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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 01/34

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 Port of Tauranga Limited (POTL).

Taxation Laws

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

This Ruling applies in respect of sections CF 2(1)(g), CF 3(1)(b), CF 3(14) and the relevant definitions in section OB 1.

The Arrangement to which this Ruling applies

The Arrangement is POTL's proposed return to shareholders of surplus capital by way of an off-market pro rata whole share repurchase and cancellation in the ratio of one share for every eight shares at a repurchase price of $7.00 per share. Further details of the Arrangement are set out in the following paragraphs.

1. POTL is a widely held company listed on the NZSE. Prior to this cancellation there are 76,482,512 fully paid ordinary shares on issue, conferring all the rights and powers attaching to shares under section 36(1) of the Companies Act 1993 and carrying full "shareholder decision-making rights" (as defined in section OB 1). POTL has only ever issued one class of share. All shares have been issued for cash or other consideration.
2. POTL's shareholders as at 15 August 2001 were as follows:

MEMBER NAME	PRESENT NO OF SHARES (M)	PRESENT (%)
Quayside Securities Ltd	42.11	55.06
ANZ Nominees Ltd	15.30	20.01
Rotorua Energy Charitable Trust	3.82	5.00
QBE Insurance (Inter) Ltd	1.87	2.45
Citibank Nominees (NZ) Ltd	0.43	0.56
Accident Rehabilitation and Compensation Insurance Corp – A/c NZCSD	0.35	0.46
Lilian Valder	0.20	0.26
MFL Mutual Fund Ltd – NZCSD	0.18	0.23
Guardian Trust Investment Nominees (RWT) Ltd	0.16	0.20
Tea Custodian Ltd – NZ Mid Cap Index Fund A/c – NZCSD	0.16	0.20
Other	11.91	15.57
Total	**76.48m**	**100.00%**

3. Options over shares in POTL, that carry "shareholder decision-making rights" (as defined in section OB 1), have never been issued.

4. POTL was established under the Port Companies Act 1988 and an Establishment Plan approved by the then Minister of Transport, and commenced trading on 1 October 1988. POTL provides wharf facilities and associated services at Mt Maunganui and operates a container crane terminal at Sulphur Point, Tauranga. POTL has extended its port services by establishing an inland port facility in Auckland, "Metroport". It has further extended its port related interests, entering into a joint venture agreement with Northland Port Corporation to establish a deep water port at Marsden Point.

5. Since 1988, POTL has been steadily increasing its revenue base and profitability. With development projects in place and after considering future growth opportunities, the directors have concluded that POTL is in a commercially under-geared position and has capital which is surplus to its current and ongoing requirements.

6. By resolution on 3 August 2001, a copy of which was provided to Inland Revenue with the ruling application, the Directors decided targets for debt to debt plus equity ratio, interest cover and dividends, and that a return of surplus capital of $67 million be made to shareholders by way of an off-market pro rata share repurchase in the ratio of 1 share for every 8 shares at a price of $7, subject to:

   (a) A binding ruling from the Inland Revenue Department that the distribution is tax free.

   (b) The approval of the High Court of New Zealand.

   (c) Shareholder approval.

7. On 7 August 2001 the Chairman announced to the NZSE and to the media the proposed share repurchase:

   RETURN OF CAPITAL TO SHAREHOLDERS

   Directors have announced that the Company ntends to return to shareholders, on a pro rata basis, surplus capital of $67 million and to cancel, in the process, one in every eight shares held. The return of capital is subject to receiving a favourable binding ruling from the Inland Revenue Department confirming that it will be tax free, and High Court approval of the arrangement.

   The Chairman, Mr Fraser McKenzie said today that the purpose of the capital reduction is to optimise the financial structure of the Company and to thereby maximise the return on funds employed in the business. Mr McKenzie said that after careful analysis the Directors had decided that returning surplus capital now was in the best interests of all shareholders and would allow the Company to improve its return on shareholder's equity for the future. Mr McKenzie confirmed that the Company's dividend distribution policy would remain the same after the capital reduction.

   The Company will be applying to the High Court for approval to return $67 million to shareholders by the cancellation of one in every eight shares held by each shareholder in the Company, and the payment to that shareholder of $7.00 for each share cancelled. This will give rise to the cancellation of approximately 9.6 million shares leaving approximately 66.9 million shares on issue at the completion of the transaction. Port of Tauranga Limited have targeted to complete this process including shareholder confirmation as quickly as possible dependent upon the favourable outcome of the binding ruling process.

8. Shareholders were notified directly by way of letter dated 16 August 2001:

   Dear Shareholders

   RETURN OF CAPITAL TO SHAREHOLDERS

   On 7 August 2001, your Directors announced that the Company would be seeking the approval of the High Court of New Zealand to return to shareholders, on a pro rata basis, surplus capital of $67 million and to cancel, in the process, one in every eight shares held.

   The return of capital is subject to a favourable binding ruling from the Inland Revenue Department confirming that it will not be a taxable dividend.

   Shareholder approval will be sought at the earliest available opportunity.

   You will all recall that in my report for the year ended 30 June 1998 we highlighted the matter of a balance sheet restructuring. Since that date the Company has seen container numbers grow threefold and an increase in reported profit of 82%. Additionally we have acquired a fleet of 12 straddle carriers, established New Zealand's first fully integrated inland port - METROPORT AUCKLAND, doubled the capacity of our on wharf cool storage capacity, invested in sophisticated information technology and commenced a 50% joint venture construction of a deepwater commercial port at Marsden Point.

   Despite the growth Directors have determined this capital to be surplus to the Company's current and future capital requirements. In this way, we will be able to optimise the financial structure of the Company and to maximise the return on funds employed in our business.

   The Company's dividend distribution policy will remain the same after the capital reduction.

> Subject to High Court approval, the return of $67 million capital to shareholders will involve:
>
> - the cancellation of one in every eight shares held by each shareholder in the Company; and
> - the payment to each shareholder of $7.00 for each share cancelled.
>
> The process will lead to the cancellation of approximately 9.6 million shares. Approximately 66.9 million shares will remain on issue at the end of the transaction.
>
> ...

9. POTL will return capital under a Court approved arrangement under section 236 of the Companies Act 1993. This Court approved arrangement will be binding on all parties, including POTL and the shareholders. The share acquisition will not occur on a stock exchange.

10. The substantive purpose of the repurchase and cancellation is the regearing of POTL, with the replacement of equity with debt. POTL directors have acted consistently with advice provided by two major financial institutions that POTL was undergeared, and to recommendations on the optimal capital structure of POTL.

11. As far back as 1997, the Directors signalled the need to review the capital structure of the company. The chairman advised shareholders that:

> Shareholders funds now represent a healthy 66.7 percent of total assets, a figure which is at the upper end of the range deemed to be appropriate by the Directors. In the year to 30 June 1998, the Board will be considering several business initiatives likely to warrant major capital expenditure. At present, the company is in a strong position to finance these through borrowings. If, however, the proposed capital investment projects fail to satisfy our investment criteria, the Directors will review the company's, proprietorship ratio in a fresh light...

12. In 1999 an asset revaluation raised the ratio of shareholder funds to total equity to 76.6%. This revaluation was undertaken for the reasons set out below expressed by the Chairman in the Annual Report:

> It has been ten years since the Company was formed, and the book value of its net assets was established. The Directors recently decided that it was timely to undertake an asset revaluation to ensure the level of investment in the Port was more accurately recorded.
>
> As a result the net asset backing per share has increased from $1.49 per share pre revaluation to $3.52 per share.

13. In the month of August 2001, the lowest traded price for POTL shares was $7.00 and the highest traded price was $7.25. The market value of all the 76,457,712 shares during this period was between $535.2m and $554.3m. The repurchase of 9,557,214 shares at a price of $7.00 provides a total repurchase amount of $66.9m. In the month of August 2001, this amount represented 12.5% of the market value of all POTL shares at their lowest traded price, and 12.1% at their highest traded price.

14. The total number of shares issued by POTL both before and at the close of 1 July 1994 was 76,219,712 and the total number of shares on issue prior to this cancellation is 76,482,512. The total amount of paid up capital on the shares before 1 July 1994 was $76,219,712. The total "qualifying share premium" (as defined by section OB 1) paid to POTL before 1 July 1994 was $41,815 not including any amounts that were later applied to pay up capital on shares in POTL.

15. POTL has never made a bonus issue.

16. No amounts have previously been distributed by POTL on the acquisition, redemption, or cancellation of shares.

17. POTL has advised that the amount of "available subscribed capital" (under section OB 1) has been calculated using the statutory formula a + b – c with the following values:

a	$76,261,527
b	$1,017,592
c	$530,000

The amount of "available subscribed capital" using these values is $76,749,119 ($76,261,527 + $1,017,592 - $530,000). All relevant amounts of available subscribed capital have been paid up (other than by way of bonus issues).

18. The total number of shares prior to this cancellation is 76,482,512. The number of shares to be cancelled, on a 1 for 8 basis, is 9,560,314. The amount of "available subscribed capital per share cancelled" (under section OB 1) is $8.03 ($76,749,119/9,560,314). The amount to be distributed per share is $7.00.

19. The repurchase is to be funded by POTL's existing bankers with POTL issuing commercial paper after obtaining Standard & Poors rating.

20. The 2001 financial year results show the debt to debt plus equity ratio is 22.71%. The return of $67m of surplus capital is forecast to result in a ratio of 45.11% in the 2002 financial year.

21. The company's dividend distribution policy will remain the same after the capital reduction. Actual ordinary dividends over the last five years have been 68.84%, 85.23%, 75.96%, 85.52% and 81.9%. In addition, special dividends

were paid in 1999 and 2000. Total dividend distributions in the period 1996 to 2001 exceeded total net profit after tax.

22. Group retained earnings stated in the statutory accounts in the period 1998 to 2001 were:

1998	$37.189m
1999	$26.268m
2000	$16.890m
2001	$32.340m

23. In 2001, with profit after tax of $22.412m, the return on equity was 8.4%, and the earnings per share 29.31 cents per share. In 2002, with forecast profit after tax of $20.768m, the return on equity is forecast at 9%, and the earnings per share 31.04 cents per share. In 2006, the forecasts are 10.6% and 33.27 cents per share.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) No "market value circumstance" (as defined in section OB 1) exists in POTL at the time of repurchase and cancellation.

b) There were no special circumstances that mean that the last NZSE traded price for POTL shares at the time POTL first notified shareholders of the proposed relevant cancellation is not a fair reflection of the market value of POTL shares at that time.

c) The cancellation of shares does not affect the current or future application of POTL's dividend policy.

d) At the time of the repurchase, POTL does not anticipate issuing any shares or raising any share capital subsequent to the cancellation.

e) The "available subscribed capital per share cancelled" (under section OB 1) is not less than $7.00.

How the Taxation Laws apply to the Arrangement

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

- The proposed share cancellation is a "ten percent capital reduction" as defined in section CF 3(14).
- The proposed share cancellation is excluded from the definition of "dividends" under section CF 3(1)(b).

The period for which this Ruling applies

This Ruling will apply from the date of signing until 30 June 2002.

This Ruling is signed by me on the 20th day of November 2001.

John Mora

Assistant General Manager (Adjudication & Rulings)

NEW LEGISLATION

STUDENT LOAN SCHEME – REPAYMENT AND INTEREST WRITE-OFF THRESHOLDS FOR 2002–03

The student loan scheme repayment threshold, which sets the income level at which compulsory repayments begin, will increase from its current level of $15,132 to $15,496 for the 2002–03 income year.

The student loan scheme interest write-off threshold, which sets the level of income that part-time or part-year students may have and still be entitled to a full interest write-off, will increase from its current level of $25,073 to $25,378 for the 2002–03 income year.

The student loan scheme repayment and interest write-off thresholds are based on the amount of the domestic purposes benefit payable to a person with two or more children. The repayment threshold is aligned to the gross amount of the benefit, rounded up so that it is divisible into whole dollars on a weekly basis, and the interest write-off threshold is aligned to the amount of other income at which the benefit is fully abated. These thresholds are reviewed annually in December each year and are set on the basis of the amount that it is projected will be payable from 1 April of the following year.

Student Loan Scheme (Repayment Threshold) Regulations 2001 and Student Loan Scheme (Income Amount for Full Interest Write-off) Regulations (No 2) 2001

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation, accrual and depreciation determinations, livestock values and changes in FBT and GST interest rates.

RIGHT TO USE CAPACITY IN THE SOUTHERN CROSS CABLE NETWORK

PROVISIONAL DEPRECIATION DETERMINATION PROV 9

The Commissioner has issued Determination PROV 9: Tax Depreciation Rates Provisional Determination Number 9, which applies to the right to use capacity in the Southern Cross Cable Network. The determination is reproduced below.

This determination may be cited as "Determination PROV 9: Tax Depreciation Rates Provisional Determination Number 9".

1. Application

This determination applies to taxpayers in the "Telecommunications" industry category.

This determination applies to a Capacity Purchaser who owns the right to use capacity in the Southern Cross Cable Network, a submarine fibre optic cable network, under a Capacity Use Agreement which contains materially the same terms as included in the Capacity Use Agreement provided to the Commissioner in the material accompanying the application for this determination.

This determination applies to "depreciable property" other than "excluded depreciable property" for the 1998/99 and subsequent income years.

2. Determination

Pursuant to section EG 10 (1)(b) of the Income Tax Act 1994, I hereby amend Determination DEP1: Tax Depreciation Rates General Determination Number 1 (as previously amended) by:

- Inserting into the "Telecommunications" industry category the provisional asset class, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

Telecommunications		Estimated useful life (years)	DV banded dep'n rate %	SL equiv banded dep'n rate %
The right to use capacity in the Southern Cross Cable Network, a submarine fibre optic cable network, under a Capacity Use Agreement (which contains materially the same terms as included in the Capacity Use Agreement provided to the Commissioner in the material accompanying the application for this determination) where the rights are granted between:	• 15 November 2000 and 23 January 2002	15 to 13.8082	12	8
	• 24 January 2002 and 6 October 2004	13.8055 to 11.1066	15	10
	• 7 October 2004 and 23 November 2006	11.1038 to 8.9753	18	12.5
The right to use capacity in the Southern Cross Cable Network, a submarine fibre optic cable network, under a Capacity Use Agreement (which contains materially the same terms as included in the Capacity Use Agreement provided to the Commissioner in the material accompanying the application for this determination) where the rights are granted between:	• 24 November 2006 and 28 July 2008	8.9726 to 7.2978	22	15.5
	• 29 July 2008 and 21 February 2010	7.2951 to 5.7288	26	18
	• 22 February 2010 and 14 November 2010	5.7260 to 5	33	24

3. Interpretation

In this determination, unless the context otherwise requires, expressions have the same meaning as in the Income Tax Act 1994.

This determination is signed by me on the 7th day of December 2001.

Martin Smith

General Manager (Adjudication & Rulings)

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 SUPPLY OF A GOING CONCERN TO A REGISTERED PERSON WAS ZERO RATED

Case:	CIR v Capital Enterprises Limited
Decision date:	18 December 2001
Act:	Goods and Services Tax Act 1985
Keywords:	*Going concern, zero rating, time of supply, agency, nomination, novation*

Summary

The Commissioner's appeal was upheld by the High Court.

Facts

A property in Wellington was sold to a property developer while subject to an existing tenancy. The vendor would accept no less than $2.85 million net of GST and the purchaser would pay no more than $2.5m. The parties finally signed an agreement for sale and purchase (ASAP) for $2.80m stating the contract to be "GST inclusive if any" and "subject to existing tenancy". The purchaser was said to be "[a named individual] or nominee".

The purchaser set up a company, CASD, which would act as a holding company in order to pass it on to a development company and claim an input credit on the second supply. CASD was formed after the ASAP was signed and the deposit was paid by a cheque from CASD's account. The purchaser, still not having made a nomination, applied to the IRD for a binding ruling on the proposed transaction. The ruling considered that the transaction was caught by section 76 of the GST Act. The purchaser applied for a second ruling on a varied transaction where the named individual, who was not registered for GST, took the property in his own name before transferring it to his development company and claiming an input credit. This transaction was approved by Adjudication and Rulings on the facts submitted and the settlement proceeded on that basis.

The Commissioner assessed the Plaintiff for output tax on the sale to the named individual, the basis being that although the supply may have been of a going concern, the purchaser was not a registered person. The Plaintiff contended that the purchaser was in fact CASD (who took the property from the named individual a few days later).

The Taxation Review Authority concluded that the transaction was the sale of a going concern and that the disputant knew that at all times the purchaser was acting on behalf of a registered person. This, notwithstanding that no nomination was ever made and the property passed in fact to the named individual. Willy J also found that the purchaser deliberately misled the vendor as to his intention to take the property in his own name.

The Taxation Review Authority decision was appealed by the Commissioner.

Decision

Durie J first considered the general approach taken by the Authority, that is, an excessively wide review of the factual background in order to determine the real justice of the case. He concurred with the Commissioner's submissions:

"The decision is peppered with observations on the respondent's subjective and unilateral perceptions. Such an approach to the facts, unless it can be strictly justified …, threatens the reliance of persons, whether parties to the contract or not, on that which has been formally recorded as representing the parties' agreement. … The Commissioner must place primary reliance on the core documents, … and only to such other material as may be put in in the Disputes process as evidencing consensual change or consequential steps."

The first sub-issue was then whether a taxable supply could exist independent of contract. The respondent had submitted that section 9 of the GST Act set the deemed time of supply and at that point (in this case, the payment of the deposit by CASD) CASD was deemed by the section to be the recipient irrespective of the form of the contract. Durie J rejected this argument stating that section 9 does no more than set the time and does not assist in the identification of the recipient. Also, the Act does not supplant common law but merely imposes tax on transactions which are essentially contractual.

The second sub-issue was whether CASD was substituted by consent as the purchaser/recipient. This argument imported further issues of nomination. His Honour held that no nomination had in fact occurred; the term "or nominee" merely giving the purchaser the right to so nominate if he wished. It was held to be immaterial that the named individual may have had an obligation to nominate a GST registered company, but the actual transfer which the parties effected, and the terms of the contract ("inclusive of GST if any") were determinative.

Next His Honour considered the main point of the whole dispute: whether Mr Stewart received the supply as agent for CASD? Durie J overturned the Authority's finding of fact in this respect. He held that the particular facts relied upon by the Authority to support that conclusion were not obvious, and that all the evidence showed was that the purchaser was merely keeping his contractual options open. In the end he decided to take title himself, an act inconsistent with the fiduciary nature of an agency relationship. See *LC Fowler & Sons Ltd v St Stephens Board of Governors* [1991] 3 NZLR 304 at 306.

The Authority, during the hearing, raised the possibility that section 183 of the Companies Act 1993 might apply; that there was a pre-incorporation contract. On the admitted facts Willy J had found that such was contemplated by the purchaser and that payment of the deposit by CASD was ratification. In the High Court His Honour held that this fell far short of a pre-incorporation contract as such evidence was merely the testimony of the director of the respondent company.

"The Judge mat have had other evidence in mind but on this appeal [counsel for the respondent] was unable to point to it."

In conclusion His Honour said:

"I consider the Judge erred in the conclusions that he reached as a result of his overall approach which effectively determined issues as between the respondent and [the named individual] and which coloured the determination of the question whether the supply was in fact to [him] or CASD.

CLAIMS DISALLOWED BECAUSE OF LACK OF EVIDENCE

Case:	TRA Number 97/021. Decision Number 11/2001
Decision date:	6 December 2001
Act:	Income Tax Act 1976, Goods and Services Tax Act 1985
Keywords:	*Undeclared income, disallowed deductions*

Summary

The objector was unsuccessful in his objection to the Commissioner's assessments.

Facts

This case concerned assessments of the objector's income for the financial years 1989 to 1992 (inclusive) in terms of undeclared income, expenditure which was disallowed deductibility, consequential GST assessments, and failure to withhold tax on certain commissions paid by the objector.

The grounds of assessment were that the objector had failed to return income required to be returned pursuant to section 65(2) of the Income Tax Act 1976, and that the objector was not entitled to certain deductions claimed because they were private in character (section106(1)(j)), or non-business related expenditure (section 104), or not evidenced as required (section 106E).

The objector was, at material times, a consultant and provider of accountancy services, and a partner in a partnership operating as a security firm. During the 1989 and 1990 income tax years he was also a type of commission agent for health insurance and life insurance companies, and referred to his frequent overseas travel at material times as:

"related to his business activities including raising off-shore finance, making enquiries into forestry markets and franchises and chemical purchases, and to most of his claimed deductions relating to those activities."

Throughout the hearing Barber J gave various adjournments for the objector to attend at various professional offices to obtain documentary evidence, which he said was available to support his case, but no such material was ever obtained. Accordingly, a decision was issued.

Decision

There were only two witnesses—the objector and the audit investigator for the Commissioner. After hearing both witnesses, His Honour commented that:

"I could not assess the objector as a credible witness. I record that I have had 20 years experience at endeavouring to assess the truthfulness of taxpayers and I made my assessment, as to the lack of credibility of the objector, after considering his evidence overall and in context of the total evidential fabric of the case, and also taking into account his manner, demeanour, and body language when giving evidence."

After considering the evidence for the Commissioner in some detail, His Honour noted that, in his view,

"[the investigator] has gone to great pains to assist the case of the objector taxpayer in every possible way but, to a substantial degree, could not alter the assessments due to lack of information from the objector."

His Honour then turned to the evidence of the objector and outlined further background that emerged from it. While a firm submission of the objector was that his expenditure, claimed as deductible, was spent in the course of one of his income-earning processes, in terms of evidence the objector added, "I can't say more than that."

"After a while in cross-examination, he seemed to be admitting that invoices and the like needed to support his claims were not available, and he said *'I accept that they are not there … I cannot take further'* proving that particular items of expenditure were business related.

"Also in cross-examination, Ms Grills took the objector through many of the financial items in dispute, but the objector could offer no supporting evidence of his various claims. He frequently, and quite candidly, said *'I can't provide evidence to support my claim'*."

Despite the objector's assertions that there was sufficient evidence available to support his claims, the objector agreed with Barber J that,

"many aspects of his case could be regarded as somewhat bizarre and that a common thread is an absence of records, and that there is, generally, only the existence of the objector's word about the various issues."

Accordingly, there being a lack of credible evidence from or on behalf of the objector, the objections failed and a total adjusted assessment figure was confirmed.

CHALLENGE TO ASSESSMENT OUTSIDE RESPONSE PERIOD – REVIEW OF TEST

Case:	CIR v Fuji Xerox Ltd
Decision date:	13 December 2001
Act:	Goods and Services Tax Act 1985, section 138D Tax Administration Act 1994
Keywords:	*Response period, leave to proceed with challenge.*

Summary

The Commissioner was successful in his appeal against the High Court judgment.

Facts

The Commissioner undertook an audit of the tax affairs of the taxpayer. The tax audit began in the middle of 1998. The tax audit at first concerned Fuji Xerox's income tax affairs, but later was expanded to include GST matters as well.

KPMG is the taxpayer's nominated tax agent in respect of income tax matters and all correspondence in relation to the tax audit (both in respect of income tax matters and GST matters) has been conducted by KPMG on behalf of the taxpayer. However, KPMG is not the taxpayer's nominated tax agent in respect of GST matters, and so the authorised address in the Department's computer system of the for GST assessments in relation to the taxpayer is the taxpayer's own address rather than that of KPMG.

There was considerable correspondence between Inland Revenue and KPMG in relation to the tax audit. A letter dated 28 May 1999 from Inland Revenue was sent to the taxpayer itself and copied to KPMG but the subsequent correspondence was between KPMG on behalf of the taxpayer and Inland Revenue.

The last letter is important because it indicates that Notices of Assessment will be issued. The letter is addressed to KPMG (not to the taxpayer care of KPMG), refers to recent discussions, attaches a Statement of Amendment and contains the statement "Notices will be issued in due course"—without saying to whom the Notices will be issued. It then continues:

"As you are aware, to protect your client's objection rights, certain actions must be taken by you within two months of the Notice. Full details are contained on the back of the Notice."

It is noteworthy that this warning refers to action being taken by "you" (ie KPMG, not the taxpayer). In fact the formal assessments referred to in the letter of 5 December were issued on 6 December 2000 (with one exception which was issued on 18 December 2000). Because the taxpayer's address was the one which was contained in Inland Revenue's computer system the Notices of Assessment were sent to the address of the taxpayer and not to KPMG. Fuji's chief accountant gave evidence that he was informed by members of his staff that Notices of Assessment had been received, but that he had no reason to expect any correspondence from Inland Revenue concerning the investigation and so he did not discuss the nature of them with his accounts staff. However, payment of the assessments was made because the taxpayer's policy was to pay all amounts due to Inland Revenue on time to avoid interest and penalties.

Meanwhile, the person responsible for the taxpayer's affairs at KPMG also expected that the assessments would be sent to KPMG. He had previously worked at Inland Revenue and his evidence was that he was not sure when the assessments would arrive and that his experience was that they could sometimes arrive some time after the advice that an assessment was about to be issued. However, he became concerned when no assessments had arrived by early February and rang the responsible officer at Inland Revenue on 7 February 2001. He was told that the assessments should have been issued, but no details were provided. He did however enquire with Fuji's chief accountant whether he was aware of any Notices of Assessment being received and he, without checking, said he was not aware that they had been received by the taxpayer and that he expected they would be sent to KPMG. It was only some time later it was discovered that the Notices of Assessment received by Fuji's accounts staff back in December 2000 had in fact been the Notices of Assessment to which the letter to KPMG of 5 December 2000 referred.

By then the response period had expired and Fuji took these proceedings seeking leave under section 138D of the Tax Administration Act, to commence a challenge out of the response period.

The High Court gave the plaintiff leave to proceed with a challenge to the Commissioner's assessment, which was appealed by the Commissioner.

Decision

The Court of Appeal, in a decision delivered by Anderson J, found for the Commissioner on the basis of straightforward statutory interpretation. The Court considered that O'Regan J had erred in a number of respects:

- In following the *Milburn* and *Treasury Technology* decisions, the High Court erred in requiring the "event or circumstance" in section 138D to be, in itself "exceptional". The term "exceptional circumstance" has its own statutory meaning.
- Such analysis thus confused the issue of the taxpayer's expectations (which may go to justification) with whether the event was beyond the control of the taxpayer.
- The Judge did not in fact give specific reasons for finding sufficient or any justification.
- The term "agent" in section 138D(2) does not mean "tax agent" as defined in section 3. It is a general term which includes employees of the taxpayer.

The Court identified the "event" as the sending of the assessments by the Commissioner to the taxpayer directly, against the background of the correspondence with KPMG. These circumstances were entirely within the taxpayer's control and provided no justification for the lack of response:

"In our view there is no basis whatever for criticising the Commissioner for sending the notices of assessment to the relevant address for GST purposes. That act was not in any sense causative of the Respondent's default. The real and effective cause of that default lay in the systemic and human failures of the Respondent itself."

The Court added that it did not find it necessary to analyse the different approaches of the *Milburn* and *Treasury Technology* cases, other than noting that the requirement to find an "exceptional circumstance" (rather than an "event or circumstance") was an "unnecessary additional gloss".

SUMMARY JUDGEMENT

Case:	CIR v Sea Hunter Fisheries Ltd
Decision date:	13 December 2001
Act:	Goods and Services Tax Act 1985

Summary

The Commissioner's appeal was allowed to the extent of setting aside the summary judgment in the sum of $2,510,414.82. There will instead be judgment for Sea Hunter in the sum of $1,247,925.

Facts

Sea Hunter Fisheries Ltd ("Sea Hunter") is a company that carries on business as a fishing vessel owner. Sea Hunter claimed an input tax credit under section 21(5) of the Goods and Services Tax Act 1985 in respect of the fishing vessel. The claim was made in a GST return received by the CIR on 19 January 1998. It was for the period ended 31 May 1997. The return sought a GST input tax credit of $2,495,850. The senior investigator handling the matter determined that more information needed to be sought from Sea Hunter before a credit adjustment or refund could be considered. As a result an account halt was activated on 3 February 1998. The account halt was due to expire on 18 February 1998.

On 18 February 1998 the account halt expired. A refund cheque was issued to Sea Hunter. The investigator became aware that the GST credit adjustment claim had been released notwithstanding an incomplete review of the matter. The investigator tried unsuccessfully to access the Department's computer system due to the power cuts in the Auckland region at the time and hence a stop payment request was issued through the banking system.

Accordingly, on 27 February Sea Hunter banked the cheque. However, on 5 March 1998 Sea Hunter's bank account was debited as a result of the stop payment request.

On 8 September 2000 Sea Hunter issued proceedings in the High Court claiming judgment for the amount of the cheque plus interest at the Judicature Act rate of 11% per annum from 27 February 1998. It sought summary judgment. The CIR sought the striking out of the proceedings.

On 2 May 2001 the Commissioner issued an assessment denying the input tax claim to Sea Hunter.

The High Court held that in order to invoke the provisions of section 46, the Commissioner must advise the taxpayer of his intention to invoke the section, and the taxpayer must receive that advice within 15 working days of the submission of the return.

Further it was held that section 27 of the Bills of Exchange Act 1908 provides that an antecedent debt or liability constitutes valuable consideration for a bill of exchange. If the notice or request, as the case may be, had not been received by the accountant by 10 February then clearly there was valuable consideration for the cheque. The CIR was therefore obliged to honour the cheque.

In a third and final judgment the Master considered Sea Hunter's claim for interest pursuant to section 57(a)(ii) of the Bills of Exchange Act 1908 at 11% per annum from 27 February 1998. The Master considered that if a cheque had not been issued and if the Department had simply failed to make payment, then the interest due to Sea Hunter would be fixed in accordance with the Tax Administration Act. There had not been any evidence put before him about the appropriate commercial rate and so the Master could not see any justification for departing from the rate prescribed in that Act. The Master therefore entered judgment for interest as at 23 May 2001 in the sum of $414,780.66 and stated that the judgment debt itself would carry interest from that date until satisfied pursuant to rule 538 of the High Court Rules.

Decision

Justice Blanchard delivered the decision of the Court. Firstly, the Court dismissed Sea Hunter's application to cross-appeal out of time against the interest judgment regarding the appropriate interest rate that should have been applied by Master Faire.

The Court then dealt with the substantial appeal holding that they are not persuaded that the Master took the wrong view of section 46. The Court accepted that the CIR is not precluded from commencing an investigation and making a request for information after the expiry of the 15 working days period. However, Parliament has deliberately chosen a short period for the CIR to make up his mind whether he needs further information or wishes to investigate the circumstances of the return. If he does not do so in due time, although he is not precluded from taking the matter further, he **must**, in the meantime, promptly **make the claimed refund**. It is the Court's view that under section 46(4) a request is not given by the CIR until it actually reaches the taxpayer or the taxpayer's agent or is deemed to have been received within section 14(2) (notices sent by post section). The CIR can therefore not be taken to have given a request for information by posting to the taxpayer a request that did not reach the taxpayer until after the 15th working day and would not have been delivered in the normal course of post within that period.

As of 2 July 2001, two months after the assessment was issued, the Commissioner became entitled to offset against his liability on the cheque, the amount due for non-deferrable tax that was due from Sea Hunter.

On the interest point the Court found the matter too difficult to decide. Their Honours were clear, however, that it is not appropriate where there is a statutory regime for the fixing of an interest rate that a different rate should apply after a judgment has been given. The Court decided that all other questions of liability of interest on either side should be deferred until the result of the challenge to the assessment is known.

WHETHER SALE OF VESSEL ATTRACTED GST – JUDICIAL REVIEW

Case:	Simunovich Fisheries Ltd v CIR and Owen Joseph Knock
Decision date:	10 December 2001
Act:	Judicature Amendment Act 1972, Goods and Services Tax Act 1985
Keywords:	*Judicial review*

Summary

The taxpayer's appeal was partially successful

Facts

In June 1995 Simunovich Fisheries Ltd ("Simunovich") purchased a fishing vessel (Longva III subsequently renamed Kermadec). Simunovich claimed the purchase price of the vessel as an input tax credit for the GST period ending 31 July 1995. In December 1997 Simunovich sold the vessel. For the GST period ending 31 January 1998 the Plaintiff claimed that the vessel was subject to GST at a 0% rate.

On 10 August 1999 the Commissioner issued Simunovich with a NOPA for the 31 January 1998 GST period. The NOPA proposed that the sale proceeds of the vessel should, so far as the 31 January 1998 taxable period was concerned, attract GST. The NOPA asserted that the transaction attracted GST because the vessel's acquisition by the Plaintiff in January 1995 was the supply of a secondhand good by an entity which was not registered for GST. That assertion was contrary to the stance previously adopted by the Commissioner for the 31 July 1995 GST taxable period in respect of which the last Notice of Assessment issued (6 November 1995) allowed the purchase price of the vessel as an input tax credit, ie as a taxable supply.

The High Court found for the Commissioner on all issues.

Decision

Richardson P delivered the judgment of the Court. The Court found that there was ample evidence that the Commissioner had actually assessed Simunovich on the basis of the purchase being a taxable supply and that this assessment has never been reversed. This being the case the Court held that it was not open for the Commissioner to make an amended assessment in respect of the sale of the Kermadec, as proposed, in the NOPA, on a basis inconsistent with the current amended assessment in respect of its purchase, ie, unless and until the Commissioner lawfully alters the basis of the 1995 assessment, he cannot amend the assessment for the 31 January 1998 period.

Their Honours held that in making the amended assessment in November 1995 the Commissioner fixed the vessel with the taxable supply GST classification. Unless removed or changed it became the basis for calculating GST on sale. On first principles, if an asset is given a character for a particular purpose, it must retain that character unless and until it is lawfully changed. Further:

"It would be inconsistent to have the same asset of the same taxpayer taxed on sale as having a different character from its characterisation in respect of its purchase. For the Commissioner to disregard a basis inconsistency of that kind would undermine the integrity of the tax system which he has a duty under s6 of the 1994 Act to use his best endeavours to protect."

Therefore, in order for the Commissioner to be able to assess the output tax on the sale of the Kermadec in the 31 January 1998 period at the 12.5% rate, the vessel must have had the GST character of secondhand goods in respect of the input tax on the purchase. Their Honours state that this is plain from para (c) of the definition of input tax and para (d) of the proviso to section 11(1). In this case the Commissioner wants to change the characterisation he gave to the vessel for GST in respect of its purchase by Simunovich. According to their Honours the only way the Commissioner can lawfully do this is by altering the basis of the November 1995 assessment.

Their Honours went on to state that the principles that they are discussing are reflected in section 29 of the GST Act. Contrary to the Commissioner's submissions, Their Honours held that section 29 binds the Commissioner to the grounds of his assessment so that he cannot make a later assessment for another period that is inconsistent with it without first legally changing the first assessment.

Their Honours stressed that this is an unusual and exceptional case because of the linkage proviso in section 11(1), ie linking the treatment of the purchase of the vessel to the treatment of the sale of the same vessel, and that it is this linkage that has given rise to the procedural difficulty the Commissioner faces. Their Honours stated that certainly in normal circumstances the issue of a NOPA could not be challenged on the ground that the notified proposed adjustment was wrong.

Having found that the Commissioner must first alter the 1995 assessment before he can alter the 1998 assessment, Their Honours declined to issue a declaration of invalidity for the NOPA. Their Honours in fact went on to state that the Commissioner may be able to issue another NOPA and may be able to revisit the 1995 assessment. They also declined to issue a decision on the section 108A time bar issue stating that if and when the Commissioner purports to alter the 1995 assessment, etc, those decisions may be susceptible to challenge and the implications for the time bar will require further consideration at some point.

On the legitimate expectation issue, Their Honours dismissed the taxpayer's application stating that, if legitimate expectation is available on the law, then it must fail on the facts. Simunovich must have been aware that, when it obtained the refund, the Commissioner was still investigating the matter and the possibility that the matter could be revisited remained open. Any possible application of the time bar was still nearly two years away when Simunovich sold the vessel. Further, the Commissioner was not even told of the proposed sale of the vessel.

JUDICIAL REVIEW

Case:	Ronald George Lawton v CIR
Decision date:	19 December 2001
Act:	Judicature Amendment Act 1972
Keywords:	*Judicial review*

Summary

The taxpayer was unsuccessful in his judicial review of the Commissioner's refusal to allow a late objection or reassess on an amended return.

Facts

The taxpayer bought and sold shares in the period 1986 to 1992. This was on a large scale. In so doing he made gains in two years but losses in others. The losses outweighed the gains substantially.

He returned neither the gains nor the losses in his original returns, but in 1993, having become aware of another case, he filed amended returns and objected to the assessment to his 1993 return.

His 1993 year objection was allowed, but the earlier years were treated as late objections and rejected as such. The late objection decision was reconsidered and confirmed several times in the period 1994 to 1997.

The taxpayer commenced the case in 2001.

Decision

The reassessment provisions did not provide a separate avenue for the taxpayer, outside the late objection provisions. They are discretionary in nature and cannot be elevated to the point of statutory duty as contended by the taxpayer. Such obligation as there may be to ensure correctness in the quantification of tax liability is not an absolute value. The only statutory means available to a taxpayer to oblige the Commissioner to issue an amended assessment is by the statutory objection procedure under Part III Income Tax Act 1976 (as then was—now, of course, Part VIII or Part IVA/Part VIIIA Tax Administration Act 1994).

"If the Commissioner were obliged to re-assess under section 23 whenever a request was made, the whole process of objection under section 30 within a defined limit would be circumvented. That cannot have been the statutory intention."

The Commissioner was entitled to treat the amended returns as applications for late objection.

Implicitly, the judgment holds that the Commissioner has an obligation to consider exercising the discretionary power to reassess, but it appears that His Honour considers that that obligation was discharged as part of the consideration of the late objection. His Honour found as a matter of fact that the Commissioner did give consideration to both section 23 and section 30 when making the decision not to allow a late objection.

The scope for legitimate expectation in taxation matters is doubtful and of limited application—that follows from the scheme and purpose of income tax legislation. In any event, the taxpayer's argument that he had a legitimate expectation that the Commissioner would reassess failed on the facts. There could be no general expectation that the Commissioner will in all or even most cases permit the re-opening of transactions after the limitation period.

Although the Commissioner had considered the taxpayer was entitled to a deduction, the obligation to ensure the correctness of the decision was not absolute. The merits of the claim and the need to ensure correctness of the tax liability were

fully canvassed by the Commissioner. The decision-maker carefully considered the taxpayer's particular circumstances. There is no impediment to the department adopting policies or guidelines (such as existed for the late objection procedure) so long as the policies or guidelines:

- are not inconsistent with statute
- permit consideration of the individual case, and
- allow for exceptions to the policy.

In the facts of this case the Commissioner did not take irrelevant considerations into account in reaching the decision not to allow a late objection to be made, nor did he act unreasonably.

The natural justice case also failed on its facts. There was no evidence that the taxpayer was denied the opportunity to make representations on the Inland Revenue conclusions.

The Commissioner had gone to substantial lengths to consider the taxpayer's case on several occasions from 1994 to 1997. Then there was a delay of almost four years before judicial review proceedings were issued. While, as above, there was no basis for a successful judicial review, had there been any basis for review there would have been powerful arguments to support the Commissioner's contention that relief should be declined.

REGULAR FEATURES

DUE DATES REMINDER

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**

MARCH 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 **Provisional tax instalments due**

For people and organisations with a March balance date

20 **Employer deductions**

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

- *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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