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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:

www.ird.govt.nz

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

If you find that you prefer to get the *TIB* from our website and no longer need a paper copy, please let me know so we can take you off our mailing list. You can do this by completing the form at the back of this TIB, or by emailing us at **IRDTIB@datamail.co.nz** with your name and details.

THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft item is available for review/comment this month, having a deadline of 31 October 2002.

Ref.	**Draft type**	**Description**
DDT00066	General depreciation determination	Graders (Capsicums)

Please see page 61 for the text of this item.

The following draft item is available for review/comment this month, having a deadline of 31 October 2002.

Ref.	**Draft type**	**Description**
PU0054	Public ruling	Provision of benefits by third parties: FBT consequences—section CI 2(1)

The following draft item is available for review/comment this month, having a deadline of 15 November 2002.

Ref.	**Draft type**	**Description**
IG0007	Interpretation guideline	Non-resident software suppliers' payments derived from New Zealand—income tax treatment

Please see page 74 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 02/06

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Public Trust as trustee ("the 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), CF 3(1)(c), 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 operation of the Trust. The operation of the Trust is governed by the Trust Deed dated 19 March 1997 ("the Trust Deed") as amended by Deeds of Modification dated 26 November 1998, 23 March 2001 and the Deed of Amendment which will be the same as, or not materially different from the draft deed provided to Inland Revenue on 10 June 2002 ("the Amending Deed").

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.

2. The Trust is managed by BNZ Investment Management Limited ("the Manager").

3. The Trust is a passive investment vehicle, investing only in a portfolio of equity securities, each of which is listed on the New Zealand Stock Exchange ("NZSE"), together with a small cash pool. The Trust will be 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").

4. Members of the public hold units in the Trust and units in the Trust are offered to new investors continually. At the time of this ruling, investors can either make an initial minimum payment to the Trustee of $5,000 (or $2,500 if also investing in another BNZ Managed Fund) or by setting up a regular savings plan with a minimum total regular contribution of $1,200 per year.

5. Unit holders of the Trust are only treated differently in relation to the application fees, issue price and exit price (to the extent that such prices change over time to reflect the change in value of the Trust) and costs associated with entry into, and maintenance of, the Trust.

6. The biggest unit holder in the Trust (at the time of this ruling) is Portfolio Nominees Limited. Portfolio Nominees Limited is the custodian of an asset administration service provided to a number of Investors. AUSMAQ (NZ) Limited is the administrator of this service. The service provided by AUSMAQ (NZ) Limited as administrator and the custodian is not an advisory service. The units in the Trust held by Portfolio Nominees Limited as custodian are held on bare trust. The custodian does not and cannot act on its own volition in relation to its investment into or withdrawal from the Trust.

The Index

7. The Index comprises up to 25 of the largest New Zealand equity securities listed on the NZSE, based on average weekly market capitalisation. 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. The weighting of each security in the Index will reflect its respective market capitalisation on the NZSE at the relevant date.

8. 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 will normally be shares but there may also be convertible notes.

9. The market capitalisation for securities that have their "home" exchange outside New Zealand will be calculated under the standard NZSE rules for weighing of non-New Zealand equities.

Cash investments of the Trust

10. Approximately 93 – 95% of the net asset value of the Trust will be invested in such investments as the Manager considers necessary to track the Index. While the majority of available funds will be invested to track the Index, a "cash pool" of up to 7% of the net assets of the Trust if the Trust Fund is below $5 million or 5% of the net assets of the Trust if the Trust Fund is above $5 million will be maintained subject to the exceptions listed in condition (a) of the existing binding private ruling for the Trust (BR PRV 02/32). The pool is only invested in bank accounts or money market deposits. Although it is not an objective of the Trust to invest in cash securities, the Trust may hold cash to facilitate easier administration of the Trust. In any event the cash pool will not exceed what is strictly necessary in order to fulfil the following purposes:

    (a) Allow for cash outflows due to expenses and net withdrawals and to pay the annual dividend to unit holders.

    (b) Allow for net cash inflows from investments and dividends to accumulate to a level sufficient to minimise the transaction and administrative costs associated with analysing which stocks are to be purchased and making the necessary purchase orders.

11. 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.

Index changes

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

    (a) At the end of each quarter (being a three month period ending on, respectively, 15 April, 15 July, 15 October and 15 January, a "quarter"), securities will be ranked according to their average weekly market capitalisation for the previous six-month period (ie the six-month period ending on the end of the month preceding the quarter end). If a security not previously included in the Index has risen at the end of the six-month period above the 21st position, that security will be included as a constituent security in the Index at the quarter end 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 by the end of the six-month period, 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.

    (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 (over a six-month period leading up to the end of the month preceding 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. In the event that there are not 25 securities that meet the liquidity requirement, the number of securities in the Index would be less than 25.

    This liquidity test does not apply to a new listing, which falls within the concessionary rule in paragraph (c) on the next page, until the end of the second complete quarter following the quarter in which listing occurs.

(c) If a security is listed on the NZSE for the first time, it will be included in the Index immediately if:

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

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

   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.

(d) If the Trustee recommends and the independent monitor referred to in paragraph 19 agrees, then the Index must be altered to reflect a material change to the rules governing the NZSE 40 Index structure made by the NZSE.

(e) If there is a merger, takeover offer, scheme of arrangement sanctioned by the High Court or other offer under the Takeovers Code for all of the issued securities of a company:

   (i) the company's securities will be removed from the Index when the offeror 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, scheme of arrangement or other offer proceeds, less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(f) If there is one or more partial offer under the Takeovers Code for control (50% or more) of a company included in the Index and at any time after such offer or offers less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(g) If there is one or more partial offer under the Takeovers Code for less than 50% of a company included in the Index and at any time after such offer or offers less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(h) If, under the Takeovers Code, a company's shareholders approve an allotment of securities and, at any time after that approval is given, less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(i) If a company's securities are acquired under Rule 7(e) of the Takeovers Code and, at any time after the securities are acquired, less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(j) If there is a rights issue or bonus issue (other than a bonus issue election scheme for reinvestment of dividends) to existing security holders, the Index will be changed to reflect the issue of shares on the issue's "ex" trading date. (If the rights issue is not fully underwritten, the adjustment is calculated as if all rights were exercised.)

(k) If there is any other form of capital reconstruction in relation to a constituent security and an adjustment is made to the NZSE 40 Index to reflect the change, the Index will be adjusted on the same date to reflect the capital reconstruction.

(l) If any other capital adjustment event such as a share issue (including under a dividend reinvestment scheme) or share buyback occurs which increases or decreases the number on issue of any constituent security 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, then an adjustment to the Index will be made, subject to five business days' notice, on the 15th day of the month in which the number of listed securities is increased or decreased.

Rights issues

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

14. Notwithstanding paragraph 13, if the securities that are the subject of the entitlement are over-represented, the Manager will sell the entitlement and reinvest the proceeds in securities to track the Index.

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

Rebalancing

16. The Trust is rebalanced in the following circumstances:

    (a) When the quarterly adjustments are made to the Index;

    (b) When the Index changes other than quarterly due to market-driven changes or corporate actions such as merger, takeover, bonus issue, rights issues and capital reconstructions;

    (c) If the Trust's holding of a security will be (or is) outside the tolerance levels provided for in paragraph 18 of this Ruling.

17. None of these factors is within the control of the Manager and the factors always trigger rebalancing.

18. The Manager will use best endeavours to track the Index as closely as possible. Rebalancing will only occur in accordance with condition (b) of the existing binding private ruling for the Trust (BR PRV 02/32) and any deviation from the Index remaining after rebalancing will not exceed 1% of the Index.

19. The Trustee 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.

20. 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, ie a subscription in the form of a basket of securities that achieves a result of the Trust tracking the then Index composition.

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

    (a) If the Trust is ever wound up.

    (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.

    (c) If, on any day, there is a net withdrawal of funds from the Trust by investors holding units in the Trust which cannot be met out of the cash pool.

    (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.

    (e) If the Trust is rebalanced in accordance with paragraph 16 of the Arrangement.

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

22. A fee is payable to the Trustee, which is currently 0.065% (plus GST, if any) per annum of the net assets of the Trust, calculated and accruing on a daily basis. A management fee is payable to the Manager, which is currently 0.95% (plus GST, if any) 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 frontend promotion fees (entry fees) will be payable.

23. The Trust is required to buy and sell shares as required to ensure that it continues to correspond to the Index. Such buying and selling will not be motivated by any intention to derive a profit or gain from such sales. In this regard, the Trust Deed when amended by the Amending Deed will state:

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

24. The Manager has confirmed that all aspects of the previous ruling (BR PRV 01/29), relating to the Trust, have been complied with.

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

26. 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. That amount will be reinvested, normally annually, by the Manager on the unit holders behalf and new units will be issued to 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.

27. The issuing of units and their redemption will be effected directly by the Trustee. No units are

27. 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.

28. The units will not be issued on such terms that their redemption is subject to the slice rule as stated in section CF 3(1)(b)(iv)(A).

29. 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.

30. Except in the event of liquidation of the Trust, any cancellation of units will be in response to the request 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) This Ruling only applies while this Trust remains a "widely-held trust", as that term is defined in section CF 3(14) and the Trust units are offered to the public. This condition will not be considered breached:

- where the Trust is suspending subscriptions in accordance with condition (o) of the existing binding private ruling for the Trust (BR PRV 02/32), or
- during the period following the Manager and/or Trustee giving notice of the termination of the Trust, units are no longer being offered to the public.

b) Any cancellation of units will not be part of a pro rata cancellation as that term is defined in section CF 3(14). This condition will not be regarded as being breached solely by reason of a pro rata cancellation occurring upon winding up of the Trust.

c) The Trust units will not be quoted on the official list of any "recognised exchange" as that term is defined in section OB 1.

d) All dividends received by the Trust, less tax and expenses, will be allocated to unit holders annually. Those amounts will be treated as dividends and then either reinvested by the Manager on the unit holders behalf resulting in new units being issued to the unit holders or paid out in cash.

e) Apart from the Trust Deed, Prospectus and Investment Statement for the Unit Trust (as updated from time to time, provided that it does not differ materially from the one supplied to Inland Revenue), and/or any Rules of the Trust that have been supplied to Inland Revenue as part of the application for this Ruling, there is no agreement, arrangement or understanding between the Trustee or the Manager (or any party acting on behalf of the Trust) and any unit holder (or any person associated with or acting on behalf of any unit holder) regarding the control of the Trust, the nature and timing of its investments, or the timing of the investing or withdrawal of funds.

This condition shall not be regarded as breached by virtue only of:

(a) the fact that a unit holder has the ability to invest, or withdraw at any time; and/or

(b) the entry into any agreement, arrangement or understanding contemplated by the Trust Deed for the purpose of enabling investment or withdrawal (including letters to incoming unit holders explaining the operation of the Trust); and/or

(c) the entry into any agreement, arrangement or understanding for appointment or supervision by the Trustee of the Manager; and/or

(d) any agreement, arrangement or understanding entered into by the Trustee in a capacity other than as trustee of the Trust, or the Manager in a capacity other than as manager of the Trust, in the ordinary course of the Trustee or the Manager conducting an independent investment advisory or investment portfolio management business.

f) The existing binding private ruling for the Trust (BR PRV 02/32) (or any such replacement ruling) remains in force and continues to apply in all respects to the Arrangement.

g) The Amending Deed provided to Inland Revenue on 10 June 2002 will be executed by 9 August 2002 so that it is the same as, or not materially different from, the draft deed provided to Inland Revenue.

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:

- Any amount received by unit holders on redemption of units in the Trust will be excluded from the definition of "dividend "in section CF 2, by section CF 3 (1)(b), to the extent that that amount does not exceed the available subscribed capital per share cancelled.
- Any amount distributed in respect of any unit in the Trust upon the winding up of the Trust, to the extent that the amount distributed does not exceed the aggregate of:

  i) the available subscribed capital per share cancelled, and

  ii) the excess return amount,

  will be excluded from the definition of dividend in section CF 2, by section CF 3(1)(c).
- The equity securities constitute capital assets of the Unit Trust for the purposes of section CF 3(7) and the definition of the term "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.

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 July 2002 to 30 June 2005.

This Ruling is signed by me on the 12th day of July 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/07

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by BNZ Investment Management Limited as Trustee ("the Trustee") of the superannuation fund known as 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.

The Arrangement to which this Ruling applies

The Arrangement is the operation by the Bank of New Zealand of a superannuation fund known as the BNZ 25 NZ Equity Index Fund ("the Fund"). The operation of the Fund is governed by the Trust Deed dated 24 February 1997 ("the Trust Deed") as amended on 23 March 2001 and the Deed of Amendment which will be the same as, or not materially different from, the draft deed provided to Inland Revenue on 10 June 2002 ("the Amending Trust Deed").

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

1. The Fund is registered under the Superannuation Schemes Act 1989, as are the "retail" superannuation funds which invest in it.

2. The Sponsor of the Fund is the Bank of New Zealand. The Trustee is also the Manager of the Fund.

3. The Fund acts as a "wholesale" superannuation fund into which other "wholesale" and "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.

4. Members of the Fund are only treated differently in relation to the application fees, issue price and exit price (to the extent that such prices change over time to reflect the change in value of the Fund) and costs associated with entry into, and maintenance of, the Fund.

5. The "retail" funds investing in the Fund are superannuation funds (both employee and personal) which have previously been (or may in future be) established completely independently from the establishment of the Fund. For example, an existing BNZ "retail" fund, the Bank of New Zealand Future Lifestyle Plan, currently invests in the Fund. Superannuation funds other than superannuation funds established by or managed by the Bank of New Zealand have also invested in the Fund.

6. The Fund was established for the purposes of being a "wholesale" investment vehicle for other "wholesale" funds and "retail" superannuation funds and for the purposes of providing retirement benefits to the limited number of individual natural persons who invest directly in it. All the "wholesale" and "retail" superannuation funds which invest in the Fund have been or will be established for the purposes of ultimately providing retirement benefits for individual natural persons.

7. The Fund is a passive investment vehicle, investing only in a portfolio of equity securities, each of which is listed on the New Zealand Stock Exchange ("NZSE"), together with a small cash pool. The Fund will be 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").

The Index

8. 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 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. The weighting of each security in the Index will reflect its respective market capitalisation on the NZSE at the relevant date.

9. 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 will normally be shares but there may also be convertible notes.

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

Cash investments of the Fund

11. Approximately 99% of the net asset value of the Fund will be invested in such investments as the Trustee considers necessary to track the Index. While the majority of available funds will be invested to track the Index, a "cash pool" of up to 1% of the net assets of the Fund will be maintained subject to the exceptions listed in condition (a) of the existing binding private ruling for the Fund (BR PRV 02/33). The pool is only invested in bank accounts or money market deposits.

12. Although it is not an objective of the Fund to invest in cash securities, the Fund may hold cash to facilitate easier administration of the Fund. In any event the cash pool will not exceed what is strictly necessary in order to fulfil the following purposes:

    (a) Allow for cash outflows due to expenses and net withdrawals.

    (b) Allow for net cash inflows from investments and dividends to accumulate to a level sufficient to minimise the transaction and administrative costs associated with analysing which stocks are to be purchased and making the necessary purchase orders.

Index changes

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

    (a) At the end of each quarter (being a three-month period ending on, respectively, 15 April, 15 July, 15 October and 15 January, a "quarter"), securities will be ranked according to their average weekly market capitalisation for the previous six-month period (ie the six-month period ending on the end of the month preceding the quarter end). If a security not previously included in the Index has risen at the end of the six-month period above 21st position, that security will be included as a constituent security in the Index at the quarter end 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 by the end of the six-month period, 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.

    (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 (over a six-month period leading up to the end of the month preceding 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. In the event that there are not 25 securities that meet the liquidity requirement, the number of securities in the Index would be less than 25.

        This liquidity test does not apply to a new listing, which falls within the concessionary rule in paragraph (c) below, until the end of the second complete quarter following the quarter in which listing occurs.

    (c) If a security is listed on the NZSE for the first time, it will be included in the Index immediately if:

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

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

        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.

    (d) If the Trustee recommends, and the independent monitor referred to in paragraph 19 agrees, then the Index must be altered to reflect a material change to the rules governing the NZSE 40 Index structure made by the NZSE.

    (e) If there is a merger, takeover offer, scheme of arrangement sanctioned by the High Court or other offer under the Takeovers Code for all of the issued securities of a company:

        (i) the company's securities will be removed from the Index when the offeror 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, scheme of arrangement or other offer proceeds, less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(f) if there is one or more partial offer under the Takeovers Code for control (50% or more) of a company included in the Index and at any time after such offer or offers less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(g) if there is one or more partial offer under the Takeovers Code for less than 50% of a company included in the Index and at any time after such offer or offers less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(h) if, under the Takeovers Code, a company's shareholders approve an allotment of securities and, at any time after that approval is given, less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(i) if a company's securities are acquired under rule 7(e) of the Takeovers Code and, at any time after the securities are acquired, less than 25% of the company's securities are freely tradeable, the company's securities will be removed from the Index.

(j) if there is a rights issue or bonus issue (other than a bonus issue election scheme for reinvestment of dividends) to existing security holders, the Index will be changed to reflect the issue of shares on the issue's "ex" trading date. (If the rights issue is not fully underwritten, the adjustment is calculated as if all rights were exercised).

(k) if there is any other form of capital reconstruction in relation to a constituent security and an adjustment is made to the NZSE 40 Index to reflect the change, the Index will be adjusted on the same date to reflect the capital reconstruction.

(l) if any other capital adjustment event such as a share issue (including under a dividend reinvestment scheme) or share buyback occurs which increases or decreases the number on issue of any constituent security 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, then an adjustment to the Index will be made, subject to five business days' notice, on the 15th day of the month in which the number of listed securities is increased or decreased.

Rights issue

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

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

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

Rebalancing

17. The Fund is rebalanced in the following circumstances:

    (a) When the quarterly adjustments are made to the Index.

    (b) When the Index changes other than quarterly due to market-driven changes or corporate actions such as merger, takeover, bonus issue, rights issues and capital reconstructions.

    (c) If the Fund's holding of a security will be (or is) outside the tolerance levels provided for in paragraph 18 of this Ruling.

18. The Manager will use best endeavours to track the Index as closely as possible. Rebalancing will only occur in accordance with condition (b) of the existing binding private ruling for the Fund (BR PRV 02/33) and any deviation from the Index remaining after rebalancing will not exceed 1% of the Index.

19. 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.

20. The Trustee is authorised to accept from an investor a subscription in kind, ie a subscription in the form of a basket of securities that achieves a result of the Fund tracking the then Index composition.

21. 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.

(e) If the Fund is rebalanced in accordance with paragraph 17 of the Arrangement.

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

22. A fee will be payable to the Trustee by each member of up to 0.3% per annum of the value of the units held by that member (plus GST, if any).

23. Each investing superannuation fund must make a minimum initial contribution to the Fund of $200,000 or such lesser amount as the Trustee with the written consent of the Sponsor may approve.

24. Under the Trust Deed for the Fund, members of the Fund have an individual Member Account, into which is credited any contributions by the member together with any growth in value of the funds invested. It is anticipated that the Member Accounts will be calculated and recorded on a unitised basis, ie the total value of the Fund will be divided into units and each member will be allocated the number of units which reflects their respective contributions and earnings.

25. The Fund is required to buy and sell shares as required to ensure that it continues to correspond to the Index. Such buying and selling will not be motivated by any intention to derive a profit or gain from such sales. In this regard, the Trust Deed when amended by the Amending Deed will state:

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

26. The powers contained in clause 10.1(h) of the Trust Deed will only be exercised to facilitate the purposes of the Fund and in any event will only be used in accordance with paragraph 25 of this Ruling.

27. Members may from time to time elect to withdraw funds from the Fund. A substantial withdrawal from the Fund could be in the millions of dollars. In that circumstance, the Fund may not be able to fund the withdrawal in one portfolio trade as, depending on the market circumstances (including liquidity), brokers are likely to be limited as to the size of the trade they will accept at all. Even if a broker (or brokers) did accept a trade of significant size, they would not be able to guarantee that the trade would be completed or settled within three business days. In these circumstances the Fund will accumulate funds to the full withdrawal amount.

28. The Manager does not have the power to purchase units from Members.

29. The Applicant has confirmed that all aspects of the previous ruling (BR PRV 01/17) relating to the Fund have been complied with except that they received a compulsory share acquisition by court order which required the Fund to hold non-Index shares. This occurred during the Fletcher Energy acquisition when the Fund was issued shares in a company that did not track the Index. (The shares were in a United States company called Capstone. Each Fletcher energy shareholder was issued with a small number of Capstone shares as well as other consideration). As it was a court approved compulsory acquisition the Manager had no choice but to receive those shares. The terms of the issue of the Capstone shares meant that all the recipients had to hold the shares for a period of time before they could sell them and use the proceeds to invest in the Index.

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

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

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

b) The existing binding private ruling for the Fund (BR PRV 02/33) (or any such replacement ruling) remains in force and continues to apply in all respects to the Arrangement.

c) The Amending Deed provided to Inland Revenue on 10 June 2002 will be executed by 9 August 2002 so that it is the same as, or not materially different from the draft deed provided to the Inland Revenue.

How the Taxation Laws apply to the Arrangement

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

- The Fund is a "superannuation fund" as defined in section OB 1.
- The Fund is a "qualifying trust" under paragraph (b) of the definition of "qualifying trust" in section OB 1.
- Amounts derived by investors as a result of withdrawals from the Fund are excluded from gross income by virtue of section HH 3(5).

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 July 2002 to 30 June 2005.

This Ruling is signed by me on the 12th day of July 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/08

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 New Zealand Guardian Trust Company Limited as Trustee of the AMP Superannuation World Index Fund.

Taxation Laws

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

This Ruling applies in respect of sections BD 2, EE 1, EE 2, EF 1, EF 2 and HH 3(5).

The Arrangement to which this Ruling applies

The Arrangement is the redemption of Units in the AMP Superannuation World Index Fund ("the Fund") by members who receive securities for their redemption, and those shares are trading stock or revenue account property of that member. Further details of the Arrangement are set out in the paragraphs below.

1. The Fund is a registered superannuation scheme under the Superannuation Schemes Act 1989.

2. The Fund invests in securities of those companies that are included in the AMP World Index (the "AMP Index" or the "Index"). The AMP Index is a customised version of the Morgan Stanley Capital International World Index (the "MSCI World Index") and tracks those securities in the MSCI World Index which are from "grey list" countries if the market capitalisation of the country's securities included in the MSCI Index represents at least 1% of the MSCI Index. The Fund has been designed to provide members with a simple and cost-efficient method of investing in a portfolio with a performance broadly representative of the world share market.

3. The Trustee of the Fund is the New Zealand Guardian Trust Company Limited ("the Trustee"), although the Trust Deed contains provision for the retirement and replacement of the Trustee.

4. The Manager of the Fund is AMP Investment Management (NZ) Limited ("the Manager"), a wholly owned subsidiary of AMP Limited.

5. Clause 5.3.1A of the Trust Deed provides:

    > The Fund shall seek to track the Index by investing in Constituent Company Securities as near as practicably possible to their weightings in the Index and the Trustee's primary investment duty shall be to seek to achieve this purpose. All other investment duties (express or implied) shall be construed subject to this duty. The Fund and the Trustee shall not have an intention to profit from holding, acquiring or selling Constituent Company Securities.

6. The Trust Deed also ensures that any statutory superannuation schemes (ie any superannuation scheme constituted under an Act of Parliament or government superannuation scheme) can also join the Fund.

7. The Fund is required to buy and sell shares as required to ensure that its portfolio continues to correspond as near as practicably possible to the Index. Such buying and selling will not be motivated by any intention to derive a profit or gain from such sales. The sole purpose of the Fund will be to continue to track the Index as near as practicably possible irrespective of whether the sale of shares will give rise to a profit or loss.

8. The beneficial interest in the Fund is divided into units. Every unit confers an equal interest in the Fund, but does not confer any interest in any particular investment of the Fund.

9. The Applicant and the Manager have confirmed that, to the best of their knowledge, the Fund has complied with the previous rulings (BR PRV 01/105 and BR PRD 99/10) relating to the Fund.

The Trust Deed and Member's Booklet for the Fund

10. The terms of the Fund are provided in the Trust Deed. There are no clauses in the Trust Deed or Rules of the Fund or any other documents that operate differently for specific members or groups of members.

Membership

11. The Fund was established as a wholesale registered superannuation scheme in which any other superannuation scheme can invest. The Fund was not established by any particular financial institution as an investment vehicle for that institution.

Date of adjustments

12. The Fund is rebalanced every quarter and other adjustments are made as a result of mergers, takeovers, rights issues and share buybacks when those events occur.

Mergers, takeovers, share buybacks and rights issue

13. The Index may be adjusted from time to time because of mergers, takeovers, share buybacks, distributions of capital, cash issues, and substitutions of companies in the Index. With the exception of any situation where shares in a Constituent Company are compulsorily acquired pursuant to any companies legislation, listing rules or takeover code requirements, in the event of a merger or takeover, the Manager will adjust the Fund portfolio at a time as close as practically possible (but in any event within three business days) to the time the Index is adjusted. The Fund will not accept an offer unless as a consequence of not accepting the offer the Fund would track the Index less accurately than if it had accepted the offer.

14. In the event of a share buyback by a Constituent Company of the Index, the Manager will adjust the Fund portfolio at a time as close as practicably possible (but in any event within three business days) to the time the Index is adjusted.
This adjustment will not be made through electing to participate in a buyback scheme of a Constituent Company, except if the Fund is able to accept a buyback offer at the same time as an Index adjustment for that Constituent Company occurs.

15. In the event of any rights issue by a Constituent Company, the Manager will hold the entitlement if the entitlement is included in the Index. If the entitlement is not included in the Index, but the securities the subject of the entitlement will be immediately included in the Index, the Manager will retain the entitlement and take up the securities. If the Manager does not know whether the securities that are the subject of the entitlement will be included in the Index the Manager will sell the entitlement at the earliest possible time and reinvest the proceeds in the Constituent Companies to track the Index.

Events that trigger acquisitions or realisations

16. Initial contributions to the Fund are made through the Manager. The Manager deposits the cash contributions from the members into the Fund. The Manager invests these cash contributions, in return for which the Manager receives units on behalf of members. The Manager subcontracts the function of converting contributions to parcels of shares in companies included in the Index to Henderson Global Investors Limited ("the Investment Manager"). The Investment Manager is a United Kingdom incorporated subsidiary of AMP Limited. The Investment Manager will purchase securities in the Index according to the pre-determined rules set out above.

17. Under the Trust Deed, the Manager is responsible for further issues of Units in the Fund. The Manager is also responsible for Unit redemptions.

18. Dividends, net of any fees or expenses of the Fund, that accrue to the portfolio of shares held by the Fund will be invested in securities that constitute the Index or are held in cash pending the investment of that dividend.

19. There are certain reasons or events when investments held by the Fund will have to be bought or sold. The Fund will only sell or otherwise dispose of securities in the following circumstances:

    - If the Fund is voluntarily or involuntarily wound up, or if the Trustee is replaced (and this of itself means that there is a technical disposal of securities);
    - If there is a change in the AMP Index composition and the composition of the Fund no longer tracks the Index or when the Fund is otherwise required to buy and sell securities to maintain tracking;
    - On the redemption of Units in order to pay benefits to members;
    - Where proceeds are received by the Fund in the form of securities;
    - Where there is no election available and where dividends are received in the form of bonus securities and they are converted to cash;
    - Where securities are purchased in error;
    - To satisfy a legal claim made against the Fund or the Trustee;
    - To meet any expenses of the Fund, which are authorised by clause 10.3.10 or 11.3.2 of the Trust Deed.

20. Clauses 10.3.10 and 11.3.2 provide for the Trustee and Manager to be reimbursed from the Fund for all Administrative Expenses (as defined in the Trust Deed) incurred by them.

Payment of benefits

21. A member is only able to dispose of its Units by requesting the Manager to redeem the Units for the purpose of paying a benefit to that member.
A member may redeem Units subject to the conditions in clause 8 of the Trust Deed.
Clause 8.3.3 requires redemptions to be for amounts of at least $10,000 or all of a member's Units and no member is to be left with less than $100,000 worth of Units. The Manager may also suspend redemptions in the limited circumstances noted (at paragraph 30).

The redemption can be in the form of cash and/or cash equivalents and/or securities. Even though the Trust Deed gives the Manager a general discretion to redeem by cheque or the transfer of Constituent Company Securities or a combination of them (clause 8.3.4 of the Trust Deed), redemption in securities will only arise at the request of the member (ie redemption in securities will not arise at the discretion of the Manager/Trustee). In addition, the Manager will not exercise this discretion with a view to increasing the performance of the Fund in any way. Where a member requests a redemption in securities the Manager will only decline a request for redemption in securities due to size constraints (ie the number of units held by the member is small and as such a parcel of securities cannot be formed).

22. Redemptions will be made from the cash pool if sufficient funds are available, otherwise redemptions will be financed from the sale of securities. In addition, following a redemption, the cash pool will not normally be topped up and there is no specified period of time in which the cash pool will be injected with further funds. Accordingly, if there is insufficient cash to pay a redemption if it arises, the redemption will be financed through the sale of securities.

23. Members redeem Units directly with the Fund, with the Manager acting on behalf of the Trustee (ie members do not sell their Units to the Manager who then redeems them with the Fund).

24. Clause 8.3.2 of the Trust Deed provides:

> Every Benefit payable under this clause 8.3 shall be determined by multiplying the Redemption Price calculated on the date of acceptance by the Manager by the number of Units redeemed and become payable to the Member not later than ten (10) Business Days following the date on which the Manager receives the Benefit request or on any later redemption date requested by the Member.

25. Redemption Price is defined in clause 3 of the Trust Deed to mean the "Current Unit Value" less the "Exit Fee".

26. Current Unit Value is defined in clause 3 of the Trust Deed as:

> … on any date an amount that is arrived at by dividing the Current Fund Value by the number of Units on issue on such date …

27. The Current Fund Value is defined in clause 3 of the Trust Deed as:

> The amount calculated by adding as at any time when a valuation is required in relation to the Fund:
>
> (a) the total of the market value of all Cash, units in the AMP Investments' World Index Fund and investments of the Fund determined pursuant to clause 6; and
>
> (b) the income of the Fund due but not yet received; and
>
> (c) any other amounts which, in the opinion of the Manager, should be included for the purposes of making a fair and reasonable determination of the value of the Fund having due regard to duly accepted accounting practice and accounting principles from time to time;
>
> and deducting therefrom such amounts:
>
> (d) as are required to meet liabilities properly attributable to the Fund (actual or contingent and not otherwise allowed for in determining the value of any asset) to the extent that the Manager has decided that provision should be made in the accounts of the Plan;
>
> (e) as represent Administration Expenses payable by the Trustee or the Manager; and
>
> (f) which, in the opinion of the Manager, should be included for the purpose of making a fair and reasonable determination of the current value of the Fund having due regard to generally accepted accounting practice and accounting principles current from time to time.

28. Clause 3 of the Trust Deed provides that Market Value in relation to the Constituent Companies Securities in the Index means:

> … the last sale price of that security on its home stock exchange at any relevant time (provided that the last sale price is the same as or higher than the current buy price and lower than the current sell price. In the event that the last sale price is lower than the then current buy price, then the market value is the then current buy price and in the event that the last sale price is higher than the current sell price then the market value is the current sell price).

29. Exit Fee is defined in clause 3 of the Trust Deed to mean:

> … such sum, if any, as the Manager in its absolute discretion may determine (either generally or in relation to a particular Benefit) to be a fair fee payable in relation to the relevant Benefit to provide for the likely per Unit cost of realising Assets to meet that Benefit, having regard to the Manager's estimate of the aggregate of all costs, charges, expenses, disbursements, commissions, brokerage and other usual fees which would be likely to be incurred in respect of the sale or disposal of Assets on the date of calculation of the Redemption Price if Assets to fund a Unit's Redemption Price were sold or disposed of on such date.

Suspension of payment of benefits

30. Clause 8.5 of the Trust Deed provides that the Manager can suspend redemptions in certain circumstances up to a period not exceeding 20 business days. The Fund will not utilise the power to suspend the redemption of units except in exceptional circumstances (where and to the extent that it is necessary to do so) being:

    (i) if the Fund is unable to convert sufficient assets into cash, to meet a redemption request; or

    (ii) if the market value of the units at the time is not a true reflection of the actual value of the units, due to a suspension in trading of any Constituent Company Securities on any exchange; or

    (iii) if, for reasons beyond its control, the Manager is unable to calculate the redemption price.

    Any such suspension will be for a maximum period of three business days, except if an exceptional circumstance occurs that is beyond the control of the Trustee and the Manager of the Fund, in which case the suspension shall be only for such period as is strictly necessary for the Fund and/or the Manager to recover from that event.

31. The Fund has suspended redemptions on one occasion before. This suspension occurred as a result of the terrorist attacks in New York on 11 September 2001 as none of the underlying securities held by the Fund were being traded.

Ability to decline membership

32. Clause 7.1.5 of the Trust Deed provides that the Manager may accept or decline any application to become a member and shall not be required to give reasons for any such decision.

33. The Manager has never refused an application for membership. However, the Manager may in the future refuse applications for membership. The circumstances where this is likely to arise include:

    - Where the applicant is not, or ceases to be, a registered superannuation scheme or statutory superannuation scheme; or

    - Where accepting the application could result in the Fund breaching a Condition of the existing private ruling for the Fund (BR PRV 01/105 or any such replacement ruling).

Hedging

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

Borrowing

35. The Fund is permitted to borrow to pay Administrative Expenses. However, the Fund will not exercise its discretion to borrow, although the Fund may become inadvertently overdrawn (for no longer than strictly necessary) where the Fund is required to fund purchases of shares due to changes in the Constituent Companies in the Index where a security is sold and another purchased and a settlement mismatch occurs.

Cash investments held by the Fund

36. Although it is not an objective of the Fund to invest in cash securities, the Fund may hold cash to facilitate the easier administration of the Fund. The Fund will hold cash in the following instances:

    - Following the sale of securities in the course of tracking the Index, pending the reinvestment of that cash;

    - Following a contribution to the Fund, pending the investment of that contribution;

    - Following the receipt of a cash dividend or a non-cash dividend and its conversion to cash, pending the investment of that dividend;

    - Following the sale of securities to meet a request to redeem units in cash;

    - To accumulate the minimum amount of cash that will be used to purchase securities in a marketable and economically sensible sized parcel so as to minimise the Fund's transaction costs. The Manager has advised that this amount is presently US$1 million, but may reduce where a lower amount can permit transaction costs to be maintained at the current level (or a level not materially different).

37. The proportion of the Fund's assets to be held as cash or cash equivalents will not be greater than what strictly arises out of the above described circumstances, and in any event will not exceed 1% of the total assets of the Fund, except if the Fund receives a large cash contribution (provided the cash is invested as soon as possible and in any event within three business days) or a member requests a large cash redemption (provided the cash is distributed within three business days of the sale of securities).

38. Cash equivalents must have a maturity date of six-months or less. Cash equivalents will not include units in any unit trust or group investment fund.

39. It is not envisaged that the amount of cash required to enable the purchase of securities in a marketable and economically sensible sized parcel will change from US$1 million unless there are improvements in share trading systems that make it economic to trade in smaller parcels of shares. This would be

beneficial for the Fund as it would be able to invest surplus cash sooner and keep the cash levels in the Fund at a lower level than might otherwise be the case if the Fund is confined to a pre-determined minimum parcel size.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The Fund is an investment vehicle primarily for investment into by superannuation funds which are themselves either:

   (i) widely-held investment vehicles for direct investment by natural persons, or

   (ii) vehicles for investment (directly or indirectly) by other superannuation funds that are widely-held vehicles for direct investment by natural persons.

b) The Fund operates in accordance with its Trust Deed dated 4 December 1998.

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

d) The Fund only tracks the AMP World Index.

e) Where cash is distributed on redemption its market value will be its nominal value.

f) Where cash equivalents are distributed on redemption the value of this distribution will be the market value of these cash equivalents.

g) The market value of a security at any time shall be the value quoted on the relevant Stock Exchange at that time, as determined by the method provided in the definition of market value in Clause 3 of the Trust Deed.

h) The Manager in determining the Members' entitlement to securities on redemption of Units in the Fund under clause 8.3 of the Trust Deed, shall use the market value of those securities at the valuation time (as defined in the Trust Deed).

i) The formula for calculating the "Current Unit Value" as defined in clause 3 of the Trust Deed will remain unaltered for the period of this ruling.

j) The amounts derived by the Member from the subsequent sale or disposal of securities received on redeeming Units in the Fund will be gross income of the Member.

k) Members do not acquire Units in the Fund for the purpose of acquiring securities.

l) Units in the Fund are not tradeable on a secondary market.

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:

- Pursuant to section HH 3(5) any amounts (including securities) received by members as a result of redemption of Units in the Fund will not be gross income of the member.
- The cost of any securities acquired by a member on redemption of Units in the Fund is the market value of those Units at the valuation time of the Units redeemed less any cash or cash equivalents received.
- The market value of the Units redeemed is equal to the Redemption Price of those units.
- The cost of a security acquired by a member on the redemption of Units is an allowable deduction under section BD 2 and is deductible:
  - in full in the income year in which the Units are redeemed, if the member acquires the securities as trading stock for the purpose of section EE 1; and
  - in accordance with section EF 2 in the later of the income year in which the securities are disposed of and the income year in which the gross income is derived in respect of the disposition of the securities, if the member acquires the securities as revenue account property other than trading stock.

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 August 2002 to 31 July 2005.

This Ruling is signed by me on the 26th day of July 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/09

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 New Zealand Guardian Trust Company Limited as Trustee of the AMP Superannuation Tracker Fund.

Taxation Laws

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

This Ruling applies in respect of sections BD 2, EE 1, EE 2, EF 1, EF 2 and HH 3(5).

The Arrangement to which this Ruling applies

The Arrangement is the redemption of Units in the AMP Superannuation Tracker Fund ("the Fund") by members who receive securities for their redemption, and those shares are trading stock or revenue account property of that member. Further details of the Arrangement are set out in the paragraphs below:

The AMP Superannuation Tracker Fund

The Fund

1. The AMP Superannuation Tracker Fund ("the Fund") is a registered superannuation scheme under the Superannuation Schemes Act 1989. The Fund is not listed on the New Zealand Stock Exchange ("NZSE").

2. The Fund has been designed to provide members with a simple and cost effective method of investing in a portfolio with a performance broadly representative of the New Zealand share market.

3. The Trustee of the Fund is the New Zealand Guardian Trust Company Ltd ("the Trustee") although the Trust Deed contains provisions for the retirement or removal and replacement of the Trustee.

4. The Manager of the Fund is AMP Investment Management (NZ) Ltd ("the Manager"). The Manager invests the investors' contributions into the Fund. The Investment Manager/ Promoter of the Fund is AMP Henderson Global Investors (New Zealand) Ltd ("the Investment Manager"). The Investment Manager purchases securities in the Index, described more particularly in paragraphs 6 – 8 below. Both the Manager and the Investment Manager are owned by AMP Ltd, incorporated in New South Wales.

5. The Fund was established, as a wholesale registered superannuation scheme, principally for the purpose of paying benefits to persons who are trustees of superannuation schemes registered under the Superannuation Schemes Act 1989 and who elect to invest in the Fund.

Investment policy

6. The Fund is a passive or index investor and is required to hold a portfolio of shares and other notes and options ("the securities") that correspond to the composition and weighting of the Russell/JB Were Tradeable Index ("the Index"). The Index is a market weighted index with a target capitalisation representing at least 95% of a defined pool of tradeable securities listed on the New Zealand Stock Exchange.

7. Despite the Trust Deed providing that the Manager and Trustee can invest in other Indexes, and apart from permitted investments of the cash pool, the Fund will only invest in the securities that make up the Russell/JB Were Tradeable Index and will continue to track the Index as near as practicably possible irrespective of whether the sale of the shares will give rise to a profit or loss.

8. The Fund is required to buy and sell shares as required to ensure that it continues to correspond as near as practicably possible to the Index. Such buying and selling will not be motivated by any intention to derive a profit or gain from such sales. In this regard, Clause 5.3.1A of the Trust Deed states:

   > The Fund shall seek to track the Index by investing in Constituent Company Securities as near as practically possible to their weightings in the Index and the Trustee's primary investment duty shall be to seek to achieve this purpose. All other investment duties (express or implied) shall be construed subject to this duty. The Fund and the Trustee shall not have an intention to profit from holding, acquiring or selling Constituent Company Securities.

9. The Applicant and the Manager have confirmed that, to the best of their knowledge, the Fund has complied with the previous rulings (BR PRV 02/04, BR PRV 99/009 and BR PRD 99/11) relating to the Fund.

Adjustments to the Fund

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

    (a) The Fund's portfolio is monitored daily, to ensure that it is tracking the Index. The reference to "Fund's portfolio" means the Constituent Companies held by the Fund.

    (b) The Manager will re-balance the Fund to the Index following any adjustments to the Index. Such re-balancing will occur as soon as possible but in any case within three business days of a change to the composition of the Index.

Management and operation of the Fund

Borrowing

11. The Fund is permitted to borrow to pay Administrative Expenses. However, the Fund will not exercise its discretion to borrow, although the Fund may become inadvertently overdrawn (for no longer than strictly necessary) where the Fund is required to fund purchases of shares due to changes in the Constituent Companies in the Index where a security is sold and another purchased and a settlement mismatch occurs.

Hedging

12. This Fund only tracks shares listed in the NZSE and hence the Fund will purchase shares in New Zealand dollars. Accordingly, the Fund will not be exposed to foreign exchange risks.

Contributions to the Fund

13. Contributions to the Fund will be by way of parcels of securities or cash. Cash may be accepted in the following circumstances:

    (a) where there is a contemporaneous redemption against which the contribution can be netted off by receiving cash into the Fund and then paying it out on the redemption; or

    (b) to the extent the application cannot be made in securities due to uneven parcel sizes provided the cash pool remains below 0.5% of the total assets of the Fund and, except where the situations listed in paragraph 15 arise or where the cash is committed to fund an obligation that was known at the time of receipt of the subscription, the cash is converted to Constituent Company Securities as soon as practicably possible.

14. Members wishing to contribute cash may be required to purchase a parcel of securities through a separate arrangement with the Manager, or through other intermediaries (such as brokers and financial advisors).

Cash investments held by the Fund ("cash pool")

15. The proportion of the Fund'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 stated in paragraph 16 of this Ruling), and will not in any event exceed 0.5% of the total assets of the Fund, except if:

    (i) the Fund receives a large cash contribution (provided the cash is invested as soon as possible and in any event within three business days); or

    (ii) a member requests a large cash redemption (provided the cash is distributed within three business days of the sale of securities); or

    (iii) the Fund receives a large cash inflow from or in respect of a Constituent Company, such as a distribution due to a pro rata buyback or takeover or a change in the Constituent Companies of the Index (provided the cash is invested as soon as possible and in any event within three business days); or

    (iv) the Fund holds cash as a result of disposing of securities in the course of and for the purposes of winding up the Fund.

16. The purpose of the cash pool as set out in Clause 5.2.5 of the Trust Deed is:

    > The Trustee may maintain or invest in Cash in any amount representing up to five percent (5%) of the Current Fund Value at any time, PROVIDED THAT the investment in Cash shall only be used to facilitate the easier administration of the Fund and to reduce the number of transactions required to be made or to facilitate redemptions from time to time, but may not be used by the Manager or the Trustee to increase the performance of the Fund by maximising the holding of securities considered to be likely to give a high return or minimising the holding of securities considered likely to give a low return.

17. "Cash", as defined in Clause 3 of the Trust Deed includes:

    > deposits, or negotiable instruments, in each case having maturities which are not later than the times at which the proceeds of realisation thereof are expected to be required, and on which there is full indefeasible liability of:
    >
    > (a) a New Zealand registered bank (having the meaning given to that term by the Reserve Bank of New Zealand Act 1989) approved by the Manager for the purpose; or
    >
    > (b) the New Zealand government.

18. The size and operation of the cash pool will be strictly managed so as to reflect its three-fold purpose of:

    (a) Allowing funds to accumulate to an appropriate amount for investment, and

    (b) Minimising the number of equity security sale and purchase transactions, and

    (c) Managing the liquidity of the Fund in respect of meeting its anticipated liabilities and withdrawals.

19. When the cash held by the Investment Manager reaches the minimum investment level, it will be applied to acquire securities to track the Index as soon as practicably possible. The Manager has advised the minimum amount required to enable the purchase of every security in the Index in a marketable and economically sensible sized parcel is approximately $50,000, but may reduce where a lower amount can permit transaction costs to be maintained at the current level (or a level not materially different).

20. It is not envisaged that the amount of cash required to enable the purchase of securities in a marketable and economically sensible sized parcel will change from $50,000 unless there are improvements in share trading systems that make it economic to trade in smaller parcels of shares. This would be beneficial for the Fund as it would be able to invest surplus cash sooner and keep the cash levels in the Fund at a lower level than might otherwise be the case if the Fund is confined to a pre-determined minimum parcel size.

21. The Fund does not normally hold cash equivalents. Rather, the cash amounts are normally held in bank deposits and interest is paid on these deposits.

Dividend reinvestment

22. In the event of a dividend reinvestment option being available to the Trustee, the Manager will only accept such an option if it is consistent with tracking the Index. In all other cases, the Manager will decline the option and will always accept the cash dividend that will be immediately allocated to members.

Events that trigger acquisitions or realisations

23. There are certain reasons or events when investments held by the Fund will have to be bought or sold. The Trustee will only dispose of securities (other than cash pool investments):

    (a) If the Fund is voluntarily or involuntarily wound up or if the Trustee is replaced (and this of itself means that there is a technical disposal of securities);

    (b) If there is a change in the Index composition and the composition of the Fund no longer tracks the Index or when the Fund is otherwise required to buy and sell securities to maintain tracking;

    (c) When transferring securities to a member if the member redeems units for securities;

    (d) Where there is no option available to receive dividends in the form of cash, and dividends are received in the form of bonus securities and are converted to cash;

    (e) To satisfy a legal claim against the Fund or Trustee or to meet expenses of the Fund, but only to the extent to which such a claim or expense cannot be met from existing resources;

    (f) If a member or members require cash on redemption of units and such redemption cannot be met from the cash pool;

    (g) Where securities are purchased in error.

Redemption of units

24. A member is only able to dispose of their units by redeeming them. A member may redeem units subject to the conditions in Clause 8 of the Trust Deed. Clause 8 requires redemptions to be for amounts of at least $10,000 or all of a member's units and no member is to be left with less than $100,000 worth of units. The redemption can be in the form of cash and/or cash equivalents and/or securities.

25. Redemptions are usually made through the transfer of Constituent Company Securities (equal to the value of the units being redeemed and may also contain a small cash balancing item) but may, in the circumstances described below, be made in cash.

26. In the following circumstances a redemption will be made in cash (where that cash is not committed for other purposes):

    (a) Where there is a contemporaneous contribution against which the redemption can be matched; or

    (b) Where the cash is sufficient to fund the redemption in full, that redemption will be made from the cash pool; and

    (c) Where the cash is not sufficient to fund the redemption in full, the balance of the redemption will be made from securities in the proportions that will ensure that the Fund will continue to match the composition and weighting of the Index as near as practicably possible.

27. Clause 8.3.2 of the Trust Deed provides:

> Every Benefit payable under this clause 8.3 shall be determined by multiplying the Redemption Price calculated on the date of acceptance by the Manager by the number of units redeemed and become payable to the Member not later than ten (10) Business Days following the date on which the Manager receives the Benefit request or on any later redemption date requested by the Member.

28. Redemption Price is defined in clause 3 of the Trust Deed to mean the "Current Unit Value" less the "Exit Fee".

29. Current Unit Value is defined in clause 3 of the Trust Deed as:

> … on any date an amount that is arrived at by dividing the Current Fund Value by the number of Units on issue on such date …

30. The Current Fund Value is defined in clause 3 of the Trust Deed as:

> The amount calculated by adding as at any time when a valuation is required in relation to the Fund:
>
> (a) the total of the market value of all Cash, units in the AMP Investments' Tracker Fund and investments of the Fund determined pursuant to clause 6; and
>
> (b) the income of the Fund due but not yet received; and
>
> (c) any other amounts which, in the opinion of the Manager, should be included for the purposes of making a fair and reasonable determination of the value of the Fund having due regard to duly accepted accounting practice and accounting principles from time to time;
>
> and deducting therefrom such amounts:
>
> (d) as are required to meet liabilities properly attributable to the Fund (actual or contingent and not otherwise allowed for in determining the value of any asset) to the extent that the Manager has decided that provision should be made in the accounts of the Plan;
>
> (e) as represent Administration Expenses payable by the Trustee or the Manager; and
>
> (f) which, in the opinion of the Manager, should be included for the purpose of making a fair and reasonable determination of the current value of the Fund having due regard to generally accepted accounting practice and accounting principles current from time to time.

31. Clause 3 of the Trust Deed provides that Market Value in relation to a Constituent Company Security in the Index means:

> … its value as in the Index at any relevant time.

32. Exit Fee is defined in clause 3 of the Trust Deed to mean:

> ... such sum, if any, as the Manager in its absolute discretion may determine (either generally or in relation to a particular Benefit) to be a fair fee payable in relation to the relevant Benefit to provide for the likely per Unit cost of realising Assets to meet that Benefit, having regard to the Manager's estimate of the aggregate of all costs, charges, expenses, disbursements, commissions, brokerage and other usual fees which would be likely to be incurred in respect of the sale or disposal of Assets on the date of calculation of the Redemption Price of Assets to fund a Unit's Redemption Price were sold or disposed of on such date.

Suspension of redemptions

33. Clause 8.5 of the Trust Deed provides that the Manager can suspend redemptions in certain circumstances up to a period not exceeding 20 business days. The Fund will not utilise the power to suspend the redemption of units except in exceptional circumstances (where and to the extent that it is necessary to do so) being:

    (i) if the Fund is unable to convert sufficient assets into cash, to meet a redemption request; or

    (ii) if the market value of the units at the time is not a true reflection of the actual value of the units, due to a suspension in trading of any Constituent Company Securities on any exchange; or

    (iii) if, for reasons beyond its control, the Manager is unable to calculate the redemption price.

    Any such suspension will be for a maximum period of three business days, except if an exceptional circumstance occurs that is beyond the control of the Trustee and the Manager of the Fund, in which case the suspension shall be only for such period as is strictly necessary for the Fund and/or the Manager to recover from that event.

Utilisation of member expenses for tax purposes

34. The Trust Deed has been amended to allow the Trustee to credit a Member's Account with units in recognition of any tax deduction that the Plan has received as a result of an election by that member under section DI 3(2) of the Income Tax Act 1994. The Trust Deed was amended, by the Second Deed of Amendment dated 1 February 2002, by inserting Clause 12A. Sub-clause 12A.1, which is relevant for the purposes of the Ruling, provides that:

> Where a Member has made an election under section DI 3(2) of the Income Tax Act 1994 (*"section DI 3(2)"*) that any expenditure, which is incurred by the superannuation scheme for which the Member is a trustee (or, in respect of a superannuation scheme constituted under an Act of Parliament, the person appointed to administer the superannuation scheme),

be treated as if it were expenditure incurred by the Plan and the Plan has received a tax deduction as a result of that election, the Trustee shall credit to the Member Account of the relevant Member such number of Units as the Trustee considers equitable to recognise such tax deduction. For the avoidance of doubt, the number of units to be issued in normal circumstances would be calculated by reference to the amount determined by dividing the amount of any tax benefit which the Manager considers arises from the tax deduction by the Issue Price applying on the Business Day on which the tax benefit is considered by the Manager to arise.

35. The Fund will always issue Units according to the above Clause and there will be no discretion as to whether the Fund will in fact issue Units in accordance with the above Clause.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following Conditions:

a) The Fund is an investment vehicle primarily for investment into by superannuation funds which are themselves either:

   (i) widely-held investment vehicles for direct investment by natural persons, or

   (ii) vehicles for investment (directly or indirectly) by other superannuation funds that are widely-held vehicles for direct investment by natural persons.

b) The Fund operates in accordance with its Trust Deed dated 10 February 1999.

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

d) The Fund only tracks the Russell/JB Were Tradeable Index.

e) Where cash is distributed on redemption its market value will be its nominal value.

f) Where cash equivalents are distributed on redemption, the value of this distribution will be the market value of these cash equivalents.

g) In determining the market value of a security at any time the last sale price for that security, as quoted on the New Zealand Stock Exchange at that time, shall be used.

h) The Manager in determining the Members' entitlement to securities on redemption of Units in the Fund under clause 8.3 of the Trust Deed, shall use the market value of those securities at the valuation time (as defined in the Trust Deed).

i) The formula for calculating the "Current Unit Value" as defined in clause 3 of the Trust Deed will remain unaltered for the period of this ruling.

j) The amounts derived by the Member from the subsequent sale or disposal of securities received on redeeming units in the Fund will be gross income of the Member.

k) Members do not acquire units in the Fund for the purpose of acquiring securities.

l) Units in the Fund are not tradeable on a secondary market.

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:

- Pursuant to section HH 3(5) any amounts including securities received by members as a result of redemption of units in the Fund will not be gross income of the member.
- The cost of any securities acquired by a member on redemption of units in the Fund is the market value of those units at the valuation time of the units redeemed less any cash or cash equivalents received.
- The market value of the units redeemed is equal to the Redemption Price of those units.
- The cost of a security acquired by a member on the redemption of units is an allowable deduction under section BD 2 and is deductible:
  - in full in the income year in which the units are redeemed, if the member acquires the securities as trading stock for the purpose of section EE 1; and
  - in accordance with section EF 2 in the later of the income year in which the securities are disposed of and the income year in which the gross income is derived in respect of the disposition of the securities, if the member acquires the securities as revenue account property other than trading stock.

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 August 2002 to 31 July 2005.

This Ruling is signed by me on the 26th day of July 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/10

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Mico Wakefield Limited ("Mico").

Taxation Laws

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

This Ruling applies in respect of sections CD 3 and CD 5. This Ruling does not consider how the "FBT rules", as defined in section OZ 1(1), apply to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is the exchange of points, accrued to customers of Mico, for travel and associated accommodation benefits ("travel benefits").

Mico has a customer trade loyalty programme entitled "Mico MAP" ("the programme").

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

1. Key customers of Mico are invited to join the programme. "Members" of the programme for the purposes of the Arrangement will generally be tradespeople, eg plumbers, electricians and builders, who treat Mico as their preferred supplier. These persons will in most cases be sole traders. The programme is subject to the terms and conditions set out below.
2. Membership is at Mico's discretion. A $50 (inclusive of GST) membership fee will be payable on joining.
3. In conjunction with the member, Mico will establish the individual sales figure for the last 12 months. From this figure a base target will be agreed for the next 12-month period.
4. An agreed percentage of actual and referred sales through nominated accounts will be transferred into the programme. In addition, Mico will contribute an agreed percentage of the sales to the member's account.
5. Mico may contribute agreed bonus points to the member's account where members achieve their set base targets.
6. Mico will award additional points for the purchase of particular nominated products during certain periods.
7. Mico will award bonus points at their discretion.
8. Each year, Mico will review the programme and membership for each member. In the event that membership is not renewed, the accumulated points must be used within 12 months of termination of membership.
9. Each year, in conjunction with the member, Mico will establish a new 12-monthly base target.
10. Each month, Mico will advise all members of their points for the month, along with the year-to-date position.
11. A booking fee of 5% will be added to the final amount of the travel cost. All travel will be booked through Mico's nominated Travel Wholesaler and Mico will always quote the points on an individual trip by trip basis.
12. Individual targets will be kept confidential between Mico and the member at all times.
13. Mico reserves the right to cancel, adjust or modify the scheme at any time, provided one month's notification is advised in writing.
14. Members can purchase product at normal price from any Mico store and the purchase figure (exclusive of GST) of goods acquired through agreed nominated accounts will be used to calculate the points that go into the scheme. Mico will advise members of the total number of points for the month which relate to purchases from any Mico store.
15. To qualify for points, accounts must be paid within the agreed payment terms. Points earned are not credited to the member until full payment has been received.
16. Members can transfer their membership to the Mico Wakefield Limited Trade Axis Programme ("Axis"). Members' accrued points cannot be transferred to Axis.
17. Any tax liability arising from the scheme will be the sole responsibility of the member and Mico make no warranty or representation in relation to such tax liability.
18. The member is not entitled to redeem the points for cash or any other benefits. In addition, the travel benefits cannot be redeemed for cash or any other benefits.

19. From time to time, relatives of the member may take the travel benefits with no money or money's worth provided to the member in respect of those benefits.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) Employees of Mico are not able to participate in the programme;

b) The points can only be redeemed by a member for the travel benefits in accordance with the programme;

c) Points and travel benefits are not able to be exchanged for purchase discounts or other purchase rebates;

d) Purchase discounts or other purchase rebates that relate to actual product purchases are not able to be exchanged for points and travel benefits;

e) The travel benefits cannot be redeemed by the member for money or money's worth or any other benefit;

f) The points cannot be assigned, sold or transferred by the member to any other party; and

g) The travel benefits cannot be assigned, sold or transferred by the member for money or money's worth, to any other party.

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 receipt of points under the programme by a member participating in the Arrangement will not be gross income for the purposes of sections CD 3 and CD 5; and
- The receipt of the travel benefits by a member participating in the Arrangement will not be gross income for the purposes of sections CD 3 and CD 5.

The period for which this Ruling applies

This Ruling will apply for the period 1 April 2002 to 31 March 2007.

This Ruling is signed by me on the 26th day of July 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/12

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 Capital Guaranteed Growth Fund Limited.

Taxation Laws

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

This Ruling applies in respect of the definitions of "financial arrangement" in section EH 14, "approved issuer", "interest" and "money lent" in section OB 1, the definition of "associated persons" in section OD 7, sections FC 1, NG 2 and NG 6 of the Income Tax Act 1994, and section 86G of the Stamp and Cheque Duties Act 1971.

The Arrangement to which this Ruling applies

The Arrangement is the issue of certain capital guaranteed growth notes and related transactions.

The Bank of New Zealand ("the BNZ") has established BNZ Capital Guaranteed Growth Fund Limited ("FundCo"), a vehicle which has issued notes to investors, the return on which is linked in part to the futures market. FundCo is a wholly owned subsidiary of the BNZ. In addition, repayment on maturity of an amount determined to be 117.5% of the initial capital invested on subscription of these notes is guaranteed by the BNZ.

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

(a) **Issue of Notes**: FundCo has issued a series of notes ("the Notes") to investors at an issue price of NZ$1,000 per Note. Each Note represents an agreement to make progress payments ("the Variable Growth Payments") and to sell, on a cash settled basis, to the investor on 7 May 2007 ("the maturity date"), a stated proportion of FundCo's assets on that date ("the FundCo Agreements"). The Notes will be debt securities under the Securities Act 1978 and accordingly FundCo has appointed a trustee and entered into a trust deed for the benefit of the Noteholders as required by the Securities Act 1978.

(b) **Termination**: On the termination or maturity date, instead of FundCo physically delivering all of the assets in the Account in settlement of all the outstanding Notes, there will be a cash settlement of each Note equal to the value of the specified proportion of the assets being purchased.
Subject to the applicable fees and charges for early settlement, the Noteholders are able to call for early settlement and settlement may also occur on the occurrence of certain events. This is outlined in the Trust Deed and the Cash Settled Agreement.

(c) **Variable Growth Payments**: During the term of the Notes, the Variable Growth Payments are to be made by FundCo to investors based upon a fixed percentage of the increase in value of the Net Assets of AHL Guaranteed Trading (NZ) Limited ("TradeCo") (see (g) next page). Restrictions may be placed on payments which would reduce the value below either of the original investment or the highest net asset value on any previous progress payment date. In addition, if there is early settlement in respect of some Notes that is taken into account when calculating the original investment or the highest net asset value.

(d) **Capital Guarantee Fund**: FundCo has used a proportion of the amount received from the issue of the Notes to invest in a deposit ("the Deposit") with the BNZ. On maturity, the value of the Deposit and of the Net Assets that will be received by FundCo from TradeCo will be cash settled. The amount to be distributed to investors has been guaranteed by the BNZ to be 117.5% of the aggregate amount subscribed by the investors on the original issue of the Notes that are then outstanding. This amount ("the Capital Guaranteed Amount") is guaranteed to be repaid to investors by the BNZ.

e) **Futures Market**: FundCo has invested the balance of the amount received from the issue of the Notes (ie after investing in the Deposit and meeting certain expenses) by way of an agreement for sale and purchase with TradeCo of that company's Net Assets ("the TradeCo Agreement"). TradeCo is owned by three trustees of a trust established for New Zealand charitable purposes. TradeCo makes investments in the futures market (see (h) next page). The TradeCo Agreement provides for a sale of TradeCo's Net Assets, with settlement at a stated time, being 10 years after entry into the agreement (subject to FundCo's right to call for early settlement and settlement on the occurrence of certain events).

(f) **Cash Settled Sale**: Instead of physical delivery of TradeCo's Net Assets on settlement, there will be a cash settlement of the agreement equal to the value of TradeCo's Net Assets. It is not intended that TradeCo's Net Assets will be physically delivered to FundCo except in the event of a default by TradeCo to make the cash settlement payment. The cash proceeds will form part of the assets of FundCo subject to the settlement referred to in paragraph (b).

(g) **Variable Growth Payments**: During the term of the Notes progress payments are to be made by TradeCo to FundCo based upon a fixed percentage of the increase in value of TradeCo's Net Assets (thereby enabling FundCo to make the payments described in paragraph (c) to investors during the term of the agreements). The restrictions described in paragraph (c) will also apply to these progress payments.

(h) **Futures Investment**: TradeCo will continue to use the moneys received by it under the agreement for sale with FundCo to invest in futures, foreign exchange and derivative contracts. This investment is being managed by Man Investment Products Limited under an Investment Management Agreement. The principal futures broker is Man Financial Limited, appointed along with the Introducing Broker, Man Management AG under an Introducing Broker Agreement.

(i) **Guarantee**: TradeCo has entered into a guarantee agreement ("the Guarantee Deed") with the BNZ under which the BNZ has agreed to guarantee repayment of the Capital Guaranteed Amount on the maturity date. This guarantee does not apply where Notes are redeemed prior to maturity.

Condition stipulated by the Commissioner

This Ruling is made subject to the following condition:

- The FundCo Agreements are not held by an associated person (as defined in section OD 7) of FundCo (section NG 2(1)(b)(i)).

How the Taxation Laws apply to the Arrangement

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

- The FundCo Agreements are "financial arrangements" as defined in section EH 14 and do not constitute debentures to which section FC 1 applies;
- The amounts invested under the FundCo Agreements constitute "money lent" as that term is defined in section OB 1;
- The FundCo Variable Growth Payments and amounts paid to investors on settlement in excess of the amounts invested will constitute "interest" as that term is defined in section OB 1;
- The FundCo Agreements may continue to be registered by an approved issuer as registered securities under section 86G of the Stamp and Cheque Duties Act 1971; and
- Because FundCo is an approved issuer under section NG 6, payments made by FundCo which constitute interest for tax purposes and which are derived by non-residents, will be subject to non-resident withholding tax at the rate of 0% pursuant to section NG 2.

The period or income year for which this Ruling applies

This Ruling will apply for the period from 1 April 2002 until 30 June 2007.

This Ruling is signed by me on the 23rd day of August 2002.

Martin Smith

General Manager (Adjudication & Rulings)

INTERPRETATION STATEMENTS

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

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

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

EASEMENTS – DEDUCTIBILITY OF THE COSTS OF PREPARATION, STAMPING, AND REGISTRATION

This interpretation statement sets out the Commissioner's view on the deductibility of expenditure incurred for the preparation, stamping, and registration of easements used in the derivation of the taxpayer's gross income—previously stated in Public Ruling BR PUB 98/7 *Easements – deductibility of costs of preparation, stamping, and registration*, published in the *Tax Information Bulletin* Vol 10, No.12 (December 1998). The ruling ceased to apply from 31 March 2002.

Public Ruling BR 98/7 has not been reissued as there is some doubt as to whether the arrangement to which the Ruling applied is an arrangement (as defined in the Act) for which a Public Ruling can be issued.

Summary

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

This interpretation statement considers whether the expenditure incurred for the preparation, stamping, and registration of an easement used in the derivation of the taxpayer's gross income is deductible under section DJ 11.

Section DJ 11 applies as follows:

- An easement is a lease for the purposes of section DJ 11.
- The Commissioner will allow a deduction for costs incurred by a taxpayer in the preparation, stamping, and registration of easements where they are used in the derivation of the taxpayer's gross income, in the income year in which the expenditure is incurred.
- Payments made for the grant of an easement are not expenditure incurred in the preparation of an easement and therefore not deductible under section DJ 11.

Background

Land may have its utility enhanced by the right to the use of an easement. Once registered an easement gives an interest in the land that is of enduring benefit.

Under section DJ 11 a taxpayer is allowed a deduction for the costs of the preparation, stamping, and registration of "any lease of property used in the derivation of the taxpayer's gross income".

Issue

The issue is whether an easement is a "lease of property" as defined in the Act.

Legislation

Section DJ 11 states:

> A taxpayer is allowed a deduction in respect of expenditure incurred by the taxpayer during an income year for the preparation, stamping, and registration of any lease of property used in the derivation of the taxpayer's gross income, of any renewal of any such lease, or in the borrowing of money employed by the taxpayer as capital in the derivation of gross income.

The following are defined terms in section OB 1:

> **"Estate"** or **"interest",** in relation to land, means any estate or interest in land, whether legal or equitable, and whether vested or contingent, in possession, reversion or remainder; and includes any right to the possession of land or to receipt of the rents or profits from the land, or to the proceeds of the sale or other disposition of the land, whether immediate or through a trustee, or otherwise; but does not include a mortgage:
>
> **"Interest"** –
>
> …
>
> (b) In relation to land, has the same meaning as **"estate"**

"Lease" –

(a) Except as provided in paragraphs (b), (d), (e), and (f) means a disposition that creates a leasehold estate:

"Leasehold estate" includes any estate however created, other than a freehold estate:

Analysis

The nature of an easement

The essential elements of an easement, as developed by common law, are that:

- there must be a dominant tenement and a servient tenement (*Hawkins v Rutter* [1892] 1 QB 668); and
- the easement must accommodate the dominant tenement such that it is related to the utility of the land and must do more than confer a personal benefit on the owner of the land (*Re Ellenborough Park* [1955] 3 All ER 667); and
- the dominant owner and servient owner must be different persons (*Metropolitan Rly Co v Fowler* [1892] 1 QB 165); and
- the easement must be capable of forming the subject matter of the grant (*Re Ellenborough Park*).

In New Zealand, the common law elements of an easement have been modified by statute. The statutory modification has created "easements in gross". Section 122 of the Property Law Act 1952 allows the creation of easements in gross. An easement in gross is one where there is no requirement for a dominant tenement. The right created by the easement is not appurtenant to another parcel of land. This modifies the first element of a common law easement, that there be a dominant and servient tenement.

While statute permits an easement where there is no dominant tenement, there must be a servient tenement. This is necessary, for if the right granted by the easement arises from ownership of the land, there is no requirement to claim that right as an easement as it already exists.

Two other features of an easement, while not defining characteristics, further describe the rights and limitations of an easement:

- An easement permanently binds the land over which the right is exercised, and similarly subsists permanently for the benefit of the dominant tenement. One issue that arises is whether the rule against perpetuities applies to an easement. If the right created by the easement vests immediately with the grantee, authority indicates that the rule against perpetuities does not apply (*Ellison v Vukicevic* (1986) 7 NSWLR 104).
- The notion that an easement cannot and does not confer a right to possession in the land over which the right is granted (*Copeland v Greenhalf* [1952] 1 All ER 809).

An easement is a lease for the purposes of the Act

Although an easement is not an estate in land, it is an interest in land as contemplated by the law of real property. In *Auckland City Council v Man O'War Station Limited* [1996] 3 NZLR 460, Anderson J observed:

> An easement… is an incorporeal hereditament, which is a right in respect of land, and therefore an **interest** in land, but it is not land in the tangible sense nor an **estate** in land in the common law sense. [page 465] [emphasis added]

An easement may be distinguished from other lesser rights such as a licence. A licence is a personal right and so does not pass an interest in the land in the way that an easement does (*Errington v Errington* [1952] 1 All ER 149 and *Thomas v Sorrell* (1673) 124 ER 1098).

A lease, as contemplated in the law of real property, is an estate of less than freehold. Estates of less than freehold exist where the duration of the estate is certain or capable of being made certain (*Charles Clay & Sons Ltd v British Railways Board* [1971] 1 All ER 1007). Adams EC (Ed) in *Garrow's Law of Real Property* (Butterworths, Wellington, 1961) categorises leases whether for a fixed term, at will, or at sufferance as the estates of less than freehold.

For the purposes of the Act, a "lease" is defined in section OB 1 as any disposition by which a "leasehold estate" is created. An easement is created by a disposition of property. The owner of the fee simple which will become the servient tenement surrenders, or disposes of, part of his or her right in the land to another person. Also implicit in the definition is that the disposition must **create** a leasehold estate. That is, the disposition must not be one that, for example, **transfers** the leasehold estate in the land. An easement qualifies, as it is not a transfer of any interest in the land but the creation of an interest in the land, a right that attaches to land so that it may improve its use and benefit.

"Leasehold estate" is also defined, as any estate however created, other than a freehold estate. The concept of a "freehold estate" was developed by common law. A freehold estate is one of uncertain duration: the feature that distinguishes it from an estate of less than freehold, ie a lease. In the case of individuals it is uncertain as it is measured by reference to their lives. For corporations, it is uncertain, as they may continue on indefinitely. There are three types of freehold estates in New Zealand: the fee simple which will endure until the holder of the estate dies intestate without heirs, the life estate which will continue only for the life of the holder and is extinguished on that person's death, and the stratum estate created by section 4(2) of the Unit Titles Act 1972.

The term “estate”, also defined in the Act, is coupled with the word “interest”. “Interest” is defined as having in relation to land the same meaning as “estate”. For the purposes of the Act, therefore, the terms “estate” or “interest” are merged and treated synonymously.

An easement is an interest in land. A lease is an estate in land. The term “lease” is the nomenclature used in the Act for estates or interest in land unless specifically excluded, such as estates of freehold and mortgages. An easement as an interest in land is therefore a “lease” as defined in the Act. Therefore section DJ 11 applies to the costs of preparation, stamping, and registration of easements.

Incurred expenditure allowable by the Commissioner

It is difficult to identify definitively the types of expenditure incurred in the preparation, stamping, and registration of easements. The costs incurred in the preparation, stamping, and registration of easements are not specified in the Act.

The Courts have not had occasion to consider the types of expenses that are incurred in the “preparation” of an easement in the context of section DJ 11. However, the word “preparation” or “prepare” has been considered judicially (*Horsley v Collier and Cartly Ltd* [1965] 2 All ER 423 and *Calabria v R* (1982) 151 CLR 671). Those cases point to the word “preparation” indicating something that is done prior to it being ready for its use.

Where the character of the expenditure is for the preparation, stamping, and registration of the easement and the easement is used in the derivation of the taxpayer’s gross income, then the statutory requirement has been satisfied and a deduction permitted accordingly. It is not possible to provide an exhaustive list of preparation costs. However, an example of costs that will be allowed are legal costs, registration fees, and surveying costs.

Costs for granting of an easement not deductible

It is not uncommon for the owner of what will become the servient tenement to receive a sum of money for granting the easement. Payment for the granting of an easement is not part of the preparation expenses.

Preparation expenses are expenses incurred in the acts or instances of preparing an easement. Payments for the grant of an easement are payments made in consideration for the grant of an easement and are not expenses incurred in the process of preparing an easement. Payments made for the grant of an easement are not deductible under section DJ 11.

Example

Farmer Ltd is a company conducting its agricultural and horticultural activities in an area where rainfall is limited and there is no natural irrigation. Farmer Ltd arranges for irrigation to be provided to the property. This requires reticulation across a neighbouring property. Farmer Ltd incurs survey costs and legal fees in the preparation, stamping, and registration of the easement allowing the diverted water to be transported to Farmer Ltd’s property. Farmer Ltd agrees to pay the owner of the neighbouring property a one-off lump sum payment for the **right** to create the easement. In addition, the owner of the dominant tenement, Farmer Ltd, agrees to pay the legal costs for reviewing and approving the drafted easement’s documentation incurred by the owner of the neighbouring property, ie the owner of the servient tenement.

The survey costs and legal fees, including those paid for the owner of the neighbouring property, are costs for the preparation, stamping, and registration of the easement and so are deductible in the income year in which they are incurred. The cost of the irrigation scheme itself is not part of the costs of preparation, stamping, and registration of the easement. The one-off payment to the owner of the neighbouring property for the **right** to create the easement is not for the preparation, stamping, and registration of the easement and therefore is not deductible.

DEDUCTIBILITY OF SPONSORSHIP EXPENDITURE

Introduction

This interpretation statement contains guidelines that the Commissioner considers relevant in determining whether sponsorship expenditure is deductible under the general deductibility provisions in section BD 2 of the Income Tax Act 1994. This statement replaces the Commissioner's statement *Deducting sponsorship as advertising expenditure*, in *Tax Information Bulletin* Vol 6, No 4 (October 1994), pages 1 and 2.

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

Summary

Sponsorship expenditure will be deductible under limb (b) of section BD 2(1) where a nexus exists between the expenditure and the taxpayer's business or income-earning activity.

- There must be a nexus or necessary relationship between the expenditure and the taxpayer's business or income earning activity.
- This requires a determination of the character of the advantage sought by the taxpayer in incurring the expenditure. This is a subjective matter, depending upon the taxpayer's purpose when incurring the expenditure. The determination of the taxpayer's purpose or purposes will require an objective analysis of surrounding circumstances, including the effect of the expenditure.
- In relation to limb (b)(ii), expenditure will be deductible where it is dictated by the business ends to which it is directed, those ends forming part of or being truly incidental to the business.
- Voluntary expenditure is deductible provided it is directed to business or income-earning ends.
- In the absence of associated party or avoidance concerns, the quantum of the expenditure is not material to the issue of deductibility.
- The fact that a third party may benefit from the expenditure incurred does not preclude that expenditure from being deductible.

In order for the nexus test to be satisfied, the taxpayer needs to show that he or she intended that the business would be promoted by incurring the sponsorship expenditure. In this regard, the following objective factors will support a taxpayer's contention that he or she intended that the business be promoted by the expenditure:

- The specific terms of the sponsorship arrangement, eg is there a specific requirement for the recipient to promote the taxpayer's business? What is the extent and prominence of the business exposure specified in the agreement?
- The place of the sponsorship arrangement in a coherent marketing strategy. For example, if a business's market research has identified that potential customers frequently attend cultural events, then part of its marketing strategy may be to sponsor such events in return for its name and products being promoted during the event.
- The relationship between the market or potential market exposure capable of being reached and the taxpayer's business. For example, market exposure at a tennis tournament is directly related to the business of a sports equipment retailer.
- The relationship between the expenditure and the resulting income derived, ie can it be shown that the expenditure resulted in income being derived? For example, the sale of 10 tractors at an agricultural field-day, by a tractor manufacturer sponsoring the event in return for being able to display the tractors, shows a direct relationship between the sponsorship expenditure and the derivation of income.

Deductibility of the sponsorship expenditure is subject to section BD 2(2), which prohibits deductions for expenditure of a capital or private or domestic nature. From an analysis of case law pertaining to the capital/revenue distinction the following seven tests are identified:

- the need or occasion which calls for the expenditure;
- whether the expenditure is recurrent in nature;
- whether the expenditure creates an identifiable asset;
- whether the expenditure creates an advantage which is of an enduring benefit to the business;
- whether the expenditure is on the profit-making structure or on the profit-making process;
- whether the source of the payment is from fixed or circulating capital;
- the treatment of the expenditure according to the ordinary principles of commercial accounting.

The indicia developed by the Courts to distinguish between capital and revenue expenditure are not necessarily all relevant in the context of sponsorship expenditure. Of the various indicia analysed, it would appear that the identifiable asset test is the most important. While the enduring advantage test appears relevant, frequently the nature of the enduring benefit resulting from the sponsorship expenditure will not be such as to warrant a capital classification because the benefit is intrinsically linked to the means of exposure.

An outgoing is of a private nature if it is exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit. Therefore, it is necessary to determine whether the sponsorship expenditure, in whole or part, relates exclusively to things of a private or domestic nature. Where a benefit of a private or domestic nature (eg private enjoyment) accrues to the recipient of sponsorship expenditure, or to any other person, but this benefit is incidental to the payer's income-earning or business activity, then the deduction is not prohibited.

Section EF 1 may apply to limit the deduction in any income year to that portion of the sponsorship expenditure which relates to the current income year. Where the expenditure relates to the purchase of goods, the current year deduction is effectively restricted to goods used in that year in deriving gross income. Where the expenditure relates to a payment for services, the current year deduction is effectively restricted to the amount incurred on services performed in that year. Where the expenditure relates to a chose in action, the deduction is deferred for the portion relating to the unexpired part of the period that the chose is enforceable.

If sponsorship expenditure is incurred in relation to depreciable property (as defined in section OB 1), a deduction will be allowed for depreciation as determined under section EG 2. The amount of the deduction is dependent upon whether the depreciable property is wholly used or available for use by the taxpayer in deriving gross income or in carrying on a business for the purpose of deriving gross income.

What is "sponsorship"?

For the purposes of this statement it is first necessary to identify what type of expenditure is being considered, ie what type of expenditure constitutes sponsorship expenditure. The term "sponsorship" is used to cover a wide range of situations, with the usage reflecting considerable overlap with the concepts of "advertising", at one end of a continuum, and "donations" at the other end. At one extreme, the taxpayer's sole purpose is to "advertise"/promote the business with the amount incurred reflecting market forces and what he or she considers will best achieve the purpose of business promotion. At the other extreme, the taxpayer's "donation" is for the sole purpose of benefiting the donee and business promotion is not contemplated or is merely incidental to the philanthropic purpose.

In between these two extremes, the taxpayer intends to promote his or her business in some manner when incurring the expenditure, but the expenditure made also benefits the recipient (or some other person) in a manner unrelated to the ordinary receipt of income from his or her income-earning activities.

This statement does not consider expenditure at the extremes of the continuum, ie expenditure made to commercial advertising media, at one end of the continuum, and charitable donations where business promotion is not a purpose, at the other end of the continuum. Instead, the statement focuses on the deductibility of expenditure in the middle of the continuum (referred to in this statement as "sponsorship expenditure"), ie where the taxpayer making the expenditure intends that his or her business will be promoted in some way, but that the recipient, or some other person, will also be benefited in some manner other than by the receipt of ordinary income from business or income-earning activities.

Legislation

Whether or not sponsorship expenditure is an allowable deduction is determined under section BD 2 of the Income Tax Act 1994 which reads as follows:

> (1) An amount is an allowable deduction of a taxpayer
>
> …
>
> (b) to the extent that it is an expenditure or loss
>
> (i) incurred by the taxpayer in deriving the taxpayer's gross income, or
>
> (ii) necessarily incurred by the taxpayer in the course of carrying on a business for the purpose of deriving the taxpayer's gross income, or
>
> …
>
> (2) An amount of expenditure or loss is not an allowable deduction of a taxpayer to the extent that it is
>
> (a) of a private or domestic nature, or
>
> …
>
> (e) of a capital nature, unless allowed as a deduction under Part D (Deductions Further Defined) or E (Timing of Income and Deductions), or
>
> …

Section EF 1 concerns accrual expenditure:

> (1) Where any person has incurred any accrual expenditure–
>
> (a) That expenditure is allowed as a deduction when it is incurred in accordance with this Act; and
>
> (b) The unexpired portion of that expenditure at the end of an income year shall be included in the gross income of the person for that income year and shall be allowed as a deduction in the following income year.
>
> …

(5) The amount of the unexpired portion (if any) of any amount of accrual expenditure of any person to be taken into account in any income year shall be–

(a) Where the expenditure relates to the purchase of goods, the amount of expenditure incurred on goods not used in deriving gross income:]

(b) Where the expenditure relates to payment for services, the amount of expenditure incurred on services not performed:

(c) Subject to subsection (8), where the expenditure is incurred by way of monetary remuneration for services that have been performed, the amount of the expenditure that has not been paid in the income year or within such further period as is specified in subsection (6):

(d) Where the expenditure relates to a payment for, or in relation to, a chose in action, the amount that relates to the unexpired part of the period in relation to which the chose is enforceable.

…

(7) In this section–

"Goods" means all real or personal property; but does not include choses in action or money:

"Services" means anything which is not goods or money or a chose in action.

…

General principles

The usual approach for determining whether or not expenditure is deductible is first to consider the general deductibility provision in section BD 2(1) ie whether the expenditure was "incurred by the taxpayer in deriving the taxpayer's gross income" (limb (b)(i)) or whether the expenditure was "necessarily incurred by the taxpayer in the course of carrying on a business for the purpose of deriving the taxpayer's gross income" (limb (b)(ii)). Having determined that the expenditure meets the criteria in section BD 2(1), it is then necessary to determine whether or not any of the prohibitions in section BD 2(2) apply.

For expenditure to be deductible under limb (b) of section BD 2(1), there must be a nexus or necessary relationship between the expenditure and the taxpayer's business or income earning activity (*CIR v Banks* (1978) 3 NZTC 61,236 at p 61,240; *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 at p 61,274). This requires a determination of the character of the advantage sought by the taxpayer in incurring the expenditure (*Buckley & Young* at p 61,274). In this regard, the character of the receipt in the hands of the recipient is not determinative (*Regent Oil Co Ltd v Strick* [1965] 3 All ER 174 at pp 350-351).

In relation to limb (b)(ii) of section BD 2(1), the function of the term "necessarily" was considered by Dixon CJ in *FCT v Snowden & Wilson Proprietary Limited* (1958) 99 CLR 431 at p 436:

> The word "necessarily" does, however, seem to me to require consideration. Clearly its operation is to place a qualification upon the degree of connection between the expenditure and the carrying on of the business which might suffice in the absence of such a qualification. In *The Commonwealth and The Post-Master General v Progress Advertising Agency Co Pty Ltd* Higgins J supplied an interpretation of "necessary" as not meaning essentially necessary but as meaning appropriate, plainly adapted to the needs of a department carrying out an Act. That was in another connection but the phrase was availed of by the Court in [*Ronpibon Tin NL & Tongkah Compound NL v FCT* (1949) 78 CLR 47] as throwing light on the use of the word "necessarily" in s.51 (1). Clearly the expression is used in relation to business. **Logical necessity is not a thing to be predicated of business expenditure. What is meant by the qualification is that the expenditure must be dictated by the business ends to which it is directed, those ends forming part of or being truly incidental to the business.** [Emphasis added]

"Necessarily" was also considered in *Europa Oil (NZ) Limited v CIR (No 2)* (1974) 1 NZTC 61,169 (CA). At p 61,208, Beattie J reiterated that logical necessity was not predicated by business expenditure, ie merely because a business expends money does not mean, of itself, that the expenditure was necessarily incurred. McCarthy P at p 61,196 stated that the determination of whether or not expenditure was necessarily incurred requires "a judgment based on common sense and business realities", but that the ordinary meaning of "necessarily" connotes that the expenditure will not be the result of an entirely free choice, but will have been dictated by the surrounding circumstances. Richmond J at p 61,205 noted that while the term "necessarily" has a restrictive sense, it also has a sense of entitlement, in that a taxpayer who has had to incur expenditure in the course of business should be able to claim a deduction for it. Support for the view that the term "necessarily" should be read down to mean that expenditure must be directed toward business ends, as opposed to being absolutely essential, can be found in *Usher's Wiltshire Brewery Ltd v Bruce* [1915] AC 433 at p 449 and *British Insulated and Helsby Cables Ltd v Atherton* [1926] AC 205 at pp 211-212 which held that voluntary expenditure may be deductible.

In the appeal from the Court of Appeal decision in *Europa (No 2)*, reported at *Europa Oil (NZ) Limited v CIR (No 2)*; *CIR v Europa Oil (NZ) Limited (No 2)* (1976) 2 NZTC 61,066 (PC), the majority of the Privy Council at p 61,071 did not focus specifically on the word "necessarily", but instead looked at what the taxpayer was legally entitled to as a result of incurring the expenditure, ie to use the words in *Buckley & Young*, it considered the character of the advantage sought by the taxpayer in incurring the expenditure. As the expenditure in that case had resulted entirely in trading stock, it held that the expenditure was deductible. Significantly, at p 61,071, the majority of the Privy Council held that the amount of expenditure is not material, ie deductibility is not dependent upon the amount of expenditure being "reasonable", citing *Cecil Bros Ltd v FCT* (1964) 111 CLR 430. At p 434, Owen J cited the following statement from *Ronpibon Tin NL & Tongkah Compound NL v FCT* (1949) 78 CLR 47 at p 60, which statement was approved by the Judicial Committee in both the *Europa Oil* cases ([1971] NZLR 641 at p 649 and (1976) 2 NZTC 61,066 at p 61,071):

> It is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent.

Thus, expenditure will be necessarily incurred by the taxpayer in the course of carrying on a business for the purpose of deriving the taxpayer's gross income, where the expenditure is dictated by the business ends to which it is directed, those ends forming part of or being truly incidental to the business. This requires a determination of the character of the advantage sought by the taxpayer in incurring the expenditure. Voluntary expenditure may be deductible, provided it is directed to business ends. In the absence of associated party or avoidance concerns, the quantum of the expenditure is not material to the issue of whether or not expenditure is deductible.

A key factor in determining whether expenditure is deductible under section BD 2(1) is determining the character of the advantage sought. This is a subjective matter, depending upon the taxpayer's purpose when incurring the expenditure (*CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 at p 6,350). In this regard, there is a distinction between purpose and effect. Thus, for example, the fact that no income is ultimately derived does not necessarily mean that it was not made for the purpose of deriving gross income. Ultimately it will be a question of fact what a taxpayer's subjective purpose or purposes were in incurring the expenditure. In this regard, a taxpayer's purpose is to be determined by an objective analysis of surrounding circumstances, including the effect of the expenditure (*National Distributors* at p 6,351).

The phrase "to the extent that" in limb (b) of section BD 2(1) contemplates apportionment (*Buckley & Young* at p-61,274), ie where part of the expenditure is incurred for a purpose unrelated to the taxpayer's business or income earning activity, or when a deduction for part of the expenditure is prohibited, then that part will not be deductible. Nevertheless, the fact that a third party may benefit from the expenditure incurred by the taxpayer does not necessarily preclude that expenditure from being deductible. This was held in *Usher's Wiltshire Brewery Ltd*, a case which concerned expenditure voluntarily incurred by a brewery company on licensed premises which it leased to publicans, who were tied to the company in that they were required to sell the company's beer. Although the lessee was obliged to keep the premises in good repair, the brewery company preferred to undertake the repairs and maintenance itself, being able thereby to ensure that the premises were maintained at a high standard. At issue, among other things, was whether or not expenditure incurred to repair the leased premises was "wholly and exclusively expenditure on repairs of premises occupied for the purpose of [its brewery] trade". The Crown contended that the premises were not occupied by the brewery company, being instead occupied by the lessee, and therefore the repair expenditure incurred by the company did not meet the criterion for deductibility. At p 427, Lord Atkinson held that the expenditure was "wholly and exclusively expenditure on repairs of premises occupied for the purpose of [the company's brewery] trade", basing his decision on the fact that the licensed premises "were the market place for [the company's] beer and none other". He stated that the fact that the lessee benefited from the company's repair expenditure did not preclude the criterion for deductibility being satisfied.

In order to reconcile the decisions in *Buckley & Young* and *Usher's*, it is necessary to distinguish between the situation where there are two or more distinct purposes for making the expenditure, not all of which relate to the taxpayer's business or income earning activity (apportionment will be required here), and the situation where the third party benefit is incidental to the purpose relating to the taxpayer's business or income earning activity (no apportionment is required here).

Having established that the expenditure is deductible under either limb (b)(i) or (b)(ii) of section BD 2(1), it is then necessary to determine whether or not the deduction is prohibited by section BD 2(2). Relevant prohibitions are those relating to expenditure of a private or domestic nature (limb (a)) and expenditure of a capital nature (limb (e)).

Prohibition – capital expenditure

Concerning the capital prohibition in limb (e) of section BD 2(2), a number of different tests have been formulated by the Courts. The most commonly used test in New Zealand is derived from the Australian decision of *Sun Newspapers Limited and Another v FCT* (1938) 61 CLR 317 where Dixon J formulated the following indicia:

- the character of the advantage sought (for which the lasting qualities may play a part);
- the manner in which the advantage is to be used, relied upon or enjoyed (and in this, and under the former head, recurrence may play its part); and
- the means adopted to obtain the advantage, eg by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment, or by making a final provision or payment so as to secure further use or enjoyment.

The indicia put forward in *Sun Newspapers* were adopted by the Privy Council in the decision of *BP Australia Limited v FCT* (1965) 14 ATD 1. The *BP Australia* formulation was adopted in New Zealand in cases such as *CIR v L D Nathan & Co Limited* [1972] NZLR 209, *Buckley & Young*, *CIR v McKenzies New Zealand* (1988) 10 NZTC 5,233, *Christchurch Press Company Limited v CIR* (1993) 15 NZTC 10,206, *CIR v Wattie* (1998) 18 NZTC 13,991, *Poverty Bay Electric Power Board v CIR* (1999) 19 NZTC 15,001, and *Birkdale Service Station Ltd v CIR* (2000) 19 NZTC 15,981.

In *McKenzies*, the Court of Appeal extracted five indicia from the Privy Council decision in *BP Australia*, which were themselves applied in *Christchurch Press*. Those five indicia are as follows:

- a consideration of the need or occasion which calls for the expenditure (recurrence may play a part here);
- whether the sums were paid out of fixed or circulating capital;
- whether the payments were of a once and for all nature, producing assets or advantages which were of an enduring benefit;
- a consideration of ordinary principles of commercial accounting; and
- whether the sums were incurred on the structure, within which the profits were to be earned, or whether they were part of the income earning process.

The Court of Appeal in *L D Nathan* at p 214 extracted several indicia from the *BP Australia* case:

- recurrence;
- whether the expenditure was from fixed or circulating capital;
- whether the expenditure related to the business entity or structure (or profit/yielding subject) or whether it related to the process by which such a structure is operated in order to obtain regular returns;
- whether the expenditure was made once and for all, with a view to bringing into existence an asset or advantage for the enduring benefit of the trade;
- whether the expenditure was ordinary expenditure in the course of the regular income-earning conduct of the business; and
- the nature of the asset obtained or sought in which its enduring character may play a part.

The most recent New Zealand Privy Council case in this area, *Wattie*, adopted the same approach as that described in *Hallstroms Proprietary Limited v FCT* (1946) 72 CLR 634 at p 648. The Privy Council also endorsed the approach taken in *BP Australia, Regent Oil, British Insulated and Helsby*, and *McKenzies*. In *Poverty Bay Electric Power Board*, the Court of Appeal referred to the approach of *BP Australia*, *Hallstroms*, and *British Insulated and Helsby*.

The Court of Appeal in *Birkdale* endorsed the approach of the Privy Council in *Wattie* and *BP Australia*.

However, these cases have recognised that although past cases can be useful in assisting with the resolution of a new case, there are dangers involved in this approach. For example, North P in the *L D Nathan* case at p 214 stated that where the distinction between capital and revenue expenditure was not clear-cut, the indicia should be weighed up in the context of the whole set of circumstances. This principle was confirmed by Richardson J at p 5,235 of the *McKenzies* case, citing *BP Australia*:

> In deciding whether expenditure is capital or income the approach generally favoured by the courts in recent years is exemplified in the following observations of Lord Pearce in *BP Australia Ltd v Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 244 at pp 264-265:
>
> **"The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer.** Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction is often hard to draw in borderline cases; and conflicting considerations may produce a situation where the answer turns on questions of emphasis and agree. That answer:
>
>> 'depends on what the expenditure is calculated to effect from a practical and a business point of view rather than upon the juristic classification of the legal rights, if any, secured employed or exhausted in the process'.
>
> per Dixon J in *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634, 648. As each new case comes to be argued felicitous phrases from earlier judgments are used in argument by one side and the other; but those phrases are not the deciding factor, nor are they of unlimited application. They merely crystallise particular factors which may incline the scale in the particular case after a balance of all the considerations has been taken." [Emphasis added]

Similar statements were made by Viscount Radcliffe in *Commissioner of Taxes v Nchanga Consolidated Copper Mines Limited* [1964] 1 All ER 208 at pp 212-213, and by Templeman J in *Tucker v Granada Motorway Services Limited* [1977] 3 All ER 865 at p 869. However, when the latter case was appealed to the House of Lords (reported at *Tucker (Inspector of Taxes) v Granada Motorway Services Ltd* [1979] 2 All ER 801), Lord Wilberforce noted at p 804 that sometimes applying analogies is the only available option:

> There are a number of tests which have been stated in reported cases which it is useful to apply, but we have been warned more than once not to seek automatically to apply to one case words or formulae which have been

> found useful in another (see *Comr of Taxes v Nchanga Consolidated Copper Mines Ltd*). Nevertheless reported cases are the best tools that we have, even if they may sometimes be blunt instruments.

From the various indicia formulated by the Courts, subject to the warning that the whole set of circumstances must be considered, the following tests or indicia may be identified:

- **the need or occasion which calls for the expenditure:** This test considers what prompted or necessitated the taxpayer to incur the expenditure and whether the surrounding circumstances and ultimate objective of the expenditure support a capital or revenue classification.
- **whether the expenditure is recurrent in nature:** This test, which is closely aligned to the previous one, states that recurrent expenditure is often of a revenue nature and that one-off expenditure is often of a capital nature. This test is not determinative, eg irregular expenditure may be of a revenue nature. To conclude that recurrent expenditure is of a revenue nature, it is necessary to establish that it is an ordinary incident of carrying on a business.
- **whether the expenditure creates an identifiable asset:** This test states that expenditure will be of a capital nature if an identifiable capital asset was acquired by the expenditure.
- **whether the expenditure creates an advantage which is of enduring benefit to the business:** This test is similar to the previous one, but instead focuses on whether an enduring advantage was acquired by expending the money. If it was, then the expenditure is likely to be of a capital nature. An enduring benefit can arise from expenditure made to relieve the business of an onerous asset. In this regard, an enduring benefit is to be distinguished from where the expenditure merely relieves the taxpayer from making revenue payments for a period of time. This test is often linked to the test of recurrence, ie expenditure made once-and-for-all with a view to acquiring an advantage of enduring benefit to the business is likely to indicate that the expenditure was of a capital nature.
- **whether the expenditure is on the profit-making structure or on the profit-making process:** This test aims at distinguishing between expenditure which relates to the business's structure (ie assets which are used in order to carry on the business) and the business's operation (ie the means by which the assets are organised in order to carry on the business). In this regard, in some businesses the structure may mainly consist of intangible assets, eg goodwill. This test is often linked to the identifiable asset and enduring advantage tests. For example, combining the tests enables to the correct classifications to be made where expenditure is made, as an ordinary incident of the business, to maintain the profit-making structure (likely to be of a revenue nature, despite relating to the profit-making process).
- **whether the source of the payment is from fixed or circulating capital:** This test states that expenditure made from fixed capital (ie capital on which a return is sought by the business's operation) is more likely to be of a capital nature, and expenditure made from circulating capital (ie capital which returns to the business as a result of the business's operation) is more likely to be of a revenue nature. The test is not now given much weight by the Courts, as it is easy for a business to choose whether to finance an asset, say, from fixed capital or to finance it from circulating capital, irrespective of the nature of the asset financed.
- **the treatment of the expenditure according to the ordinary principles of commercial accounting:** How expenditure is classified according to ordinary commercial accounting principles may support the classification made from applying the other indicia. However, this test is not usually determinative, since tax and accounting have different aims and the respective treatments may consequently differ from each other.

Many of these indicia overlap and some factors will carry more weight in given circumstances. Therefore, while these indicia are helpful as a starting point, it is nevertheless necessary to make a final judgment of whether the expenditure is of a capital or revenue nature by analysing the facts as a whole, weighing up which factors carry the most weight in the light of these facts.

Prohibition – private or domestic expenditure

The prohibition of deductions for expenditure of a private or domestic nature (limb (a) of section BD 2(2)) was considered in *CIR v Haenga* (1985) 7 NZTC 5,198. This case concerned whether or not contributions to a welfare society, which were required by statute to be made, were deductible (the case related to an income year before deductions were prohibited for expenditure incurred in deriving income from employment). At p 5,207, Richardson J stated:

> **An outgoing is of a private nature if it is exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit.** While ordinarily health care is uniquely personal to the individual concerned and affects his private life as well as his work potential, there may be such emphasis under the employment contract in attaining and maintaining a particular standard of fitness (or even grooming) that expenditure directed to that end cannot fairly be characterised as private or domestic or for that matter as other than work-related.

> That is not this case but it suggests that it is overly simplistic to brand these contributions to this welfare society as inherently of a private rather than an employment character. On the contrary, in the very unusual circumstances of this case I have come to the conclusion, not without hesitation, that the required nexus exists between the expenditure in question and the gaining of the employment income. That expenditure is imposed on the employee by Statute. It reflects a recognition by the employer and the unions endorsed by the Legislature that the availability of the benefits afforded by membership of the welfare society has a perceived if not readily quantifiable impact on the work performance of the employees concerned. It is more than a prerequisite to the earning of income. It is directed to the income earning process itself. Clearly all those immediately concerned in the employment relationship have bona fide regarded that expenditure as work-related being directed to preserving and enhancing the employee's performance of his duties and in the end I have concluded that we would not be justified in taking a different view. [Emphasis added]

In coming to this conclusion of the application of the law to the particular facts in question, Richardson J held that expenses properly characterised as consumption (eg food, clothing and shelter) are not incidental and relevant to the derivation of income merely because they are required in order for a person to be able to earn income.

In several Taxation Review Authority cases (*Case E87* (1982) 5 NZTC 59,455; *Case F30* (1983) 6 NZTC 59,704; *Case F159* (1984) 6 NZTC 60,358), whether or not expenditure was of a private or domestic nature was determined by ascertaining whether anybody received a benefit of a private or domestic nature. However, by solely focusing on the recipient of the benefit resulting from the expenditure, it would prohibit a deduction for wages paid, for example, where the recipient of the wages used the money received to purchase food and accommodation. It is not considered, therefore, that this is the correct approach. Rather, as Richardson J did in *Haenga*, it is necessary to determine whether the expenditure, in whole or part, related exclusively to things of a private or domestic nature. Where a benefit of a private or domestic nature accrues to the recipient, but this benefit is incidental to the income-earning or business activity of the payer, then it follows from the approach in *Usher's* – where expenditure was held to be deductible because the third-party benefit was incidental – that the deduction is not prohibited.

In summary, then, an outgoing is of a private nature if it is exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit. Where a benefit of a private or domestic nature accrues to the recipient, but this benefit is incidental to the income-earning or business activity of the payer, then the deduction is not prohibited. Where the private or domestic benefit accrues from a purpose of the taxpayer distinct from the business promotion purpose, then apportionment will be necessary.

Apportionment

By virtue of the definition of "sponsorship" used in this statement (ie benefits contemplated to the taxpayer and to some other party), and because of the inclusion of the phrase "to the extent that" in sections BD 2(1) and BD 2(2), the issue of apportionment must be considered. Apportionment will be required where the expenditure may partly be on revenue account and partly on capital account. Apportionment will also be required where a sponsorship agreement is entered into to achieve more than one end (eg income-earning and private)—whether or not the dual purposes are evident on the face of the relevant documentation. It will also be required where part of the sponsorship expenditure is not deductible at all eg preliminary expenditure incurred before the business began (*Calkin v CIR* (1984) 6 NZTC 61,781 at p 61,786). Merely because it may be difficult under a sponsorship arrangement to determine what part of the expenditure relates to business promotion, or which part is prohibited by virtue of section BD 2(2), this does not preclude the need for apportionment where, in fact, more than one purpose was envisaged by incurring the expenditure (*Buckley & Young* at p 61,274).

Accrual expenditure

Even if a deduction is allowed for expenditure under limb (b) of section BD 2(1), and is not prohibited under section BD 2(2), it needs to be considered whether the expenditure is accrual expenditure such that section EF 1 applies to limit the deduction in any income year. Section EF 1(1) states that "accrual expenditure" is deductible when incurred, but (subject to section EF 1(3)) any "unexpired portion" of it at the end of the income year is included in the taxpayer's gross income for the year but is allowed as a deduction in the following income year. The term "accrual expenditure" is defined in section OB 1 to mean any expenditure deductible under the Act (with certain exceptions specified in the definition in section OB 1). The "unexpired portion" of an amount of accrual expenditure is defined in section EF 1(5) which reads as follows:

> The amount of the unexpired portion (if any) of any amount of accrual expenditure of any person to be taken into account in any income year shall be–
>
> (a) Where the expenditure relates to the purchase of goods, the amount of expenditure incurred on goods not used in deriving gross income:
>
> (b) Where the expenditure relates to payment for services, the amount of expenditure incurred on services not performed:
>
> (c) Subject to subsection (8), where the expenditure is incurred by way of monetary remuneration for services that have been performed, the amount of the expenditure that has not been paid in the income year or within such further period as is specified in subsection (6):

> (d) Where the expenditure relates to a payment for, or in relation to, a chose in action, the amount that relates to the unexpired part of the period in relation to which the chose is enforceable.

Essentially, the unexpired portion of accrual expenditure is that portion of the expenditure which relates to future income years.

Depreciation

If a deduction is prohibited because of the capital prohibition in section BD 2(2), a deduction for depreciation may be allowed under subpart EG. Broadly, for a deduction to be allowed for depreciation the taxpayer must own the "depreciable property" (section EG 1(1)), which is defined in section OB 1 to mean:

> … any property of [the] taxpayer which might be reasonably expected in normal circumstances to decline in value while used or available for use … in deriving gross income or in carrying on a business for the purpose of deriving gross income.

Where there is depreciable property, the amount of the deduction allowed for depreciation is determined under section EG 2 and is dependent upon whether the depreciable property is wholly used or available for use by the taxpayer in deriving gross income or in carrying on a business for the purpose of deriving gross income.

Application to Sponsorship Expenditure

Having considered the general principles relating to sections BD 2(1) and BD 2(2), it is necessary to apply these principles in the context of sponsorship expenditure. This will be approached as follows:

- is the sponsorship expenditure deductible pursuant to section BD 2(1);
- do any of the prohibitions in section BD 2(2) apply (the need for apportionment will considered under this head);
- if a deduction is prohibited because of the capital prohibition in section BD 2(2), is a deduction for depreciation allowed;
- does section EF 1 apply to limit the deduction in any given income year.

Deductibility under section BD 2(1)

Concerning the general deductibility provision in section BD 2(1), the following principles were identified:

- There must be a nexus or necessary relationship between the expenditure and the taxpayer's business or income earning activity.
- This requires a determination of the character of the advantage sought by the taxpayer in incurring the expenditure. This is a subjective matter, depending upon the taxpayer's purpose when incurring the expenditure. The determination of the taxpayer's purpose or purposes will require an objective analysis of surrounding circumstances, including the effect of the expenditure.
- In relation to limb (b)(ii), expenditure will be deductible where it is dictated by the business ends to which it is directed, those ends forming part of or being truly incidental to the business.
- Voluntary expenditure is deductible provided it is directed to business or income-earning ends.
- In the absence of associated party or avoidance concerns, the quantum of the expenditure is not material.
- The fact that a third party may benefit from the expenditure incurred does not preclude that expenditure from being deductible.

For the purposes of this statement, sponsorship expenditure has been defined to mean expenditure where the payer intends that his or her business will thereby be promoted in some way, but that the recipient, or some other person, will also be benefited in some manner other than by the receipt of ordinary income from business or income-earning activities.

Expenditure of the type which meets this definition was held to have been incurred in deriving income in the Australian case, *Cliffs International, Inc v FCT* 85 ATC 4374. In this case, the taxpayer contributed to the annual running of a golf tournament in which the taxpayer's joint venture partners and key Japanese customers participated. Another case where sponsorship expenditure, as so defined, was held to be incurred in deriving income is the South African case, *Income Tax Case No. 696* 17 SATC 86. This case concerned a company which dealt in agricultural equipment. It purchased some footballs which it endorsed with words associated with the equipment in which it traded, and then gave them to various school football clubs. It also acquired two silver trophies which it donated to agricultural societies, having engraved them with the company's name and the names of various pieces of equipment in which it traded. All three members of the Cape Income Tax Special Court held that the expenditure incurred on the footballs was deductible (one member held that the expenditure on the cups was capital in nature). In relation to the expenditure on the footballs, Newton Thompson J put it this way at p 87:

> I am satisfied that this expenditure is for advertisement purposes, that it has that effect; that it assists in selling articles in which the appellant deals; that it is incurred in the production of income…

Two issues immediately arise from the definition of sponsorship adopted in this statement. Firstly, what evidence supports a taxpayer's contention that particular expenditure meets this definition? Secondly, what effect does the third-party benefit have upon deductibility?

In relation to the first issue, in order for the nexus test to be satisfied, the taxpayer needs to show that he or she intended that the business would be promoted by incurring the sponsorship expenditure. In this regard, the following objective factors will support a taxpayer's contention that he or she intended that the business be promoted by the expenditure:

- The specific terms of the sponsorship arrangement, eg is there a specific requirement for the recipient to promote the taxpayer's business? What is the extent and prominence of the business exposure specified in the agreement?
- The place of the sponsorship arrangement in a coherent marketing strategy. For example, if a business's market research has identified that potential customers frequently attend cultural events, then part of its marketing strategy may be to sponsor such events in return for its name and products being promoted during the event.
- The relationship between the market or potential market exposure capable of being reached and the taxpayer's business. For example, market exposure at a tennis tournament is directly related to the business of a sports equipment retailer.
- The relationship between the expenditure and the resulting income derived, ie can it be shown that the expenditure resulted in income being derived? For example, the sale of 10 tractors at an agricultural field-day, by a tractor manufacturer sponsoring the event in return for being able to display the tractors, shows a direct relationship between the sponsorship expenditure and the derivation of income.

In *Case 696* (SA), the evidentiary support for the expenditure on the cups being deductible was described like this (Mr Galbraith at p 91):

> … the company annually incurs expenditure on advertising the agricultural implements in which it deals. This advertising takes various forms, such as circulating pamphlets, distributing calendars, pocket-books, copper ash-trays, etc. It never takes the form of press advertising because the potential and actual customers of the company are too few to warrant advertising in newspapers.

This description illustrates the company's marketing strategy and the cups and footballs donated fitted within this strategy, being articles on which the names of pieces of equipment were endorsed.

Case P16 (1992) 14 NZTC 4,107 illustrates that evidence of a relationship between the potential market exposure capable of being reached and the taxpayer's business is support for the expenditure being deductible, and that the amount of expenditure was not relevant to the determination of whether or not the expenditure was deductible.

In response to the company's contention that the racing promotion was intended to associate the company with speed and efficiency, Keane J stated at p 4,114:

> … the company's decision was inherently logical from a business perspective, and the related steps taken wholly explicable from that perspective even if the level of expenditure ultimately incurred was greater than was first anticipated.

Similarly, in the Australian Board of Review case, *Case F67* 74 ATC 397, evidence of a relationship between the potential market exposure capable of being reached and the taxpayer's business was support for the expenditure being held to be deductible. That case concerned a consulting engineer who also derived commission income as the sole representative of several foreign boat designers in Australia. In order to promote commission sales, the taxpayer had a power boat built to one of the designs for which he was the Australian representative. He had the names of his business and the designer painted on the hull, along with his address and contact telephone number. The boat was then raced. Despite incurring the sponsorship expenditure, no commission sales were made in the income year in question, but this did not preclude deductibility of the revenue expenditure. Nor did the relatively high cost involved stop the Board of Review from finding that the revenue expenditure was deductible.

In *Cliffs International*, sponsorship expenditure was held to be deductible on the basis of evidence showing the place of the sponsorship arrangement in a coherent marketing strategy, and the relationship between the market exposure capable of being reached and the taxpayer's business. As noted earlier, in this case the taxpayer contributed to the annual running of a golf tournament in which the taxpayer's joint venture partners and key Japanese customers participated. In finding that the sponsorship expenditure was deductible, Kennedy J stated at p 4,392:

> This event was a carefully planned annual function, which was specifically directed to enhancing the relationship between the Robe River joint venture and its customers in Japan, being six of the major steel mills. It was the only formal social function held each year and was carefully adapted to the nature of the Japanese business. It was attended by senior executives from Cliffs, whilst Mitsui & Co. was represented by the highest ranking personnel within its iron ore department, together with one of its corporate executive vice presidents. Each of the mills was represented by its highest ranking purchasing officer and two or three of his subordinates. The day was meticulously planned, so that those whom it was desired to bring together for business reasons were brought together. The day concluded with formal speeches of goodwill and presentations.

The issue of the relationship between the expenditure and the resulting income was referred to in *Case 696* at p 92, but in that case the absence of any supporting evidence was given little weight by the majority of the Court:

> With regard to this expenditure being too remote from the income to be an allowable deduction, I consider that it can fairly be stated that it is normally impossible to connect any particular sales with any particular advertising, though many companies go to considerable lengths in an endeavour to ascertain which media of advertisements produce the best results.

The issue of the remoteness of sponsorship expenditure from income derived was also referred to in the Canadian case *No 511 v MNR* 19 Tax ABC 248, a case concerning a taxpayer in the lumber business which sponsored a local baseball team with the intention of building up its declining sales through promoting its name and products. In that case, as with *Case 696*, the fact that sponsorship was not direct advertising was not sufficient to preclude deductibility provided there was evidence that the company intended to advertise itself by sponsoring the baseball team.

A New Zealand case where there was evidence of a direct relationship between the sponsorship expenditure and the taxpayer's income was *Case P16*. The taxpayer in this case was a national courier which had acquired and raced a Jaguar motor car, having marked it with the company's logo. Evidence that showed that there was a marked increase in turnover as a result of the racing promotion supported the conclusion drawn by Keane J that the related revenue expenditure was deductible.

Example 1

Andrew is a sole trader who operates a motor mechanic business. He sponsors the local rugby league team. Under the terms of sponsorship agreement, which covers the year to 31 March, Andrew agrees to pay up-front a sum of $3,000 towards the team's running costs. In return, the team agrees to display Andrew's business logo on all rugby uniforms, bags and vehicles used by the team during the year.

Is the expenditure incurred by Andrew under the sponsorship agreement deductible?

The expenditure incurred by Andrew will be fully deductible. The requirement that the team display his business logo and name on the uniforms etc indicates that the expenditure was incurred to promote his business and is therefore deductible.

Example 2

Elizabeth operates a business in Wellington as a sole-trader. She gives $500 to the boarding school which her son attends in Auckland in the name of her business. She makes no stipulations about how the school is to use the money or that her business is to be promoted in return for the payment. Nevertheless, her business's name subsequently appears in a list of donors on the back page of the school's annual magazine. In all, there were 20 donors and Elizabeth's business name is not distinguished in any way from the other 19 donors.

It is considered that no deduction under section BD 2 is allowed for the $500 expenditure (although a rebate may be available under section KC 5). There was no stipulation that Elizabeth's business be promoted. The fact that there was some business promotion in the form of her business's name appearing in the magazine is not determinative unless Elizabeth can show that such promotion was a purpose of the expenditure. While every case must be considered on its particular facts, it is considered that any marketing exposure resulting from the business name appearing on the back page of an annual school magazine is most likely to be minimal since it one of 20 donors with no prominence given it compared to the names of the other donors. This supports the view that it is incidental to other purposes (eg private) of making the payment. As well, the fact that her son's school is in Auckland is likely to mean that little, if any, increase in revenue would be expected to result to her business since it operates in Wellington. Therefore, based on an objective analysis of the surrounding circumstances, it is considered that the expenditure does not have the requisite nexus with the earning of her business's income.

The second issue which arises from the definition of sponsorship expenditure is the effect on deductibility, if any, of a third-party benefiting from the expenditure. In this regard, as noted earlier in this statement, this fact does not of itself preclude deductibility (*Usher's Wiltshire Brewery Ltd* at p 427). Rather, in order to determine whether apportionment is needed, it is necessary to determine whether the third-party benefit resulted from a purpose distinct from the business promotion purpose (apportionment will be required here), or whether the third-party benefit was only incidental to the purpose relating to the taxpayer's business (no apportionment required). This will be a question of fact. The distinction between incidental purposes and separate purposes will be illustrated by examples following the application of the law relating to the private or domestic expenditure prohibition.

Other issues, which may appear relevant to whether or not sponsorship expenditure is deductible, arise where the expenditure is voluntary or where the amount expended is higher than seems reasonable. However, as noted earlier in this statement, the fact that the taxpayer may have voluntarily entered into an agreement whereby someone else is benefited by the expenditure will not, of itself, preclude deductibility since voluntary expenditure is deductible provided it is directed to business or income-earning ends. Nor, of itself, will deductibility be precluded by the fact that the taxpayer expended more than they would have done if the third party benefit were not contemplated. This is because the quantum of the expenditure is not material (*Ronpibon Tin* at p 60; *Cecil Bros* at p 434; *Europa Oil* [1971] NZLR 641 at p 649; *Europa Oil* (1976) 2 NZTC 61,066 at p 61,071).

Case F67, considered earlier in this statement, was a case where relatively high expenditure did not preclude deductibility.

If it has been determined that the sponsorship expenditure is prima facie deductible under section BD 2(1), it is then necessary to ascertain whether or not any of the prohibitions in section BD 2(2) apply. The two prohibitions potentially relevant to sponsorship expenditure are the capital prohibition in limb (e) and the prohibition of expenditure of a private or domestic nature in limb (a).

Prohibition – capital expenditure

From an analysis of case law pertaining to the capital/revenue distinction the following seven tests were identified:

- the need or occasion which calls for the expenditure;
- whether the expenditure is recurrent in nature;
- whether the expenditure creates an identifiable asset;
- whether the expenditure creates an advantage which is of an enduring benefit to the business;
- whether the expenditure is on the profit-making structure or on the profit-making process;
- whether the source of the payment is from fixed or circulating capital;
- the treatment of the expenditure according to the ordinary principles of commercial accounting.

In the context of sponsorship expenditure, some of the indicia will be more relevant than others. In relation to a given set of facts, it will be necessary to weigh up the factors in order to determine whether all or part of the sponsorship expenditure is of a capital nature. These factors will now be considered in turn.

The need or occasion which calls for the expenditure

This test considers the need or occasion calling for the expenditure and whether the surrounding circumstances and ultimate objective of the expenditure support a capital or revenue classification. When considering the general deductibility provision in section BD 2(1), the taxpayer's purpose in incurring the expenditure needed to be ascertained. However, in determining whether or not the capital prohibition applies, it is necessary to consider what prompted or necessitated the taxpayer to incur the expenditure in the first place.

In this regard, all the cases analysed when considering the general deductibility provision in section BD 2(1) illustrated that business promotion was the purpose of incurring the sponsorship expenditure. In none of the cases was it held that the underlying reason which prompted or necessitated the expenditure indicated that the expenditure was of a capital nature. It would appear, then, that this test will be of limited use in the context of sponsorship expenditure, although arguably it would be relevant where the facts point to the business promotion being related to establishing a market for a new business. However, in such a case as this, the expenditure is likely to have not even been deductible under section BD 2(1), it being preliminary expenditure which would not have been incurred in the course of carrying on that business (*Calkin* at p 61,786).

Recurrence

As noted earlier in this statement, this test is not determinative as irregular expenditure may be of a revenue nature. To conclude that recurrent expenditure is of a revenue nature, it is necessary to establish that it is an ordinary incident of carrying on the business.

In the context of sponsorship expenditure, it is possible for some types of sponsorship expenditure to be once and for all (eg a once-only sponsorship of a sports event), and for other types to be recurrent (eg regularly sponsoring the sports event). Thus, recurrence, of itself, would not be determinative of the expenditure being of a revenue nature. An example of where recurrence would have supported a finding of sponsorship expenditure being of a revenue nature, had it been at issue, is *Cliffs International*. Here the golf tournament was held annually.

An example of once-only sponsorship expenditure being of a revenue nature is *Case 696* (SA) considered earlier in this statement. In that case, the two silver cups constituted a one-off payment. Nevertheless, the majority judgment was that the expenditure incurred on these cups was of a revenue nature. While this finding was principally based on the fact that no enduring asset was acquired by the company, since it divested itself of the ownership of the cups, it nevertheless indicates that recurrence is not determinative.

However, while recurrence of itself is not determinative, as noted above, it is also necessary to establishing that expenditure is an ordinary incident of carrying on a business for that expenditure to be of a revenue nature. In the context of sponsorship expenditure, as it is defined in this statement, it is not considered that much weight should be placed on this test. This is because a taxpayer's business promotion purpose, necessary to establish that the expenditure is deductible under section BD 2(1), would appear to be sufficient to show that the expenditure was an ordinary incident of business. That is, whatever third-party benefit may arise from sponsorship expenditure, it would appear that the business promotion purpose is sufficient evidence of the expenditure being an ordinary incident of business. In the Canadian case, *No. 608 v MNR* 21 Tax ABC 396, at p 400, Mr Boisvert put it this way:

> Nowadays business advertising takes on a wide variety of forms and, as long as it can be linked with a business, whether the latter profits from it or not, it is a deductible expense … **Advertising has become a necessity in the business world.** [Emphasis added]

Identifiable asset

Where the expenditure results in an identifiable asset owned by the taxpayer, the capital prohibition is likely to apply.

The majority decision in *Case 696* (SA) is an example of where no identifiable asset being retained by the taxpayer was the basis for finding that the capital prohibition did not apply. Distinguishing cases where an identifiable asset was retained by the taxpayer, and the expenditure incurred to acquire it was held to be of a capital nature (*Income Tax Case No. 217* 4 SATC 137; *Income Tax Case No. 469* 11 SATC 261), the majority stated at p 93:

> In my opinion this case is clearly distinguishable. Appellant company purchased cups and immediately presented them to agricultural societies, **thereby divesting itself of ownership It had no asset as a result of this advertising expenditure** … [Emphasis added]

Thus, if the sponsorship expenditure results in an identifiable asset, and the taxpayer does not divest itself of the ownership of the asset, then the capital prohibition will apply.

Example 3

> Consider the facts in example 1, above. Suppose Andrew also agreed to reimburse the team for the purchase of their van (ie the team owns the van) provided his business logo is prominently displayed on the van. Would this expenditure be deductible? Alternatively, what if he instead purchased the van himself, retaining ownership of it, but allowed the team to have full use of it provided his business logo is prominently displayed on it—would the expenditure be deductible?
>
> Where Andrew reimburses the team for the purchase of their van, although the van is a capital item it is not considered that the capital prohibition applies since the van is not owned by Andrew, nor was it acquired by him. Therefore, no enduring asset results to Andrew from this expenditure.
>
> However, if Andrew purchased the van himself and retained ownership of it, the capital prohibition would apply as the expenditure results in an enduring asset (ie the van) owned by him (although a deduction for depreciation may be allowed under section EG 2).

Example 4

> John Jones runs a sports goods store called *Jones's Sports*. Being particularly interested in soccer, John sponsors an annual soccer competition for the three local primary schools, to be named the *Jones Competition*.
>
> He considers that the sponsorship arrangement will result in increased sales. He supplies the necessary sporting equipment to each school (all of which is clearly labelled with his business's name) as well as a trophy to be presented to the winner of the competition. The trophy is labelled the *Jones Competition sponsored by Jones's Sports*, and each year the trophy is engraved with the winner's name. He incurs a total of $5,000 in the first year of this arrangement.
>
> Here there is a relationship between John's business and the sponsorship, both being related to sport. Therefore, even though it may be impossible to identify what sales, if any, resulted from the sponsorship arrangement, John's contention that the expenditure was incurred in order to increase sales is reasonable. Therefore, it is considered that the expenditure is deductible under limb (b)(i) of section BD 2(1). As well, the fact that the business name appears on the sporting equipment donated, as well as on the trophy, supports the conclusion that the expenditure would be deductible under limb (b)(ii) of section BD 2(1) being necessarily incurred in the course of carrying on his business. In this light, it is considered that John's private enjoyment of soccer is incidental and therefore a deduction for the expenditure will not be prohibited by limb (a) of section BD 2(2). Further, although the cup is an enduring asset, it is not owned by John and so the capital prohibition in limb (e) of section BD 2(2) will not apply. This conclusion is consistent with the finding in *Income Tax Case 696* 17 SATC 86 (South Africa).

Enduring advantage

This test focuses on whether an enduring advantage of benefit to the business is acquired by expending the money. If it is, then the expenditure is likely to be of a capital nature. Other than cases where an identifiable asset is acquired by expending the money, this test would appear to be the most relevant in the context of sponsorship expenditure. This test is often linked to the test of recurrence, ie expenditure made once and for all with a view to acquiring an advantage of enduring benefit to the business is likely to indicate that the expenditure was of a capital nature.

However, in order to determine whether or not an enduring advantage arises such that the capital prohibition would apply, it is first necessary to distinguish between long-term advertising and goodwill/branding that may arise from such advertising. In the case of the former, any expenditure to obtain the long-term advertising merely relieves the taxpayer from making revenue payments for a period of time. It is not considered that this type of "enduring advantage" is of a capital nature (*Anglo-Persian* at p 262). However, section EF 1 may apply to limit the deduction in any income year because part of the expenditure relates to future income years (section EF 1 is considered more fully later in this statement).

As to whether the capital prohibition would apply because the expenditure resulted in an enduring advantage of branding or goodwill, it is considered that any "branding/goodwill" advantage gained is intrinsically linked to the business exposure itself. The advantage is not one that results from the business's prior operation (in contrast to goodwill acquired when the business is purchased, which would be a capital asset). Although the advantage may endure beyond the end of the sponsorship agreement, this is no different from ordinary advertising. In both cases, any "branding" gained will usually dissipate rapidly unless the exposure or advertising is repeated in order to maintain it. For this reason, it is considered that any incremental contribution to long-term goodwill or brand value is properly to be regarded as incidental, as similar increments can be achieved by ordinary advertising, good customer service, product quality, etc. Therefore, it is considered that the expenditure on it is of a revenue nature and the capital prohibition does not apply. This conclusion is in line with the majority judgment in *Case 696* (SA):

> There is little doubt that the benefit of this advertising was not confined to the year of assessment, but the same can probably be said about most advertising except in connection with special "bargain sales". With regular advertising in various forms it is normally impossible to state when and for how long any benefit may be received and if, to be allowable as a deduction, its effect must be confined to the year of assessment, it appears to me that very little advertising expenditure could be allowed as a deduction. **I am of the opinion that all successful advertising must inevitably tend to increase the goodwill of the advertiser or of the merchandise advertised, but I am unable to agree that, therefore, such advertising becomes expenditure of a capital nature.** [Emphasis added]

Profit-making structure or profit-making process

This test aims at distinguishing between expenditure which relates to the business's structure (ie assets which are used in order to carry on the business) and the business's operation (ie the means by which the assets are organised in order to carry on the business).

As noted earlier in this statement, this test is often linked to the identifiable asset and enduring advantage tests. As such, in the context of sponsorship expenditure, this test would not appear to add anything to the analyses under these heads. In particular, however, it is noted that the business promotion aspect of sponsorship expenditure, as it is defined in this statement, would appear ordinarily to be related to the profit-making process rather than to the profit-making structure. The principal exception would be where an identifiable asset is acquired as a result of expending the money in which case, as noted earlier in this statement when considering the identifiable asset test, the profit-making structure is enhanced by the sponsorship expenditure, and the capital prohibition would apply.

The source of the payment

This test states that expenditure made from fixed capital (ie capital on which a return is sought by the business's operation) is more likely to be of a capital nature, and expenditure made from circulating capital (ie capital which returns to the business as a result of the business's operation) is more likely to be of a revenue nature.

As noted earlier in this statement, the test is not now given much weight by the Courts, as it is easy for a business to choose whether to finance an asset, say, from fixed capital or to finance it from circulating capital, irrespective of the nature of the asset financed. In the context of sponsorship expenditure, also, a business may finance it from either fixed or circulating capital, without thereby changing its inherent nature. Therefore, it is considered that this test is unhelpful.

The treatment of the expenditure according to the ordinary principles of commercial accounting

How expenditure is classified according to ordinary commercial accounting principles may support the classification made from applying the other indicia. In this regard, sponsorship and promotional expenditure would ordinarily be classified as being of a revenue nature according to generally accepted accounting practice. This supports treating sponsorship expenditure as deductible. However, this test is not usually determinative since tax and accounting have different aims and the respective treatments may consequently differ from each other. Nevertheless, in the context of sponsorship expenditure, if for some reason a taxpayer treated such expenditure as being of a capital nature for accounting purposes, there may be some grounds for analysing whether or not this accounting classification should be followed for tax purposes.

Conclusion–capital prohibition

The indicia developed by the Courts to distinguish between capital and revenue expenditure are not necessarily all relevant in the context of sponsorship expenditure. Of the various indicia analysed, it would appear that the identifiable asset test is the most important. While the enduring advantage test appears relevant, frequently the nature of the enduring benefit resulting from the sponsorship expenditure will not be such as to warrant a capital classification because the benefit is intrinsically linked to the means of exposure.

Prohibition–private or dometic expenditure

An outgoing is of a private nature if it is exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit (*Haenga* at p 5,207). In particular, expenses properly characterised as consumption (eg food, clothing and shelter) are not incidental and relevant to the derivation of income merely because they are required in order for a person to be able to earn income.

In this regard, it is necessary to determine whether the expenditure, in whole or part, relates exclusively to things of a private or domestic nature. Where a benefit of a private or domestic nature accrues to the recipient, but this benefit is incidental to the income-earning or business activity, then the deduction is not prohibited.

In the context of sponsorship expenditure, the key will be to determine whether or not any private or domestic benefit accruing as a result of the sponsorship expenditure is incidental to the business promotion purpose. Where a separate private or domestic purpose is identifiable, then apportionment will be necessary.

A number of Taxation Review Authority cases have involved situations where someone (usually an employee of the taxpayer) gained private enjoyment from the sponsorship expenditure. In *Case L7*, the taxpayer was a radiator manufacture and repair company whose principal was interested in go-kart racing. The company decided to become involved in go-kart racing as a means of promoting the business. The go-kart bore the name of the company, the principal drove the go-kart, the pit crew (company employees) wore company colours, and the company was promoted on a billboard at the racetrack and in the racing program. The issue before the Taxation Review Authority was whether the associated expenditure should be apportioned between business promotion (deductible) and private enjoyment (no deduction allowed). At p 1,055, Barber DJ concluded that the expenditure was fully deductible, with the private enjoyment being purely incidental:

> I agree with the submission of Mr Nation, that the fact that Mr S obtained substantial enjoyment from the kart racing is not a significant factor in deciding whether or not the expenses incurred in that activity should be tax deductible. In my view, the issue is whether the expenditure is bona fide advertising expenditure in character, or is wholly or partly expenditure in the pursuance of go kart racing as a sport or recreational pastime. That factual issue pivots on the credibility of the evidence. I accept Mr S as an honest witness. I find that although he enjoyed his involvement in kart racing and had previously been quite strongly interested in racing in general, he made a calculated decision to boost his business enterprise by participating in kart racing with a high business profile. He sought business contacts in the motor trade and work from those contacts and from the general public. I am satisfied that these aims were achieved, and continue to be retained, in a substantial manner. I do not suggest that advertising must have good results to be deductible. I appreciate that, after much consideration, the respondent took the view that there were two equal factors in relation to the advertising expenditure, namely, the obtaining of personal pleasure in go kart racing and the attracting of business from that activity. **On the evidence which I have heard, I find on the balance of probability that the business expended money on go-kart racing predominantly to advertise the business and that any private intentions or purposes of Mr S were quite incidental to the predominant objective of business expansion.** In other words, I am satisfied that there was a sufficient link between the expenditure and the income earning process of the radiator manufacturing and repair business, with regard to the entire expenditure and not merely to 50% of it. [Emphasis added]

The same approach was taken in *Case P16*, where the company's principal was interested in car racing. In that case, at p 4,114, Keane J held that he saw no reason to elevate the principal's private enjoyment of racing the car to the status of a competing purpose.

In *Case M131* (1990) 12 NZTC 2,850, Bathgate DJ approved of the approach in *Case L7*. The taxpayer in this case owned a building business that had a substantial connection, both business and private, with the racing industry. To maintain and extend the business relationship, the taxpayer purchased and raced a horse and sponsored several races in return for the business name appearing on the race books of the races sponsored. While the horse was raced under the names of the individual owners, it was soon identified with the company. The percentage of income derived from the racing industry increased following the increased promotional activity. While the deductibility of the sponsorship expenditure was not at issue in this case, in relation to remaining revenue expenditure, Bathgate DJ held that the statutory nexus was satisfied and that the element of private enjoyment was incidental to the main purpose of business promotion.

Example 6

> Bruce is in business as a sole-trader builder, trading as *Bruce Builders*. He agrees to build the gymnasium at his daughter's school in return for an annual 50% discount on his daughter's school fees for the time she attends the school. The school will provide the materials, but Bruce will supply the labour (himself and three of his employees). While the gymnasium is being built, the school agrees for Bruce to erect signage on the construction site stating that the gymnasium is being built by *Bruce Builders*. After it is completed, a prominent plaque will be displayed on the front of the gymnasium stating that it was constructed by *Bruce Builders*. Does the prohibition for expenditure of a private or domestic nature apply to the expenditure Bruce incurs on staff wages in relation to the construction?
>
> The expenditure on the wages was not incurred by Bruce in deriving gross income since he derives no income from building the gymnasium (limb (a) of section BD 2(1)). It is arguable, too, that they were not necessarily incurred in the course of carrying on Bruce's business for the purpose of deriving his gross income since, arguably, he did not need to construct the gymnasium (limb (b) of section BD 2(1)). Even if it were considered that limb (b) of section BD 2(1) applied (because his business was promoted during the construction and after the construction was completed), one purpose of incurring the expenditure was to gain the 50% discount on his daughter's school fees, ie the advantage sought was of a private nature.

On the facts presented, it is not considered that this private advantage was just incidental to any business promotion contemplated by Bruce in entering into the arrangement with the school. Therefore, as a minimum, it would be necessary to apportion the expenditure between that which was of a private nature (not deductible), and that which was deductible (if any). In this regard, the burden of proof is on Bruce to show what part of the expenditure was deductible.

Example 7

Jenny is in business as a scuba-diving instructor. She enjoys horse riding and watching horse riding competitions. She decides to organise a gymkhana with prizes being given for the winning rider. She arranges for a billboard to be erected at the site of the competition with her business name etc on it. She expends a total of $2,000 in arranging the competition. Is her expenditure deductible?

In this case, Jenny's scuba-diving instructing business bears no relationship to horse riding. The attendees are not a natural audience for the scuba-diving promotion so as to reasonably form a potential market. This, considered with the fact of Jenny's private enjoyment of horse riding, strengthens the conclusion that there is no identifiable nexus between the expenditure and her business. While there is some business exposure in the form of a billboard, it is considered that the expenditure on the competition was likely to have been incurred for private enjoyment with any business promotion being incidental to that private enjoyment purpose. On this basis, and in the absence of further evidence as to Jenny's purpose in incurring the expenditure, it is considered that no deduction would be allowed for expenditure on the competition.

Example 8

A firm, AAA Accounting, has entered into an agreement with the national opera company whereby the firm will cover the cost to the opera company of financing the orchestra that accompanies the operas. In return, the opera company will prominently display the words "proudly sponsored by AAA Accounting" on the buildings where the operas are performed and on all programs sold, as well as in all advertisements for the operas. AAA Accounting's purpose in entering into the agreement was to provide exposure to influential members of the audience, as confirmed in its marketing plan. A survey, which it had commissioned, showed that a significant proportion of opera attendees were individuals from whom the firm sought business, being people who were of high net worth or who were influential in the corporate and government sectors. On the basis of the survey, it considered that the exposure obtained from sponsoring the opera company would attract these people as clients. In the opera company's annual report, the managing director referred to the agreement with AAA Accounting and noted that two of the three partners in the firm had personally had a long association with opera in the past, being "opera lovers" themselves. Is the expenditure under the agreement deductible to AAA Accounting?

In this case, although AAA Accounting is not in a business related to opera, it does obtain business exposure through the agreement. As well, the agreement is part of the firm's marketing strategy as indicated in the firm's marketing plan. While the private enjoyment of opera by two of the three partners in the firm may indicate that the expenditure was incurred for private purposes, it is considered that the reasoning given in the marketing plan shows that the expenditure was incurred for business purposes and any private enjoyment will be incidental to the business purpose of incurring the expenditure.

Accrual expenditure

As noted earlier, section EF 1 may apply to limit the deduction in any income year to that portion of the expenditure which relates to the current income year. Where the expenditure relates to the purchase of goods, the current year deduction is effectively restricted to goods used in that year in deriving gross income. Where the expenditure relates to a payment for services, the current year deduction is effectively restricted to the amount incurred on services performed in that year. Where the expenditure relates to a chose in action, the deduction is deferred for the portion relating to the unexpired part of the period that the chose is enforceable.

Example 9

John owns and operates a restaurant. He enters into a sponsorship agreement with the local brass band whereby he agrees to pay $9,000 up-front towards the band's running costs for the next three years in return for the name of his restaurant to be displayed prominently on the drums. What effect, if any, does section EF 1 have on the deductibility of the $9,000?

In order to determine whether or not section EF 1 applies, it is necessary to determine if there is any "unexpired portion" at the end of the income year. In this regard, limb (d) of section EF 1(5) applies. This is because the expenditure results in John acquiring the chose in action consisting of the right to have his name displayed on the drums. Therefore, the unexpired portion of the expenditure at the end of the income year will be the portion of the $9,000 that relates to the unexpired part of the three-year period in relation to which the choses are enforceable. If a full 12 months under the agreement falls within the first income year, the unexpired portion will be $6,000 relating to the two years remaining under the agreement.

Example 10

PQR Ltd pays a local trust $3 million toward the cost of construction of a swimming complex in return for naming rights for a 10-year period. PQR pays the $3 million in one lump sum in the current income year.

Here, business exposure is obtained by the expenditure in the form of the company's name appearing on the complex and therefore PQR is allowed a deduction for $3 million when it incurs the expenditure.

In this regard, it is considered that any enduring advantage from the expenditure, namely business exposure for a 10-year period, is of the same nature as advertising ie of a revenue nature. The fact that the expenditure is made in a lump sum does not change its revenue character, as it merely relieves the company from making revenue payments for the 10-year period (*Anglo-Persian* at page 262). Hence, it is not considered that the capital prohibition applies in this case.

However, the right to this exposure, which lasts for 10 years, is a chose in action and, therefore, section EF 1 applies to require that the unexpired portion of the expenditure be included in PQR's gross income at the end of the current income year. The amount of the unexpired portion is determined under limb (d) of section EF 1(5), this being the amount of the expenditure which relates to the unexpired part of the period in relation to which the chose is enforceable. In the absence of any other relevant facts, the unexpired portion at any point in time will be determined by calculating the proportion of the 10-year period remaining and multiplying it by $3 million. For example, if at the end of the current income year, 9½ years remains of the 10-year period, then the unexpired portion will be $2,850,000. This will be included in PQR's gross income, but will be allowed as a deduction in the next income year. At the end of that year, the unexpired period will be 8½ years and so $2,550,000 must be included in PQR's gross income in that income year. And so on until the 10-year period is expired.

Depreciation

If the expenditure was incurred in relation to depreciable property (as defined in section OB 1), a deduction will be allowed for depreciation as determined under section EG 2. The amount of the deduction is dependent upon whether the depreciable property is wholly used or available for use by the taxpayer in deriving gross income or in carrying on a business for the purpose of deriving gross income.

Example 11

Paul owns and operates a plant nursery. He purchases a van on which he displays his business name prominently. He makes the van available to the local garden society on weekends, but retains ownership of it and uses the van for business purposes during the week. Is Paul allowed a deduction for the cost of the van? If not, would he be allowed a deduction for the depreciation of the van?

The cost of the van is not deductible by virtue of the capital prohibition. However, a deduction for depreciation may be allowed. In this case, the question which arises is whether or not Paul would be allowed a deduction for the full amount of depreciation on the van calculated pursuant to limb (a) of section EG 2(1) or whether limb (d) of section EG 2(1) would apply. In this regard, it could be thought that when the van was being used by the garden society members, it would not be used or available for use by Paul for business purposes and that, therefore, limb (d) of section EG 2(1) would apply to limit the deduction otherwise available. However, because Paul's business name is prominently displayed on the van, this provides business exposure. As well, the garden society members are a potential market for his plant nursery business. Hence, it is considered that the van is being used for business purposes, even when it is being used by the garden society members, and that, therefore, limb (d) of section EG 2(1) does not apply to limit the deduction available for depreciation.

Example 12

John is a shareholder-employee of ABC Ltd, a marine products supplier. His hobby is to race yachts. ABC purchases a yacht which John races in various yachting competitions. The company's name and logo is painted on the hull of the boat.

Here, a physical asset is acquired by the business and therefore no deduction is allowed by reason of the capital prohibition in section BD 2(2). However, because the company's name is displayed on the yacht, and ABC's business of supplying marine products would be potentially promoted in a yachting competition, a deduction for depreciation will be allowed under section EG 2. The fact that John enjoys yachting does not preclude a depreciation deduction being allowed.

Monetary remuneration

There may be occasions where an employer sponsors an employee to take part in some event such as by paying his or her entry fees. At first glance, this might appear to be another instance of sponsorship expenditure, the deductibility of which would need to be tested in the ways considered so far in this statement.

However, where expenditure is on account of an employee, then it will be deductible under limb (b) of section BD 2 by virtue of being monetary remuneration of that employee (the definition of "monetary remuneration" in section OB 1 includes within it any expenditure on account of an employee). Although there may be an element of "sponsoring" the employee, in that the payment on his or her behalf is over and above what would ordinarily be paid, the expenditure will be deductible for the same reasons that his or her ordinary salary is deductible.

Example 13

> XYZ Ltd pays the entrance fee of one of its employees (Anne) who is going to compete in the local triathlon competition. Anne agrees to display the firm's name prominently on her T-shirt, bicycle and swimming togs.
>
> Here, Anne is the one who enters the race and therefore the payment of the entrance fee is expenditure on account of Anne. Hence, the amount paid is monetary remuneration of an employee and as such is deductible under limb (b) of section BD 2(1).

TREATY OF WAITANGI SETTLEMENTS – GST TREATMENT

Introduction

All legislative references are to the Goods and Services Tax Act 1985 ("the GST Act"), unless otherwise stated.

This Interpretation Statement considers whether Treaty of Waitangi settlements between Maori claimant groups and the Crown are subject to the GST Act. The Crown is currently negotiating and settling claims for historical Treaty of Waitangi breaches. This is being carried out through the Office of Treaty Settlements (the "OTS"). Generally, the purpose of a Treaty of Waitangi settlement is for the Crown to provide redress to the Maori claimant group for historical wrongs that were breaches of the Treaty of Waitangi. The redress can take various forms, but commonly includes the transfer of land, property (eg artefacts and buildings), other agreements (eg an agreement to preserve specific land sites, or native plants and animals) and the payment of money by the Crown to the Maori claimant group. As part of the settlement it is also common for the Maori claimant group to give certain undertakings (eg to support the passing of the settlement legislation in Parliament) or agreements (eg an agreement that the Treaty settlement will be in full and final settlement of the Treaty grievance).

Issues

In a Treaty settlement situation the main issues are:

- Is there a "supply" of goods or services from the Maori claimant group to the Crown; and
- Whether the Treaty settlement payments (either cash or non-cash items) constitute "consideration" for the provision of those goods or services.

This statement also considers:

- Whether the Treaty settlement payments are deemed to be consideration for a supply of goods or services by being in the nature of a "grant or subsidy" under section 5(6D); and
- Whether in a Treaty settlement, a transfer of land, property or other agreements entered into by the Crown are supplies for which "consideration" is received from the Maori claimant group.

Conclusions

This statement reaches the following conclusions:

In terms of whether the Maori claimant group's undertakings and agreements are supplies, that:

- In a Treaty of Waitangi settlement, undertakings or agreements provided by the Maori claimant group to the Crown may fall within the broad definition of a "supply" of goods or services. However, the provision of the Treaty settlement payments (either cash or non-cash) by the Crown to the Maori claimant group are not "consideration" for the supply of those goods or services. The real or substantive nexus is between the Treaty settlement payments and the redress of historical wrongs which were breaches of the Treaty of Waitangi.
  The Treaty settlement payments are therefore not "consideration" for the supply of goods or services for the purposes of section 8(1). Accordingly, in these circumstances, no GST is chargeable.
- Where the Treaty settlement payments are true compensation payments they will not come within the meaning of "grant or subsidy" in section 5(6D). Consequently, the Treaty settlement payments will not be deemed consideration for a supply of goods or services under that provision.

In terms of the Crown's provision of land, property or services as part of the Settlement, that:

- The Crown makes a supply of goods (eg land or property) or services (eg an agreement to preserve specific land sites, or native plants and animals) to the Maori claimant group. However, the undertakings or agreements provided by the Maori claimant group are not "consideration" for the supply of those goods or services. The supplies were linked to the redress of historical wrongs that were breaches of the Treaty of Waitangi. The undertakings or agreements provided by the Maori claimant group are only part of the procedures by which the historical grievance is settled or conditions to the settlement of those grievances, and they are not consideration for the supply of goods or services for the purposes of section 8(1). Consequently, in these circumstances no GST is chargeable on this basis either.

Legislation

Section 20(3) states:

> … in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period.. input tax..

Section 20(4) states:

> For the purposes of subsection (3), output tax in relation to a supply made by a registered person must be attributed to a taxable period…

"Output tax" is defined in section 2(1) as:

> in relation to any registered person, means the tax charged pursuant to section 8(1) in relation to any person, in respect of a supply of goods or services made by that person.

"Input tax" is defined in section 3A(1) as:

> (a) Tax charged under section 8(1) on the supply of goods and services made to that person, being goods and services acquired for the principal purpose of making taxable supplies:
> …

Section 8(1) states:

> Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 12.5 percent on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after the 1st day of October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

Section 2(1) defines "goods" as "all kinds of personal or real property; but does not include choses in action or money".

Section 2(1) defines "services" as "anything which is not goods or money".

The definition of "supply" in section 5(1) "includes all forms of supply".

Section 10 determines "the value of a supply of goods and services". It states:

> (1) For the purposes of this Act the following provisions of this section shall apply for determining the value of any supply of goods and services.
>
> (2) Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of,
>
> (a) To the extent that the consideration for the supply is consideration in money, the amount of the money:
>
> (b) To the extent that the consideration for the supply is not consideration in money, the open market value of that consideration
>
> …

Section 2(1) defines "consideration":

> [I]n relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any nonprofit body.

A payment is "deemed to be consideration for a supply" under section 5(6D). It reads:

> For the purposes of this Act, where any payment in the nature of a grant or subsidy is made on behalf of the Crown or by any public authority to-
>
> (a) Any person (not being a public authority) in relation to or in respect of that person's taxable activity; or
>
> (b) Any person for the benefit and on behalf of another person in relation to or in respect of that other person's taxable activity,-
>
> that payment shall be deemed to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made in the course or furtherance of that person's taxable activity.

Section 6(1) defines "taxable activity" as:

> (a) Any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association or club:
>
> (b) Without limiting the generality of paragraph (a) of this subsection, the activities of any public authority or any local authority.

"Registered person" in section 2(1) means "a person who is registered or liable to be registered under this Act".

The liability to register arises under section 51(1):

> (1) Subject to this Act, every person who, on or after the 1st day of October 1986, carries on any taxable activity and is not registered, becomes liable to be registered—
>
> (a) At the end of any month where the total value of supplies made in New Zealand in that month and the 11 months immediately preceding that month in the course of carrying on all taxable activities has exceeded $40,000 (or such larger amount as the Governor-General may, from time to time, by Order in Council declare):
>
> Provided that a person does not become liable to be registered by virtue of this paragraph where the Commissioner is satisfied that the value of those supplies in the period of 12 months beginning on the day after the last day of the period referred to in the said paragraph will not exceed that amount:

(b) At the commencement of any month where there are reasonable grounds for believing that the total value of the supplies to be made in New Zealand in that month and the 11 months immediately following that month will exceed the amount specified in paragraph (a) of this section:

Provided that any such person shall not become liable where the Commissioner is satisfied that that value will exceed that amount in that period solely as a consequence of—

(c) any ending of, including a premature ending of, or any substantial and permanent reduction in the size or scale of, any taxable activity carried on by that person; or

(d) The replacement of any plant or other capital asset used in any taxable activity carried on by that person.

Analysis

Under section 8(1) of the Goods and Services Tax Act 1985 (the "GST Act"), goods and services tax is imposed at a rate of 12.5 percent where the following requirements are met:

- there is a supply of goods or services in New Zealand;
- by a registered person;
- in the course or furtherance of a taxable activity carried on by that person.

If these requirements are met then tax is calculated by reference to the value of that supply.

The value of a supply of goods or services is defined in section 10(2) as being the "consideration for the supply".

"Consideration" is defined in section 2(1) as being "any payment made … in respect of, in response to, or for the inducement of, the supply of any goods and services".

Under section 5(6D) of the Act, payments are deemed to be consideration for a supply of goods or services in the course or furtherance of that person's taxable activity if the payments are:

- in the nature of a "grant or subsidy";
- made on behalf of the Crown or by any public authority;
- made to a person;
- made in relation to or in respect of that persons taxable activity.

Under section 2(1) a "registered person" means a person who is registered or is liable to be registered under the GST Act.

1. Whether the Maori claimant group makes a supply of goods or services which is chargeable with GST under section 8(1)

Many of the Maori claimant groups who receive Treaty settlement payments will be registered for GST, and so it is possible to argue that any supplies made might be made in the course of the Maori claimant group's taxable activity. This will always depend on the particular facts in each case, but this interpretation statement will (for convenience) proceed on the assumptions that:

- the Maori claimant group is a registered person, and
- any relevant supplies could arguably be seen as being made in the course or furtherance of a taxable activity carried on by that Maori claimant group.

The further requirements of section 8(1) are discussed below.

(a) Whether in a Treaty settlement the Maori claimant group makes a supply of goods or services in New Zealand

Definition of "goods"

"Goods" as defined in section 2 of the GST Act means all kinds of (tangible) personal or real property; but does not include choses in action or money.

A chose in action is a right to recover a thing (if withheld by action) of which a person does not have immediate enjoyment and possession. Examples include debts, insurance contracts, shares, copyrights, patents and trademarks.

When a particular Maori claimant group and the Crown reach a settlement in relation to a Treaty grievance, the Maori claimant group will often provide certain undertakings or agreements. For example, the Maori claimant group may agree to accept the settlement as final settlement and not to pursue the claim in Court, and may also agree to support the passing of the legislation that gives effect to the settlement deed. In a Treaty settlement generally no tangible or real property passes from the Maori claimant group to the Crown or another person. Therefore, in most such cases, the Maori claimant group will not provide something as part of the settlement agreement that could be described as a "good".

However, it is possible that a future Treaty settlement agreement between a Maori claimant group and the Crown could contain a provision whereby some tangible or real property passes from that Maori claimant group to the Crown or another person. If that were so, then the Maori claimant group would provide something as part of the settlement agreement that could be described as a "good" for the purposes of the GST Act.

Definition of "Services"

"Services" as defined in section 2 of the GST Act means "anything which is not goods or money".

According to *Case S65* (1996) 17 NZTC 7,408, for an activity to be a "service" it must benefit the recipient in some way. In *Case S65* the taxpayer previously ordered by a disciplinary tribunal to pay costs was denied a claim for an input tax credit for payment of those costs on the basis that he had not been supplied with goods or services.

As stated above, when a particular Maori claimant group and the Crown reach settlement of a Treaty of Waitangi grievance, the Maori claimant groups often provide certain undertakings or agreements. The Maori claimant group's undertakings and agreements are of some benefit to the Crown, therefore the undertakings and agreements could arguably be considered "services" for the purposes of the GST Act.

Definition of "Supply"

"Supply" is defined in section 5(1) as including all forms of supply.

Both the New Zealand and English courts have held that the word "supply" should be given a very wide meaning.

The High Court in *Databank Systems Ltd v CIR* (1987) 9 NZTC 6,213 considered whether Databank had supplied services to various banks. In this case, the court interpreted the word "supply" as "furnish with or provide".

English courts have held that "supply" means to "furnish with or serve". In *Carlton Lodge Club Limited v C and E Commrs* [1974] 3 All ER 798 the court held that the serving of drinks to members of an unincorporated club was a supply. In reaching this decision Milmo J said (at p 801):

> "the word 'supply' in its ordinary and natural sense means to furnish or to serve";

In *C and E Commrs v Oliver* [1980] 1 All ER 353 and 355 the court held that the purchase of a stolen car at an auction was a supply. Griffiths J also said (at p 354):

> "There is no definition of 'supply' in the Act itself, but it is quite clear from the language of the Act that 'supply' is a word of the widest import... . 'Supply' is the passing of possession in goods pursuant to an agreement whereunder the supplier agrees to part with and the recipient agrees to take possession. By 'possession' is meant, in this context, control over the goods, in the sense of having the immediate facility for their use. This may or may not involve the physical removal of the goods."

Given that supply merely requires something to be conferred by a person, and that it is defined in wide terms for GST purposes, the word appears to encompass all transactions, agreements, and other events where value is bestowed by one person on to another person. Therefore, the furnishing of goods or the provision of services will be a supply.

The GST Act focuses on contractual supplies. This approach was reiterated in *Wilson & Horton Limited v CIR* (1995) 17 NZTC 12,325. This case discussed circumstances in which a newspaper publisher should account for GST on the services of placing advertisements for non-resident clients. In the Court of Appeal decision Richardson J said at p 12,328:

> Those provisions are directed to the contractual arrangements between the supplier and the recipient of the supply. In keeping with the general statutory scheme in that respect s 11, providing for zero rating of supply transactions where the stated overseas element is present, follows the same pattern. It follows that where, as in the presently material s 11(2)(e), the provision refers to "services … supplied … to a person" the statutory dictionary applies and the phrase refers to the contractual position and so to the person who has provided the consideration.

There must also be an identifiable supply. The need to identify the supply was noted by Tipping J in *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075 (CA). The *Chatham Islands Enterprise Trust* case involved a payment made by the Crown to a charitable trust that was established by the Crown to provide services and promote the wellbeing of Chatham Islands residents. Blanchard J said (at p 15,081):

> While it is clear that the services do not have to be supplied to the person providing the consideration (as defined) for them, it is still necessary for there to be a supply of services within the proper meaning of the phrase. **Although services are defined as meaning anything which is not goods, it is still necessary for there to have been a supply of something.** [Emphasis added]

From the case law the word "supply":

- means to "furnish with or to provide or to serve" (*Databank Systems Ltd, Carton Lodge Club Limited v C and E Commrs,* and *C and E Commrs v Oliver*),
- focuses on contractual supplies (*Wilson & Horton Limited* and *Chatham Islands Enterprise Trust*).

In a Treaty settlement the Maori claimant groups enter into undertakings and agreements that are of benefit to the Crown, and no goods are provided by the Maori claimant groups to the Crown, and so therefore the undertakings and agreements entered into by the Maori claimant groups may be a supply of services. The undertaking and agreements are clearly identifiable supplies. As such, the undertakings and agreements provided by the Maori claimant group to the Crown as part of the Treaty settlement may fall within the broad definition of "supply".

Whether "forbearance to sue" is a supply?

There are two TRA cases that have considered whether forbearance to sue is a supply.

In *Case S77* (1996) 17 NZTC 7,483 Barber DJ considered an agreement to take no further enforcement steps and to have the proceedings struck out of court was not a supply of goods or services. In this case, the taxpayers were a farming couple who set fire to stubble on their farm. The fire burnt out of control and spread to a neighbouring farm where the fire damaged farm machinery, owned by the L partnership. The taxpayers and the L partnership reached an out of court settlement based on the value of the machinery and various costs to the L partnership. The taxpayer sought an input tax credit on the sum paid. The Authority considered that the surrender was not of itself a supply, as the L partnership did not forgo any legal right, rather it achieved enforcement of its legal right to damages. Therefore the taxpayer was not entitled to an input tax credit.

Barber DJ commented that although the concept of "supply" is a very wide one (citing *Databank Systems Ltd*) the concept of "supply" could not cover the situation in *Case S77*, as the L partnership did not supply anything to the taxpayers (at p 7,487).

In *Case T22* (1997) 18 NZTC 8,124, Willy DJ also discussed the forbearance to sue point. He referred to the Commissioner's policy statement on the "GST treatment of damages and out of court settlements" and made the following comments (at p 8,147):

> That [policy statement] appears to me to be a sensible appreciation of the legal consequences of an out of Court settlement in so far as it may impact upon the payment of goods and services tax. One can readily understand how a given settlement may involve the transfer of property which can be "connected back to the original taxable supplies" and that where a part of the payment relates to the original supply an apportionment of a global settlement sum may be required. I put it no higher than that. It is for that reason no doubt that the Commissioner relied as he did on the matters set out in his letter of 1 February 1994. To go beyond that and assert that the mere forbearance to sue is in some way the provision of goods or a service is on the face of it a surprising proposition.

In *Case T22* Willy DJ was also of the view that although the definition of "service" was wide, it did not include a forbearance to sue. He considered it could not be said that the taxpayer had provided a service to the Crown merely by choosing to not exercise the existing legal rights. Further Willy J commented it may be that the Crown has derived some benefit from the taxpayer's decision, but that did not convert the taxpayer's decision into the provision of services (at p 8,148):

> Viewed in that general way it cannot be said that merely by desisting from exercising rights otherwise available to it the objector has provided any service to the Crown. It may be that the Crown considers it has derived some benefit from the decision of the objector not to exercise those rights, but that does not convert the decision of the objector into one for the provision of services to the Crown.
>
> I repeat what is said earlier in this judgment from the decision of the Court of Appeal in *C of IR v New Zealand Refining Company Ltd* at p 13,193 of the unreported judgment of Blanchard J:
>
> "It is fundamental to the GST Act that the tax is levied on or in respect of supplies. It is not a tax on receipts or on turnover; it is a tax on transactions:".
>
> There has been no transaction in this case answering that description and therefore there is nothing to tax. The reality is that the objector has simply surrendered some rights which it considered it otherwise had in return for a payment to it by the Crown of $2,000,000.
>
> Therefore even if the Commissioner had persuaded me that he should have been allowed to rely upon the forbearance to sue argument I am satisfied for the reasons I have given that it too would have failed.

In both cases, the TRA decided that a mere forbearance to sue was not a supply.

It is considered that it is unnecessary to narrow the concept of "supply of a service" in this way in order to give effect to the intention that GST will only be payable on transactions. The definitions of "supply" and "services" are very wide, and would seem able to include agreements to do things such as enter into a lease, and agreements not to do things such as a restraint of trade. These cases are not considered strong enough to exclude the possibility that a forbearance to sue may in certain circumstances be a supply.

It is considered that in a Treaty settlement the Maori claimant group's forbearance to sue (ie agreeing not to pursue the claim in Court) given as part of the Maori claimant group's undertakings and agreements may be a supply of a service also.

Conclusion

The Commissioner considers that in a Treaty of Waitangi settlement the Maori claimant group's undertakings and agreements may be supplies of goods or services in New Zealand for the purposes of section 8(1).

(b) Whether any consideration was received in respect of, or for the inducement of, that supply

The Treaty of Waitangi settlement payments or redress provided by the Crown to the Maori claimant groups can take various forms, but commonly includes the transfer of land, property (eg artefacts and buildings), other agreements (eg an agreement to preserve specific land sites, or native plants and animals) and the payment of money.

GST is levied under section 8(1) "by reference to the value of that supply". Section 10(2) provides that the value of a supply is "the consideration for the supply". "Consideration" in section 2(1) means "any payment made … in respect of, in response to, or for the inducement of, the supply of any goods and services...".

Therefore, the next question is whether the Treaty settlement payments are made in respect of, in response to, or for the inducement of the Maori claimant group's undertakings and agreements.

Definition of "consideration"

The main requirement for "consideration" is that there must be a direct or substantial nexus between the payments and the supply of goods or services.

In *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 the court said that for a payment to constitute consideration there must be a sufficient connection between the payment and the supply. In *New Zealand Refining* the court considered that there was little or no connection between the payments made by the Crown and any supply of goods or services by New Zealand Refining Co Ltd (the company). Further the court said that although the payments were intended as an inducement to the company to keep the refinery open for three years, they were not payments for any supply. Blanchard J said that although there may have been an expectation that the refinery would continue to operate, there was no contractual requirement to that effect and no stipulation for the supply of product or services to any buyer or buyers. The only requirement was that the refinery continued to remain operational. Blanchard J noted that to qualify for the payment, the company simply had to keep the refinery operational, a requirement that it could satisfy just by processing its own products without making any supplies (at p 13,192). His honour continued (at p 13,193):

> It is fundamental to the GST Act that the tax is levied on or in respect of supplies. It is not a tax on receipts or on turnover; it is a tax on transactions: C of IR v Databank Systems Ltd. It is therefore necessary, as Mr Green submitted, to distinguish between supplies and the taxable activity (as defined in s 6) in the course of which they are made. The definition in s 6 itself requires a nexus between a supply and consideration, as does s 10.
>
> The tax itself is levied by s 8 on a supply in the course or furtherance of a taxable activity and is "by reference to the value of that supply". Section 10 provides that the value of a supply is "to the extent of the consideration for the supply" the amount of the money involved or the nonmonetary open market value of the consideration. **Already, before turning to the definition of "consideration", it can be seen that, again, a linkage between supply and consideration is requisite to the imposition of the tax.**
>
> **The definition of "consideration", though broad, cannot and does not dispense with that requirement. To constitute consideration for supply a payment must be made for that supply, though it need not be made to the supplier nor does the supply have to be made to the payer.**
>
> **There is a practical necessity for a sufficient connection between the payment and the supply. The mechanics of the legislation will otherwise make it impossible to collect the GST.** [Emphasis added]

The court took a similar approach in *Chatham Islands Enterprise Trust* saying that there must be a sufficient nexus between the payment (or other conduct) and the relevant services. In *Chatham Islands Enterprise Trust* the court also held that the payments were not consideration for (assumed) supplies, even though it concluded earlier that no supplies were made. Tipping J said (at p 15,081):

> If one assumes, contrary to my earlier conclusion, that what the trustees did amounted to the supply of services to the Crown as settlor and/or to the Islanders as beneficiaries, it must also be shown that the payments by the Crown had a sufficient connection with those services to fulfil at least one limb of the statutory definition.
>
> The money was not paid for any particular purpose, albeit that in terms of ordinary trustee law it had to be used within the terms of the Trust. I therefore have difficulty in seeing how it can be said that the payments made by the Crown were in respect of or for the inducement of any services. Clearly the payments were not in response to the supply of services. With the use of the money not in any way related to any particular purpose and not in any way circumscribed or mandated, except by the conventional requirement that the trustees should keep within broad and general powers vested in them by the Trust deed, I do not consider the relationship between the payment and the (assumed) services fulfils the definition of consideration. As a consequence, the trustees did not make their (assumed) supply of services in the course or furtherance of a taxable activity.

Therefore, it is not sufficient that each party merely provides something, there must be a direct or substantial nexus or link between the supply and the consideration, in the sense that the supply must be the occasion or reason for the consideration.

In *Case T22*, Judge Willy did not accept that the taxpayer had made a supply of goods or services to MAF by ceasing to conduct its farming activity in return for the payment. As the regulations had already removed the taxpayer's ability to carry on the business, there was not a sufficient connection between the ceasing of the business and the payment.

In summary, the main requirement is that for a payment to be consideration for a supply, there must be a direct or substantial nexus or link between the payment and the supply of goods or services (*NZ Refining*; *Chatham Islands Enterprise Trust*).

Undertakings and agreements

As stated in *NZ Refining*, the mere fact that there may be some form of supply by the Maori claimant group to the Crown does not of itself mean that the Treaty settlement payments the Crown makes to the Maori claimant group is consideration for that supply. The Treaty of Waitangi settlement payments made by the Crown to the Maori claimant group takes various forms, of both cash and non-cash items. For GST purposes there must be a direct or substantial nexus between the supplies made by the Maori claimant groups and the receipt of the Treaty settlement payments.

Anything supplied by the Maori claimant group under the settlement agreement must provide the occasion or reason for the receipt of the Treaty settlement payments from the Crown.

However, in most Treaty of Waitangi settlement situations where the Crown makes Treaty settlement payments to the Maori claimant group, there is no real or substantial nexus between the supplies and the Treaty settlement payments. In many settlement situations such a nexus will not be present. Treaty of Waitangi settlement payments are generally made by the Crown to recognise and compensate for historical wrongs that were breaches of the Treaty of Waitangi and its principles. Therefore, the real or substantive nexus is between the Treaty settlement payments made by the Crown and the redress or compensation for historical wrongs, not the undertakings or agreements provided by the Maori claimant group as part of the Treaty settlement.

The undertakings or agreements are only part of the mechanism or procedure by which the Treaty grievance is settled. In such a situation there is no direct or substantial nexus between the supplies made by the Maori claimant group and the receipt of the Treaty settlement payments from the Crown.

An example of a case where there was a forbearance to sue is the British VAT tribunal decision of *Cooper Chasney* [1990] 5 BVC 677. Unfortunately in that case the tribunal did not comment on whether there was a difference between the forbearance to sue and an agreement to give up the right to use a company name.

Conclusion

In a Treaty settlement situation, the Commissioner considers that supplies are made by the Maori claimant groups, but there is no real or substantial nexus between the supplies and the Treaty settlement payments (either cash or non-cash items) received from the Crown. The real or substantive nexus is between the Treaty settlement payments made by the Crown and the redress of historical wrongs which were breaches of the Treaty of Waitangi, not the undertakings or agreements provided by the Maori claimant group as part of the Treaty settlement. The undertakings or agreements are only part of the mechanism or procedure by which the Treaty grievance is settled. Unless the payments from the Crown to the Maori claimants are "consideration" for other matters, the payments will not be subject to GST.

(c) Whether in terms of section 5(6D) the Treaty settlement payments (cash or non-cash) are deemed consideration for supply in the course or furtherance of the Maori claimant group's taxable activity

Under section 5(6D) of the Act, payments are deemed to be consideration for a supply of goods or services in the course or furtherance of that person's taxable activity if the payments are:

- in the nature of a "grant or subsidy";
- made on behalf of the Crown or by any public authority;
- made to a person; and
- made in relation to or in respect of that person's taxable activity.

In order for section 5(6D) to apply all of the factors mentioned above must be met. The first question that section 5(6D) raises is whether the Treaty settlement payments meet the case law definitions of "grant or subsidy".

The phrase "grant or subsidy" is not defined in the legislation, but the words are given meaning by case law. The case law shows that the following factors when combined together usually indicate that a payment is in the nature of a "grant or subsidy", ie where the payment is:

- A gift, in the sense that there is no obligation to make it (*De Morgan and Anor v The Director General of Social Welfare* (1996) 17 NZTC 12,441 and *GTE Sylvania v R* [1974] CTC 751).
- Special assistance (*First Provincial Building Society Ltd v FCT* 95 ATC 4145, *Placer Development Ltd v Commonwealth of Australia* (1969) 121 CLR 353, *De Morgan and Anor v The Director General of Social Welfare* (1996) 17 NZTC 12,441, *Director-General of Social Welfare v De Morgan and Anor* (1996) 17 NZTC 12,636).
- A payment to promote or encourage an industry or enterprise (*GTE Sylvania v R* [1974] CTC 751, *Reckitt & Coleman Property Ltd v FCT 4* ATR 501 and *Placer Development Ltd v Commonwealth of Australia* (1969) 121 CLR 353).
- Made out of public funds (*GTE Sylvania v R* [1974] CTC 751).
- Beneficial to the public interest (*GTE Sylvania v R* [1974] CTC 751 and *Placer Development Ltd v Commonwealth of Australia* (1969) 121 CLR 353).

In deciding whether a payment is in the nature of a "grant or subsidy" it is the character or quality of what is paid and of the consideration given that is crucial, not its receipt in the hands of the payee (*Director General of Social Welfare v S & D De Morgan* (1996) 17 NZTC 12,636).

In order to make a decision as to whether the Treaty settlement payments are payments in the nature of a "grant or subsidy", all the above factors must be weighed and the relevant facts taken into account.

In the Treaty context, the settlement payments are redress or compensation for historical wrongs. Compensation is something that is to be paid which makes up for the loss that the person has sustained (*Great Western Railway v Helps* [1918] AC 141) or a payment to be placed into the hands of the owner expropriated, the full money equivalent of the thing of which he has been deprived (*Nelungaloo Pty Ltd v The Commonwealth* (19471948) 75 CLR 495).

The meaning of compensation is inconsistent with payments that are in the nature of a "grant or subsidy".

If the Treaty settlement payments (either cash or non-cash) are a true compensation payment for historical wrongs, they will not be payments in the nature of a "grant or subsidy".

A Treaty settlement payment is not assistance or aid to supplement the recipient's efforts, but a payment to make up for a wrong done or loss suffered in the past that were breaches of the Treaty of Waitangi. In this sense, it is not gratuitous or a gift, given that it is occasioned by a moral, and possibly legal, obligation to correct the wrong done. It does not have the purposes of promoting a particular industry or enterprise. While it may be used for an industry or enterprise, the real purpose is to compensate for a wrong done or make up for loss.

Conclusion

The Commissioner considers that where the Treaty settlement payment is a true compensation payment for historical wrongs that were breaches of the Treaty of Waitangi it will not be a payment in the nature of a "grant or subsidy". Consequently, the Treaty settlement payments (either cash or non-cash) are not deemed to be consideration for the supply of goods or services in terms of section 5(6D).

2. Whether the Crown makes a supply of goods or services which is chargeable with GST under section 8(1)

The Crown is the party to a Treaty of Waitangi settlement with the Maori claimant groups and the Crown itself transfers land and property, enters into agreements (eg an agreement to preserve specific land sites, or native plants and animals), or makes payment of money pursuant to the settlement agreement. It appears therefore that the Crown is making supplies of goods or services to the Maori claimant groups. In order to decide whether such supplies are subject to GST it is necessary to consider whether any consideration was received in respect of, or for the inducement of those supplies.

If no consideration was received for those supplies, section 8(1) will not apply and it will then be unnecessary to discuss the other requirements that need to be met in section 8(1).

(a) In a Treaty settlement, does the Crown make a supply of goods or services in New Zealand?

Definition of "goods" or "services"

As part of a Treaty settlement, the Crown often transfers land or property (eg historical artefacts and buildings) to the Maori claimant groups. Section 2 defines "goods" as "all kinds of personal or real property". The transfer of land or property by the Crown to the Maori claimant group clearly falls within the definition of "goods".

The Crown may also make payments of money. The definition of "goods" in section 2 does not include "choses in action or money". Section 2 also defines "services" as "anything which is not goods or money". Therefore, the payment of money by the Crown to the Maori claimant group is clearly not "goods or services".

The Crown could also make provision for other agreements (eg an agreement to preserve specific land sites, or native plants and animals). The provision of any other agreements (eg an agreement to preserve specific land sites, or native plants and animals) by the Crown to the Maori claimant group clearly falls within the definition of "services".

Definition of "supply"

As stated above, from the case law the word "supply":

- means to "furnish with or to provide or to serve" (*Databank Systems Ltd*, *Carton Lodge Club Limited v C and E Commrs*, *C and E Commrs v Oliver*, *Case T22*),
- focuses on contractual supplies (*Wilson & Horton Limited*, *Chatham Islands Enterprise Trust*).

In a Treaty settlement, the Crown furnishes or provides land, property (eg historical artefacts or buildings) and other agreements (eg an agreement to preserve specific land sites, or native plants and animals) to the Maori claimant groups that fall within the definitions of goods and services. Possession of the land and property passes from the Crown to the Maori claimant group. The services are also of benefit to the Maori claimant group. There are also clearly identifiable supplies. As such, the provision of land, property (eg historical artefacts or buildings) and other agreements (eg an agreement to preserve specific land sites, or native plants and animals) by the Crown to the Maori claimant groups are capable of being regarded as a supply of goods or services.

Conclusion

The Commissioner considers that, in a Treaty settlement, the land, property or other agreements (eg an agreement to preserve specific land sites, or native plants and animals) provided by the Crown to the Maori claimant groups may also be supplies of goods or services in New Zealand for the purposes of section 8(1).

(b) Is any consideration received in respect of, in response to, or for the inducement of, that supply?

Definition of "consideration"

As stated above, the main requirement is that, for a payment to be "consideration", there must be a direct or substantial nexus or link between the payment and the supply of goods or services (*NZ Refining*, *Chatham Islands Enterprise Trust*).

For the purposes of GST, it is necessary to establish whether there is a direct or substantial nexus or link between the supply of goods or services provided by the Crown and the undertakings or agreements entered into by the Maori claimant groups. If so, GST will be chargeable by the Crown and the Maori claimant groups may be able to claim an input tax deduction.

The undertakings or agreements provided by the Maori claimant groups are capable of falling within the definition of "consideration". However, for the reasons outlined below, in the absence of other factors, there will be no GST chargeable by the Crown on the supply of the goods or services.

First, although supplies are made there is no real or substantial nexus between the provision of goods and services by the Crown and the Maori claimant group's undertakings or agreements. The provision of goods (eg land or property) or services (eg an agreement to preserve specific land sites, or native plants and animals) are generally made by the Crown to recognise and compensate for historical wrongs that were breaches of the Treaty and its principles. Therefore, the real or substantive nexus is between the goods or services provided by the Crown and the wrongs done in the past, not the undertakings or agreements provided by the Maori claimant groups as part of the Treaty settlement.

Also, GST is determined according to the value of the supply. Under section 10(2), if the consideration is not in money (eg the Maori claimant group's undertakings or agreements), the value of the supply is the open market value of the consideration. Because the undertakings or agreements are made in order to correct past wrongs and to settle historical Treaty of Waitangi grievances, the undertakings or agreements do not have and are not intended to have any open market value. The Crown is not transferring the goods (eg land and property) or services (eg an agreement to preserve specific land sites, or native plants and animals) in order to receive consideration of value from the Maori claimant groups. It is transferring the goods or services in order to correct past wrongs.

Furthermore, the undertakings or agreements are only the mechanism or procedure by which the historical grievance is settled or conditions to the settlement of those grievances. In such a situation there is no direct or substantial nexus between the supplies made by the Crown and the undertakings or agreements provided by the Maori claimant groups.

Conclusion

The Commissioner considers that in a Treaty settlement situation the Crown does not make a supply of goods or services which is chargeable with GST under section 8(1) as:

- The direct or substantial nexus is between the goods (eg land or property) or services (eg an agreement to preserve land sites, or native plants and animals) provided by the Crown and the redress of historical wrongs, not the undertakings or agreements provided by the Maori claimant groups as part of the Treaty settlement.
- It is not intended that the Crown receive anything from the Maori claimant groups of significant open market value under the Treaty settlement agreement in return for that supply.
- Any undertakings or agreements are just a procedure by which the historical grievance is settled or conditions to the settlement of those grievances.

Example

It has been concluded that certain actions taken against a particular iwi during the 1850s and 1860s were a breach of the Treaty of Waitangi. Descendants of that particular iwi (the Maori claimant group) and the Crown have entered into a Treaty of Waitangi Settlement agreement to settle the historical Treaty claims. In the settlement agreement, the Crown acknowledges that the wrongs committed against the iwi were breaches of the Treaty of Waitangi during the 1850s and 1860s. Accordingly, the Crown agrees to provide redress to atone for the wrongs done. The settlement agreement provides that the redress (cash and non-cash items) will include certain areas of land and improvements on land, money, and the return of other property (held as artefacts in a provincial museum) that belonged to the iwi that were taken by the Crown. The Crown also makes an agreement to preserve specific land sites, native plants and animals in the Maori claimant group's tribal area.

While the Treaty settlement agreement states that the redress is to atone for the wrongs done that were breaches of the Treaty of Waitangi, the Maori claimant group also enters into certain undertakings or agreements with the Crown. These include accepting that the settlement payments are in full and final settlement of the Crown's breaches of the Treaty of Waitangi in relation to their historical Treaty claims and to support the passing of legislation which is required to give effect to the settlement agreement.

The Maori claimant group has registered as an entity for GST purposes.

The Maori claimant group and the Crown want to know whether any GST is payable on the Treaty settlement.

In terms of section 8(1) or section 5(6D), does the Maori claimant group make a supply of goods or services to the Crown for any consideration?

The undertakings or agreements provided by the Maori claimant group to the Crown fall within the broad definition of supply.

However, the Treaty settlements payments (either cash or non-cash) provided by the Crown to the Maori claimant group are not consideration for supplies of goods or services. The real or substantive nexus is between the Treaty settlement payments provided by the Crown and the redress of historical wrongs. In these circumstances no GST is chargeable.

The Treaty settlement payments (either cash or non-cash) are to compensate for historical Treaty breaches.
The Treaty settlement payments are a true compensation payment and, as such, they do not fall within the definition of a "grant or subsidy" for the purposes of section 5(6D). Therefore the Treaty settlement payments are not deemed consideration for a supply under section 5(6D) either.

In terms of section 8(1), does the Crown make a supply of goods or services to the Maori claimant group for any consideration?

Clearly, the transfer of land or property from the Crown to the Maori claimant group or the entering into certain agreements (eg an agreement to preserve specific land sites, native plants and animals) are supplies of goods or services.

However, the undertakings or agreements entered into by the Maori claimant group are not consideration for the supply of those goods or services. The real or substantive nexus is between the goods or services provided by the Crown and the redress of historical wrongs. Therefore, no GST is chargeable by the Crown on the supply of these goods or services.

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.

PIPELINE CRAWLER, INFLATABLE PIPELINE PLUG

PROVISIONAL DEPRECIATION DETERMINATION PROV 10

This Determination may be cited as "Determination Prov 10: Tax Depreciation Rates Provisional Determination Number 10".

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" for the 2002 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 "Dairy Plant", "Fishing", and "Oil and Gas" industry categories, the provisional asset class, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

	Estimated useful life (years)	DV banded dep'n rate (%)	SL equiv banded dep'n rate (%)
Pipeline Crawler	5	33	24
Inflatable Pipeline Plug	3	50	40

- Inserting into the "Compressed Air", "Factory and Other Sundries", "Reticulation Systems", and "Water and Effluent Treatment" asset categories, the provisional asset class, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

	Estimated useful life (years)	DV banded dep'n rate (%)	SL equiv banded dep'n rate (%)
Pipeline Crawler	5	33	24
Inflatable Pipeline Plug	3	50	40

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 11th day of September 2002.

Martin Smith

General Manager (Adjudication and Rulings)

GRADERS (CAPSICUMS)

DRAFT GENERAL DEPRECIATION DETERMINATION

Please quote reference: DDT00066

The Commissioner proposes to issue a general depreciation determination that will insert a new asset class "Graders (Capsicums)" into the "Agricultural, Horticulture and Aquaculture" and "Food Processing" industry categories, with a depreciation rate of 22% DV (15.5% SL) based on an estimated useful life of eight years.

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

GENERAL DEPRECIATION DETERMINATION DEP xx

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

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" for the 2002/03 and subsequent income years.

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:

- Inserting into the "Agricultural, Horticulture and Aquaculture" and "Food Processing" industry categories the general asset class, estimated useful life, and diminishing value and straight-line depreciation rates listed below:

Asset class	Estimated useful life (years)	DV banded dep'n rate (%)	SL equiv banded dep'n rate (%)
Grader (Capsicums)	8	22	15.5

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 and Communication
Adjudication & Rulings
National Office
Inland Revenue Department
P O Box 2198
WELLINGTON

We need to receive your submission by 31 October 2002 if we are to take it into account in finalising the determination.

COMMISSIONER'S EXEMPTIONS

Exemption granted to Papua New Guinea shipping operators under section CN 1(2)

The Commissioner of Inland Revenue has added Papua New Guinea to the list of countries with whom New Zealand has a reciprocal arrangement to exempt from income tax shipping operators of the other country, under section CN 1(2) of the Income Tax Act 1994. Section CN 1(2) enables the Commissioner to exempt shipping operators of another country from New Zealand income tax on merchandise, goods, livestock, mail or passengers shipped from New Zealand, if New Zealand shipping operators are similarly exempt in the other country.

Papua New Guinea has recently provided an undertaking, backdated to 1 April 1999, to exempt New Zealand shipping operators from Papua New Guinea income tax on freight shipped from Papua New Guinea. New Zealand has therefore responded by exempting Papua New Guinea shipping operators deriving income from the shipment of freight from New Zealand, also with effect from 1 April 1999.

Other countries with whom New Zealand has previously entered into exemption arrangements under section CN 1(2) are Barbados, Bermuda, Brazil, Chile, Greece, Hong Kong, Israel, Liberia, Netherlands Antilles, New Caledonia, Panama, Poland, Tonga and Vanuatu.

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.

JUDICIAL REVIEW

Case:	Surjeet Singh v CIR
Decision date:	7 August 2002
Act:	Income Tax Act 1976, Income Tax Act 1994, Tax Administration Act 1994 ("TAA")
Keywords:	Amended Returns, NOPA; Deemed Acceptance; Exceptional Circumstances s 89K TAA

Summary

The CIR was successful in resisting the application for judicial review.

Facts

On 10 June 1998, the CIR issued to the plaintiff a default assessment for income tax in relation to his business as a motor mechanic for the year ended 31 March 1997. On 10 August 1998, he issued similar default assessments for the years ended 1990 –1996 and 1998.

As the plaintiff had not previously furnished any returns of income, he could dispute the default assessments only by furnishing a returns of income for the relevant periods: section 89D(2) TAA.

According to the CIR's records, the plaintiff's accountant prepared returns for the 1990 – 1996 years, and filed them on 22 September 1998. A second return for 1996 was filed on 26 January 1999. Returns for the 1997 and 1998 years were filed on 19 November 1998.

The plaintiff claimed, and the CIR disputed, that on 22 October 1998 further tax returns were filed for the period 1990 – 1998 to which the CIR did not respond within two months.

On 23 March 2001, the CIR took enforcement proceedings in the District Court, and in the course of those proceedings, the plaintiff sought to file NOPA's out of time.

The CIR claimed it was not competent for the plaintiff to proceed by way of judicial review rather than by way of the statutory challenge procedure.

The plaintiff claimed, as a first cause of action, the alleged returns of 22 October 1998 were to be construed as NOPA's issued under section 89D, which the CIR failed to respond to, and accordingly the CIR was deemed by section 89H to have accepted those returns.

As a second cause of action, the plaintiff sought a determination the CIR acted wrongly in failing to find the delays in challenging the assessments were due to "exceptional circumstances," so the time for challenge should be extended under section 89K.

The CIR disputed the factual claim that the alleged returns were filed on 22 October 1998. He also disputed he was deemed to have accepted the contents of the alleged returns, or that there were any grounds for challenging his decision that there were no "exceptional circumstances."

Decision

The Court declined to consider the factual question of whether or not the CIR had invited the plaintiff to file a NOPA out of time, as the issue had already been determined against him by the District Court on 12 August 2001. The plaintiff was therefore bound by that decision, and could not challenge it, except by appeal brought within time.

The Court held that if tax returns were filed on 22 October 1998, they would have no legal significance. It was therefore unnecessary to decide whether or not additional returns were filed on that date. The reasons for this conclusion follow:

The 1998 year

- This year could not be challenged as it was the subject of an agreed adjustment signed on 13 April 1999. Section 89I precluded the plaintiff from challenging it.

The 1990 – 1996 years

- The CIR had superseded the default assessments with amended assessments based on the returns filed on 22 September 1998, which meant the default assessments had no continuing effect.

The 1996 year

- An additional reason applies to 1996. The initial return filed on 22 September 1998 was superseded by a second return filed on 26 January 1999, leading to an amended assessment on 16 February 1999. The CIR may under section 113 accept late returns and process them outside the response period, which he did in the case of this second return. As the plaintiff had filed a return, he had the right under section 89D(1) to issue a NOPA in response to the assessment, until 16 April 1999. As he did not do so, he cannot dispute the issue, unless he can establish "exceptional circumstances".

The 1997 year

- A similar process applied to the 1997 year as to 1996.

Exceptional circumstances

On this issue, the Court found there was no point in considering whether the plaintiff could demonstrate exceptional circumstances in relation to the returns allegedly filed on 22 October 1998, as they had no legal significance for reasons set out above.

In addition, in relation to the 1990 – 1997 years, no facts were pleaded or proved to support the submission the CIR acted wrongly in finding the statutory test for extraordinary circumstances was not met.

TRANSFER APPLICATION DISMISSED

Case:	Actonz Investment Joint Venture, Erris Promotions, Arsenal Limited and others v CIR
Decision date:	15 August 2002
Act:	Tax Administration Act 1994
Keywords:	Transfer application dismissed

Summary

The CIR was unsuccessful in his attempt to transfer six cases from the TRA to the High Court.

Facts

Actonz Investment Joint Venture ("Actonz") setup a scheme involving the purchase of software ("the scheme") which the CIR considers to be the second largest tax avoidance arrangement in New Zealand to date, for both income tax and GST purposes.

The GST side of the case is currently in the High Court, Actonz having challenged the CIR's assessment disallowing the GST input claimed as a result of the scheme. The income tax assessments for the individual investors disallowing the depreciation losses claimed as a result of the scheme, and imposing 100% shortfall penalties for taking an abusive tax position, were made earlier this year. Six of the individual investors, representing the 420 odd Actonz investors, filed challenges to the income tax assessments in the Taxation Review Authority ("TRA"). These six "representative" cases were commenced before the TRA, as test cases.

Given the public importance of the issues involved and the amount of money at stake, the CIR applied to have the six depreciation cases transferred from the TRA to the High Court and consolidated in the High Court with the GST case.

Actonz cross-applied to have the GST case stayed until the depreciation case has been heard.

Decision

Hammond J dismissed both the CIR's application for a transfer of the depreciation case to the High Court, and Actonz application for a stay of the GST case in the High Court.

His Honour went through the legislative basis for the removal of proceedings from the TRA to the High Court, ie section 138N(2) of the Tax Administration Act 1994 (TAA) and the relevant authorities in the area and concluded that the overall test is that of the justice of the case.

The relevant authorities set out certain factors which need to be traversed in the consideration of a transfer application and included the factual complexity and difficulties of any given dispute, the sums involved and the existence of difficult issues of principles.

His Honour considered that the reasons why the investors filed in the TRA were relevant. The first consideration related to the fact that the TRA is a specialist tribunal and that it is the individual's right to have his case dealt with economically, confidentially, expeditiously and in a forum of his choice. The second consideration related to the issue of legal costs. It was suggested by counsel for the investors that the hearing costs in the TRA are "minute in comparison with the costs of conducting a [lengthy] trial in the High Court." The third consideration was that of anonymity in that proceedings in the TRA are not in open Court but rather by way of a hearing that is closed to the public.

Under the heading of "Costs" His Honour was not persuaded that the sums in issue (around $226m in total—averaging at $80,000 per taxpayer) in this case are of real moment for present purposes. His Honour accepted that the amounts were considerable but thought it is trite that the sum of money in issue in a proceeding is in and of itself a poor measure of the difficulties likely to attend on a case.

Under the heading of "Objector/Plaintiff autonomy" His Honour found that plaintiff (objector) autonomy should weigh in favour of those parties in the context of these cases. The plaintiffs are entitled, in His Honour's view, to say "I want the less formal, less expensive and private TRA, at least in the first instance." The structure of the statute supports this view according to His Honour.

Under the heading "the forensic overlap in the proceedings", His Honour was not persuaded that these cases should be co-joined in the way sought by the CIR. The first reason was because of the differences in parties, ie the Actonz plaintiff in the GST case is different from the objectors in the depreciation proceedings in the TRA. If the CIR is allowed to co-join the two then the objectors will have the plaintiff in the GST case "thrust upon them".

Secondly, if they are co-joined the ambit of the dispute is considerably widened for the objectors and the length of the combined proceedings would escalate the costs for the objectors.

Thirdly, His Honour felt that there are arguably some real differences in the legal issues between the cases.

The availability (or rather possibility of unavailability) of the CIR's senior counsel, Mr Jim Farmer QC for a trial that would last several weeks, if the matters were co-joined, was also a factor that Hammond J took into consideration in reaching his decision.

Therefore essentially for practical reasons His Honour took the view that the respective proceedings should remain in the forums in which they were commenced.

Staying the GST case so the depreciation case can be heard

His Honour stated that Actonz counsel seemed to want the best of both worlds in applying for a stay of the GST case yet arguing against the transfer of the income tax cases.

In His Honour's view the adjournment application is premature and that when the issues are more closely defined from the income tax cases, and the final "shape" of the GST litigation can be discerned, it may or may not be appropriate for there to be an adjournment in the then context of the overall litigation.

The application for a stay was therefore dismissed.

COSTS SENT BACK TO THE HIGH COURT FOR A NEW ASSESSMENT

Case:	Brent Leroy Miller & Ors v CIR; Managed Fashions Limited & Ors v CIR
Decision date:	19 August 2002
Act:	Income Tax Act 1976, Tax Administration Act 1994
Keywords:	Costs, High Court's discretion

Summary

The Court of Appeal upheld the appellants' appeal of the High Court costs judgment. The High Court was ordered to make a fresh costs assessment.

Facts

This appeal was from a decision of Baragwanath J, dated 17 June 1999, refusing to recall an earlier costs judgment. The costs related to litigation about a tax avoidance scheme known as the JG Russell template. The template has been held to constitute tax avoidance in all New Zealand courts, including the Privy Council (see *Miller v CIR* [2001] 3 NZLR 316).

On 13 July 1994 the Taxation Review Authority delivered a decision reported as *Case R25* (1994) 16 NZTC 6,120. After that decision some of the appellants, who were parties in *Case R25*, entered into settlement agreements with the Commissioner. These settlements were later abandoned as the Commissioner decided they were ultra vires as they involved remitting more than $50,000 of core tax (which the Commissioner did not have the statutory authority to do).

Subsequent to the failed settlements, the appellants appealed *Case R25* and also judicially reviewed the Commissioner. Baragwanath J, in three judgments, found largely for the Commissioner. Costs of $80,000 were awarded to the Commissioner.

Other participants of the JG Russell template also attempted to settle their liabilities, and the Commissioner also resiled from those settlements. A group of taxpayers, known as the *Kemp* litigants, judicially reviewed the Commissioner in relation to the failed settlements. In a decision reported as *Kemp & Ors v CIR* (1999) 19 NZTC 15,110, Robertson J found for the Commissioner (the settlements were not enforceable), but was of the opinion that that was one of the rare cases where the successful party should pay costs to the unsuccessful party (the Commissioner had to pay costs to the unsuccessful applicants).

In the current case the appellants submitted that the costs judgment should be recalled because new evidence relevant to costs had arisen since the date of the costs judgment. On 17 June 1999 Baragwanath J refused to recall the costs judgment. That decision was appealed.

The appellants argued that the Commissioner was guilty of conduct that necessitated continuation of the litigation, that the High Court was unaware of the failed settlement when it delivered the costs judgment (and that that was relevant to costs), and that other taxpayers (the *Kemp* litigants) in a similar position had costs awarded in their favour.

The Commissioner argued that the decision to recall a judgment is a discretionary decision and the actual decision which the appellants wanted to recall was a costs decision, another discretionary decision.
The Commissioner further argued that as he was substantially successful in the High Court that he was entitled to costs and that Baragwanath J did not err in his approach. Furthermore, the *Kemp* litigants were in a fundamentally different situation than the appellants.

Decision

Glazebrook J, delivering the decision of the Court of Appeal, found for the appellants. Her Honour noted that Baragwanath J's costs judgment was made without knowledge of the aborted settlement deeds. It also pre-dated the *Kemp* litigation.

Her Honour questioned some of Baragwanath J's comments but recognised the judge had a discretion when awarding costs. However, Glazebrook J noted that the Court of Appeal was concerned by a statement in Baragwanath J's judgment to the effect that the appellants could not have allied themselves with the *Kemp* litigation without electing to discontinue their substantive appeal. The Court of Appeal held that the appellants would only have had to do this if the settlements were upheld.

This concern persuaded the Court of Appeal that the appeal should be allowed. It made an order recalling the costs judgment. Baragwanath J was ordered to make a fresh costs assessment in light of the Court of Appeal's decision.

JUDICIAL REVIEW CAUSE OF ACTION STRUCK OUT

Case:	John George Russell & Ors v Taxation Review Authority & CIR
Decision date:	20 August 2002
Act:	Tax Administration Act 1994, New Zealand Bill of Rights Act 1990
Keywords:	Judicial Review, strike out

Summary

The Commissioner was successful in his application to strike out the applicants' amended fourth cause of action.

Facts

This case relates to the JG Russell template. The template has been held to constitute tax avoidance in all New Zealand courts, including the Privy Council (see *Miller v CIR* [2001] 3 NZLR 316). In early 2000 Mr Russell and a number of companies associated with him and his tax avoidance template brought judicial review proceedings against the Commissioner and the Taxation Review Authority ("TRA"). The review proceedings consisted of five causes of action.

On 2 October 2000 Fisher J, in the High Court in Auckland (*Russell v Taxation Review Authority* (2000) 19 NZTC 15,924), struck out the first and fifth causes of action and stayed the second and third causes of action. The fourth cause of action was sent back for the plaintiffs to amend the pleadings. An amended statement of claim was filed and the Commissioner applied to strike it out. This judgment was the result of the Commissioner's strike-out application.

The fourth cause of action alleged that the Commissioner acted unfairly in his conduct with the plaintiffs, in particular by refusing to call the "correct" witnesses and in not complying with discovery obligations. Because of the Commissioner's conduct certain decisions of the TRA should be reconvened.

The plaintiffs argued that the Commissioner is obliged by the common law, section 6 of the Tax Administration Act 1994, and section 27 of the New Zealand Bill of Rights Act 1990 to act honestly and fairly in his proceedings before the TRA. The obligations include an obligation of disclosure of relevant documents and ensuring witnesses are available for examination and cross-examination. The plaintiffs alleged that the Commissioner had failed to comply with these obligations.

Decision:

Section 27 of the Bill of Rights Act

The plaintiffs argued that the Commissioner will have breached section 27(1) of the New Zealand Bill of Rights Act 1990 if he conducts the proceedings before the TRA in a way such as to impair the rights guaranteed by that section. Section 27(1) refers to the principles of natural justice. The Commissioner argued, and O'Regan J accepted, that the primary focus of section 27(1) should be on the judicial body (the TRA) rather than any public official (the Commissioner). It was also noted that section 27(3) of the Bill of Rights Act says that civil proceedings against the Crown should be treated in the same manner as civil proceedings between individuals.

O'Regan J concluded that if the Commissioner conducts proceedings before the TRA in compliance with the rules governing hearings in the TRA, it will be very difficult to establish any conduct which could be said to infringe any duty he has in terms of section 27(1).

Section 6 of the Tax Administration Act

The plaintiffs argued that the Commissioner has a duty to act honestly and fairly by virtue of section 6 of the Tax Administration Act 1994. That section says that the Commissioner must at all times use his best endeavours to protect the integrity of the tax system. The plaintiffs argued that section 6 should be interpreted in the same way as the New Zealand Bill of Rights Act, and that breaches of the obligations created by section 6 should be treated in the same way as breaches of the New Zealand Bill of Rights Act.

The Commissioner argued that section 6 did not impose specific duties of the kind described, but rather said that section 6 was a general statement as to the standard of conduct required by the Commissioner.
The Commissioner submitted that failures to meet those standards could lead to a complaint to the Commissioner (or the Ombudsman or the TRA in appropriate cases) but could not be the foundation of an independent High Court action.

O'Regan J held that section 6 did not create rights or obligations akin to those created by the New Zealand Bill of Rights Act and therefore that it could not be the foundation of an action for the remedy sought by the plaintiffs.

The *Scally* Principle

The *Scally* principle (named after *R v Bolton Justices, ex parte Scally* [1991] 2 All ER 619) is a principle applied in some criminal cases "that a challenge may also lie where unfairness in the conduct of proceedings resulted in some failure on the prosecutor's part, even when no-one has been guilty of fraud or dishonesty..." *R v Criminal Injuries Compensation Board, ex p A* [1997] 3 All ER 745, 761.

The plaintiffs argued that there was no reason not to extend the application of this principle to proceedings which did not have a criminal flavour. O'Regan J did not accept the plaintiffs' submissions and noted that there was no compelling reason to extend this principle to cases outside the criminal and quasi criminal arena.

Conclusion

O'Regan J concluded by saying that

> "the Commissioner's obligation to act honestly and fairly does not encompass an obligation to call witnesses or make them available, in circumstances where the Commissioner (and the Commissioner's counsel), do not seek to lead evidence from them for the purposes of the Commissioner's case…" .

Similarly, his Honour found that the TRA's powers for discovery are also adequate. Furthermore, O'Regan J noted that any deficiencies could be dealt with on appeal.

O'Regan J therefore struck out the cause of action.

The plaintiffs have indicated that they are going to appeal this decision.

APPLICATION TO AMEND PLEADINGS

Case:	North Harbour Nominees Limited v CIR
Decision date:	29 August 2002
Act:	Goods and Services Tax Act
Keywords:	Application to amend pleadings by way of declaration dismissed

Summary

High Court discretion to amend pleadings by way of declaration not exercised.

Facts

North Harbour Nominees Ltd ("NHNL") sought leave to file an amended statement of claim for a matter which has been set down for 5 days hearing commencing 9 September 2002. All interlocutory steps, discovery, and exchange of briefs have been completed.

The proposed amended statement of claim deletes the challenge to the assessment for the 31 March 1997 taxable period and replaces it with a declaration that the plaintiff (NHNL) satisfies the criteria for an input tax deduction in the taxable period ended 30 April 1997 and that section 76 of the GST Act has no application.

The Commissioner opposed the application for amendment because, in his submission, it is an attempt to change the GST taxable period in issue in this case. It seeks to replace a challenge to an assessment for the GST period ending 31 March 1997 with a declaration that NHNL satisfies the criteria for an input tax deduction in the 30 April 1997 taxable period. The Commissioner argued that the Court has no jurisdiction to change the taxable period in issue.

By way of background, NHNL claimed an input tax deduction in its GST return for the taxable period ending 31 March 1997. The claim related to the importation of a fishing vessel called the Ocean Dawn. One of several issues in the case is whether GST on the import of the boat was levied or paid in the taxable period ending 31 March 1997. The question of the correct taxable period was raised by the CIR over four years ago in his NOPA. NHNL was aware of this issue and responded to it in its Notice of Response.

In May 2002, NHNL claimed that, as a result of certain documents provided by the CIR as part of the pre-trial discovery process, it was obliged to accept that the taxable period ended 31 March 1997 was not the correct taxable period to claim the credit.

The Commissioner asserted that the documents referred to by NHNL were actually its own documents.

Decision

His Honour Justice Hansen made it quite clear in his decision that NHNL counsel conceded that it was an error on the part of NHNL that has led to this application. Counsel also accepted that he could not simply amend the pleadings by changing the relevant GST period. However, Counsel did submit that there was jurisdiction for the Court to hear the substantive dispute and deal with the matter by way of the declarations now sought. Counsel submitted that this was a pragmatic approach given that a five day hearing had been set for September the 9th. Counsel also submitted that this was an exceptional case, as in *Golden Bay*, and leave should be granted accordingly.

His Honour stated that the problem facing NHNL is that it cannot challenge the assessment for the April period in this Court until such time as the disputes procedures under the relevant legislation had been undertaken.

His Honour held that in this case it is clear that the Court has jurisdiction to grant the leave to amend. In exercising the discretion it is appropriate to take into account whether or not the trial will be postponed, whether the setting down rules could be rendered nugatory and whether there is prejudice to the defendant. However, at the end of the day the important factor is to ensure that the real controversy between the parties goes to trial.

It seemed to His Honour that in virtually any other type of proceedings leave would be granted in the circumstances confronting the Court. However, for valid reasons a different approach has been taken by the Courts in relation to tax disputes, ie in cases such as *Miller v CIR, Simunovich Fisheries Ltd v CIR, Golden Bay Cement Co Ltd v CIR etc.*

His Honour held that, while he had considerable sympathy for NHNL, he had reached the conclusion that it would be inappropriate to grant the leave sought. The authorities cited make it plain that it is inappropriate to attempt to challenge an assessment by way of judicial review proceedings and declarations based on that review. Even though what was sought here was a declaration pursuant to the Court's inherent jurisdiction as a matter of principle it is hard to see any difference between a declaration made pursuant to the inherent jurisdiction and a declaration made under proceedings initiated under the Judicature Amendment Act.
Here NHNL is seeking a declaration relating to substantive matters which it says the CIR erred in the course of the assessment.

Further, this case is distinguishable from *Golden Bay* in that it is not a truly exceptional case. First, the problem was of its own making. Second, the imbalance in UOMI rates is a statutory matter determined by the Legislature and it applies in all such cases. Third, there are still two weeks to go before trial and the Court resources will not necessarily be wasted. Therefore, there are insufficient factors in this case to create the necessary exceptional circumstances that would warrant leave.

REGULAR FEATURES

DUE DATES REMINDER

September 2002

5 **Employer deductions and employer monthly schedule**

Large employers ($100,000 or more PAYE and SSCWT deduction 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 deduction 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

30 **GST return and payment due**

October 2002

7 **Employer deductions and employer monthly schedule**

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

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

21 **Employer deductions**

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

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

Employer deductions and employer monthly schedule

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

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

FBT return and payment due

31 **GST return and payment due**

These dates are taken from Inland Revenue's Smart business tax due date calendar 2002 - 2003

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

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

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

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On the homepage, click on "The Rulings Unit welcomes your comment on drafts of public rulings/interpretation statements before they are finalised . . ." Below the heading "Think about the issues", click on the drafts that interest you. You can return your comments by internet.

Name ______________________________

Address ______________________________

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		Comment deadline
	Draft interpretation guideline	
☐	IG0007: Non-resident software suppliers' payments derived from New Zealand—Income tax treatment	15 November 2002
	Draft public ruling	
☐	PU0054: Provision of benefits by third parties: FBT consequences—Section CI 2(1)	31 October 2002

Items are not generally available once the comment deadline has passed

No envelope needed—simply fold, tape shut, stamp and post.

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