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This TIB has no appendix

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

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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.

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THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft item is available for review/comment this month, having a deadline of 28 February 2002.

Ref.	Draft type	Description
ED0025	Standard Practice Statement	Voluntary disclosures

Please see page 21 for details on how to obtain a copy.

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 01/17 – CORRECTION

Two errors in statutory nomenclature have been identified in BR Prd 01/17. These errors are classified as "minor errors" under section 91 GI of the Tax Administration Act 1994. The Commissioner is therefore not required to withdraw the ruling and issue a replacement ruling. The original ruling has been corrected.

In the sixth bullet point of "How the Taxation Laws Apply to the Arrangement", the words "assessable income" should be read as a reference to "gross income".

The paragraph, as corrected, reads:

- Any distribution of category B income to category B unitholders is included within the definition of "beneficiary income" as defined in section OB 1, and is included in the gross income of the unitholder under section HH 3(1).

In the eighth bullet point of "How the Taxation Laws Apply to the Arrangement", the words " not assessable" should be read as a reference to "not gross income".

The paragraph, as corrected, reads:

- The amount paid to category B unitholders on the redemption of units is not gross income to the unitholders under section HH 3(5), to the extent that it does not include any "beneficiary income".

NEW LEGISLATION

CHILD SUPPORT AMENDMENT ACT 2001

Introduction

Three main changes will:

- increase the minimum payment for formula assessments,
- increase the maximum income level used in formula assessments, and
- clarify earlier changes to the income year used to assess child support under formula assessments.

The most significant of several consequential changes is an increase to the income threshold that determines eligibility for an exemption.

The amendments to the minimum amount payable and the maximum income amount reinforce one of the underlying principles of the child support scheme that all parents should contribute to the financial support of their children.

Background

Legislation introduced in the Child Support Amendment Bill in June 2001 was enacted on 6 November 2001.

The minimum rate of child support had not been adjusted since October 1990, when it was last set. Although the maximum income amount had changed annually in line with movement in the average wage, the cap at twice the average ordinary time weekly wage had prevented a significant number of custodians from receiving an appropriate contribution towards the cost of raising their children.

The new legislation has also fine-tuned 1999 amendments to the relevant income year for assessments, which did not accurately reflect the policy intent.

Application dates

The amendments to the minimum rate and the maximum income level will take effect from the child support year beginning 1 April 2002.

As the changes relating to relevant income year correct amendments to the Act that came into force on 1 April 2001, these remedial changes apply to the child support year that began on that date (and subsequent child support years).

Key Changes

The minimum child support payment under a formula assessment is to increase from $520 a year to $663 a year, an increase of $2.75 in the weekly payment, effective for the child support year beginning 1 April 2002.

The amendments also provide for an annual adjustment in the minimum payment to reflect CPI movement in the previous calendar year.

A consequential change increases the investment threshold that determines entitlement to an exemption from child support liability for long-term hospital patients and prisoners.

The maximum income amount used in a formula assessment is to increase from twice to 2.5 times the average ordinary time weekly wage.

The remedial amendments fine-tune the 1999 amendments to the Child Support Act 1991, so that they correctly provide that liable parents' assessments of child support are based on their previous year's income if their income in that year was from salary, wages, interest or dividends.

Assessments for liable parents who received other types of income in the previous year, including those who received withholding payments, are to be based on their income from two years earlier.

Detailed Analysis

Minimum rate of child support

Child Support Act, sections 72 (main amendment), 29, 41, 73, 75, 98, 110 and 112

The increase in the minimum payment of child support reflects the actual and predicted movement in the consumer price index (CPI) from October 1990 to April 2002. The increase restores the real value of the minimum payment and ensures that the relativity is maintained in the future.

The relativity will be achieved for the child support year beginning 1 April 2003 by adjusting the $663 minimum from the previous year by the movement in the CPI in the nine months ending 31 December 2002.

For following child support years, the minimum annual rate applying in the previous child support year will be adjusted by the movement in the CPI in the immediately preceding calendar year.

The investment income threshold that determines entitlement to an exemption will be linked to the relevant minimum amount payable so that it will also adjust annually in line with CPI movements. However, the new threshold will not apply to orders and agreements that are not affected by changes to the minimum amount. The increased threshold will ensure that those liable parents who do not qualify for the exemption do have sufficient income to meet their weekly child support liability.

Departure orders and administrative determinations made before 7 November 2001 will not be affected by the new minimum even if they apply after 1 April 2002. However, liable parents or custodians affected by them can apply for a new order or determination.

New departure orders and administrative determinations made on or after 7 November 2001 that relate to the child support year beginning 1 April 2002 and subsequent years must be set so that they are never less than the relevant minimum amount as it adjusts each year.

These changes do not affect the minimum rate of spousal maintenance orders, child maintenance orders and voluntary agreements. These minimum rates will remain at $520 per year ($10 per week).

Maximum income level for assessment of child support

Sections 29, 38A and 39

The increase in the maximum income level is to 2.5 times the average ordinary time weekly wage (as published by the Department of Statistics) as at mid-February in the income year immediately preceding the most recent income year. The increased amount will allow children to benefit from liable parents' income as they would if they were living together without taking the maximum so high that it becomes a disincentive to pay. It also brings that aspect of the New Zealand child support scheme into line with the Australian scheme on which it was modelled.

Remedial amendments relating to relevant income year for assessments of child support

Sections 2, 29 and 38A

Liable parents whose income in the year immediately before the child support year was from salary, wages, interest or dividends will have their child support assessment based on that income as was intended in the 1999 amendments.

Liable parents who received other types of income in the previous year will have assessments based on their income from two years earlier. This will include those who received withholding payments to enable them to claim the deductions to which they are entitled under tax law.

The changes affect the definition of "last relevant income year" as it applies throughout the Act and will validate assessments that were issued for the year that began on 1 April 2001.

A savings provision has been included, however, to allow a liable parent to continue to have the benefit of an amended assessment, if the assessment relates to the year that began on 1 April 2001, and was amended following an objection that the liable parent's income amount in the assessment was incorrect, because it was based on income from the wrong year. The objection must have been made before 12 June 2001 (the date the bill was introduced).

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

SIX-MONTHLY GST RETURN THRESHOLD GNL – 420

Introduction

This Standard Practice Statement (SPS) provides guidelines on how Inland Revenue will exercise the discretion to allow registered persons to remain, or become, six-monthly return filers (category C return filers) for goods and services tax (GST) purposes where the value of annual taxable supplies exceed $250,000.

The SPS outlines the principles behind the legislation and how they will be applied by Inland Revenue when considering applications from registered persons.

Application

This SPS applies from 1 January 2002.

Summary

Inland Revenue will exercise the discretion to permit registered persons to remain, or become, category C return filers providing they meet the three cumulative tests as follows.

- Have a good compliance history
- Have satisfactory record keeping practices and the cost of more regular filing would be excessive
- Their turnover is subject to seasonal or low volume/high value cashflow peaks.

Background

The Government recognises that filing on a two-monthly basis once the value of taxable supplies exceed $250,000 may involve significant compliance costs for registered persons. These costs can be disproportionately high when balanced against the cost to the Government in revenue terms. Registered persons will be permitted to remain, or become, category C return filers where their compliance history and the nature and volume of the supplies do not warrant them filing GST returns on a more regular basis.

For the purpose of this Standard Practice Statement

Compliance costs are broadly described as time and expense borne by registered persons complying with their obligations under the GST Act 1985.

Compliance costs include time spent collecting GST on behalf of the Crown, associated record keeping requirements, and time spent completing returns where such time could have been spent elsewhere by registered persons. Compliance costs also include organising business practice to cater for GST obligations and disruption to operations when persons are required to attend to GST administrative matters.

Compliance risk is an evaluation by Inland Revenue as to the performance by registered persons with meeting their GST obligations; such as their ability to provide complete and accurate returns on time, pay related GST liabilities by due dates and have adequate business records and controls in place.

Legislation

Section 15A(1AA) of the GST Act 1985 provides:

"The Commissioner may, on written application by a registered person who falls within any one of categories A, B or D, direct that the registered person be placed within category C after considering the following factors:

(a) the person's history of filing and paying tax:
(b) the person's record keeping practices:
(c) whether the person has been placed within category C before:
(d) the nature and volume of the person's taxable supplies."

Section 2(1) of the GST Act 1985 defines "Tax" as being goods and services tax.

Standard Practice

Section 15A(1AA) factors

Four factors are prescribed under section 15A(1AA) of the GST Act 1985, which Inland Revenue is required to consider when deciding applications. The four factors are:

1. *The registered person's history of filing and paying tax.*

   Performance by registered persons in filing completed returns and making payments of their GST liability by due dates will be instrumental indicators as to whether they pose a compliance risk.

Where compliance by registered persons meets the standard of reasonable care, Inland Revenue will view this factor as having been met. As the word "tax" is to be read as GST as defined under section 2 of the GST Act 1985, a registered person's compliance history for other tax types is not relevant when considering this factor.

Registered persons who:

- have not met their tax obligations e.g. they are in arrears for GST, and/or have outstanding GST returns, regularly file late or file incomplete or inaccurate GST returns, and
- do not have an arrangement in place to rectify their compliance obligations, prior to Inland Revenue receiving an application from them to remain, or become, a six-monthly return filer,

are likely to have their application declined due to the future compliance risk.

2. *The registered person's record keeping practices.*

Inland Revenue will look at the quality of current record keeping practices to gauge the compliance risk related to registered persons being able to prepare accurate six-monthly returns. In addition, Inland Revenue will have regard to compliance costs registered persons are likely to incur should they be required to change to, or remain in, a more regular return filing category.

Features Inland Revenue will consider are:

- the standard of current record keeping systems
- the ability of the registered person to compile accurate GST returns from those records, and
- the potential compliance costs to upgrade systems to file more regular returns.

Note: Some costs in changing to a more regular return filing category will usually be necessary. Where costs likely to be incurred as a proportion to the overall business operational costs are excessive, or likely to cause unreasonable disruption to the operation of a taxable activity, Inland Revenue will look at whether registered persons should be allowed to remain, or move to, the six-monthly return filer category. Where persons have not maintained adequate business records, Inland Revenue will require them to upgrade their accounting system and is likely to place them on a more regular return basis having regard to the compliance risk.

Inland Revenue may refer to observations by staff of record keeping practices during previous contact with a registered person, or may perform brief enquiries in the absence of such information being held, prior to deciding applications.

3. *Whether the registered person has been placed within category C before.*

This factor considers whether registered persons have previously been on a six monthly filing basis. This factor is looking at the compliance cost of changing to a more regular return filing category, or for persons to remain in such a category. Where previous category C return filers, who currently file monthly or two-monthly returns, can demonstrate they experience significant additional compliance costs by having to provide more frequent returns, applications to shift back to the six-monthly category will be considered.

The provisions under section 15A refer to change in registered person's taxable period and by implication, apply to established registered persons. New registration cases, which have no established GST compliance history, will generally not be allowed by Inland Revenue to commence as category C return filers where their projected value of taxable supplies for the following 12 month period exceed the $250,000 threshold.

4. *The nature and volume of the registered person's taxable supplies.*

Inland Revenue will look at the nature and volume of annual taxable supplies that exceed the $250,000 threshold.

Where the breach of the threshold is due to a steady uplift in the value of taxable supplies made through much of the year, and the future supplies are likely to remain at a static level over the $250,000 threshold, registered persons are likely to be directed to shift to a more regular return filing category.

Where the breach of the $250,000 threshold is due to a seasonal fluctuation of taxable supplies, or low volume/high value taxable supplies, which peak at the end of a return period and/or within a 12 month period to create a distortionary effect on the regular cashflow pattern, Inland Revenue is likely to allow registered persons to remain, or move to, the six-monthly return filer category.

Note: An example of low volume/high value taxable supplies is a computer software developer who may not produce many products during any 12 month period.

Applications

Applications from registered persons are to be in writing, giving reasons why they should remain, or become, a category C return filer. Applications should specifically address the following criteria:

- that they have a good compliance history
- their record keeping practices must have adequate capability to cope with the filing of six-monthly returns
- the cost of remaining or changing to a more frequent return basis would be excessive when compared to the overall business structure; and
- the value of annual taxable supplies is largely influenced by seasonal or low volume/high value taxable supplies which create a distortionary impact on regular cashflow trends of the taxable activity.

Confirmation

Decisions on whether persons can remain six-monthly return filers will be conveyed by letter.

Where applications have been declined, reasons will be given for not allowing registered persons to remain, or become, six-monthly return filers. Further, where registered persons are directed to file GST returns on a more regular basis, they will be given the option of returns ending either on odd or even month periods.

Examples

The following examples aim to provide an understanding of how Inland Revenue will generally consider the factors in the following case scenarios.

Example One

Jack B is an apple grower who has purchased a neighbouring orchard to expand his taxable activity. Jack B travels overseas extensively as part of promoting his goods to potential overseas markets and as a consequence, is absent from the office much of the time. Having regard to the seasonal aspect of growing apples, Jack B would like to remain on the six-monthly return filing basis. With the upturn in sales from his direct marketing activities, the business turnover has increased to $1.2 million and is likely to be sustained in future years. Jack B applies to Inland Revenue to continue as a six-monthly GST return filer.

Jack B's application is considered by Inland Revenue as follows:

- **The registered person's history of filing and paying tax**

  Jack B. has a good compliance history of filing returns on time (two late returns since registered for GST back in 1985) which were completed and processed as self calculated. Jack B. has income tax arrears which are being repaid by an instalment arrangement with Inland Revenue.

  Two late returns over 15 years of registration does not present Jack B. as a compliance risk. Jack B.'s income tax position has no relevance to the factors Inland Revenue is required to consider; arrears for other revenues do not have any bearing on applications received. Compliance for GST purposes is very good and the application satisfies this factor.

- **The registered person's record keeping practices**

  The present record system is organised using a PC program package designed to produce GST return figures on a six-monthly basis, although the system can also produce monthly financial cash flow reports. Jack B. looks after the tax and financial reporting duties and employs an office clerk to look after the day to day needs using a petty cash float for unforeseen or minor expenses. The majority of sales are from exports for which Jack B. maintains the book work. To require him to employ an accountant or an experienced accounts clerk to prepare GST returns on a more regular basis would be an unnecessary expense and an unfair burden on his business as Jack B. can attend to such matters when he is present in New Zealand. In addition, Jack B. is reluctant to provide cheque signing authority to an employee or agent in his absence as he wants to maintain direct control over the business finances.

  Inland Revenue will consider the nature and volume of supplies related to his taxable activity, in determining whether systems and practices should change to provide more frequent GST returns. Regard will also be given to any potential disruption to Jack B.'s business schedule and associated compliance cost. For current return purposes, the present record practice is adequate for Jack B. to comply with his obligations as a six-monthly return filer.

- **Whether the registered person has filed on a six-monthly basis in the past**

  Jack B is on a six-monthly return basis and would like to remain so.

- **The nature and volume of the registered person's taxable supplies**

  Jack B. enters his goods for export directly to overseas markets around the months of March to May each year. Jack B. wants to remain a six monthly filer to avoid disruption to his business activities and minimise time spent attending to GST matters during the peak of his export season.

Conclusion

Jack B. satisfies the criteria to remain on a six-monthly return filing basis. His compliance record is good and his current record keeping practices or systems are sufficient to enable him to comply with his GST obligations without presenting any significant risk as to future compliance. To require him to shift to a more frequent return filing basis would cause considerable disruption to the operation of the taxable activity, so Inland Revenue will exercise its discretion to allow Jack B. to remain a six-monthly return filer. A pertinent factor is also the seasonal nature of his business. Allowing Jack B. to remain a six-monthly filer avoids any extraordinary disruption to the arrangement of his business operation and seasonal export activities.

Example Two

Anne G. operates a craft shop selling gifts and homeware goods to her local community. With the development of tourism in the community, coaches regularly stop at her craft shop for souvenirs and as a result Anne G. has expanded her activity to include a licensed café. Anne G. phones the Inland Revenue Call Centre to advise the value of her annual taxable supplies is likely to be $300,000 plus and asks Inland Revenue to permit her to remain a six-monthly return filer.

Anne G. is advised by the Call Centre of the factors that will be looked at by Inland Revenue and is asked to place her request in writing as required by legislation. Upon receipt of the written request, Inland Revenue considers her case as follows:

- **The registered person's history of filing and paying tax**

  Anne G's compliance history with her GST obligation to file returns and pay GST by due date is impeccable. Her application satisfies this factor.

- **The registered person's record keeping practices**

  The expansion of the craft shop activity to include a licensed café requires Anne G to upgrade her business records to keep track of the diversified activities under the one business structure. Anne G has automated her sales system with the introduction of the café service so she can keep track of the increased volume of sales and minimise her time in maintaining records.

  The computerised cash book software has the ability to provide roll-up figures on command, of sales, purchases, and adjustments for goods taken for own use. Inland Revenue is satisfied the revised accounting system is adequate for business purposes and no significant issues arise in regard to future compliance ability.

  The application satisfies this factor.

- **Whether the registered person has filed on a six-monthly basis in the past**

  Anne G has been a six-monthly return filer to date.

- **The nature and volume of the registered person's taxable supplies**

  While the tourism industry may be subject to seasonal fluctuations, the development of the licensed café has a projected steady monthly turnover in excess of $25,000 for the taxable activity over the next twelve months.

  As there is no marked seasonal fluctuation and the average projected monthly turnover exceeds the $250,000 threshold, Anne G's application will not satisfy this factor.

Conclusion

Anne G. has upgraded her record system to facilitate the introduction of her expanded business activities and has the ability to provide information for GST returns on a more regular filing basis without incurring any significant additional compliance costs. As the higher value of taxable supplies stem from increased regular monthly sales, and do not represent a seasonal or low volume/high value taxable supply situation, the application would be declined. Anne G. will be directed to adopt a more regular return basis.

Example Three

Peter and Sue Y. left the busy city lifestyle to settle into semi retirement at a secluded part of the country. To supplement the Ys' income, Peter and Sue operated a bed and breakfast homestay with fishing excursions and bush walks for visitors. In year two of their activity, they established a web site to attract overseas visitors and increase their retirement income. Demand from overseas tourists was such that the homestay developed into a lodge for tourists that are more affluent. Peter and Sue Y. predict that the value of annual taxable supplies from bookings will exceed $250,000 in the next twelve months and have made an application to register for GST. The partnership seeks Inland Revenue's permission to file six-monthly GST returns to minimise time and cost related to record keeping requirements.

- **The registered person's history of filing and paying tax**

  The partnership is a new GST registration and has no compliance history for GST purposes. Any compliance history for other tax types is not relevant to the application for GST.

  This factor is not able to be ascertained in the absence of any history.

- **The registered person's record keeping practices**

  There is no established record keeping practice as the previous homestay activity was treated as a hobby rather than a business. Inland Revenue may enquire as to what accounting system will be used and how they propose to retain business records.

  Whether they meet this factor will depend on whether Inland Revenue is satisfied the registered person has adequate systems in place to meet their future GST obligations.

- **Whether the registered person has filed on a six-monthly basis in the past**

  The partnership is a new GST registration and has not filed returns on a six-monthly basis.

- **The nature and volume of the registered person's taxable supplies**

  While the lodge is open for business throughout the year, bookings by overseas tourists are heaviest for the warmer climatic period of November to February. The turnover is largely influenced by a seasonal fluctuation of guests.

  The partnership application would meet this factor.

Conclusion

The legislation provides Inland Revenue some flexibility to make a compliance cost concession where existing registered persons do not represent any compliance risk. In the absence of an established GST compliance history, Inland Revenue will need to be satisfied there will be adequate accounting and record keeping systems in place to enable the partnership to comply with its future GST obligations. While the seasonal nature of the taxable activity would generally meet the last factor, the provisions of section 15A apply to established registered persons seeking change. On this basis, Inland Revenue would direct the registered person to commence on a more frequent return basis. Should the partnership seek to change the return filing category once they have established a return filing and compliance history, Inland Revenue will consider the application.

Margaret Cotton

National Manager Technical Standards

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.

CORRECT METHOD OF APPEALING CHALLENGE-BASED DECISIONS OF TRA

Case:	CIR v Dick and Grierson
Decision date:	31 October 2001
Act:	Income Tax Act 1976
Keywords:	*Charity, assessable income*

Summary

The CIR was successful in his appeal from the Taxation Review Authority decision reported at *Case T50* (1998) 18 NZTC 8,346

Facts

A businessman established the taxpayer trust in 1987 as a charitable trust which assisted people to gain vocational training. The businessman's solicitor drafted the trust document and was initially the only trustee. The intention in setting up the trust was that the trust would run gaming machines, and use the resulting income to assist people in gaining vocational training. The appropriate gaming machine licence was issued in 1988. The Commissioner treated the taxpayer as a charitable trust for the purposes of the Stamp and Cheque Duties Act 1971 and the Estate and Gift Duties Act 1968 and issued it with an exemption certificate for interest earned at source. The Commissioner later became concerned that the trustee and businessman were deriving benefits from the trust's property transactions, and adopted the view that the taxpayer's income was not exempt from tax.

Decision

Glazebrook J held that:

- The taxpayer was a charity.
- The trust's purposes were not limited to New Zealand. While all donations made so far were for purposes in New Zealand, there was retained income and a fair apportionment basis had to be ascertained. This aspect remitted to TRA.
- The trustees and settlor derived benefits from the trust such that it should be taxed on business income.

"FEES" PAID BY TAXPAYER TO SUBSIDIARY WERE CAPITAL IN NATURE AND NON-DEDUCTIBLE

Case:	Mainzeal Holdings Ltd v CIR
Decision date:	22 November 2001
Act:	Income Tax Act 1976
Keywords:	*Capital, revenue, fees, loan, joint venture agreement*

Summary

The Court of Appeal upheld the High Court finding that the Commissioner was correct to disallow the deductions claimed by the taxpayer.

Facts

Mainzeal Holdings Limited ("Mainzeal NZ") claimed deductions for amounts paid to its Australian subsidiary ("Mainzeal Aust") in the 1986 and 1987 income years.

Mainzeal Aust was a property developer that was having cash flow difficulties. Pursuant to an agreement dated 11 July 1986 Mainzeal NZ made payments ("fees") to Mainzeal Aust to cover certain

expenses on two projects (Strathpine and Gregory). Under the terms of the agreement, upon the sale of the developments, any profits were to be first paid towards the fees paid as reimbursement, and secondly split 50/50 between Mainzeal NZ and Mainzeal Aust.

Upon sale of the developments no profits arose. Mainzeal therefore claimed the payments as deductible for tax purposes in the 1986 and 1987 years.

Decision

The Court of Appeal stated that it was not enough for the appellant to point to its existing business as a property developer and to clauses in the agreement about the proposed division of profits if the surrounding circumstances at the date of the agreement were not consistent with any expectation of profit from the venture.

"It can be accepted that the taxpayer had under the agreement a legal entitlement to any profits which might be earned. But it must show that it actually had an intention or purpose of profit making from the joint venture when it entered into the agreement. Unless that was the position, the payments cannot be regarded as necessarily incurred as part of its business as a property developer."

The Court went on to state that lack of a reasonable prospect of profit may indicate that, no matter what legal entitlement to a profit may have existed, the taxpayer did not make the expenditure with that intention. (*Grieve v CIR* [1984] 1 NZLR 101)

The Court discussed the fact that the High Court Judge did not directly deal with whether the taxpayer had a profit-making intention when entering into the agreement with the subsidiary and making payments pursuant to it, but it did agree with the Commissioner that reading the judgment as a whole would lead to the view that there was not this intention. Therefore the Court thought it preferable to consider all of the evidence de novo, but taking into account the High Court Judge's view of the taxpayers witnesses as "unclear and unconvincing".

After discussing the evidence the Court held that:

"plainly there was no prospect of profit for the joint venture in July 1986 or at any time thereafter and that Mainzeal NZ has not established that it genuinely had a profit making intention or purpose when the venture was entered into. This is not to deny that the arrangement was genuine, in the sense of creating for the taxpayer a legal right to share in any profit. What we are saying, rather, is that the intent actually to derive such profit was lacking. The expenditures were thus not deductible under Section 104(b)."

The Court went on to hold that even if the payments fell within Section 104(a) they would have been considered non-deductible in terms of Section 106 as an expenditure of a capital nature.

APPLICATION TO STRIKE OUT JUDICIAL REVIEW PROCEEDINGS

Case:	JG Russell & Ors v Taxation Review Authority & Anor
Decision date:	26 November 2001
Act:	Judicature Amendment Act 1972
Keywords:	*Judicial review, strike out*

Summary

The applicants were unsuccessful in their appeal against Fisher J's orders in the High Court striking out or staying their causes of action.

Facts

This case relates to a well-known tax avoidance scheme promoted by Mr J G Russell. The scheme, which involved exploiting the loss-grouping provisions in section 191 of the Income Tax Act 1976, was determined by the Taxation Review Authority to be tax avoidance and therefore void under section 99 of the Income Tax Act 1976 in *Case R25* (1994) 16 NZTC 6,120.

Both the High Court and the Court of Appeal upheld *Case R25*. Collateral judicial review proceedings brought by the participants in the scheme have also been unsuccessful in the High Court, the Court of Appeal, and most recently the Privy Council (*O'Neil v CIR* [2001] 3 NZLR 316).

This case was an appeal from orders given in the High Court striking out or staying causes of actions in a new, related, judicial review proceeding. The statement of claim pleaded five causes of action:

1. That the decision in *Case R25* was issued without the Authority hearing certain evidence and was therefore unlawful, invalid and in breach of natural justice and should be overturned.
2. A similar pleading in relation to *Case T52* (1998) 18 NZTC 8,378.
3. A similar pleading in relation to *Case T59* (1998) 18 NZTC 8,429.
4. A pleading relating to fraudulent and dishonest conduct by the Commissioner, and an abuse of process by the Taxation Review Authority.
5. A pleading requesting the High Court to make certain orders relating to discovery in the Taxation Review Authority.

The Commissioner applied to strike out the proceeding on the grounds that it sought to relitigate matters that had already been decided or related to other proceedings that were already before the courts.

In the High Court ((2000) 19 NZTC 15,924) Fisher J struck out the first and fifth causes of action, stayed the second and third causes of action and gave leave to the applicants to file an amended statement of claim in relation to the fourth cause of action.

The applicants appealed Fisher J's decision relating to the first, second, third and fifth causes of actions to the Court of Appeal.

Decision

In relation to the first cause of action Fisher J had held that the complaints in the current proceedings were directly in issue in the earlier ones and that the courts had already determined that they could not be sustained. His Honour also held that the High Court had no jurisdiction to quash the Taxation Review Authority's decision since the Court of Appeal had upheld it in *Miller v CIR* [1999] 1 NZLR 275.

Blanchard J considered that the applicants could not overcome the fact that the assessments in *Case R25* had already been determined to be correct in the Court of Appeal and stated that:

"The present proceeding, in so far as it relates to [*Case R25*], amounts to a collateral attack upon the judgment of this Court determining that the assessments which were the subject of the objections in *Case R25* were correctly made by the Commissioner.

...

As the correctness of the tax assessments is no longer capable of dispute, how can it then be said that they ought to be set aside because of some irregularity in the way the Commissioner went about the process of making them, which is what the "new" evidence would be directed to?"

His Honour further commented as follows:

"This Court has confirmed that the assessments were correctly made. It cannot now be said that it was not the Commissioner's fair determination of the taxpayers' liability. Therefore, whatever criticisms can be properly be made of the conduct of departmental officers, the assessments were not made arbitrarily or in disregard of the law or facts know to the Commissioner. Nor were they made on a tentative basis only (*Miller* (PC) at para [35])."

In relation to the second and third causes in action Blanchard J upheld Fisher J's exercise of discretion staying them. The issues could be covered in yet to be heard appeals of those cases. However, it was noted that the High Court could be asked to lift the stay if matters arose that could not be dealt with in the appeals of *Case T52* and *Case T59*.

In relation to the fifth cause of action Blanchard J approved Fisher J's refusal to exercise his discretion to make orders for discovery in proceedings before the Taxation Review Authority. The Authority had adequate powers to make the orders itself if necessary.

COMMISSIONER'S APPLICATION TO STRIKE OUT TAXPAYER'S JUDICIAL REVIEW PROCEEDING DISMISSED

Case:	Abattis Properties Ltd v CIR
Decision date:	23 November 2001
Act:	Judicature Amendment Act 1972
Keywords:	*Judicial review, strike out*

Summary

The Commissioner was unsuccessful in his attempt to strike out the taxpayer's judicial review application. The background of this case can be found in the Court of Appeal proceedings *CIR v Abattis Properties Ltd* (2001) 20 NZTC 17,013.

Facts

Following the making of an assessment in May 1999, the Commissioner demanded the tax due from the taxpayer. This demand was not met and the Commissioner accordingly issued proceedings to put the taxpayer into liquidation. The taxpayer defended those proceedings on the basis that the assessment was statute barred and that the Commissioner was not entitled to issue an assessment when a matter had been referred to adjudication. At the hearing a further defence was raised, namely that the taxpayer had not received notice of the assessment prior to the issue of a demand for payment.

Master Thomson in the High Court held that:

- The assessment was made on 27 May 1999.
- The Commissioner was not estopped from issuing an amended assessment regardless of the fact that disputes resolution procedures were in process.
- Liquidation should not be ordered because the Commissioner was not able to prove that the assessment had been served in time.

The Commissioner appealed to the Court of Appeal. The Court of Appeal accepted that the assessment was made on 27 May 1999 and held that, as a matter of law, liability existed once the assessment was made. The court held that notice of assessment

is a separate issue from validity, and that the Commissioner's failure to give notice did not affect the validity of the assessment. The court held that the Master was wrong to conclude that the assessment had to be served prior to the expiry of the limitation period, but held that in the special circumstances of the case, the Master was entitled to dismiss the application for liquidation in his discretion. The court also considered that the sensible course in relation to the assessment would seem to be for the Commissioner to set a new date for the response period to run.

The Commissioner did this and granted the taxpayer a further two months to challenge the assessment by notice dated 27 February 2001. The taxpayer has made this challenge in separate proceedings. At the same time this present application for judicial review was filed upon grounds of want of proper process. The taxpayer seeks a declaration that the assessment made by the Commissioner on 27 May 1999 is invalid. The grounds on which it is alleged to be invalid are:

1. That the assessment was made after 31 May 1999 and is therefore statute barred.
2. The Commissioner failed to comply with statutory procedures in that the parties exchanged statements of position, but the matter did not proceed to adjudication, whereas the taxpayer had a legitimate expectation that it would do so.
3. The notice of assessment given by the Commissioner was invalid.
4. The delay between making the assessment and giving notice of it was prejudicial to the taxpayer.

The Commissioner applied to strike out the taxpayer's application for judicial review.

Decision

His Honour Justice Durie found that the process complained of by the taxpayer relates to steps taken or not taken as a necessary prelude to the formation of the decision to reassess the taxpayer. In addition a challenge is made to the efficacy of the notice of 27 February 2001. The taxpayer also contends that the CIR cannot establish the date on which the assessment was made and whether it was before or after 31 May 1999.

His Honour held that the Court of Appeal did not decide that the assessment was valid but only that any validity it may have had was not affected by any subsequent imperfection over the dispatch of notice.

His Honour stated:

"The Court of Appeal held (at paragraph 3) that as a matter of law, liability existed once the reassessment was made. No umbrage is taken with that, as a general proposition, in the current proceedings for review. Liability exists from the moment the reassessment is made, but equally, it ceases to exist if later the reassessment is shown to be wrong, whether inherently through lack of process, or whether because it is wrong in fact. In any event the main question here is whether the reassessment was ever validly made in the first instance and before any notice was due to have been given."

Further, it was agreed that matters not raised and pursued in litigation, when the opportunity presented, cannot generally be raised for determination in later proceedings. However, according to His Honour that is not what occurred in the present case. In this case, the earlier proceedings were focused upon a different question, that is whether good cause existed to dismiss an application to have the taxpayer wound up because of a genuine dispute over liability. There was no room for the taxpayer to have introduced the issues it is now raising.

In regards to the second issue, His Honour held that even though there is a need to respect and maintain the integrity of the statutory process for challenging reassessments, it is important that the issues should be kept distinct, with questions of substance reserved for the statutory process and questions of the process itself kept within the separate area of judicial review.

Accordingly, His Honour dismissed the Commissioner's application to strike out the taxpayer's judicial review proceeding.

WHETHER LATE PAYMENT CHARGE ON INSURANCE PREMIUMS WAS INTEREST AND TAXABLE, OR ADDITIONAL PREMIUMS AND TAX-EXEMPT

Case:	CIR v Colonial Mutual Ltd
Decision date:	4 December 2001
Act:	Income Tax Act 1976
Keywords:	*Interest on overdue premiums, investment, premium*

Summary

The Privy Council found that the interest charged on overdue premiums is itself in the nature of a premium as it is paid to maintain the policy. As a consequence it is not assessable under the then legislation.

Facts

Colonial Mutual Ltd ("CML") was a life insurance company. It charged premiums for life insurance policies taken out by clients. If a premium was not paid on time it charged clients a sum referred to as interest in the insurance contract. After a policy had been afoot for two years CML was (by statute) able to offset any arrears in paying premiums against the surrender value of the policy. Book entries were made to reflect this. CML treated the additional sum (referred to as interest in the policy documents) as additional premiums. This meant, under the legislation as it was then, it was tax-free. The Commissioner took the view the sum was interest and properly taxable.

Decision

The Privy Council concluded the sum was a premium amount and thus not taxable.

The Council considered that the book entries could not of themselves change the nature of the parties' contractual relationship.

It was considered that Section 204 split gross revenue received into two broad streams premium and investment income. The issue was considered to be whether an expansive meaning should be given to the word "premium" (as contended by CML) or the word "investment" (as contended by the CIR).

The Council considered that an expansive meaning of "premium" better suited the statutory purpose of the section. This was determined by reference to Treasury documents to be that CML was taxed as proxy for the policyholder. Thus any payment made by the policyholder to maintain the policy should be considered part of the premium necessary to get the benefits of the policy, and therefore not taxable.

Noting the Commissioner's argument that the interest charged on the premium replaced interest that would have been earned had the premium been promptly paid and invested, the Council however, concluded that this merely reflected an adjustment to the premium based on time value of money and that such "incongruities" occur once a dividing line is drawn.

The Commissioner's other argument was that the section's definition of "gross revenue" includes items not expressly mentioned in the list (based on the use of the word "includes" in the section). Thus if the interest was not a premium it did not matter what it was called as it would taxable as gross revenue. This was dismissed on the basis that if it was correct, there was no effective way of obtaining the deductions for these other income items.

REGULAR FEATURES

DUE DATES REMINDER

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)

FEBRUARY 2002

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

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

7 **2001 end-of-year income tax due**

For people and organisations with a March balance date and who do not have an agent

20 **Employer deductions**

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

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

Employer deductions and Employer monthly schedule

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

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

28 **GST return and payment due**

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

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	Draft standard practice statement	*Comment deadline*
☐	ED0025: Voluntary disclosures	28 February 2002

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