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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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THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft items are available for review/comment this month, having a deadline of 30 June 2002.

Ref.	Draft type	Description
DDG0057	General depreciation determination	Modular nylon tile carpets

Please see page 22 for the text of this item.

PU0059a-d	Public Rulings	GST and resource consents
IS3387	Interpretation Statement	GST treatment of court awards and out of court settlements

Please see page 29 for details on how to obtain copies

BINDING RULINGS

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

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

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

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

PRODUCT RULING – BR PRD 02/02

This is a product ruling made under section 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by BNZ Investment Management Ltd as trustee of the BNZ 25 NZ Equity Index Fund (the "Fund").

Taxation Laws

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

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

The Arrangement to which this Ruling applies

The Arrangement is the establishment and operation by the Bank of New Zealand of a superannuation fund known as the BNZ 25 NZ Equity Index Fund. The operation of the Fund is governed by the Trust Deed dated 24 February 1997. The Trust Deed was amended on 23 March 2001 ("the Amended Trust Deed").

Details of the Arrangement are set out in the paragraphs below.

1. The Trustee of the Fund is BNZ Investment Management Ltd ("the Trustee"). The Fund acts as a "wholesale" superannuation fund into which other "retail" superannuation funds invest. The Fund also operates for the purpose of providing retirement benefits to the limited number of natural persons who invest directly in it. The minimum investment amount required in respect of natural persons is $200,000.
2. The Fund is registered under the Superannuation Schemes Act 1989, as are the "retail" superannuation funds which invest in it.
3. Members of the Fund will receive payments from the Fund on withdrawal of part or all of the relevant member's account (being the account maintained for the member under the Trust Deed). Withdrawal may occur as a result of a request made at any time after a member attains the age of 50 years, on death of a member upon a request being made by the member's legal personal representatives, or at any other time upon a withdrawal request being made by a member.
4. The Fund is a passive investment vehicle, investing only in a portfolio of equity securities each of which is listed on the NZSE. The Fund is managed so as to track the composition of a set of listed equity securities which together form the constituent part of an Index known as the BNZ 25 Equity Index ("the Index").
5. The Index comprises up to 25 of the largest New Zealand equity securities listed on the NZSE, based on average weekly market capitalisation. The Fund is not subject to any active management as such. Rather, it is managed to track the composition of a set of listed equity securities that together form the constituent parts of the Index. The weighting of each security in the Index will reflect its respective market capitalisation on the NZSE at the relevant date.
6. The "home" exchange of each stock can be any of the "grey list" countries as they are defined in New Zealand tax law. If the equity security is listed on the NZSE and meets the other criteria, it will be included in the Index. There is no discretion as to whether a grey-list country

security listed on the NZSE is included in the Index. The equity securities are normally shares but there may also be convertible notes.

7. The market capitalisation for securities that have their "home" exchange outside New Zealand are calculated under the standard NZSE rules for weighting of non-New Zealand equities.

8. Where identical constituent securities exist in the market except for ownership restrictions (such as Air New Zealand A and B shares) ("identical securities"), the Index previously only included one of those constituent securities. The Index now includes all the identical securities.

9. Approximately 95% of the net asset value of the Fund is invested in such investments as the Trustee considers necessary to track the Index. While the majority of available funds are invested to track the Index, a "cash pool" of the net assets of the Fund is maintained in order to minimise the number of sale and purchase transactions and to fund any daily net fund withdrawals and net fund inflows pending purchase of equity securities and to manage the liquidity of the Fund in respect of meeting anticipated liabilities, withdrawals and distributions. The cash pool is only invested in bank accounts, cash or futures contracts that give appropriate equity exposure.

10. Changes will only be made to the Index composition in the following circumstances:

    (a) At the end of each quarter, securities will be ranked according to their average weekly market capitalisation for the previous 6-month period. If a security not previously included in the Index has risen at the quarter end above 21st position, that security will be included as a constituent security in the Index and the lowest ranked Index security held at the quarter end will be removed. If a security that is currently included in the Index at the quarter end has dropped below a ranking of 30th, that security will be removed as a constituent security from the Index and the highest ranked security at the quarter end not already included in the Index will be included. The Trust Deed defines "quarter" as the three months ending on the 15th of April, July, October and January respectively. Currently, the quarterly rebalancing occurs at the end of a month.

    (b) At the end of each quarter, securities are reviewed with regard to compliance with the necessary minimum liquidity requirements. In order to be included and to maintain inclusion in the Index, a constituent security must meet a minimum liquidity requirement. Liquidity is defined as the average daily trading volume of a security (over a 6-month period leading up to the end of the relevant quarter, after eliminating the highest and lowest months), expressed as a percentage of the total issued and quoted securities of the same class. The minimum liquidity measure for inclusion in the Index is 0.75% per month. This requirement does not apply to a security listed on the NZSE for the first time until the end of the second complete quarter following listing. If there are less than 25 securities which meet the minimum liquidity requirements, then there may be less than 25 securities included in the Index.

    (c) If an event such as a share issue or share buy-back occurs so as to increase or decrease the number of any constituent security on issue and that increase or decrease, measured by market capitalisation on a cumulative basis since the last adjustment, is less than 0.03% of the Index, then any adjustments to the Index will be made at the end of the quarter in which the number of listed securities are increased or decreased. In the event that an increase or decrease represents more than 0.03% of the Index, an adjustment to the Index will be made, subject to five business days' notice, on the 15th of the month in which the number of listed securities is increased or decreased.

    (d) If a security is listed on the NZSE for the first time, it will be included in the Index in the month of listing if:

        (i) it ranks, in terms of market capitalisation, above 21st position (compared with other Index securities ranked according to their average weekly market capitalisation for the previous 6-month period); and

        (ii) at least 25% of the security is freely tradeable at the time of listing.

        If the security is listed before the 15th day of the month, it will be included in the Index on the 15th day and otherwise will be included at the end of the month. The security previously ranked 25th within the Index at that time will be removed.

        If a security listed on the NZSE for the first time does not meet the 25% free float test at the time of listing but meets that 25% test at the end of the quarter in which listing occurs or the following quarter, it will be included in the Index at the relevant quarter end (subject to ranking above 21st at that time). Again, the security previously ranked 25th will be removed at that time.

(e) If the Trustee recommends, and the Fund's auditors agree, the Index must be altered to reflect a material change to the rules governing the NZSE 40 Index structure made by the NZSE.

(f) If there is a merger, takeover offer or scheme of arrangement sanctioned by the High Court for 100% of the issued securities of a company:

(i) the company's securities will be removed from the Index when the offeror or acquiror becomes entitled to, and announces that it will, proceed with compulsory acquisition; and

(ii) if the offer has less than 100% acceptance, but nevertheless proceeds and, at that time or any time after the merger, takeover offer or scheme of arrangement proceeds, less than 25% of the company's securities are freely tradeable as a result of the merger or takeover offer, the company's securities will be removed from the Index.

11. The Trustee will use best endeavours to track the Index as closely as possible. In circumstances where the Trustee is using best endeavours to track the Index as closely as possible, deviation from the Index may occur where it is not possible to exactly replicate the Index for one or more of the following reasons:

(a) The time taken to buy equities;

(b) Difficulties in acquiring equities;

(c) Rounding errors; or

(d) Price fluctuations

but in any such case deviation from the Index will not exceed the following levels:

(a) in the case of securities the Index weighting of which is 10% or greater of the total Index, the deviation from the Index replication is no larger than 1% of the Index; or

(b) in the case of securities whose Index weighting is less than 10% of the Index, the deviation from the Index replication is no greater than 10% of the relevant security's weighting in the Index.

12. The Trustee has appointed an independent party (the Fund's auditors) to provide an annual confirmation that the operations of the Fund have conformed to these criteria.

13. The minimum subscription amount for a natural person investing in the Fund is $200,000. The Trustee is authorised to accept from an investor a subscription in kind, i.e. a subscription in the form of a basket of securities that achieves a result of the Fund tracking the then Index composition.

14. Disposition of securities by the Trustee on behalf of the Fund (other than those in the cash pool) will only occur in the following circumstances:

(a) If the Fund is ever wound up.

(b) If, at any time, the Index composition changes and as a result the composition of the securities in the Fund no longer tracks the weightings in the Index.

(c) If, on any day, there is a net withdrawal of funds from the Fund by investing superannuation funds or natural persons which cannot be met out of the cash pool.

(d) If there is a claim on the Trustee in respect of the Fund that cannot be met other than as a result of liquidating some securities. This is not anticipated, but the Trustee needs some ultimate protection against extraordinary circumstances such as, say, a change in taxation law or an unanticipated liability or expense.

In respect of the events under subparagraphs (a) to (d), sales of securities will only be made to the extent required in each case.

15. A fee is payable to the Trustee of 0.3% per annum of the value of the net assets of the Fund.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

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

b) "Retail" funds which invest in the Fund are registered under the Superannuation Schemes Act 1989.

How the Taxation Laws apply to the Arrangement

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

- The Fund is a "superannuation fund" as defined in section OB 1.
- The Fund is a "qualifying trust" under paragraph (b) of the definition of "qualifying trust" in section OB 1 of the Act.

- By virtue of section HH 3(5), any amounts received by investors from the Fund shall not be included in the gross income of the investor.

The period or income year for which this Ruling applies

This Ruling will apply for the period from 1 April 2002 to 30 June 2002.

This Ruling is signed by me on the 20th day of March 2002

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/03

This is a product ruling made under section 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by the Public Trustee as trustee of the BNZ NZ Equity Index Trust ("the Trust").

Taxation Laws

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

This Ruling applies in respect of sections CF 3(1)(b) and CF 3(7) and the definition of "excess return amount" in section CF 3(14).

The Arrangement to which this Ruling applies

The Arrangement is the establishment and operation of the Trust which holds a portfolio of securities listed on the New Zealand Stock Exchange ("NZSE") and the repurchase by the Manager of, or arranging for the redemption of, units in the Trust for the Unit Holders.

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

1. The Bank of New Zealand ("the Settlor") formed a unit trust, under the Unit Trusts Act 1960 known as BNZ NZ Equity Index Trust ("the Trust"). The operation of the Trust is governed by the Trust Deed dated 19 March 1997 as amended by Deeds of Modification dated 26 November 1998 and 23 March 2001. The Trust is managed by BNZ Investment Management Limited ("the Manager") and its trustee is the Public Trustee ("the Trustee"). Members of the public hold units in the Trust and units in the Trust are offered to new investors continuously.

2. The Trust is a passive investment vehicle, managed so as to track the composition of a set of listed equity securities which together form the constituent part of the Index ("the Index"), known as the BNZ 25 Equity Index. The index comprises up to 25 of the largest New Zealand equity securities listed on the NZSE. The Trust will not be subject to any active management as such. Rather, it will be managed to track the composition of a set of listed equity securities that together form the constituent parts of the Index.

3. The Index is an equivalent of the well-known NZSE 10 and NZSE 40 indices, except that it will comprise up to 25 of the largest listed New Zealand equity securities, measured by average weekly market capitalisation. As with the NZSE 10 and NZSE 40 indices, the weighting of each security in the Index reflects its respective market capitalisation on the NZSE at the relevant date. The "home" exchange of each stock can be any of the "grey list" countries as they are defined in the New Zealand tax law.

4. If the equity security is listed on the NZSE and meets the other criteria, it will be included in the Index. The equity securities are normally shares, but there may also be convertible notes.

5. The market capitalisation for securities that have their "home" exchange outside New Zealand are calculated under the standard NZSE rules for weighting of non-New Zealand equities.

6. Where identical constituent securities exist in the market except for ownership restrictions (such as Air New Zealand A and B shares), the Index previously only included one of those constituent securities. The Index now includes all the identical securities.

7. Approximately 95% of the net asset value of the Trust Fund of the Trust is invested in such investments as the Manager considers necessary to track the Index. While the majority of available funds are invested to track the Index, a "cash pool" of the net assets of the Trust is maintained in order to minimise the number of sale and purchase transactions and to fund any daily net fund withdrawals and net fund inflows pending purchase of equity securities and to manage the liquidity of the Trust in respect of meeting anticipated liabilities, withdrawals and distributions. The cash pool is only invested in bank accounts, cash, derivatives or futures contracts that give appropriate equity exposure.

8. The beneficial interest in the Trust is divided into units. Each unit (other than a fractional unit that will confer a proportional interest in the Trust) confers an equal interest in the Trust, but does not confer any interest in any particular part of the Trust or any investment of the Trust.

9. Changes are made to the Index composition in the following circumstances:

   (a) At the end of each quarter, securities will be ranked according to their average weekly market capitalisation for the previous 6-month period. If a security not previously included in

the Index has risen at the quarter-end above 21st position, that security will be included as a constituent security in the Index and the lowest ranked Index security held at the quarter end will be removed. If a security that is currently included in the Index at the quarter end has dropped below a ranking of 30th, that security will be removed as a constituent security from the Index and the highest ranked security at the quarter end not already included in the Index will be included. The Trust Deed defines "quarter" as the three months ending on the 15th of April, July, October and January respectively. Currently, the quarterly rebalancing occurs at the end of a month. The change in date is purely administrative, that is, to avoid clashing with the end of the financial year of the Trust and to avoid the inconvenience resulting from the high level of market activity at that time.

(b) At the end of each quarter, securities are reviewed with regard to compliance with the necessary minimum liquidity requirements. In order to be included and to maintain inclusion in the Index, a constituent security must meet a minimum liquidity requirement. Liquidity is defined as the average daily trading volume of a security (over a 6-month period leading up to the end of the relevant quarter, after eliminating the highest and lowest months), expressed as a percentage of the total issued and quoted securities of the same class. The minimum liquidity measure for inclusion in the Index is 0.75% per month. This requirement does not apply to a security listed on the NZSE for the first time until the end of the second complete quarter following listing. If there are less than 25 securities which meet the minimum liquidity requirements, then there may be less than 25 securities included in the Index.

(c) If an event such as a share issue or share buy-back occurs so as to increase or decrease the number of any constituent security on issue and that increase or decrease, measured by market capitalisation on a cumulative basis since the last adjustment, is less that 0.03% of the Index, then any adjustments to the Index will be made at the end of the quarter in which the number of listed securities are increased or decreased. In the event that an increase or decrease represents more than 0.03% of the Index, an adjustment to the Index will be made, subject to five business days' notice, on the 15th day or the last day (whichever next follows the relevant increase or decrease) of the month in which the number of listed securities is increased or decreased.

(However, it should be noted that if there is a rights issue to existing security holders including the Trustee, the Manager will endeavour to take up the rights issue in anticipation of the change to the Index which is expected to result from the issue.)

(d) If a security is listed on the NZSE for the first time, it will be included in the Index in the month of listing if:

(i) it ranks, in terms of market capitalisation, above 21st position (compared with other Index securities ranked according to their average weekly market capitalisation for the previous 6-month period); and

(ii) at least 25% of the security is freely tradeable at the time of listing.

If the security is listed before the 15th day of the month, it will be included in the Index on the 15th day and otherwise will be included at the end of the month. The security previously ranked 25th within the Index at that time will be removed.

If a security listed on the New Zealand Stock Exchange for the first time does not meet the 25% free float test at the time of listing but meets that 25% test at the end of the quarter in which listing occurs or the following quarter, it will be included in the Index at the relevant quarter end (subject to ranking above 21st at that time). Again, the security previously ranked 25th will be removed at that time.

(e) If the Manager recommends, and the independent party (the Trust's auditors) agrees, the Index must be altered to reflect a material change to the rules governing the NZSE 40 Index structure made by the NZSE.

(f) If there is a merger, takeover offer or scheme of arrangement sanctioned by the High Court for 100% of the issued securities of a company:

(i) the company's securities will be removed from the Index when the offeror or acquiror becomes entitled to, and announces that it will, proceed with compulsory acquisition; and

(ii) if the offer has less than 100% acceptance but nevertheless proceeds and, at that time or any time after the merger, takeover offer or scheme of arrangement proceeds, less than 25% of the company's securities are freely tradeable as a result of the merger, take over offer or scheme of arrangement, the company's securities will be removed from the Index.

10. The criteria stipulated in paragraph 9 (with the exception of subparagraphs (d), (e), and (f)) are similar to the criteria adopted with regard to the NZSE 10 Index. The Manager has appointed an independent party (the Trust's auditors) to provide an annual confirmation that the operations of the Trust have conformed to these criteria.

11. The Manager will use best endeavours to track the Index as closely as possible. In circumstances where the Manager is using best endeavours to track the Index as closely as possible, deviation from the Index may occur where it is not possible to exactly replicate the Index for one or more of the following reasons:

    (a) The time taken to buy equities;

    (b) Difficulties in acquiring equities;

    (c) Rounding errors; or

    (d) Price fluctuation

    but in any such case deviation from the Index will not exceed the following tolerance levels:

    (a) in the case of securities the Index weighting of which is 10% or greater of the total Index, the deviation from the Index replication is no larger than 1% of the Index; or

    (b) in the case of securities whose Index weighting is less than 10% of the Index, the deviation from the Index replication is no greater than 10% of the relevant security's weighting in the Index.

12. The minimum subscription amount for units in the Trust is $5,000. Investors are able to subscribe for units in the Trust by making a cash payment. The Manager is authorised to accept from an investor a subscription in kind, i.e. a subscription in the form of a basket of securities that achieves a result of the Trust tracking the then Index composition.

13. Disposition of securities by the Trustee on behalf of the Trust (other than those in the cash pool) only occurs in the following circumstances:

    (a) If the Trust is ever wound up either by sale of securities for cash and distribution of the cash, or alternatively by distribution of securities in specie to investors holding units in the Trust.

    (b) If, at any time, the Index composition changes and as a result the composition of the securities in the Trust no longer tracks the weightings in the Index. Any such disposition will not involve any discretionary exercise of investment management powers.

    (c) If, on any day, there is a net withdrawal of funds from the Trust by investors holding units in the Trust. It is expected that dispositions of securities to fund withdrawals will be likely on at most a weekly basis. It will be possible for the Trustee to satisfy a withdrawal request by distributing a basket of securities in specie.

    (d) If there is a claim on the Trustee in respect of the Trust that cannot be met other than as a result of liquidating some securities. This is not anticipated, but the Trustee needs some ultimate protection against extraordinary circumstances such as, say, a change in taxation law or an unanticipated liability or expense.

    In respect of the events under subparagraphs (a) to (d), sales of securities will only be made to the extent required in each case.

14. A fee is payable to the Trustee of 0.07% per annum of the net assets of the Trust, calculated and accruing on a daily basis. A management fee is to be payable to the Manager of 0.95% per annum of the net assets of the Trust, calculated and accruing on a daily basis. No other general management fee will be levied, but it is contemplated that front-end promotion fees (entry fees) will be payable.

15. Any income on the held securities received by the Trustee in respect of the Fund is distributed, on an annual basis, to investors holding units in the Trust at that point in time. To the extent that the distribution can be fully imputed, an amount equal to taxable gross income is allocated to Unit Holders and reinvested, normally annually, by the Manager into new units on behalf of the Unit Holders. The Unit Holders, therefore, derive dividends for tax purposes. In addition, it is possible that the Trust may on occasions distribute cash amounts on account of taxable gross income.

16. The Trust will generally determine dates of allocation of entitlements and the distribution periods to which entitlements relate in terms of clauses 32 and 33 of the Trust Deed so that investors receive distributions just prior to the 31 March of each year.

17. Under clause 32 of the Deed, the Manager is required to allocate taxable gross income to Unit Holders, and reinvest those amounts into new units on behalf of the Unit Holders. To the extent that the distribution can be fully imputed, an amount equal to taxable gross income will be allocated to Unit Holders and reinvested, normally annually, by the Manager into new Units on behalf of the Unit Holders.

Any departure from this practice can only occur if Unit Holders elect to have their entitlements distributed in cash pursuant to clause 33.4 of the Trust Deed.

18. Unit Holders are able to redeem their units at any time by giving notice, in the form of a repurchase request, to the Manager. Their units are redeemed at a price equal to the net assets of the Trust (adjusted to take into account the costs of selling the net assets of the Trust) at the time, divided by the number of units on issue.

19. It is possible for the Manager to purchase the units from the Unit Holders as an alternative to redemption. Where units are repurchased, the Manager pays the Unit Holder a price equal to the net assets of the Trust (adjusted to take into account the costs of selling the net assets of the Trust) at the time, divided by the number of units on issue.

20. The issuing of units and their redemption will be effected directly by the Trustee. No units are otherwise quoted on the official list of any "recognised exchange", as defined in section OB 1. All units will be issued on terms that the reverse ordering rule applies.

21. Any cancellation of units will only be effected in order to allow Unit Holders to exit the Trust or decrease their holding in the Trust, unless an investor's unit holding falls below a minimum value specified in the Trust Deed, in which case the Manager can require the Unit Holder to redeem their units. Units will also be cancelled in the event that the Trust is liquidated

22. Except in the event of liquidation of the Trust, any cancellation of units will be in response to the activities of a particular Unit Holder, and not all the Unit Holders of the Trust. All redemptions will be of whole units (including whole fractional units), not part units.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) Subject only to the second paragraph of this condition, the proportion of the Applicant's assets to be held as the cash pool will not exceed what is strictly necessary in order to fulfil the purposes of the cash pool (as described in paragraphs 7 and 8 of this Ruling), and will not in any event exceed 5% of the total assets of the Trust.

   This condition will not be regarded as being breached if, pending investment of contributions or disbursement of the redemption proceeds, the Trust is forced to hold cash in excess of 5% of the net asset value of the Trust. In any such case the excess will only be to the extent, and exist only for the time, that is strictly necessary in order to invest contributions or disburse redemption proceeds and the Trust will invest or disburse such cash, as soon as possible.

b) The cash pool must not be used in order to increase the performance of the Trust or to enhance the Trust Fund's value. To the extent that the operation of the cash pool seeks to obtain the maximum market rate of return on cash pool investments, any such maximisation will not of itself be taken to be a breach of this condition.

c) The reason for changing the end of the quarter from the end of the relevant month (being March, June, September, and December) to the 15th of the relevant month (being, April, July, October and January) is purely administrative. It is to avoid the need to undertake the re-balancing and matters associated with the end of the financial year of the Trust at the same time, and also to avoid a flurry of activities in the market at that time because of the large number of "passive" index-linked funds that are in existence in the market and rebalance then. The purpose of this change is not to increase the performance of the Trust or enhance the value of the share capital in the Trust.

(d) The Manager will not exercise its discretion under clauses 32 and 33 of the Deed to determine the dates of allocation of entitlements and the distribution periods to which entitlements relate to increase the performance of the Trust or to enhance the Trust Fund's value.

(e) The Manager will only depart from the requirement to reinvest taxable distributions for Unit Holders in further units upon a written request from Unit Holders to do so pursuant to clause 33.4 of the Deed.

(f) The Manager will use best endeavours to track the Index as closely as possible.

   In circumstances where the Manager is using best endeavours to track the Index as closely as possible, deviation from the Index may occur where it is not possible to exactly replicate the Index for one or more of the following reasons:

   (i) The time taken to buy equities;

   (ii) Difficulties in acquiring equities;

   (iii) Rounding errors; or

   (iv) Price fluctuations,

but in any such case, deviation from the Index will not exceed the following levels:

(i) in the case of securities the Index weighting of which is 10% or greater of the total Index, the deviation from the Index replication is no larger than 1% of the Index; or

(ii) in the case of securities whose Index weighting is less than 10% of the Index, the deviation from the Index replication is no greater than 10% of the relevant security's weighting in the Index.

g) Decisions by the Manager not to participate in dividend reinvestment plans will only be made to avoid an acquisition of equity securities that would lead to the Trust not tracking the Index.

h) Dispositions resulting from changes to the Trust Deed, and the resultant inclusion of dual-listed securities and the inclusion of identical constituent securities will only occur once, and any disposition will not be to increase the performance of the Trust or to enhance the Trust Fund's value or involve any discretionary exercise of investment management powers.

How the Taxation Laws apply to the Arrangement

Except in relation to Unit Holders who are non-resident companies holding 20% or more of the units in the Trust, and subject in all respects to the conditions above, the Taxation Laws apply to the Arrangement as follows:

- Amounts paid from the Trust to Unit Holders on redemption of units do not constitute amounts paid in lieu of dividends for the purposes of section CF 3 (1)(b)(iii).
- Equity securities of the Trust constitute "capital assets" for the purposes of section CF 3 (7) and the definition of "excess return amount" in section CF 3 (14).
- For the purposes of the definition of the term "excess return amount" in section CF 3 (14), gains realised on dispositions of equity securities by the Trust are capital gain amounts available for distribution to Unit Holders at the time of winding up of the Trust in the present circumstances where prior distributions of amounts to Unit Holders on redemption of units will be treated as falling outside the definition of the term "dividend", as a result of the application of section CF 3 (1)(b) and the reverse ordering rule.

The period or income year for which this Ruling applies

This Ruling will apply for the period from 1 April 2002 to 30 June 2002.

This Ruling is signed by me on the 20th day of March 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/04

This is a product ruling made under section 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by Sovereign Services (NZ) Limited.

Taxation Laws

This Ruling applies in respect of the following sections of the Income Tax Act 1994 and the Goods and Services Tax Act 1985:

- Income Tax Act 1994, sections BD 1, BD 2, EH 1- EH 10, HH 1(8), HH 3 to HH 8 and the definitions of "unit trust", "beneficiary income", "trustee income", "core acquisition price", "financial arrangement" and "unit holders" in section OB 1.
- Goods and Services Tax Act 1985, sections 3, 14 and 55(7) and the definition of "insurance" in section 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the establishment, administration and carrying on of the Select Investor Service ("the Service") by Sovereign Services (NZ) Limited ("SSNZL"). SSNZL is the agent of Investors in the Service and the Manager of the Service. Further details of the Arrangement are set out in the paragraphs below.

1. SSNZL (formerly called Colonial Services (NZ) Limited) launched the Service [previously known as "Navigator Select Investor Service"] during August 1998, and for that purpose obtained Product Ruling BR Prd 98/71, and subsequently BR Prd 00/01. This Ruling replaces BR Prd 00/01 which expires on 31 March 2002.

2. The Service provides access for Investors to a range of investment products and fund managers with all reporting consolidated. It is open to all potential investors though at the option of SSNZL where the Service is promoted through a particular distribution channel or adviser it may be co-branded with the name of the distributor, though always retaining the word "Select".

3. The Administrator of the Service is Aegis Limited ("Aegis"), a subsidiary in the Sovereign group of companies. This role may be assigned to another entity in the Sovereign group from time to time without affecting in any way the duties of the Administrator. This Ruling applies only to those activities of the Administrator that are carried on in relation to the Service and are described in this Arrangement.

4. The Custodian and bare trustee of the Service, and the Nominee of the Investors, is the Public Trustee acting at all times through its nominee and wholly owned subsidiary, Navigator Nominees Limited ("NNL"), who may also act as the trustee of any superannuation scheme made available through the Service.

5. Investors are able to switch between investment options and make lump sum or regular contributions and withdrawals.

6. Investors are offered the choice of investing in:

   (i) unit trusts (New Zealand, Australian and elsewhere);

   (ii) group investment funds ("GIFs"); and

   (iii) UK Investment Trusts.

7. Possibly in the future a master superannuation fund will be added. The superannuation fund will in turn offer a choice of investment in wholesale superannuation funds, GIFs and unit trusts. In addition, Investors may be offered the facility to invest in "direct" investment securities on a case by case basis including: participatory securities, interest bearing securities, and shares other than unit trusts, group investment funds and Investment Trusts.

8. The Manager will approve the various unit trusts, GIFs and the Investment Trusts selected by Jarden Morgan Investment Services Limited from time to time based on performance. Investors will be entitled to select their own "direct" investments if that option is offered to the Investors.

9. In addition to the various investment options, Investors may also elect to include supplementary insurance benefits such as life cover, total and permanent disablement, trauma cover and income cover.

10. Investors in the Service may be supplied with both life and non-life insurance cover through the Service.

11. Investors come to SSNZL to use the Service through their financial advisers. The Manager, the

Administrator and the Custodian of the Service act only as directed by Investors and do not give any investment advice or make any investment decisions under delegated authority from the Investors. Jarden Morgan Investment Services Limited under contract to SSNZL selects the product mix of the Service and makes the asset allocation decisions of the premixed selection options.

12. Reporting to Investors under the Service is purely to provide information to Investors on details of their investments and income from their investments as well as to deliver an annual statement for taxation purposes. The reports do not constitute what is regarded in the industry as "monitoring" nor do they contain investment advice.

13. The Investors' agent and Manager of the Service is SSNZL. The Manager of the Service is appointed as the Investors' agent pursuant to an investment authority given under the Investor Information Document ("the IID") to instruct the Custodian to acquire, dispose of, and receive the income from investments on behalf of the Investor.

14. The Administrator is charged under the Administration Agreement primarily with making and withdrawing from investments on behalf of Investors as well as collecting and processing the cash flows that arise from them. As an adjunct to that activity it must carry out the consequential administration, reporting and record keeping activities that make up the Service.

15. Investors under the IID appoint the Custodian to act as bare trustee and nominee in subscribing for and holding investments in safe custody in its name on their behalf. Investors undertake to be bound by the terms of the Custodian Agreement, and authorise the Manager to delegate its powers (including those delegated to it by the Custodian) to the Administrator.

16. The Custodian also establishes a trust account under the Cash Holding Account Agreement to facilitate all the cash flows of the Service. The administration and management of that account is delegated to the Manager who in turn delegates it to the Administrator.

17. An Investor who wishes to use the Service will be handed an IID, which will:

    (i) Background the structure of the Service.

    (ii) Explain in general terms the operation of the pertinent Administration, Custodian, Delegation and Cash Holding Account Agreements (together with the IID described in this Ruling as "the Agreements") by which the Service is implemented.

    (iii) Contain detachable application forms and an Investment Authority by which Investors can identify their investment selections.

18. An Investor wishing to use the Service will then make application and execute an Investment Authority under which the Investor will:

    (i) Provide a declaration pursuant to which Investors will: authorise the Manager and Custodian to act as their agent and bare trustee/nominee respectively, be bound by the Custodian Agreement, and consent to the delegation of services to the Administrator.

    (ii) Confirm the Investor's receipt of investment statements for each option selected.

19. Investors in products other than the superannuation fund first pay their moneys into a Cash Holding Account of the Custodian run by the Administrator who records and identifies by Investor all deposits, investments, income, withdrawals, expenses, and tax information. From this account the Administrator as delegate of the Manager disperses funds into Investors' various investment options. Interest and dividend income as well as sale proceeds and further investment moneys are all received into the Cash Holding Account which acts as a general clearing account for all funds received from or to be disbursed to Investors. Investors are required to maintain a minimum credit balance in this account.

20. Investors in the superannuation scheme (if made available) will become direct members of the scheme, and their investment choices are activated as members of the scheme.

21. Investors expressly acknowledge receipt of an investment statement (and at their option a prospectus) where one has been issued from their financial adviser for each product that they select, including the superannuation scheme (if made available).

22. The relevant documentation is:

    (i) The Administration Agreement, being an agreement between the Manager and the Administrator.

    (ii) The Custodian Agreement, being an agreement between the Manager and the Custodian.

    (iii) The Cash Holding Account Agreement between the Custodian and the Manager.

    (iv) The IID (and the Investment Authority given under the IID by the Investor) between the Manager, the Investor and the Investor's financial adviser.

(v) The Delegation Agreement between the Manager and the Custodian.

23. The Investor undertakes in the IID to be bound by the three other agreements relevant to the Investor.

24. Title to investments is held by the Custodian, and the Cash Holding Account is also in the name of the Custodian.

25. The Administrator will operate the Cash Holding Account, record and trace all investments made by individual Investors, and report to them at regular intervals on the value of their investments, the income derived and any tax deductions made.

26. The Administrator under the Administration Agreement provides a means of recording each Investor's interest in the underlying products.

27. The Custodian Agreement at paragraph 2.1(e) expressly describes the pooling as aggregation for "administrative convenience". The pooling is subject to the proviso that adequate tracing be maintained at all times.

28. Taking into account the effect of delegations, the essence of the Agreements can be summarised as follows:

(i) The Manager provides the entire facility and arranges for investments to be made, changed, or sold by instructing the Custodian as the Investor's agent.

(ii) The Custodian holds title to the investments and the Cash Holding Account as bare trustee for each Investor.

(iii) The Administrator makes, changes or sells the investments, pays and collects the resulting cash flows and attends to all consequential administration, processing, record keeping and reporting requirements of the Service.

29. The services rendered in respect of each fee charged in relation to the Service are:

(i) Investment/Contribution fee:

- Processing applications by Investors.
- Arranging the acquisition of investments.
- Providing four switches per annum.
- Providing documentation.

(ii) Administration fee:

- Keeping records of Investors and their portfolios.
- Investor level transaction recording and tracing.
- Maintaining a computer system that delivers the service requirements.
- Allocating and processing distributions for Investors.
- Reporting to Investors and preparation of Investor tax statements.
- Executing proxies and voting rights of the Custodian.
- Reporting to the Custodian.
- Maintaining Investors' Cash Holding Accounts.
- Responding to Investor queries about the Service.

(iii) Custodian fee:

- Use of the Custodian's name as security holder. (The tasks of subscribing, safe custody and withdrawing from the investments are delegated to the Administrator, leaving the Custodian merely lending his or her name as security holder for the investment.)

(iv) Switching fee:

- Processing investment switches.

(v) Expense fee:

- Printing and distributing Investor information documentation, investment statements and prospectuses, excluding establishment expenses of the Service.
- Audit, accounting and legal compliance services, excluding establishment expenses of the Service.

(vi) Regular withdrawal fee:

- Direct crediting money to accounts for singular/regular withdrawals.

(vii) Withdrawal fee:

- Processing withdrawal applications.

(viii) Adviser service fee:

- Supplying financial planning and portfolio monitoring services.

(ix) Fund manager fee:

- On-going charging for management (investment and administration) of GIFs or unit trusts (where charged to the Investor by the Fund Manager or trustee) for:

- Annual management costs.
- On-going monitoring of the investments.
- Purchasing and selling investments.
- Maintaining computer system to record investments.
- Receiving and processing distributions.
- Reporting to Investors.
- Reporting to trustee.
- Responding to customer queries.
- Acting as trustee.
- Use of the trustee/statutory supervisor's name as security holder. (The tasks of subscribing, safe custody and withdrawing from the investments are delegated to the Manager, leaving the trustee/ statutory supervisor merely lending his or her name as security holder for the investment.)
- Maintaining register of Investors.
- Accounting and legal fees excluding establishment expenses of the fund.
- Preparing and distributing cheques and statements.
- Printing stationary.
- Cost of holding investor meetings.
- Any other miscellaneous cost incurred in managing the funds.
- Issuing expenses.

(x) Brokerage fee:

- Brokerage paid to broker to arrange entry into listed trusts.
- Brokerage paid to broker to arrange exit from listed trusts.

(xi) Insurance cover:

- The supply of life insurance cover.
- The supply of non-life insurance cover.

30. The way in which each fee is calculated is set out in the Agreements. The rates and methods used to calculate such fees may be varied from time to time. However, any type of fee not described above, charged in the future, will not be subject to this Ruling.

31. The adviser service fee, the fund manager fee and the brokerage fee are not charged by the Manager, Custodian or the Administrator of the Service. Investors through the Service pay these fees for services supplied to them through the Service by their adviser, fund managers and brokers. This Ruling does not consider the goods and services tax treatment of the adviser services fee, the fund manager fee and the brokerage fee paid by Investors.

32. In respect of the fees charged by fund managers, a separate contribution fee is ordinarily charged for set up costs. Due to the size of the investment through the Service, the fund managers have waived this fee for Investors through the Service.

Assumption made by the Commissioner

This Ruling is made subject to the following assumption:

a) The Investors are resident in New Zealand under section OE 1 or OE 2 of the Income Tax Act 1994.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The final form of the Agreements will not differ materially from the draft Agreements received by Adjudication & Rulings on 16 March 1999 and 23 June 1999. The changes contained in the new schedule B to the Administration Agreement as a result of the assignment of the Agreement to Aegis, which was provided to Adjudication & Rulings on 27 November 2001, are not material to the Ruling.

b) Where an Investor is under a legal disability, the Manager, Administrator and the Custodian will not have or exercise the receipt, control, or disposition of any income derived by that investor, but may act on the instructions of whomsoever the law gives the capacity to act on behalf of that Investor. No additional powers accrue to the Manager, Administrator or the Custodian because of a lack of capacity of an Investor beneficiary so as to change the nature of the bare trust relationship.

c) Except for the non-life insurance cover supplied to Investors through the Service, the investments and facilities available through the Service are any debt security, equity security, participatory security, credit contract, contract of life insurance, superannuation scheme, or futures contract

referred to in section 3(1)(ka) of the Goods and Services Tax Act 1985.

d) The fees described in this Ruling are charged only for the services listed under each fee in the Arrangement.

e) The fees charged by the Administrator to the Manager under the Administration Agreement will be negotiated on an arm's length basis.

f) The Manager, Custodian and the Administrator undertake no services that, either directly or indirectly through the selection of the product mix of the Service, involve planning an Investor's portfolio or advising on an Investor's portfolio or making investment decisions or recommendations for an Investor.

g) Sovereign makes goods and services tax returns as a group under the provisions of section 55 of the Goods and Services Tax Act 1985.

h) The only activities carried on by the Administrator in relation to the Service are as described in the Arrangement to this Ruling.

i) The Manager will only disapprove investments in "direct" investment securities (if that option is offered to Investors) if, and only if, the purchase of a particular share or investment on behalf of the customer will, in the reasonable and bona fide view of the Manager:

- Result in excessive costs to the Manager due to administrative complexity; or
- Be unlawful or contrary to the Manager's own interests; or
- Expose the Manager to use its own funds with respect to uncalled or partly paid shares.

j) Any fee that is charged in relation to the Service is on an arm's length, stand alone commercial basis so as only to reflect the relevant services listed and will not be directly or indirectly related to or affected by any other services or fees.

How the Taxation Laws apply to the Arrangement

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

- The Service, to be launched to the public by SSNZL, as the Manager and the Investors' agent, Aegis Limited as the Administrator, and NNL as the Custodian of the Service pursuant to a bare trust, is not a "unit trust" as defined in section OB 1 and the Investors are not "unit holders" as also defined in section OB 1.
- As a consequence of Investors having direct ownership of their investment choices, the income from investments made by the Investors through the Service and held by the Custodian, will be gross income of the relevant Investor under section BD 1, and not the Manager, the Administrator or the Custodian.
- All the fees listed in the Arrangement that are paid by an Investor who is liable to be assessed pursuant to sections CD 3, CD 4, or CD 5 in respect of gross income received from investments through the Service, are deductible to that Investor under section BD 2, except to the extent that the fees (not being either contingent upon implementation of a "financial arrangement" or non-contingent upon implementation of a "financial arrangement" but exceeding 2% of the "core acquisition price" of a "financial arrangement" as those terms are defined in the qualified accrual rules) are incurred in gaining or producing exempt income or an amount that is excluded from being gross income.
- The following fees are not deductible to an Investor who is not liable to be assessed pursuant to sections CD 3, CD 4, or CD 5 in respect of gross income received from investments through the Service:
  - The investment/contribution fee.
  - The withdrawal fee.
  - The brokerage fee.
  - The switching fee.
  - The adviser service fee to the extent that it relates to planning services.
- The following fees paid by an Investor who is not liable to be assessed pursuant to sections CD 3, CD 4, or CD 5 in respect of gross income received from investments through the Service, are deductible to that Investor under section BD 2 except to the extent that the fees (not being either contingent upon implementation of a "financial arrangement" or non-contingent upon implementation of a "financial arrangement" but exceeding 2% of the "core acquisition price" of a "financial arrangement" as those terms are defined in the qualified accrual rules) are incurred in gaining or producing exempt income or an amount that is excluded from being gross income:
  - The administration fee.
  - The custodian fee.
  - The expense fee.
  - The regular withdrawal fee.

- The fund manager fee.
- The adviser service fee to the extent that it relates to monitoring services.

- The fees paid by the Manager in relation to the Service to the Administrator, or to any broker, agent, or associate of the Administrator, or to any independent research resource, are deductible under section BD 2 by the Manager.
- GST is payable in respect of any fees charged for non-life insurance cover to Investors through the Service.
- Except for any fees charged for non-life insurance cover to Investors through the Service, the fees listed in the Arrangement in this Ruling that are charged by the Manager, the Custodian and the Administrator in relation to the Service are exempt from GST by reason of the application of section 14 of the Goods and Services Tax Act 1985.
- The representative member of the Sovereign group is required to make a return of goods and services tax under section 55(7) of the Goods and Services Tax Act 1985 in respect of any fee charged for the Administrator's services supplied in relation to the Service, where Investors are supplied with non-life insurance cover through the Service.
- There is no requirement for the representative member of the Sovereign group to make a return of goods and services tax under section 55(7) of the Goods and Services Tax Act 1985, in respect of the Administrator's services supplied in relation to the Service, except where Investors are supplied with non-life insurance cover through the Service.

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 April 2002 until 30 June 2002.

This Ruling is signed by me on the 28th day of March 2002.

Martin Smith

General Manager (Adjudication & Rulings)

NEW LEGISLATION

TAX PROVISIONS OF NEW ZEALAND STOCK EXCHANGE RESTRUCTURING ACT 2002

Introduction

The New Zealand Stock Exchange Act was enacted on 22 February 2002. The purpose of the Act is to:

- enable a qualifying member's ownership entitlement in the New Zealand Stock Exchange (NZSE) to be determined;
- provide a mechanism for the conversion of the NZSE into a company, if the NZSE members decide this course of action;
- allow all the property, rights, and liabilities of the NZSE to vest on the restructuring day in the company that the NZSE becomes or a wholly owned subsidiary of that company; and
- treat the company and the NZSE as the same person upon its conversion.

The Act also contains tax provisions addressing specific tax issues related to the NZSE's conversion.

Background

The NZSE, a body corporate, was established by statute in 1981 to take over the rights and responsibilities of the previous four regional exchanges. This current corporate form does not allow the NZSE, a private organisation, to operate a modern and flexible corporate governance structure. The New Zealand Stock Exchange Restructuring Act 2002 provides a mechanism for the conversion of the NZSE into a company incorporated under the Companies Act 1993, if its members so choose. The NZSE Board is required to prepare a restructuring proposal that, amongst other things, sets out a method for establishing, or a statement as to which qualifying members have a ownership entitlement and the extent of that ownership entitlement.

Key features

If the NZSE members approve the restructuring plan and the NZSE converts into a company, on the restructuring day the company must issue shares to the qualifying members in accordance with their ownership entitlements. Section 15(1) of the New Zealand Stock Exchange Restructuring Act provides that the issue of such shares is not a dutiable gift for the purposes of the Estate and Gift Duties Act 1968. “Restructuring day” means the day specified as the restructuring day by the Governor-General by Order in Council.

Section 15(2) of the New Zealand Stock Exchange Restructuring Act provides for the purposes of Income Tax Act 1994 that:

- qualifying members will acquire the shares issued for a cost equal to the value immediately before the restructuring day of member's ownership entitlement as determined under the method or statement referred to in the restructuring proposal; and
- those members will have held shares and voting interest attributable to those shares at all times prior to the restructuring day.

Application date

The tax related provisions apply from the day of enactment, 23 February 2002.

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.

MODULAR NYLON TILE CARPETS DRAFT GENERAL DEPRECIATION DETERMINATION

Please quote reference: DDG00057

We have been asked to review the basic economic depreciation rate applying to "Carpets" under the "Residential Rental Property Chattels", "Hotels, Motels, Restaurants, Cafes, Taverns and Takeaway Bars" and "Shops" industry categories and the "Building Fit-out" asset category as it applies to carpets constructed of modular nylon carpet tiles.

The Commissioner proposes to issue a general depreciation determination which will insert a new asset class "Carpets (modular nylon tile construction)" into the "Residential Rental Property Chattels", "Hotels, Motels, Restaurants, Cafes, Taverns and Takeaway Bars" and "Shops" industry categories and the "Building Fit-out" asset category. It is also proposed to amend the description of the existing "Carpets" asset class to "Carpets (other than modular nylon tile construction)" in those same industry and asset categories. The "Carpets (modular nylon tile construction)" will have a depreciation rate of 12% DV (8% SL), based on an estimated useful life of 15.5 years while the depreciation rate for "Carpets (other than modular nylon tile construction)" of 33% DV (24% SL) based on an estimated useful life of five years, remains unchanged.

The draft determination follows. The proposed new depreciation rate is based on the estimated useful life set out in the draft determination and a residual value of 13.5%.

This determination may be cited as "Determination DEP[x]: Tax Depreciation Rates General Determination Number [x]".

1. Application

This determination applies to taxpayers who own the asset classes listed below.

This determination applies to "depreciable property" other than "excluded depreciable property" acquired on or after the date this determination is made.

2. Determination

Pursuant to section EG 4 of the Income Tax Act 1994 I hereby amend Determination DEP1: Tax Depreciation Rates General Determination Number 1 (as previously amended) by:

- Deleting from the "Residential Rental Property Chattels", "Hotels, Motels, Restaurants, Cafes, Taverns and Takeaway Bars" and "Shops" industry categories and the "Building Fit-out" asset category, the general asset class, estimated useful life, and diminishing value and straight-line depreciation rates listed below:

General asset class	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Carpets	5	33	24

- Inserting into the "Residential Rental Property Chattels", "Hotels, Motels, Restaurants, Cafes, Taverns and Takeaway Bars" and "Shops" industry categories and the "Building Fit-out" asset category, the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

General asset class	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Carpets (modular nylon tile construction)	**15.5**	**12**	**8**
Carpets (other than modular nylon tile construction)	**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.

If you wish to make a submission on the proposed changes, please write to:

Manager, Field Liaison & Communication
Adjudication & Rulings
Inland Revenue Department
National Office
P O Box 2198
WELLINGTON

We need to receive your submission by 30 June 2002 if we are to take it into account in finalising the determination.

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.

TAX AVOIDANCE AND EVIDENCE EXCLUSION RULE

Case: TRA 004/2000 and 05/2000

Decision date: 16 April 2002

Act: Income Tax Act 1976, S 99; Income Tax Act 1994, BB 9, GB 1, Tax Administration Act 1994, S 138G.

Keywords: *Tax Avoidance, Evidence Exclusion Rule*

Facts

Two dentists practising in partnership restructured their existing dental practice as two trading trusts. This decision concerns only one of the trading trusts and former partners.

Decision

The TRA decision is an interim decision, apparently as the TRA has requested further evidence to determine the 1996-year. A question arises as to whether the TRA is at liberty to act on any further evidence, because of S 138G of the Tax Administration Act 1994.

The TRA made the following findings:

- The restructuring was an arrangement within S 99/76 and SS BB 9 and GB 1 of the 1994 Act.
- The purpose of the arrangement was tax avoidance for 1995, but not for 1996.
- For 1995, the effect of the arrangement in terms of tax saving is merely incidental. As noted above, Judge Barber indicated he has not come to a final decision, and has requested further evidence in respect of the effect of the arrangement in 1996.
- On the evidence exclusion argument, the TRA found that any sensible consideration of the issues must cover what took place, which involves looking at whether a reduction in tax actually occurred or could occur. The TRA considered that while the statement of position did not specifically raise the change in balance date argument, the argument was merely a refinement of argument based on available evidence. He accepted a submission from the taxpayer that S 138G is not designed to close off avenues of argument from disclosed facts, it is only designed to stop a taxpayer from producing new documents and arguments at the last moment.

CONDITIONAL LEAVE TO GO TO PRIVY COUNCIL REFUSED

Case: M & J Wetherill Company Ltd & Ors v Taxation Review Authority & Commissioner of Inland Revenue

Decision date: 30 April 2002

Act: Tax Administration Act 1994, Taxation Review Authorities Act 1994

Keywords: *Judicial Review. Leave to go to Privy Council*

Summary

The applicants were unsuccessful in their application for leave to appeal to the Privy Council.

Facts

This case relates to certain participants of a well-known tax avoidance scheme developed by Mr J G Russell, an Auckland accountant. Mr Russell's template has been held to be a tax avoidance arrangement (see the Privy Council in *O'Neil v CIR* (2001) 20 NZTC 17,051).

This case was an application for conditional leave to apply to the Privy Council against a judgment of the Court of Appeal dated 14 March 2002 ((2002) 20 NZTC 17,624). The Court of Appeal's decision was an appeal and cross-appeal from a High Court decision of O'Regan J, delivered on 9 May 2001 ((2001) 20 NZTC 17,166). That decision was a judicial review application relating to two earlier Taxation Review Authority ("TRA") cases, *Case U35* (2000) 19 NZTC 9,330 and *Case U41* (2000) 19 NZTC 9,380.

The Commissioner had attempted to have a number of cases stated, relating to Mr Russell's template, heard in the High Court rather than the TRA. The taxpayers resisted this course of action. In *Case U35* the TRA granted the Commissioner leave to file the cases stated in the TRA out of time. The taxpayers attempted to appeal *Case U35* to the High Court. In *Case U41* the TRA refused to allow an appeal of *Case U35* and struck out the application.

The taxpayers/applicants judicially reviewed the two TRA decisions. The applicants were largely successful before O'Regan J in the High Court (O'Regan J ordered Judge Barber to reconsider his decision in *Case U35*), but appealed certain points where they had been unsuccessful. The Commissioner cross-appealed on all points where he was unsuccessful.

The Court of Appeal dismissed the applicants' appeal and allowed the Commissioner's cross-appeal. Effectively the TRA's decision in *Case U35* was upheld, as was the decision in *Case U41*.

The applicants sought conditional leave to appeal to the Privy Council from the Court of Appeal's judgment of 14 March 2002. To obtain leave the applicants had to come within rule 2(a) or rule 2(b) of the Privy Council (Judicial Committee) Rules Notice 1973.

Decision

The Court of Appeal dismissed the application. Richardson P noted that "[t]he issues are essentially of a procedural and process nature and are not directed at the substantive tax liabilities of the applicants". The President then addressed the four situations raised by the applicants.

Case U35 – rule 2(a)

The applicants argued that their civil right (valued more than $5,000) was the right for a direction that their objections be allowed if the TRA was satisfied that there are reasonable grounds for the Commissioner's failure to file the cases stated on time. They relied on *CIR v Vela Fishing Limited* (2002) NZTC 17,448, where conditional leave was granted. However, the President distinguished *Vela* on the grounds that it turned on the validity of the assessment.

Richardson P said:

> *Vela* is distinguishable. It turned on the validity of the assessment. … There is no basis for concluding, even assuming that the reasonable grounds inquiry is confined to the restricted period for which Mr Judd contends, that the civil right has any particular value, let alone a value of at least $5,000.

Case U35 – rule 2(b)

Richardson P rejected the applicant's application under this limb. The applicants argued that the Court of Appeal had not properly addressed the scope of "reasonable grounds" in regulation 6(4) of the Taxation Review Authority Regulations. His Honour held that they had ample opportunity to raise the relevant arguments before the Court of Appeal and noted that the relevant procedural regulations were from a statutory scheme which has now been superseded.

Case U41 – rule 2(a)

The applicants argued that the civil right was the right of general appeal to the High Court under section 26 of the Taxation Review Authorities Act 1994 against the decision of the TRA. They further submitted that the tax at stake, and therefore the value of the civil right, was over $5,000. The applicants argued that although the judicial review was unsuccessful, the right of appeal was still worth $5,000. However, Richardson J concluded that although the tests are different, in some circumstances they overlap to the extent that the same decision would have to be given whatever route is chosen. The application under rule 2(a) was dismissed.

Case U41 – rule 2(b)

The Court of Appeal rejected the application under this heading noting that the merits of the case had been decided in relation to *Case U35*, so any appeal relating to *Case U41* would be redundant.

OTHER ITEMS OF INTEREST

FURTHER CLARIFICATION OF RULES FOR NON-RESIDENT CONTRACTORS

The tax-rules for non-resident contractors, in New Zealand for short periods of time, were recently simplified. From 1 April 2002, non-resident contractors who are present in New Zealand for less than 62 days in total in any 12-month period and are exempt under a double tax agreement no longer have to apply for a certificate of exemption.

Applying this initiative in practice

We have received a number of queries on how this initiative would work in practice. The article *'Tax simplification – reducing compliance costs for non-resident contractors'* in TIB Vol 14 No 3 (March 2002) outlined a number of scenarios in which the new rules would or would not apply. The two primary considerations are:

(a) New Zealand presence of less than 62 days in any 12-month period

The "presence" test requires a non-resident contractor to have been present in New Zealand for a total period of less than 62 days in any 12-month period. The test takes into account prior as well as current (or proposed) presence in New Zealand.

For example, if a non-resident contractor who intends to be present in New Zealand for a period of 20 days starting on 1 June 2002, was also present for a period of 15 days in August 2001, the total time expected to be spent in New Zealand in the relevant 12-month period (from 21 June 2001 to 20 June 2002) would be 35 days. The non-resident contractor would, therefore, comply with the presence test under the new rules.

On the other hand, if the non-resident contractor expected to be present in New Zealand for a longer period—say, from 1 June to 20 July 2002 (50 days)—then his or her total expected presence in New Zealand for the relevant 12-month period (from 21 July 2001 to 20 July 2002) will exceed the prescribed limit.

(b) Whether the non-resident contractor is exempt under a double tax agreement

New Zealand has double tax agreements with 26 countries including Australia, the United Kingdom and the United States, and agreements with several others are pending. A full list of New Zealand's double tax agreements follows at the end of this article. While these agreements generally exempt short-term non-resident contract activities in the respective countries, specific exclusions apply.

For example, if a non-resident contractor is deemed to have a permanent establishment or other fixed base in New Zealand for the purposes of conducting a contract activity, that activity is taxable in New Zealand. A "permanent establishment" is a defined term and means a fixed place of business through which the business of an enterprise is wholly or partly carried out. This can range from a branch or an office to a factory or other work-site.

Some double tax agreements also deem a permanent establishment to exist where activities are carried out in connection with the exploration or exploitation of natural resources, or if substantial equipment is used in respect of a contract being undertaken here. Our double tax agreements with Australia and the United Kingdom, for example, have an exploration/ exploitation clause. The treaty with Australia also has a substantial equipment clause. Our double tax agreements with other countries, such as Japan and Canada to name a few, also have their own distinctive provisions.

Most double tax agreements also allow New Zealand to tax "royalties" derived by non-resident contractors from New Zealand. Royalties are typically defined for purposes of double taxation agreements as including, for example, payments for the supply of commercial, industrial and scientific equipment and/or certain forms of knowledge. If the non-resident contact activity involves the supply of such equipment or information, that activity is likely to be taxable in New Zealand.

Once again, not all double tax agreements are the same, and some will allow the taxation of services that would not normally be considered as royalties. For example, our double tax agreement with Canada extends to payments made in respect of the supply of scientific, technical, industrial or commercial assistance, including the provision of management services. Other double tax agreements may only tax equipment rentals if they are based on production. While this is not usually referred to in the royalty article, it is contained in the agreement's "protocols".

Obligations on non-resident contractors and their employers

It is the responsibility of non-resident contractors and their employers, when applying this initiative, to take reasonable care ensuring that the New Zealand presence test is met and in determining whether the contract activity being undertaken is exempt under a double tax agreement. If reasonable care has not been taken, resulting in a breach of the legislation and/or default of tax, Inland Revenue may take the appropriate steps to recover any tax payable and may also impose penalties and interest.

As the onus is on the payer—typically the employer—under the non-resident contractors' withholding tax rules to deduct tax where applicable, if there is a default, Inland Revenue will have to consider what penalties (and interest) should be imposed. Each case will be looked at on its merits when deciding whether reasonable care has been taken by a payer. Depending on the circumstances, Inland Revenue may have to consider if a taxpayer has displayed gross carelessness, made an unacceptable interpretation of the legislation, taken an abusive tax position, or committed evasion.

Contact Inland Revenue if unsure about your obligations

The application of New Zealand's double tax agreements can be complex. Similarly, establishing the period of presence of a non-resident contractor in New Zealand may prove difficult. Circumstances may also arise which unexpectedly result in the qualification criteria being breached. If unsure of your obligations contact Inland Revenue on (04) 802-6056 (email: nr.contractors@ird.govt.nz) for further information on how this tax simplification change affects you.

Countries with which New Zealand has double tax agreements

Australia	Belgium
Canada	China
Denmark	Fiji
Finland	France
Germany	India
Indonesia	Ireland
Italy	Japan
Korea	Malaysia
Netherlands	Norway
Philippines	Switzerland
Singapore	Thailand
Sweden	United States of America
Taiwan	United Kingdom

REGULAR FEATURES

DUE DATES REMINDER

MAY 2002

6 **Employer deductions and employer monthly schedule**

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

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

20 **Employer deductions**

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

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

Employer deductions and employer monthly schedule

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

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

31 **GST return and payment due**

FBT annual and fourth quarter returns and payment due

JUNE 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

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)

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- *Employer monthly schedule (IR 348)* due

28 **GST return and payment due**

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

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

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	Draft public rulings	***Comment deadline***
☐	PU0059a-d: GST and resource consents	30 June 2002

	Draft interpretation statement	***Comment deadline***
☐	IS3387: GST treatment of court awards and out of court settlements	30 June 2002

Items are not generally available once the comment deadline has passed

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