TAX INFORMATION BULLETIN

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Inland Revenue
Te Tari Taake

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

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

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 items are available for review/comment this month, with a deadline of 8 January 2003.

Ref.	Draft type	Description
IG0010	Interpretation guideline	Work of a minor nature
XPB0003	Draft public ruling	Netherlands social security pensions—taxation when the recipient is a NZ resident

Please see page 97 for details on how to obtain copies.

Ref.	Draft type	Description
ED0038	Other items of interest	Retrospective adjustment to salaries paid to shareholder-employees—withdrawal of previous QWBA

Please see page 95 for the text of this item.

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 02/14

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

Names of the Persons who applied for the Ruling

This Ruling has been applied for by:

- Westpac Banking Corporation ("Westpac"); and
- WestpacTrust Investments Limited ("Issuer").

Taxation Laws

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

This Ruling applies in respect of:

Section BG 1

Section CF 2

Section EH 47

Section EH 48

Section GC 22

Section GC 23, and

the following definitions in section OB 1:

"dividend"

"shareholder"

"specified option".

The Arrangement to which this Ruling applies

In 1999 Westpac raised equity of $650 million in New Zealand by the issue of NZ Shares in the Issuer. The Arrangement includes the Exchange Deed, the Voting Deed, and the Support Deed. Further details of the Arrangement are set out in the paragraphs below.

1. The New Zealand operations of Westpac are predominantly conducted through a branch (the "Branch"), which was established by the Bank of New South Wales in 1861. Thus, the capacity to raise ordinary equity in New Zealand was previously constrained by Westpac's legal and operating structure.

2. The equity raising was achieved in a way that did not involve the full incorporation of Westpac's New Zealand operations as this would have involved considerable regulatory, reporting, taxation and accounting complexities (both in New Zealand and Australia) which inevitably would have taken some considerable time to resolve.

3. The transaction for raising the ordinary equity therefore reflected the existing limitations of a direct equity raising by the New Zealand operations. It involved the offer of shares (the "NZ Shares") to the public: primarily in New Zealand and, to a lesser extent, interested international investors. No Westpac group entity or associated party acquired NZ Shares pursuant to the offer. The offer occurred in October 1999, and the NZ Shares were issued by the Issuer, a New Zealand company which was an existing wholly owned subsidiary of Westpac Holdings-NZ-Ltd ("Parent"), on 15 October 1999. Until the time of the issue of the NZ Shares, all of the shares in the Issuer were held by the Parent, with the exception of one share which was held by Westpac. Prior to the offer, the Issuer had shares on issue with paid up capital and reserves of approximately NZ$250 million, comprising both ordinary and redeemable preference shares.

4. At the time of the original issue of NZ Shares, the Issuer owned properties used by Westpac in New Zealand, leasing those properties to the various Westpac branches and subsidiaries. Since then, the Issuer has sold properties as part of the strategy of Westpac's New Zealand group to sell certain non-core assets. Following the sale of its remaining properties, the Issuer's business will consist of arranging and managing property leases in relation to properties occupied by Westpac group companies in New Zealand. Ultimately, as part of a reorganisation of the Branch's property activities, the Issuer may divest itself of all its property activities. Issuer is then unlikely to conduct any separate activity unrelated to the NZ Shares.

5. The NZ Shares are listed on the New Zealand Stock Exchange ("NZSE"). Although it was envisaged, and intended, at the time the NZ Shares were issued that the NZ Shares would track the value of Westpac ordinary shares, that are listed on the Australian Stock Exchange ("the ASX"), in fact, during the period up to the issue of this Ruling, this has not occurred. The price of the NZ Shares, as quoted on the NZSE, has not tracked precisely the value of Westpac ordinary shares, as quoted on the ASX. Although Westpac is an "overseas listed issuer" on the NZSE, its shares are not quoted on the NZSE and must therefore be traded through Australian brokers. The implementation of the Arrangement was approved by the NZSE, ASX and the Australian Prudential Regulation Authority ("APRA").

6. At the time of the issue of the NZ Shares the existing New Zealand-based ordinary shareholders in Westpac amounted to approximately 1.2% of the ordinary share capital of Westpac. The issue of the NZ Shares by the Issuer raised capital equivalent to up to approximately 3% of the ordinary share capital of Westpac. The Issuer may decide to raise further capital by a further issue of NZ Shares.

Terms of NZ Shares

7. The key terms of the NZ Shares are as follows:

   (i) The Issue Price was related to the price of a Westpac ordinary share on or about the issue date, (15 October 1999), converted into New Zealand dollars, and was set at $11.95. Payment for the NZ Shares was in two tranches. The first tranche of the issue price was payable on application for the NZ Shares and was set at $7.20. The second tranche was paid on 20 December 2000 and was set at $4.75. The Issue Price was based on a book-building process undertaken during the offer period.

   Under the book-building process, institutional and other qualified bidders in selected jurisdictions (including selected brokers and investors in New Zealand) were invited to indicate the number of NZ Shares they wished to purchase at a range of prices. The final price was set based on these prices and other factors, including:

   - the price at which Westpac ordinary shares traded on the ASX between the date of registration of the prospectus (3 September 1999) and the final date of bids from institutional investors;
   - the Issuer's objective of maximising the proceeds of the issue of NZ Shares;
   - the level of demand from investors not involved in the book building process; and
   - the Issuer's desire for an orderly secondary market for the NZ Shares.

   The NZ Shareholders were notified before the issue of the NZ Shares of the amount to be paid in aggregate (ie the issue price of $11.95).

   (ii) The payment of dividends is at the discretion of the directors of the Issuer. However, if dividends are declared on the NZ Shares, they will be based on the cash dividends of Westpac ordinary shares. In such circumstances, the dividends on the NZ Shares will equal dividends paid by Westpac on the Westpac ordinary shares multiplied by the exchange fraction (discussed below), converted into New Zealand dollars at the prevailing foreign exchange rates. To date, all dividends paid by the Issuer in respect of the NZ Shares have been the NZ dollar equivalent of the dividend paid on the Westpac ordinary shares (with the exchange rate set 2 business days before the record date applicable to the Westpac ordinary shares).

To date, the following dividends have been paid in respect of the NZ Shares:

	Net dividend (cents per share)	**Imputation credit**	**Gross dividend**
Final 1999	0.2994	0.1475	0.4469
Interim 2000	0.3267	0.1609	0.4876
Final 2000	0.3590	0.1768	0.5358
Interim 2001	0.3739	0.1842	0.5581
Final 2001	0.4029	0.1984	0.6013
Interim 2002	0.3978	0.1959	0.5937

(iii) At the discretion of the directors of the Issuer, the Issuer will "mirror" all bonus issues (other than those arising under dividend reinvestment plans), share splits, consolidations and rights issues undertaken by Westpac in respect of Westpac ordinary shares. Where "mirroring" is not undertaken the exchange fraction will be adjusted. Since the NZ Shares were issued, Westpac has not undertaken any bonus issues, share splits, consolidations or rights issues. In addition, no adjustment or alteration has been made to the exchange fraction.

(iv) The holders of the NZ Shares ("NZ Holders") have restricted voting rights in the Issuer. Extensive waivers have been granted by the NZSE to allow voting rights at Issuer shareholder meetings to be limited to:

- Decisions concerning major transactions under the New Zealand Companies Act and the NZSE Listing Rules;
- Amendments to the Issuer's Constitution to the extent that such amendments affect the rights attached to the NZ Shares; and
- Amendments to the Exchange Deed and Voting Deed.

In each case the approval of a special resolution of NZ Holders is required except in the case of votes concerning major transactions which only require an ordinary resolution. In addition, the Constitution of the Issuer provides for certain approved capital changes, but otherwise prohibits it from undertaking any variation in the capital that affects the rights attached to the NZ Shares. No amendments have been made, since the issue of the NZ Shares, to the Issuer's Constitution, the Exchange Deed, or the Voting Deed.

(v) Subject to a cap, rights to receive distributions on liquidation of the Issuer are on a pro rata basis with the Issuer's ordinary shareholders. These rights and the right to dividends are protected by the Constitution of the Issuer. The quantum of the cap, which is specified in the Constitution of the Issuer, depends on whether Westpac is also in liquidation. The purpose of the cap is to ensure that NZ Holders are not entitled to windfall gains, which could arise if NZ Holders received the full benefit of the Exchange Deed (refer paragraph 17) without relinquishing their NZ Shares. The Exchange Deed is referred to in the Issuer's Constitution.

8. The offer was made primarily to the New Zealand public. The offer of NZ Shares was not specifically made to current Westpac ordinary shareholders. Shareholders in Westpac were not required to give up their shares to acquire shares in Issuer. There is no "stapling" of shares in any form.

9. There is no specific requirement in the terms of issue of the Issuer's shares that equivalent dividends must be paid by the Issuer on both the ordinary shares of the Issuer and the NZ Shares at the same time. However, it is intended that this will happen although, from time to time, additional dividends may be declared to distribute surplus funds to the ordinary shareholders of the Issuer. To date, no such additional dividends have been declared, or paid to the ordinary shareholders.

10. It is intended to attach imputation credits to the fullest extent possible to the dividends paid to the NZ Holders. The imputation credits will arise from payments of tax made by the Issuer in respect of its taxable income. To date, all dividends paid by the Issuer to NZ Holders have been fully imputed (refer to the table at paragraph 7(ii) above).

Support Deed

11. Westpac has entered into a deed dated 3 September 1999 (the "Support Deed") under which it undertakes to ensure that the Issuer is solvent after the payment of any dividend. This is not a guarantee or security of the payment of any dividends, but merely a covenant to the Issuer.

Voting Deed

12. NZ Holders have the benefit of a voting deed dated 3 September 1999 (the "Voting Deed") granted by a special purpose company ("SPC"), called Namotu Pty Limited, which holds enhanced voting shares in Westpac (the "Enhanced Voting Shares"). SPC is owned by a third party, Namotu Holdings Pty Limited, a company associated with Allens Arthur Robinson, one of the major Australian law firms.

13. SPC holds 500 existing ordinary shares in Westpac. Westpac has granted enhanced voting rights in addition to the one vote ordinarily attached to each of those shares in respect of the Enhanced Voting Shares. The enhanced voting rights are equivalent, in aggregate, to the number of NZ Shares on issue from time to time not owned by Westpac or any of its subsidiaries, adjusted by the exchange fraction. The enhanced voting rights are proportional to the amount paid on the NZ Shares. SPC holds the full legal and beneficial interest in the Enhanced Voting Shares, retaining all dividend, voting and other rights in respect of these shares. Dividends received by SPC from Westpac are used for its own purposes and any gains or losses on disposal will be to the account of SPC.

14. SPC is not able to borrow, and is only able to sell the Enhanced Voting Shares to a transferee approved by Westpac, or if required to do so by a special resolution of NZ Holders. In either case the transferee will need to execute a new Voting Deed.

15. The Voting Deed provides that:

    (i) The NZ Holders have the right to indicate, by post, whether or not they approve the resolutions being put to Westpac's ordinary shareholders; and

    (ii) SPC covenants under the Voting Deed to exercise such proportion of the enhanced voting rights on any poll requested at the Westpac meeting as corresponds to, and in accordance with, the indications of the NZ Holders. However, SPC will not take any action where no poll is demanded.

    SPC also covenants not to exercise its votes in relation to those shareholders who would have a greater than 10% holding in Westpac (or such other percentage permitted under Westpac's Deed of Settlement) if their shares were exchanged at that time. The Voting Deed does not affect SPC's ability to cast votes in respect of the voting rights attached to the ordinary Westpac shares prior to the attachment of the enhanced voting rights.

16. The ability of holders of NZ Shares to indicate their views, through the voting mechanism provided for in the Voting Deed, on resolutions voted on by polls at meetings of WBC's shareholders was considered important given their rights under the Exchange Deed. While this could give rise to a perception in the market of a degree of equivalence between shares in Westpac and the NZ Shares, neither the NZ Holders nor the Issuer have any rights against Westpac under the Voting Deed. Furthermore, neither the NZ Holders nor the Issuer have any rights to vote directly at shareholder meetings of Westpac. If the SPC fails to vote in accordance with its covenant under the Voting Deed, the only remedy available to the NZ Holders is against the SPC for breach of the Voting Deed. The use of the SPC and voting deed structure was considered by Westpac to be an important marketing feature when the NZ Share offer was originally promoted. The SPC and voting deed structure was the most obvious and straight forward mechanism for providing this feature and other structures were not considered.

Exchange Deed

17. The NZ Shares are exchangeable, in certain circumstances, for Westpac ordinary shares. Westpac entered into a deed dated 3 September 1999 (the "Exchange Deed"), prior to the issue of the NZ Shares, under which it covenanted to exchange the NZ Shares, based on the exchange fraction, for Westpac ordinary shares if an exchange event occurs.

    Pursuant to clause 4.10 of the Exchange Deed, the parties agreed at the time of entering into the Exchange Deed that on any exchange of NZ Shares for Westpac ordinary shares, the lowest price is to be equal to the market value of the NZ Shares exchanged for the Westpac ordinary shares. This agreement forms part of the terms of the shares from when the Exchange Deed was executed by virtue of paragraph 4.9 of the Constitution of the Issuer.

18. The exchange fraction is currently on a one-for-one basis. The exchange fraction will be adjusted, as is necessary, from time to time to take account of situations where the Issuer has not mirrored bonus issues (other than under a dividend reinvestment plan), share splits, consolidations or rights issues and other types of capital reorganisations or a distribution in specie. The exchange fraction will also be adjusted where a dividend is not paid by the Issuer and NZ Holders elect to exchange their shares. The exchange fraction has not, to date, been adjusted.

19. Similarly, if the Issuer does any of the matters listed in the preceding paragraph and Westpac does not mirror it, the exchange fraction will be adjusted as appropriate. No adjustment will be made to the exchange fraction where both the Issuer and Westpac offer shares to their respective shareholders, or an offer is made by either the Issuer or Westpac to all the shareholders of both entities, or either the Issuer or Westpac has made a placement of shares, or has made an on-market buy-back.

20. All communications made by Westpac to its ordinary shareholders, including notice of Westpac general meetings and the resolutions to be put at such meetings, are sent to the NZ Holders and the NZSE. All announcements made to the ASX are copied to the NZSE.

21. The events leading to an exchange are those specified in the Schedule to the Exchange Deed, and are of three types:

    (i) Compulsory exchanges will arise upon the happening of specified events, including the following situations:

    (a) the commencement of liquidation, statutory management or administration of the Issuer or Westpac (in so far as it relates to Westpac in Australia);

    (b) if a recommended takeover offer, or scheme of arrangement for Westpac's ordinary shares, is announced which will extend to cover Westpac ordinary shares being issued on an exchange event;

    (c) if a person becomes entitled to more than 50% of Westpac's ordinary shares on an unconditional basis;

    (d) if a scheme of arrangement involving a new holding company of Westpac is announced and the exchange structure is not replicated; or

    (e) where Westpac ceases to have control of the Issuer.

    (ii) Westpac will have the option of issuing Westpac ordinary shares in exchange for NZ Shares upon the happening of specified events, including the following situations:

    (a) where the binding rulings of either the New Zealand Inland Revenue Department ("the IRD") or the Australian Taxation Office ("the ATO") are no longer valid and are not renewed;

    (b) if a change of law or policy adversely affects the rights of Westpac, the Issuer or NZ Holders as a class, including if APRA ceases to accept the NZ Shares as Tier 1 capital of the Westpac group;

    (c) if specified events occur which may precede liquidation, statutory management, or any other similar events in respect of Westpac or the Issuer;

    (d) if less than 15% of the NZ Shares are held by NZ Holders (other than Westpac or any entities it controls);

    (e) if the Issuer is placed in receivership; or

    (f) the commencement of a liquidation, statutory management or administration of Westpac occurs in any country other than Australia.

    (iii) NZ Holders will have the option of exchanging some (being in multiples of 100) or all of their NZ Shares for Westpac ordinary shares upon the happening of specified events, including the following situations;

    (a) where the Issuer fails to pay a dividend based on the Westpac dividend;

    (b) if the Support Deed or the Voting Deed is no longer effective;

    (c) if the Issuer's listing on the NZSE is cancelled for more than 5 consecutive business days, or suspended for more than 14 consecutive business days;

    (d) if the IRD private or product binding rulings, or the ATO ruling, is no longer valid, and is not replaced, and the NZ Holders are adversely affected; or

    (e) if a holder of Westpac's ordinary shares becomes entitled to more than 30% of all such shares by any means.

    Westpac must promptly notify the NZ Holders of any occurrence which might trigger an optional exchange event for the NZ Holders.

22. At no time are the NZ Shares able to be exchanged for Westpac ordinary shares until an event of exchange has occurred.

23. Where an exchange event arises and shares are exchanged, the Issuer will be passive other than to record the transfer of the NZ Shares, to Westpac, in its share register. Although the Exchange Deed is referred to in the Constitution of the Issuer, there is no recourse to the Issuer for the performance of the exchange. Any recourse is only to Westpac, subject to any limitations applicable to insolvency situations.

24. NZ Holders are entitled to vote on amendments to the Exchange Deed. To date, no such amendments have been made.

25. On an exchange, if Westpac ordinary shares cannot legally be allotted then in exchange for their NZ Shares, the NZ Holders will receive a payment equivalent to the amount that would have been paid to them if they had been issued the non-allotted Westpac ordinary shares at the exchange fraction, less any distributions they receive from the Issuer (if the Issuer is in liquidation). If Westpac is in liquidation, the right to receive this payment will be subordinated to the rights of all other creditors of Westpac (including any holders of redeemable preference shares). Any such payment will be effected at the same rate and date as any distributions paid by Westpac to its ordinary shareholders on the liquidation of that company.

26. The NZ Shares have the benefit of the exchange arrangement to swap into Westpac ordinary shares in certain circumstances and are expected, though not required, to pay dividends declared based on any Westpac dividends. These benefits are designed to enhance the value of the NZ Shares, and it was envisaged at the time of their issue that their value would track the value of Westpac ordinary shares. In fact, the price of the NZ Shares has not tracked precisely the value of Westpac ordinary shares.

Use of Proceeds

27. The funds raised from the issue were lent by the Issuer to the Borrower (a New Zealand resident company which is a wholly owned subsidiary of the Parent) pursuant to a loan dated 1 October 1999 ("the Money Market Loan"). The Money Market Loan is repayable (either in full or in tranches) at the option of the Borrower. At the time of entering into the Money Market Loan the Borrower did not hold any shares in the Issuer. There is no current intention that Borrower will acquire shares in the Issuer.

Swap

28. The Issuer and the Branch have entered into a debt/equity swap ("the Swap") pursuant to an agreement dated 1 October 1999. Under the Swap, to the extent of the number of NZ Shares on issue, less any shares held as Treasury Stock, the Issuer pays to the Branch a money market equivalent yield (based on the New Zealand 3-month bank bill rate, plus a premium) and the Branch pays to the Issuer a pretax equity equivalent yield based on dividends paid on Westpac ordinary shares (allowing for the exchange fraction), grossed up by the applicable New Zealand corporate tax rate. The Issuer's obligations under the Swap are funded from the Money Market Loan, other income, cash reserves and equity subscriptions if necessary.

Commercial Purpose

29. The issue of shares to the public, in New Zealand, is part of Westpac's broader capital management strategy and supports Westpac's regional banking and branding strategy. The method of raising ordinary equity in New Zealand was constrained by the existing legal and operating structure of the New Zealand group.

Previous Rulings

30. The Applicants have confirmed that, to the best of their knowledge, all aspects of the previous binding rulings relating to the Arrangement (BR Prv 99/056 and BR Prd 99/13), have been complied with, although Westpac determined that it was not necessary to make elections under section FG 4(14D) for the purposes of consolidating the Branch and the companies included in the New Zealand Group.

Assumptions made by the Commissioner

This Ruling is made subject to the following assumptions:

(i) That the Issuer will attach imputation credits to dividends paid on all classes of share to the fullest extent possible without incurring penalties or additional debits, taking into account the credits that are in the imputation credit account. However, this Assumption will not be breached if a dividend is paid in circumstances where such a payment was inadvertent and was overlooked so long as this did not occur due to an absence on the part of the Issuer to take reasonable care.

(ii) Apart from specific dividends or particular transactions that are declared to ordinary shareholders only, the Issuer will, where possible, pay dividends on the ordinary shares and the NZ Shares at the same time. This Assumption will not be breached if a dividend is paid in circumstances where such a payment was inadvertent and was overlooked so long as this did not occur due to an absence on the part of the Issuer to take reasonable care.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) That no Westpac group entity or associated party, except the Issuer, has held or acquired, or will hold or acquire, singularly or in aggregate, more than a 5% interest in the NZ Shares other than holdings acquired pursuant to exchanges under the Exchange Deed. However, shares held by the Westpac group entity during its ordinary course of business, as an agent or trustee acting at arm's length, on behalf of any independent third party that is not in any other way associated with the Westpac group entity, will not contravene this condition.

b) That no Westpac group entity or associated party has acquired, or will acquire, an interest in NZ Shares for purposes inconsistent with the commercial reasons for the Arrangement outlined in paragraph 29 of the Arrangement. However, shares held by the Westpac group entity during its ordinary course of business, as an agent or trustee acting at arm's length, on behalf of any independent third party that is not in any other way associated with the Westpac group entity, will not contravene this condition.

c) The Exchange Deed is on arm's length terms and conditions.

d) The interest rate on the Money Market Loan will at all times be determined by a fixed relationship to banking rates or general commercial rates or economic, commodity, industrial, or financial indices.

e) That although the Swap enables the Issuer to hedge its position and there is nothing in the documents referred to in the description of the Arrangement to suggest an obligation to pass on the proceeds of that Swap to the NZ Holders as dividends, the Issuer is not otherwise, and will not in the future be, party to or subject to any understanding with, or obligation to, Westpac to pass the equity equivalent yield on to the NZ Holders as dividends.

f) That the Issuer will not issue any further classes of share.

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:

- Prior to an exchange event occurring, the NZ Holders are not "shareholders", as defined in section OB 1, in Westpac.
- Section GC 22 does not apply to the Arrangement.
- Section GC 23 does not apply to the Arrangement.
- The share options inherent in the Exchange Deed are "specified options" as defined in section OB 1.
- In the event of any Exchange, the market value of the NZ Shares exchanged for Westpac ordinary shares under the Exchange Deed will be the value of the "consideration" in section EH 47, as determined under section EH 48(3)(a).
- An exchange of NZ Shares for Westpac ordinary shares by NZ Holders will not give rise to a "dividend", as defined in sections OB 1 and CF 2, to the NZ Holders.
- Section BG 1 does not apply to negate or vary the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 October 2002 to 30 September 2007.

This Ruling is signed by me on the 19th day of September 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING - BR PRD 02/15

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

Names of the Persons who applied for the Ruling

This Ruling has been applied for by:

- Westpac Banking Corporation ("Westpac"); and
- WestpacTrust Investments Limited (Issuer).

Taxation Laws

All legislative references are to the Estate and Gift Duties Act 1968 unless otherwise stated.

This Ruling applies in respect of section 63(1) and the definition of "gift" in section 2.

The Arrangement to which this Ruling applies

In 1999 Westpac raised equity of $650 million in New Zealand by the issue of NZ Shares in the Issuer. The Arrangement includes the Exchange Deed, the Voting Deed, and the Support Deed. Further details of the Arrangement are set out in the paragraphs below.

1. The New Zealand operations of Westpac are predominantly conducted through a branch (the "Branch"), which was established by the Bank of New South Wales in 1861. Thus, the capacity to raise ordinary equity in New Zealand was previously constrained by Westpac's legal and operating structure.

2. The equity raising was achieved in a way that did not involve the full incorporation of Westpac's New Zealand operations as this would have involved considerable regulatory, reporting, taxation and accounting complexities (both in New Zealand and Australia) which inevitably would have taken some considerable time to resolve.

3. The transaction for raising the ordinary equity therefore reflected the existing limitations of a direct equity raising by the New Zealand operations. It involved the offer of shares (the "NZ Shares") to the public: primarily in New Zealand and, to a lesser extent, interested international investors. No Westpac group entity or associated party acquired NZ Shares pursuant to the offer. The offer occurred in October 1999, and the NZ Shares were issued by the Issuer, a New Zealand company which was an existing wholly owned subsidiary of Westpac Holdings-NZ-Ltd ("Parent"), on 15 October 1999.

   Until the time of the issue of the NZ Shares, all of the shares in the Issuer were held by the Parent, with the exception of one share which was held by Westpac. Prior to the offer, the Issuer had shares on issue with paid up capital and reserves of approximately NZ$250 million, comprising both ordinary and redeemable preference shares.

4. At the time of the original issue of NZ Shares, the Issuer owned properties used by Westpac in New Zealand, leasing those properties to the various Westpac branches and subsidiaries. Since then, the Issuer has sold properties as part of the strategy of Westpac's New Zealand group to sell certain non-core assets. Following the sale of its remaining properties, the Issuer's business will consist of arranging and managing property leases in relation to properties occupied by Westpac group companies in New Zealand. Ultimately, as part of a reorganisation of the Branch's property activities, the Issuer may divest itself of all its property activities. Issuer is then unlikely to conduct any separate activity unrelated to the NZ Shares.

5. The NZ Shares are listed on the New Zealand Stock Exchange ("NZSE"). Although it was envisaged, and intended, at the time the NZ Shares were issued that the NZ Shares would track the value of Westpac ordinary shares, that are listed on the Australian Stock Exchange ("the ASX"), in fact, during the period up to the issue of this Ruling, this has not occurred. The price of the NZ Shares, as quoted on the NZSE, has not tracked precisely the value of Westpac ordinary shares, as quoted on the ASX. Although Westpac is an "overseas listed issuer" on the NZSE, its shares are not quoted on the NZSE and must therefore be traded through Australian brokers. The implementation of the Arrangement was approved by the NZSE, ASX and the Australian Prudential Regulation Authority ("APRA").

6. At the time of the issue of the NZ Shares the existing New Zealand based ordinary shareholders in Westpac amounted to approximately 1.2% of the ordinary share capital of Westpac. The issue of the NZ Shares by the Issuer raised capital equivalent to up to approximately 3% of the ordinary share capital of Westpac. The Issuer may decide to raise further capital by a further issue of NZ Shares.

Terms of NZ Shares

7. The key terms of the NZ Shares are as follows:

   (i) The Issue Price was related to the price of a Westpac ordinary share on or about the issue date, (15 October 1999), converted into New Zealand dollars, and was set at $11.95.

Payment for the NZ Shares was in two tranches. The first tranche of the issue price was payable on application for the NZ Shares and was set at $7.20. The second tranche was paid on 20 December 2000 and was set at $4.75. The Issue Price was based on a book-building process undertaken during the offer period. Under the book-building process, institutional and other qualified bidders in selected jurisdictions (including selected brokers and investors in New Zealand) were invited to indicate the number of NZ Shares they wished to purchase at a range of prices. The final price was set based on these prices and other factors, including:

- the price at which Westpac ordinary shares traded on the ASX between the date of registration of the prospectus (3 September 1999) and the final date of bids from institutional investors;
- the Issuer's objective of maximising the proceeds of the issue of NZ Shares;
- the level of demand from investors not involved in the book building process; and
- the Issuer's desire for an orderly secondary market for the NZ Shares.

The NZ Shareholders were notified before the issue of the NZ Shares of the amount to be paid in aggregate (ie the issue price of $11.95).

(ii) The payment of dividends is at the discretion of the directors of the Issuer. However, if dividends are declared on the NZ Shares, they will be based on the cash dividends of Westpac ordinary shares. In such circumstances, the dividends on the NZ Shares will equal dividends paid by Westpac on the Westpac ordinary shares multiplied by the exchange fraction (discussed below), converted into New Zealand dollars at the prevailing foreign exchange rates. To date, all dividends paid by the Issuer in respect of the NZ Shares have been the NZ dollar equivalent of the dividend paid on the Westpac ordinary shares (with the exchange rate set 2 business days before the record date applicable to the Westpac ordinary shares).

To date, the following dividends have been paid in respect of the NZ Shares:

	Net dividend (cents per share)	**Imputation credit**	**Gross dividend**
Final 1999	0.2994	0.1475	0.4469
Interim 2000	0.3267	0.1609	0.4876
Final 2000	0.3590	0.1768	0.5358
Interim 2001	0.3739	0.1842	0.5581
Final 2001	0.4029	0.1984	0.6013
Interim 2002	0.3978	0.1959	0.5937

(iii) At the discretion of the directors of the Issuer, the Issuer will "mirror" all bonus issues (other than those arising under dividend reinvestment plans), share splits, consolidations and rights issues undertaken by Westpac in respect of Westpac ordinary shares. Where "mirroring" is not undertaken the exchange fraction will be adjusted. Since the NZ Shares were issued, Westpac has not undertaken any bonus issues, share splits, consolidations or rights issues. In addition, no adjustment or alteration has been made to the exchange fraction.

(iv) The holders of the NZ Shares ("NZ Holders") have restricted voting rights in the Issuer. Extensive waivers have been granted by the NZSE to allow voting rights at Issuer shareholder meetings to be limited to:

- Decisions concerning major transactions under the New Zealand Companies Act and the NZSE Listing Rules;
- Amendments to the Issuer's Constitution to the extent that such amendments affect the rights attached to the NZ Shares; and
- Amendments to the Exchange Deed and Voting Deed.

In each case the approval of a special resolution of NZ Holders is required except in the case of votes concerning major transactions which only require an ordinary resolution. In addition, the Constitution of the Issuer provides for certain approved capital changes, but otherwise prohibits it from undertaking any variation in the capital that affects the rights attached to the NZ Shares. No amendments have been made, since the issue of the NZ Shares, to the Issuer's Constitution, the Exchange Deed, or the Voting Deed.

(v) Subject to a cap, rights to receive distributions on liquidation of the Issuer are on a pro rata basis with the Issuer's ordinary shareholders. These rights and the right to dividends are protected by the Constitution of the Issuer. The quantum of the cap, which is specified in the Constitution of the Issuer, depends on whether Westpac is also in liquidation. The purpose of the cap is to ensure that NZ Holders are not entitled to windfall gains, which could arise if NZ Holders received the full benefit of the Exchange Deed (refer paragraph 17) without relinquishing their NZ Shares. The Exchange Deed is referred to in the Issuer's Constitution.

8. The offer was made primarily to the New Zealand public. The offer of NZ Shares was not specifically made to current Westpac ordinary shareholders. Shareholders in Westpac were not required to give up their shares to acquire shares in Issuer. There is no "stapling" of shares in any form.

9. There is no specific requirement in the terms of issue of the Issuer's shares that equivalent dividends must be paid by the Issuer on both the ordinary shares of the Issuer and the NZ Shares at the same time. However, it is intended that this will happen although, from time to time, additional dividends may be declared to distribute surplus funds to the ordinary shareholders of the Issuer. To date, no such additional dividends have been declared, or paid to the ordinary shareholders.

10. It is intended to attach imputation credits to the fullest extent possible to the dividends paid to the NZ Holders. The imputation credits will arise from payments of tax made by the Issuer in respect of its taxable income. To date, all dividends paid by the Issuer to NZ Holders have been fully imputed (refer to the table at paragraph 7(ii) above).

Support Deed

11. Westpac has entered into a deed dated 3 September 1999 (the "Support Deed") under which it undertakes to ensure that the Issuer is solvent after the payment of any dividend. This is not a guarantee or security of the payment of any dividends, but merely a covenant to the Issuer.

Voting Deed

12. NZ Holders have the benefit of a voting deed dated 3 September 1999 (the "Voting Deed") granted by a special purpose company ("SPC"), called Namotu Pty Limited, which holds enhanced voting shares in Westpac (the "Enhanced Voting Shares"). SPC is owned by a third party, Namotu Holdings Pty Limited, a company associated with Allens Arthur Robinson, one of the major Australian law firms.

13. SPC holds 500 existing ordinary shares in Westpac. Westpac has granted enhanced voting rights in addition to the one vote ordinarily attached to each of those shares in respect of the Enhanced Voting Shares. The enhanced voting rights are equivalent, in aggregate, to the number of NZ Shares on issue from time to time not owned by Westpac or any of its subsidiaries, adjusted by the exchange fraction. The enhanced voting rights are proportional to the amount paid on the NZ Shares. SPC holds the full legal and beneficial interest in the Enhanced Voting Shares, retaining all dividend, voting and other rights in respect of these shares. Dividends received by SPC from Westpac are used for its own purposes and any gains or losses on disposal will be to the account of SPC.

14. SPC is not able to borrow, and is only able to sell the Enhanced Voting Shares to a transferee approved by Westpac, or if required to do so by a special resolution of NZ Holders. In either case the transferee will need to execute a new Voting Deed.

15. The Voting Deed provides that:

    (i) The NZ Holders have the right to indicate, by post, whether or not they approve the resolutions being put to Westpac's ordinary shareholders; and

    (ii) SPC covenants under the Voting Deed to exercise such proportion of the enhanced voting rights on any poll requested at the Westpac meeting as corresponds to, and in accordance with, the indications of the NZ Holders. However, SPC will not take any action where no poll is demanded.

    SPC also covenants not to exercise its votes in relation to those shareholders who would have a greater than 10% holding in Westpac (or such other percentage permitted under Westpac's Deed of Settlement) if their shares were exchanged at that time. The Voting Deed does not affect SPC's ability to cast votes in respect of the voting rights attached to the ordinary Westpac shares prior to the attachment of the enhanced voting rights.

16. The ability of holders of NZ Shares to indicate their views, through the voting mechanism provided for in the Voting Deed, on resolutions voted on by polls at meetings of WBC's shareholders was considered important given their rights under the Exchange Deed. While this could give rise to a perception in the market of a degree of equivalence between shares in Westpac and the NZ Shares, neither the NZ Holders nor the Issuer have any rights against Westpac under the Voting Deed. Furthermore, neither the NZ Holders nor the Issuer have any rights to vote directly at shareholder meetings of Westpac. If the SPC fails to vote in accordance with its covenant under the Voting Deed, the only remedy available to the NZ Holders is against the SPC for breach of the Voting Deed. The use of the SPC and voting deed structure was considered by Westpac to be an important marketing feature when the NZ Share offer was originally promoted. The SPC and voting deed structure was the most obvious and straight forward mechanism for providing this feature and other structures were not considered.

Exchange Deed

17. The NZ Shares are exchangeable, in certain circumstances, for Westpac ordinary shares. Westpac entered into a deed dated 3 September 1999 (the "Exchange Deed"), prior to the issue of the NZ Shares, under which it covenanted to exchange the NZ Shares, based on the exchange fraction, for Westpac ordinary shares if an exchange event occurs.

    Pursuant to clause 4.10 of the Exchange Deed, the parties agreed at the time of entering into the Exchange Deed that on any exchange of NZ Shares for Westpac ordinary shares, the lowest price is to be equal to the market value of the NZ Shares exchanged for the Westpac ordinary shares. This agreement forms part of the terms of the shares from when the Exchange Deed was executed by virtue of paragraph 4.9 of the Constitution of the Issuer.

18. The exchange fraction is currently on a one-for-one basis. The exchange fraction will be adjusted, as is necessary, from time to time to take account of situations where the Issuer has not mirrored bonus issues (other than under a dividend reinvestment plan), share splits, consolidations or rights issues and other types of capital reorganisations or a distribution in specie. The exchange fraction will also be adjusted where a dividend is not paid by the Issuer and NZ Holders elect to exchange their shares. The exchange fraction has not, to date, been adjusted.

19. Similarly, if the Issuer does any of the matters listed in the preceding paragraph and Westpac does not mirror it, the exchange fraction will be adjusted as appropriate. No adjustment will be made to the exchange fraction where both the Issuer and Westpac offer shares to their respective shareholders, or an offer is made by either the Issuer or Westpac to all the shareholders of both entities, or either the Issuer or Westpac has made a placement of shares, or has made an on-market buy-back.

20. All communications made by Westpac to its ordinary shareholders, including notice of Westpac general meetings and the resolutions to be put at such meetings, are sent to the NZ Holders and the NZSE. All announcements made to the ASX are copied to the NZSE.

21. The events leading to an exchange are those specified in the Schedule to the Exchange Deed, and are of three types:

(i) Compulsory exchanges will arise upon the happening of specified events, including the following situations:

(a) the commencement of liquidation, statutory management or administration of the Issuer or Westpac (in so far as it relates to Westpac in Australia);

(b) if a recommended takeover offer, or scheme of arrangement for Westpac's ordinary shares, is announced which will extend to cover Westpac ordinary shares being issued on an exchange event;

(c) if a person becomes entitled to more than 50% of Westpac's ordinary shares on an unconditional basis;

(d) if a scheme of arrangement involving a new holding company of Westpac is announced and the exchange structure is not replicated; or

(e) where Westpac ceases to have control of the Issuer.

(ii) Westpac will have the option of issuing Westpac ordinary shares in exchange for NZ Shares upon the happening of specified events, including the following situations:

(a) where the binding rulings of either the New Zealand Inland Revenue Department ("the IRD") or the Australian Taxation Office ("the ATO") are no longer valid and are not renewed;

(b) if a change of law or policy adversely affects the rights of Westpac, the Issuer or NZ Holders as a class, including if APRA ceases to accept the NZ Shares as Tier 1 capital of the Westpac group;

(c) if specified events occur which may precede liquidation, statutory management, or any other similar events in respect of Westpac or the Issuer;

(d) if less than 15% of the NZ Shares are held by NZ Holders (other than Westpac or any entities it controls);

(e) if the Issuer is placed in receivership; or

(f) the commencement of a liquidation, statutory management or administration of Westpac occurs in any country other than Australia.

(iii) NZ Holders will have the option of exchanging some (being in multiples of 100) or all of their NZ Shares for Westpac ordinary shares upon the happening of specified events, including the following situations;

(a) where the Issuer fails to pay a dividend based on the Westpac dividend;

(b) if the Support Deed or the Voting Deed is no longer effective;

(c) if the Issuer's listing on the NZSE is cancelled for more than 5 consecutive business days, or suspended for more than 14 consecutive business days;

(d) if the IRD private or product binding rulings, or the ATO ruling, is no longer valid, and is not replaced, and the NZ Holders are adversely affected; or

(e) if a holder of Westpac's ordinary shares becomes entitled to more than 30% of all such shares by any means.

Westpac must promptly notify the NZ Holders of any occurrence which might trigger an optional exchange event for the NZ Holders.

22. At no time are the NZ Shares able to be exchanged for Westpac ordinary shares until an event of exchange has occurred.

23. Where an exchange event arises and shares are exchanged, the Issuer will be passive other than to record the transfer of the NZ Shares, to Westpac, in its share register. Although the Exchange Deed is referred to in the Constitution of the Issuer, there is no recourse to the Issuer for the performance of the exchange. Any recourse is only to Westpac, subject to any limitations applicable to insolvency situations.

24. NZ Holders are entitled to vote on amendments to the Exchange Deed. To date, no such amendments have been made.

25. On an exchange, if Westpac ordinary shares cannot legally be allotted then in exchange for their NZ Shares, the NZ Holders will receive a payment equivalent to the amount that would have been paid to them if they had been issued the non-allotted Westpac ordinary shares at the exchange fraction, less any distributions they receive from the Issuer (if the Issuer is in liquidation). If Westpac is in liquidation, the right to receive this payment will be subordinated to the rights of all other creditors of Westpac (including any holders of redeemable preference shares). Any such payment will be effected at the same rate and date as any distributions paid by Westpac to its ordinary shareholders on the liquidation of that company.

26. The NZ Shares have the benefit of the exchange arrangement to swap into Westpac ordinary shares in certain circumstances and are expected, though not required, to pay dividends declared based on any Westpac dividends. These benefits are designed to enhance the value of the NZ Shares, and it was envisaged at the time of their issue that their value would track the value of Westpac ordinary shares. In fact, the price of the NZ Shares has not tracked precisely the value of Westpac ordinary shares.

Use of Proceeds

27. The funds raised from the issue were lent by the Issuer to the Borrower (a New Zealand resident company which is a wholly owned subsidiary of the Parent) pursuant to a loan dated 1 October 1999 (“the Money Market Loan”). The Money Market Loan is repayable (either in full or in tranches) at the option of the Borrower. At the time of entering into the Money Market Loan the Borrower did not hold any shares in the Issuer. There is no current intention that Borrower will acquire shares in the Issuer.

Swap

28. The Issuer and the Branch have entered into a debt/equity swap (“the Swap”) pursuant to an agreement dated 1 October 1999. Under the Swap, to the extent of the number of NZ Shares on issue, less any shares held as Treasury Stock, the Issuer pays to the Branch a money market equivalent yield (based on the New Zealand 3-month bank bill rate, plus a premium) and the Branch pays to the Issuer a pretax equity equivalent yield based on dividends paid on Westpac ordinary shares (allowing for the exchange fraction), grossed up by the applicable New Zealand corporate tax rate. The Issuer’s obligations under the Swap are funded from the Money Market Loan, other income, cash reserves and equity subscriptions if necessary.

Commercial Purpose

29. The issue of shares to the public, in New Zealand, is part of Westpac’s broader capital management strategy and supports Westpac’s regional banking and branding strategy. The method of raising ordinary equity in New Zealand was constrained by the existing legal and operating structure of the New Zealand group.

Previous Rulings

30. The Applicants have confirmed that, to the best of their knowledge, all aspects of the previous binding rulings relating to the Arrangement (BR Prv 99/056 and BR Prd 99/13), have been complied with, although Westpac determined that it was not necessary to make elections under section FG 4(14D) for the purposes of consolidating the Branch and the companies included in the New Zealand Group.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following condition:

a) That the market value of the New Zealand shares will not be materially different from the market value of Westpac ordinary shares at the time of an exchange under the Exchange Deed.

How the Taxation Laws apply to the Arrangement

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

- Any exchange of NZ Shares and Westpac ordinary shares, pursuant to the Exchange Deed, will not give rise to a “gift” as defined in section 2 of the Estate and Gift Duties Act 1968.

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 October 2002 to 30 September 2007.

This Ruling is signed by me on the 19th day of September 2002.

Martin Smith
General Manager (Adjudication & Rulings)

PRODUCT RULING - BR PRD 02/16

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 Toyota Finance New Zealand Limited trading as Toyota Financial Services.

Taxation Laws

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

This Ruling applies in respect of section 9, section 10, and section 76.

The Arrangement to which this Ruling applies

The Arrangement comprises the agreements entered into at retail, being the Vantage Lease Agreement ("the Lease Agreement") and Guaranteed Minimum Value Certificate ("the GMV Certificate"), between Toyota Financial Services and its customers.

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

1. Under the Lease Agreement, Toyota Financial Services agrees to lease a motor vehicle to a retail customer for a specified period. There is no limit on the period which may be agreed to, but typically leases are entered into for a period of between three and five years. The customer undertakes to make periodic lease payments, usually payable monthly. The Lease Agreement also specifies:

    (a) A Residual Value; and

    (b) The number of kilometres over which the vehicle may be driven during the term of the Lease.

2. The Lease Agreement contains an acknowledgement by the customer that it has no right to purchase the leased vehicle (clause 6.2).

3. During the term of the Lease Agreement, the customer is required to maintain the vehicle (clause 3.1) and keep it insured (clause 4.1(d)).

4. On termination of the Lease Agreement the customer is required to deliver up the vehicle (clause 13). Toyota Financial Services may then sell it. If Toyota Financial Services does not wish to sell it, or is unable to do so, then the vehicle must be valued. If the Residual Value exceeds the Sale Price (or amount established by valuation if there is no sale) then the customer is required to pay the difference to Toyota Financial Services (clause 13.1(a)). If the Sale Price (or amount established by valuation if there is no sale) exceeds the Residual Value, Toyota Financial Services must pay the customer the excess (clause 13.3(b)).

Residual Value

5. The Residual Value figure is generally Toyota Financial Services' estimate of the market value of the vehicle on termination of the lease, assuming that it has been driven for no more than the agreed number of kilometres. However, at the customer's request, a lower Residual Value may be set. The customer in that case would be making commensurately higher periodic lease payments.

The GMV Certificate

6. Toyota Financial Services will generally only offer a GMV Certificate to a customer who enters into a Lease Agreement for the lease of a Toyota, Daihatsu, or Lexus vehicle, which is either:

    (a) new; or

    (b) a demonstrator model; or

    (c) a Signature Class vehicle; or

    (d) a second hand NZ new vehicle first registered after 1 April 1997.

7. A GMV Certificate will not be offered if:

    (a) on termination of the lease the vehicle will be more than 10 years old; or

    (b) the kilometre allowance permitted under the terms of the lease is such that when added to the odometer reading of the vehicle at the beginning of the lease, the total is in excess of 150,000 kilometres.

8. The customer is not required to enter into a GMV Certificate. There is no charge for the GMV Certificate and no consideration moves to Toyota Financial Services from the customer who accepts an offer of a GMV Certificate.

9. The GMV Certificate applies if, at the termination of the Lease Agreement:

    (a) the customer wishes to offer to acquire the vehicle (clause 3); or

(b) the customer purchases a replacement vehicle from a Toyota or other Toyota Financial Services' nominated dealer or finances a replacement vehicle using a Toyota Financial Services' product (clause 2), and elects to do so pursuant to the terms of the GMV Certificate.

10. Under clause 3 of the GMV Certificate the customer must inform Toyota Financial Services at least one month before the end of the lease if they intend to offer to buy the vehicle. Toyota Financial Services undertakes that if it accepts this offer the sale will be at the Residual Value. Toyota Financial Services expects that it will not refuse a customer who makes an offer to acquire the vehicle at the end of the Lease Agreement.

11. If the customer does not buy the vehicle, and returns the vehicle pursuant to the terms of the GMV Certificate, then the provisions of the Lease Agreement apply as modified by clause 2 of the GMV Certificate (provided, as set out above, that the customer acquires a replacement vehicle from a Toyota or other Toyota Financial Services' nominated dealer or finances a replacement vehicle using a Toyota Financial Services' product). The modification is that the customer does not have to pay the shortfall if the Sale Price is less than the Residual Value (Toyota Financial Services must still pay the customer any surplus of the sale price over the Residual Value).

12. The vehicle must be returned in as good a condition as when the customer received it, apart from fair wear and tear, and have been regularly serviced. There are also some other conditions, including an adjustment for an Excess Kilometre Charge. If these requirements are not met, the amount of money payable by the customer or Toyota Financial Services as the case may be will be adjusted accordingly (clause 2).

How the Lease Agreement and GMV Certificate are expected to operate

13. The Lease Agreement operates as an ordinary finance lease. The customer is able to gain the use of a vehicle in exchange for an obligation to make periodic rental payments (Toyota Financial Services will likely require some of the rental payments to be paid to it in advance at the commencement of the lease, as a form of security). At the end of the lease, the customer is required to return the vehicle, and undertakes to make up any shortfall between the value of the vehicle at that time and the Residual Value agreed at the beginning of the Lease. Toyota Financial Services undertakes to pay the customer any excess of the sale price over the Residual Value.

14. The GMV Certificate achieves two additional things:

    (a) It explicitly provides that if the parties agree, at the end of the lease, that the customer will acquire the vehicle, then the customer may acquire the vehicle for the Residual Value.

    (b) It gives the customer an assurance that if the customer does not wish to keep the vehicle at the termination of the lease, it will not suffer if the market value at that time is less than the Residual Value (provided the customer either purchases a replacement vehicle from a Toyota or other Toyota Financial Services' nominated Dealer or finances a replacement vehicle using a Toyota Financial Services' product).

Assumption made by the Commissioner

This Ruling is based on the assumption that:

- All terms of the Arrangement between Toyota Financial Services and the customer that are material to this Ruling are contained in the Lease Agreement and the GMV Certificate.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

(a) Where an option to make an offer to buy is exercised by the customer, Toyota Financial Services will not accept that offer to buy until the Lease Agreement is within two months or less of expiring.

(b) There is no understanding or agreement, written or oral, entered into between Toyota Financial Services and the customer that the vehicle will be sold to the customer at the end of the lease otherwise than as allowed under the GMV Certificate.

(c) Toyota Financial Services will not give an impression, understanding or expectation to the customer upon entering into the Lease Agreement and GMV Certificate arrangement that offers to buy made under a GMV Certificate must be accepted by Toyota Financial Services.

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 Arrangement is an "agreement to hire" as defined in section 9(3)(c)
- When the periodic payments a customer promises to make to Toyota Financial Services under the Lease Agreement for a vehicle, plus the Residual Value of the vehicle, in aggregate exceed the "cash price" (as defined in section 2 of the Credit Contracts Act 1981) of that vehicle the Arrangement will be a "credit contract" under section 3(1)(e) of the Credit Contracts Act 1981. Where there is a "credit contract", section 10(5) of the Goods and Services Tax Act 1985 applies to the Arrangement and the consideration in money for the supply will be the higher of the "cash price" of the vehicle and the price Toyota Financial Services would have charged the customer had the customer paid in full at the time the contract was entered into.
- Section 76 does not apply to negate or vary the conclusions that the Arrangement is (a) an "agreement to hire" under section 9(3)(c), and (b) a "credit contract" under section 10(5) whenever the periodic payments a customer promises to make to Toyota Financial Services under the Lease Agreement for a vehicle, plus the Residual Value of the vehicle, in aggregate exceed the "cash price" (as defined in section 2 of the Credit Contracts Act 1981) of that vehicle.

The period or income year for which this Ruling applies

This Ruling will apply for the period 31 May 2002 to 1 June 2007.

This Ruling is signed by me on the 27th day of September 2002.

John Mora

Assistant General Manager (Adjudication & Rulings)

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, the Court of Appeal and the Privy Council.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision. Where possible, we have indicated if an appeal will be forthcoming.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

STRUCK OFF COMPANIES RESTORED TO COMPANIES REGISTER

Case:	Commissioner of Inland Revenue v Registrar of Companies
Decision date:	2 August 2002
Act:	Companies Act 1993
Keywords:	struck off companies

Summary

The Commissioner sought to restore 17 companies to the companies register in order to obtain information from them and, in some cases, to enable assessments to be made prior to the time bar of 30 September 2002. The High Court granted the Commissioner's application.

Facts

The application by the Commissioner related to 17 companies. These companies were part of a complicated group. The Commissioner was concerned that a number of the companies were involved in tax avoidance, facilitated by complex transactions between different companies in the group. The Commissioner took the view that the companies needed to be restored because of the impact of these transactions.

The Commissioner argued that he was entitled to have the companies restored because he was a "creditor" of the companies, in terms of section 329(1)(a)(iv) of the Companies Act 1993, in the sense set out by the High Court in *Re Saxpack Foods Limited* [1994] 1 NZLR 605. This was notwithstanding the fact that assessments had not been made to many of the companies and thus the debt had not yet crystallised. The Commissioner alternatively argued that it would be "just and equitable" for the companies to be restored in terms of section 329(1)(b).

Sections 329(1)(a)(iv) and 329(1)(b) of the Companies Act 1993 provide:

> **329. Court may restore company to New Zealand register—**
>
> (1) The Court may, on the application of a person referred to in subsection (2) of this section, order that a company that has been removed from the New Zealand register be restored to the register if it is satisfied that,—
>
> (a) At the time the company was removed from the register,—
>
> …
>
> (iv) The applicant was a creditor, or a shareholder, or a person who had an undischarged claim against the company; or
>
> …
>
> (b) For any other reason it is just and equitable to restore the company to the New Zealand register.

The Commissioner applied:

1. To be given leave pursuant to rule 256D(1)(e) of the High Court Rules for leave to commence restoration proceedings (this application was not opposed and was granted).
2. For an order that the 17 companies be restored to the register of companies.
3. For an order that the companies, if they were restored, be directed to file the annual returns for the years in which the returns were outstanding.

A notice of opposition asserted that:

1. None of the grounds in section 329 of the Companies Act was made out.
2. No proper grounds had been raised by the Commissioner for restoring the companies to the register.
3. The costs of restoration, and putting the returns in order, would be substantial.

Decision

Hammond J noted that "creditor" is not defined in section 329 or in Part XVII of the Companies Act. However, Hammond J also noted that there are a number of decisions which support a wide interpretation of the word "creditor" in relation to other sections of the Act. The Commissioner argued that the term should include persons who are secured, unsecured, contingent and prospective creditors, and that meaning of the term should be applied to section 329.

Hammond J held that he was satisfied that section 329(1)(a)(iv) is wide enough for the Commissioner to apply for restoration in this case. He noted that the authorities were understandably cast in wide terms because otherwise it would be possible for a company to avoid a legal dispute by getting itself struck off. His Honour also noted that the Commissioner has wide powers to impugn transactions and recast them until the expiry of the relevant time limitations. Investigations are notoriously complex and take time to investigate and mount. His Honour concluded:

> [U]ntil time has expired the Commissioner must surely be a prospective creditor with respect to recovery of tax. I do not think a notice of assessment (for instance) must have been issued. Otherwise the bizarre conclusion would be arrived at, that "an evasion upon an evasion" can occur.

Hammond J had some sympathy for the submissions by the parties opposing the application and noted that bringing up the records would put them to some expense. However, His Honour recognised that these assessments are quite complex and what had to weigh most heavily was the fact that the Commissioner maintains the public purse has been deprived of approximately $10m worth of taxation.

The companies were, therefore, ordered to be restored to the register. It was not necessary for Hammond J to consider the "just and equitable" grounds.

STATUTORY DEMAND REINSTATED, RETIRED TRUSTEE'S GST LIABILITY

Case:	CIR v Chester Trustee Services Limited
Forum:	Court of Appeal
Decision date:	14 October 2002
Act:	Goods and Services Tax Act 1985; Companies Act 1993
Keywords:	Statutory demand, other grounds, setting aside, liquidation, trustee's liability, section 57(3)

Summary

Appeal allowed—trustee liable for GST; statutory demand reinstated

Facts

This was an appeal from a judgment of Master Venning of the High Court in Christchurch, setting aside a statutory demand served on the respondent by the Commissioner (reported at 20 NZTC 17,725).

Under section 289 of the Companies Act 1993, the Commissioner had issued the statutory demand to the respondent as trustee of two family trusts, claiming payment of GST plus penalties and/or interest. At the time the GST debt was incurred, the respondent was the sole trustee of the two trusts which were separately registered for GST.

The two trusts had acquired and developed land at Cambridge. The debt resulted from the issue of invoices to purchasers of parts of a subdivision of that land.

The Commissioner, under section 27 of the GST Act, made a single joint tax assessment against the two trusts, registering them as a single entity for GST purposes. This was never challenged under the procedures available in the Tax Administration Act 1994.

The respondent had resigned as trustee of each trust, but did not give the Commissioner notice of having done so until the following year.

The Commissioner claimed the respondent was liable under section 57 of the GST Act to pay the assessment, as trustee of each trust throughout the period covered by the assessment.

One of the arguments advanced by the respondent in the High Court was that as the taxpayer had no assets "nothing will come of the liquidation".

In the High Court, the Master held that under section 57(3) of the GST Act, the respondent's resignation relieved it from liability for the GST, and then relied upon section 290(4)(a) of the Companies Act 1993 to set aside on the statutory demand on the grounds there was a substantial dispute whether or not the debt is owing or due. The Master also held that even if he were wrong as to section 290(4)(a), then the demand ought to be set aside under section 290(4)(c), being other grounds.

The "other grounds" relied upon by Master Venning included that there was no realistic prospect of the respondent's trading in the future; that rights of indemnity of the respondent by the family trusts are worthless; and that if the respondent were placed in liquidation it would have to resign in relation to the 35 other trusteeships it held, with consequential transfers both of shares and titles to land (entailing some $20,000 in fees, $3000 costs plus GST, for which no funds are available to a liquidator).

Decision

GST liability

Baragwanath J delivered the principal judgment of the Court of Appeal upholding the appellant's appeal. Tipping J made further comment and Hammond J concurred.

The Court found the respondent was liable for the GST, its resignation did not relieve it of the GST liability. The Court stated that as the proper construction of section 57(3) of the GST Act is clear from the current provision, the question then is what the statute provided before the amendment. The true construction of the pre-amendment section 57(3) is that the trustee's liability is for all tax that that becomes payable by the trust while that trustee remains a trustee of that trust. This accords with the natural meaning of the provision, requires a smaller departure from the statute's literal words than the alternative construction, conforms with the common law and avoids the certainly unintended result that a trustee could avoid liability by resigning at any time prior to judgment.

Statutory Demand

The Court of Appeal set aside the order setting aside the statutory demand. Baragwanath J and Tipping J stated creditors are not entitled to liquidation as of right, but there is a prima facie entitlement to an order putting the insolvent company into liquidation.

Parliament has chosen not to categorise what the circumstances giving rise to "other grounds" are, and it is not for the Court to create an exhaustive list. Tipping J endorsed Baragwanath J's comments that the courts should not seek to fetter the general discretion parliament has given them in section 290(4)(c). Baragwanath J also noted caution is required when exercising how the discretion may properly be used, and it must be confined to cases which clearly justify a departure from the fundamental principle that insolvency should bring the end of a company's existence. The grounds advanced by the insolvent company to outweigh the creditor's prima facie entitlement must be sufficiently compelling.

The Court found the respondent was and is an assetless trustee, and did as trustee engage in the conduct performed on behalf of the two trusts which gave rise to the GST liability, stating:

> "For a trustee company to have no substance is generally a reason not to protract but to terminate its operation."

The "other grounds" relied upon by the Master did not, in the opinion of the Court of Appeal, outweigh the desirability of liquidating a company that has incurred debt through trading and the position of the beneficiaries (whom, in the case of infants, the Court has a responsibility to protect) and whose interests the respondent is incapable of protecting:

> "The very purpose of the legislation creating a legal entity distinct from its directors and shareholders is to allow it to engage in business activities entailing risk without exposing shareholders to greater liability than the amount of their investment. The condition of the privilege [of incorporation] is that the company be able to pay its due debts. Inability to pay debts triggers a series of consequences."

> "To relieve the company and its officers of liability to close examination of their affairs and conduct is a course not lightly to be taken. Perverse incentives would be created if the Court were too readily prepared to accept an argument that "nothing will come of the liquidation"."

The statutory demand was reinstated and time for compliance was to start running from the date of the judgment.

The respondent has indicated it will appeal this decision.

APPLICATION TO SET ASIDE BANKRUPTCY NOTICE

Case:	The bankruptcy of Moti Singh (ex parte CIR)
Decision date:	14 October 2002
Act:	Insolvency Act 1967
Keywords:	Bankruptcy, Application to Set Aside Bankruptcy Notice

Summary

An application to set aside bankruptcy proceedings commenced by the CIR was dismissed, and the debtor was adjudicated bankrupt.

Facts

The Commissioner sought an order adjudicating Moti Singh bankrupt, based on Mr Singh's failure to comply with the provisions of a bankruptcy notice served on him.

The bankruptcy notice was based on a judgment obtained by the Commissioner in civil proceedings the District Court in 2001. Judgment against Mr Singh was obtained in the sum of $84,473.94 together with costs and disbursements totalling $10,102.08. The civil proceedings followed two sets of criminal proceedings brought against Mr Singh and revolved around Mr Singh's filing of fraudulent tax returns on behalf of both himself and his clients, and obtaining refunds based on those returns. He was convicted of 66 offences against both the Income Tax Act 1976 and the Inland Revenue Department Act 1974.

Mr Singh filed an application to set aside the bankruptcy notice, and it was ultimately heard in March 2002 before Master Gendall. The application was dismissed, paving the way for the current petition.

Mr Singh appealed Master Gendall's decision to the Court of Appeal, however this was deemed to have been abandoned because of Mr Singh's failure to provide the necessary security for costs.

The Commissioner's petition was filed in July 2002, however some difficulty was encountered in serving Mr Singh. In September 2002, Mr Singh filed a notice of intention to oppose the petition, and appeared in person before Master Lang—the proceeding was adjourned for defended hearing on 14 October 2002, however there was no appearance by or on behalf of Mr Singh on this date.

Decision

Master Lang was satisfied that jurisdiction existed under section 19(1)(d) of the Insolvency Act 1967 to make an order of adjudication. A bankruptcy notice was served upon Mr Singh requiring him to make payment of the stated amount within a specified time. Mr Singh failed to comply with these requirements.

The only real issue raised in the documents filed in opposition to the petition was whether the Court should exercise its discretion not to make an order of adjudication.

After noting the principles to be applied as set out in the Court of Appeal decision of *Baker v Westpac Banking Corporation* (CA 212/92, 13 July 1993), the Master went on to consider each of the matters raised in the documents filed in opposition, namely

- the existence of a counter claim, set-off or cross demand against the Commissioner;
- the fact that the judgment in the District Court was obtained in breach of section 27(1) of the New Zealand Bill of Rights Act 1990 ("NZBORA")(right to justice);
- the fact that the judgment in the District Court was based on criminal convictions in circumstances where the debtor had been denied a hearing in the Court of Appeal because of the fact that his application for legal aid had been wrongly declined;
- that the Court should exercise its discretion under section 26(2) of the Insolvency Acy 1967 not to declare him bankrupt.

In relation to counter claim, set-off or cross demand, Master Lang was not prepared to reopen this issue as it had previously been raised before and rejected by Master Gendall in refusing to set aside the bankruptcy notice. Rule 146 of the High Court Rules also provides that in any proceeding by the Crown relating to the recovery of taxes, duties or penalties no defendant shall be entitled without leave of the Court to avail himself of any set-off or counter claim. Furthermore, the Master was satisfied that Mr Singh had been allowed a set-off in respect of a tax credit due to him, and that any right to set-off was therefore extinguished.

Regarding the NZBORA issue, the Master noted that Mr Singh's appeal against the District Court decision was deemed to have been abandoned, no judicial review proceedings were ever filed, and that Mr Singh therefore had some difficulty in raising this matter in the context of the current proceeding. The Master was further satisfied that Rule 169(2) of the District Courts Rules 1992 (broadly similar to Rule 146 above) did represent an intrusion on section 27, but it was a "permissible limit prescribed by law which can be demonstrably justified in the context of the legislation within which it appears".

In dealing with the issue of denial of legal aid in the Court of Appeal, the Master held that the fate of the criminal appeals was of no relevance to the present proceeding, which was based on a civil judgment, was not appealed or reviewed, and followed a defended hearing in which a wide variety of issues were canvassed.

The last issue, the exercise of the Court's discretion, encompassed seven grounds, being:

- that the Commissioner was motivated by vindictiveness and that he had a vendetta against Mr Singh;
- that the Commissioner failed to grant relief by way of remission;
- that bankruptcy would prevent him from being able to repay his student loan;
- that bankruptcy was an exercise in futility as he had no assets;
- that there were outstanding complaints to the United Nations;
- that the Commissioner was pursuing this proceeding in order to prevent Mr Singh's admission to the Bar;
- that the Commissioner's treatment of him is in breach of section 9 NZBORA (right not to be subjected to torture or to cruel, degrading, or disproportionately severe treatment or punishment).

Master Lang had no hesitation in rejecting the first ground, which had been raised in District Court proceedings seeking to strike out the civil proceedings, and again in the High Court when Mr Singh sought to appeal the decision dismissing his strike out application. In each case it was expressly found that the Commissioner was not acting in an oppressive or improper manner and that the proceeding was not brought solely to harass, intimidate and embarrass Mr Singh. The Master was satisfied that the same was true in the present proceeding.

In relation to the second ground, Mr Singh applied for a remission of his personal taxes and penalties at the end of 1998. This was declined due to proceedings being outstanding before the Taxation Review Authority in relation to a number of aspects of the debtor's personal taxes. After the TRA decision was released, Mr Singh again applied for remission. This was declined for a number of reasons, including that the Commissioner did not accept it could properly be argued that a thief could be caused serious hardship by being denied the fruits of his fraudulent activity. The Master held that the Commissioner had acted "entirely reasonably and properly in declining the … application for relief".

As far as Mr Singh's ability to repay his student loan being severely impaired by an adjudication of bankruptcy, Master Lang had "no confidence that [Mr Singh] will make any attempt at all to repay his outstanding student loan indebtedness" and considered that it was not in the wider public interest to decline bankruptcy on that ground.

Mr Singh further claimed that he had no assets and that bankruptcy would be futile, however there was some evidence before the Court that there are matters requiring investigation by the Official Assignee. The Master therefore did not accept that it would be a futile exercise.

Likewise, the Master had before him no independent evidence to support Mr Singh's contention that there remain outstanding a number of complaints to the United Nations.

As far as the sixth ground was concerned, Master Lang considered that the Auckland Crown Solicitor's letter to the Auckland District Law Society drawing the attention of the Society to a number of matters stemming from Mr Singh's criminal convictions was entirely proper, and was not a "back door" attempt by either the Crown Solicitor or Commissioner to prevent Mr Singh being enrolled as a barrister and solicitor.

On the final ground, the Master saw no substance to Mr Sigh's claims that the Commissioner's treatment of him was cruel or disproportionately severe.

Consequentially, the Master felt that the public interest required an order of adjudication, and saw no reason to exercise his discretion against the making of such an order.

SPECIAL LEAVE TO APPEAL REFUSED BY PRIVY COUNCIL

Case:	John George Russell & Ors v Taxation Review Authority and CIR
Decision date:	2 October 2002
Act:	Judicial Committee (General Appellate Jurisdiction) Rules Order 1982 (UK)
Keywords:	leave to appeal, Privy Council

Summary

Leave to appeal to the Privy Council was refused.

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.

Fisher J's decision was appealed to the Court of Appeal, which upheld his judgment (*Russell v Taxation Review Authority* (2001) 20 NZTC 17,418). The Court of Appeal further refused leave for the petitioners to appeal to the Privy Council (*Russell v Taxation Review Authority* (2002) 20 NZTC 17,602).

In this matter, the petitioners appealed directly to the Privy Council for permission that the Privy Council hear their appeal from the Court of Appeal's decision refusing to overturn Fisher J's decision.

The issue for the Privy Council to decide was whether there were issues of law of such general importance as to warrant special leave, so that the Privy Council should hear the appeal.

The petitioners argued that there had been a denial of a right to hear an argument relating to an alleged "vendetta" against the petitioners, that there were deficiencies in the TRA's process, that the High Court should have exercised a discretion in the petitioners' favour and that there was bias in the Court of Appeal.

The Commissioner argued that the "vendetta" argument had already been determined to be irrelevant in another proceeding, that deficiencies in the TRA could be addressed in yet to be heard appeals, the High Court's decision was a proper exercise of its discretion and that no point was taken at the earlier hearing in relation to the alleged bias point and that, therefore, there were no issues arising of far-reaching importance.

Decision

The Privy Council does not provide a written decision in applications for special leave. Their Lordships read the written submissions in advance, then immediately give a decision (giving or refusing leave) after oral argument. No reasons are provided for the decision.

The Privy Council dismissed the petitioners' application for special leave.

SPECIAL LEAVE TO APPEAL REFUSED BY PRIVY COUNCIL

Case:	M & J Wetherill Company Ltd & Ors v Taxation Review Authority & CIR
Decision date:	2 October 2002
Act:	New Zealand (Appeals to the Privy Council) Order 1910, Judicial Committee (General Appellate Jurisdiction) Rules Order 1982 (UK)
Keywords:	leave to appeal, Privy Council

Summary

Leave to appeal to the Privy Council was refused.

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).

The Commissioner had attempted to have a number of cases stated relating to the Russell template heard in the High Court rather than the Taxation Review Authority ("TRA"). The taxpayers resisted this course of action. In *Case U35* ((2000) 19 NZTC 9,330) the TRA granted the Commissioner leave to file the cases stated in the TRA out of time. The taxpayers attempted to appeal *Case U35* to the High Court. In *Case U41* ((2000) 19 NZTC 9,380) the TRA refused to allow an appeal of *Case U35* and struck out the application.

The taxpayers/petitioners judicially reviewed the two TRA decisions. The petitioners were largely successful before O'Regan J in the High Court (O'Regan J ordered Judge Barber to reconsider his decision in *Case U35*), but appealed certain minor points where they had been unsuccessful. The Commissioner cross-appealed on all points where he had been unsuccessful. The High Court decision is reported at *M & J Wetherill & Co Ltd & Ors v TRA & CIR* (2001) 20 NZTC 17,166.

The Court of Appeal dismissed the petitioners' appeal and allowed the Commissioner's cross-appeal (*M & J Wetherill & Co Ltd & Ors v TRA & CIR* (2002) 20 NZTC 17,624). Effectively the TRA's decision in *Case U35* was upheld, as was the decision in *Case U41*. The Court of Appeal further refused leave for the petitioners to appeal to the Privy Council (*M & J Wetherill & Co Ltd & Ors v TRA & CIR* (2002) 20 NZTC 17,681).

In this matter, the petitioners appealed directly to the Privy Council for permission that the Privy Council hear their appeal from the Court of Appeal's decision overturning O'Regan J's decision.

The issue for the Privy Council to decide was whether the Court of Appeal was wrong in refusing to grant the petitioners leave. The Privy Council was also asked to consider whether there were issues of law of such general importance as to warrant special leave, so that they should hear the appeal.

The petitioners argued that their appeals involves directly or indirectly some civil right amounting to or of the value of $5,000 or upwards so as that leave must be granted. The Commissioner argued that the Court of Appeal was correct—the only right was the right to have certain of the Taxation Review Authorities Regulations 1994 applied according to law, and this right could not be sensibly given a monetary value.

The petitioners further argued that there were matters worthy of being heard by the Privy Council, and, secondly, that they had not had the opportunity of being heard in some respects. The Commissioner argued that there were no important questions of law and that hearing of this litigation on the merits is long overdue.

Decision

The Privy Council does not provide a written decision in applications for special leave. Their Lordships read the written submissions in advance, then immediately give a decision (giving or refusing leave) after oral argument. No reasons are provided for the decision.

The Privy Council dismissed the petitioners' application for special leave.

TAXATION (RELIEF, REFUNDS AND MISCELLANEOUS PROVISIONS) ACT 2002 – Public Act 2002 No 32

The Taxation (Relief, Refunds and Miscellaneous Provisions) Bill was introduced on 3 December 2001. It passed its first reading in the same month, and was referred to Parliament's Finance and Expenditure Committee for consideration. The committee reported back to Parliament in May 2002. The bill was awaiting its second reading when Parliament was dissolved in June in preparation for the general election in July. The new Parliament convened in late August. The bill passed through its remaining stages in October, the new legislation receiving Royal assent on 17 October 2002.

As a result of the delay in the bill's passage through Parliament, the application dates of several measures in the bill had to be amended from those originally proposed. This was done by means of a Supplementary Order Paper in October.

The Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002 amends the following Acts: Income Tax Act 1994, Tax Administration Act 1994, Goods and Services Tax Act 1985, Estate and Gift Duties Act 1968, Student Loan Scheme Act 1992, and Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001.

NEW RULES ON TAXPAYER FINANCIAL RELIEF

Sections 139BA, 176, 177, 177A, 177B, 177C, 177D and 177E of the Tax Administration Act 1994

Introduction

Amendments to the Tax Administration Act 1994 give effect to the tax debt and taxpayer hardship proposals outlined in the government discussion document *Taxpayer compliance, standards and penalties: a review*, released in August 2001. They correct deficiencies in the current legislation and provide guidance to both Inland Revenue and taxpayers as to the appropriate treatment of a person in debt.

The effectiveness of the new legislation relies on taxpayers contacting Inland Revenue with their debt problems as early as possible. The rules provide Inland Revenue with considerable flexibility. The outcome of early discussion is more likely to be positive, with reduced stress and cost for taxpayers.

Key features

The debt and hardship provisions have been rewritten:

- to provide that Inland Revenue's role is to maximise the recovery of outstanding tax but not if:
  - recovery represents an inefficient use of Inland Revenue's resources; or
  - recovery places a taxpayer in serious hardship;
- to provide that if Inland Revenue can collect more of the debt over time through an instalment arrangement than from bankruptcy or liquidation, Inland Revenue is required to enter the instalment arrangement and any amount not recovered under the instalment arrangement is written off as unrecoverable;
- to provide that amounts not recovered are written off permanently, and generally cannot be reinstated;
- to include fairer instalment arrangements, including provision that late payment penalties stop when taxpayers contact Inland Revenue requesting financial relief; and
- to clarify the application of the rules, the definition of "serious hardship" in the legislation lists both circumstances which meet that test and circumstances which do not.

Background

The old debt and hardship rules in the Tax Administration Act dated back to the 1930s. They were designed for asset-rich but cashflow-poor taxpayers of the Depression era. The rules were significantly deficient in that they provided little guidance to either taxpayers or Inland Revenue on the appropriate treatment of a person in debt. The old debt and hardship rules were not reviewed as part of the introduction of the current compliance and penalty legislation. As a consequence, no significant consideration of their purpose or consequences was undertaken until the Finance and Expenditure Committee's 1999 Inquiry into the Powers and Operations of the Inland Revenue Department. The Committee made several specific recommendations relating to the administrative practice of "write-off", and these recommendations have been taken into account in developing the new rules.

The new rules also build on the recent amendments to the late payment penalty legislation: imposing the initial late payment penalty in two stages and not imposing the late payment penalty while taxpayers are meeting the terms of their instalment arrangements. All of these amendments are aimed at encouraging taxpayers to comply with their tax obligations.

The 1 July 2002 application date originally proposed in the bill was later changed to 1 December 2002 as a result of the delay in the passage of the bill through Parliament.

Application date

The proposed amendments apply to tax that is outstanding as at 1 December 2002, unless:

- that tax is subject to an instalment arrangement entered into before 1 December 2002, in which case the instalment arrangement continues to apply; or
- the Commissioner of Inland Revenue has advised the taxpayer that the outstanding tax has been written off.

The new rules also apply if the taxpayer has been advised that the outstanding tax has been written off before 1 December 2002 and the debt is reinstated after 1 December 2002. Inland Revenue will reinstate the debt and will consider how the new rules apply to the reinstated debt.

The proposals apply to all taxes, but do not apply to child support and student loans.

Detailed analysis

The new taxpayer financial relief rules provide a framework for Inland Revenue to consider how best to provide relief for taxpayers in financial difficulties. Inland Revenue has prepared Standard Practice Statements outlining how the department will administer the rules.

Maximising the amount recovered

Under the new section 176(1), Inland Revenue's role is to maximise the recovery of outstanding tax, as this maintains both the equity and efficiency of the tax system.

Under this provision, Inland Revenue is required to adopt the approach which maximises the collection of the amount outstanding. If Inland Revenue can collect more of the debt over time through, for example, an instalment arrangement, than from bankruptcy or liquidation, Inland Revenue is required to enter an instalment arrangement. In considering the collection options, Inland Revenue will take risk into account: a certain dollar today is worth more than the promise of a dollar in the future. Any amount not covered by an instalment arrangement is written off as unrecoverable.

Examples

> Mr M operates a business employing about 30 staff. He has arrears of PAYE and GST totalling $400,000 which he cannot pay in full. He offers to pay $250,000 to settle the arrears in one sum. Inland Revenue considers that bankruptcy would yield $100,000. Therefore Inland Revenue accepts Mr M's offer of $250,000 and writes off the balance.
>
> Company F employs four staff and has arrears of $100,000. The company offers to enter an instalment arrangement and pay off $20,000 of the debt over the next three years. Inland Revenue considers that liquidation would yield only $50,000, and would make the staff redundant. Given that liquidation maximises the recovery of outstanding tax, Inland Revenue will discuss with the company whether it could make an improved offer exceeding $50,000. If the company cannot improve its offer to over $50,000, the company will be liquidated.

The specific requirement for Inland Revenue to undertake net present value calculations has been removed. However, in line with Inland Revenue's role to maximise the amount of outstanding tax recovered when the repayment options are very similar, the net present value calculation is still likely to be used in determining which repayment option is preferable.

Recognition of the administrative costs of collection of tax

Recovering overdue taxes uses administrative resources. The new section 176(2)(a) provides Inland Revenue with a clear discretion allowing for the efficient use of administrative resources. A debt can be written off if the administrative costs of recovering the debt outweigh the amount collected.

Taxpayers cannot write to Inland Revenue asking that a debt be written off merely because they consider that the administrative costs of collecting the debt are more than the amount that will be collected. Inland Revenue determines when this provision applies.

In collecting outstanding tax, Inland Revenue also considers the effect that requiring payment has on taxpayers who comply with all of their tax obligations. In some cases requiring payment of an amount that is equivalent to the cost of collection may encourage taxpayers to pay promptly in future, resulting in Inland Revenue not incurring future administrative costs.

Serious hardship

Inland Revenue is prevented from collecting outstanding tax if recovery places a taxpayer in serious hardship. Recovery of a debt continues until the point where further recovery places a taxpayer in serious hardship. (Note that in some cases no recovery may have taken place as any action to recover the outstanding tax would place the taxpayer in serious hardship.) Any debt that cannot be recovered is written off.

Section 177A defines "serious hardship" to include significant financial difficulties that arise because of:

- a taxpayer's inability to meet minimum living expenses according to normal community standards;
- the cost of medical treatment for an illness or injury of the taxpayer or the taxpayer's dependant;
- a serious illness suffered by the taxpayer or the taxpayer's dependant; or
- the cost of education for the taxpayer's dependant/s.

Serious hardship does not include significant financial difficulties that arise because:

- the taxpayer is obligated to pay tax;
- the taxpayer may become bankrupt;
- the taxpayer's social activities and entertainment may be limited; or
- the taxpayer is unable to afford goods or services that are expensive or of a high quality or standard according to normal community standards.

The definition of "serious hardship" has been drafted as widely as possible to ensure that each taxpayer's specific circumstances can be taken into account.

When the bill was introduced, a definition of "dependant" was included in the legislation. The government later decided that the definition might be too narrow, so the definition was removed. Whether a person is a taxpayer's dependant is determined on a case-by-case basis.

Examples

> Ms N is having a hard time paying the tax she owes Inland Revenue. Inland Revenue considers her situation and notes that she sends her children to a private school. The definition of "serious hardship" states that serious hardship does not include financial difficulties that arise because the taxpayer is unable to afford goods or services that are expensive or of a high quality or standard according to normal community standards. Normal community standards in this case do not extend to private schooling of dependants, so Inland Revenue may suggest that Ms N send her children to a public school.
>
> In similar circumstances to those of the example above, a taxpayer's child is hearing-impaired and requires special schooling. In this case, however, the cost of that schooling would be considered appropriate under normal community standards.

Consideration of serious hardship is generally limited to natural persons. The definition of "serious hardship" in section 177A has been amended to make this clear. Legal entities such as companies cannot suffer hardship, although the recovery of the full amount of tax from a company may cause serious hardship for a shareholder. The legislation provides Inland Revenue with the discretion to "look through" the company and examine the effect of its actions on:

- a shareholder who owns, or two shareholders who jointly own, 50% or more of the shares in a company in serious hardship; or
- a shareholder-employee of a close company in serious hardship.

This second group of taxpayers was added as the result of submissions. This type of taxpayer typically works for the company and reinvests any earnings in the company. For the purposes of the look-through rule, the definition of "close company" is restricted to five or fewer natural persons whose voting interests or market value interests exceed 50%. The provision does not apply to all companies. The government considered extending the provision to all companies, but was concerned that taxpayers might, for example, invest all of their life savings in a public company, that might not then pay its outstanding tax and the taxpayers might argue that if the company was liquidated they would face serious hardship.

Example

> Company G is owned by two shareholders, one who owns 95% of the shares and the other 5% of the shares. The company owes $100,000, with the only asset in the company being a debit balance in the principal shareholder's current account of $100,000. If the company were placed into liquidation, the $100,000 in the current account would be called up. The principal shareholder's assets are a house valued at $90,000 and a car with a value of $5,000. Any action taken to liquidate this company could impose serious hardship on the principal shareholder. The company arranges with Inland Revenue that $70,000 raised by way of mortgage will be paid to Inland Revenue and the balance of the debt will be written off as collection would cause serious hardship.

Financial relief

Under the new rules, taxpayers can contact Inland Revenue requesting financial relief. The forms of financial relief available are:

- the taxpayer and Inland Revenue enter an instalment arrangement for all of the outstanding tax;
- the taxpayer and Inland Revenue enter an instalment arrangement for part of the outstanding tax and the balance is written off; or
- all of the taxpayer's outstanding tax is written off.

The amendments provide financial relief for taxpayers facing financial difficulties, including writing off amounts outstanding when they cannot be collected and providing a clearer and more flexible instalment arrangement process which ensures that taxpayers who are attempting to comply voluntarily can quickly resolve their problems.

Late payment penalties

Under the new rules, late payment penalties stop being imposed when a taxpayer contacts Inland Revenue seeking financial relief. If the taxpayer is granted financial relief, late payment penalties are not imposed.

To clarify the rules, a definition of "outstanding tax" was inserted. The definition clarifies that the rules apply to amounts owing to Inland Revenue before or after the due date for payment. Taxpayers who are in financial difficulties can therefore contact Inland Revenue before the due date and enter an instalment arrangement. This definition applies only for the purpose of the taxpayer financial relief rules.

If a taxpayer and Inland Revenue enter an instalment arrangement, late payment penalties are not imposed if the taxpayer complies with the arrangement. If the taxpayer defaults on the arrangement, late payment penalties are imposed from the date of default.

The late payment penalties previously not imposed, either while the instalment arrangement was being negotiated or while the taxpayer was complying with the arrangement, are not then re-imposed.

Example

> Mrs O contacts Inland Revenue stating that she cannot pay her outstanding tax. Inland Revenue determines that part of the amount outstanding should be written off and the other part of the amount outstanding is payable immediately. The amount payable immediately is treated as an instalment arrangement, and late payment penalties are not imposed from the date the taxpayer contacted Inland Revenue. If she then defaults on the amount payable immediately, late payment penalties apply from the date of the default. The amount written off and the late payment penalties not previously imposed are not reinstated.

If a taxpayer contacts Inland Revenue seeking financial relief and relief is not granted, the late payment penalties that were not imposed while the taxpayer and Inland Revenue negotiated are then imposed as if the request for financial relief had not been made.

Example

> Mr Y has tax to pay of $10,000 due on 7 February. On 2 April he contacts Inland Revenue and explains that owing to his financial situation, he is having difficulty paying the amount due and would like to enter an instalment arrangement and pay the amount outstanding over a year. At this point late payment penalties would stop being imposed. Inland Revenue requests copies of Mr Y's bank accounts. After six weeks he provides copies of the accounts, which show that he has sufficient funds to pay the amount due immediately. Inland Revenue declines to enter an instalment arrangement. The late payment penalties not imposed since 2 April are now imposed again, as if the request for financial relief had never been made.

Recent amendments to the late payment penalty legislation in section 139B mean that from 1 April 2002 the initial late payment penalty is imposed in two stages: 1% the day after the due date and a further 4% six days later. Furthermore, if a taxpayer enters an instalment arrangement before the due date for payment of the tax (known as a pre-emptive instalment arrangement), the second phase of the initial late payment penalty is not imposed. These principles also apply under the new rules that provide taxpayer financial relief. Not imposing the second phase of the initial late payment penalty (the 4%) provides an incentive for taxpayers to contact Inland Revenue before the due date and before administrative costs are incurred. Note that the first part of the initial late payment penalty is still imposed.

In developing these proposals, the government considered whether as a condition of granting financial relief the legislation should require that the taxpayer's other tax commitments be met; if they were not met, Inland Revenue could overturn, for example, an instalment arrangement. However, the government decided against this as other penalties apply if those other obligations are not met, and taxpayers who are, for example, a party to an instalment arrangement would effectively face a harsher penalty than other taxpayers for not complying with their other tax obligations.

Application for financial relief

Taxpayers may apply for financial relief either in writing or over the telephone. In many cases they will be required to provide relevant details of their financial position. The legislation also provides a discretion whereby Inland Revenue may require applications for serious hardship to be in writing.

Upon receipt of an application for financial relief Inland Revenue may:

- accept the request;
- decline the request;
- request further information from the taxpayer; or
- make a counter-offer to the taxpayer.

Response periods

The legislation does not specify a period of time within which Inland Revenue must respond to a request for financial relief. If financial relief is granted, late payment penalties cease applying from the time the taxpayer contacts Inland Revenue.

In circumstances where Inland Revenue requests more information or makes a counter-offer, the legislation provides that the taxpayer should be given 20 working days from the date of Inland Revenue's response to provide any financial or other information required by Inland Revenue or consider the counter-offer. If the circumstances warrant, however, Inland Revenue has the authority to set a longer period. If taxpayers are unable to respond because of circumstances beyond their control, Inland Revenue will allow a longer period. However, if there is a delay in responding and the delay is due to the taxpayer's inaction, a longer period would not be provided.

In cases where the information or response is not provided within the standard 20-working-day period (or the longer period set by Inland Revenue), late payment penalties are imposed, as if no application had been made. If the taxpayer then provides the necessary information, receipt of the information is treated as a new request for financial relief.

Example

> On 1 February Mr P requests financial relief, and on 10 February Inland Revenue writes to him requesting further information. The information is available to Mr P but he does not send it to Inland Revenue until mid-April. Inland Revenue treats receipt of the information in mid-April as a new request for financial relief. In this case, the imposition of the late payment penalties stop from mid-April, the date the information is received by Inland Revenue.

Taxpayers who request financial relief will be advised when the request is received by Inland Revenue and the name of the Inland Revenue officer handling the request.

If Inland Revenue and a taxpayer do not agree as to the terms of an instalment arrangement, late payment penalties and recovery action begin again as if no application had been made.

If an agreed instalment arrangement involves Inland Revenue writing off part of a taxpayer's outstanding tax and the taxpayer making payment of the remainder, the write-off action is taken once agreement has been reached. Default by the taxpayer in payment does not result in reinstatement of the amount already written off.

Counter-offer

If Inland Revenue believes the taxpayer can make instalments of a higher amount than offered or that the amount offered by the taxpayer would place him or her in serious hardship, it will make a counter-offer reflecting what it considers to be the appropriate amount of the repayments.

Writing off tax

For clarity, the legislation sets out a number of circumstances in which tax may be genuinely written off. Inland Revenue may write off tax that cannot be recovered. This provision covers cases where:

- the taxpayer is facing serious hardship;
- the administrative costs of collecting the tax are greater than the amount to be collected; or
- Inland Revenue considers that the tax cannot be recovered.

In addition to those cases Inland Revenue must write off tax that cannot be recovered in the following situations:

- bankruptcy;
- liquidation; or
- confirmation of the distribution of a deceased taxpayer's estate.

One of the aims of the new legislation is that taxpayers and Inland Revenue know what is expected of them and, from a taxpayer's perspective, that means knowing the amount to be repaid and the date of the payments. When taxpayers contact Inland Revenue saying that they are experiencing financial difficulties, the department will look at their financial situation and determine how much they can afford to pay. Any amount that cannot be repaid is written of when the instalment arrangement is entered into. Writing off the tax at the beginning of the instalment arrangement ensures that taxpayers are fully aware of the amount they are expected to pay and also ensures that the effect of use-of-money interest on the debt is known.

Example

> Mr G works from home and has arrears of $150,000. His assets are made up of a freehold home of $120,000 (which includes his workshop) and a work van worth $10,000. Inland Revenue contacts him concerning the debt and determines he would face serious hardship if the debt were fully repaid. Mr G agrees to mortgage his home for $100,000, which is paid to Inland Revenue, and Inland Revenue writes off the remaining $50,000. Inland Revenue had considered an instalment arrangement for the unpaid $50,000 but rejected it because income in excess of that needed to maintain the business is committed to repaying the mortgage.

Evasion or abusive tax position

Section 177C(3) does not allow an amount to be written off under section 177C(1) when a taxpayer is liable for an abusive tax position or evasion shortfall penalty in relation to that amount. The legislation has been clarified to ensure that the section applies to both the tax shortfall and to the shortfall penalty itself. This provision ensures that those taxpayers who take such tax positions face the entire consequences of their actions.

Example

> Ms X has tax to pay of $20,000. She is then audited by Inland Revenue and the audit reveals evaded tax of $5,000. Inland Revenue imposes a shortfall penalty of $7,500. Ms X is then made redundant from her job. She has no assets. She contacts Inland Revenue requesting financial relief. Inland Revenue then determines that the outstanding tax of $32,500 is not recoverable, although the department may write off only $20,000 of it.

If Inland Revenue writes off the outstanding tax under section 177C(2) because a taxpayer is bankrupted, liquidated or the taxpayer's estate has been distributed, the restriction under section 177C(3) does not apply. This restriction prevents Inland Revenue from writing off amounts if a taxpayer is liable to a shortfall penalty for an abusive tax position or evasion.

Tax losses

As part of the determination of a taxpayer's assets, Inland Revenue takes into account the tax losses of a taxpayer. If any tax revenue is written off, Inland Revenue must also extinguish part or all of the taxpayer's tax losses in proportion to the amount written off. When the loss is extinguished Inland Revenue will send the taxpayer a new notice of determination of loss.

Example

> Inland Revenue writes off $5,000 of Mr T's debt. Mr T has losses of $20,000 to be carried forward. To calculate the new loss balance, the amount written off, $5,000, is divided by 33% ($5,000 ÷ 33% = $15,151.51). This amount is subtracted from Mr T's losses ($20,000 - $15,151.51 = $4,848.48). A new notice of determination of loss of $4,848.48 will be issued to reflect this.

When the Taxation (Relief, Refunds and Miscellaneous Provisions) Bill was first introduced it required the losses to be measured on the date the debt was written off, which meant taxpayers would be required to file a part-year return of income up to the date the debt was written off. In order to reduce compliance costs, the legislation provides that net losses are now measured as at the previous year's income tax return.

The government considered applying this provision to future losses, but decided against doing so, mainly because to do so would be equivalent to reinstating a tax debt that had been written off when the taxpayer's circumstances change.

Reversal of write-off

In contrast to the old rules, when tax is written off under the new legislation, it is permanently written off. However, the legislation provides for specific situations when the amount written off can be reversed. They are if:

- the write-off is based on false or misleading information provided by the taxpayer;
- within one year of the amount being written off on grounds of serious hardship the taxpayer declares bankruptcy or is subject to bankruptcy proceedings;
- within one year of the amount being written off on grounds of serious hardship the taxpayer is or is in the course of being liquidated; or
- Inland Revenue receives additional funds in respect of a taxpayer who has been bankrupted, liquidated or their estate has been distributed.

The second situation was added as the result of submissions on the discussion document *Taxpayer compliance, standards and penalties: a review.* The submissioner was concerned that the taxpayer's other creditors could encourage the taxpayer to have an amount owing to Inland Revenue written off so that when the taxpayer subsequently declares bankruptcy the dividend paid to the other creditors is greater. The government agreed with the concerns expressed in the submission and extended the rule to cover liquidations.

The last criterion was added because the government was concerned that the legislation did not provide for a debt to be reinstated if a previously unknown asset was identified and Inland Revenue would not be able to claim any portion of the newly identified asset.

Instalment arrangements

The recovery of most debts involves the consideration of serious hardship, the writing off of tax, or the use of Inland Revenue's administrative resources. It also involves taxpayers trying to comply with their tax obligations but facing cashflow problems. One option, an alternative to applying whatever recovery action is considered appropriate, is for the taxpayer and Inland Revenue to enter an instalment arrangement.

Taxpayers who contact Inland Revenue can request an instalment arrangement by telephone or in writing. On receipt of a request for an instalment arrangement, imposition of any late payment penalties is suspended. Any amount not recovered through the instalment arrangement is written off as unrecoverable, either because collection would place the taxpayer in serious hardship, because recovery represents an inefficient use of Inland Revenue's resources or because Inland Revenue considers that the amount cannot be collected.

Inland Revenue may cancel an instalment arrangement if the arrangement is based on information provided by the taxpayer that is later found to be misleading or fraudulent or if the taxpayer defaults on the instalment arrangement. If an arrangement is cancelled because it was based on false or misleading information, those late payment penalties not imposed because of the instalment arrangement are then imposed as if the instalment arrangement had not been entered into.

Inland Revenue must not knowingly place a taxpayer in serious hardship and must use administrative resources efficiently. These requirements override any instalment arrangement. For example, taxpayers may consider that they can pay back the tax owed, and they may be willing to incur serious hardship to do so. Nevertheless, they should not be required to do so. Another example is where a taxpayer is initially in a position to pay but the taxpayer's financial affairs worsen during an instalment arrangement, to the extent that serious hardship applies. At this point, part of the taxpayer's debt would be written off and the rest would be subject to a new instalment arrangement.

What is an "instalment arrangement"?

The government considered including in the new rules a definition of "instalment arrangement". After much consideration, however, it decided against doing so. The taxpayer financial relief rules have been designed to be as flexible as possible and the government was concerned that defining what it considered an instalment arrangement to be could result in constricting the definition.

An instalment arrangement may be one (a lump sum) or more payments. If the instalment arrangement consists of more than one payment the payments do not have to be of equal amounts, nor do the payments have to be made at equal intervals.

Examples

> Mr J owes Inland Revenue $40,000. This is the first time Mr J has got behind in his payments. He telephones Inland Revenue seeking financial relief. He offers to pay $15,000 in a lump sum and proposes repayments of $400 per month. He has no other overdue debts and from the information provided it appears that he can afford the repayments. Mr J and Inland Revenue enter into the instalment arrangement.
>
> Mrs D owes Inland Revenue $270,000. She has a house which is currently for sale. Mrs D and Inland Revenue enter an instalment arrangement under which Mrs D agrees to pay Inland Revenue the entire amount outstanding in one lump sum once the house is sold.
>
> Miss P owes Inland Revenue $12,000. She is currently out of work but has been offered a job starting in two months. She contacts Inland Revenue and requests an instalment arrangement. Inland Revenue and Miss P agree to an instalment arrangement under which Miss P pays $200 a month for three months and then the instalments increase to $1000 a month.

When Inland Revenue and a taxpayer enter an instalment arrangement Inland Revenue will send a letter to the taxpayer setting out clearly what is expected of him or her. The letter will also include the amount and frequency of the repayments, and advise the taxpayer to contact Inland Revenue as soon as possible should the taxpayer's financial circumstances change.

As set out in Inland Revenue's forthcoming Standard Practice Statement, if a taxpayer pays more than is required under an instalment arrangement with Inland Revenue, the excess cannot be used as a credit towards future expected obligations. Instead, the excess helps reduce the term of the instalment arrangement and the amount of use-of-money interest payable.

Reasons for declining to enter an instalment arrangement

Under section 177B(2), Inland Revenue has the discretion to decline to enter an instalment arrangement if:

- to do so does not maximise the recovery of outstanding tax from the taxpayer;
- Inland Revenue considers that the taxpayer is in a position to pay all of the outstanding tax immediately;
- the taxpayer is being frivolous or vexatious; or
- the taxpayer has not complied with a previous instalment arrangement; or

When the legislation was introduced there were two other reasons for which Inland Revenue could decline to enter an instalment arrangement. They were when:

- a taxpayer was requesting an instalment arrangement to stop the Commissioner taking action to recover the outstanding tax; and
- the taxpayer had previously made a request to enter into an instalment arrangement and the request was declined.

The first criterion was removed because the legislation does not provide that recovery action stops when taxpayers request financial relief. In the discussion document *Taxpayer compliance, standards and penalties: a review* the government proposed that when taxpayers requested financial relief, any recovery action underway would be suspended. When the legislation was drafted this proposal was overlooked. On reflection, however, the government considered that any recovery action already under way should continue. The administrative and compliance costs of suspending the action would be great and would outweigh any benefit of suspending the action. When a taxpayer contacts Inland Revenue seeking financial relief, as part of the negotiation of the type of relief to be given the taxpayer and Inland Revenue may decide to suspend any recovery action already under way. However, this would be decided on a case-by-case basis.

In relation to the criterion where the taxpayer had requested an instalment arrangement and the request was declined, the government was initially concerned that taxpayers who had their requests to enter an instalment arrangement declined could repeatedly request an instalment arrangement in relation to the same debt. On reflection, it was decided that if the taxpayer's circumstances had not materially changed, the reason for declining the first time remained relevant and the arrangement could be declined for that reason.

Renegotiation of instalment arrangements

The legislation clearly provides taxpayers with the option to renegotiate an instalment arrangement if their financial situation changes. Under section 177B(5), a renegotiation is treated in the same manner as a request for financial relief. If taxpayer's circumstances improve in the intervening period, resulting in their being able to repay the debt more quickly, they can contact Inland Revenue and arrange to do so. Use-of-money interest, which compensates the Crown for not having the use of its money, also provides taxpayers with an incentive to repay the debt as quickly as possible. Any amount previously written off is not reinstated merely because a taxpayer's circumstances have improved.

If taxpayer's circumstances change, resulting in their not being able to meet the repayment obligations under the instalment arrangement, they should contact Inland Revenue as soon as possible, stating that they wish to renegotiate the arrangement. One of the clear criteria provided by the amendments for Inland Revenue to decline an instalment arrangement is when a previous arrangement has not been adhered to, so any delay in contacting Inland Revenue may result in unfavourable consideration of future instalment arrangement applications.

Inland Revenue has an option to renegotiate an arrangement only after two years from the date the arrangement is entered into.

Proof of debt

If a taxpayer is bankrupted or liquidated, any proof of debt is for the entire amount owing to Inland Revenue, including any amount subject to an instalment arrangement. The government was concerned that if an amount is subject to an instalment arrangement and the taxpayer is complying with the arrangement there may be an opportunity for the amount owing under the instalment arrangement to be omitted from the proof of debt. This was never the intention and the legislation has therefore been clarified.

NEW RULES ON TRANSFERS OF OVERPAID TAX

Part XB, and section 3(1) of the Tax Administration Act 1994, sections MB 8(1) and (2), MD 1(3), MD 2(5A), NF 7(5), NG 16(4) of the Income Tax Act 1994, and section 46 of the Goods and Services Tax Act 1985

Introduction

Comprehensive new rules governing the transfer of overpaid tax have been inserted as Part XB of the Tax Administration Act 1994. Taxpayers may request a transfer to another period or tax type of the taxpayer or to another taxpayer. The new provisions set out the effective date of the transfer, which differs depending upon the relationship between the transferor and the transferee.

The new rules should address uncertainty about the rules relating to transfers that existed before the law was changed.

Background

There has been some uncertainty and inconsistent practice in relation to the rules for the transfer of excess tax. Proposals for new rules were set out in the discussion document *Taxpayer compliance, standards and penalties: a review*, issued in August 2001. The changes that have been enacted are essentially the same as the proposals in the discussion document.

Key features

New Part XB has been inserted into the Tax Administration Act 1994 to allow Inland Revenue, at the request of a taxpayer, to transfer tax that is overpaid by the taxpayer to another period or type of tax or to another taxpayer.

Sections 173L and 173M set out the effective date of transfer, which differs depending on the relationship between the transferor and the transferee.

Section 173L applies to transfers to another period or tax type of the same taxpayer. When there is a transfer of excess tax that was paid directly to Inland Revenue by the taxpayer (such as provisional tax or tax deducted on behalf of another taxpayer), the date of transfer is any date chosen by the taxpayer that comes after the date of overpayment of the tax. When a registered person is entitled to a GST refund (rather than paying GST) the date of the transfer is any day after the end of the taxable period in which the refund arose. In the case of tax deducted at source on behalf of the taxpayer, it is any date after the end of the taxpayer's accounting year.

Section 173M applies to transfers to other taxpayers. In the case of a transfer to associated taxpayers listed in subsections (2)(a) – (e) and (3), the same date of transfer as described in the previous paragraph will apply. In the case of all other transfers, the date of transfer is a date chosen by the taxpayer but no earlier than the later of the date of the transfer request and the date of filing of the relevant return.

Sections 173P, 173Q and 173R provide formulae for determining the amounts of provisional tax that can be transferred from various dates. These sections apply only to transfers to another period or tax type of the same taxpayer, or to other associated taxpayers listed in section 173M(2)(a) – (e) and (3).

Refunds resulting from childcare and charitable gifts rebates, as well as credit use-of-money interest can also be transferred – section 173N and 173S apply respectively.

Section 173T provides that when excess tax is used to offset an outstanding tax liability, the taxpayer or the taxpayer's agent can request that the offsetting occurs at a date allowed by the new transfer rules.

Application date

The new provisions apply to:

- excess tax paid in the 2002-2003 and future years;
- excess tax paid in an earlier year if the excess arises between 1 April 2002 and 17 October 2002 if the taxpayer notifies Inland Revenue that Part XB should apply;
- excess tax paid in an earlier year if the excess arises on an assessment made after 17 October 2002;
- refunds in relation to childcare and charitable donations rebates claimed after 17 October 2002;
- GST supplies made on or after 1 April 2002;
- tax deducted on behalf of another taxpayer that is paid on or after 1 April 2002; and
- dividend withholding payments and duties paid on or after 1 April 2002.

Amendments to offset rules in sections MB 8(1) & (2), MD 1(3), NF 7(5), NG 16(4) of the Income Tax Act 1994 apply to offsets in the 2002-03 and subsequent income years. These amendments provide that when excess tax is transferred to offset an existing tax liability the taxpayer or the taxpayer's agent may apply to have the offset applied from any date that would satisfy section 173L.

For example, assume excess tax arose for the 2001-02 year, and section MD 1(3) is applied to offset that excess against tax outstanding for the 2000-01 year. Inland Revenue applies section MD 1(3) at the time the 2001-02 return is processed in November 2002. The taxpayer or the taxpayer's agent could elect a transfer date in these circumstances because Inland Revenue applies the excess tax in the 2002-03 income year.

Detailed analysis

Application

New section 173K sets out the circumstances in which the new transfer rules will apply, and the effect of the rules. Although the section refers separately to transferors and transferees, the transferor and transferee will be the same person when the transfer is to another period or type of tax of the same taxpayer.

Excess tax may be transferred at the request of the taxpayer. "Tax" includes all taxes, levies and duties included in the definition of "tax" in section 3. In addition, section 3(1)(ac) specifically includes:

- a repayment obligation, as defined in the Student Loan Scheme Act 1992;
- rebates for child care and charitable donations; and
- financial support, as defined in the Child Support Act 1991 (child support).

Although section 173U prohibits the transfer of excess child support payments, excess amounts from other revenues may be transferred to cover child support liabilities.

Part XB applies only to excess tax that is refundable. This means, in the case of income tax, that it will not apply when the company's imputation credit account has insufficient credits and the amount is retained by the Commissioner under sections MD 2 or MD 3 of the Income Tax Act.

The new rules also do not apply if the Commissioner offsets the excess against an outstanding tax liability under section MD 1(3) of the Income Tax Act. That provision overrides the new rules. Tax should not be available for transfer to another taxpayer if the taxpayer has an outstanding tax liability. However, section 173T provides that if excess tax is used in this way, the taxpayer or the taxpayer's agent can elect to have the offset apply for a date that is allowed by the new transfer rules.

The amount transferred is treated as a refund to the transferor on the date of the transfer. So, for example, a corporate transferor should record the amount transferred as a refund on the transfer date in its imputation credit account. The amount transferred is tax paid by the transferee on the date of transfer for all purposes except the imposition of shortfall penalties. Therefore when tax is transferred by taxpayer A to satisfy an unpaid tax liability of taxpayer B as at the due date of the tax, any accrued use-of-money interest and late payment penalties in relation to the underpayment will be cancelled.

Transfers within a taxpayer's own accounts

Section 173L applies to requests by a taxpayer for a transfer to another period or to another type of tax of the same taxpayer.

Taxpayers may choose the date on which the excess is to be transferred, provided it is after the dates set out in the section. When registered persons are entitled to a GST refund (rather than paying GST), the date of the transfer is the day after the end of the taxable period in which the refund arose. In relation to tax deducted at source on behalf of a taxpayer, the transfer can be made only after the end of the accounting year. When the taxpayer has an early balance date (say 30 November), the earliest date for the transfer of tax deducted at source is 1 April. This is because salary earned up until 31 March is included in the return to the previous 30 November.

Transfers of taxes that are paid directly to Inland Revenue (for example, provisional and terminal tax, taxes deducted on behalf of another taxpayer, and duties) can be made at any time on or after the date the tax is paid.

Allowing taxpayers to choose the date of transfer, subject to these limitations, enables them to choose a date that is most advantageous for them.

The effect of a transfer at this date is that taxpayers can transfer overpaid tax to another period or type of tax at the earliest opportunity to reduce use-of-money interest on underpaid tax. This should mean that, generally, taxpayers are not charged use-of-money interest (currently at 11.93%) in relation to an underpayment over the same period that they are also receiving use-of-money interest at a lower rate (currently 4.83%) in relation to an overpayment.

Example 1 – transfer to the same taxpayer

> In September 2002, Dr A is assessed in relation to her 2001-2002 income year and discovers she has overpaid her tax. She has in the meantime paid her first provisional tax instalment for the 2002-2003 year on 7 July 2002, using the standard uplift method. However, she is now concerned that that amount will not be sufficient and a use-of-money interest liability will arise. She requests Inland Revenue to transfer the excess as at 7 July, which it does.

Transfer to certain listed associated taxpayers

Section 173M applies to transfers to other taxpayers. If the transfer is between certain listed associated taxpayers, the date of transfer is the same as that applying to transfers within a taxpayer's own accounts (see the previous commentary on section 173L). This applies to transfers between:

- companies in the same group (that is, companies that are at least 66% commonly owned);
- a shareholder-employee and company, and vice versa;
- partners in the same partnership;
- family members within one degree of relationship (husband/wife, de facto spouse, same sex partner, parent/child); and
- a family trust and a beneficiary.

Because tax can be transferred between these taxpayers generally at the date of overpayment, a transfer may offset unpaid tax liabilities and cancel use-of-money interest and late payment penalties of the transferee. The taxpayers eligible for this treatment fall into one of two categories. They either are, or consider themselves to be, one economic entity, or they share in an income stream and allocate income amongst themselves after the end of the year.

It is not appropriate for all transfers to other taxpayers to be made at this date. This would result in high administrative costs on Inland Revenue, as it would need to field and action transfer requests and reissue statements of account to reflect the transfers and resulting cancelled interest and late payment penalties. This increases the complexity of the tax system. To allow all transfers to cancel accrued use-of-money interest and late payment penalties of the transferee also undermines the incentive for individuals to pay the right amount of tax on time.

Example 2 – transfer to a related party

> Company A estimates its provisional tax and paid provisional tax of $120,000 at each instalment date for the 2002-2003 year (7 July and 7 November 2002 and 7 March 2003). In May 2003 Company A files its return, which shows that its residual income tax is $300,000 for the year. It has therefore overpaid tax of $20,000 at each instalment date.
>
> Company B is in the same group as Company A, being 66% commonly owned. Company B underestimated its first provisional tax instalment at 7 July 2002 by $20,000 and has incurred use-of-money interest on the underpayment. Company A therefore requests Inland Revenue to transfer the $20,000 excess tax paid on 7 July to Company B as at that date. Company A has no outstanding tax liability, and its imputation credit account has sufficient credits, so Inland Revenue actions the transfer at the date requested.

The amount transferred is treated as a refund to Company A. It therefore records a debit of $20,000 in its imputation credit account as at 7 July. The amount transferred is tax paid by Company B, which records a credit in its imputation credit account as at 7 July. Use-of-money interest that has accrued in relation to Company B's underpayment is cancelled.

All other transfers

Section 173M(4)(b) sets out the effective date for all transfers to all other taxpayers. Again, taxpayers can choose the effective date but it must be no earlier than the later of the date of the request and the day after the relevant return is filed.

Example 3 – transfer to unrelated party

In July 2005, Company A's 2002-2003 return is reassessed. The reassessment results in excess tax which Company A requests Inland Revenue to transfer to unrelated Company B. The latter underpaid its provisional tax in the 2002-2003 year, incurring a use-of-money interest liability. Company A cannot transfer its excess to Company B retrospectively. The date of transfer must be no earlier than the later of the date of the request (July 2005) and the date the relevant return was filed (May 2003). Company A therefore decides not to transfer the excess and Inland Revenue refunds it.

The date of request is the date on which the taxpayer requests the transfer of that particular excess. So, if in example 3, Company A had calculated in its 2002-2003 return that it had overpaid tax and requested the transfer of that excess in May 2003, this is not the relevant date of request in relation to the excess arising on reassessment.

Transfer of a rebate for childcare or charitable donations

Section 173N provides that a rebate for childcare or charitable donations can be transferred only at the later of the date of the request and the date on which the taxpayer applies for the refund. It cannot be transferred at an earlier date because no use-of-money interest is payable in relation to these rebates. Therefore the rebate should not be transferable to another type of tax or another taxpayer so that use-of-money interest, in effect, becomes payable on it.

Example 4 – transfer of rebates

Mrs B makes a charitable donation in the 2002-2003 year and claims a refund in December 2003. Her husband underpaid his provisional tax on 7 July 2003. Mrs B therefore requests in a letter attached to the claim form that the refund be transferred to her husband as at 7 July 2003 in order to minimise use-of-money interest on the underpayment.

Inland Revenue will transfer the excess only as at December 2003.

Transfer of credit use-of-money interest

Credit use-of-money interest is also available for transfer. The transfer date is the date the interest would have been paid to the taxpayer, in the absence of a transfer request. This is provided by section 173S.

No transfer date specified by the taxpayer

Section 173O provides a default date for a transfer if the taxpayer does not specify one in the application. Inland Revenue will transfer the excess tax on the date it considers appropriate. The date chosen will be the one that maximised credit use-of-money interest, or minimised the differential use-of-money interest for taxpayers within the constraints of the new rules. Inland Revenue will issue administrative instructions about determining the most appropriate date.

The taxpayer may subsequently choose a different date, as long as that date satisfies sections 173L and 173M.

Provisional tax

Section 173P, 173Q and 173R provide rules for determining the amount of excess provisional tax that can be transferred at a particular date.

Sections 173P and 173Q provide that amounts which can be transferred before an assessment is issued are:

- payments in excess of the provisional tax payable on the instalment dates before the date the transfer is actioned; and
- the difference between the provisional tax paid and the estimated (or revised estimated) residual income tax for the year, if a taxpayer estimates provisional tax after having paid instalments on the uplift basis, or revises an estimate.

After an assessment is issued, section 173R provides that the amount that can be transferred is the difference between the provisional tax paid and the residual income tax for the year.

General rule

Section 173P is the general rule that applies before tax is assessed for the year and when the taxpayer has paid more provisional tax than is necessary (whether liability it is calculated on the estimation or uplift basis). This amount is refundable under section MD 1(1) of the Income Tax Act 1994 (subject to its limitations).

Whether there is an excess is determined at the time the transfer request is actioned. The formula calculates an amount that is available for transfer at any particular date (date A) that the taxpayer wishes. The formula can be applied a number of times to calculate the excess tax available for transfer at specific dates as requested by the taxpayer—for example, at P1, P2, or P3. When the formula is applied at P1, date A is P1. When it is applied at P2, date A becomes P2, and so on. If the amount is first available at date A and is not transferred at that date, it will be included in the amount available for transfer at a subsequent date A.

The Commissioner must not transfer an amount on date A if, as a result of the transfer, the taxpayer would not satisfy its provisional tax liability on a subsequent date before the transfer is actioned. This can apply in two situations: first, when a taxpayer prepays provisional tax by date A and therefore pays less than it otherwise would have at subsequent instalment dates (see example 8); and second, when a taxpayer has received a refund of overpaid provisional tax after date A and before the transfer is actioned (see example 9).

If the Commissioner cannot transfer an amount because it would result in a provisional tax underpayment after date A, a temporary transfer is allowed—the amount must be transferred back to the taxpayer's account in time to meet the provisional tax liability on that date. The following examples illustrate the application of section 173R. The examples relate to standard balance dates unless otherwise stated.

Example 5 – overpayment of provisional tax at each instalment date

Mr C estimates provisional tax at $150,000 ($50,000 at each provisional tax payment date) but pays $75,000 at each provisional tax instalment date. On 31 March, he requests a transfer of the excess provisional tax paid as at the earliest dates. The total amount available for transfer is $75,000. The relevant dates A are P1, P2 and P3. These are considered in date order because transfers at earlier dates (for example P1) are reflected in "refunds" at subsequent dates (P2 and P3).

		P1	P2	P3
Amount paid		$75k	$75k	$75k
PT liability		$50k	$50k	$50k
PT paid	=	$75k	$150k	$225k
Refunds	=	$0	$25k	$50k
PT liability	=	$50k	$100k	$150k
PT overpaid		$25k	$25k	$25k

$25,000 is transferable at P1, and if $25,000 is transferred at P1 or up to P2 (as it is in this example), only $25,000 is transferable at P2. (If nothing were transferred before P2, $50,000 would be transferable at P2 and so on).

Subsection (3) of section 173P does not apply to restrict the amount transferred in this example—if $25,000 is transferred at P1, Mr C still satisfies his provisional tax liability at subsequent dates; the same applies to the transfers at P2 and P3.

Example 6 – voluntary payment

Mr D pays provisional tax on the uplift basis, but is subject to use-of-money interest. His provisional tax liability based on last year's residual income tax plus 5% is $90,000, and he pays the required amounts at P1, P2 and P3. However, he is concerned that this is not sufficient and, in order to minimise a use-of-money interest liability on underpayments, makes a voluntary payment on 20 March. On 31 March, he requests a transfer of the excess provisional tax which is $20,000. He wants to transfer the maximum available at the earliest dates. The relevant dates are the provisional tax dates and 20 March, which are considered in date order.

		P1	P2	P3	20/3
Amount paid		$30k	$30k	$30k	$20k
PT liability		$30k	$30k	$30k	$0
PT paid	=	$30k	$60k	$90k	$110k
Refunds	=	$0	$0	$0	$0
PT liability	=	$30k	$60k	$90k	$90k
PT overpaid	$0	$0	$0	$20k	

The excess of $20,000 is available for transfer on 20 March.

Subsection (3) does not apply in this example—if the $20,000 is transferred on 20 March Mr D will still have met her provisional tax obligations in relation to the year.

Example 7 – taxpayer misses P1

Ms G pays provisional tax on the uplift basis and is required to pay $50,000 at each instalment. She misses instalment 1, but pays $100,000 at instalment. After P2, she requests a transfer of tax she considers overpaid at P2.

	P1	P2
Amount paid	$0	$100k
PT liability	$50k	$50k

Section 173P does not apply, because at the date on which the Commissioner actions the request (say, 1 December) Ms G has not paid more than the provisional tax payable by that date.

Example 8 – taxpayer pays excess provisional tax at P1

Ms H pays provisional tax on the uplift basis and is required to pay $50,000 at each instalment. She pays $150,000 at P1.

Transfer request actioned before P2

Before P2, Ms H calls Inland Revenue to request a transfer as at P1 of the excess tax paid on that date.

		P1
Amount paid		$150k
PT liability		$50k
PT paid	=	$150k
Refunds	=	$0
PT liability	=	$50k
PT overpaid		$100k

The amount available for transfer as at P1 is $100,000. Subsection (3) does not apply because a transfer of $100,000 at P1 will mean that Ms H has still satisfied her provisional tax obligations up to the date the transfer is actioned. P2 has not yet passed and it is assumed that further instalments would be paid at P2 and P3.

Transfer request actioned after P2 and before P3

Assume that Ms H has made no request for a transfer before P2. She pays no provisional tax on the second instalment date (because she knows that she paid sufficient to cover this at P1.)

After P2 and before P3, she calls Inland Revenue to request a transfer—she wants to transfer the maximum available at P1.

		P1	P2
Amount paid		$150k	$0
PT liability		$50k	$50k
PT paid	=	$150k	$150k
Refunds	=	$0	$50k
PT liability	=	$50k	$100k
PT overpaid		$100k	$0

The formula calculates the amount overpaid at P1 at $100,000 but subsection (3) applies to restrict this. If the Commissioner transfers the $100,000 there will be a provisional tax underpayment at P2. Therefore the Commissioner will transfer only $50,000 at P1. (The Commissioner will transfer the additional $50,000 only if it is transferred back at P2.)

Assume Ms H pays no provisional tax at P3 and waits until after P3 to request the transfer.

	P1	P2	P3
Amount paid	$150k	$0	$0
PT liability	$50k	$50k	$50k

Section 173P does not apply—the taxpayer has not paid more provisional tax than the provisional tax payable by the date the transfer is actioned.

Example 9 – refund of provisional tax paid at P1

Mr J's provisional tax liability is $150,000 for the year. He pays $150,000 (an additional $100,000) at P1 (7 July) and then obtains a refund of $75,000 on 1 August. Shortly before P2 he seeks to transfer any excess tax overpaid at P1 (which is date A).

		P1	1/8
Amount paid		$150k	-$75k
PT liability		$50k	
PT paid	=	$150k	
Refunds	=	$0	
PT liability	=	$50k	
PT overpaid		$100k	

The formula calculates the amount overpaid at P1 at $100,000 but subsection (3) applies to restrict this because Mr J has had a refund on 1 August (which is date B). Transfer of the $100,000 would give rise to an underpayment of provisional tax as at 1 August. The Commissioner can therefore transfer only $25,000 as at P1. (However, A can temporarily transfer the remaining $75,000 until 1 August).

Revisions before assessment

Section 173Q applies in limited situations to transfers actioned before tax is assessed for the year. It applies in only two circumstances in which provisional tax would be refundable under section MB 8 of the Income Tax Act 1994.

First, it applies to taxpayers who pay provisional tax on the estimation basis and revise their estimate on or before P3, so that (at the time of the transfer request) they have paid more provisional tax than their revised estimate for the year.

Secondly, it applies to taxpayers who pay the first one or two instalments on the uplift basis and estimate at P2 or P3 with the result that they have paid more provisional tax (at the date the transfer is actioned) than their estimated residual income tax for the year.

The section does not apply when a taxpayer pays all provisional tax instalments on the uplift basis. (Taxpayers in this situation will, nevertheless, be able to transfer, at provisional tax dates the difference between provisional tax paid and residual income tax [RIT] after assessment.)

In short, section 173Q provides for the transfer of the difference between provisional tax paid and the revised estimated (or estimated) RIT for the year. Unlike section 173P, it can apply when a taxpayer has paid only its provisional tax liability on provisional tax instalment dates.

The formula is subject to a cap in subsection (4)—the maximum amount that can be transferred under the formula is the net provisional tax paid (that is, the tax paid less refunds of that tax) less the revised estimated RIT, or estimated RIT.

Regardless of the formula, the Commissioner cannot transfer an amount at date A that would result in the taxpayer underpaying the revised estimated RIT, or estimated RIT, that would be due under the use-of-money interest provisions on a subsequent date B if the revised estimated RIT, or estimated RIT, were actual residual income tax and the safe harbour provisions in section 120K(4) did not apply. However, temporary transfers are permitted when the amount is transferred back in time to ensure the taxpayer pays its estimated, or revised estimated, RIT at date B.

The formula in section 173Q is essentially the same as that in section 173R, which applies after assessment. The difference is that section 173Q refers to "estimated RIT" or "revised estimated RIT" rather than the actual RIT.

Taxpayers should note that if they ask for a transfer at a provisional tax date under section 173Q, and their revised estimated, or estimated, RIT is lower than their actual RIT, they could expose themselves to late payment penalties and use-of-money interest in relation to underpaid provisional tax at that date.

The following examples illustrate the application of proposed section 173Q.

Example 10 – revised estimated RIT filed at P3

Mr K estimates RIT at $300,000 and pays P1 and P2 on this basis. By P3, it is clear that his RIT is more likely to be $150,000. He files this revised estimate at P3, and does not pay any further provisional tax.

Section MB 8 allows the Commissioner to refund provisional tax in these circumstances. Mr K requests the Commissioner to transfer the excess provisional tax at the earliest date available.

Mr K can transfer a total of $50,000, being the difference between the amount of provisional tax paid in the year ($200,000) and the revised estimated RIT ($150,000).

		P1	P2	P3
Amount paid		$100k	$100k	$0
revised est. RIT		$50k	$50k	$50k
PT paid	=	100k	$200k	$200k
Refunds	=	$0	$50k	$50k
Est RIT	=	$50k	$100k	$150k
Tax overpaid		$50k	$50k	$0

The $50,000 excess is available for transfer at P1. The formula itself would calculate $50,000 as also being available at P2, but the cap in subsection (4) of section 173Q applies to restrict the amount available to the $50,000 transferred at P1.

(Subsection (3) of section 173Q does not apply in this situation. If $50,000 is transferred at P1, the revised estimated RIT that would be due under Part VII on P2 and P3 has still been paid—that is, there is no deficit at P3 because of the excess tax paid relative to the revised estimated RIT due at P2.)

Example 11 – revised estimated RIT at P2 then P3

Dr L estimates RIT at $300,000 and pays P1 on this basis. At P2 D he revises this estimate to $250,000 and pays $75,000 at P2. At P3, it is clear that Dr L's RIT is more likely to be $150,000. Dr L files this revised estimate at P3 and does not pay any further provisional tax.

Dr L can transfer a total of $25,000, being the difference between the amount of provisional tax paid in the year ($175,000) and the revised estimated RIT ($150,000).

Dr L wants to transfer the excess at the earliest date.

		P1	P2	P3
Amount paid		$100k	$75k	$0
revised est. RIT		$50k	$50k	$50k
PT paid	=	100k	$175k	$175k
Refunds	=	$0	$25k	$25k
Est RIT	=	$50k	$100k	$150k
Tax overpaid		$50k	$50k	$0

The $25,000 excess is transferable at P1. Although the amount calculated under the formula at P1 is $50,000, this is subject to the cap in subsection (4). Only $25,000 is transferable.

Subsection (3) does not apply to restrict the $25,000 that is transferable at P1—if $25,000 is transferred at P1, the taxpayer has still paid the right amount of revised estimated RIT at P3. ($0 is paid at P3 because this is, in effect, prepaid at P1 and P2.)

Example 12 – provisional tax paid does not exceed revised estimated RIT

Mr M estimates RIT at $90,000 and pays P1 and P2 on this basis. After P2, it is clear that his RIT is more likely to be $75,000. He files this revised estimate after P2, and seeks to transfer the excess at provisional tax dates.

Section MB 8 allows the Commissioner to refund provisional tax in these circumstances. However, section 173Q does not apply because Mr M has not paid more provisional tax than the revised estimate for the year. He has paid only $60,000 and the revised estimate is $75,000.

	P1	P2
Amount paid	$30k	$30k
revised est. RIT	$25k	$25k

Example 13 – revised estimated RIT at P3

Ms N estimates RIT at $150,000 and pays P1 and P2 on this basis. By P3, it is clear that her RIT is more likely to be $75,000. She files this revised estimate at P3, and does not pay any further provisional tax.

Section MB 8 allows the Commissioner to refund excess provisional tax in these circumstances. After P3, Ms N requests the Commissioner to transfer the excess provisional tax at the earliest date available.

Section 173Q applies because the provisional tax paid ($100,000) exceeds the revised estimated RIT ($75,000).

The taxpayer can transfer a total of $25,000, being the difference between the amount of provisional tax paid in the year ($100,000) and the revised estimated RIT ($75,000). She wants to transfer the excess at the earliest date.

		P1	P2	P3
Amount paid		$50k	$50k	$0
revised est. RIT		$25k	$25k	$25k
PT paid	=	$50k	$100k	$100k
Refunds	=	$0	$25k	$25k
Est RIT	=	$25k	$50k	$75k
Tax overpaid		$25k	$25k	$0

She can transfer the $25,000 excess at P1. The formula by itself would calculate $50,000 as also being available at P2, but the cap in subsection (4) applies to restrict the amount available to what has been transferred at P1.

Subsection (3) does not apply in this example to reduce the $25,000 that can be transferred at P1. If $25,000 is transferred at P1, the taxpayer has still paid on all subsequent dates the revised estimated RIT due on those dates. (The amount that would be due at P3 is prepaid at P2.)

Example 14 – application of subsection 173Q(3)

Mr O estimates RIT at $60,000 and pays P1 on this basis. After P1, he is certain he will be in loss for the year. He files a revised estimated RIT of $0 and seeks a refund of the $20,000. At P2, the business situation has improved dramatically for him and he files a further revised estimated RIT of $60,000. He pays $40,000 at P2. By P3 he considers his estimated RIT will be $30,000. He files a further revised estimate and pays nothing at P3.

Section MB 8 allows the Commissioner to refund provisional tax in these circumstances. Mr O requests the Commissioner to transfer the excess provisional tax at the earliest date available.

The taxpayer can transfer a total of $10,000, being the difference between the net provisional tax paid in the year ($40,000) and the revised estimated RIT ($30,000).

		P1	31/8	P2	P3
Amount paid		$20k	-$20k	$40k	$0
revised est. RIT		$10k		$10k	$10k
PT paid	=	$20k	$20k	$60	$60k
Refunds	=	$0	$20k	$20k	$30k
Est RIT	=	$10k	$10k	$20k	$30k
Tax overpaid		$10k		$20k	$0

The formula itself would calculate $10,000 as available for transfer at P1. However, the transfer of this amount is restricted because subsection (3) applies. If the $10,000 were transferred at P1, on 31 August Mr O would not have paid the estimated RIT that would be due on that date ($10,000). Therefore nothing can be transferred permanently at P1. (This is reflected in "refunds" at P2, which comprises only the $20,000 refunded on 31 August.) He could, however, temporarily transfer the $10,000 if it is transferred back by 31 August.

$10,000 is available for transfer at P2 (the formula calculates $20,000 overpaid at P2 but the cap in subsection (4) applies to restrict this to $10,000). Subsection (3) does not apply to restrict the transfer of the $10,000 at P2 because nothing is due on P3. The $40,000 payment at P2 covers the $10,000 that would be due at each of P1, P2 and P3 plus the $10,000 transferred.

Transfers after assessment

Section 173R applies once tax has been assessed, if the provisional tax paid exceeds the residual income tax for the year.

The formula in subsection (2) calculates the amount that is available for transfer on a particular date (date A) which can be any date the taxpayer chooses. The total excess that may be transferred under the formula is capped at the net provisional tax paid for the year less the residual income tax for the year.

Under section 173R(3), the Commissioner cannot transfer an amount at date A when that would result in the taxpayer incurring use-of-money interest on unpaid tax, or a late payment penalty, at a subsequent date (date B). This will apply to restrict a transfer when, for example, subsequent to date A there was a refund or transfer of provisional tax, or if provisional tax for the year was prepaid by date A. Examples 15 to 18 illustrate the application of section 173R.

Example 15 – equal provisional tax instalments: RIT = $0

Company C pays $20,000 provisional tax at each of P1, P2, P3 on the uplift or estimation basis. The company is assessed as having a loss for the year.

The total credit available for transfer is $60,000, being the difference between the provisional tax paid ($60,000) and the residual income tax ($0).

The company asks for this amount to be transferred at the earliest dates. The amount that may be transferred at the first, second and third provisional tax dates is calculated as follows:

		P1	P2	P3
Amount paid		$20k	$20k	$20k
RIT due		$0	$0	$0
PT paid	=	20k	$40k	$60k
Refunds	=	$0	$20k	$40k
RIT	=	$0	$0	$0
Tax overpaid		$20k	$20k	$20k

Company C may transfer $20,000 at each of P1, P2 and P3 (this is reflected in "refunds" at P2 and P3). Subsection (3) does not apply to restrict the amount transferred at any of those dates because transfer of those amounts would not result in late payment penalties or interest arising in relation to the provisional tax payments.

If, instead of transferring at the provisional tax payment dates above, the company wanted to transfer the excess to its first provisional tax date (7 July) for the following year, it would calculate the amount available at that date, which is $60,000.

Example 16 – equal provisional tax payments with RIT

Company D estimates its provisional tax and pays $120,000 at P1, P2 and P3. RIT is $300,000.

The total excess available for transfer is $60,000, being the difference between provisional tax paid ($360,000) and RIT ($300,000). Company D wants to transfer the excess at the earliest dates.

		P1	P2	P3
Amount paid		$120k	$120k	$120k
RIT/3		$100k	$100k	$100k
PT paid	=	$120k	$240k	$360k
Refunds	=	$0	$20k	$40k
RIT	=	$100k	$200k	$300k
Tax overpaid		$20k	$20k	$20k

The company has overpaid $20,000 at each instalment and can transfer at those dates.

Example 17 – no provisional tax payment at P3

Company E estimates its RIT at $300,000 and pays instalments due on P1 and P2 on this basis. By P3, it is clear that the company's RIT is more likely to be $150,000. It files this revised estimate at P3, and does not pay any further provisional tax. Its return is assessed and his RIT is $150,000.

Company E can transfer a total of $50,000 (being provisional tax paid of $200,000 less the RIT of $150,000). It wants to transfer this at the earliest date.

		P1	P2	P3
Amount paid		$100k	$100k	$0
RIT/3		$50k	$50k	$50k
PT paid	=	100k	$200k	$200k
Refunds	=	$0	$50k	$50k
RIT	=	$50k	$100k	$150k
Tax overpaid		$50k	$50k	$0

The company can transfer the $50,000 on P1. The formula would calculate $50,000 as overpaid at P2, but it has already transferred the maximum at P1, so the cap in subsection (4) would apply to prevent this. (If the company had transferred nothing at P1, the formula would calculate $100,000 available at P2—again the cap in subsection (4) would apply.)

Subsection (3) does not apply to restrict the transfer at P1 as the transfer would not result in late payment penalties or interest arising at a subsequent date.

Example 18 – no provisional tax payment at P3

Company G pays provisional tax on the uplift basis. It paid its liability of $20,000 on P1 and P2 but misses P3. The residual income tax is $15,000.

The total excess that may be transferred is $25,000, being provisional tax paid ($40,000) less RIT ($15,000). The company wishes to transfer the excess at the earliest date.

		P1	P2	P3
Amount paid		$20k	$20k	$0
RIT/3		$5k	$5k	$5k
PT paid	=	$20k	$40k	$40k
Refunds	=	$0	$15k	$25k
RIT	=	$5k	$10k	$15k
Tax overpaid		$15k	$15k	$0

The company can, and does, transfer $15k at P1 (see "refunds" at P2) and $10,000 on P2. (The formula itself calculates $15,000 available at P2 but the amount transferable is restricted to $10,000 by the cap in subsection (4).) Subsection (3) does not apply to restrict either transfer. (If $15,000 is transferred at P1, the RIT due subsequently is paid by the due date under Part VII. The same applies to the $10,000 transferred on P2.)

Example 19 – taxpayer misses P2 – application of subsection (3)

Mr P pays provisional tax on the uplift basis, but he is subject to use-of-money interest. He paid his liability of $20,000 on P1, missed the payment due on P2, and paid $20,000 on P3. His RIT is $15,000.

The total excess that may be transferred is $25,000, being tax paid of $40,000 less the RIT of $15,000. Mr P wants to transfer the maximum available at the earliest dates.

		P1	P2	P3
Amount paid		$20k	$0	$20k
RIT/3		$5k	$5k	$5k
PT paid	=	$20k	$20k	$40k
Refunds	=	$0	$10k	$10k
RIT	=	$5k	$10k	$15k
Tax overpaid		$15k	$0	$15k

P1 is considered first. The formula calculates $15,000 available at P1. However subsection (3) applies to limit this. If the $15,000 were transferred the taxpayer would be liable for late payment penalties and interest at P2. Therefore only $10,000 is transferable at P1 (though the additional $5,000 may be transferred out and back by P2).

$10,000 is transferred at P1 (reflected in "refunds" at P2 and P3), the remaining $15,000 is transferred at P3.

Example 20 – taxpayer misses P2 – application of subsection (3)

Company H pays its provisional tax liability of $20,000 on P1, but misses P2 and pays $20,000 on P3. RIT is $30,000. The total excess transferable is $10,000, being the difference between provisional tax paid ($40,000) and the RIT ($30,000). The formula below calculates when the excess may be transferred. Company H wants to transfer the excess at the earliest dates.

		P1	P2	P3
Amount paid		$20k	$0	$20k
RIT/3		$10k	$10k	$10k
PT paid	=	$20k	$20k	$40k
Refunds	=	$0	$0	$0
RIT	=	$10k	$20k	$30k
Tax overpaid		$10k	$0	$10k

The formula calculates $10,000 available for transfer at P1 but subsection (3) applies to restrict that amount to zero (reflected in "refunds" at P2) because that would result in late payment penalties, and perhaps use-of-money interest, at P2. However, the company can temporarily transfer the $10,000 at P1 provided it is back in by P2.

The $10,000 is available for permanent transfer only at P3.

Example 21 – taxpayer increasing estimate at P2

Company J estimates its provisional tax at $300,000. It pays $100,000 on P1 then reestimates to $450,000 at P2 and pays $200,000 at P2 and $150,000 at P3. The RIT is $300,000. The excess that may be transferred is $150,000 ($450,000 - $300,000). The company wants to transfer at the earliest date in each of the variations below.

		P1	P2	P3
Amount paid		$100k	$200k	$150k
RIT/3		$100k	$100k	$100k
PT paid	=	$100k	$300k	$450k
Refunds	=	$0	$0	$100k
RIT	=	$100k	$200k	$300k
Tax overpaid		$0	$100k	$50k

The company can transfer $100,000 at P2 and, if it does so, $50,000 at P3. If it does not transfer anything before P3, $150,000 would be transferable on P3.

Example 22 – taxpayer decreasing estimate at P2

Company K estimates its provisional tax at $300,000. It pays P1 of $100,000 then reestimates to $200,000 at P2 and pays $33,333 at P2 and $66,667 at P3. The residual income tax is $150,000.

The total excess transferable is $50,000 (provisional tax paid of $200,000 less residual income tax of $150,000). The company wants to transfer the excess at the earliest dates.

	P1	P2	P3
Amount paid	$100k	$33,333	$66,667
RIT/3	$50k	$50k	$50k
PT paid =	$100k	$133,333	$200k
Refunds =	$0	$ 33,333	$33,333
RIT =	$50k	$100,000	$150k
Tax overpaid	$50k	$0	$16,667

The company can transfer only $33,333 on P1. (The formula calculates $50,000 available at P1 but subsection (3) applies to reduce the amount transferable at P1 to $33,333 because transfer of the $50,000 will result in late payment penalties or interest at P2. However, the company can temporarily transfer the remaining $16,667 until P2.)

The balance of the total excess, $16,667, can be permanently transferred on P3.

Example 23 – taxpayer pays terminal tax then reassessment

Company L paid $600,000 provisional tax and $100,000 terminal tax for the 2002-2003 year. The original RIT was $700,000. It is reassessed for that year—RIT after reassessment is $450,000.

The total excess provisional tax transferable is $150,000 ($600,000 provisional tax paid less $450,000 RIT). Excess terminal tax is $100,000.

		P1	P2	P3	TT
Amount paid		$200k	$200k	$200k	$100k
RIT/3		$150k	$150k	$150k	
PT paid	=	$200k	$400k	$600k	
Refunds	=	$0	$50k	$100k	
RIT	=	$150k	$300k	$450k	
Tax overpaid		$50k	$50k	$50k	$100k

$50,000 is available at each of P1, P2 and P3 (plus $100,000 on the terminal tax date).

Example 24 – taxpayer receives refund of excess provisional tax after P2

Company M estimates its provisional tax at $300,000. It pays P1 of $100,000 then reestimates at P2 to $40,000. It pays nothing at P2 and P3 and seeks a refund after P2 of $60,000. RIT is $30,000.

The total excess available for transfer is $10,000 (the difference between net provisional tax paid of $40,000 ($100,000 - $60,000) and RIT of $30,000).

		P1	P2	P3
Amount paid		$100k	$0 $-60,000	$0
RIT/3		$10k	$10k	$10k
PT paid	=	$100k	$100k	$100k
Refunds	=	$0	$10k	$70k
RIT	=	$10k	$20k	$30k
Tax overpaid		$90k	$70k	$0

The company can transfer the $10,000 on P1. (The formula calculates $90,000 available for transfer at P1 but the cap in subsection (4) applies to restrict this to $10,000.)

Example 25 – taxpayer receives refund of excess provisional tax before P2

Company N estimates its provisional tax at $300,000. It pays P1 of $100,000 then re-estimates in September to $40,000 and seeks a refund of $60,000 before P2. It pays nothing at P2 and P3. The RIT is $30,000.

The total excess available for transfer is $10,000 (net provisional tax paid of $40,000 less RIT of $30,000).

		P1		P2	P3
Amount paid		$100k	$-60,000	$0	$0
RIT/3		$10k		$10k	$10k
PT paid	=	$100k		$100k	$100k
Refunds	=	$0		$70k	$70k
RIT	=	$10k		$20k	$30k
Tax overpaid		$90k		$10k	$0

The company can transfer $10,000 on or after P1. (The formula calculates $90,000 available for transfer at P1 but the cap in subsection (4) applies to restrict this to $10,000.)

Example 26 – taxpayer receives refund of excess provisional tax after P2 but offsetting excess at P2

Company O estimates its provisional tax at $300,000. It pays $100,000 at P1 and P2 and then re-estimates in December to $140,000. It seeks a refund after P2 of $60,000 and pays nothing at P3. RIT is $30,000.

The total excess available for transfer is $110,000 (being the difference between net provisional tax paid of $140,000 and RIT of $30,000).

		P1	P2	20/12	P3
Amount paid		$100k	$100k	$-60,000	$0
RIT/3		$10k	$10k		$10k
PT paid	=	$100k	$200k	$200k	$200k
Refunds	=	$0	$90k	$170k	$170k
RIT	=	$10k	$20k	$20k	$30k
Tax overpaid		$90k	$90k	$10k	$0

The company can transfer $90,000 on P1 and $20,000 on P2. (The formula calculates $90,000 available for transfer at P2 but the cap in subsection (4) applies to restrict this to $20,000. The cap also applies in relation to the $10,000 the formula calculates as available at 20/12.)

Example 27 – new provisional taxpayer

Newly formed Company P starts business on 1 September 2002. It is a new provisional taxpayer and is required to pay two equal instalments of provisional tax (section MB 4(2)(a)). It pays $30,000 on November 7 (P1) and $30,000 on 7 March (P2). It also makes a voluntary payment on 31 March of $10,000. RIT is $50,000.

The total excess available for transfer is $20,000 (being the difference between provisional tax paid of $70,000 and RIT of $50,000).

Under section 120K(3) of the Tax Administration Act, RIT is spread equally over the two instalment dates.

		P1	P2	31/3
Amount paid		$30k	$30k	$10k
RIT/2		$25k	$25k	$0
PT paid	=	$30k	$60k	$70k
Refunds	=	$0	$5k	$10k
RIT	=	$25k	$50k	$50k
Tax overpaid		$5k	$5k	$10k

The company can, and does, transfer $5,000 at P1 and P2 and $10,000 at 31 March.

Example 28 – taxpayer with transitional year

Company Q is changing balance dates from 31 March to 31 August—it will have a 17-month year. It is required to make five instalments of provisional tax—due on 7 July, 7 November, 7 March, 7 July and 7 August. It pays on the estimation basis (MB 5A(6). It estimates RIT for the transitional year at $50,000. The amount payable on the first four instalment dates is

(4 x 1) x $50,000/17 = $200,000/17 = $11,760. The amount payable at P5 is $50,000 - $47,040 = $2,960. RIT is $40,000. The RIT is spread as below (120K(4A)). (It is not evenly spread across provisional tax instalments, which is why the spread needs to match that under 120K.)

The total excess that is transferable is $10,000, being the difference between provisional tax paid of $50,000 and RIT of $40,000.

The excess may be transferred at the following dates. (The example assumes that the excess is transferred as soon as it is available.)

	P1	P2	P3	P4	P5
Amount paid	$11.76k	$11.76k	$11.76k	$11.76k	$2.96k
RIT	$9.41k	$9.41k	$9.41k	$9.41k	$2.36k
PT paid =	$11.76k	$23.52k	$35.28k	$47.04k	$50k
Refunds =	$0	$2.35k	$4.70k	$7.05k	$9.40k
RIT =	$9.41k	$18.82k	$28.23k	$37.64k	$40k
Tax overpaid	2.35k	$2.35k	$2.35k	$2.35k	$0.60k

Transfers of credit use-of-money interest

Section 173S clarifies that credit use-of-money interest can be transferred. The earliest date from which it can be transferred is the date on which the use-of-money interest would be paid to the taxpayer in the absence of a transfer request.

Application of excess tax if taxpayer has an unsatisfied tax liability

If a taxpayer has an unpaid tax liability, Inland Revenue has the right to offset that liability against excess tax belonging to the same taxpayer. Provisions which allow these offsets (offset rules) have priority over Part XB because, to be transferable, excess tax must be refundable.

However, offset rules in sections MB 8(1) & (2), MD 1(3), NF 7(5) and NG 16(4) of the Income Tax Act 1994 and section 46(6) of the Goods and Service Tax Act 1985 do not specify a date for the transfer of the tax to offset the liability.

Section 173T addresses this issue and provides that the taxpayer or the taxpayer's agent may apply to have the offset applied from any date that would satisfy section 173L.

Example 29 – offset of unsatisfied tax liability

Company R owes income tax of $200,000 relating to the 1999 year. Its return of income for 2003 results in a refund of $90,000. The refund is offset against the amount outstanding under section MD 1(3) of the Income tax Act. As the company has a balance date of 31 March, the transfer is effective from 1 April 2003.

The company's agent requests that the excess tax be transferred at the earliest possible dates. Provisional tax was paid by the company for 2003 on the basis of an estimated RIT of $240,000 ($80,000 paid at each instalment date). RIT for 2003 is $150,000.

The transfer will be reversed under section 173T and new transfers made on the following dates.

	P1 (7/7/02)	P2 (7/11/02)	P3 (7/3/03)
Amount paid	$80k	$80k	$80k
RIT/3	$50k	$50k	$50k
PT paid =	$80k	$160k	$240k
Refunds=	$0	$30k	$60k
RIT =	$50k	$100k	$150k
Tax overpaid	$30k	$30k	$30k

Excess tax of $30,000 is available for transfer effective from each of the provisional tax instalment dates.

The changes to the offset rules in sections MB 8(1) & (2), MD 1(3), NF 7(5), and NG 16(4) apply to offsets in the 2002-03 and subsequent income years. The reference to the 2002-03 income year is a reference to the year in which an assessment is issued, not to the year in which excess tax arose.

For example, assume excess tax arose for the 2001-02 year and section MD 1(3) is applied to offset that excess against tax outstanding for the 2000-01 year. Inland Revenue applies section MD 1(3) at the time the 2001-02 return is processed in November 2002. The taxpayer or the taxpayer's agent could elect a transfer date, as long as the date was consistent with section 173L, in these circumstances because Inland Revenue applies the excess tax in the 2002-03 income year.

Transfers to child support liabilities

Section 173U clarifies that excess tax can be transferred to satisfy financial support liabilities under the Child Support Act 1991.

Excess tax retained by Commissioner because ICA has insufficient credits

A new section MD 2(5A) has been inserted into the Income Tax Act as an adjunct to the amendments relating to transfers of excess tax at the request of a taxpayer. Section MD 2(5) applies when income tax paid in excess is not refunded to a corporate taxpayer because its imputation credit account has insufficient credits. Instead, it is retained and applied in payment of tax that is payable by the company. It is not clear that the excess can be credited as at a date on which there is no liability to pay provisional tax but from which use-of-money interest applies in relation to underpaid residual income tax. The amendment clarifies that the excess can be credited as at that date, so as to prevent debit use-of-money interest owing.

TAX SIMPLIFICATION MEASURES

Various sections of the Income Tax Act 1994 and Tax Administration Act 1994

Introduction

The following changes have been made to further simplify the tax system and reduce compliance costs for taxpayers.

- Removing the need to file an income tax return or request an income statement, on behalf of a deceased taxpayer, in respect of income earned in the year in which the taxpayer died. This change applies if the taxpayer would not have been required to file a return or request an income statement for that income year if he or she were alive.
- Removing the need for taxpayers with small amounts of income from which tax has not been withheld to file a return in respect of these amounts if the total value of this income is $200 or less, before any allowable deductions.
- Removing the need for companies to file “interim” imputation returns. Companies with credit balances in their imputation credit accounts at the end of an imputation year, and who have extensions of time for filing their returns, can now have these amounts refunded once they have filed the imputation return for that year.
- Payment of the family tax credit to the principal caregiver instead of both spouses in a two-parent family, from the 2003-04 income year, and removing the need to make a number of adjustments when calculating income, for family assistance purposes.
- Allowing interest payers, such as banks, greater flexibility in communicating resident withholding tax information to interest earners, including the provision of resident withholding tax deduction certificates in electronic form. The threshold for communicating resident withholding tax information has also been increased from $20 to $50 of gross withholding income.
- Increasing the threshold under which individual provisional taxpayers who do not estimate their provisional tax are not subject to the use-of-money interest rules, from $30,000 to $35,000, of residual income tax.
- Allowing taxpayers who reasonably estimate that they have less than $5,000 worth of trading stock at the end of an income year not to value it or include any change in the value in their calculation of business income. This option applies to taxpayers who have turnover of less than $1.3 million in a year.

Background

The tax system imposes compliance costs on taxpayers. Compliance costs range from the time and effort spent on complying with tax obligations, such as filing tax returns, to psychological costs, such as the stress that comes from not being certain that all tax obligations have been met, or even what those obligations are.

The government released a discussion document, *More time for business*, in May 2001 outlining a number of proposals to simplify the compliance burden of taxpayers, especially in relation to the uncertainty and risk they face in meeting their tax obligations. Although the discussion document was principally aimed at simplifying requirements and reducing tax compliance costs for small businesses, a number of initiatives to extend the non-filing provisions, simplify the payment and calculation of family assistance and allow greater flexibility in the communication of resident withholding tax information were also proposed. These, along with some of the smaller tax simplification measures for small businesses in *More time for business* have been implemented as part of the government’s continuing tax simplification programme.

Extending non-filing of income tax returns

The change to remove filing requirements in respect of deceased taxpayers recognises the stress placed on their families from having to comply with tax obligations at a difficult time. It also recognises that the compliance costs typically incurred in determining whether a deceased taxpayer had a tax file number, obtaining the relevant source documents, filing a return or requesting an income statement, and going through the time-consuming process of waiting for the part-year assessment to be confirmed often outweigh the tax consequences of filing. Equally, the $200 threshold for filing a return in respect of income from which tax has not been withheld recognises that taxpayers with small amounts of such income often incur compliance costs disproportionate to the amount of the income in order to return it, as well as the risk of penalties and interest if they do not.

Previously, a company that was allowed an extension of time, up to the end of the following income year to file an imputation return was also required to file an "interim" imputation return before any income tax was refunded. The interim return related to the company's imputation credit account balance in the extension of time period, to ensure the imputation credit account did not move into debit in this period. The change recognises that companies incur unnecessary compliance costs in filing interim imputation returns, as these returns are unnecessary to monitor compliance, given the incentives for taxpayers to maintain a credit balance in their imputation credit accounts, such as the imputation penalty tax on debit balances.

Simplifying family assistance

The change to the payment of the family tax credit will better target family assistance to the person with the primary responsibility for the day-to-day care of a child or children. It will also simplify the end-of-year family assistance square-up, as it will now be limited to only one spouse. The removal of certain adjustments when calculating income for family assistance purposes will reduce compliance costs associated with making these adjustments and, more importantly, getting them right. The adjustments were required to move the assessment of family assistance from a taxable income basis towards more a "welfare" definition of income—a "cash in hand" concept.

Greater flexibility in communicating resident withholding tax information

Banks and other interest payers will be able to use a variety of new media to communicate resident withholding tax information more efficiently to interest earners. For example, interest payers will be able to provide deduction certificates—statements of the withholding income earned by an interest earner in an income year and the resident withholding tax deducted from that income—as part of bank and financial statements or electronically using email or their websites. The change recognises that interest payers can provide resident withholding tax information just as effectively using existing customer interfaces instead of as a separate document at the end of each income year, and that technological changes in the financial services industry have made customer contact more readily achievable by electronic means.

Small business and other tax simplification measures

Raising to $35,000 the residual income tax threshold under which certain provisional taxpayers—individuals who calculate their provisional tax using a previous year's residual income tax liability plus an uplift of 5% are removed from the application of the use-of-money interest rules should provider greater certainty for a larger number of taxpayers. The $5,000 threshold for valuing trading stock will reduce compliance costs associated with valuing and making adjustments for small amounts of trading stock at the end of the year. It will also reduce the risk of penalties and interest applying for not valuing trading stock of less than $5,000 accurately.

Key features

Extending non-filing

Section 33A(2)(l) of the Tax Administration Act 1994 has been repealed and section 43(4) amended to extend the non-filing prov ision to deceased taxpayers. The former excluded them from the non-filing provisions and the latter allows executors and administrators of a deceased taxpayer's estate to apply the non-filing provisions. New section 43(5) allows a return to be filed on behalf of a deceased taxpayer, now subject to the non-filing provisions, if so desired.

New section 33A(1)(iv) of the Tax Administration Act 1994 provides that taxpayers who earn a total of $200 or less of gross income in a income year from which tax has not been withheld are not required to return this income.

New section MD 2(1A) of the Income Tax Act 1994 allows companies with extensions of time for filing their income tax and imputation returns to be refunded income tax to the value of the credit balances of their imputation credit accounts on the last day of an imputation year, when the imputation return for that year has been furnished.

Simplifying family assistance

Section KD 3(4) of the Income Tax Act 1994 has been amended to allow the family tax credit to be paid fully to the principal caregiver, as defined in section OB 1, in a two-parent family.

Section KD 1(1) of the Income Tax Act 1994 has been amended to remove the need to make the following adjustments to taxable income for family assistance purposes:

- Recipients will no longer need to add back exempt income—such as interest from post office development bonds, farm vendor mortgage bonds, New Zealand savings certificates and bursaries and scholarships, deposits to income equalisation and adverse event income equalisation accounts, income that is spread to other income years, depreciation claimed on buildings, and developmental expenditure relating to farming, forestry, fishing and agriculture.

- Recipients will not have to subtract refunds from income equalisation and adverse event income equalisation accounts, income spread from another income year, and depreciation recovered on the sale of buildings

Examples of how this change will apply are provided in "Detailed analysis" on the next page.

Greater flexibility in communicating resident withholding tax information

In relation to changes in the way resident withholding tax information can be communicated, section 25 of the Tax Administration Act 1994 has been amended to:

- remove the Commissioner of Inland Revenue's prescription as to the form of resident withholding tax deduction certificates (subsection (1));
- require resident withholding tax deduction certificates to provide an interest earner with the following information (subsection (6)):
  - total amount of withholding income earned,
  - total amount of resident withholding tax deducted;
  - the resident withholding tax rate applied;
  - the year to which the income and tax deductions relate; and
  - whether the withholding income is interest or specified dividends;
- increase the resident withholding tax notification threshold from $20 to $50 of gross withholding income under which a resident withholding tax deduction certificate does not need to be provided to an interest earner (subsection (7)); and
- allow interest payers to furnish resident withholding tax deduction certificates electronically, if an interest earner agrees to this (subsection (10)).

A number of consequential amendments have been made to section 51 to ensure that the resident withholding tax information that Inland Revenue receives from interest payers remains unchanged.

Small business and other tax simplification measures

Section 120K(4)(b) of the Tax Administration Act 1994 has been amended to increase to $35,000 the residual income tax threshold under which the use-of-money interest rules do not apply for provisional taxpayers who are individuals and who do not estimate their provisional tax. The threshold for becoming a "new provisional taxpayer", as defined in section OB 1 of the Income Tax Act 1994, has been increased accordingly.

New section EE 2A of the Income Tax Act 1994 allows taxpayers with turnover of less than $1.3 million in a year to use the value of their opening stock as the value of closing stock if they reasonably estimate their closing stock to be less than $5,000.

Application dates

Extending non-filing

The changes removing the need to file income tax returns and request income statements on behalf of deceased taxpayers and for small amounts of income from which tax has not been withheld apply from the 2002-03 income year.

The change removing the need for companies to file "interim" imputation returns in order to receive refunds of income tax applies to refunds paid on or after 1 April 2001.

Simplifying family assistance

The changes to the family assistance rules—the payment of the family tax credit to the principal caregiver and the removal of a number of adjustments from the family assistance income calculation process—apply from the 2003-04 income year.

Greater flexibility in communicating resident withholding tax information

The changes making it easier for banks and other interest payers to communicate resident withholding tax information to their customers apply to deduction certificates provided on or after 1 April 2002. The increase in the resident withholding tax notification threshold from $20 to $50 gross income applies from the 2002-03 income year.

Small business and other tax simplification measures

The change increasing to $35,000 the residual income tax threshold under which individual provisional taxpayers who do not estimate their provisional tax are removed from the use-of-money interest rules applies from the 2003-04 income year

The change not requiring small businesses to value and make adjustments for small amounts of trading stock at the end of the year applies from the 2002-03 income year.

Detailed analysis – calculation of family assistance income

The examples here highlight the family assistance adjustments to taxable income (income after deductions) that are no longer required when calculating family assistance income. However, some of the adjustments may still need to be made on a temporary basis—for example, when income is recognised under the new family assistance rules but the expenditure incurred in earning that income was disallowed as a deduction under the old family assistance rules. Here, under the new rules, this income should not be treated as family assistance income.

Example 1 - exempt income

Mr A receives a bursary of $500 in the 2002-03 year (1 April 2002 to 31 March 2003). This income is exempt for income tax purposes. However, when applying for family assistance in the 2002-03 year under the old family assistance rules, he was required to add back the bursary to his taxable income.

He also receives a bursary of $500 in the 2003-04 year (1 April 2003 to 31 March 2004) and, again, this income is exempt for income tax purposes. Under the new family assistance rules he will not have to add back the bursary to taxable income.

Example 2 - income equalisation account deposits

Mrs B derived farming income of $5,000 in the 2002-03 year, which she deposited in an income equalisation account. For income tax purposes, an income equalisation account deposit is allowed as a deduction (meaning that it reduces taxable income). When applying for family assistance in the 2002-03 year under the old family assistance rules, however, Mrs B was required to add back the income equalisation account deposit to her taxable income.

She derives farming income of $6,500 in the 2003-04 year and, as in the previous year, deposits this amount in an income equalisation account. Under the new family assistance rules, she will not have to add back the income equalisation deposit to taxable income when applying for family assistance in the 2003-04 year.

Example 3 - income equalisation account refunds

In the 2002-03 year, Mr C received a refund of $10,000 upon expiry of an income equalisation account in that year. This amount was treated as taxable income in the 2002-03 year. For family assistance purposes, however, under the old family assistance rules he was not required to account for the refund as income—that is, the $10,000 was taken off taxable income.

In the 2003-04 year, Mr C receives a refund of $12,000 upon expiry of an income equalisation account in that year. The income equalisation scheme deposits to which the refund relates were made in the 1998-99 year. Under the new family assistance rules, income equalisation account refunds are income for family assistance purposes (meaning that no adjustment is required to taxable income). However, this is only to the extent that the refund relates to deposits that were made under the new rules. In this case, Mr C made the income equalisation account deposits under the old rules—that is, the deposits were added back to taxable income, for family assistance purposes, in the 1998-99 year. Consequently, he will need to reduce his taxable income in the 2003-04 year by the amount of the refund, $12,000. Not doing so would result in double counting of this income—in both the 1998-99 and 2003-04 years.

Example 4 - income spread to another year

Mrs D received $20,000 in the 2002-03 year from the sale of some land to the Crown. For income tax purposes, she spread the sales receipt equally over that income year and three subsequent years (2003-04 to 2005-06) - meaning taxable income of $5,000 in each "spread" year. For family assistance purposes, however, the full sale amount was recognised as income in the 2002-03 year under the old rules. Consequently, the $15,000 in income spread to other years for income tax purposes was added back to taxable income of $5,000 in the 2002-03 year for family assistance purposes.

In the 2003-04 year, Mrs D receives a further $16,000 from the sale of land. As in the previous year, she spreads the receipt, equally over the 2003-04 to 2006-07 period for tax purposes. Under the new family assistance rules, she will no longer have to account for the full sale amount in the year of receipt. Consequently, no adjustment is necessary to taxable income in the 2003-04 year for family assistance purposes.

Example 5 - income spread from another year

The $20,000 Mrs D received in the 2002-03 year from the sale of land to the Crown was spread to a number of future years including the 2003-04 year for tax purposes.

When applying for family assistance in the 2003-04 year, Mrs D will need to make an adjustment for the income spread to the 2003-04 year from the 2002-03 year. This means that for family assistance purposes, the "spread" income (of $5,000) will need to be taken off taxable income in the year to which it was spread. Although the new family assistance rules recognise "spread" income as income in the year to which it was spread, because the $5,000 has already been accounted for (along with the rest of the $20,000) in the 2002-03 year, for family assistance purposes in that year it should not be included as income in the 2003-04 and subsequent years as well. Doing so would result in double counting of this income for family assistance purposes, in the year it was spread from (2002-03) as well as the years it was spread to (2003-04 and beyond).

Example 6 - depreciation on buildings

Mr E owns a rental property and claims a yearly depreciation deduction of $2,500. The deduction reduces taxable income. Under the old family assistance rules, when claiming family assistance in the 2002-03 year he was required to add back depreciation to taxable income.

Under the new rules for calculating family assistance, however, he will not be required to add back depreciation to taxable business income in the 2003-04 year.

Example 7 - depreciation recovered on the sale of buildings

Mrs F sold her rental property in the 2003-04 year for $120,000. At the time of sale it had a book value of $100,000. For tax purposes, she is required to treat the difference, $20,000 (the depreciation that has been recovered), as income in the year of sale.

When applying for family assistance in the 2003-04 year, Mrs F will need to make an adjustment to the depreciation recovered on sale, for the portion of depreciation attributable to the 2002-03 and previous years. This is because in those years the old family assistance rules applied—meaning that depreciation had to be added back to taxable income, for family assistance purposes. Consequently, the depreciation recovered on sale will need to be adjusted for family assistance purposes, to exclude the portion of depreciation recovered that relates to the 2002-03 and prior years. Taxable income will need to be reduced accordingly, for family assistance purposes.

Example 8 - developmental expenditure

Mrs G incurred forestry development expenditure of $3,500 in the 2002-03 year, which was allowed as a deduction for tax purposes. Under the old family assistance rules, however, this amount was required to be added back to taxable income when calculating family assistance in the 2002-03 year.

Mrs G incurs $5,000 in development expenditure in the 2003-04 year. Under the new family assistance rules, she will not have to add back this amount to taxable income when applying for family assistance in the 2003-04 year.

OTHER POLICY MEASURES

PROCEEDS OF THE REPURCHASE OF DAIRY BOARD SHARES

Sections CB 1(1)(d) and CB 10(5) of the Income Tax Act 1994

Introduction

The legislation has been amended to ensure that there is no tax liability for diary companies that disposed of New Zealand Dairy Board shares as part of the recent Dairy Board restructuring. Sections CB 1(1)(d) and CB 10(5) exempt from income tax certain proceeds from a repurchase of Dairy Board shares. At the time of enacting the Dairy Industry Restructuring Act 2001, it was not anticipated that these proceeds would be taxable.

Background

The Dairy Industry Restructuring Act 2001 provides for the buy out of an exiting company's shares in the Dairy Board. Exiting companies are, by definition, Tatua, Westland and Premier Co-operative Dairy Companies. The original policy behind that Act and wider statutory producer board expectations were that any proceeds received from the disposal of Dairy Board shares would not be taxable.

Under previous tax law the repurchase proceeds would have been taxable as a dividend, and likewise the interest on repurchase proceeds would have been taxable. However, if the shares had been sold to a third party, no tax liability would have arisen.

The amendments were added to the bill at the select committee stage of its passage through Parliament.

Key features

The repurchase proceeds paid to Tatua, Westland and Premier Co-operative Dairy Companies by the Dairy Board and any interest on these proceeds are specifically exempt from income tax.

Section CB 10(5) provides that repurchase proceeds received by Tatua, Westland and Premier are exempt dividends. Section CB 1(1)(d) ensures that any interest payable on the repurchase proceeds under schedule 4, clause 12 of the Dairy Industry Restructuring Act is exempt from tax.

Application date

Section CB 10(5) applies from 1 January 2002, and section CB 1(1)(d) from 1 June 2001.

HOLIDAY PAY

New section CD 3A, section DF 5, new sections DF 10 and DF 11, section EF 1 and new section EF 1A of the Income Tax Act 1994

Introduction

Uncertainty about the tax treatment of wage-related provisions when employees are transferred from one employer to another has been removed.

When a business is sold, the vendor will generally be able to obtain a deduction for any wage-related provisions transferred, such as holiday pay, at the time the time of sale. If the sale is between associated persons, however, the vendor will not qualify for a deduction, but the purchaser will be able to claim deductions for amounts that would have been deductible had the business not been sold. Deductions to the purchaser will be allowed when the amounts are paid.

If employees are transferred between employers who are associated persons, but the business is not sold, the rules apply as if the business had been sold to an associated person.

Background

Under general principles, wage-related provisions are usually on revenue account and should be deductible. The Income Tax Act 1994 defers the deduction until such time as amounts are actually paid out to the employees.

Following the Privy Council decision in CIR v NZ Forest Research Institute Ltd [2000] 3 NZLR 1, it is clear that when a business and its employees are transferred, the purchaser does not obtain a deduction when the wage-related provisions are eventually paid out. In many cases the vendor is also unable to obtain a deduction.

This anomaly has been corrected, for arm's-length sales, by allowing the vendor a deduction for the wage-related provisions, as it is the vendor who bears the economic cost of the provisions transferred.

Key features

New section DF 10 of the Income Tax Act 1994 (Deduction allowed for actual and contingent monetary remuneration on sale of business) is the primary provision for the tax treatment of the wage-related provisions.

Arm's-length transactions

Under section DF 10, the vendor may claim a deduction for the value of any provision for contingent monetary remuneration transferred to a new owner. Provisions for actual monetary remuneration transferred are deductible under normal rules because these amounts have been incurred (see the Privy Council case CIR (Hong Kong) v Lo & Lo [1984] 1 WLR 986; [1989] BTC 281).

Section EF 1 (Accrual expenditure), which times the deduction, has been amended to clarify that a deduction may be claimed by the vendor for actual and contingent monetary remuneration when the business is sold, as long as the vendor and purchaser agree in writing to the amount transferred, and this amount is reflected in the consideration paid. The date the business is sold is deemed to be the settlement date (see section DF 10(6)).

If the provision for actual and contingent monetary remuneration is less than the amount actually paid by the purchaser, the purchaser can claim a deduction for the difference.

If the provision for actual and contingent monetary remuneration is more than the amount actually paid by the purchaser, the excess is gross income of the purchaser at the time generally accepted accounting practice recognises the actual or contingent liability as being reduced. This is the effect of new section CD 3A (Monetary remuneration may be gross income of purchaser of the business).

Transactions between associated persons

Under section DF 10(4), the vendor cannot claim a deduction but the purchaser may deduct the amount of actual and contingent monetary remuneration transferred if the amount would have been deductible to the vendor had the business not been sold. Section DF 10(4)(c) ensures that a deduction is not inadvertently allowed to the vendor by section EF 1 (Accrual expenditure).

Section DF 11 deals with the situation where employees are transferred from one associated person to another (the new employer), other than on sale of a business. The new employer may claim deductions for actual and contingent monetary remuneration transferred if the amount would have been deductible to the original employer had the employees not been transferred.

Minor changes

Consequential changes have been made to section DF 5 (Retiring allowances payable to employees). The first change removes the timing element. Section DF 5 provides a deduction for a bonus, gratuity, or retiring allowance on the occasion of the retirement of any employee. Under the new rules, the timing of such deductions will be governed by section EF 1.

The other change is that no deduction is allowed to an employer under section DF 5 to the extent that the liability was assumed as part of the purchase of a business and the transfer of employees, and a deduction was allowed to the vendor. This prevents a double deduction by both the vendor and purchaser of the business.

Application date

The amendments generally apply from the date of enactment, although a number of amendments apply retrospectively to deductions claimed in returns for the 1997-98 or subsequent income years.

The amendments that apply retrospectively are:

- sections DF 10(2) and DF 10(3) and EF 1(6A), relating to deductions to vendors;
- section DF 10(4), relating to deductions to purchasers; and
- section DF 11, relating to deductions when employees are transferred otherwise than on sale of a business.

UNIT TRUSTS: EXCESS IMPUTATION CREDITS

Section CF 7A of the Income Tax Act 1994

Introduction

A new section CF 7A of the Income Tax Act 1994 deals with the tax treatment of unit trusts and category A group investment funds (both referred to here as "fund"). The new section ensures that when fund managers redeem units with the fund in the ordinary course of their business, they will not obtain excess imputation credits when the dividend received merely reflects their purchase cost of the units.

This is a revenue protection measure announced by the government on 6 November 2001. It is designed to prevent fund managers using section CF 2(15) to achieve an unintended windfall gain.

Background

Investors in funds often dispose of their units by selling them back to the fund manager at market value. The manager then redeems them at the same time with the fund. This is usually a straightforward operation in which the manager does not make a cash gain or loss.

The fund manager is considered to receive taxable dividend income to the extent that the amount received on redemption exceeds the original amount the redeemed units were issued for. The fund generally attaches imputation credits to the dividend.

The need for the amendment arose because some fund managers considered that section CF 2(15) of the Income Tax Act 1994 applied to such transactions. That section reduces the gross income of a taxpayer by the amount of any dividend (excluding imputation credits).

If the fund manager had made no cash gain or loss, applying section CF 2(15) following redemption with the fund gave rise to excess imputation credits for the fund manager. Managers were using these excess imputation credits to offset the tax on their other income.

Excess imputation credits in this situation were inconsistent with the economic reality of the transaction and provided an unintended windfall gain to the fund manager.

Key features

New section CF 7A provides for the tax treatment of the proceeds from the redemption of units in a fund by the fund manager (or anyone nominated by the manager). When a fund manager redeems units in the ordinary course of his or her business, the dividend derived does not include any imputation credits attached to the dividend if it constitutes a recovery of the purchase price.

For the purposes of certainty, where this provision applies, section FC 3 of the Income Tax Act does not apply.

As the following example illustrates, the amendment ensures that fund managers do not gain excess imputation credits following the simple redemption of units.

Example

The example illustrates how excess imputation credits arose when section CF 2(15) was applied to the redemption of units, as described earlier. It also shows that the effect of the amendment is to ensure that the dividend does not include the imputation credits.

1. X purchases 100 units from the trustees of a unit trust at $1 a unit—that is, the original cost or available subscribed capital.
2. X later redeems the 100 units with the fund manager for their market value of $1.20 per unit. (Strictly speaking, X sells to the fund manager.)
3. The fund manager then redeems the units with the trustees of the fund at $1.20 per unit. Full imputation credits of $10 are attached to the dividend portion of the redemption.
4. The consideration received by the fund manager is $120. Applying section CF 2(15), the gross "sale" proceeds of the fund manager is the consideration reduced by the amount of any dividends (exclusive of any imputation credits)—$120 received on redemption minus the $20 dividend = $100 gross "sale" proceeds.

5. Adding back the dividend received (inclusive of imputation credits), the gross income of the fund manager is $130. Deducting the $120 cost of the units gives rise to taxation of $3.30 on $10 net income and excess imputation credits of $6.70. These can be converted to a $20 tax loss for the fund manager, even though the economic effect of the transaction is that the fund manager has neither a cash gain nor a loss.

Application date

The amendment applies retrospectively from 1 April 1996, the date the current unit trust manager rules were put in place. The amendment does not apply, however, to fund managers who claimed imputation credits in a return of income or by using the disputes procedures in Part IVA of the Tax Administration Act 1994 before 6 November 2001 (the date of announcement of the proposed amendment). This savings provision applies only in respect of transactions before 6 November 2001.

Example

	Position pre-amendment	Position post-amendment
Consideration received for cancellation of units	$120.00	$120.00
Less dividend portion exclusive of credits	20.00	20.00
Therefore gross “sale” proceeds	100.00	100.00
Plus dividend (including imputation credits)	30.00	20.00
Gross income of fund manager	130.00	120.00
Less manager’s cost of units	120.00	120.00
Net income	10.00	0.00
Taxation thereon	3.30	0.00
Less imputation credits	10.00	0.00
Surplus imputation credits	6.70	0.00
Losses created from surplus imputation credits	20.00	0.00

CONTROLLED PETROLEUM MINING ENTITIES

Sections CJ 6, CJ 7(1)(a), CJ 7(2) and DM 6 of the of the Income Tax Act 1994

Introduction

Changes to the petroleum mining taxation rules ensure that taxpayers are no longer able to obtain unintended deductions on disposal of ownership interests in controlled petroleum mining entities.

Background

The petroleum mining taxation rules are intended to tax all gains and losses arising from petroleum mining activity, including disposals of petroleum mining assets. An investor may own petroleum mining assets directly, or indirectly through the ownership of a subsidiary company known as a controlled petroleum mining entity.

The rules in sections CJ 6, CJ 7(1)(a), CJ 7(2) and DM 6 were intended to tax the net proceeds from the sale of ownership interests in a controlled petroleum mining entity. These rules were intended to prevent investors using a controlled petroleum mining entity to structure around the tax payable on disposal of petroleum mining assets.

These rules did not achieve their policy objectives. Instead they were used to obtain unintended deductions.

Key features

The amendment places the disposal of a controlled petroleum mining entity on capital account. This outcome is achieved through amendments to section CJ 6 and DM 6:

- Proceeds derived from the disposal of a controlled petroleum mining entity are not gross income. (CJ 6)
- A taxpayer is not allowed a deduction for either the cost of the ownership interests in a controlled petroleum mining entity or any disposal costs. This overrides the deduction that could otherwise be allowed under section BD 2(1)(b)(i) or (ii).). (DM 6)

Consequential amendments

As a result of the amendments to section CJ 6 and DM 6, sections CJ 7(1)(a) and CJ 7(2) are no longer required. References to CJ 7 and DM 6 have also been removed from the definition of "consideration" in section OB 1 and "associated person": in section OD 8(1).

Application date

The amendments apply to any disposal of ownership interests arising from contracts entered into on or after 3 December 2001, the date the Taxation (Relief, Refunds and Miscellaneous Provisions) Bill was introduced into Parliament.

PENSIONS PAID TO FORMER PARTNERS

Sections DF 4, new sections DF 8A and DF 8B, and section FF 17 of the Income Tax Act 1994

Introduction

The law has been clarified to ensure that pensions paid to former partners are deductible for tax purposes, thus removing uncertainty.

Background

Although there has been uncertainty about whether pensions paid to former partners and surviving spouses are deductible for tax purposes, there is no doubt that, from a policy perspective, such pensions are taxable in the recipient's hands. The amendments merely clarify the law.

Key features

New section DF 8A provides a deduction for a pension paid by a partnership to a retired partner or a surviving spouse. The deduction will be allowed if the partnership paying the pension operates the same business as the partnership to which the retired partner belonged.

For the deduction to be allowed, the pension:

- must be payable as of right under a deed;
- must be in consideration for past services; and
- must be for life or a fixed period.

It can be paid to a surviving spouse on the same terms (for life or for a fixed period) or until any remarriage.

The partner involved must also have retired from the partnership and the partnership must not be an investment partnership.

New section DF 8B caters for circumstances where a partnership has been dissolved. Section DF 8A could exclude a situation where one partner in a two-partner partnership retired and was paid a pension by the former partner who carried on the business as a sole trader.

Section DF 8B ensures that the sole trader is entitled to a deduction for the pension paid to the former partner or spouse, as long as the conditions that apply for section DF 8A deductions are satisfied.

A consequential amendment to section FF 17 (Pensions) ensures that deductions under section DF 8A and 8B are not disturbed if part of the pension is paid to a former spouse under a matrimonial agreement or order.

Application date

The amendments apply from the beginning of the 2000-2001 income year.

CHARITABLE ORGANISATIONS

Section KC 5 of the Income Tax Act 1994

The Akha Rescue Ministry Charitable Trust has been ~~granted charitable donee status from the 2002-03 income~~ year. The trust's main activity at present is the rescue of children from the mountain tribes of Northern Thailand who are in danger of being sold or kidnapped into prostitution. The trust has established a hostel to accommodate the children it has rescued.

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

TAX DEDUCTIONS FOR BRIBES

Section DJ 22 of the Income Tax Act 1994

Introduction

Bribes paid to foreign or domestic public officials in the conduct of business have been made explicitly non-deductible for tax purposes, thus aligning New Zealand's tax law on this matter with that of all other OECD member countries.

This measure, and an associated amendment to the Crimes Act 1961 in May 2001 which criminalises bribery of foreign public officials, arose from an OECD initiative for combating bribery in international business transactions. New Zealand became a signatory of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions in December 1997.

Key features

A new section DJ 22 has been inserted into the Income Tax Act 1994 to ensure that bribes paid or promised in the conduct of business are not deductible.

Any person that corruptly gives, offers or agrees to give a bribe to a domestic or foreign public official, whether directly, or indirectly through another person, will be denied a deduction for the bribe. However, the provision does not apply if the bribe was paid to expedite the performance of a routine government action and the value of the benefit is small.

Section DJ 22 is closely aligned with the provisions of the Crimes Act 1961, including the amendments that criminalise active bribery of foreign public officials.

As such, the provision will apply only where a payment is an offence under the laws of the jurisdiction of that public official. Taxpayers claiming a deduction for such a payment should therefore ensure that payment does not give rise to an offence in the other jurisdiction.

Application date

The amendment applies to bribes paid on and after the date of enactment, 17 October 2002.

DEBT FORGIVENESS FOR TRUSTS

Sections EH 5(2), EH 5(2A), EH 5(3)(b), EH 5(4), EH 52(2A), EH 52(3)(b) and EH 52(4) of the Income Tax Act 1994

Introduction

The concession for natural love and affection has been amended to ensure that resettlements for a forgiven amount will be subject to the existing debt forgiveness rules for trusts.

Background

Before this amendment was made, existing family trusts that qualified for the natural love and affection concession were discouraged from resettling into a second trust because of the risk that it could trigger additional, unintended tax liabilities. The reason for this uncertainty arose because, at the point of resettlement, it could be argued that a distribution was made to the trustee of the second trust for whom the creditor had no natural love and affection. Allowing the natural love and affection concession to apply in resettlements recognises that this practice is often necessary.

Key features

New sections EH 5(2A) and EH 52(2A) ensure that the claw-back rules are in certain situations not triggered on resettlement from a trust that previously qualified for the natural love and affection concession to a second trust. The claw-back rules will not operate if, at the time of resettlement, the second trust would have qualified for the concession if the creditor had forgiven a debt directly to the second trust.

A further amendment has been made to the term "distribution" in sections EH 5(2) and EH 52(2). This ensures that the claw-back provisions only result in gross income for the trustee. Therefore, no beneficiary income will arise under the normal operation of trust rules.

Further minor amendments have been made to sections EH 5(3)(b), EH 5(4), EH 52(3)(b) and EH 52(4) to clarify that the claw-back rules extend only to amounts that have previously qualified for the natural love and affection concession.

Application date

The amendments apply from 17 October 2002, the date of enactment.

INCREASE IN BLOODSTOCK DEPRECIATION RATES

Section EM 1 of the Income Tax Act 1994

Introduction

The effective depreciation rate for broodmares has been increased by reducing the age to which a mare must be depreciated from 15 to 11.

Background

The change in the depreciation rate for broodmares arose from a review of bloodstock depreciation rates. The review was undertaken to ensure that bloodstock depreciation rates accurately reflected the average breeding cycle of mares and stallions. The review showed that, on average, broodmares finished breeding by age 11. Before the change was made, broodmares used for breeding purposes had to be depreciated to age 15.

Key features

New section EM 1(1)(ab) sets out the criteria for applying the new broodmare depreciation rate. New section EM 1(1)(d) outlines the method for calculating depreciation on a broodmare to which new section EM 1(1)(ab) applies. A number of consequential amendments have also been made.

Application date

The change applies from the date of enactment to all broodmares that are first used for breeding purposes or purchased with the intention of being used for breeding purposes on or after 1 April 2001.

Detailed analysis

New section EM 1(1)(ab) outlines the criteria for applying the new depreciation rate. Under this section, the new rate will apply to:

- broodmares that are first used for breeding purposes on or after 1 April 2001; or
- broodmares that are purchased on or after 1 April 2001 with the intention of being used for breeding purposes; or
- broodmares that are owned by a taxpayer who is in the business of breeding bloodstock, and on or after 1 April 2001 the bloodstock owner first intends to use the mare for breeding purposes.

The new rate will apply from the first income year in which one (or more) of these criteria are met, subject to the condition that the broodmare at the end of that income year is at least two years of age. The depreciation allowed in the first income year is calculated under new section EM 1(4)(d).

New section EM 1(1)(ba) clarifies the depreciation treatment of broodmares, in years subsequent to the first income year, if they qualify for the new rate in the first income year. In those subsequent years, depreciation is also calculated under new section EM 1(4)(d).

New section EM 1(4)(d) outlines the method for calculating the depreciation on a mare, at the new higher rate. Under this calculation method, a mare must be depreciated until age 11, starting from the age at which it become eligible for depreciation (being an age of two years or older). If a mare becomes eligible for depreciation at age eight or older, it must be depreciated over a period of three years.

When the new broodmare depreciation rate will apply

Example 1

> Mr A purchased a broodmare (age 4) on 31 May 2001 with the intention of using it in his breeding operations. The first breeding attempt was made on 15 June 2001. This mare can be depreciated using the new rate (to age 11) because Mr A purchased the bloodstock, with the intention of breeding from it, after 1 April 2001.

Example 2

> Mrs B purchased a broodmare (age 3) on 1 January 2001, and the first breeding attempt was made on 1 June of that year. The mare can be depreciated at the new rate because Mrs B first used the bloodstock for breeding purposes after 1 April 2001.

Example 3

> Mr C purchased a broodmare (age 5) on 31 November 2000. He did not depreciate the mare in the 2000-01 year. On 31 November 2001, he decides to use the mare for breeding. This mare can be depreciated using the new rate, from the 2001-02 year, because the intention to use the bloodstock for breeding purposes was formed after 1 April 2001

When the new broodmare depreciation rate will NOT apply

Example 1

> Ms D purchased a broodmare (age 7) on 7 February 2001 with the intention of immediately using this bloodstock in her breeding business. The old depreciation rate will apply to this mare because Ms C purchased this bloodstock, with the intention of breeding from it, before 1 April 2001.

Example 2

Mr E purchased a broodmare (age 5) on 11 January 2001, with the first breeding attempt made on 20 March 2001. The old broodmare depreciation rate will apply to this bloodstock because Mr D first used the bloodstock for breeding purposes before 1 April 2001.

Example 3

Mrs F purchased a broodmare (age 6) on 1 April 2000. On 25 March 2001, she decides to use the mare for breeding. The old depreciation rate will apply to this mare because the intention to use the bloodstock for breeding purposes was formed before 1 April 2001.

OVERTAXATION OF QUALIFYING UNIT TRUSTS AND CATEGORY A GROUP INVESTMENT FUNDS – A SOLUTION TO THE "NEGATIVE DIVIDENDS" PROBLEM

Section MD 2A, Subpart MJ of the Income Tax Act 1994

Introduction

New provisions prevent the over-taxation of qualifying unit trusts and category A group investment funds ("qualifying funds"). This is primarily as a result of the loss of the non-taxable status of unit-holders' paid up capital in certain circumstances.

A new subpart MJ and section MD 2A preserve available subscribed capital (ASC) that were previously lost to qualifying funds when units were redeemed. A new Supplementary ASC account records amounts of ASC contributed by unit holders and members of qualifying funds but not returned to unit holders on redemption of their units. The Supplementary ASC account balance can then be converted to imputation credits and transferred to the qualifying fund's imputation credit account at the end of an imputation year or when the qualifying fund ceases to operate an imputation credit account. Only a Supplementary ASC account balance sufficient to meet the debit balance in the qualifying fund's imputation credit account can be converted and transferred.

Background – the "negative dividend" problem

The unit trust industry had been concerned about an issue referred to as the "negative dividend" problem. This issue affected unit trusts and Category A group investment funds. The issue arose from the operation of the company tax rules to unit trust-type vehicles when the fund elected to use the "slice rule" for determining the tax treatment of the proceeds from the redemption of units.

Under the slice rule, repurchase proceeds are deemed to come from both taxable and non-taxable (ASC) reserves of the company, depending upon the proportions such reserves in the company bear to the repurchase proceeds. When units are redeemed for less than the amount subscribed for, the particular unit (or for all units subscribed by the same unit-holder) the excess ASC is lost.

This loss of ASC is not consistent with the underlying policy relating to redemption of units. Under the company tax rules, ASC can generally be returned to unit-holders without a tax cost. When the slice rule resulted in a loss of ASC, affected qualifying funds were overpaying their tax in order to fully impute the dividend element of redemption proceeds paid to unit-holders.

Two aspects of the ordinary operation of unit trusts were likely to give rise to the loss of ASC. In both cases, units were redeemed for less than the ASC.

The two cases were:

- when the fund had experienced losses in the period between subscription and redemption of those units; or
- when part of the subscription price of the unit represented accumulated income of the fund that was subsequently paid out to the unit-holder, thus bringing the unit price down below the subscription price (that is, subscription price was effectively cum dividend).

In the first case, an exiting unit-holder was being paid out the tax benefit associated with the reduction in the value of the fund. Although that benefit could have manifested itself in the fund to the extent that it could have been offset against tax on future increases in fund value, such subsequent increases in fund value are gains that the remaining and future unit-holders will expect to be fully imputed. However, the fund will pay no tax on those gains as they are merely a reversal of previous losses (and are thus naturally offset for tax purposes).

In the second case, ASC was effectively re-characterised and paid out as a taxable dividend to which imputation credits have been attached. The result was that the unit-holder paying the cum-dividend subscription price received imputation credits on a distribution that was not sourced from taxable income, and therefore any attached imputation credits did not represent tax paid or payable by the fund.

Key features

New section MD 2A and subpart MJ applies to qualifying funds that use the slice rule. The funds may choose to keep Supplementary ASC accounts to record ASC that is lost. ASC is the paid-up capital an investor invests in the fund. Alternatively, funds may choose to determine ASC lost on liquidation.

Operation of Supplementary ASC account

Over the imputation year qualifying funds that choose to operate a Supplementary ASC account will record the ASC lost on redemption of units. Lost ASC is determined by comparing ASC on subscription to the ASC returned on redemption. If there is less ASC returned on redemption the difference will be recorded in the Supplementary ASC account.

Each qualifying fund may keep a record of lost ASC throughout an imputation year (1 April to 31 March) in a separate memorandum account, the Supplementary ASC account. If the fund has a debit in its imputation credit account at the end of the imputation year, an amount from the Supplementary ASC account can be converted into imputation credits and transferred into the imputation credit account to meet the debit balance. The same process can occur if the qualifying fund ceases to use an imputation credit account, for example, on winding up. If on winding up there is a credit in the Supplementary ASC account, a refund of prepaid tax can be sought to the extent of that credit.

Opening balance of Supplementary ASC account

The legislation provides for an opening balance based on the actual ASC lost if there are records to support this or, if not, on a notional wind-up calculation. If the qualifying fund chooses not to use these options, but still chooses to operate a Supplementary ASC account, the opening balance of that account will be nil.

The legislation provides that the actual calculation or the notional wind-up calculation is done as at a date anywhere in the period from the date of enactment to 30 September 2003. The window within which the opening balance calculation must be undertaken is to provide a degree of flexibility for qualifying funds and their managers. The result of this calculation will then be used for the opening balance of the Supplementary ASC account, which will operate according to the substantive provisions from the start date.

The notional wind-up calculation will determine the shortfall in imputation credits for the qualifying fund as if it were wound up as at the start date. This shortfall will be adjusted to take account of distributions that would not normally be expected to have generated imputation credits or dividend withholding payment credits, such as non-taxable gains. The resulting shortfall in imputation credits will be converted to ASC by using the company tax rate for the purposes of the opening balance of the Supplementary ASC account.

Application date

The new provisions apply from the 2002-03 imputation year, which began on 1 April 2002 and ends on 31 March 2003. The new Supplementary ASC account may have an opening balance at 1 April 2002 that takes into account ASC lost before this date.

Detailed analysis

The opening balance

The legislative solution to the negative dividend problem includes the introduction of a new Supplementary ASC account. If a fund chooses to calculate an opening balance for its supplementary ASC account it must choose one of the following options. A combination of the options cannot be used.

Option one – actual ASC lost

The first option is to calculate some or all of the actual ASC that has been lost to date. This can be done if the fund has records of ASC lost. This is the difference, in total, between the capital paid on subscription for any unit and the amount paid out on redemption of that unit. If the amount received on redemption is less than the available subscribed capital per share there is lost ASC. The total of this difference for all or some of the units redeemed up to the date of the calculation is the total ASC lost.

Option two – notional wind-up

The second option is to carry out a notional wind-up calculation. The process for this calculation is set out below. A fund can also choose to determine a Supplementary ASC account balance on actual liquidation.

With respect to the notional wind-up calculation, the legislation provides a broad framework for providing that supplementary ASC arises only in respect of ASC that is actually lost as a result of the negative dividend problem. Interpretations of the legislation producing an unintended effect will be subject to challenge by the Commissioner.

Step 1: Notional liquidation calculation

Undertake a notional liquidation calculation for the fund in order to determine the total tax that would be payable on a liquidation. Assets and liabilities are treated as liquidated at their market value as at the notional liquidation date. This is a date chosen by the fund within the window of the date of enactment of the legislation and 30 September 2003. This date is referred to as the start date.

It is expected that the calculations are undertaken in a manner consistent with the preparation of financial statements and unit pricing calculations. The calculation should be based on an orderly realisation of assets in the ordinary course of the business, and fund managers need to be able to demonstrate that the market valuations are appropriate if required by Inland Revenue.

The notional tax payable is calculated in accordance with the tax rules applying as at the effective date for the calculation.

In effect, this process notionally crystallises all current and deferred tax liabilities and also reconciles the cash tax position with Inland Revenue.

Step 2: Notional tax credits available

Determine what notional tax credits will be available after notional tax is paid, as in step 1 (that is, the total of existing imputation credits and dividend withholding payment credits taking into account the notional tax payable).

Step 3: Notional tax credit requirements

Determine what notional tax credits are required to fully impute all redemption dividends to unit-holders under the same notional wind-up scenario as in step 1. This requires the aggregation of all (positive only) redemption dividends (on a unit holder-by-unit holder basis). This aggregate multiplied by the full imputation credit ratio of 0.4925 equates to the notional imputation credits required.

Step 4: Calculation of the imputation credit shortfall

Any shortfall between the notional credits available (step 2) and the level required (step 3) is termed the "prima facie" shortfall and is the basis for quantifying an opening balance.

It is probable that not all of a prima facie shortfall will be caused by the negative dividends issue. It may be, for example, that some of the fund's income was not subject to tax in New Zealand, or tax was partially offset by foreign withholding taxes. Accordingly, it is necessary to identify and adjust for certain causes of the prima facie shortfall calculated at step 3. These adjustments are always reductions in the shortfall.

The causes of shortfall to be adjusted for here are the "expected" imputation shortfalls—systemic or structural features of the tax system that could reasonably be expected to give rise to an imputation shortfall upon liquidation of the trust.

The causes of "expected" imputation shortfalls include, without limiting the possible causes, the following:

- non-taxable gains (including exempt income, but not foreign dividends);
- imputation credits lost as a result of continuity breaches;
- foreign tax credits; and
- pre-imputation retained earnings.

Comments

- At this point in the calculation the values are stated at imputation credit equivalent values, so all adjustments to the prima facie shortfall need to be at the imputation credit or tax credit equivalent value.
- Non-taxable gains include exempt income but not foreign dividends subject to subpart NH of the Income Tax Act 1994, because a dividend withholding payment is made in respect of these dividends that will be available as a dividend withholding payment account credit.
- Foreign tax credits are adjusted for unless the fund's imputation ratio was reduced in the past to enable these to be distributed.
- If any pre-imputation retained earnings exist, an adjustment is made for this amount.
- All adjustments are made for items occurring over the life of the fund back to 1 April 1988, the date of introduction of the imputation rules.

Step 5: Conversion into the opening balance of the Supplementary ASC memorandum account

The imputation credit shortfall amount is calculated at imputation credit values so needs to be grossed up to the ASC equivalent to convert the adjusted shortfall into the opening balance of the Supplementary ASC memorandum account. This conversion is undertaken on the following basis:

Final imputation credit shortfall (step 4 above)   0.4925.

The go-forward position

Lost ASC can be accumulated in the Supplementary ASC memorandum account on a continuing basis from the day after the start date. The method to be used is the same as under option one for calculating the opening balance, but applied to the unit redemption transactions that occur on a day-by-day basis.

Example

Calculation of opening supplementary ASC account balance using the notional liquidation option

The "notional wind-up" option for calculating the opening balance of the supplementary ASC account starts by calculating the tax that would be payable if the fund were liquidated according to an orderly realisation of all assets and liabilities in the ordinary course of business.

Step 1:	**Calculation of tax payable on notional liquidation**	**($)**	**($)**
	Taxable income		
	Gain on realisation of revenue account assets	750,000	
	Accrual income	275,000	
	Dividends	55,000	
	Interest	140,000	
	Imputation credits	22,000	
	Loss on realisation of revenue account assets	(575,000)	667,000
	less expenses (since last tax return)		
	Expenses (net of non-deductible expenses)		(32,000)
	Taxable income on notional liquidation		635,000
	Tax		@33%
	Notional tax payable		$ 209,550
Step 2:	**Notional tax credits available**		
	Imputation credit account balance		143,000
	Withholding payments account balance		37,000
	Notional tax payable (from Step 1)		209,550
	Total notional tax credits available		$ 389,550
Step 3:	**Notional tax credit requirements**		
	Total redemption dividends (on notional liquidation)		1,522,000
	Dividends @ 0.4925		@0.4925
	Total imputation credits required		$ 749,585
Step 4:	**Calculation of the imputation credit shortfall**		
	Notional tax credits available (from Step 2)		389,550
	less imputation credits required (from Step 3)		(749,585)
	Prima facie imputation credit shortfall		(360,035)
	less adjustments for structural features of tax system		
	Non-taxable gains (at imputation credit equivalent value)	15,500	
	Lost imputation credits - continuity breach	27,000	
	Foreign tax credits	19,462	
	Pre-imputation retained earnings @31/03/88		
	(at imputation credit equivalent value)	123,000	
			184,962
	Final imputation credit shortfall		**$ (175,073)**
	Divided by 0.4925 *equals* opening (credit) balance of Supplementary ASC account		**$ (355,478)**

Notes on Step 1

The fund will need to identify what taxable income or loss arises under a notional liquidation from all of its assets and liabilities including:

- revenue account assets;
- financial arrangements (including off-balance sheet financial instruments) that would be subject to a base price adjustment calculation;
- recognition of realised and accrued income from other sources of taxable income, such as interest and dividends;
- deductions for expenses and other tax deductible items.

Expenses need to be included covering the period from the last tax return to the date of calculation of the opening balance. Non-deductible items should be excluded as usual.

Notes on Step 2

The imputation credit account and dividend withholding payment account balances are as at the date of calculation of the opening balance, as reconciled to the cash tax-paid position with Inland Revenue. Reconciling to the cash tax-paid position will eliminate any double counting of any outstanding tax liability as at the date of calculation in the opening balance and when the tax is actually paid, giving rise to an actual imputation credit. Tax payable on the notional liquidation comes directly from Step 1.

Notes on Step 4

The adjustment items in Step 4 take account of the structural features of the taxation and imputation systems that give rise to an expected shortfall of imputation credits. These adjustment items are made against the prima facie imputation credit shortfall at imputation credit tax credit equivalent values, meaning that adjustments for income related items must first be converted to the imputation credit equivalent value.

The legislation identifies the key items that require adjustment here, although is not exhaustive of such items.

Contact point for further queries

If you have any queries arising from this Tax Information Bulletin item, particularly interpretive issues arising from undertaking the calculations, contact the Investment Desk that operates within the Corporates Banking and Insurance Sectors, Inland Revenue, at the following contact points.

Christchurch post - P.O. Box 2871 Christchurch
Christchurch fax - (03) 363 1489
Wellington voicemail box - (04) 802 6096

UNIT TRUSTS: DEBITS TO IMPUTATION CREDIT ACCOUNT

Section ME 41 of the Income Tax Act 1994

Introduction

An amendment to section ME 41 of the Income Tax Act 1994 prevents a unit trust's or group investment fund's ("funds") imputation credit account being double debited. This could occur when there was both a debit resulting from a significant change to the shareholding of the fund and a debit of the imputation credits received when a fund manager redeemed units with the fund.

This is a remedial amendment designed to resolve a double taxation problem that arose through the interaction of two different provisions.

Background

Section ME 41 provides that the imputation credits received when fund managers redeem units with the fund in the ordinary course of their business are offset by a debit to the fund manager's imputation credit account. This debit occurs on the date the income tax return is filed for the income year in which the dividends are derived.

When a fund manager breaches the shareholding continuity rules, section ME 5(1)(i) requires a manager to debit the imputation credit account of those credits in the account at the date of the shareholding change. The imputation credit account balance at the date of the shareholding change will include the imputation credits received on redemption that have not yet been offset by a section ME 41 debit. The debit that occurs as a result of the change in continuity does not remove the requirement under section ME 41 to debit the imputation credit account at the time of filing an income tax return for the full amount of imputation credits received on redemptions in that income year.

As a result, fund managers are effectively required to make a double debit to their imputation credit account for imputation credits received on redemption that have not previously been offset by a section ME 41 debit at the time of a shareholding continuity breach.

Key features

Section ME 41(2) has been amended to exclude from the imputation credit account debit made under section ME 41, any imputation credits received from the fund during the relevant income year that have previously been debited under section ME 5(1)(i) because of a continuity breach.

Application date

The amendment will apply from 1 April 1996, the date that section ME 41 of the Income Tax Act 1994 came into effect.

CARRY FORWARD OF LOSSES AND CREDITS AFTER A "SPINOUT"

Sections OB 1 and OD 5(6A)-(6F) of the Income Tax Act 1994

Introduction

New subsections OD 5(6A) to (6F) apply in certain circumstances when there is a spinout of a company in a group and that company holds shares in a subsidiary that has tax losses or credits. The new provisions preserve the losses or credits to the extent that there is no change in ownership of the company on the spinout.

A spinout occurs when shares in a subsidiary company are transferred to shareholders of the parent company.

Background

Section OD 5(6)(b) provides a concessionary rule for measuring the ownership of a group company that has tax losses or credits. Instead of requiring ownership to be traced up a corporate chain to the individual small shareholders of the holding company, the holding company is treated as holding the shares in the subsidiary on behalf of its own small shareholders. So, for example, if Company A is owned by a group of shareholders each owning less than a 10% interest in the company, and Company A owns Company B, for the purposes of the loss and credit continuity provisions Company A is treated as holding the interests in Company B that would otherwise have been held by the small shareholders in Company A.

This can give rise to problems, however, when there is a spinout of the subsidiary businesses. The spinout may result in a change in holding company for the businesses, even though there may well be no change in the underlying economic ownership of the subsidiary businesses as a result of the spinout. A change of holding company could create a substantial change of ownership interests and may prevent the carry forward of tax losses and tax credits in the subsidiary businesses.

Example 1 shows the effect of a spinout in the absence of the new provisions. In this example, listed Company A is owned by small unrelated shareholders each holding less than 10% of the company. Company A spins out its interests in Company B and Company C. Before the spinout, Company A holds all voting interests in Company C on behalf of its small shareholders, in accordance with section OD 5(6)(b). After the spinout, Company B holds these same interests in Company C on behalf of the same small shareholders. From an economic perspective, there is no change in the ownership of Company C. However, if Company B wishes to apply section OD 5(6)(b) after the spinout, there would have been a 100% change of ownership interests in Company C. In such cases, Company B could have resorted to the core tracing rules in sections OD 3 and OD 4 to satisfy the shareholder continuity tests. That might not be practical, however, and would involve additional compliance costs.

Key features

New subsections OD 5(6A) to OD 5(6F) apply when:

- A widely-held or listed parent company (company A) spins out a wholly-owned subsidiary (Company B) which in turn holds shares in a subsidiary that has losses or credits to carry forward (Company C).
- Before the spinout, Company A's interests in Company C were calculated using the concessional tracing rule in section OD 5(6)(b). This provides that it is not necessary to trace ownership in Company C through to the small shareholders in Company A. Instead, Company A itself is deemed to hold those interests on behalf of its small shareholders.
- After the spinout, Company B calculates its interests in Company C using the tracing rule in section OD 5(6)(b). That is, Company B is treated as holding the interests of its small shareholders in Company C.

Section OD 5(6B) provides that for the purpose of applying the loss and credit continuity provisions after the spinout, Company B will be treated as holding the interests in Company C that were, before the spinout, deemed to be held by Company A on behalf of Company A's small shareholders. However, the rule will apply only to the extent that the same shareholders hold a common interest in both Company A and Company B immediately after the spinout, calculated as if the only shares in Company A and Company B were those of the small shareholders.

This means that the losses and credits in Company C are not forfeited simply because of the spinout when, in substance, there has been no change in economic ownership of Company C.

Application date

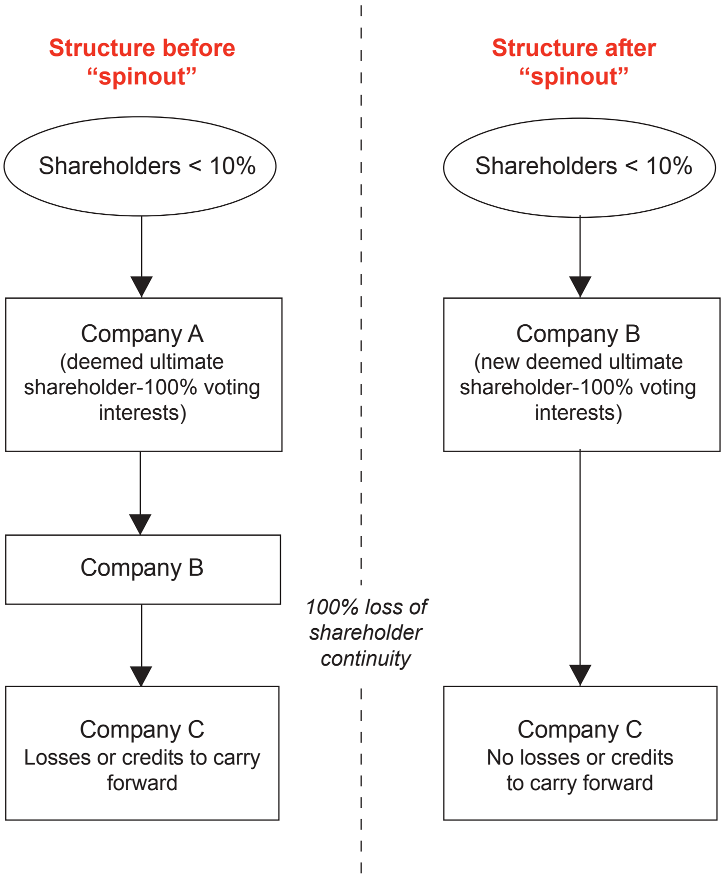
The amendments apply to a spinout occurring on and after 1 March 2002.

Detailed analysis

When the new rules apply

Section OD 5(6A) sets out when the substantive new rule in subsection (6B) applies. It applies only when all of the following conditions are met.

Example 1:
Loss of shareholder continuity in the absence of legislature amendment



- A company (Company A) spins out its subsidiary Company B. (A spinout can happen in a number of ways, and the legislation envisages that Company A could transfer or distribute to its shareholders the shares it owns in Company B, or new shares could be issued in Company B. The new rules also accommodate the possibility that, in a spinout, Company A will retain some of the shares in company B as a nominee of a shareholder in Company A and sell these on behalf of the shareholder.)
- Before the spinout, Company A is treated as holding voting or market value interests in another company (Company C) on behalf of Company A's small shareholders under section OD 5(6)(b).
- After the spinout, Company B is treated as holding voting or market value interests in Company C on behalf of Company B's small shareholders under section OD 5(6)(b).
- Before the spinout, Company B is 100% owned by Company A. (There is no requirement that Company B must exist for the entire period since the tax losses or credits arose. Company B could potentially be a newly incorporated company that was established for the purpose of the spinout. Furthermore, Company A need not own 100% of all the spun out businesses, since other shareholders could own part of Company C.)
- At the time of the spinout, Company A is a limited attribution company. ("Limited attribution company" is already defined in section OD 5(10) and broadly means a widely-held or listed company.)
- From the date of the spinout until the date tax losses or credits are used, Company B is a limited attribution company.

Effect of application of new rules

Section OD 5(6B) is the substantive new rule. It provides that, for the purpose of applying the continuity provisions after the spinout, Company B is treated as holding the ownership interests in Company C that, before the spinout, were deemed to be held by Company A on behalf of its small shareholders.

The rule applies only to the extent that there is a group of shareholders who have common interests in both Company A and Company B immediately after the spinout. Commonality is measured only in relation to the interests held by Company A and Company B under section OD 5(6)(b). In other words, the common interests of shareholders in Company A and Company B are calculated as if the only shares in Company A and Company B were those that are treated as being held by those companies under section OD 5(6)(b). This is illustrated in Example 2 on the next page.

In example 2, E owns 20% of listed Company A and small shareholders, each holding less than 10%, hold the remaining 80%. Company A owns 100% of Company B which in turn owns 100% of Company C.

Under section OD 5(6)(b), Company A is treated as holding 80% of the shares in company C on behalf of its small shareholders. Under the general ownership tracing rules, E is treated as holding the other 20% of the shares in Company C.

Company B is spun out, together with Company C. E is not receiving shares in the spunout Company B. Following the spinout, therefore, Company B is entirely owned by the small shareholders, who own 80% of the shares in Company A.

Subsection (6B) requires measurement of shareholders' common voting or market value interests in Company A and Company B immediately after the spinout. They are calculated as if the only interests that are held in Company A and Company B are those of small shareholders, whose interests are treated as being held by Company A and Company B under section OD 5(6)(b). In this example, there is 100% commonality because the 20% shareholding of E in Company A is ignored, and the remaining shares are then held in the same proportion in both companies. (Ignoring E's shareholding for the purpose of measuring commonality in Company A and Company B prevents double counting of the change in shareholding that arises because E does not receive shares in Company B.)

Under the new rule, Company B will be treated as holding 80% ownership interests in Company C previously held by Company A on behalf of its small shareholders. The rule does not affect E's interest.

Therefore, for the purpose of applying the continuity provisions after the spinout, the ownership interests in Company C under the new rule are as follows:

Before the spinout		*After the spinout*	
Company B	80%	Company B	100%
E	20%		

Because Company B is deemed to hold the 80% interest before the spinout for the purpose of applying the continuity provisions after the spinout, to that extent Company A does not hold that 80% interest.

There is an 80% continuity over the entire period since Company B holds at least 80% of Company C over that period. The rule does not affect losses or tax credits that have been used before the spinout.

In summary:

- Before the spinout, in respect of Company C's losses or tax credits arising and used before the spinout, continuity in Company C would be determined under the normal rules. Company A would be regarded as holding 80% of Company C under section OD 5(6)(b).
- After the spinout, in respect of losses or credits arising in Company C before the spinout but not yet used, Company B will now be treated as having held 80% in Company C from the dates the losses or credits arose until the spinout. Company B would hold 100% voting interests in Company C from the date of the spinout under section OD 5(6)(b).
- After the spinout, in respect of losses or credits arising in Company C after the spinout, Company B would hold 100% voting interests in Company C under section OD 5(6)(b).

The new sections OD 5(6D), (6E) and (6F) provide the rules for determining common interests in Company A and Company B. These are calculated as if the only interests in Companies A and B were those of small shareholders whose interests are deemed to be held by those companies under section OD 5(6)(b).

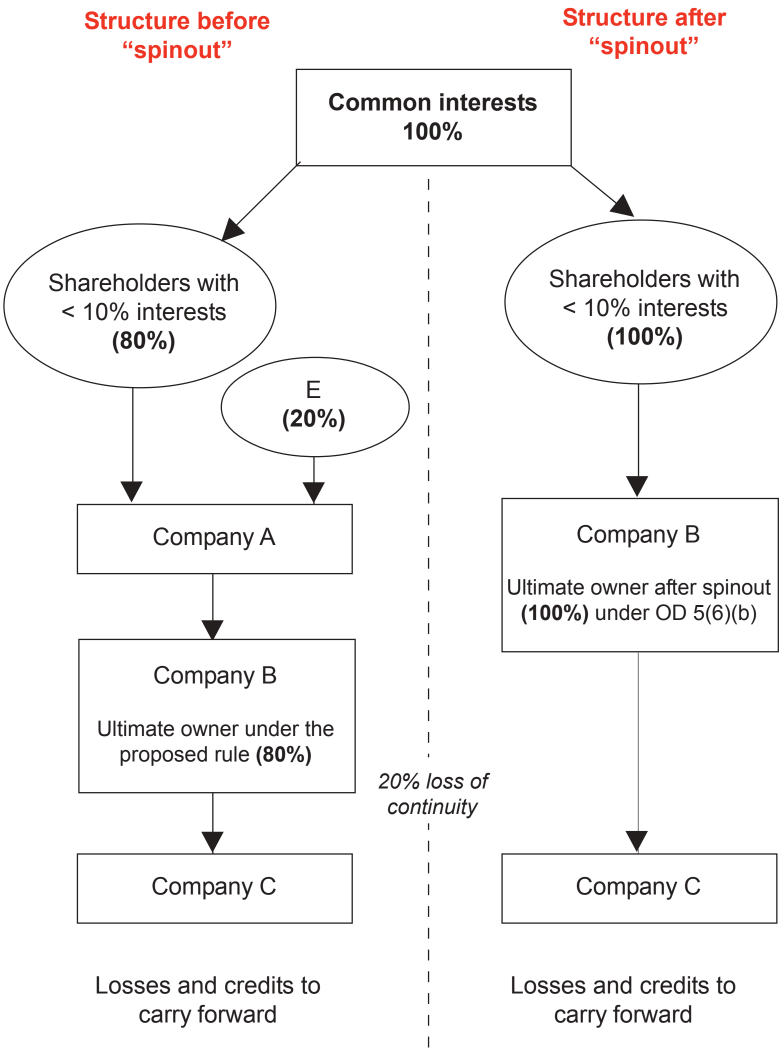
Spinout of partly owned subsidiaries

Example 3 shows a spinout of a partly owned subsidiary. In this example, Y owns 20% of Company C. Company A spins out its 80% stake held through Company B. As in Example 2, only the small shareholders in Company A receive interests in Company B.

Before the spinout, under section OD 5(6)(b) Company A held 64% of the interests in Company C on behalf of Company A's small shareholders. Under the general ownership tracing rules, Y held 20% and E held 16% of Company C.

Under new subsection (6B), Company B will be treated as holding the 64% interest in Company C previously held by Company A on behalf of its small shareholders, but only to the extent of shareholders' common interest in Company A and Company B after the spinout. As in Example 2, there is 100% commonality in Companies A and B because E's shareholding is ignored.

EXAMPLE 2: EFFECT OF LEGISLATIVE AMENDMENT



In Example 3, the deemed ownership interests in Company C under subsection (6B) are as follows:

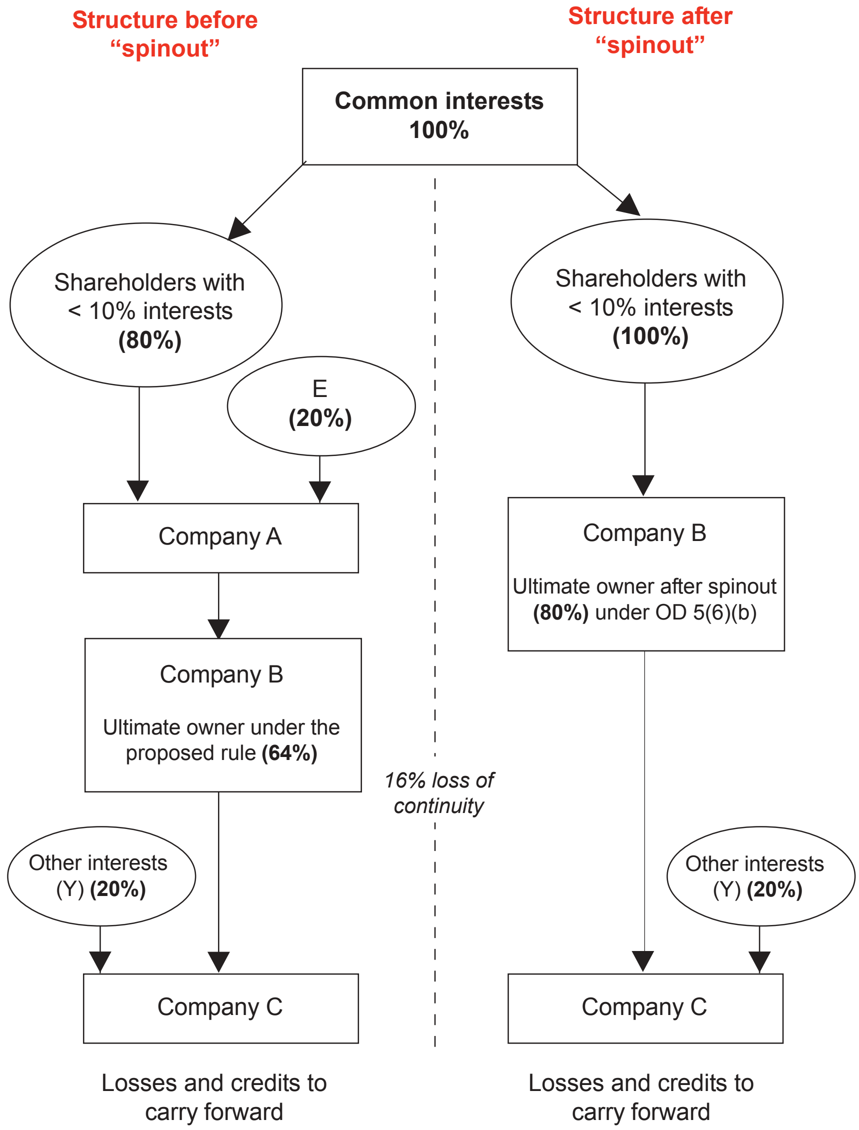
Before the spinout		*After the spinout*	
	20%	Y	20%
Company B	64%	Company B	80%
E		16%	

In summary:

- Before the spinout, in respect of Company C's losses or tax credits arising and used before the spinout, continuity in Company C would be determined under the normal rules. Company A would hold 64% of the interests in Company C under section OD 5(6)(b). E would be treated as holding 16%, and Y would be treated as holding 20%, of the interests in Company C.
- After the spinout, in respect of losses or credits arising in Company C before the spinout but not yet used, Company B will now be treated as having held Company A's 64% interest in Company C from the dates the losses or credits arose until the spinout. Company B would hold 80% of the interests in Company C from the date of the spinout under section OD 5(6)(b).
- After the spinout, in respect of losses or credits arising in Company C after the spinout, Company B would hold 80% voting interests in Company C under section OD 5(6)(b).

There is 84% continuity over the relevant period.

EXAMPLE 3
SPINOUT OF PARTLY OWNED SUBSIDIARIES



Ownership changes after a spinout

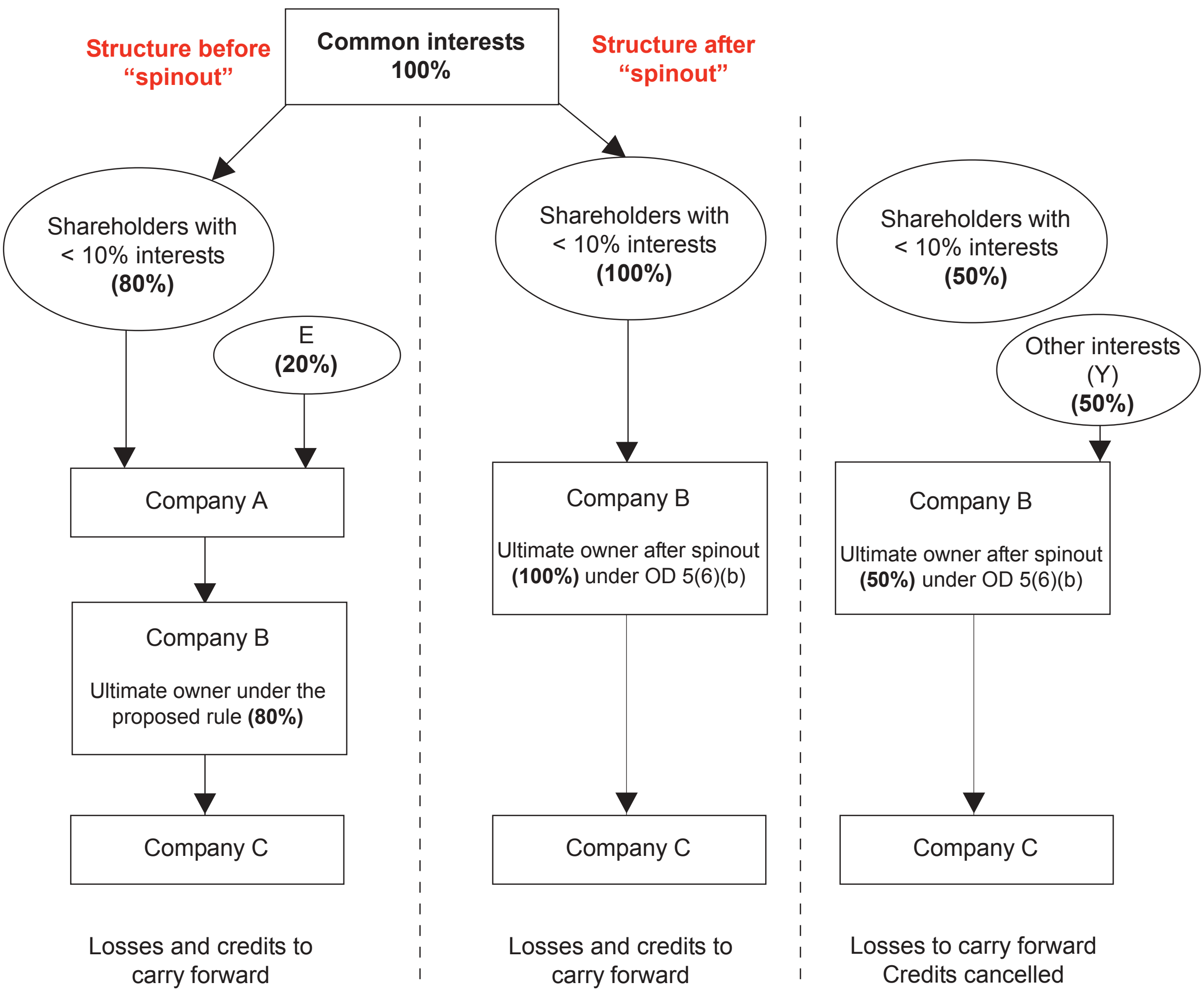
Example 4 shows the effect of the new rule if a change of ownership occurs after the spinout. This example is the same as Example 2, except that a natural person, Y, acquires 50% of Company B from its small shareholders after the spinout.

Under the new rule, the ownership interests in Company C are as follows:

Before the spinout		*After the spinout*		*Subsequent takeover*	
Company B	80%	Company B	100%	Company B	50%
E	20%			Y	50%

Since Company B owns at least 50% of Company C over the entire period, a subsequent change in ownership of 50% would not adversely affect the ability of Company C to carry forward its losses. However, pre-spinout imputation credits could not be carried forward after Y acquires 50% of Company B.

EXAMPLE 4
CHANGE OF OWNERSHIP SUBSEQUENT TO THE SPINOUT



LOSS OF SHAREHOLDER CONTINUITY ON CORPORATE CONVERSION

Section OD 5B of the Income Tax Act 1994

Introduction

Section OD 5B has been inserted into the Act to ensure that shareholder continuity is not broken when a company of proprietors that is established by statute converts to a limited liability company.

Background

Before this amendment was made there was a potential tax problem for New Zealand companies owned by an overseas company that is to be converted from an unincorporated company of proprietors into a limited liability company. The issue related to the measurement of shareholder continuity in the New Zealand companies following the conversion of its overseas parent. It is possible that as a consequence of the conversion there was a technical breach of the shareholder continuity rules for the New Zealand companies, resulting in these companies losing their imputation credits and tax losses at the date of conversion. This was contrary to the policy behind the shareholder continuity rules in the Income Tax Act 1994 because there was no change to the underlying beneficial ownership of the New Zealand companies as a result of conversion.

The amendment was added to the bill at the select committee stage of its passage through Parliament.

Key features

Section OD 5B clarifies that there is no change in shareholding as a result of a conversion from an unincorporated company of proprietors into a limited liability company, and therefore no breach of the shareholder continuity rules for tax purposes.

Application date

The amendment applies from 1 July 2002.

PUBLIC BINDING RULINGS FOR AN INDEFINITE PERIOD

Sections 91DA(1)(e), 91DC(1)(b), 91DC(1)(c), 91DE(4) and 91DE(5)(c) of the Tax Administration Act 1994

Introduction

Amendments have been made to the binding rulings legislation to allow public rulings to be issued by the Commissioner for an indefinite period. An indefinite period ruling will apply until it is either formally withdrawn or the taxation law on which the ruling is based is amended or repealed in a way that changes the way the taxation law applies in the ruling.

The amendments improve taxpayer certainty by reducing the risk of substantial time delays between a ruling lapsing and its reissue and allow Inland Revenue to more effectively allocate its resources.

The amendments do not alter the Commissioner's ability to issue public rulings for finite periods.

Background

Binding rulings are intended to reduce uncertainty for taxpayers about the tax implications of business decisions, and to assist taxpayers in complying with the tax law.

Public binding rulings are rulings that are publicly available and can be applied by all taxpayers for the particular tax matter(s) and arrangement(s) covered by the ruling.

The binding rulings legislation previously required that these rulings be issued for a finite period. This may have resulted in delays between the date a ruling expired and the date it was reissued, leaving both taxpayers and Inland Revenue with a period of time in which the application of the law was unclear. Such delays could have reduced the effectiveness of rulings as they would have decreased taxpayers' certainty as to the tax effect of transactions.

The amendment addresses this issue by giving the Commissioner the discretion to issue a public ruling for an indefinite period.

Key features

An amendment has been made to section 91DA to require the Commissioner to state in a public ruling issued for an indefinite period (an indefinite period public ruling), the date or income year from which the ruling applies.

Section 91DC has been amended to provide that when a public ruling is issued for an indefinite period, the ruling will apply, from the date or income year specified in the ruling, to arrangements entered into on, or after, that date or income year. Another amendment to this section prescribes that when a public ruling has been issued for an indefinite period, the ruling will apply for an indefinite period.

Section 91DE(4) has been amended to provide a specific rule for the withdrawal of public rulings issued for an indefinite period. The rules applying to finite period public rulings permit a withdrawn ruling to continue to apply for the remainder of the period or income year to which the ruling had originally applied, if the arrangement was entered into before the date of withdrawal. This treatment could not be extended to indefinite period public binding rulings because they have no expiry date. Instead, a withdrawn indefinite period public binding ruling will continue to apply to an arrangement to which it previously applied that was entered into before the date of withdrawal, for three years after the date stated in the notice of withdrawal.

Section 91G also applies so that the ruling will not apply from the date a taxation law is repealed or amended to the extent that the repeal or amendment changes the way the taxation law applies in the ruling.

An amendment has also been made to section 91DE(5) to require the Commissioner to state in the notice of withdrawal of an indefinite period public ruling the date or income year from which the ruling applies.

Application date

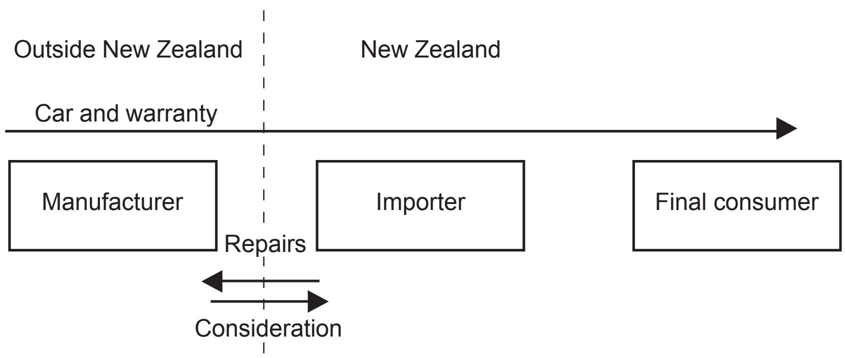
The amendment applies from 17 October 2002.

ZERO-RATING OF WARRANTY PAYMENTS

Sections 2 and 11A(1)(ma) of the Goods and Services Act 1985

Introduction

Amendments to section 11A(1) allow for the zero-rating of payments made under a warranty agreement by a non-registered offshore warrantor in respect of goods imported with an embedded warranty, as illustrated in the diagram.



The change removes the potential for a double impost of GST to occur in relation to warranted repairs.

Background

Goods that are imported into New Zealand with a warranty are subject to GST at the border on the total cost of the good, including the value attributable to anticipated warranted repairs represented by the warranty. When the good is re-supplied to the retailer and subsequently the customer, the anticipated repair cost is passed along with the good as part of the total purchase price. The importer and the retailer are able to recover the GST cost through an input tax credit, leaving the final GST cost on the full value of the good, including the anticipated warranty repairs, to be borne by the customer.

The performance of actual warranted repair services on the good in New Zealand is a taxable supply to the offshore warrantor for GST purposes. However, the supply is now zero-rated in recognition that GST has effectively been prepaid on the repair services by the final consumer. The repairer can claim an input credit for the GST cost incurred in supplying the repair service.

The application date originally proposed in the bill was the date of Royal assent. This was later changed by way of a Supplementary Order Paper to 1 August 2002.

Key features

The double impost is relieved by zero-rating supplies of goods and services made under a warranty agreement when:

- the warranty agreement was included in the purchase price of goods which attracted GST on importation into New Zealand; and
- consideration for the supply is paid by the non-registered offshore warrantor.

Deemed single supply

Commonly, two types of warranty cover imported goods, a "factory warranty" offered by the non-resident manufacturer to the importer and an extended warranty offered by the importer or distributor to the final consumer. The Court of Appeal decision in Suzuki New Zealand Ltd v CIR (2001) 20 NZTC 17 clarified that when the New Zealand importer provides the service of remedying a defect under a factory warranty to the non-resident warrantor, payment from the non-resident warrantor is consideration for the supply of those services. The amendments zero-rate this supply.

Section 5(20) ensures that, when this supply occurs, the payment from the non-resident warrantor cannot be treated as consideration for any other supply not covered by the zero-rating provision, such as a supply of services from the importer to the final consumer under an extended warranty.

Warranty given under a supply agreement

The reference in the amendment to a warranty "given under a supply agreement" is intended to limit the amendment to certain warranty arrangements. When the value of the warranty is embedded in the purchase price of the good, GST is paid by the non-resident warrantor on that value as part of the GST impost on the total purchase price. The amendments remove the second impost that occurs with this type of warranty when GST is paid on the actual warranted repairs. However, when an offshore warranty agreement is given separately from the goods, and the value of that agreement is readily identifiable, the warranty may not be subject to GST, and repair services performed under it should not be zero-rated.

The term "supply agreement" therefore describes an agreement that includes a warranty given for the good supplied but which may be contained in the sale and purchase agreement or another document or other documents. It does not cover a warranty that is not incorporated into the purchase price of the goods.

Definition of "warranty"

An important aspect of zero-rated repair services is that they relate to defects that have been anticipated in the warranty agreement at the time the good is supplied and that subsequently materialise. The amendments will not cover the remedying of defects which were known at the time of sale and therefore potentially factored into the purchase price.

The policy is therefore that the terms of the warranty arrangement must be identified and agreed at the time the supply occurs. Thus, the definition of "warranty" requires that the defect appear "during a certain period of time after the goods are supplied or before a certain level of usage is reached". The reference to the usage reached applies to motor vehicle warranties that are confined to defects occurring within a specified distance of travel.

Goods and services zero-rated

The supply zero-rated by the amendment is the service of remedying defects covered by the warranty agreement. Remedying the defect may involve a variety of activities from repairing or replacing a part of the good to replacing the whole good.

Section 5(21) explicitly treats the supply of goods and services as a supply of services under section 11A(1)(ma). This ensures that the amendments cover the variety of remedies that may be provided for in warranties. For example, when a replacement is made under warranty the value of the service zero-rated will include the cost of the replacement part or good, not just the service of replacing the part or good.

Application date

The amendments apply from 1 August 2002.

NON-PROFIT BODIES AND THE DEFINITION OF "INPUT TAX"

Section 3A of the Goods and Services Tax Act 1985

Introduction

The amendment clarifies the legislative basis for registered non-profit bodies to claim deductions of input tax for goods and services acquired in relation to all activities, except the making of exempt supplies.

Background

For GST purposes, non-profit bodies are organisations established other than for the profit of their members and are prohibited from making cash or other distributions to their members. They include, for example, sporting and other recreational clubs as well as charities.

Inland Revenue's practice is to allow input tax credits to non-profit bodies for goods and services acquired in relation to all their activities, other than the making of exempt supplies.

The government discussion document *Tax and Charities,* released in June 2001, noted a possible inconsistency between this practice, however, and the GST legislation in relation to claims for input tax credits by non-profit bodies. Specifically, in considering the relevant legislation, the discussion document expressed doubt as to whether input tax credits were available in relation to activities that did not involve the supply of goods and services in exchange for payment (non-taxable supplies) such as, for example, donation-gathering activities.

The discussion document therefore proposed to clarify the legislation in line with practice, and the amendment achieves this. The amendment therefore provides certainty for charities and other non-profit bodies in relation to their GST obligations.

Key features

The definition of "input tax" in section 3A of the GST Act 1985 has been amended to clarify that GST registered non-profit bodies are entitled to claim input tax credits for goods and services acquired in relation to all their activities except the making of exempt supplies (such as the supply of donated goods and services, financial services or residential accommodation). The amendment confirms that non-profit bodies are, for example, able to claim input tax credits in respect of GST incurred on the cost of collecting donations or fund raising.

Application date

The amendment applies from 17 October 2002

REMEDIAL AMENDMENTS

THIN CAPITALISATION

Sections FG 4(3)(ca) and FG 4(4) of the Income Tax Act 1994

Introduction

A minor remedial amendment has been made to the thin capitalisation rules to allow taxpayers to include the depreciated value of assets under a finance or specified lease in the definition of "assets" for thin capitalisation purposes when they are excluded for accounting purposes. The amendment makes the application of the rules more consistent and fairer to taxpayers who have specified or finance leases.

Background

The thin capitalisation rules are designed to limit interest deductions if the debt/asset ratio of a New Zealand operation, controlled by non-residents, exceeds a certain threshold. It had been identified, however, that in some cases there was an unintended overstatement of the New Zealand group's debt/assets ratio owing to a difference between the tax definition and the accounting definition of "finance" and "specified leases".

The thin capitalisation rules define what an "asset" is and what is "debt" for the purposes of calculating the debt/asset ratio. Under the rules, an asset must be calculated under generally accepted accounting practice. A debt is defined as a financial arrangement, which includes a loan.

For tax purposes, a finance or a specified lease is treated as a sale of the leased asset with a loan from the lessor to the lessee. The loan from the lessor to the lessee will always be included in the lessee's calculation of the debt/asset ratio. The asset itself may not necessarily be included because the debt/asset ratio follows the accounting treatment of the asset.

Under generally accepted accounting practice the definition of a finance lease is narrower than the definition of either a finance or a specified lease for tax purposes. Therefore, under the thin capitalisation rules, the asset definition would not capture all the deemed assets, whereas it would capture all the deemed loans. This would in some cases, contrary to the original policy intent, overstate the debt/asset ratio and possibly require taxpayers to limit their tax deductions.

The amendment allows taxpayers to include the cost of the asset less accumulated depreciation ("adjusted tax value") of the finance or specified lease asset in the definition of "asset" for thin capitalisation purposes but only if that asset has not already been included in the taxpayer's financial accounts.

Key features

Section FG 4(3)(ca) has been added to the Income Tax Act 1994 and section FG 4(4) of the Act has been amended. The changes allow the adjusted tax value of a lease asset under a specified or finance lease to be included in the total assets of a New Zealand group if the lease asset is not recognised as an asset under generally accepted accounting practice.

Application date

The amendment will apply to measurement dates from 3 December 2001.

THE MINOR BENEFICIARY RULE

Sections HH 3D, HH 3F and OB 1 of the Income Tax Act 1994

The minor beneficiary rule was enacted in March 2001 to ensure that certain distributions of beneficiary income from a trust to a child under the age of 16 years are taxed at 33% as if it were trustee income. Four minor remedial amendments have been made to the minor beneficiary rule to ensure that the legislation more clearly reflects the original policy intent.

- Section OB 1 of the Income Tax Act 1994 has been amended to provide certainty that the definition of "settlement" has the corresponding meaning to the definition of "settlor" for the purpose of the minor beneficiary rule.
- The second amendment ensures that section HH 3D, which provides an exclusion to the rule, will apply only to "mixed trusts" as intended. A mixed trust is one that has both a settlement that is caught by the rule and a settlement which is excluded from the rule.
- The third amendment, also to section HH 3D, clarifies that the $1,000 threshold for application of the minor beneficiary rule relates to the value of the loan(s) provided to the trust, not to the value of the interest foregone on the loan(s).
- Section HH 3F has been amended to clarify that in determining whether a beneficiary is a "minor", the age of the minor should be determined on the balance date of the year in which the income is earned by the trust.

Application date

The amendments apply to beneficiary income derived in relation to the 2001-02 and subsequent income years (the application date of the minor beneficiary rule) except if the trustee had filed a return for the 2001-02 income year, before 3 December 2001 (the date of introduction of the Taxation [Relief, Refunds and Miscellaneous Provisions] Bill into Parliament) on the basis of the existing legislation.

FRINGE BENEFIT TAX – CHANGE IN BASIS OF CALCULATION

Sections ND 1 and ND 2(4) of the Income Tax Act 1994

Introduction

The fringe benefit tax (FBT) rules in the Income Tax Act 1994 have been amended to ensure that employers are able, after electing to pay FBT at the flat 64% for the year, to request that the FBT liability be calculated using the multi-rate calculation. Employers will have two months to make this request after the date of the notice advising that an assessment for the final quarter or the year has been made. A specific application date rule applies for the 2000-01 and 2001-02 income years.

Background

The FBT rules allows employers to calculate their FBT liability using either the multi-rate calculation or a flat rate of 64% on the value of all fringe benefits provided. A number of employers who calculated their FBT liability for the 2000-01 year using the 64% flat rate subsequently sought to have their FBT liability reassessed using the multi-rate calculation.

The legislation was ambiguous as to whether employers could change the basis of calculating their FBT liability for the year once the final quarterly return or the annual return had been filed. In practice, however, Inland Revenue used its discretion to amend some assessments. The Minister of Finance and Revenue raised the issue of clarifying the legislation to allow employers to change their method of calculating their FBT liability within a limited time frame with the Finance and Expenditure Committee during its consideration of the Taxation (Relief, Refunds and Miscellaneous Provisions) Bill. The Committee recommended, as part of its report-back on the bill, that it considered it appropriate that employers be allowed a two-month period to request a reassessment of their final FBT liability in such circumstances.

Key features

Section ND 1 of the Income Tax Act has been amended to allow employers who have elected to pay FBT using the 64% flat rate on the value of all fringe benefits to request Inland Revenue to amend their FBT liability for that year. To do this, employers must provide the information necessary for the liability to be calculated using the multi-rate method of calculation provided under sections ND 5 and 6, (including the simplified method). The employer must provide this information to Inland Revenue within the two-month period that occurs after the date of the notice advising the employer that an assessment for the final quarter or year has been made.

The ability to change the basis of calculation applies to employers who either pay FBT on a quarterly basis or yearly basis (annual or income year).

Section ND 2(4) which provides that an "election is irrevocable" has been amended to clarify that it only applies for the purposes of section ND 2.

Application date

The general application date of this amendment is 17 October 2002. However, in respect of the 2000-01 and 2001-02 income years, if an employer has received a notice of assessment for the final quarter or the year before the date of assent of the Act, the employer is able to use the multi-rate method of calculation by providing the necessary information to Inland Revenue during the two-month period that occurs after the date of assent.

FRINGE BENEFIT TAX – LOW-INCOME REBATE AND THE MULTI-RATE CALCULATION

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

Introduction

The definition of "tax on cash remuneration" in section ND 5(1) of the Income Tax Act 1994 has been amended to ensure that the full low-income rebate applies in the multi-rate calculation, irrespective of the employee's residence status.

Background

The Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) Act 2001, enacted early last year, included an equivalent amendment to section ND 5(2). However, as a result of an oversight, section ND 5(1) was not amended at the same time. This amendment corrects the oversight and ensures that employers are not required to ascertain an employee's residence status in calculating the tax on the employee's cash remuneration.

Key features

Section ND 5(1) has been amended to ensure that in calculating the tax payable on an employee's cash remuneration, as part of the multi-rate calculation, the low-income rebate is calculated as if the employee were resident in New Zealand for the full income year. In other words, employers do not have to apportion the low-income rebate on the basis of the individual periods of residency in New Zealand of their employees.

Application date

The amendment applies to fringe benefits provided:

- on or after 1 April 2000 for employers who pay fringe benefit tax on a quarterly or an annual basis; or
- during the 2000-01 or a subsequent income year for an employer who pays FBT on an income year basis.

REMEDIAL CHANGES TO THE GOODS AND SERVICES TAX ACT 1985

PENALTY INTEREST

Section 14(3) of the Goods and Services Tax Act 1985

Introduction

Amendments have been made to section 14(3) of the Goods and Services Tax Act 1985 concerning the treatment of penalty interest. The amendments extend the treatment of penalty interest, as consideration for an exempt supply, to charges imposed under an enactment and charges in the nature of penalty or default interest.

Background

As enacted in the Taxation (GST and Miscellaneous Provisions) Act 2000, penalty interest charged under a contract for the supply of goods and services is treated as consideration for an exempt supply. This is based on the policy that payments that compensate for the time value of money should not, in principle, be subject to GST and is comparable to other exempt supplies included in the section 3 definition of "financial services".

The wording of section 14(3) meant that the exemption of penalty interest applied only to amounts charged under contract for goods and services. This created a problem for some statutory authorities which had similar charges for default or late payment that were imposed under an enactment.

In response to submissions, the Finance and Expenditure Committee recommended an additional amendment to widen the exemption to include charges "in the nature of interest". This is to ensure that penalty charges imposed either under statute or contract that compensate for the time value of money, but are not specifically labelled as interest, are included within the ambit of section 14(3).

A further change defers the application of the amendment to 1 July 2003 for penalty interest and charges in the nature of penalty or default interest imposed by local authorities. This change was made to the amendment by way of a Supplementary Order Paper after additional consultation with affected taxpayers.

Key features

The amendment extends the exempt treatment of penalty interest in section 14(3) to:

- penalty interest charges imposed under an enactment, and
- charges in the nature of penalty or default interest.

Example

> An individual is late in paying a fee for a statutory licence. The relevant legislation allows the public authority to levy an additional 10% as the payment has not been made on the due date. If the 10% penalty is consideration for the time value of money then it should be treated as consideration for an exempt supply. If, however, the payment is treated as an increase in the fee for the licence then the amount should be treated as an increase in the consideration payable for the taxable supply.

Application date

The amendment applies to most statutory bodies, except local authorities, from 10 October 2000 - the date of enactment of the Taxation (GST and Miscellaneous Provisions) Act 2000. Local authorities will be able to apply the amendment from 1 July 2003 in relation to interest penalties applicable on rates.

APPLICATION OF THE CHANGE-IN-USE ADJUSTMENTS

Sections 21G(1A), 21H(3)(b) and (e) of the Goods and Services Tax Act 1985

A remedial amendment has been made to replace section 21F(3) with new section 21G(1A). The amendment confirms that a one-off adjustment for assets with a value of less than $18,000 can indeed only be made once and is not applicable on a period-by-period basis.

Section 21G(1) provides a general rule in respect of the timing of adjustments allowed under section 21F. Section 21F allows adjustments when there is a change-in-use to making taxable supplies. The general rule requires that adjustments for changes-in-use be made either on a taxable period-by-taxable period basis or annually. The concession to allow a one-off adjustment for assets with a value of less than $18,000 is included in a separate section as is appropriate when a specific rule overrides a general rule.

Two other amendments have been made to correct cross-references to sections 21H(3)(b) and (e).

The amendments do not involve policy changes.

Application date

The amendments apply from 10 October 2000, the date of enactment of the Taxation (GST and Miscellaneous Provisions) Act 2000.

GST ADJUSTMENT ON THE VALUE OF FRINGE BENEFITS

Section 23A(2) of the Goods and Services Tax Act 1985

The Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) Act 2001 included a business tax simplification initiative that moved the return of GST adjustments on the value of fringe benefits to fringe benefit tax returns. Previously, the adjustments were made as part of GST returns. Moving the adjustments from one return to another was intended to make them easier to calculate, as well as reduce the incidence of their omission.

A new section 23A(2) has been added to the GST Act which enhances the administration of the tax simplification initiative by recharacterising the adjustment as a payment of FBT for administration purposes. Before this amendment was made the adjustment retained its character as a payment of GST. The change means that the adjustment will be included with the underlying FBT in returns, notices, for the imposition of interest and penalties and for other similar administration processes.

Application date

This amendment has the same application date as the underlying reform and applies to tax paid on fringe benefits included in fringe benefit tax returns due:

- on and after 31 May 2002, for an employer who pays fringe benefit tax on a quarterly or an annual basis; and
- by the terminal tax date for the 2000-01 income year, for an employer who pays fringe benefit tax on an income year basis, and to subsequent fringe benefit tax returns required to be filed on an income year basis.

MINOR TECHNICAL AMENDMENTS

A number of other minor technical amendments have been made to the tax Acts, none of which results in a policy change. Unless otherwise stated, these amendments apply from the date of enactment.

THE NEW ZEALAND TEACHERS COUNCIL

Section CB 3A of the Income Tax Act 1994

When the New Zealand Teachers Council was established by the Education Standards Act 2001 (which amended the Education Act 1989), instead of saying that the Council is a public authority for income tax purposes, that Act inadvertently said that it was not one. This error has been corrected by adding a new section (CB 3A) to the Income Tax Act 1994 which over-rides the Education Act 1989. This provision will remain in effect until the Education Act 1989 is amended.

SUPERANNUATION FUND WITHDRAWAL TAX

Section CL 8(2) of the Income Tax Act 1994

A correction has been made to section CL 8(2) of the Income Tax Act 1994 to clarify that the exemption from superannuation fund withdrawal tax applies only if employer contributions in the income year of cessation of employment and each of the two preceding income years do not exceed 150% of the contributions made in the previous year.

FINANCIAL ARRANGEMENTS – ABSOLUTE ASSIGNMENTS AND DEFEANSES WITH DEFERRED CONSIFERATION

Section EH 46 of the Income Tax Act 1994

Section EH 46(4) has been inserted into the Income Tax Act 1994 to clarify the policy intention that an absolute assignment of existing financial arrangements or the defeasance of obligations under financial arrangements with deferred considerations will not terminate the financial arrangements. Thus a base price adjustment will not be performed for the financial arrangements under these circumstances and the deferred considerations will not be brought to tax under the base price adjustment. Instead, the deferred considerations will be taxed, as originally intended, on an accrual basis over the term of the arrangements.

FOREIGN TAX CREDITS

Section LC 14A of the Income Tax Act 1994

The content of section OE 6 of the Income Tax Act 1994 has been relocated to subpart LC (relating to foreign tax credits) as new section LC 14A. Former section OE 6 provided that a dividend paid by a non-resident company is deemed to be derived from that company's country of residence for the purposes of a double tax agreement between New Zealand and that other country. The provision was originally enacted in 1960 as part of the foreign tax credit provisions, and its purpose was to facilitate foreign tax credit claims by New Zealand residents. However, when the Income Tax Act 1994 was enacted this provision was incorrectly included in Part OE, as part of the provisions defining the classes of income deemed to be derived from New Zealand. The amendment places this provision in the correct part of the Income Tax Act 1994, which is subpart LC concerning foreign tax credits.

NON-STANDARD INCOME TAX PROVISIONAL TAXPAYERS

Section MB 2A of the Income Tax Act 1994

An amendment clarifies the law to ensure that taxpayers in a "non-standard income year" can elect to become provisional taxpayers under section MB 2A of the Income Tax Act 1994. The amendment applies from the 1998-99 income year (the application date of the section being amended).

INACCURATE SECTION HEADINGS

Section MC 1 of the Income Tax Act 1994

Section 61 of the Tax Administration Act 1994

The former section heading of section MC 1 was "Assessment and payment of terminal tax". The assessment function of this provision (former subsection (1)) was repealed as part of the 1996 core provisions amendments. Accordingly, the section MC 1 heading has been changed to: "Payment of terminal tax by provisional taxpayer" to more accurately reflect the section's contents.

The former section heading of section 61 of the Tax Administration Act 1994 was "Disclosure of interest in foreign investment fund". This heading was inaccurate because section 61 requires disclosure of income interests and control interests in all foreign companies as well as interests in foreign investment funds (FIFs). Although there is some overlap between these two categories, there are many interests in foreign companies which are not FIF interests—for example, interests in grey list companies. (Exemptions from these disclosure requirements are made by the Commissioner under section 61(2).) Accordingly, the section 61 heading has been replaced by "Disclosure of interest in foreign company or foreign investment fund" to more accurately reflect the section's contents.

GROUP INVESTMENT FUNDS' IMPUTATION CREDITS

Section ME 4 of the Income Tax Act 1994

A minor drafting error in section ME 4(1)(a) has been corrected to ensure that taxes paid by group investment funds on category A income qualify for imputation credits. Category A income of group investment funds are taxed in accordance with company tax rules, while category B income are taxed under the trust rules. Thus only income taxes paid on category A income should qualify for imputation credits. However, a drafting error in section ME 4(1)(a) meant that group investment funds were prohibited from claiming imputation credits for income tax paid on category A income but were allowed to claim imputation credits on category B income since the 1997-1998 income year. The amendment corrects this drafting error, with retrospective effect from the 1997-1998 income year.

CHARITABLE ENTITY IN RECEIPT OF FOREIGN DIVIDENDS

Section NH 1 of the Income Tax Act 1994

Section NH 1 has been amended to correct an error and clarify the law to ensure that a company or deemed company which is exempt from income tax under section CB 4 of the Income Tax Act 1994 (non-profit bodies "and charities" exempt income) is also exempt from dividend withholding payment obligations. The amendment applies from the 1997-1998 income year (the application date of the core provisions amendments).

DEFINITION OF "DISPOSITION OF PROPERTY"

Section OB 1 of the Income Tax Act 1994

The definition of "disposition of property" in section OB 1 of the Income Tax Act 1994 has been amended so that it also applies for the purpose of the definition of "settlor" (which is also contained in section OB 1). The term "disposition of property" is used in the definition of "settlor". However, the definition of "disposition of property" did not previously state that it applies for the purpose of the settlor definition.

NON-FILING TAXPAYERS

Section OB 1 of the Income Tax Act 1994

The definition of "non-filing taxpayer" in section OB 1 of the Income Tax Act 1994 has been amended by replacing the reference to "natural person" with "person". This amendment reinstates the position as it was before 1 April 1999, when the definition was inadvertently changed so that it referred to natural persons only. The previous reference to "natural person" meant that a non-resident company which derived section NG 3-type non-resident withholding income (dividends, unrelated party interest and copyright royalties) only did not come within the definition. As a consequence, such a taxpayer did not come within section BC 2, which provides that the income tax liability of a non-filing taxpayer is the total of the tax deductions required to be made from that taxpayer's gross income. As a matter of policy, this type of taxpayer should come within the definition of "non-filing taxpayer". The amendment applies from 1 April 1999.

TAXPAYERS NOT REQUIRED TO FILE INCOME TAX RETURNS

Section 33A of the Tax Administration Act 1994

Section 33A(1)(a) of the Tax Administration Act 1994 contains one of several conditions that must be satisfied before an individual is entitled not to file an income tax return. The condition is intended to be satisfied only if the person's annual gross income is derived exclusively from certain types of income from employment, interest or dividends. The word "only" has been inserted into this provision to ensure that its policy intention is more clearly stated. Also, the term "annual gross income" is replaced with the more simple term "gross income" without changing the effect of the provision.

CHARITABLE DONATIONS/CHILDCARE REBATES

Section 41A of the Tax Administration Act 1994

Section 41A of the Tax Administration Act 1994 has been amended to reinstate the correct rule that:

- Standard and early balance date taxpayers can apply for a refund for an income year from 1 April next following the end of the taxpayer's income year.
- Late balance date taxpayers can apply for a refund for an income year from the first day of the taxpayer's next accounting year.

The rule was inadvertently removed in 2001 as part of the change that extended the time for claiming rebates on donations and childcare expenses.

This rule has been reinstated from the 2001-02 income year.

TRUST INCOME TAX RETURNS

Section 59 of the Tax Administration Act 1994

Section 59(3) of the Tax Administration Act 1994 relates to income tax returns required to be filed by trustees of trusts. The provision has been amended to clarify that a trustee is required to furnish a return of all income the trustee derives, whether the income is beneficiary income or trustee income. This has always been the policy intention of this provision. However, the legislation was previously not clear on this issue, since a 1996 amendment related to the core provisions replaced a reference to "whole income" with "taxable income". This amendment replaces the taxable income reference with a reference to all income derived by a trustee of a trust. The amendment applies from the 1997-98 income year.

LATE PAYMENT PENALTIES

Section 139B of the Tax Administration Act

Section 139B of the Tax Administration Act 1994 has been amended to make it clear that:

- Incremental late payment penalties can be imposed after 1 April 2002 regardless of whether the initial late payment penalty or previous incremental late payment penalties were imposed under the current or prior penalty rules.
- For instalments entered into from 1 April 2002, the non-imposition of late payment penalties on debt that is subject to compulsory deductions applies only if repayments are being received in accordance with the deduction notice.

183AB of the Tax Administration Act 1994

The new section 183AB reinstates a provision that allows penalties to be cancelled if instalment arrangements or compulsory deduction action started before 1 April 2002. The new rules that prevent penalties from being imposed if instalments or compulsory deductions are being made do not apply if the instalment arrangement was entered into before 1 April 2002 or a compulsory deduction order was issued before that date.

TAXATION (TAXPAYER ASSESSMENT AND MISCELLANEOUS PROVISIONS) ACT 2001

Section 239 of the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001

Section 239(1) of the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001 has been amended by omitting the reference to section 90 of the Taxation (GST and Miscellaneous Provisions) Act 2000. Section 239(1) amends the voucher provisions in section 10 of the GST Act for the period between 1 October 1986 and 19 May 1999. Section 239(1) correctly refers to amending section 10 of the GST Act as it was before its amendment by section 79 of the Taxation (Remedial Matters) Act 1999, which amendment had effect from 20 May 1999. However, the previous reference in the same provision to section 90 of the Taxation (GST and Miscellaneous Provisions) Act 2000 was incorrect and has accordingly been omitted. The amendment applies from 24 October 2001.

STANDARD PRACTICE STATEMENTS

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

INSTALMENT ARRANGEMENTS FOR PAYMENT OF TAX DEBT

Standard Practice Statement IR– SPS RDC 610

This Standard Practice Statement also appears in *Tax Information Bulletin* Vol 14, No 11 (November 2002).

Introduction

This Standard Practice Statement (SPS) states the Commissioner's practice on providing relief by way of an instalment arrangement when taxpayers are in debt. The Commissioner's practice on providing relief by way of write-off is detailed in Standard Practice Statement RDC 620 - Writing off tax debt.

Application

This SPS applies to applications for relief by way of instalment arrangement made on or after 1 December 2002 and replaces Standard Practice Statement RDC 6.1 originally published in *Tax Information Bulletin* Vol 13, No 4 (April 2001).

This SPS does not relate to instalment arrangements for payment of child support arrears by non-custodial or custodial parents.

References to late payment penalties and interest in this SPS do not apply to student loan repayment obligations.

Summary

Section 177 of the Tax Administration Act 1994 (TAA) allows a taxpayer to apply for financial relief by requesting to enter into an instalment arrangement.

The Commissioner will negotiate with the taxpayer to determine what method of payment best suits the taxpayer's financial situation and will maximise recovery of the outstanding tax from the taxpayer.

Applications for relief by way of an instalment arrangement may be made by telephone or in writing.

The Commissioner may require relevant financial information to be provided in support of the application. This information must be provided within 20 working days or such other time as negotiated between the taxpayer and the Commissioner.

The legislation imposes no time limit in which an instalment arrangement must be completed. However, these will generally be over the shortest period of time in order to maximise the recovery of outstanding tax.

When considering an application for financial relief, the Commissioner is required to ensure that the proposed instalment arrangement maximises the recovery of the outstanding tax, but must not enter into an instalment arrangement that:

- would be an inefficient use of the Commissioner's resources, or
- would place a taxpayer, being a natural person, in serious hardship.

Use-of-money interest will continue to accrue during the term of an instalment arrangement.

Monthly incremental late payment penalties however, will not be imposed on any debt under instalment arrangement for each month that the instalment arrangement is adhered to. This non-imposition applies from the date the taxpayer contacts Inland Revenue seeking financial relief, provided relief is granted.

When the Commissioner accepts an instalment arrangement, a letter of confirmation setting out both the taxpayer's and the Commissioner's obligations will be issued.

Background

The Commissioner's authority to enter into instalment arrangements for the payment of tax, pursuant to the TAA was amended with effect from 1 December 2002 to:

- clarify the debt and hardship provisions so that the Commissioner's role is to maximise the recovery of outstanding debt from a taxpayer, but not if:
  - recovery would represent an inefficient use of the Commissioner's resources; or
  - a taxpayer, being a natural person, would be placed in serious hardship by enforcement of the debt.
- provide that, if the Commissioner can collect more of a debt over time through an instalment arrangement than from bankruptcy or liquidation action, the Commissioner is required to enter into an instalment arrangement.

The late payment penalty provisions in the TAA were also amended with effect from 1 April 2002. The initial late payment penalty is now split with a staggered application. In addition, certain penalties will not be charged while a debt is under an instalment arrangement.

Legislation

All legislative references are to the Tax Administration Act 1994 (TAA) unless otherwise stated.

176 Recovery of tax by Commissioner

(1) The Commissioner must maximise the recovery of outstanding tax from a taxpayer.

(2) Despite subsection (1), the Commissioner may not recover outstanding tax to the extent that-

(a) recovery is an inefficient use of the Commissioner's resources; or

(b) recovery would place a taxpayer, being a natural person, in serious hardship.

177 Taxpayer may apply for financial relief

(1) A taxpayer, or a person on a taxpayer's behalf, applies for financial relief by either-

(a) making a claim stating why recovery of outstanding tax would place the taxpayer in serious hardship; or

(b) requesting to enter into an instalment arrangement with the Commissioner by telephone or in writing.

(2) The Commissioner may require a taxpayer, or a person on a taxpayer's behalf, to apply for financial relief under subsection (1)(a) in writing.

(3) Upon receiving a request, the Commissioner may –

(a) accept the taxpayer's request; or

(b) seek further information from the taxpayer; or

(c) make a counter offer; or

(d) decline the taxpayer's request.

(4) A taxpayer has 20 working days, or a longer period allowed by the Commissioner, to provide the information sought or to respond to a counter offer.

(5) If the Commissioner receives information or a response from a taxpayer outside the time period allowed under subsection (4), the receipt of the information or the response will be treated as a new request for financial relief.

177A Definition of serious hardship

(1) In this section and sections 176, 177, 177B and 177C**, serious hardship**, in relation to a taxpayer, being a natural person,-

(a) includes significant financial difficulties that arise because of-

(i) the taxpayer's inability to meet minimum living expenses according to normal community standards; or

(ii) the cost of medical treatment for an illness or injury of the taxpayer or the taxpayer's dependant; or

(iii) a serious illness suffered by the taxpayer or the taxpayer's dependant; or

(iv) the cost of education for the taxpayer's dependant; and

(b) does not include significant financial difficulties that arise because-

(i) the taxpayer is obligated to pay tax; or

(ii) the taxpayer may become bankrupt; or

(iii) the taxpayer's, or the taxpayer's dependant's, social activities and entertainment may be limited; or

(iv) the taxpayer is unable to afford goods or services that are expensive or of a high quality or standard according to normal community standards.

(2) The Commissioner may take into account whether the recovery of outstanding tax would place-

(a) a shareholder who owns, or 2 shareholders who jointly own, 50% or more of the shares in a company in serious hardship; or

(b) a shareholder-employee of a close company in serious hardship.

(3) For the purpose of subsection (2), **close company** means a company that satisfies paragraph (a) of the definition of **close company** in section OB 1 of the Income Tax Act 1994.

177B Instalment arrangements

(1) The Commissioner must not enter into an instalment arrangement with a taxpayer to the extent that the arrangement would place the taxpayer in serious hardship.

(2) The Commissioner may decline to enter into an instalment arrangement if -

(a) to do so would not maximise the recovery of outstanding tax from the taxpayer; or

(b) the Commissioner considers that the taxpayer is in a position to pay all of the outstanding tax immediately; or

(c) the taxpayer is being frivolous or vexatious; or

(d) the taxpayer has not met their obligations under a previous instalment arrangement.

(3) A taxpayer may renegotiate an instalment arrangement at any time.

(4) The Commissioner may renegotiate an instalment arrangement at any time after the end of 2 years from the date on which the instalment arrangement was entered.

(5) The renegotiation of an instalment arrangement is treated as if it were a new request for financial relief.

(6) The Commissioner may cancel an instalment arrangement if –

(a) it was entered into on the basis of false or misleading information provided by the taxpayer; or;

(b) the taxpayer is not meeting their obligations under the arrangement.

177CA Proof of debt

(1) This section applies if –

(a) a taxpayer has entered into an instalment arrangement with the Commissioner; and

(b) the taxpayer is a person who has become bankrupt, or a company which is in the course of being liquidated.

(2) Any amount outstanding under the instalment arrangement must be included in the Department's proof of debt.

139B Late payment penalty

(1) A taxpayer is liable to pay a late payment penalty if and to the extent the taxpayer does not pay on time the amount of tax (in this section referred to as "the unpaid tax") –

(a) that the taxpayer calculates as payable; or

(b) for which the taxpayer has been assessed.

(2) The late payment penalty comprises an initial late payment penalty and an incremental late payment penalty.

(2A) The initial late payment penalty is –

(a) 1% of the unpaid tax; and

(b) 4% of the amount of tax to pay at the end of the 6th day after the day on which a penalty is imposed under paragraph (a).

(2B) The incremental late payment penalty is 1% of the amount of tax to pay on each day that falls one month after the day on which a penalty is imposed under subsection (2A)(a) or this subsection, or section (2) as it was before the enactment of section 51(1) of the Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) Act 2001.

(3) The part of an initial late payment penalty imposed under subsection (2A)(a) is to be added to the unpaid tax to which it relates on the day after the due date for payment of the unpaid tax.

(3A) The part of an initial late payment penalty imposed under subsection (2A)(b) is to be added to the tax to pay to which it relates at the end of the 6th day after the day on which an initial late payment penalty is imposed under subsection (2A)(a).

(3B) The part of an initial late payment penalty imposed under subsection (2A)(b) is not to be added if the Commissioner has exercised powers available under section 157 of this Act or section 43 of the Goods and Services Tax Act 1985 or any similar tax law before the end of the 6th day after the day on which an initial late payment penalty is imposed under subsection (2A)(a) and has received the tax deducted in accordance with the requirements of a notice issued as a result of the Commissioner exercising those powers.

(4) An incremental late payment penalty is to be added to the tax to pay to which it relates on the day after the last day of successive monthly intervals during which the tax to pay remains unpaid.

(5) If an incremental late payment penalty would, apart from this subsection, be added to any tax to pay on a date that does not exist in a month, the penalty is to be added to the tax to pay on the last day of the month.

(5A) An incremental late payment penalty is not to be added if, for a month during which the tax to pay remains unpaid, the Commissioner has exercised powers available under section 157 of this Act or section 43 of the Goods and Services Tax Act 1985 or any similar tax law and has received the tax deducted in accordance with the requirements for the month of a notice issued as a result of the Commissioner exercising those powers.

(6) In this section and section 139BA –

(a) The term "tax to pay" means, at any time, an amount equal to the unpaid tax together with any late payment penalty that has been imposed in whole or in part in respect of the unpaid tax, to the extent that at that time the amount remains unpaid:

(b) The unpaid tax is deemed to be the last part of any tax to pay that a taxpayer pays:

(c) The term "unpaid tax" –

(i) includes a deduction of tax that must be made and paid to the Commissioner under a tax law; but

(ii) does not include a late payment penalty.

139BA Imposition of late payment penalties when financial relief sought

(1) If a taxpayer has outstanding tax and contacts the Commissioner seeking financial relief before the due date, the Commissioner must impose the late payment penalty under section 139B(2A)(a) on unpaid tax but must not impose the late payment penalty under section 139B(2A)(b).

(2) If a taxpayer has outstanding tax and contacts the Commissioner seeking financial relief on or after the due date, the Commissioner must not impose an incremental late payment penalty on unpaid tax on and after the date of the request.

(3) Subsections (1) and (2) apply until the earlier of-

(a) the date that the Commissioner makes a decision not to give financial relief; and

(b) the last day of the response period allowed by section 177(3) if the taxpayer does not provide the information sought or respond to a counter offer.

(4) If an instalment arrangement is entered into, an incremental late payment penalty is not to be added if, for a month during which the tax to pay remains unpaid, the taxpayer complies with all of their obligations under the arrangement.

(5) If an instalment arrangement is cancelled on the basis of false or misleading information provided by the taxpayer, the Commissioner must impose those late payment penalties not imposed as if the instalment arrangement had not been entered into.

(6) If financial relief is not given, the Commissioner must impose those late payment penalties not imposed as if the request for financial relief had not been made.

Standard Practice

The TAA allows a taxpayer to apply for financial relief. The relief may be in the form of an instalment arrangement and/or write-off of all or part of the tax outstanding. However, the Commissioner must not enter into an instalment arrangement if this would place a taxpayer, being a natural person, in serious hardship, or if recovery would represent an inefficient use of the Commissioner's resources. (The Commissioner's practice on providing relief by way of write-off is detailed in Standard Practice Statement RDC 620 – Writing off tax debt).

Taxpayers may apply for an instalment arrangement by telephone or in writing. In all cases it will be necessary to provide supporting financial information. This information can be supplied either orally or in writing. In some cases, it will be necessary for the Commissioner to obtain written financial information to verify or further support the application.

When considering an instalment arrangement the Commissioner will ensure that the agreed instalment arrangement will enable the taxpayer to meet minimum living expenses according to normal community standards and to make provision for future tax obligations.

Upon receipt of an application the Commissioner may:

1. *Accept the taxpayer's request*

   Confirmation that the request has been accepted will be made in writing. This will include the commencement date of the instalment arrangement, together with any terms and conditions in addition to the agreed repayments under the instalment arrangement negotiated between Inland Revenue and the taxpayer.

   If the taxpayer disagrees with any of the terms and conditions they should contact the Inland Revenue officer who issued the confirmation immediately.

2. *Seek further information from the taxpayer*

   If the Commissioner requires additional information it must be received by a date agreed to between the Commissioner and the taxpayer.

3. *Make a counter offer*

   The Commissioner may make a counter offer to the taxpayer if, after consideration of the taxpayer's financial circumstances, the Commissioner considers the taxpayer is in a position to make instalments at a higher amount than was proposed by the taxpayer in the application. Alternatively, the Commissioner may consider that to accept instalments based on the amount the taxpayer offers to pay would place the taxpayer in serious hardship. In this case the Commissioner may make a counter offer to accept instalments of a lesser amount.

4. *Decline the request*

   The Commissioner must not enter into an instalment arrangement to the extent that it would place a taxpayer, being a natural person, in serious hardship or if recovery would represent an inefficient use of the Commissioner's resources. If the Commissioner declines a request for an instalment arrangement the taxpayer will be notified of the reasons for the decision.

   In addition, the Commissioner may decline to enter into an instalment arrangement if it is considered that the taxpayer is able to pay the debt in full. For example, a taxpayer has term deposits or other investments or the ability to borrow sufficient funds to pay the outstanding tax. The Commissioner may also decline a request if he considers that more can be recovered by commencing bankruptcy or liquidation proceedings.

Timeframe for responding

If the Commissioner is unable to make a decision on granting relief immediately and requires further information, or makes a counter offer, the taxpayer will be advised in writing. The letter will contain the following details:

- the date the application was received;
- the name and contact number of the Inland Revenue staff member handling the request;
- what additional information the taxpayer is required to supply (if applicable);
- the timeframe for the supply of that information;
- the consequences of failing to provide that information by the required date.

The taxpayer is required to provide the information requested or respond to the Commissioner's counter offer within 20 working days. However, the Commissioner may allow a longer period if the taxpayer is having difficulties obtaining the required information or responding to the counter offer within the time frame. In this situation, the taxpayer may contact Inland Revenue to request an extension of the response period. The Commissioner will consider such a request on its own merits, taking into account the reason the taxpayer is having difficulty providing the information or responding to the counter offer.

Late payment penalties will not be charged during this period. However, use-of-money interest will continue to be charged on a daily basis.

If the information or response to the Commissioner's counter offer is not provided within the negotiated timeframe, late payment penalties will be imposed as though no application had been made. If the information is forwarded at a later date, the Commissioner will treat this as a new request for financial relief unless there is good reason why the taxpayer was unable to provide the information or respond to the Commissioner's counter offer within the timeframe. Possible reasons could include illness, or involvement in an accident which prevented the taxpayer from contacting Inland Revenue to request an extension.

If the Commissioner, upon receipt of the information requested, declines to enter into an instalment arrangement, any late payment penalties not imposed during the response period will be imposed as though no application for financial relief had been made.

The Commissioner will not commence recovery action during a negotiation period. However, if recovery action has already commenced, the Commissioner will discuss with the taxpayer whether this recovery action will continue during the negotiation period. For example, a taxpayer may already be paying an outstanding amount by way of an instalment arrangement and may contact the Commissioner to discuss a reduction in the instalment amounts. In this instance, the Commissioner will discuss with the taxpayer whether the current instalment arrangement is to continue until such time as a new instalment arrangement is successfully negotiated.

If the taxpayer incurs further debt during the response period, this amount may be added to the total amount under negotiation.

Considering the request

When considering a request for an instalment arrangement, Inland Revenue will take into account the following factors:

1. *Whether the proposal will place the taxpayer, being a natural person, in serious hardship*

   This requires the Commissioner to take into account the circumstances of the taxpayer, specifically:

   - whether the taxpayer will be unable to meet minimum living expenses according to normal community standards;
   - the cost of medical treatment for an illness or injury of the taxpayer or the taxpayer's dependant(s);
   - a serious illness suffered by the taxpayer or the taxpayer's dependant(s);
   - the cost of education for the taxpayer's dependant(s).

   The Commissioner may take into account whether the recovery of outstanding tax would place a shareholder who owns, or two shareholders who jointly own, 50% or more of the shares in a company or a shareholder-employee of a close company in serious hardship.

   A "close company" for these purposes means a company which has five or fewer natural persons whose voting interests or market value interests exceed 50%.

   Serious hardship does not include financial difficulties that arise because:

   - the taxpayer is obligated to pay tax;
   - the taxpayer may become bankrupt;
   - the taxpayer's, or the taxpayer's dependant's, social activities and entertainment may be limited;
   - the taxpayer is unable to afford goods or services that are expensive or of a high quality or standard according to normal community standards.

Whether a person is a taxpayer's "dependant" will be determined on a case-by-case basis. In determining dependency issues, the Commissioner will consider whether the person is dependent on the taxpayer for financial support and what degree of financial support is provided by the taxpayer. The Commissioner will also consider to what extent providing financial support impacts on the taxpayer's ability to meet minimum living expenses according to normal community standards.

For further discussion on consideration of serious hardship, refer to Standard Practice Statement RDC 620 – Writing off tax debt.

2. *Whether the instalment arrangement would maximise the recovery of outstanding tax from the taxpayer*

The Commissioner has a duty to maximise the recovery of outstanding tax from a taxpayer. Inland Revenue is therefore obliged to compare the value of the likely recovery from entering into an instalment arrangement with any other viable options for recovery. In some cases, it is clear which option will maximise recovery. In other cases there may be options that could yield similar returns. Accordingly it is necessary to determine which option will maximise recovery.

Whilst not necessary in most circumstances, one method of distinguishing between alternative repayment options is to apply a net present value calculation.

A net present value calculation recognises the time value of money, as well as the probability of payment (risk). The proposed payments are discounted for the time value of money and for the likelihood of receiving the money. Inland Revenue needs to determine the amount, date, and probability of each payment and apply an appropriate discount rate. The discount rate is calculated from published Government stock rates. Inland Revenue uses a calculation that multiplies the amount of payment by the probability of payment (for risk), divided by the discount factor appropriate to the term (for interest).

The methodologies for determining the discount rate, probability of payment and net present value are outlined in the appendix to *Tax Information Bulletin* Vol 6, No. 14 (June 1995).

The legislation imposes no time limit in which an instalment arrangement must be completed. However, the Commissioner considers it desirable, in order to maximise the recovery of outstanding tax, that instalment arrangements are over a shorter period of time, rather than a longer period of time. This is because the longer the period the greater the risk of non-payment and the greater the loss of the time value of money.

Generally where payment in full cannot be made and a proposed instalment arrangement is for an amount less than $10,000 and for less than 12 months' duration, the Commissioner will consider recovery to be maximised by an instalment arrangement.

The Commissioner will also consider whether the proposed instalment arrangement would lead to a monetary return to Inland Revenue greater than any amount likely to be received if legal proceedings were instigated.

3. *Whether the taxpayer is in a position to pay all of the outstanding tax immediately*

This opinion will be based on the financial information provided by the taxpayer and the result of any further enquiries the Commissioner considers necessary.

4. *Whether the taxpayer has met their obligations under a previous instalment arrangement*

Where a taxpayer has previously had an instalment arrangement accepted by the Commissioner and has not met their obligations under that instalment arrangement, the Commissioner may decline to enter into a further instalment arrangement.

In reaching this decision, the Commissioner will also take into account the length of time since the previous instalment arrangement, whether the previous instalment arrangement was realistic, any changes in the taxpayer's position over that time and whether there are any other factors likely to indicate that the taxpayer will meet their obligations if an instalment arrangement is agreed to this time.

5. *Whether the taxpayer is being frivolous or vexatious*

This includes situations where the Commissioner considers the taxpayer is not seriously contemplating entering into, and/or complying with an instalment arrangement, or where previous requests for instalment arrangements have been declined and the taxpayer provides the same information when requesting a further instalment arrangement. The Commissioner may decline to enter into an instalment arrangement.

For example, if the Commissioner has previously declined to enter into an instalment arrangement and the taxpayer makes subsequent requests for an instalment arrangement, and provides the same or similar information as supplied with the earlier requests for an instalment arrangement, the Commissioner may decline to enter into an instalment arrangement.

6. *Whether the proposal is realistic*

   This opinion will be based upon the financial information provided by the taxpayer and any further information the Commissioner considers necessary. The Commissioner will consider whether the taxpayer can reasonably afford to repay the outstanding amount at the rate detailed in the taxpayer's application.

7. *The likelihood of future compliance*

   The Commissioner will consider whether entering into an instalment arrangement would be likely to allow the taxpayer to meet future tax obligations by their due dates. For example, if a taxpayer is continuing in business, whether the instalment arrangement would allow the taxpayer to meet his or her ongoing terminal, provisional and GST obligations as they arise.

8. *Whether the taxpayer has filed all required returns*

   Inland Revenue may, in certain circumstances, request outstanding returns to be filed in order to ascertain the taxpayer's full debt situation. This may occur if the outstanding amount relates to assessments made by the Commissioner in the absence of returns having been filed.

Cancellation of an instalment arrangement

In accordance with section 177B, the Commissioner may cancel an instalment arrangement under the following circumstances:

- If the instalment arrangement was entered into on the basis of false or misleading information provided by the taxpayer. For example, where a taxpayer has overstated outgoings or understated income, it may not have been appropriate for the Commissioner to have entered into an instalment arrangement; or where a taxpayer has a vested right to income or assets of a trust, and this was not disclosed to the Commissioner.
- If the repayment obligations under the instalment arrangement are not being met.

If an instalment arrangement is cancelled because misleading information was provided, any late payment penalties not charged under the instalment arrangement from the date the taxpayer contacted Inland Revenue seeking financial relief will be reinstated in full.

Where an instalment arrangement is cancelled due to the repayment obligations not being met, incremental late payment penalties will be imposed on a monthly basis from the date the taxpayer stops meeting the repayment obligations. Any late payment penalties not charged under the instalment arrangement from the date the taxpayer contacted Inland Revenue seeking financial relief, to the date Inland Revenue cancels the instalment arrangement are not reinstated.

Payments

The Commissioner will negotiate with the taxpayer to determine what frequency and method of payment best suits the taxpayer's financial circumstances and will maximise recovery of the outstanding tax from the taxpayer.

Inland Revenue cannot apply any credits that arise in a taxpayer's account to the outstanding amount when an instalment arrangement exists unless requested to do so by the taxpayer.

A taxpayer may start making voluntary payments at any time, without contacting the Commissioner to request an instalment arrangement. However, in these situations the taxpayer will not be eligible for any late payment penalty reduction or suppression. If the taxpayer does subsequently make contact to request an instalment arrangement, after commencing the voluntary payments, and that request is granted, the suppression of penalties will apply from the date the taxpayer contacted the Commissioner requesting financial relief.

Reviewing instalment arrangements

A taxpayer may renegotiate an instalment arrangement at any time.

The Commissioner may only initiate renegotiation of an instalment arrangement after the end of 2 years from the date on which the instalment arrangement was entered into. Such a review will consider whether the instalment arrangement is still appropriate to the taxpayer's financial circumstances and may therefore require updated financial information from the taxpayer.

The date the instalment arrangement is entered into is the date the instalment arrangement is accepted by the Commissioner and will be set out in the letter from the Commissioner to the taxpayer when the Commissioner accepts the instalment arrangement.

Instalment arrangements for student loan repayment obligations

The definition of tax in section 3 of the TAA specifically excludes student loan repayment obligations. Therefore, Inland Revenue cannot enter into instalment arrangements with taxpayers for repayment of student loan repayment obligations under section 177 of the TAA. However, when the general recovery provisions in section 156 of the TAA are exercised in conjunction with the Commissioner's discretion under section 6A, the Commissioner is able to enter into instalment arrangements for student loan debt. This is provided there is a reasonable basis for believing that such steps will result in the collection of the highest net revenue over time, having regard to the factors listed in section 6A(3).

To ensure consistency, it is appropriate to have substantially the same criteria and processes for all instalment arrangements. Therefore, the criteria the Commissioner will use for instalment arrangements for outstanding student loan repayment obligations are:

- any application for relief by way of an instalment arrangement may be made orally or in writing;
- an instalment arrangement must result in the collection of highest net revenue over time.

Where the Commissioner considers entering into an instalment arrangement to clear tax arrears would maximise recovery and the taxpayer also has arrears relating to student loan repayment obligations, the Commissioner considers entering into an instalment arrangement for the student loan repayment obligation debt would result in the collection of highest net revenue over time.

No right of objection or challenge

There is no statutory right to challenge or object to any decision of the Commissioner to grant or cancel relief.[1]

However, if a taxpayer does not agree with the Commissioner's decision not to grant relief, the taxpayer may request that the decision be reviewed by the officer involved or their superior officer. The decision may also be reviewed by the Ombudsman or by way of judicial review.

Late payment penalties

Imposition of late payment penalties

Late payment penalties under section 139B of the TAA may be imposed on late payment of all revenues except student loan repayment obligations and child support payments by custodial or non-custodial parents. Late payment penalties in respect of student loan repayment obligations and child support arrears are charged under section 44 of the Student Loan Scheme Act 1992 and section 134 of the Child Support Act 1991 respectively.

Late payment penalties imposed under section 139B comprise an initial late payment penalty and an incremental late payment penalty.

The initial late payment penalty is a two-step penalty being:

- an initial late payment penalty of 1% imposed on the day after due date; and
- a second initial late payment penalty of 4% imposed at the end of the 6th day after the date on which the 1% initial late payment penalty is imposed if the tax owing remains outstanding. In practice, if the tax owing remains outstanding, this means the 4% second initial late payment penalty is imposed at the end of the 7th day after the due date.

An incremental late payment penalty of 1% is imposed on the balance of debt outstanding at the end of every month after the date the initial 1% late payment penalty was imposed.

For instalment arrangements entered into on or after 1 April 2002, the Commissioner will review these on a monthly basis to determine whether the amount expected in respect of the instalment arrangement has been received for the previous month. Where the instalment has been received, no incremental late payment penalty will be imposed for that month.

The agreed instalment arrangement amount is the minimum amount that is due each month. Extra payments in one month are not used as credits toward future monthly obligations. Instead they help toward reducing the term of the instalment arrangement and the amount of interest payable.

Instalment arrangements entered into before the due date pre-emptive arrangements

Where the taxpayer contacts the Commissioner seeking financial relief by way of an instalment arrangement before the due date, the 1% initial late payment penalty will be imposed. However, the 4% initial late payment penalty will not be imposed. This type of arrangement is called a "pre-emptive" instalment arrangement.

In addition, where monthly repayment obligations under the instalment arrangement have been met, the monthly incremental late payment penalty of 1% will not be imposed for that month. Failing to meet any monthly repayment obligations will result in the incremental late payment penalty being imposed for that month based on the balance outstanding under that instalment arrangement.

If financial relief is not granted, the late payment penalties mentioned above will be imposed as if the taxpayer had not requested financial relief.

[1] Section 138E(1)(e)(iv) Tax Administration Act 1994

Instalment arrangements entered into on or after due date

Where the taxpayer contacts the Commissioner seeking financial relief on or after the due date, both the 1% initial late payment penalty and the 4% initial late payment penalty will be imposed. In addition, any incremental late payment penalties imposed up to the date the taxpayer requests financial relief are also payable.

The monthly incremental late payment penalty of 1% will not be charged in those months where the monthly repayment obligations are met. Failing to meet monthly repayment obligations will result in an incremental penalty being imposed for that month based on the balance outstanding under that instalment arrangement.

If all obligations under the instalment arrangement are met, these instalment arrangements will, in effect, be charged only the 1% and 4% initial late payment penalties plus any monthly incremental penalties imposed prior to the taxpayer requesting financial relief.

Other instalment arrangements

For instalment arrangements entered into prior to 1 April 2002, instalment arrangements for student loan repayment obligations and additional tax imposed on any period prior to 1 April 1997, additional taxes or late payment penalties will continue to apply during the term of the instalment arrangement. Any additional tax or late payment penalties charged **after the date the instalment arrangement was entered into** will be cancelled upon successful completion of the instalment arrangement. In practice, cancellation of penalties can occur as each period under the instalment arrangement clears provided the instalment arrangement is being adhered to.

This Standard Practice Statement was signed by me on 11 November 2002.

Colin Hutchins
National Manager
Technical Standards

WRITING OFF TAX DEBT

Standard Practice Statement IR – SPS RDC 620

This Standard Practice Statement also appears in *Tax Information Bulletin* Vol 14, No.11 (November 2002).

Introduction

This Standard Practice Statement (SPS) states the Commissioner's practice for granting financial relief by permanently writing off tax debt. The Commissioner's practice on providing relief by way of instalment arrangements is detailed in SPS RDC 610 – Instalment arrangements for payment of tax debt.

Application

This SPS applies to all write-offs from 1 December 2002.

This SPS does not apply where the Commissioner has, prior to 1 December 2002, advised the taxpayer in writing that the outstanding tax has been provisionally written off (payment deferred) unless the amount provisionally written off is reinstated after 1 December 2002.

This SPS does not apply to financial support as defined in the Child Support Act 1991 or to student loan repayment obligations.

Summary

Taxpayers who cannot pay their tax may apply to the Commissioner for financial relief. The financial relief may be in the form of an instalment arrangement and/or write-off of some or all of the outstanding tax.

In negotiations with a taxpayer, the Commissioner will endeavour to determine as soon as possible whether or not the taxpayer is eligible for financial relief and to what extent.

Where the Commissioner is unable to make a decision on granting relief immediately as further information is required from the taxpayer, the taxpayer must provide the information within 20 working days or such other time as negotiated between the taxpayer and Commissioner. Late payment penalties will not be charged during this period provided financial relief is granted. However, use-of-money interest will continue to be charged on a daily basis.

The Commissioner must maximise the recovery of outstanding tax from a taxpayer but not if recovery represents an inefficient use of the Commissioner's resources or would place a taxpayer, being a natural person, in serious hardship.

The Commissioner must write off amounts that cannot be recovered due to bankruptcy, liquidation or where a taxpayer's estate has been distributed. The Commissioner may also write off amounts that cannot be recovered.

An amount written off may be reinstated if:

- the outstanding tax was written off on the grounds of serious hardship and the taxpayer for whom the debt was written off is adjudged bankrupt or placed in liquidation within a year of the amount being written off; or
- the Commissioner receives, by operation of law, additional funds in respect of a taxpayer after the taxpayer becomes bankrupt, is liquidated or if additional funds due to the taxpayer's estate are discovered after the taxpayer's estate has been distributed; or
- the outstanding tax was written off on the basis of false or misleading information provided by the taxpayer.

If an amount is written off and the taxpayer has tax losses, all or part of the net loss will be reduced by the amount of the write-off grossed up by 33%.

Outstanding tax can not be written off if the taxpayer was liable to a shortfall penalty for an abusive tax position or evasion or similar act in relation to the outstanding tax.

Background

The Commissioner's authority to write off debt permanently pursuant to the Tax Administration Act 1994 (TAA) has changed from 1 December 2002.

Previously, sections 176 and 177 of the TAA allowed the Commissioner to remit tax debt for financial and serious hardship. The Commissioner also had authority to provisionally write off the debt in accordance with a joint 1990 Treasury, Inland Revenue Department circular.

From 1 December 2002, the terminology and the circumstances for writing off tax debt have changed. The terms "remit" and "remission" are no longer used. The term is now write-off and, except in limited circumstances, any write-off is permanent. The Commissioner no longer provisionally writes off tax debt.

Legislation

All legislative references are to the Tax Administration Act 1994 (TAA) unless otherwise stated.

176 Recovery of tax by Commissioner

(1) The Commissioner must maximise the recovery of outstanding tax from a taxpayer.

(2) Despite subsection (1), the Commissioner may not recover outstanding tax to the extent that-

(a) recovery is an inefficient use of the Commissioner's resources; or

(b) recovery would place a taxpayer, being a natural person, in serious hardship.

177 Taxpayer may apply for financial relief

(1) A taxpayer, or a person on a taxpayer's behalf, applies for financial relief by either-

(a) making a claim stating why recovery of outstanding tax would place the taxpayer in serious hardship; or

(b) requesting to enter into an instalment arrangement with the Commissioner by telephone or in writing.

(2) The Commissioner may require a taxpayer, or a person on a taxpayer's behalf, to apply for financial relief under subsection (1)(a) in writing.

(3) Upon receiving a request, the Commissioner may –

(a) accept the taxpayer's request; or

(b) seek further information from the taxpayer; or

(c) make a counter offer; or

(d) decline the taxpayer's request.

(4) A taxpayer has 20 working days, or a longer period allowed by the Commissioner, to provide the information sought or to respond to a counter offer.

(5) If the Commissioner receives information or a response from a taxpayer outside the time period allowed under subsection (4), the receipt of the information or the response will be treated as a new request for financial relief.

177A Definition of serious hardship

(1) In this section and sections 176, 177, 177B and 177C, **serious hardship**, in relation to a taxpayer, being a natural person,–

(a) includes significant financial difficulties that arise because of –

(i) the taxpayer's inability to meet minimum living expenses according to normal community standards; or

(ii) the cost of medical treatment for an illness or injury of the taxpayer or the taxpayer's dependant; or

(iii) a serious illness suffered by the taxpayer or the taxpayer's dependant; or

(iv) the cost of education for the taxpayer's dependant, and

(b) does not include significant financial difficulties that arise because –

(i) the taxpayer is obligated to pay tax; or

(ii) the taxpayer may become bankrupt; or

(iii) the taxpayer's, or the taxpayer's dependant's, social activities and entertainment may be limited; or

(iv) the taxpayer is unable to afford goods or services that are expensive or of a high quality or standard according to normal community standards.

(2) The Commissioner may take into account whether the recovery of outstanding tax would place-

(a) a shareholder who owns, or 2 shareholders who jointly own, 50% or more of the shares in a company in serious hardship; or

(b) a shareholder-employee of a close company in serious hardship.

(3) For the purpose of subsection (2), **close company** means a company that satisfies paragraph (a) of the definition of **close company** in section OB 1 of the Income Tax Act 1994.

177C Write-off of tax by Commissioner

(1) The Commissioner may write off outstanding tax that cannot be recovered.

(2) The Commissioner must write off outstanding tax that cannot be recovered in the following situations:

(a) bankruptcy:

(b) liquidation:

(c) a taxpayer's estate has been distributed.

(3) Despite subsection (1), the Commissioner must not write off outstanding tax (inclusive of any shortfall penalties), if a taxpayer is liable to pay, in relation to the outstanding tax, a shortfall penalty for an abusive tax position or evasion or a similar act.

(4) Despite subsection (2), the Commissioner may reinstate all or part of the outstanding tax written off if the Commissioner receives, by operation of law, additional funds in respect of a taxpayer after the taxpayer becomes bankrupt, is liquidated or if additional funds due to the taxpayer's estate are discovered after the taxpayer's estate has been distributed.

(5) If the Commissioner writes off outstanding tax for a taxpayer who has a net loss, the Commissioner must extinguish all or part of the taxpayer's net loss, by dividing the amount written off by 33% and reducing the net loss by that amount.

(6) For the purpose of subsection (5), a taxpayer's net loss is measured according to the taxpayer's return of income for the income year immediately before the income year in which the outstanding tax is written off.

(7) The Commissioner may reverse a write-off if –

(a) outstanding tax is written off on the grounds of serious hardship, and the taxpayer for whom the debt was written off-

(i) declares bankruptcy within a year of the outstanding tax being written off; or

(ii) is subject to bankruptcy proceedings brought by a creditor within a year of the outstanding tax being written off; or

(b) outstanding tax is written off on the grounds of serious hardship, and the taxpayer for whom the debt was written off is a company which, within a year of the outstanding tax being written off, is, or is in the course of being, liquidated; or

(c) the outstanding tax was written off due to false or misleading information provided by the taxpayer.

(8) If the Commissioner enters into an instalment arrangement that provides for some outstanding tax to be written off, the Commissioner may not reverse the write-off even if, during the term of the instalment arrangement, the taxpayer does not meet the instalment arrangement's terms.

Standard Practice

The TAA allows a taxpayer to apply for financial relief. The relief may be in the form of an instalment arrangement and/or write-off of all or part of the tax outstanding.

The Commissioner must maximise the recovery of outstanding tax from a taxpayer but not if recovery represents an inefficient use of the Commissioner's resources or would place a taxpayer, being a natural person, in serious hardship. In these circumstances, the Commissioner may write off the outstanding debt.

Instances where the Commissioner must write off tax debt

The Commissioner must write off any outstanding tax that cannot be recovered due to bankruptcy, liquidation or where a taxpayer's estate has been distributed.

In the case of bankruptcy or liquidation, write-off action will be taken once the Commissioner either receives a final dividend or receives advice from the Official Assignee or liquidator that there will be no dividend to Inland Revenue. Where an estate has been distributed the Commissioner will write off the debt upon receipt of confirmation from the administrator that an estate has been distributed.

Write-off due to serious hardship

"Serious hardship" is defined in section 177A. Individual taxpayers (natural persons) who consider that payment of their outstanding tax would place them in serious hardship may apply to the Commissioner for all, or part of that tax to be written off.

Applications for outstanding tax to be written off on the grounds of serious hardship must generally be made in writing. The application should set out why recovery would place the taxpayer in serious hardship and include supporting documentation. However, written application is not required when it is evident from information already available that recovery would place a taxpayer in serious hardship. This may occur in instances where relief is requested by way of an instalment arrangement, but on examination of the information obtained, it is evident that repayment, even by way of instalment arrangement, would place the taxpayer in serious hardship.

In some cases a decision can be made immediately. In others further information may be required. In these circumstances the taxpayer must supply the information within 20 working days, unless the Commissioner allows a longer period. Late payment penalties will not be charged during this period provided relief is granted. However, use-of-money interest will continue to be charged on a daily basis.

In order for the Commissioner to determine if an individual would be placed in serious hardship, Inland Revenue will request relevant details of the person's financial position, typically:

- details of income and expenditure,
- assets and liabilities,
- a 12 month cash flow projection,
- asset valuations,
- profit and loss statements (where applicable),
- balance sheet (where applicable),
- list of debtors and creditors (where applicable).

The Commissioner will consider each application on its own merits. In considering whether a taxpayer, being a natural person, will be placed in serious hardship the Commissioner will have regard to the following:

- the taxpayer's ability to meet minimum living expenses according to normal community standards;
- the cost of medical treatment for any illness or injury of the taxpayer or the taxpayer's dependant(s);
- costs arising due to a serious illness suffered by the taxpayer or the taxpayer's dependant(s);
- the cost of education for the taxpayer's dependant(s).

Serious hardship does not include financial difficulties that arise because:

- the taxpayer is obligated to pay tax;
- the taxpayer may become bankrupt;
- the taxpayer's, or the taxpayer's dependant's, social activities and entertainment may be limited;
- the taxpayer is unable to afford goods or services that are expensive or of a high quality or standard according to normal community standards.

Whether a person is a taxpayer's "dependant" will be determined on a case-by-case basis. In determining dependency issues, the Commissioner will consider whether the person is dependent on the taxpayer for financial support and what degree of financial support is provided by the taxpayer. The Commissioner will also consider to what extent providing financial support impacts on the taxpayer's ability to meet minimum living expenses according to normal community standards.

While normal community standards must be considered in the context of the wider community of all New Zealand, the actual expenditure of taxpayers in different parts of the country may vary due to, for example, higher or lower housing costs or travel expenses. When calculating a taxpayer's minimum living expenses, the Commissioner will consider the cost of food, heating and accommodation in accordance with normal community standards based on information provided on a geographical basis by Statistics New Zealand.

In some instances, a taxpayer may be able to pay part of the amount outstanding, but recovery of the full amount would place the taxpayer in serious hardship. In these cases, the Commissioner will negotiate a lump sum payment or an instalment arrangement with the taxpayer and write off the unrecoverable amount. The unrecoverable amount will be written off at the time the instalment arrangement is entered into.

Example

A taxpayer has a debt of $5,000 and has been putting funds aside to clear this amount by the due date. However, at the due date they have only managed to save $1,000 towards this amount. Due to the taxpayer's financial circumstances, any payments over and above the $1,000 they have saved would cause difficulty in meeting day to day living expenses. Inland Revenue accepts the lump sum payment of $1,000 and writes off the balance on the grounds of serious hardship as it is not feasible for Inland Revenue to enter into an instalment arrangement for payment of the outstanding $4,000.

Writing off company debt

Serious hardship generally applies to natural persons only. A company cannot apply for tax to be written off on the grounds of serious hardship. However, the Commissioner may take into account whether the recovery of outstanding tax would place a shareholder who owns, or two shareholders who jointly own, 50% or more of the shares in a company or a shareholder-employee of a close company in serious hardship.

A "close company" for these purposes means a company which has five or fewer natural persons whose voting interests or market value interests exceed 50%.

In addition to the above, the Commissioner may also write off company debt if it is consistent with the duty to maximise recovery.

Example

A company owes $100,000, with the only asset in the company being a debit balance in the principal shareholder's current account of $100,000. If the company were placed into liquidation, the $100,000 in the current account would be called up. The shareholder's assets are a house valued at $90,000 and a car with a value of $5,000. Inland Revenue recognises that any action taken to liquidate this company could impose serious hardship on the shareholder. The company and shareholder arrange with Inland Revenue that $70,000, raised by way of mortgage on the principal shareholder's home, will be paid to Inland Revenue and the balance of the debt will be written off, as collection would cause serious hardship.

Maximising recovery

The Commissioner has a duty to maximise the recovery of the outstanding amount from a taxpayer. Inland Revenue is therefore obliged to compare the value of the likely recovery from accepting a proposal from a taxpayer with any other viable options for recovery. In some cases, it is clear which option will maximise recovery. In other cases there may be options that could yield similar returns. Accordingly it is necessary to determine which option will maximise recovery.

Whilst unnecessary in most circumstances, one method of distinguishing between alternative repayment options is to apply a net present value calculation.

A net present value calculation recognises the time value of money, as well as the probability of payment (risk). The proposed payments are discounted for the time value of money and for the likelihood of receiving the money. Inland Revenue needs to determine the amount, date, and probability of each payment and apply an appropriate discount rate. The discount rate is calculated from published Government stock rates. Inland Revenue uses a calculation that multiplies the amount of payment by the probability of payment (for risk), divided by the discount factor appropriate to the term (for interest).

The methodologies for determining the discount rate, probability of payment and net present value are outlined in the appendix to *Tax Information Bulletin* Vol 6, No.14 (June 1995).

If a negotiated agreement for payment of all or part of the amount outstanding would yield more than bankruptcy or liquidation action, the Commissioner must enter into the negotiated agreement. Any amount not recoverable under the agreement will be written off at the time the agreement is entered into.

Example

A taxpayer has arrears of $80,000 and makes an offer of $60,000 to settle the arrears over a period of three years. Inland Revenue considers that bankruptcy would yield $40,000. Inland Revenue would write off $20,000 and enter into an instalment arrangement over three years for $60,000.

Inefficient use of the Commissioner's resources

If the Commissioner considers that recovery of part, or all, of the outstanding debt would not reflect an efficient use of administrative resources the debt will be written off.

This is in line with the Commissioner's duty to collect, over time, the highest net revenue that is practicable within the law having regard to the resources available to the Commissioner. It is also consistent with the Commissioner's duty to maximise the recovery of outstanding tax from a taxpayer.

A taxpayer cannot request that tax be written off because they consider that collection would result in an inefficient use of the Commissioner's resources. The provision is discretionary and acknowledges that the Commissioner has limited resources to collect debt and, in some instances, the cost of collection may be higher than the outstanding debt. A decision to write off on the basis that recovery would represent an inefficient use of the Commissioner's resources will be made on a case-by-case basis.

Amounts provisionally written off

Any debt provisionally written off (deferred) prior to 1 December 2002 will not automatically be permanently written off under the new legislation. However, if that debt is reinstated after 1 December 2002, Inland Revenue will consider how the new rules apply to the debt including considering whether it can be written off permanently.

Instances where debt will not be written off

The Commissioner can not write off outstanding tax if the taxpayer was liable to pay, in relation to that outstanding tax, a shortfall penalty for either an abusive tax position or evasion or a similar act. This means that recovery action will continue, to collect both the shortfall penalty and the underlying tax even if recovery would place a taxpayer, being a natural person, in serious hardship. The only exception to this is if the taxpayer has been adjudged bankrupt or placed in liquidation or the taxpayer's estate has been distributed.

The Commissioner will distinguish between debt arising from such assessments and other arrears so that part of the taxpayer's total debt may be written off if the required criteria are met, leaving the debt to which the shortfall penalty applies and the penalty itself outstanding.

Example

A taxpayer has GST arrears for the 31 March 2002 period and also has arrears for the 1999 income tax year including a shortfall penalty for taking an abusive tax position. In this instance the GST arrears could be written off. However, the income tax arrears would not be written off, regardless of whether payment would cause serious hardship.

Reversal of write-off

The Commissioner may reverse a write-off in the following circumstances:

- the outstanding tax is written off on the grounds of serious hardship, and the taxpayer declares bankruptcy within a year of the outstanding tax being written off or is subject to bankruptcy proceedings brought by a creditor within a year of the outstanding tax being written off.
- the outstanding tax is written off on the grounds of serious hardship, and the taxpayer for whom the debt was written off is a company which, within a year of the outstanding tax being written off, is, or is in the course of being, liquidated.
- if the debt has been written off due to bankruptcy or liquidation of the taxpayer, and the Commissioner receives, by operation of law, additional funds in respect of the taxpayer after the taxpayer becomes bankrupt, the taxpayer company is liquidated or if additional funds due to the taxpayer's estate are discovered after the taxpayer's estate has been distributed.
- the outstanding tax was written off on the basis of false or misleading information provided by the taxpayer, eg where a taxpayer has overstated outgoings or understated income or where a taxpayer has a vested right to income or assets of a trust, and this was not disclosed to the Commissioner.

Losses

As part of the determination of the taxpayer's assets the Commissioner will take into account any tax losses of the taxpayer. If any tax debt is written off and the taxpayer has tax losses, all or part of the net loss will be reduced by the amount of the write-off grossed up by 33%. A new notice of determination of loss will be issued to reflect the amended position.

The value of the losses to be reduced is taken according to the taxpayer's return of income for the income year immediately before the income year in which the outstanding tax is written off.

No right of objection or challenge

There is no statutory right to challenge or object to any decision of the Commissioner to grant or cancel relief.[1]

However, if a taxpayer does not agree with the Commissioner's decision not to grant relief, the taxpayer may request that the decision be reviewed by the officer involved or their superior officer. The decision may also be reviewed by the Ombudsman or by way of judicial review.

This Standard Practice Statement was signed by me on 11 November 2002.

Colin Hutchins
National Manager
Technical Standards

[1] Section 138E(1)(e)(iv) Tax Administration Act 1994

QUESTIONS WE'VE BEEN ASKED

This section of the TIB sets out answers to some day-to-day questions that people have asked.

We publish these as they may be of general interest to readers.

These items are based on letters we've received. A general similarity to items in this package will not necessarily lead to the same tax result. Each case will depend on its own facts.

SECTION 108 TAX ADMINISTRATION ACT 1994 (TAA): COMMENCEMENT OF FOUR-YEAR STATUTORY PERIOD

We have been asked to clarify when the four-year statutory period in section 108 of the TAA commences in respect of taxpayers with non-standard balance dates and consequently when the time bar takes effect.

Section 108 of the TAA provides that the Commissioner may not increase the amount assessed if 4 years have passed from the end of the income year in which the taxpayer provides the tax return.

For the purposes of this item, the section 108 of the TAA four-year statutory period will be referred to as the "statutory period". The end of the statutory period will be referred to as "time bar" or "time barred" as context requires.

Income Year

The definition of "income year" is found in section OB 1 of the Income Tax Act 1994 (ITA). The definition refers to the 'year' in which income and loss for which a person is assessed for income tax, is allocated. "Year" is defined in section OB 1 of the ITA as a year commencing on 1 April and ending on 31 March. Both these definitions apply to the TAA by virtue of section 3(2) of the TAA.

For the purposes of section 108 of the TAA, income year is a year ending on 31 March.

In the case of a taxpayer with a non-standard balance date, case law confirms that income year for a non-standard balance date taxpayer is a year ending on 31 March. (*F. E. Jackson Co. Ltd. v CIR (NZ)* 72 ATC 6052; *Case K41* (1988) 10 NZTC 348).

Commencement of statutory period

The commencement of the statutory period is determined by the date the taxpayer furnishes the return and not determined by the taxpayer's balance date. Therefore, for a taxpayer with a non-standard balance date, the statutory period begins on 1 April following the date on which the taxpayer provides their return.

As a practical example, a taxpayer's non-standard balance date of 30 September 1999 is deemed to be in respect of the 1998/1999 income year, ie 1 April 1998 to 31 March 1999. If the taxpayer provides their return on 15 January 2000, the statutory period begins on 1 April 2000 and increases to the assessment generally become time barred after 31 March 2004.

OTHER ITEMS OF INTEREST

EXPOSURE DRAFT FOR COMMENT AND DISCUSSION ONLY.

Please quote reference : ED0038

Tax Administration Act 1994

RETROSPECTIVE ADJUSTMENT TO SALARIES PAID TO SHAREHOLDERS -EMPLOYEES—WITHDRAWAL OF PREVIOUS QWBA

In *Tax Information Bulletin* Vol 9, No 4 (April 1997) at page 9 we published a QWBA item entitled *Retrospective adjustment to salaries paid to shareholder-employees* to the effect that where an error has been made in the preparation of the accounts of a company, Inland Revenue will amend the company's assessment to take account of the additional expenses that should have been included in the original return but will not agree to consequential adjustments that the company and the shareholder-employee may wish to make in relation to any salary that was originally agreed to be paid. So neither the company's nor the individual's assessments would be amended to reflect the fact that a reduced salary would be paid.

Subsequently *Case U27* (1999) 19 NZTC 9,261 considered this same issue and his Honour Willy DJ arrived at a different conclusion, holding that a decision as to the amounts of a shareholder-employee's salary for two income years that was made mistakenly could be reversed or amended. Furthermore, section 75 of the Income Tax Act 1976 (now section EB 1 of the Income Tax Act 1994), which deems a person to have derived income when it has been dealt with in the person's interest or on his or her behalf in any of various ways, including being "credited in account", took effect accordingly, i.e. it operated on the circumstances brought about by the company resolutions correcting the error. The Taxation Review Authority decided that the company was entitled to and did rectify the error when it came to its notice and the shareholder-employee was obliged to pay tax only on the reduced amounts of income for the relevant income years.

In the light of *Case U27* it has been decided that the 1997 QWBA should now be withdrawn. Provided the appropriate resolution has been passed amending or rescinding the previous resolution, then generally Inland Revenue will, where a genuine error has been made and a request for correction has been filed, consider the request in accordance with Standard Practice Statement INV-510 entitled *Requests to amend assessments* published recently in *Tax Information Bulletin* Vol 14, No 8 (August 2002) and the principles set out therein. It is expected that the request would be made in a timely fashion. Where Inland Revenue agrees to amend an assessment, section EB 1 will deem the shareholder-employee's salary to be the amount as determined by the amending resolution and under section 113 of the Tax Administration Act 1994 Inland Revenue will adjust the company's and employee's assessments accordingly.

This item addresses the question of when a correction to a shareholder-employee's salary may be made. The above approach should not be taken as being applicable to situations where other mistakes have been made in a company's accounts and the company is seeking to rectify them.

Disclaimer: This is a draft item only. It may not be relied upon by taxation officers, taxpayers or practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

REGULAR FEATURES

DUE DATES REMINDER

November 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)* du

7 **Provisional tax instalments due for people and organisations with a March balance date**

20 **Employer deductions**

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

29 **GST return and payment due**

December 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)* du

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

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.

By internet: Visit **www.ird.govt.nz.** 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.

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	Draft interpretation guideline	*Comment deadline*
☐	IG0010: Work of a minor nature	8 January 2003
	Draft public ruling	*Comment deadline*
☐	XPB0003: Netherlands social security pensions—Taxation when the recipient is a NZ resident	8 January 2003

Items are not generally available once the comment deadline has passed

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