise requirements. These may include the type of vehicle, the term for which it is required, the number of kilometres expected to be used, and the date that delivery of the vehicle is required. In relation to an Annual Lease, the term required will always be 12 months or 9 months.

A Vehicle Order must be completed prior to the commencement of each new lease and reflects the details for that lease only.

(g) Acceptance

Custom Fleet may then accept the offer made by the Lessee through the Vehicle Order by ordering the vehicle or executing and issuing to the Lessee the Vehicle Schedule (which then becomes part of the FLA) in respect of the vehicle.

In all cases, the contract between the Lessee and Custom Fleet contains the following terms and conditions:

- The Lease Term (9 or 12 months under an Annual Lease).
- No provision for automatic renewal of the term of the lease and no option conferred on the Lessee to renew, extend or vary the term of the lease.
- No provision for an incentive to the Lessee to take up a further lease of the vehicle.
- No penalty on the Lessee if it does not take up a further lease of the vehicle.

(h) Issue of Vehicle Schedule

A Vehicle Schedule is issued by Custom Fleet upon delivery of the vehicle. At this point in time, a contract between the Lessee and Custom Fleet exists, whether by way of the Vehicle Schedule being issued or the vehicle being ordered by Custom Fleet.

The Vehicle Schedule contains certain additional information that is not included in the Vehicle Order. This may include the registration number of the vehicle supplied, confirmation of the market value, and confirmation of the total rent. Its terms must be read in conjunction with the FLA, although if there is any inconsistency between the terms and conditions of the FLA and the Vehicle Schedule, then the latter shall prevail.

The lease may terminate before the Lease Term has been completed, where the Kilometre Ceiling (if any) specified in the Vehicle Schedule is exceeded. However, the parties may agree to the lease continuing, subject to an excess kilometre charge being paid, and subject also to the maximum excess kilometre allowance not being exceeded. The lease will cease once the full Lease Term of 9 or 12 months is completed.

6. As standard practice, Custom Fleet advises the Lessee of the status of the lease at least three months prior to the expiration of the Lease Term. It is Custom Fleet's standard practice to make this contact with the Lessee so that it can:
   - Discuss variations from the existing lease (e.g. excess kilometres which may have occurred during the period of the lease).
   - Discuss the condition of the vehicle
   - Discuss the Lessee's intentions upon the expiration of the lease (e.g. whether they will continue to lease the vehicle).
   - Provide time to attend to new documentation, should the Lessee wish to enter into a new lease agreement.
   - Plan for the disposal of the vehicle once it has been returned to Custom Fleet.
7. Custom Fleet reserves the right not to enter into a further lease in respect of any existing Lessee. Reasons for not entering into a new lease arrangement can include, but are not limited to, unsatisfactory credit risk, poor condition of the vehicle when returned under previous leases, and unacceptable wear and tear on the vehicle returned under previous leases.
8. If the Lessee does not wish to lease the vehicle for a further Lease Term of 9 or 12 months, the vehicle is returned to Custom Fleet upon expiry of the lease. If the Lessee wishes to retain the vehicle, a new lease is entered into for a further period.
9. This new lease is assigned a separate and distinct number or record in Custom Fleet's computer system, which is used to manage vehicles leased using its Annual Lease product. In all cases, the old record for the previous lease is noted as having terminated. In addition, a new Vehicle Order and Vehicle Schedule are required for the new lease. Again, the general conditions set out in the FLA are incorporated into that new lease agreement.
10. The new Vehicle Order will outline the commencement date of the new lease, being the date after expiration of the current lease.

Bailment of the vehicle will be broken, the vehicle inspected, and then supplied to the Lessee in the normal course of business on the commencement of the new lease agreement.

11. The rental rates for the second and third agreements will be lower than for the first agreement. The rates reduce as the depreciation on the vehicle reduces. If the Lessee does not renew, it does not get the benefit of reduced rates. However, there is no obligation on Custom Fleet to provide vehicles for subsequent 9 or 12 month leases and there is no obligation on Lessees to enter into a subsequent lease.

12. Where the vehicle has already been leased for three 12-month periods, and a fourth lease of 9 months is entered into, the vehicle is generally outside the warranty period. As a result, servicing and maintenance costs tend to increase, and for this reason the monthly rental in the fourth 9 month period may exceed the monthly rental charged in the previous 12 month lease.

13. Prior to the new lease commencing, an agent of Custom Fleet will inspect the vehicle, determine the mileage, and review the condition of the vehicle. This information is used to calculate the new rental. It also allows Custom Fleet to determine the market value of the vehicle at the commencement of the new lease period. Custom Fleet advises 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 (if any) to ensure whether the forecasts are accurate or need to be changed in any way.

14. There is no transfer of ownership, or option to transfer ownership, of the vehicle at any time during the lease of the vehicle, and the total term of the leases does not exceed 75% of the useful life of the vehicle.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

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

b) The lease is not a "finance lease" or a "specified lease", as defined in section OB 1.

c) No Lessee is associated with Custom Fleet pursuant to section OD 7.

d) The Lessee and Custom Fleet do not agree to a vehicle remaining in the possession of the Lessee for any periods pursuant to the terms of clause 9.5 of the FLA.

e) Any rental rate for the Lessee 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 Lessee.

f) No contract, agreement, plan, or understanding (whether enforceable or unenforceable) is entered into between Custom Fleet and the Lessee in relation to the Arrangement, other than the FLA, the Vehicle Order and the Vehicle Schedule.

g) 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 Lease Term.

h) 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.

i) 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 FLA, the Vehicle Order, and the Vehicle Schedule.

j) 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.

k) 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 or 9-month lease commences.
- Section GC 15 does not apply to the Arrangement.
- Section GC 17 does 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 for the period 29 August 2001 to 28 August 2004.

This Ruling is signed by me on the 29th day of August 2001.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/29

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 Custom Fleet (NZ) Limited.

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 Custom Fleet (NZ) Limited ("Custom Fleet") to employers ("Lessees") under its "15 Month Lease" product, when the Lessees provide the motor vehicles to their employees for their private use and enjoyment. Further details of the Arrangement are set out in the paragraphs below.

1. Custom Fleet conducts a fleet leasing business. One of the options offered to customers is a motor vehicle lease with a Lease Term of 15 months, and the possibility of entering into two further leases, both of which have a Lease Term of 15 months. This option is referred to as a 15 Month Lease.

2. The lease from Custom Fleet to the Lessee is made under the terms and conditions contained in the Fleet Lease Agreement and Guarantee ("FLA"), the Vehicle Order, and the Vehicle Schedule (copies of which were received by the Rulings Unit on 11 July 2001).

3. There are no penalties payable as a result of a Lessee choosing not to take up a further lease of the vehicle concerned upon the expiry of a Lease Term. By comparison, if a customer terminated a 45 month lease after 15 months, Custom Fleet would be entitled to impose a significant penalty for that early termination under the clause 10 of the FLA.

4. Custom Fleet expects Lessees to find the 15 Month Lease product appealing because of this absence of penalties and the flexibility it provides Lessees.

5. The leasing of the motor vehicles by Custom Fleet to Lessees comprises the following steps:

   a) Initial lease enquiry

   This is the initial contact from the potential Lessee enquiring about leasing vehicles from Custom Fleet.

   (b) Marketing response

   This includes the initial meeting between Custom Fleet and the Lessee and the distribution of promotional material.

   (c) Lease quote

   Custom Fleet provides the Lessee with a Lease Quote. This is not a contractual document. It provides an example of the terms and conditions on which Custom Fleet can provide particular vehicles to the Lessee.

   (d) Credit application

   If the Lessee wishes to proceed, they make a credit application and this is assessed by Custom Fleet.

   (e) Motor Vehicle Leasing Terms and Conditions

   Custom Fleet provides the Lessee with the FLA. This document sets out the general terms and conditions for motor vehicles to be subsequently leased from Custom Fleet. There is no specific reference to actual vehicles in the FLA.

   f) Vehicle Order

   The Lessee then completes (and delivers to Custom Fleet) a Vehicle Order which details their precise requirements. These may include the type of vehicle, the term for which it is required, the number of kilometres expected to be used, and the date that delivery of the vehicle is required. In relation to a 15 Month Lease, the term required will always be 15 months.

   A Vehicle Order must be completed prior to the commencement of each new lease and reflects the details for that lease only.

   (g) Acceptance

   Custom Fleet may then accept the offer made by the Lessee through the Vehicle Order by ordering the vehicle or executing and issuing to the Lessee the Vehicle Schedule (which then becomes part of the FLA) in respect of the vehicle.

In all cases, the contract between the Lessee and Custom Fleet contains the following terms and conditions:

- The Lease Term (15 months under a 15 Month Lease);
- No provision for automatic renewal of the term of the lease and no option conferred on the Lessee to renew, extend or vary the term of the lease;
- No provision for an incentive to the Lessee to take up a further lease of the vehicle;
- No penalty on the Lessee if it does not take up a further lease of the vehicle.

(h) Issue of Vehicle Schedule

A Vehicle Schedule is issued by Custom Fleet upon delivery of the vehicle. At this point in time, a contract between the Lessee and Custom Fleet exists, whether by way of the Vehicle Schedule being issued or the vehicle being ordered by Custom Fleet.

The Vehicle Schedule contains certain additional information that is not included in the Vehicle Order. This may include the registration number of the vehicle supplied, confirmation of the market value, and confirmation of the total rent. Its terms must be read in conjunction with the FLA, although if there is any inconsistency between the terms and conditions of the FLA and the Vehicle Schedule, then the latter shall prevail.

The lease may terminate before the Lease Term has been completed, where the Kilometre Ceiling (if any) specified in the Vehicle Schedule is exceeded. However, the parties may agree to the lease continuing, subject to an excess kilometre charge being paid, and subject also to the maximum excess kilometre allowance not being exceeded. The lease will cease once the full Lease Term of 15 months is completed.

6. As standard practice, Custom Fleet advises the Lessee of the status of the lease at least three months prior to the expiration of the Lease Term. It is Custom Fleet's standard practice to make this contact with the Lessee so that it can:
   - Discuss variations from the existing lease (e.g. excess kilometres which may have occurred during the period of the lease);
   - Discuss the condition of the vehicle;
   - Discuss the Lessee's intentions upon the expiration of the lease (e.g. whether they will continue to lease the vehicle);
   - Provide time to attend to new documentation, should the Lessee wish to enter into a new lease agreement; and
   - Plan for the disposal of the vehicle once it has been returned to Custom Fleet.

7. Custom Fleet reserves the right not to enter into a further lease in respect of any existing Lessee. Reasons for not entering into a new lease arrangement can include, but are not limited to, unsatisfactory credit risk, poor condition of the vehicle when returned under previous leases, and unacceptable wear and tear on the vehicle returned under previous leases.

8. If the Lessee does not wish to lease the vehicle for a further Lease Term of 15 months, the vehicle is returned to Custom Fleet upon expiry of the lease. If the Lessee wishes to retain the vehicle, a new lease is entered into for a further period.

9. This new lease is assigned a separate and distinct number or record in Custom Fleet's computer system, which is used to manage vehicles leased using its 15 Month Lease product. In all cases, the old record for the previous lease is noted as having terminated. In addition, a new Vehicle Order and Vehicle Schedule are required for the new lease. Again, the general conditions set out in the FLA are incorporated into that new lease agreement.

10. The new Vehicle Order will outline the commencement date of the new lease, being the date after expiration of the current lease. Bailment of the vehicle will be broken, the vehicle inspected, and then supplied to the Lessee in the normal course of business on the commencement of the new lease agreement.

11. The rental rates for the second agreement will be lower than for the first agreement. The rates reduce as the depreciation on the vehicle reduces. If the Lessee does not renew, it does not get the benefit of reduced rates. However, there is no obligation on Custom Fleet to provide vehicles for subsequent 15 month leases and there is no obligation on Lessees to enter into a subsequent lease.

12. Where the vehicle has already been leased for two 15 month periods, and a third lease of 15 months is entered into, the vehicle is generally outside the warranty period for at least part of the third Lease Term. As a result, servicing and maintenance costs tend to increase, and for this reason the monthly rental in the third 15 month period may exceed the monthly rental charged in the previous 15 month lease.

13. Prior to the new lease commencing, an agent of Custom Fleet will inspect the vehicle, determine the mileage, and review the condition of the vehicle. This information is used to calculate the new rental. It also allows Custom Fleet to determine the market value of the vehicle at the commencement of the new lease period. Custom Fleet advises 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 (if any) to ensure whether the forecasts are accurate or need to be changed in any way.
14. There is no transfer of ownership, or option to transfer ownership, of the vehicle at any time during the lease of the vehicle, and the total term of the lease does not exceed 75% of the useful life of the vehicle.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

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

b) The lease is not a "finance lease" or a "specified lease", as defined in section OB 1.

c) No Lessee is associated with Custom Fleet pursuant to section OD 7.

d) The Lessee and Custom Fleet do not agree to a vehicle remaining in the possession of the Lessee for any periods pursuant to the terms of clause 9.5 of the FLA.

e) Any rental rate for the Lessee 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 Lessee.

f) No contract, agreement, plan, or understanding (whether enforceable or unenforceable) is entered into between Custom Fleet and the Lessee in relation to the Arrangement, other than the FLA, the Vehicle Order and the Vehicle Schedule.

g) 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 Lease Term.

h) 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.

i) 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 FLA, the Vehicle Order, and the Vehicle Schedule.

j) 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.

k) 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 the Lease Term (of 15 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 15 month lease commences;
- Section GC 15 does not apply to the Arrangement;
- Section GC 17 does not apply to the Arrangement; and
- 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 for the period 29 August 2001 to 28 August 2004.

This Ruling is signed by me on the 29th day of August 2001.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/30

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 BNZ Investment Management Limited as trustee of The BNZ International Equity Index Fund.

Taxation Laws

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

This Ruling applies in respect of sections HH 3(5) and the section OB 1 definitions of "qualifying trust" and "superannuation fund".

The Arrangement to which this Ruling applies

The Arrangement is the establishment and continued operation of the BNZ International Equity Index Fund ("the Fund") pursuant to the Trust Deed of the Fund, dated 21 May 1997, as amended by the Amending Trust Deed dated 1 July 2001 ("the Trust Deed").

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

1. The Fund invests in equity securities that correspond to the composition of the Morgan Stanley Capital International World Index ("MSCI"), modified such that the securities invested in will be of those countries specified in Part A of Schedule 3 to the Act ("grey-list countries") that each comprise 1% or more of the MSCI ("the BNZ Index"). The Fund has been designed to enable investors to obtain, through one security, the same financial results that can be obtained through the direct investment in the securities of those companies that make up the BNZ Index.

2. The Trustee of the Fund is BNZ Investment Management Limited ("the Trustee").

3. The Investment Manager of the Fund is State Street Global Advisors, Australia, Limited ("the Investment Manager").

4. The Sponsor of the Fund is the Bank of New Zealand.

5. The Fund is a wholesale superannuation fund into which other wholesale and retail superannuation funds invest. The Fund was established for the purpose of being a wholesale investment vehicle for retail superannuation funds, other wholesale superannuation funds and for the purpose of providing retirement benefits to the limited number of natural persons who invest directly in it. There is no minimum investment amount.

6. The Fund is registered under the Superannuation Schemes Act 1989.

7. The Trust Deed, as amended with effect from 1 July 2001, states that the investment policy of the Fund will be:

   (a) to invest the Fund (other than the Cash Pool) in accordance with Schedule 2 to this Deed only in such investments as the Trustee considers necessary to track the modified grey list components of the World Index; and

   (b) to invest the Cash Pool in restricted investments, being deposits with banks, and futures contracts.

8. The Fund buys and sells shares as required to ensure that it continues to correspond to the BNZ Index. Such buying and selling will not be motivated by any intention to derive a profit or gain from such sales. In this regard, the Trust Deed states:

   The Fund and the Trustee do not have an intention to profit from holding, acquiring or selling Index Company securities.

9. The Applicant has confirmed that all material aspects of the previous rulings (Prv 97/125, Prv 01/11 and Prd 97/38), relating to the Fund, have been complied with.

10. There has been no change to the Trust Deed of the Fund (except for the noted Amending Trust Deed), nor any material change to the management or operation of the Fund since its establishment.

Date of Adjustments

11. The Fund is re-balanced in the following circumstances:

   - If a security is outside its BNZ Index weight by the lesser of:
   - 0.5% of the total Fund, whether positive or negative; or
   - three times the BNZ Index weight of the individual security;

- When the periodic (currently quarterly) adjustments are made to the MSCI; and
- If there are any MSCI market-driven changes or corporate actions such as a merger, takeover, new listing or reduction or increase in capital affecting any index company in the BNZ Index.

12. Such re-balancing will occur as soon as possible after the above events have occurred and in any event within 5 business days.

Events that trigger acquisitions or realisations

13. There are certain reasons or events when investments held by the Fund will have to be bought or sold. The Trustee will only dispose of securities (other than cash pool investments) if:
    - the Fund is wound up;
    - there is a change in the BNZ Index and composition of the securities of the Fund no longer tracks the BNZ Index (whether as a result of a change to the countries included or a change to the securities included);
    - there is a compulsory acquisition of one of the Fund's securities or a security is acquired on a compulsory acqusition which does not track the BNZ Index;
    - there is a net withdrawal of funds from the Fund by members;
    - there is a claim on the Trustee in respect of the Fund which cannot be otherwise satisfied; or
    - the fund is re-balanced in accordance with the first bullet point in paragraph 11, above.

Rights issues

14. In the event of any rights issue by an index company, the Investment Manager will retain the entitlement and take up the securities if the securities that are the subject of the entitlement will be immediately included in the BNZ Index.

15. Notwithstanding paragraph 14, if the securities that are the subject of the entitlement are over-represented, the Investment Manager will sell the entitlement and reinvest the proceeds in the index companies to track the BNZ Index.

16. If the Investment Manager does not know whether the securities that are the subject of the entitlement will be included in the Index the Investment Manager will sell the entitlement at the earliest possible time and reinvest the proceeds in the index companies to track the BNZ Index.

Mergers, takeovers and share buy-backs

17. The BNZ Index may be adjusted from time to time because of mergers, takeovers, share buy-backs, distributions of capital, cash issues, and substitutions of companies in the BNZ Index.

18. In the event of a merger or takeover of a BNZ Index company the Investment Manager will adjust the Fund portfolio at a time as close as practicably possible (but in any event within 5 business days) to the time the BNZ Index is adjusted. The Fund will not accept an offer unless as a consequence of not accepting the offer the Fund would track the BNZ Index less accurately than if it had accepted the offer.

19. The Investment Manager will not participate in a share buy-back by a BNZ Index company.

Hedging

20. There is no specific provision in the Trust Deed that allows the Fund to hedge foreign exchange risks.

21. The Fund will not take any action to hedge or manage foreign exchange risks or exposures that arise from the investments of the Fund being held in non-New Zealand currencies.

Borrowing

22. Clause 10.1(c) of the Trust provides:

    > …The Trustee may:
    >
    > borrow money for the purpose of the Fund upon terms and conditions agreed by the Sponsor and the Trustee and charge all or part of the assets of the Fund with repayment and payment of interest on the moneys so borrowed;

23. However, the Fund will not in fact borrow, although involuntary borrowing may occur if there is a settlement mismatch between the purchase and sale of securities.

Cash investments held by the Fund

24. Although it is not an objective of the Fund to hold cash, the Trustee and the Investment Manager may hold cash to facilitate the easier administration of the Fund. The cash held by the Trustee and the Investment Manager is on "call". Wherever possible, futures contracts will be entered into by the Investment Manager to cover cash held by the Investment Manager. This is known as "equitised cash".

25. The Investment Manager or the Trustee will hold cash in the following circumstances:
    - Following the sale of securities in the course of tracking the BNZ Index or in the course of a compulsory acquisition, pending the reinvestment of that cash.
    - Following a contribution to the Fund, pending the investment of that contribution.
    - Following the sale of securities to meet a request for withdrawal by a member.
    - When a dividend is paid to the Fund in respect of an investment in a security.
    - To accumulate the minimum amount of cash required to allow for minimum trade sizes and to obtain a reasonable representation of the number of securities on the BNZ Index ("the minimum investment level"). The Investment Manager has advised that this amount is presently approximately NZ$5 million, and will increase to US$3 million as at 31 May 2002 (to take account of changes to the MSCI described in the MSCI Announcement, dated 10 December 2000). The minimum investment level may also increase (or reduce) in the future to the extent that a different amount is required to purchase the equivalent representation of securities on the BNZ Index.

26. The Investment Manager may hold up to an amount equivalent to the minimum investment level in cash (including both free and equitised cash). This threshold may be exceeded in the following circumstances:
    - for up to 10 business days preceding a MSCI structural change or for up to 3 business days following a significant new investment;
    - for up to 3 business days after a MSCI structural change;
    - for up to 10 business days prior to a pending withdrawal in respect of which it has received a withdrawal request.

27. In addition to any funds held by the Investment Manager, the Trustee may hold up to NZ$2 million in cash. This threshold may be exceeded in the following circumstances:
    - for up to 10 business days if there are withdrawals pending in respect of which it has received a withdrawal request; or
    - for up to 3 business days if the excess results from a significant new investment.

28. At all times, there is a limit on the total cash (including cash held by the Trustee and free and equitised cash held by the Investment Manager) of 5% of the total Fund (except if there is a significant withdrawal or investment).

29. The Investment Manager will use best endeavours to equitise all cash, subject to futures contract size constraints.

30. The following futures contracts are used:

Country	Contract
Australia	SPI200
Canada	S&P/TSE60
Japan	Nikkei 225
Germany	DAX
United Kingdom	FTSE100
United States	S&P500

31. In the event that alternative futures contracts in one or more markets enable improved tracking of the BNZ Index, or that one or more of the above contracts ceases to exist, the Investment Manager will use such alternative contract or contracts.

Dividends

32. The Investment Manager will receive the dividend (and other income) distributions from the securities in which funds are invested and will hold these as part of the cash pool, subject to the terms of paragraph 25 above.

33. The Investment Manager will not elect to participate in any dividend reinvestment plan.

Foreign Currencies

34. The Investment Manager may enter into spot foreign exchange contracts where these are necessary in order to purchase or sell the foreign currencies necessary to invest in BNZ Index securities. These contracts are not speculative and are settled within 2 business days.

Suspension of subscriptions and withdrawals

35. Clause 18.7 of the Trust Deed enables the Fund to suspend the payment of benefits relating to withdrawal requests. The Fund has not previously suspended withdrawals. The Fund also has the power under clause 3.2 of the Trust Deed to refuse any application for membership without giving reasons. The Fund has never exercised this power.

36. The Fund will only suspend withdrawals or subscriptions in the following exceptional circumstances:
    - if the volume of withdrawals is too large to be processed; or
    - if the volume of withdrawals exceeds the immediately available funds; or
    - trading on the relevant equity markets has been suspended.
37. Any suspension will only be for 3 business days unless the exceptional circumstance giving rise to the need to suspend is beyond the control of the Trustee and Investment Manager, in which case the suspension will only be for such period as is strictly necessary for the Trustee and/or the Investment Manager to recover from that event.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) If the Fund is resettled this Ruling shall not apply from the date of resettlement.

b) The Fund is an investment vehicle primarily for investment into by superannuation funds which are themselves either: (i) widely held investment vehicles for direct investment by natural persons or, (ii) vehicles for investment (directly or indirectly) by other superannuation funds that are widely held vehicles for direct investment by natural persons.

c) The Fund is registered under the Superannuation Schemes Act 1989.

d) All investors in the Fund who are not natural persons are registered under the Superannuation Schemes Act 1989.

e) The existing binding private ruling for the Fund (BR Prv 01/65) remains in force and continues to apply in all respects to the Arrangement.

How the Taxation Laws apply to the Arrangement

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

- The Fund is a "superannuation fund" as that term is defined in section OB 1.
- The Fund is a "qualifying trust" as that term is defined in section OB 1.
- Investors are not assessable to income tax on withdrawals from the Fund, by virtue of section HH 3(5).

The period or income year for which this Ruling applies

This Ruling will apply for the period 6 September 2001 to 30 June 2004.

This Ruling is signed by me on the 6th day of September 2001.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/31

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 Fund Managers Canterbury Limited.

Taxation Laws

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

This Ruling applies in respect of the definition of "beneficiary income" contained in section OB 1, and sections NF 1 to NF 3.

This Ruling expressly does not consider or rule on the potential (if any) for application of section BG 1 to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is the establishment and operation of a Group Investment Fund (referred to as "GIF") under the Trustee Companies Act 1967. The GIF is to be known as the Canterbury Mortgage Trust Group Investment Fund (referred to as "CMGIF" or "the Fund").

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

1. The initial funds to be invested in the Fund will be derived from a unit trust, Canterbury Mortgage Trust, that is currently being managed by the applicants.

2. The Trustees Executors and Agency Company of New Zealand Limited (trading as Tower Trust) will establish CMGIF. Canterbury Mortgage Trust will then be wound up following the redemption of the units outstanding at market value. The investors will then invest the funds obtained from the redemption in CMGIF.

3. The Fund will be governed by a trust deed dated 26 June 2001. This trust deed has been drafted in a manner that purports to limit the investment activities of the Fund to the types of investments listed in paragraphs (a) to (j) of section 4 of the Trustee Act 1956 (read and construed as if the Trustee Amendment Act 1988 had not been enacted).

4. In confining its investment activity to those investments listed in paragraphs (a) to (j) of section 4 of the Trustee Act 1956, the proposed GIF will be a "designated GIF" for the purposes of the Income Tax Act 1994.

5. The Fund will be governed by the trust deed. Clause 269 of the deed defines the authorised investments of the Fund as:

   "authorised investments" to the extent to which the trustee is lawfully permitted from time to time to hold such investments for the purposes of the fund, means:

   1. cash, deposits with, loans to, or other debt securities of any bank whether secured or unsecured
   2. loans made upon security of any mortgages or mortgage backed securities
   3. the acquisition of any mortgage backed securities by way of transfer or assignment of the mortgage or chargeholder's interest in the mortgage or security
   4. property which comes into the possession ownership or control of the trustee by virtue of the exercise of the powers authorities and discretions vested in the trustee by any mortgage backed security held by the trustee
   5. public sector securities
   6. derivatives
   7. any trust (including a unit trust under the Unit Trusts Act 1960) which invests primarily or wholly in one or more of the investments referred to in the preceding bullet points

   provided that until such time as the manager and the trustee agree to the contrary the fund shall:

   - primarily be invested in loans upon the security of mortgages and mortgage backed securities; and
   - only be invested in investments in which a group investment fund is permitted to invest in order to fall within the definition of a designated group investment fund as defined in section OB 1 of the Income Tax Act 1994, with the intent that (unless agreed by the parties to the contrary) the fund shall always be a designated group investment fund for taxation purposes.

6. The trustee of this GIF will be The Trustees Executors and Agency Company of New Zealand Limited (trading as Tower Trust). Section 29 of the Trustee Companies Act 1967 allows a "Trustee company", as defined in section 2 of that Act, to establish a GIF. The trustee is a Trustee company as defined in section 2.
7. The manager (and also the applicant) of Canterbury Mortgage Trust Group Investment Fund is Fund Managers Canterbury Limited. Fund Managers Canterbury Limited is a company operating out of Christchurch. This company currently manages Canterbury Mortgage Trust. Canterbury Mortgage Trust began through the transfer of investments in the nominee companies of Wynn Williams & Co, McFarlane Dougall Stringer, and Harman & Co. Since then it has acquired the activities of a further two law firms' nominee companies in Canterbury. Investments are also directly lodged with Canterbury Mortgage Trust by independent investors.
8. The rationale behind the establishment of this "designated GIF" as an investment vehicle is to enable each New Zealand resident unit holder to be effectively taxed at source at their marginal tax rate on any resident withholding income they derive from the Fund as beneficiaries of the trust.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) That the discretion contained in clause 269 will not be exercised to allow investments to be made by CMGIF, which are not investments that a "designated GIF" can invest in as referred to in the definition of "designated group investment fund" contained in section OB 1.

b) That the power to amend as contained in clause 254 will not be exercised in any way so as to affect the "designated GIF" status of the Fund.

c) The beneficiaries will be resident in New Zealand for tax purposes.

How the Taxation Laws apply to the Arrangement

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

- To the extent that any gross income derived during an income year by the trustee vests absolutely in interest in the beneficiary, or is paid or applied by the trustee to or for the benefit of the beneficiary during or within six months after the end of the income year, it will be "beneficiary income" as defined in section OB 1 of the Income Tax Act 1994 and gross income of the beneficiary under section HH 3(1).
- Pursuant to the provisions of sections NF 1, NF 2, and NF 3, if the trustees hold a certificate of exemption and no resident withholding tax has been deducted from resident withholding income, that they receive and distribute as beneficiary income, the trustees will be under an obligation to deduct resident withholding tax at the appropriate rate from the resident withholding income paid to the beneficiary unless the beneficiary provides a certificate of exemption.

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 September 2001 to 31 August 2004.

This Ruling is signed by me on the 6th day of September 2001.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/32

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 Fund Managers Auckland Limited.

Taxation Laws

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

This Ruling applies in respect of the definition of "beneficiary income" contained in section OB 1, and sections NF 1 to NF 3.

This Ruling expressly does not consider or rule on the potential (if any) for the application of section BG l to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is the establishment and operation of a Group Investment Fund (referred to as "GIF") under the Trustee Companies Act 1967. The GIF is to be known as the Auckland Mortgage Trust Group Investment Fund (referred to as "AMGIF" or "the Fund").

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

1. The initial funds to be invested in the Fund will be derived from a unit trust, Auckland Mortgage Trust, that is currently being managed by the Applicant.

2. The Trustees Executors and Agency Company of New Zealand Limited (trading as Tower Trust) will establish AMGIF. Auckland Mortgage Trust will then be wound up following the redemption of the units outstanding at market value. The investors will then invest the funds obtained from the redemption in AMGIF.

3. The Fund will be governed by a trust deed dated 27 June 2001. This trust deed has been drafted in a manner that purports to limit the investment activities of the Fund to the types of investments listed in paragraphs (a) to (j) of section 4 of the Trustee Act 1956 (read and construed as if the Trustee Amendment Act 1988 had not been enacted).

4. In confining its investment activity to those investments listed in paragraphs (a) to (j) of section 4 of the Trustee Act 1956, AMGIF will be a "designated GIF" for the purposes of the Income Tax Act 1994.

5. The Fund will be governed by the trust deed. Clause 268 of the deed defines the authorised investments of the fund as:

   "authorised investments" to the extent to which the trustee lawfully permitted from time to time to hold such investments for the purposes of the fund, means:

   - cash, deposits with, loans to, or other debt securities of any bank whether secured or unsecured
   - loans made upon security of any mortgages or mortgage backed securities
   - the acquisition of any mortgage backed securities by way of transfer or assignment of the mortgage or chargeholder's interest in the mortgage or security
   - property which comes into the possession ownership or control of the trustee by virtue of the exercise of the powers authorities and discretions vested in the trustee by any mortgage backed security held by the trustee
   - public sector securities
   - derivatives
   - any trust (including a unit trust under the Unit Trusts Act 1960) which invests primarily or wholly in one or more of the investments referred to in the preceding bullet points

   provided that until such time as the manager and the trustee agree to the contrary the fund shall:

   - primarily be invested in loans upon the security of mortgages and mortgage backed securities; and
   - only be invested in investments in which a group investment fund is permitted to invest in order to fall within the definition of a designated group investment fund as defined in section OB 1 of the Income Tax Act 1994, with the intent that (unless agreed by the parties to the contrary) the fund shall always be a designated group investment fund for taxation purposes.

6. The trustee of AMGIF will be The Trustees Executors and Agency Company of New Zealand Limited (trading as Tower Trust). Section 29 of the Trustee Companies Act 1967 allows a "Trustee company", as defined in section 2 of that Act, to establish a GIF. The trustee is a Trustee company as defined in section 2.

7. The Manager (and also the applicant) of AMGIF is Fund Managers Auckland Limited. Fund Managers Auckland Limited is a company operating out of Auckland. This company currently manages Auckland Mortgage Trust. Auckland Mortgage Trust began through the transfer of investments in the solicitor's nominee companies of Hesketh Henry and Cairns Slane. Investments are also directly lodged with Auckland Mortgage Trust by independent investors.

8. The rationale behind the establishment of this "designated GIF" as an investment vehicle is to enable each New Zealand resident unit holder to be effectively taxed at source at their marginal tax rate on any resident withholding income they derive from the Fund as beneficiaries of the trust.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

(a) That the discretion contained in clause 268 will not be exercised to allow investments to be made by AMGIF, which are not investments that a "designated GIF" can invest in as referred to in the definition of "designated group investment fund" contained in section OB 1.

(b) That the power to amend as contained in clause 253 will not be exercised in any way so as to affect the "Designated GIF" status of the Fund.

(c) The beneficiaries will be resident in New Zealand for tax purposes.

How the Taxation Laws apply to the Arrangement

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

- To the extent that any gross income derived during an income year by the trustee vests absolutely in interest in the beneficiary; or is paid or applied by the trustee to or for the benefit of the beneficiary during or within six months after the end of the income year, it will be "beneficiary income" as defined in section OB l of the Income Tax Act 1994 and gross income of the beneficiary under section HH 3(1).
- Pursuant to the provisions of sections NF 1, NF 2, and NF 3, if the trustees hold a certificate of exemption and no resident withholding tax has been deducted from resident withholding income, that they receive and distribute as beneficiary income, the trustees will be under an obligation to deduct resident withholding tax at the appropriate rate from the resident withholding income paid to the beneficiary unless the beneficiary provides a certificate of exemption.

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 September 2001 to 31 August 2004.

This Ruling is signed by me on the 6th day of September 2001.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 01/33

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 Fund Managers Otago Limited.

Taxation Laws

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

This Ruling applies in respect of the definition of "beneficiary income" contained in section OB 1, and sections NF 1 to NF 3.

This ruling expressly does not consider or rule on the potential (if any) for application of section BG 1 to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is the establishment and operation of a Group Investment Fund (referred to as "GIF") under the Trustee Companies Act 1967. The GIF is to be known as the NZ Mortgage Income Trust Group Investment Fund (referred to as "NZMGIF" or "the Fund").

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

1. The initial funds to be invested in the Fund will be derived from a unit trust, NZ Mortgage Income Trust, that is currently being managed by the applicants.

2. The Trustees Executors and Agency Company of New Zealand Limited (trading as Tower Trust) will establish NZMGIF. NZ Mortgage Income Trust will then be wound up following the redemption of the units outstanding at market value. The investors will then invest the funds obtained from the redemption in NZMGIF.

3. The Fund will be governed by a trust deed dated 30 July 2001. This trust deed has been drafted in a manner that purports to limit the investment activities of the Fund to the types of investments listed in paragraphs (a) to (j) of section 4 of the Trustee Act 1956 (read and construed as if the Trustee Amendment Act 1988 had not been enacted).

4. In confining its investment activity to those investments listed in paragraphs (a) to (j) of section 4 of the Trustee Act 1956, the proposed GIF will be a "designated GIF" for the purposes of the Income Tax Act 1994.

5. The Fund will be governed by a trust deed. Clause 268 of the deed defines the authorised investments of the Fund as:

   "authorised investments" to the extent to which the trustee is lawfully permitted from time to time to hold such investments for the purposes of the fund, means:

   1. cash, deposits with, loans to, or other debt securities of any bank whether secured or unsecured
   2. loans made upon security of any mortgages or mortgage backed securities
   3. the acquisition of any mortgage backed securities by way of transfer or assignment of the mortgage or chargeholder's interest in the mortgage or security
   4. property which comes into the possession ownership or control of the trustee by virtue of the exercise of the powers authorities and discretions vested in the trustee by any mortgage backed security held by the trustee
   5. public sector securities
   6. derivatives
   7. any trust (including a unit trust under the Unit Trusts Act 1960) which invests primarily or wholly in one or more of the investments referred to in the preceding bullet points

   provided that until such time as the manager and the trustee agree to the contrary the fund shall:

   - primarily be invested in loans upon the security of mortgages and mortgage backed securities; and
   - only be invested in investments in which a group investment fund is permitted to invest in order to fall within the definition of a designated group investment fund as defined in section OB1of the Income Tax Act 1994, with the intent that unless agreed by the parties to the contrary the fund shall always be a designated group investment fund for taxation purposes.

6. The trustee of this GIF will be The Trustees Executors and Agency Company of New Zealand Limited (trading as Tower Trust). Section 29 of the Trustee Companies Act 1967 allows a "Trustee company", as defined in section 2 of that Act, to establish a GIF. The trustee is a Trustee company as defined in section 2.

7. The manager (and also the applicant) of NZ Mortgage Income Trust Group Investment Fund is Fund Managers Otago Limited. Fund Managers Otago Limited is a company operating out of Dunedin. This company currently manages NZ Mortgage Income Trust. NZ Mortgage Income Trust began through the transfer of investments in the Anderson Lloyd Solicitors Nominee Company Limited. Since then it has acquired the activities of a further 14 law firms' nominee companies in Otago, Southland, and South Canterbury. Investments are also lodged directly with NZ Mortgage Income Trust by independent investors.

8. The rationale behind the establishment of this "designated GIF" as an investment vehicle is to enable each New Zealand resident unit holder to be effectively taxed at source at their marginal tax rate on any resident withholding income they derive from the Fund as beneficiaries of the trust.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) That the discretion contained in clause 268 will not be exercised to allow investments to be made by NZMGIF, which are not investments that a "designated GIF" can invest in as referred to in the definition of "designated group investment fund" contained in section OB 1.

b) That the power to amend as contained in clause 253 will not be exercised in any way so as to affect the "designated GIF" status of the Fund.

c) The beneficiaries will be resident in New Zealand for tax purposes.

How the Taxation Laws apply to the Arrangement

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

- To the extent that any gross income derived during an income year by the trustee vests absolutely in interest in the beneficiary, or is paid or applied by the trustee to or for the benefit of the beneficiary during or within six months after the end of the income year, it will be "beneficiary income" as defined in section OB 1 of the Income Tax Act 1994 and gross income of the beneficiary under section HH 3(1).
- Pursuant to the provisions of sections NF 1, NF 2, and NF 3, if the trustees hold a certificate of exemption and no resident withholding tax has been deducted from resident withholding income, that they receive and distribute as beneficiary income, the trustees will be under an obligation to deduct resident withholding tax at the appropriate rate from the resident withholding income paid to the beneficiary unless the beneficiary provides a certificate of exemption.

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 September 2001 to 31 August 2004.

This Ruling is signed by me on the 6th day of September 2001.

Martin Smith

General Manager (Adjudication & Rulings)

TAXABILITY OF PAYMENTS UNDER THE HUMAN RIGHTS ACT 1993 FOR HUMILIATION, LOSS OF DIGNITY, AND INJURY TO FEELINGS

PUBLIC RULING – BR PUB 01/09

Note (not part of Ruling): This ruling replaces Public Ruling BR Pub 98/2 published in *TIB* Vol 10, No 3 (March 1998). This new Ruling is essentially the same as the previous Ruling. The main changes update relevant case law references and clarify the Commissioner's approach to out of court settlements where he has some doubt about the amount attributed to humiliation, loss of dignity, or injury to feeling. The Ruling applies from 1 April 2001 to 31 March 2006.

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 CD 5, CH 3, and the definition of "monetary remuneration" in section OB 1.

The Arrangement to which this Ruling applies

The Arrangement is:

- The payment of an award of damages to a complainant or aggrieved person by the Complaints Review Tribunal for humiliation, loss of dignity, and injury to feelings under section 88(1)(c) of the Human Rights Act 1993 for breaches of Part 2 of that Act where the complaint involves an employer/employee relationship; or
- The making of a payment to a complainant or aggrieved person for humiliation, loss of dignity, and injury to feelings pursuant to an out of court settlement genuinely based on the complainant's rights to damages under section 88(1)(c) of the Human Rights Act 1993 for breaches of Part 2 of that Act where the complaint involves an employer/employee relationship.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Payments for damages that are genuinely and entirely awarded for humiliation, loss of dignity, and injury to feelings under section 88(1)(c) of the Human Rights Act 1993 are not "monetary remuneration" in terms of the definition in section OB 1 of the Income Tax Act 1994. Consequently, such payments do not form part of the gross income of the employee under section CH 3.
- Payments for damages that are genuinely and entirely awarded for humiliation, loss of dignity, and injury to feelings under section 88(1)(c) of the Human Rights Act 1993 are not gross income under ordinary concepts under section CD 5.

The period for which this Ruling applies

This Ruling will apply to payments received between 1 April 2001 and 31 March 2006.

This Ruling is signed by me on the 7th day of November 2001.

Martin Smith

General Manager (Adjudication & Rulings)

COMMENTARY ON PUBLIC RULING BR PUB 01/09

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 01/09 ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR Pub 98/2 published in *TIB* Vol 10, No 3 (March 1998) at page 31. The Ruling applies for the period from 1 April 2001 to 31 March 2006.

Background

Under the Human Rights Act 1993 people can make a complaint to the Human Rights Commission ("the Commission") regarding breaches of that Act. If the Commission is unable to settle the complaint, the matter may proceed to the Complaints Review Tribunal ("the Tribunal").

The Human Rights Act 1993 provides protection for people in areas of public life against discrimination on the grounds of sex, marital status, religious or ethical belief, race, colour, ethnic or national origins, age, disability, political opinion, employment status, family status, and sexual orientation.

The Tribunal is an independent body that hears and determines complaints that have been made to the Human Rights Commission, the Race Relations Office, the Privacy Commissioner, and the Health and Disability Commissioner which have been unable to be resolved. The Tribunal has the power of a Court similar to the District Court, and its decisions can be enforced in the District Court if parties fail to comply with its orders or directions.

Legislation

Section 86(1) and (2) of the Human Rights Act provides a number of remedies for the Tribunal when the Tribunal determines that a breach of any of the provisions of Part 2 of the Human Rights Act has been committed:

(1) In any proceedings before the Complaints Review Tribunal brought by the Proceedings Commissioner or the complainant or, as the case may be, the aggrieved person, the plaintiff may seek such of the remedies described in subsection (2) of this section, as he or she thinks fit.

(2) If in any such proceedings the Tribunal is satisfied on the balance of probabilities that the defendant has committed a breach of any of the provisions of Part 2 of this Act, it may grant one or more of the following remedies:

- (a) A declaration that the defendant has committed a breach of this Act:
- (b) An order restraining the defendant from continuing or repeating the breach, or from engaging in, or causing or permitting others to engage in, conduct of the same kind as that constituting the breach, or conduct of any similar kind specified in the order:
- (c) Damages in accordance with section 88 of this Act:
- (d) An order that the defendant perform any acts specified in the order with a view to redressing any loss or damage suffered by the complainant or, as the case may be, the aggrieved person as a result of the breach:
- (e) A declaration that any contract entered into or performed in contravention of any of the provisions of Part 2 of this Act is an illegal contract:
- (f) Relief in accordance with the Illegal Contracts Act 1970 in respect of any such contract to which the defendant and the complainant or, as the case may be, the aggrieved person are parties:
- (g) Such other relief as the Tribunal thinks fit.

Section 88(1) of the Human Rights Act provides the circumstances in which damages may be awarded under the Act, including damages payments for humiliation, loss of dignity, and injury to feelings.

In any proceedings under sections 83(1) or section 83(4) of this Act, the Tribunal may award damages against the defendant for a breach of any of the provisions of Part II of this Act in respect of any one or more of the following:

(a) Pecuniary loss suffered as a result of, and expenses reasonably incurred by the complainant or, as the case may be, the aggrieved person for the purpose of, the transaction or activity out of which the breach arose:

(b) Loss of any benefit, whether or not of a monetary kind, which the complainant or, as the case may be, the aggrieved person might reasonably have been expected to obtain but for the breach:

(c) Humiliation, loss of dignity, and injury to the feelings of the complainant or, as the case may be, the aggrieved person.

Part 2 of the Human Rights Act sets out what constitutes "unlawful discrimination" under that Act. Section 21 sets out the general prohibited grounds of discrimination, and sections 22 to 74 go on to deal with discrimination in specific situations.

The Ruling considers whether such payments for humiliation, loss of dignity, and injury to the feelings of the employee are "monetary remuneration". Paragraph (a) of the definition of "monetary remuneration" in section OB 1 states:

> "Monetary remuneration" …means any salary, wage, allowance, bonus, gratuity, extra salary, compensation for loss of office or employment, emolument (of whatever kind), or other benefit in money, in respect of or in relation to the employment or service of the taxpayer;…

Section CH 3 states that "all monetary remuneration derived by a person is gross income".

Section CD 5 also states that "the gross income of a person includes any amount that is included in gross income under ordinary concepts".

Application of the Legislation

If payments for humiliation, loss of dignity, and injury to feelings, under section 88(1)(c) of the Human Rights Act 1993 were "monetary remuneration", they would be included under section CH 3 as gross income. They would be included in the calculation of "net income" under section BC 6, and would consequently form part of "taxable income" as calculated under section BC 7.

Section OB 1 defines "monetary remuneration" to include any "…other benefit in money, in respect of or in relation to the employment or service of the taxpayer…". Payments under section 88(1)(c) of the Human Rights Act 1993 are a benefit in money. The issue is, therefore, whether these payments are made "in respect of or in relation to the employment or service of" the recipient.

While many of the categories of discrimination in Part 2 of the Human Rights Act 1993 may relate, directly or indirectly, to an employer/employee relationship, it is clear that many of them are intended to apply to much wider situations. Consequently, in many instances of complaints under the Human Rights Act, payments awarded will be completely outside any employment relationship and will clearly not be "in respect of or in relation to employment". In such cases payments under section 88(1)(c) will not fall within the definition of "monetary remuneration" and will not be included in the gross income of the taxpayer under section CH 3. The Ruling does not consider such situations.

However, it is likely that complaints heard by the Tribunal under the Human Rights Act 1993 often will involve an employee/employer relationship. The question to be answered in the Ruling, therefore, is whether payments under section 88(1)(c) of the Human Rights Act 1993 where the complaint involves an employee/employer relationship are made "in respect of or in relation to the employment or service of the taxpayer".

The meaning of "in respect of or in relation to"

The Court of Appeal has endorsed a very wide meaning of the phrase "in respect of or in relation to". In *Shell New Zealand Limited v CIR* (1994) 16 NZTC 11,303, where lump sum payments had been made by Shell to employees who transferred at the request of Shell, the Court discussed the relevant part of the definition of "monetary remuneration". McKay J, delivering the judgment of the Court, said at page 11,306:

> The words "in respect of or in relation to" are words of the widest import.

Although McKay J acknowledged that the payments in Shell were not made under the contract of employment in that case, this did not mean that the employees received the payment outside the employee relationship. The learned Judge had earlier referred to the fact that the payments were not expressly provided under the employees' written employment contracts, but were made pursuant to Shell's employment policy as a matter of discretion. They were still made "because he or she is an employee".

Other cases have also stressed the width of the words "in respect of or in relation to". In the Queens Bench case of *Paterson v Chadwick* [1974] 2 All ER 772, Boreham J considered the meaning of the phrase "in respect of" in relation to discovery, and adopted the comments of Mann CJ in the Australian case *Trustees, Executors & Agency Co Ltd v Reilly* [1941] VLR 110, where the learned Chief Justice said:

> The words "in respect of" are difficult of definition but they have the widest possible meaning of any expression intended to convey some connection or relation in between the two subject-matters to which the words refer.

Similarly, in *Nowegijick v The Queen* [1983] CTC 20 at page 25, the Supreme Court of Canada described the phrase "in respect of" as "probably the widest of any expression intended to convey some connection between two related subject-matters".

Recently, other New Zealand cases (*Case U38* [2000] 19 NZTC 9,361 and *CIR v Kerslake* [2001] 20 NZTC 17,158) have considered the phrase "in respect of or in relation to". Both cases are consistent with the authorities cited above in this commentary.

Context may affect the meaning

However, many cases have demonstrated that the meaning to be given to the phrase "in respect of or in relation to" may vary according to the context in which it appears.

In *State Government Insurance Office v Rees* (1979) 144 CLR 549, the High Court of Australia considered the meaning of the phrase "in respect of" in determining whether the debt due to the Government Insurance Office fell within section 292(1)(c) of the Companies Act 1961-1975 (Q.) as "amounts … due in respect of workers' compensation under any law relating to workers' compensation accrued before the relevant date". The Court held that amounts which could be recovered by the Government Insurance Office from an uninsured company pursuant to section 8(5) of the Workers' Compensation Act 1916-1974(Q.) for money paid to workers employed by the uninsured company were not amounts due "in respect of" workers' compensation under the Companies Act.

At page 561 Mason J observed that:

> ... as with other words and expressions, the meaning to be ascribed to "in respect of" depends very much on the context in which it is found.

Stephen J also discussed the meaning of the phrase "in respect of", noting at pages 553-554 that it was capable of describing relationships over a very wide range of proximity, and went on to say:

> Were the phrase devoid of significant context, it could, I think, be taken to be descriptive of the relationship between the present indebtedness owed to the State Government Insurance Office and the subject matter of workers' compensation. However a context does exist which is in my view sufficient to confine the operation of s 292(1)(c) to bounds too narrow to be of service to the appellant.

In *TRA Case R34* (1994) 16 NZTC 6,190, certain payments were made to a New Zealand distributor by its overseas parent in relation to repairs which had to be made to cars sold to the New Zealand subsidiary and then sold to dealers. The issue was whether the payments were zero-rated for GST purposes. The definition of "consideration" in section 2 of the Goods and Services Tax Act 1985 was relevant. Part of the definition of "consideration" states:

> …any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services …

The TRA stated at page 6,200 that:

> A sub-issue is whether the reimbursing payment from the overseas manufacturer (MC) was made "in respect of, in response to, or for the inducement of" the repair work in the sense required by the definition of "consideration" in s 2 of the Act. … Although the definition of consideration creates a very wide potential link between a payment and a particular supply it is, in any case, a matter of degree, commonsense, and commercial reality whether a payment is direct enough to have the necessary nexus with a service, i.e, whether the link is strong enough.

The High Court's decision on the appeal of *Case R34* is *CIR v Suzuki New Zealand Ltd* (2000) 19 NZTC 15,819, which was later upheld by the Court of Appeal. In the High Court McGechan J said:

> …it is necessary there be a genuine connection. The legislature is not to be taken as taxing on an unrealistic or tenuous connection basis.

In *Cleland v CIR* (2001) 20 NZTC 17,086, the High Court has also recently considered the matter. At issue was the tax treatment of sums awarded to Mr Cleland by the Employment Court for a personal grievance he brought against his employer. The Employment Court awarded a total amount of $126,000 to Mr Cleland. This comprised $46,000 for loss of wages, $50,000 for loss of benefits, and $30,000 for humiliation.

There was no issue regarding the amount paid for humiliation before Hammond J in the High Court, and accordingly he made no comment on this amount. He concluded that the amount paid for lost wages was therefore assessable as "monetary remuneration". In respect of the further amount of $50,000, Hammond J concluded that it was compensation for loss of office or employment. In order to reach this conclusion Hammond J had to consider whether the amount was "in respect of or in relation to" Mr Cleland's employment or service.

Hammond J referred to the Court of Appeal decision in Shell and noted that those words are to be interpreted widely. Counsel for the taxpayer relied heavily on the Full Federal Court decision in Rowe. Hammond J stated at paragraphs 46 to 48 of his judgment:

> The award is clearly a "rolled up" one by the Employment Court in respect of or in relation to Mr Cleland's past employment.
>
> …As a sub-part of the argument, it was said for Mr Cleland that, because the award was calculated on future wages and benefits, it was not compensation for (past) loss of office or employment. That is not the test. The test is whether the wages and benefits actually awarded arose out of Mr Cleland's employment. It does not at all follow that, because the award was made relating to a period after the termination of the employment, it was not made in respect of, or in relation to, the employment. As Mr Almao said, "compensation for loss of office or employment by its very nature encompasses future benefits; benefits that an employee might have received had his or her employment continued".

Not all payments to employees are "monetary remuneration"

Not all payments to employees that have a connection with their work are within the definition of "monetary remuneration". In *Fraser v CIR* (1995) 17 NZTC 12,356, at page 12,363, Doogue J in the High Court said:

There is no dispute that the words "emolument (of whatever kind), or other benefit in money, in respect of or in relation to the employment or service of the taxpayer" are words of the widest possible scope: see *Shell New Zealand Ltd v C of IR* (1994) 16 NZTC 11,303 at page 11,306, and Smith v FC of T 87 ATC 4883; (1987) 164 CLR 513; (1987) 19 ATR 274. Mr Harley does, however, submit, correctly, that it does not follow that all payments made are necessarily income and refers, for example, to reimbursement payments.

In *FC of T v Rowe* (1995) ATC 4,691 the taxpayer was employed as an engineer for the Livingston Shire Council. As a result of a number of complaints against him he was suspended. An inquiry was commenced, and he incurred legal costs as a result of engaging counsel to defend himself against dismissal during the course of the inquiry. The taxpayer was cleared of any charges of misconduct but was dismissed a year later. The taxpayer claimed his legal costs as a deduction. Although the Council refused to reimburse the taxpayer for his legal costs, the Queensland government subsequently made an ex gratia payment.

The Full Federal Court considered, amongst other things, whether the ex gratia payment constituted assessable income. By majority, the Court concluded that the payment was not assessable under section 25(1) of the Australian Income Tax Assessment Act 1936 as income in accordance with ordinary concepts, nor was it assessable under section 26(e) of that Act as being compensation "in respect of, or for or in relation directly or indirectly to" any employment. Accordingly, Burchett and Drummond JJ (with Beaumont J dissenting) held that the payment was not assessable. Burchett J held that the payment was **not a reward for the taxpayer's services but was a recognition for the wrong done to him.** The payments were not remuneration but a reparation, and they were not sufficiently related to the performance of income-earning activities. On the same reasoning, it was too remote from the employment to be caught by section 26(e). Further, the payment was not assessable under section 26(e) because the employer/employee relationship between the Council and the taxpayer was **merely part of the background facts** against which the ex gratia payment was made. On appeal, the majority of the Full High Court confirmed the Federal Court's decision: *FC of T v Rowe* (1997) ATC 4,317.

In the Australian case of *FCT v Dixon* (1954) 5 AITR 443, the taxpayer received payments from his prior employer topping up his military pay. It would appear from the judgment that the Australian Commissioner argued that even a slight relationship to employment was sufficient to satisfy the test in section 26(e) of the Australian Income Tax Assessment Act 1936 [which made assessable certain sums granted to the taxpayer "in respect of, or for or in relation directly or indirectly to, any employment…".]. This argument was rejected by Dixon CJ and Williams J, who stated at page 446 that:

We are not prepared to give effect to this view of the operation of s.26(e) …There can, of course, be no doubt that the sum of £104 represented an allowance, gratuity or benefit allowed or given to the taxpayer by Macdonald, Hamilton and Company. Our difficulty is in agreeing with the view that it was allowed or given to him in respect of, or in relation directly or indirectly to, any employment of, or services rendered by him …We are not prepared to give s.26(e) a construction which makes it unnecessary that the allowance, gratuity, compensation, benefit, bonus or premium shall in any sense be a recompense or consequence of the continued or contemporaneous existence of the relation of employer and employee or a reward for services rendered given either during the employment or at or in consequence of its termination.

In the same case, at page 450, McTiernan J stated that:

The words of paragraph (e) are wide, but, I think, not wide enough to prevent an employer from giving money or money's worth to an employee continuing in his service or leaving it, without incurring liability to tax in respect of the gift. The relationship of employer and employee is a matter of contract. The contractual relations are not so total and all embracing that there cannot be personal or social relations between employer and employee. A payment arising from those relations may have no connexion with the donee's employment.

These principles have also been applied by the courts in cases involving contracts for services. In *Scott v FCT* (1969) 10 AITR 367, Windeyer J in the High Court of Australia considered the meaning of the words "in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by him" in section 26(e) of the Income Tax and Social Services Contribution Assessment Act 1936-1961. The case concerned a solicitor who received a gift of £10,000 from a grateful client. Windeyer J stated at page 374 that the meaning of the words of the legislation "must be sought in the nature of the topic concerning which they are used". Windeyer J at page 376 referred to a passage from the judgment of Kitto J in *Squatting Investment Co Ltd v FCT* (1953) 5 AITR 496, at 524, where Kitto J (speaking of certain English cases) said:

The distinction these decisions have drawn between taxable and non-taxable gifts is the distinction between, on the one hand, gifts made in relation to some activity or occupation of the donee of an income-producing character … and, on the other hand, gifts referable to the attitude of the donor personally to the donee personally.

Adopting this as a general principle, his Honour held that the £10,000 was not given or received as remuneration for services rendered and it did not form part of the taxpayer's assessable income.

A recent case discusses the words "in respect of the employment" in the Australian FBT legislation: *J & G Knowles & Associates Pty Ltd v FC of T* (2000) ATC 4,151. The case concerned interest-free loans to directors of a corporate trustee. Units in the trust fund were held by discretionary family trusts established by the directors. The lower courts were satisfied by a causal relationship, or a discernible and rational link between the loans and each director's employment. However, the Full Federal Court said that there had to be more than just any causal relationship between the benefit and the employment: the link had to be sufficient or material.

The nature and context of the payments

The words "in respect of or in relation to" have been given a very wide meaning to classify most payments made by an employer as monetary remuneration. There must also be a sufficient or material relationship between the payment and the employment. Under the Employment Relations Act 2000 ("ERA") it is true that if an employee were not an employee then there would be no entitlement to receive the payments under section 123(1)(c)(i) of the ERA for humiliation, loss of dignity, and injury to feelings. However, those payments are not compensation for services rendered or for actions that occur in the normal course of the employment relationship. They are based on the existence of a personal grievance.

Under section 88 of the Human Rights Act, damages may be awarded by the Tribunal for a breach of any of the provisions of Part 2 of that Act. As discussed above, breaches of Part 2 will not necessarily be in an employee/employer situation. If a claim is brought in the Tribunal which does not involve an employee and employer relationship it is clear that payment under section 88(1)(c) cannot be described as monetary remuneration.

Where the complaint brought before the Tribunal does occur in the context of an employee/employer relationship, the connection of the employment relationship with payments under the Human Rights Act is tenuous. The Human Rights Act is not "employment legislation", although it may often operate in the employment context. Payments under section 88(1)(c) of the Human Rights Act for humiliation, loss of dignity, and injury to feelings are **not** compensation for services rendered or for actions that occur in the normal course of the employment relationship. Rather the payments would be in the nature of reparation for a wrong done to the complainant and so would not be in respect of employment.

Payments of damages awards under section 88(1)(c) of the Human Rights Act 1993 differ markedly from the situation in *Shell v CIR*. In that case at page 11,306, McKay J said:

> It is true …that the payment is not made under the contract of employment.…It is nevertheless paid to an employee only because he or she is an employee, **and** is paid to compensate for the loss incurred in having to change the employee's place of residence in order to take up a new position in the company. (Emphasis added)

Thus, in the *Shell* case, the employees received the payments as employees, and in order to compensate for the loss sustained as a result of the employment-related relocation.

The Commissioner considers payments under section 88(1)(c) of the Human Rights Act to be too remote from the employment relationship to be within the definition of monetary remuneration. If a complaint is brought in the Tribunal which involves an employee and an employer, the employment relationship in such instances is merely part of the background facts against which the damages payments are made. The payments are not made "in respect of or in relation to the employment or service of the taxpayer".

Income under ordinary concepts

Payments for damages made under section 88(1)(c) of the Human Rights Act are not "gross income under ordinary concepts" under section CD 5.

Although the legislation does not define "gross income under ordinary concepts", a great number of cases have identified the concept by reference to such characteristics as periodicity, recurrence, and regularity, or by its resulting from business activities, the deliberate seeking of profit, or the performance of services (*Scott v C of T* (1935) 35 SR (NSW) 21 and *Reid v CIR* (1985) 7 NZTC 5,176). It is clear that payments under section 88(1)(c) will not generally be made periodically or regularly, or generally recur. Nor as we have seen above, are they compensation for services.

Capital receipts do not form part of "gross income" unless there is a specific legislative provision to the contrary. And by analogy with common law damages, damages payments under section 88(1)(c) of the Human Rights Act are of a capital nature as Barber DJ acknowledged in Case L92, where he stated at page 1,536 that:

> I appreciate only too well that it is possible to interpret the evidence as showing that the $7,179.30 was formulated as a payment in the nature of common law damages for human hurt and breach and unfairness… I appreciate that the latter concepts are akin more to payments of capital than to wage revenue.

Out of court settlements

The Commission endeavours to settle disputes between parties and sometimes, the parties negotiate a settlement before the dispute is referred to the Tribunal. The settlement agreement may state that the payment is for humiliation, loss of dignity, or injury to feelings. In return for the complainant or aggrieved person surrendering his or her rights under the Human Rights Act, the other party will agree to pay a sum of money. There should be no difference in the tax treatment of the payments dependent on whether or not the parties use the Tribunal. A payment can be for humiliation, loss of dignity, or injury to the feelings of the complainant or aggrieved person whether the Tribunal is involved or not.

Shams

The Ruling will not apply to payments which are akin to sham payments. A sham is a transaction set up to conceal the true intention of the parties and is inherently ineffective. The nature of a sham was discussed by Diplock LJ in *Snook v London and West Riding Investment Ltd* [1967] 1 All ER 518 at 528 where he stated:

> I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the "sham", which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.

Richardson J, in the New Zealand case of *Mills v Dowdall* [1983] NZLR 154, stated that the "essential genuineness of the transaction is challenged" in a sham situation.

It is noteworthy that, in the Taxation Review Authority decision, *Case S 96* (1996) 17 NZTC 7,603, Judge Barber stated at page 7,606:

> Of course, seemingly excessive allocations to compensation for feelings injury should be reopened by the IRD.

If the parties to an agreement agree to characterise or describe payments as being for humiliation, loss of dignity, or injury to feelings when they are in reality for lost wages, this transaction would be a sham which would be open to challenge by the Commissioner. Where the Commissioner has some doubt about the amount attributed to humiliation, loss of dignity, or injury to feelings, he may ask the parties to an agreement what steps they took to evaluate objectively what would be a reasonable amount to attribute to humiliation, loss of dignity, or injury to feelings. This would be so regardless of whether the payment was made as a result of an out of court settlement and whether or not the agreement is settled by the Human Rights Commissioner under the Human Rights Act. The onus of proof regarding the taxability of any such payment would be on the taxpayer.

NEW LEGISLATION

TAXATION (TAXPAYER ASSESSMENT AND MISCELLANEOUS PROVISIONS) ACT *[2001, NO.85]*

The Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provisions) Bill was introduced into Parliament on 2 April 2001 and passed on 16 October. The two resulting Acts were enacted on 24 October 2001.

The main features of the bill as introduced were amendments relating to research and development expenditure, unit trusts, interest deductibility for companies, and taxpayer self-assessment, and confirmation of the income tax rates for the year. Three further measures were added to the bill after its introduction: changes relating to the application before 1999 of GST to certain services contracted for outside New Zealand, transfers of overpaid tax, and extension of the deadline for claiming donation and housekeeper-childcare rebates.

The new Acts amend the Income Tax Act 1994, Tax Administration Act 1994, Goods and Services Tax Act 1985, Estate and Gift Duties Act 1968, Income Tax Act 1976, Student Loan Scheme Act 1992, Child Support Act 1991, Gaming Duties Act 1971, Taxation (GST and Miscellaneous Provisions) Act 2000 and Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) Act 2001.

RESEARCH AND DEVELOPMENT EXPENDITURE

Sections DJ 9A, DJ 9B, EG 19, OB 1 of the Income Tax Act 1994

Introduction

Section DJ 9A has been inserted into the Income Tax Act 1994 to provide taxpayers with some certainty as to when they can treat research and development (R&D) expenditure as not being capital (or, broadly speaking, as being "revenue") for tax purposes. This is important because, if taxpayers can treat R&D expenditure as revenue, it is very likely that they will be entitled to deduct the expenditure immediately under the general deductibility rules contained in section BD 2(1)(b)(i), and (ii) of the Act.

The section achieves this by, broadly, allowing taxpayers to treat R&D expenditure as revenue if the expenditure does not satisfy all the asset recognition criteria contained in Financial Reporting Standard 13 (FRS 13). These criteria are designed to approximate the point at which the R&D expenditure gives rise to a valuable asset.

Background

Before the enactment of these rules, three sets of provisions in the Act permitted the deduction of R&D expenditure—the general deductibility provisions in section BD 2, the specific deduction allowed for scientific research expenditure in section DJ 9, and the depreciation rules. Which of these provisions allowed a deduction for an item of R&D depended on the nature of the expenditure. Taxpayers can still use these provisions to deduct their R&D.

The general deductibility provisions allow a taxpayer a deduction for expenditure if the expenditure is incurred in the income-earning process and is not "of a capital nature". It can often be very difficult for taxpayers and Inland Revenue to determine whether R&D expenditure is capital or revenue. It was this lack of certainty, and the risks that this gave rise to, that many taxpayers and their advisers considered to be the greatest problem in this area.

The new rules address this uncertainty by permitting taxpayers to follow accounting treatment to the extent that when R&D expenditure is immediately written off for financial reporting purposes after applying the asset recognition criteria in FRS 13, they can treat the expenditure as not being capital for tax purposes.

Under FRS 13, expenditure on "research" is always written off (under paragraph 5.1), while "development" expenditure is written off until it is considered that the expenditure has resulted in a valuable asset with sufficiently certain future economic benefits. Paragraph 5.2 of FRS 13 determines that this point is reached when the product or process being developed meets five asset recognition criteria. From the point at which all these criteria are met, further "development" expenditure is amortised (subject to the application

of paragraph 5.4 of FRS 13, discussed below). The asset recognition criteria are:

- The product or process is clearly defined and the costs attributable to the product or process can be identified separately and measured reliably.
- The technical feasibility of the product or process can be demonstrated.
- The entity intends to produce and market, or use, the product or process.
- The existence of a market for the product or process or its usefulness to the entity, if it is to be used internally, can be demonstrated.
- Adequate resources exist, or their availability can be demonstrated to complete the project and market or use the product or process.

The proposal that led to the new R&D rules was contained in a Government discussion paper released in November 2000 (*Research & Development – Accounting Treatment for Tax Purposes*).

Key features

A new section DJ 9A has been introduced into the Act. It provides that spending on R&D that is expensed for accounting purposes after applying paragraphs 5.1, 5.2 or 5.4 of FRS 13 is not expenditure "of a capital nature" for the purposes of section BD 2(2)(e) of the Act. Provided the other criteria for deductibility are met, this will confirm that taxpayers are allowed a deduction for such expenditure under the Act's general deductibility rules (section BD 2(1)(b)(i), (ii)).

Fixed assets (such as vehicles, buildings and patents) that are used in the R&D process will continue to be depreciated under the normal tax rules.

Use of this new rule will be optional. Taxpayers are able to use the deductibility rules available before the changes to deduct R&D if they prefer.

The new rules will not generally allow taxpayers to treat automatically as revenue for tax purposes R&D expenditure that they have expensed as immaterial for accounting purposes (if an amount of R&D expenditure incurred by a firm is immaterial it may be expensed automatically for accounting purposes). To take advantage of the new rules, it is generally necessary to have been able to expense the R&D, both material and immaterial, after having applied paragraphs 5.1, 5.2 or 5.4 of FRS 13.

Application date

The changes apply from the beginning of the 2001–2002 income year.

Detailed analysis

The new rules have been effected by inserting new sections DJ 9A and DJ 9B into the Act and amending sections EG 19 and OB 1 (new definitions of "research" and "development") of the Act.

Section DJ 9A(1)

Overview

This subsection is the provision that enacts the core R&D change. Broadly, it provides that expenditure that taxpayers write off as R&D after applying paragraphs 5.1, 5.2 and 5.4 of FRS 13 is not to be treated as expenditure "of a capital nature" for the purposes of section BD 2(2)(e) of the Income Tax Act. (This is the provision that excludes capital expenditure from the general deductibility rules in section BD 2.)

Aside from the capital exclusion, the general deductibility rules will apply in full. Therefore a deduction will be granted only if there is a sufficient link between the R&D expenditure and the income-earning process, and the deduction is not prohibited by the exclusions in paragraphs (a) to (d) or (f) of section BD 2(2). (These prohibitions relate to private expenditure, expenditure incurred in deriving exempt income or income from employment, and expenditure specifically disallowed as a deduction.)

Paragraph (a)

This paragraph provides that a taxpayer who has recognised material or immaterial R&D expenditure as an expense for financial reporting purposes after applying paragraphs 5.1 or 5.2 of FRS 13 can treat the expenditure as not being of a capital nature. As noted above, paragraph 5.1 provides that all "research" must be expensed, and paragraph 5.2 requires that "development" expenditure must be expensed until the point at which all five asset recognition criteria (listed above) are satisfied.

Paragraph (b)

This paragraph provides that "development" expenditure is not "of a capital nature" if the taxpayer has not treated the expenditure as an asset for financial reporting purposes by virtue of paragraph 5.4 of FRS 13. Paragraph 5.4 limits the amount of "development" expenditure that can be treated as an asset to an amount equal to the likely future economic benefit that will be gained from the asset. "Development" expenditure in excess of this must be expensed. This provision has the effect of allowing taxpayers a deduction for "development" expenditure incurred after the five asset recognition criteria have been satisfied to the extent that, if the expenditure were treated as an asset, the recognised costs would exceed the probable future economic benefits.

Paragraph (c)

This paragraph allows access to the new rules for taxpayers who have expensed R&D for financial reporting purposes because it is immaterial but, had they applied paragraphs 5.1, 5.2 or 5.4 to the expenditure, would have been required to recognise the R&D as an expense for financial reporting purposes. This paragraph is necessary because, under paragraph 2.3 of FRS 13 taxpayers are required to apply the accounting standards set out in FRS 13 only if their application is of material consequence. Immaterial R&D is, therefore, generally expensed. Paragraph (c) recognises that there can be very good reasons why taxpayers may want to expense automatically immaterial R&D for financial reporting purposes. The benefits of the new rules should still be available provided the R&D expenditure would be required to be expensed for financial reporting purposes if paragraphs 5.1, 5.2 or 5.4 of FRS 13 had been applied.

Section DJ 9A(2)

This subsection exempts from the core rule those taxpayers who have total annual R&D expenditure of $10,000 or less, and who write off the expenditure as immaterial for accounting purposes. These taxpayers can treat the expenditure as not being of a capital nature without being required to expense the amount after applying paragraphs 5.1, 5.2 or 5.4 of FRS 13.

Given the low level of the threshold, this exemption is likely to apply mainly to small taxpayers. It has been targeted in this way because it is understood that small taxpayers are less likely to have access to professional accounting advice. The application of paragraphs 5.1, 5.2 and 5.4 of FRS 13 could, therefore, give rise to significant compliance costs for these taxpayers.

Section DJ 9A(3)

This provision removes the potential argument that R&D expenditure that is incurred in devising a patented invention should be carried forward under section EF 2 and deducted when the resulting patent is sold. Such expenditure is intended to be deductible on the same basis as any other R&D expenditure.

Section DJ 9A(4)

This provision removes capital inputs into the R&D process from the ambit of the new rules. Current tax treatment applies to this property. For example, if the asset qualifies for a depreciation deduction the depreciation rules apply. The cost of an asset that is not currently deductible (such as costs associated with know-how) remains non-deductible.

The subsection does not apply to an asset that is itself created from the R&D. This confirms that R&D expenditure incurred on such assets is eligible for a deduction. Without this proviso, there is an argument that R&D expenditure incurred on, for example, a prototype would not be deductible on the basis that the prototype could qualify for a depreciation deduction.

Section DJ 9A(5)

This provision allows taxpayers that apply paragraphs 5.1, 5.2 or 5.4 of FRS 13 to expense their R&D for financial reporting purposes to choose not to use the new rules for tax purposes. Some taxpayers may wish to expense some R&D for accounting purposes but capitalise and depreciate the expenditure for tax purposes.

Section DJ 9A(6)

This provision provides that "research" and "development" have the meanings set out in paragraphs 4.1 and 4.2 of FRS 13 (as interpreted by the relevant commentary in FRS 13). FRS 13 defines "research" and "development" as follows:

"Research" is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

"Development" is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

Ability to use current rules

The tax deductibility rules that taxpayers used to deduct R&D before the enactment of these rules are still available. For example, taxpayers that have used the new rules to deduct immediately a large portion of their R&D but, for financial reporting purposes, would be required to capitalise the remaining portion, are able to argue that the amount capitalised is deductible either under the general deductibility rule (section BD 2(1)(b)(i) and (ii)), or section DJ 9 (scientific research).

Section DJ 9B

This section addresses the Government's concern about re-categorisation of expenditure as R&D, and avoidance schemes developing around R&D. By providing that certain types of expenditure and activity can be removed from the definition of R&D by regulation, the Government will be able to move quickly to counter tax avoidance.

Interaction with the depreciation rules

A new subsection (2)(A) has been added to section EG 19 (disposition of depreciable property). It ensures that deductions taken for R&D costs incurred in relation to creating software are not clawed back under section EG 19(2) if the software is subsequently sold.

Timing of the deduction

The timing of the deduction is determined in accordance with normal rules, under which an expense is deductible when incurred, unless sections EF 1 or EF 2 apply. These sections apply in limited circumstances to defer a deduction. Section EF 1 defers a deduction for the purchase of goods until the goods are used in deriving income, and defers a deduction for payment for services until the services are performed. Section EF 2 defers a deduction for the cost of revenue account property.

Other provisions in the Act also apply as they normally do to revenue expenditure. For example, taxpayers who produce R&D for the purpose of sale may be subject to the trading stock rules and be required to include in income the value of their work in progress at year-end. The effect of this requirement is to defer the deduction until the trading stock is sold.

Costs that are amortised for accounting

Normal tax treatment applies to costs that are capitalised for accounting. Because the new rules is optional, taxpayers that amortise costs for accounting may nevertheless argue that such costs are on revenue account for tax purposes.

If R&D costs that are amortised for accounting are considered to be on capital account for tax purposes, they will be immediately deductible under section DJ 9 if they are incurred in connection with "scientific research". Some taxpayers argue that that term includes development expenditure. Section DJ 9 has not been changed.

R&D "black hole" expenditure

Expenditure that is not deductible at all is called "black hole" expenditure. Theoretically, some R&D expenditure falls within this category—for example, development costs on capital account that do not give rise to a depreciable asset. In practice, however, it appears that taxpayers generally find a way to deduct black hole expenditure.

The new rules are likely to reduce the amount of any R&D expenditure that is black hole. R&D costs that do not lead to an asset can be expensed for accounting. They are, therefore, able to be deducted immediately for tax.

Interpretation

Two areas of dispute could arise between Inland Revenue and the taxpayer. The first is whether the expenditure is R&D. The second is whether the asset recognition criteria in paragraph 5.3 are satisfied. It is a matter of judgement when the criteria for amortisation in that paragraph are satisfied. Taxpayers will be in the best position to make those judgements. They are likely to be challenged by Inland Revenue only when they are clearly not sustainable.

Example of tax treatment

D Co aims to create a new product that builds upon existing know-how that it has purchased. It spends one year developing this to the point where it considers the new product can be demonstrated to be technically feasible (and the other asset recognition criteria in paragraph 5.3 of FRS 13 are satisfied). Its R&D costs for this period are:

- $100,000 salary for scientific services performed
- $10,000 consumables used
- $20,000 rent
- $5,000 power, cleaning
- $30,000 purchase of capital laboratory equipment
- $50,000 purchase of unpatented know-how

For financial reporting purposes D Co accounts for these costs under paragraph 5 of FRS 13. The first four items, and depreciation of the last two, are expensed under paragraph 5.2 of FRS 13 because at the time the expenditure was incurred the asset recognition criteria had not all been satisfied.

For tax purposes, the first four items are expensed under the general deductibility rules (section BD 2 (1)(b)(i) and (ii)). For the purposes of these rules, section DJ 9A(1) confirms that this expenditure is not "of a capital nature".

Section DJ 9(A)(1) does not apply to the laboratory equipment. This is because the equipment is property that is used in carrying out the R&D for which a depreciation deduction is allowed (see section DJ 9A(4)(a)). Therefore tax depreciation is claimed on the laboratory equipment under the general depreciation provisions in the Income Tax Act.

Section DJ 9A(1) does not apply to the unpatented know-how. This is because it is intangible property that is not depreciable intangible property (it is not included on Schedule 17 of the Act) (see section DJ 9A(4)(d)). Because the property is not depreciable intangible property there is no depreciation deduction (or other deduction) available. In other words, the expenditure on the unpatented know-how is "black hole" expenditure.

INTEREST DEDUCTIBILITY FOR COMPANIES

Sections BD 2(2), DD 1, EH 8, 10 and 26 of the Income Tax Act 1994

Introduction

The general interest deductibility rules for companies have been clarified and simplified. The changes ensure that interest incurred by most companies is deductible, subject to the existing thin capitalisation and conduit interest allocation rules. Certain companies are excluded from the new rules.

The purpose of these changes is to reduce compliance costs for taxpayers by removing both the uncertainty that surrounded these tax rules and their need to structure to achieve the same result.

Background

The policy is that interest on business borrowings should be deductible, in a manner similar to other business-related expenses. Before the recent changes most interest incurred by companies was deductible, provided it was incurred:

- to derive gross (taxable) income, or
- as part of a business of deriving gross income; or
- as part of the cost of acquiring shares in a group company.

Groups of companies frequently used the third test to ensure that interest on all of their borrowings was deductible. However, this involved some structuring, and having to go through this process could cause companies significant compliance costs.

Moreover, there was a technical doubt that the third test was effective in all the circumstances in which it could be expected to work. This doubt, which arose as a result of the major changes made to the Act's core provisions in 1997, is discussed later.

The situation was exacerbated by uncertainty surrounding the interpretation of the tax law as it applies to interest deductions given that the case law is neither comprehensive nor fully convergent.

There have also been practical problems with trying to apply restrictions to interest deductions. Money is fungible, meaning it is substitutable with other money. For example, a company might establish a pool of funds for a variety of purposes. The pool could be sourced from sales revenue, equity finance, loans or overdrafts or the proceeds from the sale of fixed assets or investments. All that restrictions such as a requirement to trace the use to which the funds are put do in these circumstances is create compliance costs.

Accordingly, the key change simplifies the general interest deductibility rules for most companies, which should reduce compliance costs for those companies that are affected by it and offer certainty as to what is the law. It was first raised in a September 1999 discussion document *Interest Deductions For Companies*.

Key features

For the majority of companies, interest deductions are no longer confined to interest incurred either in deriving gross income, or in the course of carrying on a business, or in relation to borrowings used to capitalise subsidiaries. Changes have been made to section DD 1 and section BD 2(2) of the Income Tax Act 1994 to give this effect.

There have also been two remedial changes to overcome any doubt inadvertently created by amendments to the Income Tax Act's core provisions in 1997. The first change involved amending section DD 1 to verify that despite the exclusions from allowable deductions in section BD 2, interest can be deducted on borrowings used to capitalise subsidiaries that are at least 66% owned, that is, group companies.

The second change involved amending sections EH 8, EH 10 and EH 26 to list the timing rules that are overridden by the accrual rules, so that any interest incurred is timed under the accrual rules rather than those other timing rules. There are, however, transitional exceptions for taxpayers that have decided to treat the interest expense as a project cost.

There are several reference changes as a consequence of adding further subsections to section DD 1. The affected sections are FG 8, FG 9, FH 5, HB 2, HG 9 and LF 7.

Application date

The amendments are backdated to the 1997-1998 income year to coincide with the application of the Taxation (Core Provisions) Act 1996. The backdating of the new interest deductibility rule was in response to submissions at the select committee stage.

Detailed analysis

New core interest deductibility rule

The key interest amendment involves overriding the specific rules relating to interest deductions in section DD 1. Deductions will no longer be confined to interest incurred either in deriving gross income, or in the course of carrying on a business, or in relation to borrowings used to capitalise subsidiaries.

Nevertheless, there are still some restrictions. The rule continues to be subject to the thin capitalisation and conduit interest allocation rules in subparts FG and FH of the Act. The thin capitalisation rules are designed to ensure that profits of foreign controlled entities are subject to New Zealand income tax and are not removed from the tax base by way of interest expense. Likewise, the conduit interest allocation rules are designed to ensure that interest expenses are not unduly allocated against the New Zealand tax base. They apply when there is some foreign ownership of a New Zealand company and that company in turn has outbound investment. The interest expense is allocated between the New Zealand company and the outbound investment.

A change has also been made to the core provisions (Part B) to ensure that section BD 2(2)(b), the provision that excludes the deduction of expenditure incurred in deriving exempt income, is expressly overridden when expenditure on interest is deductible under section DD 1(3).

These changes apply to the majority of companies. The current rules will continue to apply to anyone else seeking to deduct interest, including individuals, trusts or partnerships and companies that do not qualify.

Definition of "company"

The change does not extend to qualifying companies or to companies that derive any exempt income (with the exception of the types of exempt income discussed below). This reflects concerns about the effectiveness of apportioning interest expense between private and domestic use and between exempt income and taxable income. This is not a problem for other companies because the private and domestic boundary is in their case effectively buttressed by the dividend rules, with any benefits obtained by shareholders being dividends in their hands.

The types of exempt income that can be earned by a company without precluding it from the new rule are:

- Dividends that are exempt income.
- Income from the disposition of shares acquired in relation to section 67 of the Companies Act 1993 (treasury stock).
- Income exempted under either section CB 9(c) or CB 9(ca) (prize money in respect of racing) provided the racing is ancillary to the company's business of breeding.

Exempt dividends

There are two types of exempt dividend under section CB 10, dividends from one company to another company within the same group (reflecting internal transfers of funds) and dividends received by New Zealand companies from foreign companies (which may be subject to dividend withholding payments).

Treasury stock

Companies are allowed under the Companies Act 1993 to buy and sell their own shares. When they hold their own shares this is called treasury stock. Tax law makes the sale proceeds exempt income whether the shares are sold at a profit or a loss.

The holding of treasury stock, while not being an everyday commercial event, should not, from a tax policy perspective, cause interest deductions to be limited. The definition of "company", therefore, includes companies that hold their own stock and subsequently dispose of those shares.

Racing stakes

The winning of race prize money, which is treated as exempt income under section CB 9(c) and 9(ca), does not preclude a company from being able to use the new deductibility rule if the income is an ancillary part of a wider associated breeding business.

Non-resident companies

Many entities operate in New Zealand as branches of overseas companies, those branches being legally part of the overseas companies. For tax purposes such companies are treated as non-resident companies because they are not incorporated in New Zealand, do not have their head offices in New Zealand, and are not controlled from New Zealand. New Zealand taxes non-resident companies on their New Zealand business and allows deductions for expenses, such as interest, only in relation to that business.

In changing the interest deductibility rule for companies, there is no intention also to allow non-resident companies to deduct their interest expenses in relation to their non-New Zealand activities. The definition of "company" in the new core interest deductibility rule has, therefore, been qualified to confirm that for a company based outside of New Zealand, interest can only be deducted in relation to expenditure on interest incurred in the course of carrying on a business through a fixed establishment in New Zealand ("fixed establishment" being a defined term in the Income Tax Act).

Group companies

In a corporate group it is often not possible to trace borrowings to their eventual use, which means that one group company can incur the interest expense while another derives the exempt income. The limitation on earning exempt income therefore extends to all group companies when one group company derives exempt income. In other words, the earning of exempt income by one member of the group taints the other companies within the group.

Retrospective application

Although from a policy perspective it is agreed that interest incurred by companies should be deductible, those making submissions on the bill to the Finance and Expenditure Committee wanted to ensure that there would be no dispute about past interest deductions given the uncertainty surrounding the application of the existing law. Submissions, therefore, proposed that the application of the new rules should be backdated.

The case for backdating was accepted. It avoids the risk of structures previously thought valid being overturned. Going back to the start of the 1997–1998 income year was considered appropriate because that is when the core provisions changes took effect and would cover the period of four years in which the Commissioner could normally reassess a taxpayer's position.

Calculation of exempt income

The legislation covers both a continuous flow of exempt income, such as with a local authority or charity, and also an exempt income stream that is variable. Irrespective of the type of income stream, the wording of the legislation applies the exempt income test to the income year in question so that exempt income has to be earned in that income year to be relevant.

Definition of "interest"

Because the application has been backdated, the definition of interest covers all variations of the financial arrangement rules that have applied since 1997-1998 (the "accruals rules", the "qualified accruals rules" and the "accrual rules") by referring to expenditure under subpart EH.

The legislation refers to "expenditure on interest". This is intended to include all situations in which expenditure arises under the accrual rules, whether or not it involves a conscious action on the part of the taxpayer to incur interest expense. For example, the mark-to-market valuation adjustments for financial arrangements do not involve a direct expenditure decision by the taxpayer but are nevertheless classified as "interest".

Ancillary changes

Clarifying the rule in relation to shares in groups companies

The first ancillary change involves clarifying the legislation to verify that interest incurred in acquiring shares in a group company (at least 66% owned) is deductible even when the income derived is exempt income. This change removes the doubt that has existed since the 1997 changes to the core provisions as to whether interest incurred is deductible in these circumstances.

The change involves amending section DD 1 by inserting a subsection (2) to verify that despite the section BD 2(2)(b) prohibition on deductions in relation to expenditure incurred in deriving exempt income, interest can be deducted on borrowings used to acquire shares in another company in the group under new subsection DD(1)(b)(iii) (previous DD 1(b)(iii)).

Treating interest deductions as a per-period expense or a project cost

The second ancillary change relates to the timing of interest deductions. The timing of interest deductions is usually governed for tax purposes by the accrual rules (or their relevant predecessors—the accruals rules and qualified accruals rules). More generally, as their name suggests, the accrual rules are a set of tax rules that quantify and time, on an accrual basis, income and expenditure in relation to financial arrangements. Interest under these rules is generally deductible when incurred, as a per-period expense.

Following the rewrite of the Act's core provisions, it has been arguable that the Act's other specific timing rules override the accrual rules. This would imply that interest associated with a project could be a cost of that project and, therefore, would not be deductible until the income from the project is realised. For example, if a land developer borrows to finance a project, does the interest form part of the cost of any unsold land at year-end, in the same way as, say, the bulldozer costs do?

In the example above, the land is no more valuable if it has been debt financed than if it had been equity financed. Thus there is no policy reason for the interest to form part of the cost. The amendments confirm this and therefore remove any doubt about having to defer the deduction.

Sections EH 8, EH 10 and EH 26 have been amended to specifically set out the relationship between the relevant accrual(s) rules and other timing rules in the Act. The amendments list the timing rules that are overridden by the qualified accruals rules or the accrual rules so that any interest incurred is timed under either the qualified accruals rules or the accrual rules rather than the other timing rules.

The other timing rules are:

- the cost of trading stock for small taxpayers;
- the cost of revenue account property;
- the cost of livestock;
- the cost of bloodstock;
- the cost of acquiring a film or a right in a film;
- film production expenditure;
- the cost of timber; and
- exploration expenditure or development expenditure in relation to petroleum mining.

Backdating the changes to the 1997–1998 income year is necessary to ensure that past taxpayer treatment of the interest as a periodic expense is not overturned.

Interest as a project cost

It seems reasonable that when taxpayers have not regarded, or were not intending to regard, interest as a periodic expense, that they should be able to choose to defer the deduction if they want to. Among other things, this will ensure that tax returns do not have to be re-opened when interest has been regarded as a project cost.

Therefore, as a transitional arrangement, taxpayers have been allowed irrespective of the clarification above, to regard interest as a cost subject to the timing rules provided:

- they have filed their tax returns on that basis; or
- will, in respect of unfiled 2000–2001 and 2001–2002 returns, be filing on that basis.

No formal election or commitment to file on this basis is needed.

There is an issue as to how these amendments affect the definition of "film cost". This will be further considered.

Consequential changes

There are several reference changes as a consequence of adding further subsections to section DD 1. The affected sections are FG 8, FG 9, FH 5, HB 2, HG 9 and LF 7.

UNIT TRUSTS: IMPUTATION CREDIT STREAMING

Sections GZ 2 and MZ 7 of the Income Tax Act 1994

Sections 234A and 394ZGA of the Income Tax Act 1976

Introduction

The amendments remove an exposure to an anti-avoidance rule relating to imputation credit streaming. This anti-avoidance rule potentially applied to unit trusts that did not attach imputation credits to amounts paid to unit trust managers for the repurchase of units during the period 1 April 1988 to 31 March 1996.

Background

Unit trusts are taxed as if they were companies and are generally subject to the same tax obligations as companies. They differ from companies, however, in the way in which their investors enter and exit the unit trust. The usual way this happens is by investors acquiring and disposing of units through the unit trust manager, who operates as a type of clearing house. The redemption of those units by the unit trust manager gives rise to a dividend to that unit trust manager.

For the period 1 April 1988 to 31 March 1996 these dividends were exempt from income tax under section 63(2H) of the Income Tax Act 1976 and section CZ 4 of the Income Tax Act 1994.

Because the dividends received upon redemption were exempt from tax, it was the standard practice of some unit trusts not to impute these dividends, since the unit trust managers could not use the imputation credits. Inland Revenue has recently formed the view that this practice technically constitutes imputation streaming and would result in the unit trusts having to attach imputation credits to those dividends. This would result in an unexpected additional tax impost for such unit trusts. The implication of this potential unexpected tax impost is that it would have a negative impact on the unit values for the current unit holders in these trusts.

Key features

A new section GZ 2 has been added to the Income Tax Act 1994 to ensure that the practice of not imputing dividends paid to unit trust managers upon redemption of the unit does not constitute imputation credit streaming for the period 1 April 1995 to 31 March 1996. In addition, a new section MZ 7 has been added to ensure that section ME 8(4) (allocation debit as a result of imputation ratio change) does not apply to a dividend to which section GZ 2 applies.

New sections 234A and 394ZGA have been added to the Income Tax Act 1976 to cover the period 1 April 1988 to 31 March 1995.

Application date

The amendments apply retrospectively for the period 1 April 1988 to 31 March 1996.

UNIT TRUSTS: GROUP INVESTMENT FUNDS – DEDUCTION FOR INVESTOR EXPENDITURE

Section DI 3A(2) of the Income Tax Act 1994

Introduction

The amendment treats management fees incurred by an investor as incurred in the same income year in which the investor incurred them if a group investment fund elects to claim a deduction for those fees.

Background

Section DI 3A allows a group investment fund to elect to claim a deduction for the management fees incurred by the investors of the fund that its pays to a trustee company on behalf or as agent for the investors. Such expenditure for which an election was made was treated as being incurred by the fund on the same day as the investor incurred it.

Submissions to the Finance and Expenditure Committee on the Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provisions) Bill raised concerns about the general application of the requirement for expenditure to be treated as being incurred on the same day, particularly if the parties involved have different balance dates. For consistency, section DI 3A was amended.

Key features

Section DI 3A(2) has been amended to treat the management fees incurred by an investor to be incurred in the "same income year" in which the investor incurred those fees, rather than on the "same day", if a group investment fund elects to claim a deduction for those fees.

Application date

The amendment applies from the beginning of the 2001–2002 income year.

UNIT TRUSTS: TRANSFER OF DEDUCTIBLE EXPENSES

Sections DI 3B, DI 3C, ME 4(1)(aab), ME 5(1)(jb),

ME 4(2)(aab), ME 5(2)(ia), ME 9(1A) and OB 1 of the Income Tax Act 1994

Introduction

New provisions allow for qualifying unit trusts, superannuation funds and Category A group investment funds to transfer their deductible expenditure to other qualifying unit trusts, Category A group investment funds they invest in.

The amendments are intended to have the effect of allowing the deductible expenditure in the retail fund to be set off against the income it relates to in the wholesale fund.

The legislation providing for the transfer is not complex and is intended to avoid unnecessary compliance costs. In particular, there is no explicit requirement in the legislation to establish a nexus between the expenditure of the retail fund and the income in the wholesale fund. Inland Revenue will be monitoring the use of these provisions to ensure they are being used for their intended purpose.

Background

It is common for unit trusts, superannuation funds and group investment funds to invest in other unit trusts and group investment funds. This is often referred to as retail funds investing in wholesale funds, and is seen as an efficient and effective way of conducting business.

This way of operating does, however, create a problem for the entities concerned. In such situations, the retail fund incurs deductible expenditure on administration and the like and receives its only income in the form of dividends. Such dividends are usually fully imputed. The effect of this is that the fund will have excess imputation credits to set off against its tax liability. These excess imputation credits can be converted into losses and carried forward. However, unless the fund has income to set off the imputation credits or losses they cannot be used.

The new provisions are similar to those already available to superannuation funds.

Key features

- A new section DI 3B will allow for a qualifying unit trust, superannuation funds or a Category A group investment fund (referred to in the legislation as the "member fund") to transfer deductible expenditure to a qualifying unit trust, or a Category A group investment fund in which it has invested in whole or in part (referred to in the legislation as the "master fund").
- The member fund and master fund must both agree to the transfer, and the amount, and the transfer cannot exceed the master fund's taxable income for the year of transfer.
- The amount paid to the member fund by the master fund for the expenses will not be considered gross income or a dividend for the purposes of the Income Tax Act 1994 or a gift for the purposes of the Estate and Gift Duties Act 1968, since there is a value-for-value transaction between the master and member funds. The parties agree to the amount of expenditure to be transferred and the payment required for this transfer, at arm's length.
- The transferred expenditure is treated as having been incurred by the master fund in the income year it is incurred by the member fund. Similar amendments have been made to allow for this same treatment for superannuation funds and group investment funds.
- The transferable expenditure is restricted to expenditure that is allowed as a deduction under section BD 2, but is not expenditure on revenue account property or financial arrangements. However, expenditure on financial arrangements will still be transferable if it relates to a financial arrangement that is denominated in New Zealand dollars and for which expenditure is allocated using the yield-to-maturity method in EH 34.
- New definitions of "qualifying unit trust", "member fund" and "master fund" have been added to section OB 1.
- A new section DI 3C allows the master fund a deduction for the expenditure transferred by the member fund. If all of the transferred expenditure cannot be claimed as a deduction by the master fund in the year of proposed transfer, the member fund can carry forward the balance of that expenditure and transfer it in a subsequent income year. If the member fund decides to claim a deduction for that carried forward expenditure in a subsequent year, the expenditure is treated as if it were a loss carried forward.
- New sections ME 4(1)(aab) and ME 5(1)(jb) provide for a "balancing" of imputation credits between the member and master funds. This addresses the issue of the member fund having surplus imputation credits and the master fund having a shortfall of imputation credits as a result of the expense transfer. Section ME 4(1)(aab) deems a credit to arise in the master fund's imputation credit account equal to 33% of the amount of the expenditure transferred. Section ME 5(1)(jb) deems a corresponding debit to the member fund's imputation credit account. Sections ME 4(2)(aab) and ME 5(2)(ia) require the credit and debit, to be made on 31 March in the income year in which the expenditure is transferred. New section ME 9(1A) provides that if the debit leaves the member fund's imputation credit account with a debit balance, there is no requirement to pay additional tax on the amount of the section ME 5(1)(jb) debit.

Application date

The new provisions will apply from the income year beginning 1 April 2001.

UNIT TRUSTS: UNIT-HOLDER CONTINUITY RULE AND DEFINITION OF QUALIFYING UNIT TRUST

Sections OB 1, OD 5(5A), OD 5(5B) and OD 5(5C) of the Income Tax Act 1994

Section 32D of the Tax Administration Act 1994

Introduction

A new continuity rule will allow the unit holders (shareholders) of a qualifying unit trust to be treated as a "notional single person" for the purposes of the shareholder continuity rules. Provided a unit trust continues to satisfy the new definition of a "qualifying unit trust", it will be able to carry forward losses and imputation credits without the need to incur the compliance costs associated with tracking unit-holding changes to ensure continuity has not been breached.

Background

The unit trust industry has expressed concern about the practical difficulties it faces in accurately determining shareholder continuity. This potentially results in the loss of credit balances in the imputation credit account of the unit trust and/or the forfeiting of tax losses brought forward.

Unit trusts are treated as companies for tax purposes and are, therefore, subject to the same continuity rules applied to companies when carrying forward imputation credits and losses.

Companies cannot carry forward imputation credits or losses unless the shareholding continuity rules are satisfied. The continuity threshold for carrying imputation credits and losses forward is 66% and 49% respectively. This means that a group of persons must hold in aggregate interests in the unit trust of at least that threshold for the imputation credits or losses to be carried forward from the year in which the tax was paid or the loss incurred to the year when the imputation credits or losses are used. The intention is to ensure that only those unit holders who paid the tax or incurred the losses are entitled to benefit from those imputation credits and losses.

Unit trusts differ from companies in the way their investors enter and exit. Investors entering a unit trust are issued units that increase the capital of the unit trust. These units are redeemed when the investor exits, causing the capital of the unit trust to decrease. In the case of a company, the capital base is generally more stable, with most shares being traded between shareholders, not between shareholders and the company. These changes in the capital base of a unit trust mean that the continuity percentages change much more than they do for a company. This imposes significant compliance costs on unit trusts in monitoring unit holder changes to ensure that no breach occurs.

Key features

- A new definition of "qualifying unit trust" has been added to section OB 1 of the Income Tax Act 1994. As a result, there will be two types of qualifying unit trusts:
  - retail unit trusts, whose unit trusts are offered to the public and which have a hundred or more unit holders; and
  - wholesale unit trusts, whose units are held by widely held investment vehicles such as other unit trusts or superannuation funds.
- A new section 32D of the Tax Administration Act 1994 requires the disclosure of associated holdings by unit holders to the trustees of a unit trust in certain circumstances, for the purposes of determining whether the unit trust is a qualifying unit trust.
- Section OD 5 has been amended by inserting new subsections (5A) and (5B) to treat the shares held by each unit holder of a qualifying unit trust as if those shares were held by a "notional single person". The continuity rules are intended to operate as "layers". That is, if a unit trust chooses to or cannot use the new rules in any income year, it uses another layer of the existing continuity rules.
- A new section OD 5(5C) provides for the transition into the new rule. If a qualifying unit trust chooses to use the new rule on the first day of its 2001-2002 income year, the balances it has in its imputation credit account and dividend withholding payment account and any losses carried forward will be treated as always having been the balances of the notional single person.

Application date

The new provisions will apply from the income year beginning 1 April 2001.

UNIT TRUSTS: SUPERANNUATION FUNDS – TRANSFER OF DEDUCTIBLE EXPENDITURE

Section DI 3(2)(c) of the Income Tax Act 1994

Introduction

The amendment treats expenditure incurred by a superannuation fund (the first fund) that is transferred and deducted by another superannuation fund (the second fund) in terms of section DI 3 to be incurred by the second fund in the same income year in which the first fund incurred that expenditure.

Background

Section DI 3 allows a superannuation fund (the second fund) to claim a deduction for expenditure incurred by another superannuation fund (the first fund), if that first fund elects to transfer that expenditure to the second fund. Such expenditure for which an election was made was treated as being incurred by the second fund on the same day as it was incurred by the first fund.

Submissions to the Finance and Expenditure Committee on the Taxation (Annual Rates, Taxpayer Assessment and Miscellaneous Provisions) Bill raised concerns about the general application of the requirement for expenditure to be treated as being incurred on the same day, particularly if the parties involved have different balance dates. For consistency, section DI 3 was amended.

Key features

Section DI 3(2)(c) has been amended to treat the expenditure transferred and claimed as a deduction by the second fund to be incurred in the "same income year" in which the first fund incurred that expenditure rather than on the "same day", if the first fund elects to transfer such expenditure.

Application date

The amendment applies from the beginning of the 2001-2002 income year.

CHARITABLE ORGANISATIONS

Section KC 5(1) of the Income Tax Act 1994

The Cry for the World Foundation New Zealand Humanitarian Aid Fund has been granted charitable donee status from the 2002–2003 income year.

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

TRANSFERS OF OVERPAID TAX TO A PERIOD OF NIL LIABILITY

Sections MD 1(1B), MZ 5 and MZ 6 Income Tax Act 1994

Section 120C(3) Tax Administration Act 1994 (in relation to the 1997-1998 to the 2001-2002 income years)

Section 122(10) Tax Administration Act 1994 (in relation to the 1995-1996 and 1996-1997 income years)

Sections 409(1A), and 409A of the Income Tax Act 1976

Section 413A(1) (definition of "tax paid") of the Income Tax Act 1976 (in relation to the 1994-1995 income year)

Section 413A(5A) of the Income Tax Act 1976 (in relation to the 1988-1989 to the 1993-1994 income years)

Introduction

Taxpayers who overpay tax in relation to a tax period can request Inland Revenue to transfer the excess to another period or type of tax, or to another taxpayer. There are no comprehensive rules governing such transfers in tax legislation, and this has given rise to uncertainty about aspects of the law relating to transfers.

The legislation has been amended to address retrospectively one issue that has caused taxpayers concern—Inland Revenue's ability to transfer excess tax to a period in which there is no outstanding liability for tax ("a nil period").

The Government has announced that it proposes, before the end of the year, to introduce legislation into Parliament that enacts comprehensive new rules. These are set out in chapter 7 of the discussion document Taxpayer compliance, standards and penalties: a review, released in August 2001. Broadly, they will apply to transfers in the 2002-2003 and future years.

Background

Inland Revenue has in the past sometimes arranged with taxpayers to transfer excess tax to a nil period. It recently doubted its ability to do this and obtained a Crown Law opinion which states that the Commissioner of Inland Revenue has no authority to make transfers in these circumstances. Some in the private sector disagree with this view.

Inland Revenue's ability to transfer excess tax to a nil period can affect a taxpayer's right to use-of-money interest. Most commonly, this will occur in the circumstances described below.

Transfers through intervening closed years

Under the use-of-money interest rules in effect before the 1997–1998 income year, taxpayers could obtain use-of-money interest on overpaid tax only until the terminal tax date in relation to the year in which the tax was overpaid. Based on previous practice, many taxpayers understood that Inland Revenue would roll over such excess tax to the next period so that, in effect, use-of-money interest would continue to be payable by the department beyond the terminal tax date and for so long as it retained the tax.

For example, a taxpayer who was reassessed in 1999 in relation to an income year before 1997–1998 might have requested Inland Revenue to roll forward excess tax arising from the reassessment through intervening years, even though any tax liability in those years had been satisfied. This would result in use-of-money interest on the excess being payable by Inland Revenue until the date of the refund. Inland Revenue agreed to such transfers in some cases, and declined to transfer in others.

Following the Crown Law opinion, Inland Revenue advised taxpayers that it has no power to transfer the excess to a nil period and has reversed transfers requested.

Transfer to offset UOMI liability on provisional tax underpayment

A further (and more common) example of the impact of transfers on use-of-money interest relates to the payment of provisional tax. Inland Revenue's view is that if taxpayers pay their estimated provisional tax liability, or pay on the basis of last year's provisional tax plus the required uplift, that amount constitutes the liability. The department considered, on the basis of the Crown Law opinion (and before enactment of the new provisions), that it could not transfer

overpaid tax from a previous year in excess of that liability. If it turned out that the provisional tax was underpaid, the excess tax could not be applied in satisfaction of the underpayment. Taxpayers could therefore receive use-of-money interest (currently at 4.83%) on the excess tax retained and simultaneously be charged use-of-money interest (at 11.93%) in relation to the underpaid terminal tax from the relevant provisional tax date.

Key features

The amendments authorise a transfer of overpaid tax to a nil period in certain circumstances and apply if the excess is (or was) refundable as at the date the transfer request is (or was) considered by Inland Revenue. Broadly, the effect of the amendments is that:

- In relation to past income years, and requests made in the past, if Inland Revenue has transferred tax to a nil period, and has paid use-of-money interest on that basis to a taxpayer, the taxpayer will retain the use-of-money interest (sections MZ 5(1) Income Tax Act 1994 and 409A Income Tax Act 1976).
- Inland Revenue will be required to transfer overpaid tax to a nil period if, before 21 April 2001, a taxpayer had requested the transfer in writing, or the department had notified the taxpayer in writing that it had received or actioned the request (sections MZ 5(1) Income Tax Act 1994 and 409A Income Tax Act 1976).

  The cut-off date of 21 April removes opportunities for taxpayers who, in the past, did not request a transfer to do so now. Taxpayers who made requests before 21 April cannot amend the transfer instructions after that date.
- In relation to past income years and current or future requests, Inland Revenue will make a transfer only if there is an assessment or reassessment on or after 21 February 2001 which gives rise to excess tax in the prior year (section MZ 5(2)).
- In relation to the current income year (2001-2002) and current year requests, the taxpayer need simply request Inland Revenue to transfer the excess to the nil period (section MZ 6).

The amendments address only the issue of transfers to a nil period. They do not set out the persons to whom the transfer can be made or the effective date of transfer (except to make it clear that a transfer cannot take effect before the date of overpayment). To be retrospectively prescriptive about these issues is not feasible. Existing practice will apply in relation to these matters (except to the extent that the new legislation necessarily overrides it).

The new provisions apply only to excess income tax, which includes provisional tax and tax that is withheld and credited in satisfaction of residual income tax (such as resident withholding tax). The legislation does not authorise transfers of, and to, other types of tax (such as GST).

The amendments are a pragmatic solution to a difficult problem and do not attempt to deal comprehensively with problems relating to transfers of excess tax.

Detailed analysis

Tax overpaid in the 1995–1996 to 2000–2001 income years

Section MZ 5(1) Income Tax Act 1994 – requests made before 21 April 2001

Under new section MZ 5(1) of the Income Tax Act 1994, Inland Revenue must transfer excess income tax paid by a taxpayer to a nil period if certain conditions are satisfied. First, the tax must have been refundable, in terms of sections MD 1, MD 2 and MD 3, as at the time the transfer request was originally considered. The last two sections limit refunds to the amount of the credit balance in a company's imputation credit account. This reflects current practice—before Inland Revenue transfers excess tax at the request of a taxpayer (rather than applying it under section MD 2(5)), it will ensure that the imputation credit account has sufficient credits.

Second, the transfer may be made only if Inland Revenue had not already applied the excess to satisfy an outstanding tax liability of the taxpayer at the time that the transfer request was considered. Clearly, if Inland Revenue had already applied the overpayment in this way, it would not be available for transfer at the request of the taxpayer.

Subsection MZ 5(1) requires Inland Revenue to transfer excess tax paid by a taxpayer to a nil period if the criteria above are satisfied and, before 21 April 2001, one of the following occurred:

- the taxpayer or the agent of the taxpayer requested Inland Revenue in writing to transfer the excess tax to the nil period; or
- the taxpayer or agent orally requested the transfer to the nil period but Inland Revenue notified them in writing that it declined their request; or
- Inland Revenue issued to the transferee (who may also be the transferor) a statement of account, or other notice in writing, which reflects or records the transfer to the nil period (whether or not the transfer was subsequently reversed).

For the transfer to be actioned, after the legislation is passed taxpayers who satisfy one of the criteria above must identify themselves to Inland Revenue as a person to whom the amendments apply. This requirement ensures that Inland Revenue has no obligation to search through all taxpayer files to identify affected taxpayers.

Section MZ 5(1) applies only in the circumstances set out in the section. It does not apply, for example, to taxpayers who have made oral requests for a transfer if the request has been declined orally by Inland Revenue.

Inland Revenue is authorised to action a request only if it is made before 21 April 2001. Any change to the request after that date will therefore not be actioned. This means that taxpayers cannot amend their request after 21 April to receive a more advantageous treatment.

Section MZ 5 applies only in relation to transfers of, and to, income tax (section MZ 5(4)). This includes provisional tax and tax that is withheld and credited in satisfaction of residual income tax (such as resident withholding tax). Transfers of, and to, other tax types, such as GST, are not provided for.

Link with use-of-money interest rules

Amounts transferred under section MZ 5 are tax paid in the period to which they are credited for the purpose of the use-of-money interest rules. This is achieved by new subsection 120C(3) of the Tax Administration Act 1994 in relation to the 1997-1998 to 2001-2002 years, and the addition of a definition of "tax paid" in section 122(10) in relation to the 1995-1996 and 1996-1997 years. The examples show how the link with the use-of-money interest rules will work in practice.

Examples (section MZ 5(1))

The following examples illustrate the operation of section MZ 5(1). The balance date in all examples is 31 March.

Example 1 – transfer through closed periods to maximise use-of-money interest

In March 1999 A Co is audited in relation to the 1995-1996 year and is found to have overpaid tax by $300,000 in that year. Assessments have been made and tax paid for the 1996–1997 and 1997–1998 years. A Co wants to maximise use-of-money interest on the amount retained by Inland Revenue before it is refunded. In March 1999, A Co writes to Inland Revenue to request it to transfer the excess to the first provisional tax payment date at 7 July 1996, and then, because it will be excess tax paid in the 1996–1997 year, to transfer it to the first provisional tax date for the 1997–1998 year (7 July 1997), before refunding the excess to the taxpayer in March 1999.

(A Co considers that once the amount transferred becomes tax paid in the 1997–1998 year, use-of-money interest is payable until the date of the refund. Therefore no further transfers are required).

In March 1999, Inland Revenue checks that the excess is refundable—the imputation credit account for the year ended March 1998 has sufficient credits. However, it argues that it cannot action such transfers because there is no outstanding liability for provisional tax in the 1996–1997 and 1997–1998 years. It refunds the excess, and pays use-of-money interest on the excess until the terminal tax date for the 1995–1996 income year (7 February 1997).

Following enactment of section MZ 5(1), A Co contacts Inland Revenue and refers to its transfer request. Inland Revenue actions the transfers to the provisional tax dates specified. Additional use-of-money interest on the excess tax is therefore payable to A Co from 7 February 1997 until the date of the refund in March 1999.

Section MZ 5(1) would apply in the same way if, instead of Inland Revenue refunding the excess to A Co in March 1999, A Co had offset the excess against a tax liability at that date.

Example 2 – transfer through closed periods to minimise debit use-of-money interest

In March 1998, B Co's 1995–1996 return is reassessed, giving rise to excess tax of $50,000. In 1996–1997 B Co had estimated its provisional tax liability as $300,000, and paid $100,000 on each instalment date. Its terminal tax liability was, however, $450,000. It paid the additional $150,000, together with use-of-money interest on the underpayment in April 1997.

B Co wrote to Inland Revenue in March 1998 to request that the excess tax be credited to its first provisional tax instalment date for the 1996–1997 year (7 July 1996) to reduce the use-of-money interest liability. The excess was refundable at that time (the imputation credit account at 31 March 1997 having sufficient credits). However, Inland Revenue declined to transfer the excess as requested because there was no outstanding provisional tax liability in the 1996-1997 year. It refunded the excess in March 1998, together with use-of-money interest on the excess until the terminal tax date for the 1995-1996 year (7 February 1997).

Following the enactment of section MZ 5(1), B Co contacts Inland Revenue. The department transfers the $50,000 excess to the 1996-1997 year effective on 7 July 1996, eliminating the use-of-money interest liability in relation to the underpayment of provisional tax as at 7 July 1996. The use-of-money interest payable will be recalculated, taking into account amounts of interest paid to and by B Co.

Example 3 – transfer to offset UOMI liability on provisional tax underpayment

C Co pays its provisional tax on the basis of last year's provisional tax plus the required uplift. It discovers in November 1999 that it overpaid tax for the 1998-99 year. In the meantime, it paid provisional tax due on each of 7 July and 7 November 1999. It receives record revenue in November so that, although it has accurately calculated and paid the amount required under the uplift method, it will be liable for use-of-money interest from 8 July and 8 November on the difference between the provisional tax paid and tax liability for the year spread equally over each provisional tax instalment date. C Co asks Inland Revenue in writing to transfer half of the excess tax in the 1998-1999 year to each of its provisional tax instalment dates on 7 July 1999 and 7 November 1999. The excess tax is refundable (the imputation credit account at 31 March 1999 having sufficient credits) but Inland Revenue considers that it has no power to do this because there is no provisional tax liability on 7 July and 7 November (even though there is a use-of-money interest liability in relation to "underpayments").

When section MZ 5(1) is enacted, C Co contacts Inland Revenue and refers to its earlier written request. The excess tax has not, as at 7 July and 7 November 1999, been transferred by Inland Revenue to satisfy an outstanding tax liability. Inland Revenue therefore transfers the amount C Co requested in its letter to 7 July 1999 and 7 November 1999. This satisfies the underpayments as at those dates and eliminates the use-of-money interest liability in relation to the amounts underpaid.

Section MZ 5(2) – transfers on assessment/ reassessment on or after 21 February 2001

Section MZ 5(2) relates to assessments or reassessments of previous year tax liabilities on or after 21 February 2001. Inland Revenue must transfer the excess tax arising on an assessment or reassessment to a nil period if the taxpayer requests this (orally or in writing).

The section only applies if the tax is refundable as at the date of the actioning of the transfer request. The imputation credit account of a company must therefore have sufficient credits at the most recently ending imputation year. The excess must also not have been offset against an existing liability as at the time the transfer request is considered.

Example 4 – section MZ 5(2)

In December 2001, D Co's income for the 1996–1997 year is reassessed and D Co finds that it overpaid tax for that year. Returns for the intervening years have been filed and tax paid. In December 2001, D Co telephones Inland Revenue to arrange for the transfer of the excess from the 1996–1997 year to its first provisional tax payment date in the 1997–1998 year before refunding it.

Inland Revenue checks that the amount is refundable. The imputation credit account has a sufficient credit as at 31 March 2001. Therefore it actions the transfer. The taxpayer therefore receives use-of-money interest on the excess tax until it is refunded.

Tax overpaid in 2001-2002 income year

Section MZ 6 of the Income Tax Act 1994 applies to income tax paid in excess for the 2001–2002 income year. Again, it applies only if Inland Revenue has not transferred the excess to satisfy an existing liability. It must transfer the excess to a nil period if the taxpayer requests this.

The section applies only to transfers of, and to, income tax including provisional tax and tax that is withheld and credited in satisfaction of residual income tax (section MZ 6(3)).

Amounts transferred under section MZ 6 are tax paid in the period to which they are credited for the purpose of the use-of-money interest rules (section 120C(3) of the Tax Administration Act 1994).

Example 5 – section MZ 6

E has an early balance date (30 November). He files his 2001–2002 return in May 2002 and finds that he has paid excess tax for that year. He has in the meantime estimated and paid his first provisional tax instalment for the 2002–2003 year on 7 March 2002. He subsequently discovers that he is likely to have underestimated that instalment and, though there is no liability (he paid what he estimated), use-of-money interest would be payable on any shortfall.

E therefore telephones Inland Revenue to arrange to transfer the excess to cover any shortfall at 7 March 2002. Section MZ 6 authorises Inland Revenue to action the request.

Tax overpaid in the 1988–1989 to 1994–1995 years

New section 409A has retrospectively been inserted into the Income Tax Act 1976. The section is in the same terms as section MZ 5 of the Income Tax Act 1994, and the commentary on that section above applies equally to it.

New provisions have also been inserted into the use-of-money interest rules so that it is clear that tax transferred into another period is tax paid in that period for the purposes of those rules. In respect of the 1994–1995 year, a definition of "tax paid" has been inserted into section 413A(1) of the 1976 Act. In relation to the period from 1988–1989 to 1993–1994, new section 413A(5A) has been inserted

so that overpaid tax that is transferred to an income year is included in item 'a' of the formula for calculating use-of-money interest.

DEADLINE FOR CLAIMING REBATES

Sections 41A(6), 41A(6AA) of the Tax Administration Act 1994

Summary

The six-month deadline for claiming rebates for charitable donations and payments for housekeeping or childcare expenses has been removed.

Background

Taxpayers who make charitable donations and pay for housekeeping or childcare expenses are entitled to a rebate of one-third of the amount donated or paid, up to a maximum of $500, each year.

In 1999, tax simplification reforms removed the need for about 1.2 million individual taxpayers to file income tax returns. As a result of these reforms, a new process for claiming these rebates that generally made them easier and faster to claim was introduced. Under the new process, taxpayers had six months from balance date to claim their rebates in respect of a particular income year.

The claim period was extended by three months last year to allow taxpayers and their agents to become familiar with the new rebate claim process. A significant number of rebates were claimed during that extension period. Although the new process works well for most taxpayers, some taxpayers, and particularly agents, have found it difficult to meet the six-month deadline. Removing that deadline should reduce compliance costs for taxpayers and their agents and make it even easier for these rebates to be claimed.

Key features

With the repeal of section 41A(6), taxpayers will have eight years to claim a rebate, the same time period allowed for claiming refunds of overpaid tax.

Application date

The new legislation will apply to rebate claims made in the 2001–2002 and subsequent income years. This will mean that claims can be made this year in relation to charitable donations and housekeeping or childcare expenses paid in the 1999–2000 income year.

TAXPAYER SELF-ASSESSMENT

Tax Administration Act 1994
Income Tax Act 1994

Introduction

The legislation for income tax has been changed to recognise that in practice taxpayers self-assess their tax liability as part of meeting their return filing obligations. Until now the legislation has been written as if it were the Commissioner of Inland Revenue who performed all functions of assessment.

No significant policy changes are involved in making the changes necessary to align the tax legislation with practice. The changes for self-assessment add to and enhance other improvements being made towards the simplification of tax administration.

Background

Our tax administration practices are based on the idea that taxpayers have the best information about their own activities. As such, taxpayers are better placed than the Commissioner to assess their tax liabilities by making the appropriate calculations and furnishing their returns each year. Inland Revenue automatically processes these returns and issues notices of assessment generally reflecting the information on each return. This approach is supported by audit processes, which in some cases will mean that the Commissioner amends an assessment.

Despite these practices, self-assessment has not, until now, been reflected in the tax legislation. Instead, the tax legislation has been written as if it were the Commissioner who actually performed all assessment activities. However, recent decades have seen many changes in administrative practices and, in particular, the availability of computer technology. These changes have to an extent, already been reflected in the tax laws, with a number of key obligations that support self-assessment practices already legislated. For example, under section 15B of the Tax Administration Act, a taxpayer is required to "correctly determine the amount of tax payable by the taxpayer under the tax laws".

Legislating for self-assessment provides a more consistent framework for our tax laws by aligning the legislation with practice. In this way, taxpayers' obligations are now provided for more clearly and directly in our tax laws.

A number of reforms in tax administration developed through the 1990s were designed on the basis of the move to self-assessment.

Those areas of reform include:

- binding rulings, introduced in 1995;
- the compliance and penalty legislation and dispute procedures introduced in 1996;
- the rewrite of the Income Tax Act; and
- more recently, tax simplification measures removing the requirement for most wage and salary earners to file returns from the 1999-2000 income year.

The need to align the legislation with practice was first signalled in August 1994 in the discussion document *Taxpayer compliance, standards and penalties*. Subsequent reforms to tax administration have been designed on the basis of moving to explicit self-assessment. The discussion document *Legislating for self-assessment of tax liability* was released in August 1998.

Key features

Requiring taxpayers to make assessments

The most important change requires taxpayers to assess their income tax liabilities each year. This has involved replacing the Commissioner's general power of assessment with a specific requirement for taxpayers to assess their taxable income, income tax liability, net loss, terminal tax or refund due. This will not involve any significant change in practice as taxpayers already calculate their own tax liabilities when furnishing their returns. Taxpayers will be required to include a notice of their self-assessment in their return of income.

The Commissioner does, however, retain specific powers of assessment and is able to amend taxpayers' assessments. For example, the Commissioner will make an assessment for any taxpayer who is allowed a family tax credit under Part KD of the Income Tax Act or if a taxpayer fails to self-assess.

The assessment made in respect of a taxpayer for an income year will not be re-made each time an adjustment is made to the assessment. Rather, the assessment will be adjusted by the Commissioner making an amendment. The changes clarify this by removing terminology such as "reassess".

Non-filing taxpayers deemed to assess tax liability

Non-filing taxpayers (as defined in section OB 1 of the Income Tax Act) are treated as having self-assessed their tax liabilities for an income year, ensuring that their respective tax positions for a year become certain and final in the same way as for taxpayers who file returns.

Determinations

Net losses are to be self-assessed as part of the process of taxpayers making an assessment each year instead of being subject, as was previously the case, to a separate determination process. Taxpayers' entitlements to use losses will continue to be subject to meeting the objective requirements in the loss rules. Other separate determination processes relating to foreign tax credits and carrying forward controlled foreign company tax credits have also been removed.

Disputes procedures

Under an equivalent process to that available for assessments made by the Commissioner, taxpayers are able to propose adjustments to their own assessments by providing the Commissioner with a notice of proposed adjustment within two months of furnishing their return of income.

Removing "Commissioner discretions" and references to the Commissioner

Consequential amendments have also been made to the tax Acts in order to remove legislative impediments to taxpayers making assessments. These include:

- replacing many "Commissioner discretions" with objective rules in areas affecting the calculation of a taxpayer's tax liability for an income year; and
- modifying language that presupposed that assessments are made only by the Commissioner.

Clarification of terminology and consequential amendments

As a result of the shift to explicit self-assessment, many terms have been standardised or clarified throughout the tax Acts in order to provide consistency or to better reflect self-assessment concepts.

Changes include replacing all references to "alter" with "amend" to maintain consistency with the definition of "assessment"; removing the terms "assessable", "general assessment", and "year of assessment"; and modifying the agency provisions.

Market value

Various references to "value" in the context of a "Commissioner determination" of value have been replaced with the more objective term "market value". The term "market value" has also been incorporated into other sections, such as section FB 4 of the Income Tax Act, to better reflect the concept of self-assessment.

Adjustments for changing between cash and accrual accounting

Section EC 1 has been replaced with a more targeted provision that requires an adjustment to be made only when changing accounting bases, from a cash to accruals basis or vice versa. For example, in a year a taxpayer changes from a cash to an accrual accounting method, amounts owing to the taxpayer must be recognised as gross income, and amounts owed by the taxpayer must be recognised as a deduction. The change clarifies how the amounts in question should be recognised, so they are recognised once, rather than leaving open the possibility that the income or expenditure may not ever be taxed or deducted properly.

Application date

The amendments apply from the 2002–2003 income year.

Detailed analysis

Requiring taxpayers to make assessments

Sections 33(2), 80G(2), 80H, 92(1), 92(3), 92(5), 92(6), and 92AA of the Tax Administration Act 1994, sections KD A1, OB 1 definition of "assessment", and various sections of the Income Tax Act 1994.

The most significant change is that former section 92 of the Tax Administration Act, which required the Commissioner to make all income tax assessments, has been replaced with a requirement for taxpayers to assess their taxable income and income tax liability. The self-assessment also includes an assessment of any net loss, terminal tax or refund due.

Taxpayers are required, under new section 33, to include notice of their self-assessment with their return of income. The requirement for taxpayers to self-assess their income tax liability is also recognised in section 15B of the Tax Administration Act, which lists taxpayers' general tax obligations.

The Commissioner still retains the power to make initial assessments in certain circumstances, such as when the taxpayer fails to self-assess or is the recipient of Part KD family tax credits. The Commissioner's power to amend any assessments, including following an audit of a taxpayer's assessment, is unaffected.

Specific aspects of the changes are detailed below.

Definition of "assessment"

The definition of "assessment" has, for the purpose of the Income Tax Act and consequently the Tax Administration Act, been amended to reflect that either the taxpayer or the Commissioner may be performing the assessment function, depending on the context. The definition also includes all amendments to assessments; these can only be made by the Commissioner, although taxpayers can propose adjustments. The definition, contained in section OB 1 of the Income Tax Act, applies in both that Act and the Tax Administration Act.

Shifting to a formal self-assessment framework has also involved some clarification of what constitutes an assessment if amendments are made. The legislation was previously unclear as to whether multiple assessments were made or if the assessment once made is subsequently amended. It has now been confirmed the assessment is made in respect of a taxpayer for an income year and this is amended when adjustments are made. As such, the assessment for a taxpayer can be subsequently adjusted only by the Commissioner amending that assessment. Related terminology in the tax Acts has been changed to better reflect this concept—for example, by removing the term "reassess".

Distinction between making an assessment and its notice

A distinction has always been drawn between the making of an assessment and the issuing of a notice of that assessment. Some provisions incorrectly referred to an assessment instead of the associated notice and have been corrected accordingly. See, for example, section FG 10(2) of the Income Tax Act and section 111(7) of the Tax Administration Act. Similarly, other provisions that should refer to an assessment being made, rather than to a notice of assessment being issued, have also been corrected. See, for example, sections 89C and 174AA of the Tax Administration Act.

Date of self-assessment

The default date of assessment will be the date taxpayers furnish their return of income. Taxpayers will also be able to fix a date on their notice of assessment, if they so wish, that occurs within a time period prescribed by the Commissioner. This period will be determined by reference to the last date on which a taxpayer is required to furnish a return of income. The Commissioner will prescribe this date when the return forms for the 2002–2003 income year are produced.

Commissioner assessments: assessment of family tax credit recipients and default assessments

Despite the general shift towards taxpayer assessment, when entitlements to family tax credits under section part KD of the Income Tax Act are involved, the Commissioner will continue to make the calculations and assessments for taxpayers, as referred to in new section KD A1 of the Income

Tax Act and new section 92AA of the Tax Administration Act. The general requirement for the Commissioner to issue a notice of proposed adjustment before making an assessment does not apply if the assessment includes a family tax credit.

The Commissioner's powers to make assessments for taxpayers who have failed to self-assess (default assessments) and in other special circumstances, such as under section 44 of the Tax Administration Act, are unchanged

If the Commissioner, instead of the taxpayer, makes the initial assessment, the requirement under section 92 of the Tax Administration Act for taxpayers to self-assess does not apply. The taxpayer will, however, still be required under section 33 to file a correct return of income.

Income statement recipients

Recipients of income statements (personal tax summaries) are treated under section 80H(1) of the Tax Administration Act as having made an assessment required under section 92 of that Act. The date of assessment for income statement recipients is determined under section 80H of the Tax Administration Act. Income statements are also treated under section 80G(2) as returns of income under section 33 and are deemed to contain a notice of assessment.

Non-filing taxpayers treated as having self-assessed

Sections 92(4) and 108(1B) of the Tax Administration Act 1994

Non-filing taxpayers generally have only wage, salary, interest or dividend income, and their tax liabilities are satisfied by tax being withheld at source. These taxpayers still have to ascertain whether in any given year they have other income subject to tax, so share the same basic tax obligations as other taxpayers in relation to ensuring the correct amount of tax is paid on time.

Under new section 92(4), non-filing taxpayers are treated as having self-assessed their tax liabilities for an income year. The date of this assessment in relation to an income year is the terminal tax date for that income year. These amendments ensure that the tax position of a non-filing taxpayer for an income year becomes certain and final, in the same way as for filing taxpayers.

Under new section 108(1B), the Commissioner may not amend a non-filing taxpayer's assessment after four years from the end of the income year in which the terminal tax date for the deemed assessment falls. This amendment ensures that the time bar for the Commissioner to amend assessments applies in the same way to non-filing taxpayers and filing taxpayers.

Determinations

Former sections 92, 112, 115, 116, 118, 131 and 132 of the Tax Administration Act 1994, sections LC 3(2), LC 4(8), LC 4(9), LC 4(11) and various other sections of the Income Tax Act 1994

No separate determination process for losses

Net losses are to be self-assessed as part of the process of taxpayers making an assessment each year under new section 92 of the Tax Administration Act. The determination of loss processes that were previously set out in former section 92(3)-(5) and all other specific references to loss determinations made by the Commissioner have been repealed. Section 112, containing a separate process for the determination by the Commissioner of a life insurer's policy holder net loss, has also been repealed. Taxpayers' entitlement to use losses continues to be subject to their meeting the objective requirements in the loss rules in the Income Tax Act.

Other determination processes removed

In the same way as the determination process is no longer required in relation to net losses, those required in relation to foreign tax credits or carrying forward controlled foreign company tax credits are also unnecessary. These credits will be taken into account by taxpayers when they assess their terminal tax liability or refund due. The following provisions relating to these credit determinations have been repealed: sections 115, 116, 118, 131, and 132 of the Tax Administration Act and sections LC 4(8) and LC 4(9) of the Income Tax Act. Sections LC 3(2) and LC 4(11)(e) have been amended to replace the reference to the notice of determination of the credit with a reference to the notice of assessment in which the credit is reflected.

Disputes procedures

Sections 89D, 89DA, 92(2) and 3(1) definitions of "notice of proposed adjustment", "response period" and "disputable decision" of the Tax Administration Act 1994

Under an equivalent process to that available for assessments made by the Commissioner, taxpayers will be able to propose adjustments to their own assessments by issuing a notice of proposed adjustment to the Commissioner within two months of furnishing their return. If a taxpayer elects an earlier assessment date, the two-month response period starts running from that date instead. Taxpayers cannot issue a notice of proposed adjustment for their self-assessment if the Commissioner has already issued one to them in respect of the assessment.

The two-month period allows taxpayers to address any errors or omissions in their assessments at an early stage. It also enables taxpayers to propose adjustments while limiting their exposure to penalties. This provides an early opportunity to address any potential problems before an investigation.

One consequence of this change is that the time period in which amendments to assessments may be proposed by taxpayers has been brought forward. The two-month period for taxpayers to propose adjustments to their self-assessments, which previously started to run when the Commissioner issued an assessment for income tax, will instead start to run when the taxpayer makes the assessment. This will usually be the date the return is furnished. This starting time will generally be between one and four weeks earlier (being the time it takes the Commissioner to process returns).

If the Commissioner has made the initial assessment for the taxpayer, the taxpayer can dispute the assessment only after furnishing a return of income. In these cases, the general requirement that a return contain a notice of assessment in accordance with section 33(2) does not apply. The non-application of this requirement recognises that the Commissioner has made the initial assessment. The two-month response period will also start running from the date the Commissioner issues the assessment, rather than from the date the taxpayer furnishes the return of income.

Removing "Commissioner discretions" and references to the Commissioner

Various sections of the income tax Acts

A large number of amendments have been made to the tax Acts to re-express some of the provisions containing references to the Commissioner. If left unmodified, these provisions would have, in a technical if not a practical sense, impeded a taxpayer's ability to self-assess. This has involved:

- replacing various "Commissioner discretions" with objective rules in areas affecting the calculation of a taxpayer's tax liability for an income year; and
- modifying language that presupposed that assessments are made only by the Commissioner.

The Commissioner's administrative functions have not generally been affected by the changes because the discharge of those functions had already presupposed that taxpayers are responsible for correctly determining their tax liability. The changes have also not affected the Commissioner's administrative powers.

Various "Commissioner discretions" are not inconsistent with self-assessment and have therefore been retained, either because they relate to the post-assessment period or are not limited to the assessment process for a particular income year but apply more broadly. Discretions retained by the Commissioner relate to procedural matters such as the requirement to obtain the Commissioner's approval to change a balance date, and the Commissioner's obligation to maintain the revenue base.

Example 1

Section CD 1(3)(a), formerly written in the form:

… such area as, **in the opinion of the Commissioner,** is required for the reasonable occupation of those premises …

has been re-expressed as:

… such area as is required for the reasonable occupation of those premises …

Example 2

Section DK 1(7), formerly written in the form:

No deduction is allowed … except to the extent that **the Commissioner is satisfied that** the interest has been paid during the income year.

has been re-expressed as:

No deduction is allowed … except to the extent that the interest has been paid during the income year.

Example 3

Section DI 2, formerly written in the form:

The **Commissioner may allow** a deduction …

has been re-expressed as:

A deduction is allowed …

Clarification of terminology and consequential amendments

Various sections of the income tax Acts

As a result of the shift to explicit self-assessment, many terms have been standardised or clarified in the tax Acts to provide consistency or to better reflect self-assessment concepts. As noted earlier, the term "reassess", for example, has been removed to better reflect the concept of the assessment. Similarly, the term "additional assessment" has also been dispensed with.

All references to "alter" have been changed to "amend". This particular change was required because the new definition of "assessment" includes any "amendment" to an assessment. Therefore terms other than "amend" to refer to adjustments made to assessments were not consistent with the definition of "assessment" and needed to be replaced. Other changes of terminology and clarifications of concepts in relation to self-assessment are explained below.

General assessment terminology

The term "general assessment" had been used in the Income Tax Act to replace references in the Income Tax Act 1976 to "assessments made under Part IV of the Income Tax Act 1976". These general assessment references became unnecessary in the light of the governing role played by the core provisions in Part B of the Income Tax Act. Most of these references were therefore removed from the 1997–1998 income year as part of the core provisions amendments.

As part of the self-assessment amendments, remaining references to "general assessment" in the Income Tax Act and the Tax Administration Act have been repealed and replaced with references to income tax assessments made under section 92 of the Tax Administration Act. Consequentially, the definitions of "general assessment" and "general income tax assessment" in section OZ 1(2) have also been repealed.

Removal of "year of assessment" concept

The previous references in the income tax Acts to "year of assessment" have been replaced with "income year", and the definition of "year of assessment" in section OB 1 of the Income Tax Act has been repealed. This has been done because for nearly 30 years, the "year of assessment" (which did not mean the year in which an assessment was made) has been the same as the income year.

Removal of "assessable"

The term "assessable", where it was used in a number of provisions as part of the phrase "assessable and liable", has been removed because it was inconsistent with self-assessment. It is sufficient if the relevant legislation refers to a taxpayer being liable for income tax. Most of the provisions amended deal with persons who are treated as agents under the Income Tax Act and are liable for income tax accordingly. For example, under section HE 1(f) the trustees of a unit trust are made liable to income tax as agent of the unit trust. The provisions amended also referred to trustees being "assessable and liable" for taxation in accordance with the trust taxation rules in Part HH. The removal of the term "assessable" while retaining the term "liable" is consistent with the core provisions, which focus on the calculation of a person's income tax liabilities.

Agency provisions

Section HK 1, the general agency provision in the Income Tax Act, has been rewritten to cater for self-assessment. It now states that an agent for a principal is required to make all assessments that the principal is required to make, as well as furnishing to the Commissioner all tax returns that the principal is required to furnish and satisfying the income tax liability of the principal. An "agent" is defined in section OB 1 as anyone declared to be an agent for the purposes of the Income Tax Act.

Section HK 3, which provides that the liability of the agent does not affect the principal's liability, has been amended to allow, with the Commissioner's agreement, the principal to be responsible for the agent's obligations under section HK 1.

A number of provisions in Part HK, dealing with special cases of agency and agents of non-residents and absentees, have been amended to remove parts of these provisions which stated that the person declared to be an agent must make returns and is "assessable and liable for income tax accordingly". This wording was unnecessary in the light of the general agency rules in section HK 1. For example, under section HK 9, a guardian who has control of the income of a person under a legal disability is declared to be the agent of that person, and the guardian is therefore responsible under section HK 1 for making assessments, furnishing returns, and satisfying the income tax liability for the disabled person.

Market value

Sections DN 1, FB 4, FB 6, FC 5(3), GD 1, GD 10, and various sections of the Income Tax Act 1994

The Commissioner's discretion was previously often used in relation to valuations. In practice, however, the Commissioner audited the values used by the taxpayer, checking that they corresponded to market values. The legislation has been amended to reflect this policy. Thus, for example, valuation rules, including provisions for the Commissioner to determine a value, have been re-expressed by replacing the reference to valuations by the Commissioner with a reference to "market value".

In general terms "market value" includes a market price and, alternatively, in the absence of a market price, an arm's length price. Thus in most circumstances, having valuation provisions refer to market value is sufficient without referring to other types of valuations.

"Market value" is a flexible concept and has not been legislatively defined so it bears its natural meaning. It is a term already extensively used in tax legislation, with its meaning determined according to the surrounding (commercial) circumstances. For example, in contrast to using the term "market price", "market value" more naturally allows for the inclusion of a discount given for trading in certain quantities or under pricing structures that recognise market segmentation (such as for retail, trade and wholesale markets).

The term "market value" is used widely in (tax and non-tax) legislation and has also been considered by the courts, particularly in respect of the general principles in *Hatrick v Commissioner of Inland Revenue* [1963] NZLR 641.

Example 4

Section DN 1(10)(c)(i), formerly written in the form:

An amount equal to **such amount as the Commissioner determines, in such manner as the Commissioner thinks fit, was the value** of that asset …

Has been re-expressed as:

An amount equal to the market value of that asset …

Apportionment

The market value principle has also been applied in sections FB 4(1), FB 6 and FC 5(3) of the Income Tax Act in order to provide objective rules for the pro-rata apportionment of the sale price of a bundle of assets, in respect of the components of that bundle.

For example under FB 4(1) there is now an objective rule for the pro-rata apportionment of the value of trading stock when being sold together with other assets of a business. The purchaser treats the amount attributed to the trading stock under this rule as being the price paid for the trading stock. This rule replaces the "Commissioner discretion" that previously (formally) determined the amount attributable to trading stock.

Leases for inadequate rent

One section that has been excluded from the general "market value" approach is GD 10, concerning certain leases of property made for inadequate rent. This section has not been amended as it is not technically an impediment to self-assessment and because the term "adequate rent" is more flexible than "market rent". The provision has, however, been placed on a self-assessment footing by removing the references to the Commissioner.

The focus of section GD 10 is on transactions between relatives involving income splitting, although it can have a much wider application. In particular, the provision can apply to any lease of property by a company to any other person (whether or not associated).

Retaining the term "adequate rent" avoids the possibility of this section being applied in situations where it would not be appropriate, in particular, if there is no opportunity to derive a tax benefit between lessor and lessee.

For example, if a mining company has caused damage to a farming company's land, as part of the settlement between the parties, the company buys the land from the farmer and leases it back to it for 30 years for a low yearly rental. There is no tax benefit in this situation. To the extent that there is a reduction in gross income to the mining company, there is also a lower tax deduction to the farmer. Therefore there is no reduction in net tax collected. Under the existing section GD 10 it is possible that, in light of the relationship between the parties and the surrounding circumstances, the rent is 'adequate" even though it is not a "market rent".

Adjustments for changing between cash and accrual accounting

Section EC 1 of the Income Tax Act 1994

Section EC 1 of the Income Tax Act allows for adjustments to be made to accounting practices adopted in previous years. Without the section it would be arguable that a tax advantage might be obtained in respect of reported income by changing from a cash to an accruals basis, and a corresponding tax disadvantage would be suffered on a change from an accruals to a cash basis. To overcome these effects the previous section EC 1 authorised the Commissioner to adjust the gross income or allowable deductions of a business when it appeared income had been understated or overstated as the result of the application of an incorrect method of accounting.

The scope of the previous section EC 1 was far from clear. In the past the Commissioner relied on the section in circumstances where an amendment to an assessment was time-barred. However, the Court of Appeal held that the section is subject to the four-year statutory time bar. Section EC 1 appears, therefore, to have applied primarily in situations already covered by the Commissioner's general power to amend assessments.

Consequently, this section has been replaced with a more targeted provision that requires an adjustment to be made when changing accounting bases, primarily from a cash to an accrual basis. Cash accounting recognises income when the income is received and recognises deductible expenses when payment is made. Accrual accounting, on the other hand, recognises income when it is earned and recognises deductible expenses when they are incurred.

Under the new section EC 1, if a taxpayer changes from a cash accounting method for one year to an accrual accounting method for the next year, amounts owing to the taxpayer at the end of the first year must be recognised as gross income in the following year. Similarly, amounts owed by the taxpayer at the end of the first year must be recognised as a deduction in the following year.

If a taxpayer changes from an accrual to a cash accounting method, amounts owed by the taxpayer that have already been allowed as a deduction are treated as gross income in the following income year. Similarly, amounts owed to the taxpayer that have already been taxed as income, are treated as a deduction in the following income year.

The changes clarify how the amounts in question should be recognised, so they are recognised once, rather than leaving open the possibility that the income or expenditure may not ever be taxed or deducted properly.

Consider, for example, a business changing from a cash to an accrual accounting method. At the end of the last income year accounted for on a cash basis, the business is owed $400 in income from its debtors and owes $200 for expenses to its creditors. In the following year (the year of adjustment) the business must account for the $400 owed to it as gross income, and the $200 owed by it as a deduction from gross income.

Conversely, if the business had instead changed from an accrual to a cash accounting method it would have already accounted for the $400 as gross income and the $200 as a deduction in its income tax return.

So in the following income year (the year of adjustment), the gross income owed to it but not received must be deducted. Similarly, the expenses owed by the business but not paid must be treated as gross income. This treatment avoids the gross income and deductions being accounted for twice.

The spreading provisions of former section EC 1 have also been repealed. These provisions allowed taxpayers to spread an increase in net income, resulting from the operation of section EC 1, over a period of up to four years. This treatment was, however, inconsistent with many of the changes recently made to the tax system. In particular, the purpose of the spreading rule was to give practical relief from the more progressive and higher tax rates that existed in 1971, when the predecessor to section EC 1 was enacted.

EXAMPLE OF CHANGING FROM A CASH TO AN ACCRUAL BASIS

Cash *End of year 1*		*Accrual* *Beginning of year 2 (year of adjustment)*	
Total debtors	Total creditors	Gross income	Deduction
(has not been taxed as payment has not been received)	(not allowed yet as a deduction)	(recognising that the debtor income has been earned)	(recognising that the expenses have been incurred)
$400	$200	$400	$200

EXAMPLE OF CHANGING FROM AN ACCRUAL TO A CASH BASIS

Accrual *End of year 1*		*Cash* *Beginning of year 2 (year of adjustment)*	
Total debtors	Total creditors	Gross income	Deduction
(already taxed as income)	(already allowed as a deduction)	(to ensure that taxpayer does not receive a double deduction)	(to offset tax liability when payment is received)
$400	$200	$200	$400

GST ON SUPPLIES TO FOREIGN-BASED PLEASURE CRAFT

Section 11 of the Goods and Services Tax Act 1985

Introduction

A new provision allows goods supplied for use on, or the use of, a foreign-based pleasure craft that cause or enable the craft to sail, or goods that ensure the safety of passengers and crew, to be zero-rated.

Changes also allow the zero-rating of the final provisioning of consumable stores supplied to a foreign-based pleasure craft that is departing New Zealand.

Background

The supply of goods to a destination outside New Zealand is generally zero-rated, provided that the goods are entered for export under the Customs and Excise Act 1996. These goods are zero-rated because they are not consumed in New Zealand and therefore should not be subject to GST.

Section 11(1)(k) allows goods that are wrought into, affixed to, attached to or otherwise form part of a temporary import to be zero-rated. This means that certain maritime goods that are not necessarily attached to the temporary import cannot be zero-rated under this provision. New section 11(1)(ka) allows such goods supplied for foreign-based pleasure craft to be zero-rated.

Before this amendment, section 11(1)(l) allowed consumable stores supplied for use outside New Zealand on a departing aircraft, fishing vessel or a foreign-going ship, other than a pleasure craft, to be zero-rated. New section 11(1)(l) extends the provision to foreign-based pleasure craft.

Key features

GST on supplies of certain maritime goods to foreign-based pleasure craft

New section 11(1)(ka) applies to foreign-based pleasure craft that are in New Zealand under a temporary import entry (TIE) issued by the New Zealand Customs Service (Customs Service). The types of goods that may be zero-rated under this provision are those that ensure that the craft can sail, or ensure the safety of passengers and crew. Examples of goods that can be zero-rated are all sails, spinnaker poles, lights for navigation and safety purposes, anchors, life-rafts, tenders, lifebuoys, sheets and halliards.

GST on supplies of consumable stores to departing foreign-based pleasure craft

Section 11(1)(l) has been extended to allow the supply of consumable stores for use outside New Zealand on foreign-based pleasure craft departing New Zealand to be zero-rated. Foreign-based pleasure craft are defined as those pleasure craft in New Zealand as temporary imports under Customs legislation. The Customs Service issues such craft, on their arrival, with a temporary import entry TIE permit. Because the provision applies to craft departing New Zealand, only final provisioning is zero-rated.

"Consumable stores" means goods, such as food and drink that passengers and crew on board a pleasure craft will consume, and goods necessary to operate or maintain a pleasure craft, including fuel and lubricants but excluding spare parts and equipment. The definition also applies to fishing ships, foreign-going ships and aircraft listed in section 11(1)(l). There is no change in what qualifies for zero-rating in relation to the types of transport included in section 11(1)(l) before this amendment.

The extension to include foreign-based pleasure craft is consistent with the overall framework of GST in that the goods in question are likely to be consumed outside New Zealand. The new provision does not apply to New Zealand-based yachts departing New Zealand.

Evidential requirements

A supplier of maritime goods and consumable stores covered by new sections 11(1)(ka) and 11(1)(l) must be satisfied that the goods and stores are for a foreign-based pleasure craft. A supplier of stores (provedore) must also be satisfied that the foreign-based pleasure craft is departing New Zealand before the consumable stores supplied can be zero-rated. Provedores are generally licensed as Customs controlled areas (CCA) under Customs legislation.

Evidence will be required to support a claim for zero-rating by the supplier under both provisions. The evidence that is appropriate includes:

- A copy of the TIE permit, issued by the Customs Service.
- A copy of the recipient's passport.
- Details of the maritime goods or consumable stores purchased. Suppliers should retain copies of invoices of supplies made.
- A written statement from the purchaser that the consumable stores are for final provisioning and are intended for consumption outside New Zealand.

- If available, a copy of the customs certificate of clearance issued by the Customs Service. In some cases this is issued up to one hour before departure, and therefore may not be available when stores for consumption required upon departure are purchased.

Example

The Customs Service issues a TIE permit for a foreign-based yacht that visits New Zealand. The yachtsperson, a non-resident, buys a life-raft, a stay sail, a spare anchor, a few lifejackets, crockery, a personal CD player and bed linen while in New Zealand. The yachtsperson also requires fuel, lubricants and food and water as final provisioning when he or she departs New Zealand. The supplier obtains copies of the TIE permit, the yachtsperson's passport, and copies of the invoices detailing the goods sold. The yachtsperson also provides a written statement to the effect that the consumable stores are for final provisioning and are intended for consumption outside New Zealand.

The following GST treatment applies:

- The final provisioning of fuel, lubricants, food and water can be zero-rated under new section 11(1)(l), if the boat is going to a destination outside New Zealand.
- The supply of the life-raft, stay sail, spare anchor and lifejackets can be zero-rated under new section 11(1)(ka).
- The supply of the crockery, the personal CD player and the bed linen are standard-rated. These items do not meet the zero-rating requirements of new section 11(1)(ka) because they do not cause or enable the craft to sail, nor do they ensure the safety of passengers and crew.

Application date

The amendments apply from 24 October 2001, the date of enactment.

GST – RETROSPECTIVE LEGISLATION CONCERNING EXPORTED SERVICES

Section 11A of the Goods and Services Tax Act 1985

Introduction

Changes made to the GST Act in 1999[1] have been made retrospective to 1 October 1986. The effect of the amendment ensures that services supplied under an agreement entered into with a non-resident but performed in New Zealand for another person are subject to GST from 1 October 1986. A detailed analysis of the application of section 11(2A) can be found in the *Tax Information Bulletin*, Vol 11, No 9 (October 1999) p12.

Background

The amendment was added to the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act after its introduction into Parliament to counter a significant revenue risk. The amendment affects section 11(2A), before it was renumbered as 11A(2), and applies where a taxpayer has sought, after 15 September 1995, to change a tax position in an earlier return.

Key features

- The amendment retrospectively applies section 11A(2) of the Goods and Services Tax Act 1985 (as enacted in 1999) to a supply made by a registered person on or after 1 October 1986 if the person has sought on any basis, after 15 September 1995 (the date of the Court of Appeal decision in *Wilson & Horton*)[2], to adjust, or to have the Commissioner adjust, the GST treatment of the supply.
- The amendment does not apply if, as a result of the person having sought an adjustment, the Commissioner has, on or before 14 May 2001, to the extent of the adjustment sought, paid a refund to the person or made an offset against, or reduction in, a tax liability of the person.
- Section 11A(2) ensures that GST is charged on the supply of services that are consumed in New Zealand but are contracted for by a non-resident who is outside New Zealand. It provides that section 11A(1)(k) does not zero-rate services supplied to a non-resident if another person (including an employee or company director of the non-resident) receives the performance of those services in New Zealand. Section 11A(2) does not apply if it is reasonably foreseeable that the services relate to the making of taxable or exempt supplies by registered persons in New Zealand.

[1] Taxation (Remedial Matters) Act 1999
[2] (1995) 17 NZTC 12, 325

Consequential amendments

A number of consequential amendments have also been made that retrospectively apply other changes made in 1999 in relation to the supply of tokens, stamps and vouchers and arranging services in respect of outbound tourism. Commentary on the application of these 1999 changes can also be found in the *Tax Information Bulletin*, Vol 11, No 9 (October 1999).

Application date

The amendments apply from 1 October 1986 to taxpayers who seek, after 15 September 1995, to adjust, or have the Commissioner of Inland Revenue adjust, an earlier tax position.

REMEDIAL LEGISLATION

ATTRIBUTION RULE

Sections GC 14B(3)(a) and GC 14D(7), ME 4(1)(ab) of the Income Tax Act 1994

Introduction

Changes to the attribution rule ensure that the rule functions as designed and that income is not overtaxed.

Background

The attribution rule was enacted last year to buttress the increase, to 39% in the top marginal tax rate for individuals with incomes above $60,000. Accordingly, it came into effect from the beginning of the 2000-2001 income year. The rule ensures that, in defined circumstances, the income from the personal services of an individual is attributed to that individual, rather than being diverted to an associated person, such as a company, that pays tax at a lower rate.

Specifically, the attribution rule applies when a provider of personal services (referred to in the legislation as person C) interposes an intermediary (referred to as person B) between him/herself and the person to whom services are provided. Income is allocated to person C, rather than to person B.

Key features

Notional credit

The attribution applies for tax purposes only, so the accounting income stays with the intermediary. This means that when the intermediary is a company, the accounting income is likely to be paid out by way of a dividend. Thus tax on the one amount of income is payable in the first instance by the provider of the personal services, and secondly, by the shareholder(s) if and when the income is paid out as a dividend. This will result in double taxation of this one amount of income.

This double taxation problem was addressed by granting an extra imputation credit of 33% of the amount attributed for intermediaries that are companies. This extra imputation credit can then be used to impute a dividend subsequently paid by the interposed company. It is intended that, for a shareholder paying tax at 33%, there will then be no further tax payable on the dividend received. However, before the amendment, the extra imputation credit was insufficient to achieve this. For example, if the amount attributed is $100,000, then

the extra credit at 33% is $33,000. If the company pays the attributed amount plus the extra credit to its shareholder, then the shareholder receives taxable income of $133,000. Tax on this at 33% is $43,890, whereas the imputation credit available is only $33,000.

This problem has been rectified by increasing the extra imputation credit from 33% to 49.25% (see section ME 4(1)(ab)). This change applies to the 2000-2001 and subsequent income years.

Qualifying companies

An associated issue is that the attribution rule can cause double taxation when an amount attributed from a company intermediary is then subsequently distributed as a dividend to the shareholder providing the services, if that shareholder's marginal tax rate is 39%. The shareholder's effective marginal tax rate becomes 48% in these circumstances.

The instances in which this is likely to arise are few. When the attribution rule applies, the income is most likely to be paid out as salary rather than as a dividend, and even when a dividend is paid, most companies involved will be qualifying companies, in which case any dividend is likely to be exempt.

The issue has been substantially addressed by not providing the notional imputation credit to companies that are qualifying companies. This change to section ME 4(1)(ab) applies to the 2000–2001 and subsequent income years.

Natural persons as intermediaries

The attribution rule did not anticipate that the intermediary could be a natural person, rather than a company, partnership or trust. If the intermediary was a natural person and employed relatives to carry out the personal services, the attribution rule could apply, with all of the income from personal services being attributed to the relatives.

There is no need for the attribution rule to apply to natural persons not in partnership, since any relatives employed will be paid a salary and the employer is taxable on any profits made. Accordingly, the scope of the attribution rule has been narrowed by amending section GC 14B(3)(a) so that the rule does not apply if the intermediary is a natural person and is not a partner of a partnership. This change applies to the 2000-2001 and subsequent income years.

When intermediary is a trust

Section GC 14D(7) has been amended to ensure that when an intermediary is a trust and some of its income is paid to the service provider as beneficiary income, that beneficiary income is not reduced. Before the amendment, the service provider's income, along with the income of other beneficiaries, was reduced to ensure that the trust did not make a net loss for the year as a result of the attributed income. Section GC 14D(7) now only reduces the other beneficiaries' income in such circumstances.

Application date

The increase in the notional credit, the exclusion of qualifying companies from obtaining the notional credit and the narrowing of the attribution rule to exclude natural person intermediaries not in partnership apply from the 2000–2001 income year. The change in relation to trust intermediaries applies from the 2001–2002 income year.

"ASSOCIATED PERSONS" DEFINITIONS

Sections OB 1 and OD 8(3) of the Income Tax Act 1994

Introduction

Several remedial amendments have been made to the definitions of "associated persons" in the Income Tax Act 1994. These changes are intended to improve the clarity of these provisions and do not result in any policy change.

Background

The previous definition of "associated person" in section OB 1 of the Income Tax Act 1994 contained a number of cross-referencing errors. In particular, the lists of operative provisions in paragraphs (b), (c) and (d) of the former definition, to which the specific definitions of associated persons in section OD 8 applied, were incorrect in various respects. (The substantive definitions in section OD 8 did correctly list the operative provisions to which they applied.)

Section OD 8(3)(a) of the Income Tax Act 1994 contains tests for determining if two companies are associated persons. The former proviso to this provision provided that two companies were not associated if one of those companies was not resident in New Zealand. The objective of this proviso was to ensure that a New Zealand resident subsidiary of a non-resident parent company was not associated with a non-resident subsidiary of the non-resident parent for the purposes of the controlled foreign company (CFC) rules. The former proviso therefore mainly applied only for the purposes of the CFC rules.

However, the section OD 8(3) definition of associated persons applies to a much larger number of operative provisions in the Income Tax Act (including, for example, the depreciation rules).

The result of the narrow application of the former proviso to section OD 8(3)(a) is that its drafting became very dense and mainly consisted of exceptions to the application of the proviso.

The reason for the complicated construction of the former proviso to section OD 8(3)(a) was historical. The section OD 8(3) definition of associated persons, when it was originally enacted in 1988 (as section 245B of the Income Tax Act 1976), applied only for the purposes of the CFC and foreign investment fund (FIF) provisions. Therefore, when enacted, the former proviso to section OD 8(3)(a) contained no exceptions. However, as the section OD 8(3) definition of associated persons was progressively applied to a larger number of provisions, it was necessary for exceptions to be made to this proviso because its policy rationale applied only for the purposes of the CFC rules.

Over time, as the section OD 8(3) definition of associated persons has been applied to a larger number of operative provisions, the exceptions in the former proviso to section OD 8(3)(a) came to greatly outnumber the limited number of provisions (mainly the CFC rules) that the proviso applied to.

Key features

The former definition of "associated person" in section OB 1 has been replaced with a definition of "associated persons" which contains a general cross-reference to the substantive definitions of associated persons in sections OD 7 and OD 8.

The former proviso to section OD 8(3)(a) has been repealed and replaced with a new subsection. New section OD 8(3A) provides that for the purposes of the CFC rules (other than section CG 8) and the FIF rules, two companies are not associated persons if one company (but not both companies) is not resident in New Zealand. The new subsection achieves the same purpose as the former proviso to section OD 8(3)(a) without the latter's complicated construction.

The opening wording of section OD 8(3), which lists the operative provisions to which this definition of associated persons applies, has also been redrafted to improve its clarity.

Application date

The amendments apply from 24 October 2001, the date of enactment.

GST – TOKENS, STAMPS AND VOUCHERS

Section 5 of the Goods and Services Act 1985

Introduction

Section 5(11G) of the Goods and Services Tax Act 1985 (the GST Act) has been redrafted to assist in its interpretation. The change clarifies the circumstances in which a token, stamp or voucher (voucher) gives rise to a supply on its redemption rather than on its issue.

Background

The Taxation (Beneficiary Income of Minors, Services-related Payments and Remedial Matters) Act 2001 amended the GST Act to clarify the application of section 5 in relation to transactions involving vouchers as enacted in the Taxation (GST and Miscellaneous Provisions) Act 2000.

The amendments clarified that if the issuer/seller of a voucher and the person supplying the goods and services in exchange for the voucher are not the same person, the issuer/seller may elect to recognise GST at the time of redemption rather than at the time the voucher was issued (which is the standard rule). The intended application of the section requires there to be an agreement between the issuer/seller and the supplier to this effect or that the issuer/seller is party to such an agreement. However, no such agreement is required if the issuer/seller of the voucher and the supplier of the goods and services are the same person.

Further amendment was considered necessary in the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001 to clarify the relationship between section 5(11G) paragraph (a) (the not practical test), and paragraph (b) (the requirement to have an agreement if a third party is involved).

Additional commentary on the application section 5(11G) can be found in the *Tax Information Bulletin*, Vol 13, No 5 (May 2001) p46.

Key features

The redraft treats the "not practical" requirement and the requirement for an agreement as disjunctive tests if the supplier of goods and services and the issuer/seller of a voucher are the same person. This means that if the supplier and the issuer/seller are the same person, the redemption basis of recognition may be used if it is not practical to recognise the supply on issue of the voucher.

If the supplier and the issuer/seller are different persons there is the additional requirement that the parties have an agreement to use the redemption basis.

Application date

The change applies from 10 October 2000, the date of the enactment of the Taxation (GST and Miscellaneous Provisions) Act 2000, in which the rules relating to the GST treatment of vouchers were substantively changed.

DUTY ON GIFTS OF FINANCIAL ARRANGEMENTS

Sections 75BA, 75BB and 75BC of the Estate and Gift Duties Act 1968

A remedial amendment removes the exemption from gift duty when the gift of a financial arrangement is treated as having occurred at market price under the accrual rules. In effect, the amendment restores the law as it applied to gift duty on gifts of financial arrangements before the enactment of an earlier amendment on 10 October 2000.

Background

The Taxation (GST and Miscellaneous Provisions) Act 2000 amended the accrual rules so that taxpayers who gift a financial arrangement do not receive an unintended deduction for the value of the financial arrangement. This was achieved by providing that when a financial arrangement is gifted it will be treated as if it had been transferred for its market price.

At the time, officials considered that it was necessary to amend the Estate and Gift Duties Act in order to avoid double taxation. The consequential amendment provided that when the gift of a financial arrangement was treated as having occurred at market price under the accrual rules, the transfer would be exempt from gift duty. The exemption applied retrospectively from the implementation date of the accrual rules.

It is now clear that double taxation does not arise in this situation. In the absence of double taxation, a gift of a valuable asset (whether it be cash or financial arrangement) should be subject to gift duty. Consequently, there should be no exemption from gift duty for gifts of financial arrangements.

Key features

Sections 75BA, 75BB and 75BC of the Estate and Gift Duties Act 1968 have been repealed so that a gift of a financial arrangement will not be exempt from gift duty.

Application date

The repeal of these sections is retrospective to their application date, although financial arrangements transferred between 10 October 2000 and 2 April 2001 (the date of the introduction of the amending legislation into Parliament) will continue to be exempt from gift duty.

TAXATION (ANNUAL RATES OF INCOME TAX 2001-2002) ACT 2001 *[2001, NO.86]*

CONFIRMATION OF ANNUAL INCOME TAX RATES FOR 2001–2002

Schedule 1, Income Tax Act 1994

The income tax rates for the 2001–2002 income year have been confirmed as follows:

Policyholder income	33 cents for every $1 of schedular taxable income
Maori authorities	25 cents for every $1 of taxable income
Undistributed rents, royalties and interest of the Maori Trustee	25 cents for every $1 of taxable income
Companies, public authorities and local authorities	33 cents for every $1 of taxable income
Trustee income (including that of trustees of superannuation funds)	33 cents for every $1 of taxable income
Trustees of group investment funds	33 cents for every $1 of schedular taxable income in respect of category A income
Taxable distributions from non-qualifying trusts	45 cents for every $1 of taxable distribution
Other taxpayers (including individuals)	
– Income not exceeding $38,000	19.5 cents for every $1 of taxable income
– Income exceeding $38,000 but not exceeding $60,000	33 cents for every $1 of taxable income
– Income exceeding $60,000	39 cents for every $1 of taxable income
Specified superannuation contribution withholding tax	39 cents for every $1 of the contribution where the employee has made an election under section NE 2AA 33 cents for every $1 of contribution where no such election is made.

The income tax rates confirmed are the same rates that applied for the 2000–01 income year. The rates apply for the 2001–2002 income year.

OTHER ACTS

DAIRY INDUSTRY RESTRUCTURING ACT 2001

Introduction

The Dairy Industry Restructuring Act 2001 provides for the regulatory and structural reforms of the dairy industry and in particular allows for:

- the amalgamation of the New Zealand Co-operative Dairy Company Ltd, Kiwi Co-operative Dairies Ltd, the Tatua Co-operative Dairy company Ltd, Westland Co-operative Dairy Co Ltd and Fonterra Co-operative Group Ltd; and
- the transition of the New Zealand Dairy Board to a wholly owned subsidiary of the new co-operative resulting from the amalgamation and its conversion into a company 12 months after the day that the Act received Royal assent.

The Act contains provisions in relation to certain tax consequences relating to the amalgamation and conversion of the Dairy Board.

The legislation received Royal assent on 26 September 2001.

Background

The tax provisions contained in the Act were implemented to ensure that any tax impediments arising from the restructuring of the industry do not impede the wider issues associated with the regulatory and structural reforms of the industry.

Key features

Shares issued on amalgamation

Section 151 of the Dairy Industry Restructuring Act provides for the issue of shares by Fonterra Co-operative Dairy Group Ltd to dairy farmers in respect of the shares held by them in the amalgamating co-operative dairy companies not be treated as a dividend for income tax purposes, or as a dutiable gift. The provision ensures that no tax implications arise on the issue of Fonterra Co-operative Dairy Group Ltd shares to dairy farmers upon amalgamation.

Available subscribed capital of Fonterra Co-operative Dairy Group Ltd

Sections 152 and 153 of the Dairy Industry Restructuring Act provide for the transfer of the available subscribed capital (ASC) of the New Zealand Dairy Board to the Fonterra Co-operative Dairy Group Ltd upon the amalgamation. Furthermore, the notional ASC of $140,000,000 that the Dairy Board will receive each year until 2006 under the Dairy Board Act 1961 will now be received by the Fonterra Co-operative Dairy Group Ltd. It will be able to nominate the proportions of ASC received between the classes of shares issued on or before the ASC is deemed to be received.

Net tax losses and imputation credits of the amalgamating co-operatives

Section 154 of the Dairy Industry Restructuring Act allows the Fonterra Co-operative Dairy Group Ltd to use the net tax losses and imputation credit balances of the amalgamating dairy co-operatives, their subsidiaries and their consolidated tax groups as at the date of the amalgamation. This will be achieved by treating shares, or options over shares, held by any person after the amalgamation to be held by that person at all times before the amalgamation. Without these provisions, these tax losses and imputation credits balances may have been forfeited on the amalgamation.

Conversion of Dairy Board into a company

Section 155 of the Dairy Industry Restructuring Act applies if the New Zealand Dairy Board becomes a company, registered under the Companies Act 1993, in terms of the Dairy Industry Restructuring Act. At present the Dairy Board is a corporate body established under the Dairy Board Act 1961.

The tax provisions in this section provide that the Dairy Board will cease to be a statutory producer board upon conversion. Furthermore, the converted Dairy Board will be entitled to claim a tax deduction for the unexpired portion of any accrual expenditure of the Dairy Board not claimed by the Board before it converts. Until the Dairy Board converts into a company, the voting interest and market value interests in the Dairy Board will continue to be determined by the provisions in section 15ZE of the Dairy Board Act (reference to qualifying milk solids). Clause 3 of Schedule 3 of the Dairy Industry Restructuring Act provides that the Dairy Board and the company to be registered will be the same person. This provision will be relevant for tax purposes.

Livestock Improvement Corporation

Section 156 of the Dairy Industry Restructuring Act deals with the tax issues associated with the establishment of the Livestock Improvement Corporation (LIC). It will be a co-operative company owned by the purchasers of its products and services. This Act requires the LIC to prepare a restructuring plan for the approval of the Minister of Agriculture. The restructuring plan is required to contain a share allocation plan for the LIC, a constitution that complies with the requirements of the Act, a proposed application for registration under the Co-operative Companies Act and a restructuring date.

Section 156(1) provides that the issue of shares by the LIC under the restructuring plan to the users of the LIC's products and services is not treated as a dividend for income tax purposes, or as a dutiable gift. The provision ensures that no tax implications arise on the issue of LIC shares as part of the restructuring plan.

When the restructuring plan is implemented, the shares in the LIC on issue immediately before the restructuring day will be cancelled and new shares issued in accordance with the share allocation plan. Section 156(2) provides that the ASC of the new shares issued will be equal to the ASC of the shares cancelled. This ensures that the ASC of the shares on issue is not forfeited upon the cancellation of the shares.

The LIC is currently exempt from income tax under section CB (4)(1)(g) of the Income Tax Act 1994 as a dairy cattle herd improvement association. Section 156(3), (4), (5) and (6) provides that if the LIC loses its tax-exempt status as a result of alterations to its constitution:

- It will become taxable from the beginning of the income year in which the alteration to the constitution takes effect. This avoids the need for the LIC to prepare two sets of financial accounts for tax purposes.
- There is a deemed sale and re-acquisition of the assets and rights of the LIC at market value at the beginning of that income year. This will allow the LIC a market value for its assets and rights for tax purposes, such as for depreciation purposes.
- The alteration of its constitution will not affect the tax-exempt status of the LIC in prior income years. However, this provision does not apply if the Dairy Board retains any interest in the LIC (unless it receives shares under the restructuring plan) so that any funds of the LIC will be used or will be available for use for the private pecuniary profit of the Dairy Board.

New Zealand Dairy Research Institute

Section 157 of the Dairy Industry Restructuring Act deals with the tax issues associated with the dissolution of the charitable trust known as the New Zealand Dairy Research Institute (DRI) and for the vesting of its assets and liabilities in the current trustee, which is a subsidiary of the Dairy Board. In particular, section 157 provides that:

- The company (the current trustee) acquires the assets and liabilities of the DRI on amalgamation date[3] for their market values. This will create a market value for its assets and liabilities for tax purposes such as for depreciation purposes.
- For the purposes of the Inland Revenue Acts, the company and the charitable trust are deemed to be same person.
- The removal of the trust's charitable purposes does not affect its tax-exempt status before the amalgamation date.
- For the avoidance of doubt, the vesting of the assets and liabilities of the trust in the company is not a dutiable gift.

Consequential amendments to the Income Tax Act 1994

Schedule 7 of the Dairy Industry Restructuring Act also makes a number of minor consequential amendments to the Income Tax Act 1994 relating to the Dairy Board.

Application date

Sections 151, 152, 153, 154 and 156 come into force on the amalgamation date. Section 155, except for subsection (4) which comes into force on the amalgamation date, applies on or after the conversion date (the date on which the Dairy Board converts into a company registered under the Companies Act). Section 157 comes into force on 27 September 2001 (the day after the Act received royal assent). The amendments in the Schedule 7 to the Income Tax Act apply from the conversion date.

[3] The amalgamation date is the date that amalgamation of the various dairy co-operatives becomes effective.

GOODS AND SERVICES TAX AMENDMENT ACT 2001 – EXEMPTION FOR VISITING FORCES

Introduction

A new provision exempts from GST goods imported by international organisations, visiting forces and other bodies temporarily based in New Zealand.

Background

The amendment grants an exemption from GST to consumables imported for the purpose of conducting military exercises. It also allows heavy weaponry to be retained in New Zealand for periods longer than the 12 months maximum usually granted by the New Zealand Customs Service to temporary imports.

The amendment is consistent with existing exemption privileges granted under the Tariff and Excise Exemption Orders 1996 to organisations and their personnel temporarily stationed in New Zealand, or attached to the New Zealand Defence Force.

Section 12 of the Goods and Service Tax Act 1985 is administered by the New Zealand Customs Service.

Key features

The new section 12(1A) in the Goods and Services Tax Act 1985 provides a GST exemption for organisations, visiting forces, expeditions, or other bodies that are:

- approved by the Chief Executive of the New Zealand Customs Service; and
- established or temporarily based in New Zealand under agreement or arrangement entered into between the Government of New Zealand and another State, the United Nations, or any other international organisation.

The exemption applies to goods that are imported and intended solely for the use of the organisation, visiting force, expedition, or other body; or for the use of a person who is temporarily resident in New Zealand for the purpose of serving as a member of such organisations.

Application date

The amendment applies from 27 September 2001.

CITIZENSHIP AMENDMENT ACT 2001

BIRTH, DEATHS AND MARRIAGES REGISTRATION AMENDMENT ACT 2001

Introduction

The Citizenship Amendment Act 2001 and the Birth, Deaths, and Marriages Registration Amendment Act 2001 authorise the disclosure of specified information to certain specified agencies for certain purposes.

Background

Previously, taxpayers requiring birth, death, marriage or citizenship information had to apply directly to the relevant registry. With the creating of information databases, Inland Revenue will be able to access the information, thereby lowering compliance costs to taxpayers.

Key features

The Citizenship Act 1987 has been amended by inserting section 26A. It allows the Commissioner of Inland Revenue to enter into an agreement with the Department of Internal Affairs for the disclosure of citizenship information for the following purposes:

- to verify the identity of a person to establish the tax file number of the person; or
- to verify the identity of a person to establish the details of an applicant for child support.

Citizenship information is information held by the Department of Internal Affairs relating to:

- the acquisition or loss of citizenship by any person; or
- the citizenship status of any person.

The Birth, Deaths, and Marriages Registration Act 1995 has been amended by inserting section 78A. The section allows the Commissioner of Inland Revenue to enter into agreement with the Registrar-General of Births, Deaths, and Marriages for the disclosure of birth information, death information and marriage information.

Birth and marriage information can be used to verify the identity of a person to establish:

- the tax file number of the person; or
- the details of an applicant for child support.

Death information can be used to identify deceased taxpayers and verify their details.

Application date

The amendments apply from 27 September 2001, the date of enactment.

INJURY PREVENTION, REHABILITATION, AND COMPENSATION ACT 2001

Introduction

The Injury Prevention, Rehabilitation, and Compensation Act 2001 makes a number of consequential amendments to tax legislation. It also provides for an information-matching programme to transfer certain information from Inland Revenue to the ACC to enable the ACC to determine liability for levies. The Act received Royal assent on 19 September 2001.

Background

The new Act is part of the second phase of the Government's strategy to return the provision of workplace accident insurance to the Accident Compensation Corporation (ACC). The new Act, among other things, makes injury prevention the primary function of ACC and reintroduces lump sum entitlements.

Key features

References in the Income Tax Act 1994, Tax Administration Act 1994, and the Goods and Services Tax Act 1985 to sections in the Accident Rehabilitation and Compensation Insurance Act 1992 and the Accident Insurance Act 1998 have been updated to refer to the relevant provisions in the new Act. Changes have also been made to the names of the premiums and levies, as shown in the box.

References in the relevant Acts to "combined tax and earner premium deduction" have been changed to "combined tax and earners' levy deduction".

Weekly compensation whether paid in instalments or as a lump sum under clause 67 of Schedule 1 of the new Act will continue to be taxable. Lump sum compensation for permanent impairment payable under clause 56 of Schedule 1 of the Act is not subject to income tax.

Exchange of information

Section 246 extends the instances where Inland Revenue can provide information to the ACC to enable it to establish liability to levies for employers, self-employed, private domestic workers and shareholder employees.

The Commissioner is currently the agent of the ACC for the collection of earner premium and residual claims levy and earner's account levy. Information collected by Inland Revenue in its agency capacity is the property of the principal (ACC) and can be transferred to the ACC. The information currently transferred on employers, self-employed persons, private domestic workers and shareholder-employees relates to their name, addresses, ACC file number, industry classification, liable income, and the date they became or ceased to be an employer, self-employed person, private domestic worker or shareholder-employee.

When Inland Revenue withdraws from the collection of return-based levies with effect from 1 April 2002, the agency relationship with regard to employers, self-employed, shareholder employees and private domestic workers will cease. At that point section 246 enables information to be transferred from Inland Revenue to the ACC by way of an information-matching programme as prescribed by the Privacy Act 1993, and the provisions and safeguards of the Privacy Act will apply.

New names for premiums and levies

Accident Insurance Act 1998	*Injury Prevention, Rehabilitation, and Compensation Act 2001*
Earner premium	Earner levy
Earners account levy	Earners' account residual levy
Self employed work account premium	Self-employed work account levy

If the ACC determines, from information received from the Commissioner, that a levy is payable, it will provide the individual concerned with a notice specifying the information received from Inland Revenue, the levy amount payable as well as the rights of the individual to object if the information is not accurate. Section 246(7) of the new Act provides that this notice satisfies the notice requirements of section 103 of the Privacy Act 1993.

The secrecy provisions of the Tax Administration Act preclude Inland Revenue from disclosing individual information unless specifically provided for. A new section has been inserted into the Tax Administration Act 1994, section 85E, to enable the disclosure of the information above once Inland Revenue is no longer responsible for collecting return-based levies.

Application date

The majority of the changes, including the changes to the Tax Acts, come into force on 1 April 2002.

NEW ZEALAND SUPERANNUATION ACT 2001

Introduction

The New Zealand Superannuation Act 2001 was enacted on 11 October 2001. The purpose of the Act is to:

- continue the current entitlements to New Zealand superannuation; and
- establish a New Zealand Superannuation Fund with sufficient resources to meet the present and future cost of New Zealand superannuation.

Background

New Zealand superannuation, before the coming into force of the New Zealand Superannuation Act, was funded on a "pay-as-you-go" basis. This means that entitlements were paid from general taxation. The Act establishes a New Zealand Superannuation Fund ("the Fund") to be administered by a Crown entity board (the Guardians of New Zealand Superannuation—"the Guardians"). The Act requires the Crown to make capital contributions to the fund. The purpose of the fund is to partially pre-fund New Zealand superannuation so that it is easier for future governments to meet the cost of New Zealand superannuation. The Crown is also required to make other contributions to the fund each year to ensure that it has sufficient money to meet the net cost of New Zealand superannuation entitlements that are payable out of the fund for the year.

The Act contains a specific provision dealing with taxation of the fund and the guardians.

New Zealand superannuation payments will continue to be taxed at source.

Key features

Section 76(1), (2), (3) and (4) of the New Zealand Superannuation Act deals with the income tax treatment of the fund. The income derived by the fund from its investments is treated as gross income, and the fund is able to claim a deduction for any allowable deduction under section BD 2 of the Income Tax Act 1994. The fund is treated as a company for tax purposes, although it is not required to establish and maintain an imputation credit account.

Section 76(5) of the New Zealand Superannuation Act treats the guardians as a public authority for the purposes of the Inland Revenue Acts. This means that the guardians are exempt from income tax.

Schedule 5 of the New Zealand Superannuation Act makes a number of consequential amendments to the Child Support Act 1991, the Income Tax Act 1994 and the Taxation (Remedial Provisions) Act 1996. These consequential amendments are due to the existing entitlement provisions for New Zealand superannuation being re-enacted in the New Zealand Superannuation Act.

Application date

Except for the provisions relating to the capital and other contributions to the fund, the Act came into force on 12 October 2001 (the day after it received Royal assent). Sections 42 to 45 (relating to capital and other contributions to the Fund) apply in relation to the financial year beginning on 1 July 2001.

GOVERNMENT SUPERANNUATION FUND AMENDMENT ACT 2001

Introduction

The Government Superannuation Fund Amendment Act 2001, enacted on 21 August 2001, establishes the Government Superannuation Fund Authority as a public authority. The authority's functions are to manage and administer the Government Superannuation Fund and, at the Minister's direction, to provide services in respect of any fund or superannuation scheme that is managed by the Crown and approved by the minister for that purpose.

Background

The purpose of the Act was to restructure the governance arrangements of the Government Superannuation Fund. Previously the superintendent of the Government Superannuation Fund administered it, and the property of the fund was held in the name of a custodian appointed by the Minister of Finance.

Key features

Section HJ 1 of the Income Tax Act 1994 has been amended by replacing "the custodian" with "the Government Superannuation Fund Authority". The authority will continue to be taxed as if it were a trustee of a Superannuation fund.

The Child Support Act 1991 has also been amended. In section 186(1)(b)(i), the "the Superintendent" has been replaced by "the Government Superannuation Fund Authority".

The property and liabilities held by the custodian or the superintendent, including the investments of the fund and any other property of the Crown will be transferred to the "authority". The authority will be treated as if it were a trustee substituted for the custodian of the fund acting in the capacity of trustee, and the same person as that custodian. The transfer of the property and liabilities does not give rise to a tax liability to GST, income tax and gift duty.

Application date

The Act came into force on 2 October 2001.

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 LEGAL EXPENSES WERE INCURRED IN CARRYING ON OF A BUSINESS ACTIVITY

Case: William L Inglis v CIR

Decision date: 19 October 2001

Act: Income Tax Act 1994

Keywords: Deduction, legal expenses, employment, business reputation, apportionment

Summary

This case concerned an appeal by the taxpayer against a decision of the Taxation Review Authority ("TRA") which was reported as Case V6 (2001) 20 NZTC 10,072.

Facts

From January 1995 until October 1997 the appellant was in employment as a business planning consultant up to the time of his dismissal on 23 October 1997 on the basis of redundancy. There followed a series of acrimonious disputes between the appellant and his employer whereby the appellant commenced proceedings against the employer seeking an order for reinstatement. The injunction was declined and the matter proceeded to four further personal grievance hearings in the Employment Tribunal, Employment Court and Court of Appeal. The appellant incurred legal expenses in excess of $100,000 during the 1998, 1999 and 2000 income years. He sought to claim those expenses as a deduction in respect of a four month period of business activity which he claimed existed from the date of his dismissal to 1 March the following year.

The TRA found that the appellant had in fact been in business during that period, however, there was insufficient nexus between the outgoing for which a deduction had been claimed, and the business activity itself. In the TRA Judge Willy held that there was no intimate connection between the legal actions which primarily sought reinstatement to his former position, and the business activity which was held to exist over that period.

The appellant appealed against the decision of the TRA on the basis that sufficient nexus did exist and the Commissioner cross-appealed in respect of the business activity itself.

Decision

Nexus with Business Activity

Doogue J proceeded on the basis that a business did exist as found by the Authority. After noting that the appellant sought to rely on section BD2(1)(b)(i) of the Act and that, as the only gross income he had derived had been in respect of previous and subsequent employment, there was no need to address the issue any further. He then moved on to the next sub-section, BD2(1)(b)(ii), and whether the expenses were necessarily incurred in the course of carrying on the business found by the TRA. His Honour gave consideration to the appellant's submission that the motive for taking such action against his previous employer was solely to preserve his reputation in the market place thereby allowing him to conduct the business. There was some evidence, albeit anecdotal, before both Courts that his previous employer had sought to smear the appellant's reputation.

His Honour considered the evidence which had been placed before the Authority and the High Court in these proceedings. He reached the conclusion that throughout the appellant's entire proceedings against his previous employer he had primarily sought reinstatement as a remedy and his evidence before the Employment Court and his actions in refusing long term projects during his alleged period of "business" indicated a dominant motive of reinstatement.

"All these actions were only consistent with reinstatement and were inconsistent with steps in respect of any business activity, as it is inconceivable that such steps had occurred in any meaningful way during that period. The legal costs in respect of the injunction proceedings could lead only to reinstatement. They could not possibly relate to the proposed business activity. While the legal costs in respect of the Employment Tribunal proceedings may be more arguable, they were clearly motivated in the first instance by a desire for reinstatement and not by any need to protect reputation."

His Honour then found that, given those circumstances, it would have been impossible for the TRA to have concluded, even given its determination in favour of the appellant in respect of his carrying on a business, that the legal expenses were necessarily incurred in the course of carrying on the business activity.

His Honour found that this was enough to dispose of the appeal but considered, obiter, other issues raised before him, which had been traversed by the TRA and raised in cross appeal.

Apportionment

In the TRA Judge Willy had found that even if there had been some portion of the legal expenses which had sufficient nexus with the business, the disputant in those proceedings would have failed in that he had proceeded on an all-or-nothing basis. Justice Doogue agreed and held that if it had been necessary he would have upheld the TRA's findings on this issue.

The appellant claimed that the Commissioner was prevented from raising apportionment as an issue as it had not been disclosed as such in his Statement of Position and thereby prevented from subsequently introducing the matter by virtue of section 138G of the Tax Administration Act 1994.

His Honour noted, however, that the onus was on the appellant to firstly establish that the expenditure was deductible and that, if so, to what extent it was deductible.

"It was a necessary part of the appellant's case to establish which part of the expenditure was deductible."

In so deciding, His Honour cited Commissioner of Inland Revenue v Banks [1978] 2 NZLR 472 (CA) and Buckley and Young Limited v Commissioner of Inland Revenue [1978] 2 NZLR 485, 498.

His Honour expanded on the appellant's second point that the expenditure had no dual character, related entirely to preservation of his reputation as a business expense, and was therefore deductible on a "all or nothing" basis. He noted that some of the receipts related to expenditure which clearly fell outside the period of business and that apportionment was inevitable.

He noted that the appellant had also sought employment in that period and that even if he were correct about the proceedings being for the protection of reputation, that would have related to his employment opportunities as well as business.

Business

His Honour dealt very briefly with the cross appeal noting that having regard to the conclusions already reached it was unnecessary to enter upon it in any detail.

"The TRA certainly seems to have taken a generous approach to the position of the appellant. For myself I would have doubted whether the evidence went any further than establishing preparatory activities, if that, in relation to a business."

His Honour noted that some evidence before the TRA provided a basis for the Authority to find as he did and therefore the Court would be necessarily reluctant to interfere with the factual determinations of a specialist tribunal.

Other Matters

In case the Court had wished to traverse the issues, the Commissioner made submissions regarding other exclusions under section BD2(2) of the Act; that the expenditure in any event had characteristics of private expenditure, expenditure incurred in deriving income from employment, or was in the character of capital. His Honour concurred that it was certainly arguable that each of those arguments could have applied to the expenditure incurred by the appellant but in any event it was not necessary to decide.

"Unlike other cases the legal expenses clearly did not arise out of the carrying on of the business activities of the appellant, and they were not related to any business in that way."

OTHER ITEMS OF INTEREST

FINALISED GUIDELINES FOR THE VALUATION OF NURSERY STOCK

Tax Information Bulletin Vol 13, No 6 (June 2001) set out a draft administrative interpretation on how nursery plants could be valued for trading stock purposes. We asked for your views on that draft and said that once finalised, the interpretation would apply from the 2001-2002 income year and would succeed the one in place since the introduction of the new trading stock rules. The draft administrative interpretation aimed to minimise compliance costs while ensuring that nursery stock is valued accurately under the trading stock rules.

The response to the draft was very positive and did not raise any issues which require it to be altered. Therefore, we have decided to adopt the administrative interpretation without making any further changes to it.

Nursery growers who are eligible to use Discounted Selling Price (DSP) to value nursery stock can use the industry-wide category approach set out below to apply the DSP method to value their nursery stock. The interpretation is valid for the 2001–2002 income year and subsequent years. As we said in June, most nursery growers should be eligible to use DSP and criterion for eligibility is set out in sections EE 8, EE 9 and EE 10 of the Income Tax Act 1994.

Nursery growers who prefer to calculate their own discounted selling prices will still be able to do so. They will need to keep records that justify their valuations.

Taxpayers not eligible to use the DSP method will have to value their stock at cost (using a cost valuation method) or at market selling value.

The administrative interpretation adopted here reflects the best information available at this time for the valuation of nursery plants at cost or market for small growers. Future changes to the underlying costs incurred, and practices, in growing nursery plants for sale will require this interpretation to be reviewed.

This interpretation does not apply to plants in the ground because, for tax purposes, they are part of the land in which they grow and are thus not trading stock.

Thanks

We would like to thank the growers and their advisors who have participated in the consultation process and the Nursery and Garden Industry Association and its members for their work in developing the draft interpretation.

Guidelines for using discounted selling price to value nursery stock

Nursery plants have been divided into seven categories. The DSP of mature plants in each category would be calculated by multiplying the selling price of the plant by the DSP value.

Type of stock	*DSP value*
Bedding plants	58%
House plants and roses	55%
Liners/plugs	52%
Shrubs and perennials	48%
Trees	42%

Example

A nursery has 500 mature rose plants on hand at balance date. The nursery sells their mature roses to a retailer for $15 each. The value of that stock for trading stock purposes is $4,125 (500 plants x $15 x 55%).

Immature plants

It is proposed to calculate the DSP of immature plants my multiplying the DSP of a mature plant by a ratio of the whole years of completed growth to the number of whole years the plant takes to reach maturity.

Example

Another nursery has 500 13-month-old flax plants and 300 25-month-old flax plants on hand at balance date. The flax plants take three years to mature and sell for $10 each.

The value for the purposes of the trading stock rules of the 1-year-old plants would be $800 (500 plants x $10 x 48% x 1/3); and the 2-year plants would be $960 (300 plants x $10 x 48% x 2/3).

Over-mature plants

It is proposed to value plants past their prime, or whose value drops, by multiplying their revised market value by the DSP value. The revised market value is the actual price at which the grower expects to sell a plant in that condition.

On the other hand, plants that are scrapped are effectively no longer part of a grower's business and therefore they should not have any value as trading stock. The particular treatments proposed for different circumstances are illustrated in the following table.

Circumstance	*Treatment*
The market selling value drops for a particular stock item, or there is no demand for the item, and the stock is scrapped	Nil value
The market selling value drops for a particular stock item, or there is no demand but stock is not scrapped	DSP based on revised market value
Plant is damaged and left in a "bargain area"	DSP based on revised market value
Plant is irrecoverably damaged and is scrapped	Nil value
Plant is over-mature and is scrapped	Nil value
Plant is over-mature and is not scrapped	DSP based on revised market value

Example

A third nursery business has 400 mature but frost-damaged Kahikatea plants at the back of its nursery. Mature plants are normally sold for $30 each. The frost-damaged items are being offered for sale at $20. The value of these plants for trading stock purposes is $3,360 (400 plants x $20 x 42%).

CORRECTION TO PREVIOUS ARTICLE

In *TIB* Vol 13, No 10 (October 2001), there was an item with exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand currency under the CFC and FIF rules for the 6 months ending 30 September 2001.

The tables contained errors in the mid-month and 12-month cumulative tables for some countries. The correct rates are:

United Kingdom

The mid-month rate for 15 August should read 0.3011

The 12-month rate for 15 August should be 0.2908

The 12-month rate for 17 September should read 0.2900

Australia

The mid-month rate for 15 August should be 0.8234.

The 12-month rate for 15 August should be 0.7941

The 12-month rate for 17 September should be 0.7990

Germany

The mid-month rate for 15 August should be 0.9325

The 12 month rate for 15 August should be 0.9221

The 12 month rate for 17 September should be 0.9181

We apologise for any inconvenience caused by these errors.

REGULAR FEATURES

DUE DATES REMINDER

DECEMBER 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

JANUARY 2002

15 **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

GST return and payment due (for 30/11/01)

21 **Employer deductions**

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

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

Employer deductions and Employer monthly schedule

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

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

FBT return and payment due

31 **GST return and payment due** (for 31/12/01)

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

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

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

By internet: Visit **www.ird.govt.nz**
On the homepage, click on "Rulings' exposure draft items are available for comment". Below the heading "Think about the issues", click on the drafts that interest you. You can return your comments by the internet.

Name ________________________________

Address ________________________________

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	Draft standard practice statement	*Comment deadline*
☐	ED0026: Retention of business records by taxpayers	3 December 2001
	Draft public ruling	*Comment deadline*
☐	PU3855: Fishing quota and secondhand goods	11 January 2002

Items are not generally available once the comment deadline has passed

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