TAX INFORMATION BULLETIN

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This TIB has no appendix

Inland Revenue
Te Tari Taake

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This is an Inland Revenue service to people with an interest in New Zealand taxation

GET YOUR TIB SOONER ON THE INTERNET

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

www.ird.govt.nz

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

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

THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft items are available for review/comment this month, with a deadline of 14 February 2003.

Ref.	**Draft type**	**Description**
IS0056	Interpretation statement	Tax treatment of payments received by petrol retailers in return for trade ties
ED0037	Standard Practice Statement	Income equalisation deposits and refunds

Please see page 65 for details on how to obtain copies of these items.

The following draft items are available for review/comment this month, with a deadline of 21 February 2003.

Ref.	**Draft type**	**Description**
DDG0065	General depreciation determination	Fishing nets
DDG0072	General depreciation determination	Compact disc players, digital versatile disc players, video game players, and related assets

Please see pages 48 and 50 for the text of these items.

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 from our website at **www.ird.govt.nz**

PRODUCT RULING – BR PRD 02/17

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:

- Telecom Corporation of New Zealand Limited ("TCNZ"); and
- Telecom New Zealand Limited ("TNZL") (together "the Applicants").

Taxation Laws

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

This Ruling applies in respect of sections 5(6D), 5(13), 10, 8 and 20 and the definition of "consideration" in section 2(1) of the GST Act.

The Arrangement to which this Ruling applies

The Arrangement is a Telecommunications Service Provider ("TSP") entering into a Telecommunications Service Obligations Instrument ("TSO Instrument") with the Crown and receiving payments from liable persons pursuant to Part 3 of the Telecommunications Act 2001 ("the Act"), where at least one of the Applicants is either a TSP or a liable person and where the TSO Instrument does not contain a "specified amount" (as defined in section 5 of the Act). Further details of the Arrangement are set out in the paragraphs below.

1. In 2000 a Ministerial Inquiry into Telecommunications was held to assess the extent to which the current regulatory regime met the Government's objectives for the telecommunications markets. The Inquiry concluded that various changes should be made to the current regime. The Act implements many of those recommendations and establishes a new regulatory regime for the telecommunications sector.
2. Part 3 of the Act sets out a regime under which the Crown can ensure that certain telecommunication services are available to end-users in areas where they would not otherwise be provided on a commercial basis or at (in the Crown's opinion) affordable prices, with the cost of providing those services being borne by members of the telecommunications industry. This purpose is recorded in section 70(1) of the Act.

The Telecommunications Act 2001

3. Section 70 of the Act provides that the Governor-General may declare that a contract, arrangement or understanding between the Crown and a TSP for the supply of a particular telecommunication service or range of telecommunication services be treated as a TSO Instrument. Such a declaration can only be made on the Minister's recommendation, which can only be given once the Minister has obtained agreement from the relevant TSP and consulted the relevant liable persons.
4. TSO Instruments will obligate the TSP to make available to its customers telecommunication services that would not otherwise be supplied on a commercial basis or at a price that is considered by the Crown to be affordable to the end-users. The TSO Instrument must identify the group of end-users to whom the service is being supplied, the geographical area within which the service must be supplied, and the retail price at (or below) which the service must be supplied. In addition, the TSO Instrument must set out criteria to enable the standard of service delivered by the TSP to be objectively evaluated.

5. Section 79 of the Act provides that a parent company and its subsidiaries (or several subsidiaries of the same parent company) shall be treated as the same entity for purposes of Part 3 of the Act. A consequence of that provision is to ensure that when a TSO Instrument is entered into by one member of a group, another member of the group which incurs costs in complying with that TSO Instrument is able to receive reimbursement payments from the liable persons.

Kiwi Share obligations are deemed to be a TSO Instrument

6. Prior to the Act, TCNZ was required by its constitution and certain side or supplemental letters, (together the "original KSO"), to supply, or procure the supply of, various local residential telephone services on agreed terms. For example, it was required to ensure that the residential line rental for rural customers did not exceed the standard line rental.

7. These obligations are commonly referred to as the "Kiwi Share obligations" and have been enforceable by the Crown as the holder of the Kiwi Share in TCNZ. They are also reflected by and defined in the Act as the "KSO".

8. The Crown, TCNZ and TNZL have negotiated a deed ("the Deed") which imposes obligations on TCNZ and TNZL to supply various local residential telephone services on agreed terms. In some cases, the relevant services are of the types that have been subject to the Kiwi Share obligations. The parties entered into the Deed prior to commencement of the Act. This Deed is defined in the Act as the "new KSO".

9. Section 71 of the Act provides that both the original KSO and the new KSO are deemed to be TSO Instruments. Furthermore, the Act provides that, while the new KSO is a deemed TSO Instrument, the original KSO ceases to have effect (section 73). However, in the event that the new KSO ceases to be a deemed TSO Instrument, then the original KSO applies.

[In relation to the KSO, the obligations are imposed on TCNZ, to the extent that the KSO is in force and has effect, whereas the costs of complying with those obligations will primarily be incurred by TNZL as TSP (for the reasons discussed above this will only occur in the event that the new KSO ceases to be a deemed TSO Instrument).]

Identifying the liable persons

10. The "net costs" incurred by a TSP in complying with the terms of a TSO Instrument are partially reimbursed by the liable persons.

11. In general terms a liable person is defined as any person whose network is interconnected with a fixed public switched telephone network operated by TCNZ.

12. The liable person definition is not confined to specific entities. As a result the number and identity of the liable persons may change over time.

Calculating the net costs incurred by a TSP

13. The Commerce Commission ("the Commission") is responsible for calculating both the net costs incurred by a TSP and the reimbursement amounts to be paid by liable persons to the TSP.

14. In respect of each TSO Instrument, the TSP and each liable person must provide certain information to the Commission within 60 working days after the end of each financial year to enable the Commission to determine the net cost incurred by the TSP and the amounts payable by each liable person to the TSP.

15. The Act defines "net cost" as:

> the unavoidable net incremental costs to an efficient service provider of providing the service required by the TSO instrument to commercially nonviable customers.

16. Section 84 requires that when the Commission is determining the net costs incurred by a TSP it:

- should take into account the range of direct and indirect revenues and associated benefits derived from providing telecommunication services to commercially nonviable customers, less the cost of providing those telecommunication services to those customers;
- should also take into account the provision of a reasonable return on the incremental capital employed in providing the services to those customers;
- may choose not to include profits from any new telecommunications services that involve significant capital investment and that offer capabilities not available through established telecommunication services and must not include any losses from telecommunication services other than services under the TSO Instrument; and
- must consider the purpose set out in section 18 of the Act. That provision provides, inter alia, that the purpose of various parts of the Act is to promote competition in the telecommunications markets for the long term benefit of end-users of telecommunications services within New Zealand.

17. The concept of net costs bears no direct correlation to the revenue the TSP would have received if the services under the TSO Instrument had been supplied on commercial terms (that the TSP would otherwise have set). Neither the definition itself nor the various factors that the Commission is required to take into account produce a figure that represents the TSP's "lost" revenue with respect to the supplies the Crown has mandated must be made available to end-users at affordable prices. Furthermore the concept of net costs does not necessarily reflect the actual net costs incurred by the TSP. Instead they are the forward-looking *hypothetical* net costs that an efficient service provider would have incurred.

Determining reimbursement amounts payable by liable persons

18. Once the net costs incurred by the TSP in complying with the TSO Instrument have been determined, the Commission calculates the reimbursement amounts payable by each liable person.

19. When determining the amounts payable by each liable person (and the portion of the net costs for which the TSP will receive no reimbursement) section 85 of the Act requires that the Commission have regard to the ability of each liable person and the TSP to pass on their portion of the net costs to their customers. In addition (and again for the purposes of establishing the liable person contributions), the Commission must determine whether the TSP has complied with its obligations by comparing the TSP's performance against the criteria set out in the TSO Instrument.

20. Once those factors have been taken into account, the net costs incurred by the TSP (less any reduction that the Commission determines is appropriate due to the TSP's noncompliance with the TSO Instrument) are allocated to each liable person and the TSP based upon their relative revenues for the applicable financial year.

21. Section 94 of the Act provides that each liable person must pay the reimbursement amount (plus interest thereon from the end of the financial year until the date on which the Commission finally determined the reimbursement amounts payable) to the TSP. Any such amounts not paid within 20 working days attract penalty interest and are recoverable by the TSP as a debt due.

Disputes and remedies

22. A TSP and liable persons can dispute the Commission's calculation of both their revenues and the net costs (and therefore their allocation of liability with respect to the net costs) by appealing to the High Court. Provision also exists for regulations to be passed that provide methods for calculating the revenues derived by the TSP and liable persons, and also for calculating the net costs.

23. Section 96 provides that the High Court can compel a TSP to comply with its obligations under a TSO Instrument. In determining whether to issue such an order the Court must take the public interest into account.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Payments that a TSP receives from liable persons under section 94 of the Telecommunications Act 2001 are not consideration for a taxable supply of goods or services by a registered person in the course or furtherance of a taxable activity and so are not subject to GST under section 8 of the GST Act.
- Liable persons are not allowed a deduction from output tax under section 20 of the GST Act in respect of any payments made to TSPs under section 94 of the Telecommunications Act 2001.

The period or income year for which this Ruling applies

This Ruling will apply for the period 20 December 2001 until 2 October 2005.

This Ruling is signed by me on the 2nd day of October 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/18

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 LeasePlan New Zealand Limited ("LeasePlan").

Taxation Laws

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

This Ruling applies in respect of sections CI 3(1), GC 15, GC 17 and BG 1.

The Arrangement to which this Ruling applies

The Arrangement is the lease pursuant to a FlexiPlan Lease of a motor vehicle from LeasePlan to an employer ("the Lessee") and the provision of that motor vehicle by the employer to an employee for their business and private use and enjoyment. Further details of the Arrangement are set out in the paragraphs below.

1. LeasePlan conducts a fleet management and leasing business. The company offers motor vehicle leases to customers with terms varying from six months to 75% of the estimated useful life of the motor vehicle. Customers may enter into short term leases, for example for a year or 15 months, with the possibility of entering into further short term leases. However, the consecutive leases never exceed a period greater than 75% of the estimated useful life of the motor vehicle. These leases are known as "FlexiPlan Leases". In the case of commercial vehicles, the period may be greater than 45 months, as commercial vehicles may have an estimated useful life of greater than 5 years.

2. The Open Calculation FlexiPlan Lease includes an annual wash-up adjustment for expired leases, which takes into account all costs incurred in relation to the vehicles, the market value of the vehicles and the mileage travelled during the lease, and may involve a payment from LeasePlan to the Lessee, or vice versa, as a result (in accordance with paragraph 11(j) of this Ruling).

3. The lease from LeasePlan to the employer is made under the terms and conditions contained in the Long Term Hire Agreement ("the Master Agreement"), the Open Calculation Quotation and Order ("the Order"), and the Open Calculation Supplement Schedule to the Master Agreement ("the Schedule").

4. The documentation used is generic. The only details that change are the name of the party (the Lessee), the term of the contract, and the details of the vehicle involved.

5. Each Lessee enters into one Master Agreement and Schedules are annexed to that Agreement which relate to the individual motor vehicles leased.

6. The leases are operating rather than finance leases for income tax purposes.

7. Employers find the FlexiPlan Lease product appealing because of its flexibility. There are no penalties payable as a result of a customer choosing not to take up a further lease of the vehicle concerned. At the expiry of each relevant period, lease obligations have been met under the FlexiPlan product.

8. By comparison, if a Lessee terminated a 45 month lease after 12 months, LeasePlan is entitled to charge its losses in a wash-up adjustment under its early termination arrangements.

9. The flexibility provided by the FlexiPlan Lease product is particularly valuable when employers are unsure of the number of employees for whom they will require vehicles or are unsure of the type of vehicle the employees may wish to have available. As a result, the employers prefer short lease terms so that they are not required to either continue renting vehicles that they do not require or pay significant penalties for early termination.

10. LeasePlan offers leases that are at least six months long. The lease term for FlexiPlan Leases is not longer than 75% of the estimated useful life of the vehicle. The total of the various lease periods in respect of any vehicle leased to the same employer would not exceed 75% of the vehicle's estimated useful life. A specific period will be agreed to in every case at the outset of the Lease and will be included as a term of the Lease.

11. The leasing of the motor vehicles comprises the following steps:

    (a) *Initial lease enquiry*

    This is the initial contact from the potential customer enquiring about leasing vehicles from LeasePlan.

    (b) *Marketing response*

    This involves the initial meeting, promotional material etc.

    (c) *Lease quote*

    LeasePlan provides the customer with a "Lease Quote". This is not a contractual document. It provides an example of the terms and conditions on which LeasePlan can provide particular vehicles to Lessees.

(d) *Credit application*

If the Lessee wishes to proceed, the Lessee's credit application is completed and assessed.

(e) *Motor vehicle leasing terms and conditions*

When a Lessee commences dealings with LeasePlan, the company then provides the Lessee with the Master Agreement. This document sets out the general terms and conditions for motor vehicles to be subsequently leased from LeasePlan. There is no specific reference to actual vehicles in the Master Agreement.

(f) *Vehicle quotation, order and acceptance*

LeasePlan provides a detailed quote to the Lessee, which incorporates the standard terms and conditions contained in the Master Agreement. Under clause 1.1 of the Master Agreement, the Lessee may sign this and submit it to LeasePlan. If LeasePlan agrees to supply the vehicle, the offer is accepted and a copy of the executed Order form is returned to the Lessee. A contract exists at this point in time. The Order is completed prior to the commencement of each new lease and reflects the details for that lease only.

In all cases, the contract between the Lessee and LeasePlan contains the following terms and conditions:

- The term of the lease.
- There is no provision for automatic renewal of the term of the lease and no option conferred on the Lessee to renew, extend or vary the term of the lease.
- There is no provision for an incentive to the Lessee if it takes up a further lease of the vehicle.
- There is no penalty on the Lessee if it does not take up a further lease of the vehicle.

(g) *Vehicle Schedule*

LeasePlan issues a Supplement Schedule to the Master Agreement once an invoice from the supplier is received (per clause 1.2 of the Master Agreement), in the event that a new vehicle is being acquired for the lease. Where a vehicle already owned by LeasePlan is made available to the Lessee, the Schedule is issued shortly after the Vehicle Order is signed. Both parties sign the Schedule.

The Schedule contains certain further information, such as the registration number of the vehicle supplied, confirmation of the market value, and confirmation of the total rent.

(h) *Procedure at end of lease*

The lease will cease once the full lease term is completed.

As standard practice, LeasePlan advises the Lessee of the status of the lease three months prior to the expiration of the lease term, and provides several options for the Lessee to consider in meeting its future leasing requirements. A short time before the expiry of the lease, if the Lessee has not yet outlined their intentions, then LeasePlan sends out a quote for entering into a new lease. LeasePlan then determines whether the Lessee wishes to lease the vehicle for a further lease term, or wishes to take up one of the other options offered, such as leasing a new vehicle. If the Lessee does not wish to enter into a new lease for the existing vehicle (or does not respond to LeasePlan's correspondence), the vehicle is returned to LeasePlan upon expiry of the lease. If the Lessee wishes to retain the vehicle, a new lease is entered into for a further period.

This new lease is assigned a separate and distinct number or record in LeasePlan's computer system, which is used to manage vehicles leased using its FlexiPlan product. In all cases, the old record for the previous lease is noted as having terminated. In addition, a new Order and Schedule are required for the new lease. Again, the general conditions set out in the Master Agreement are incorporated into that new lease agreement.

The rental rates for the subsequent period or periods are lower than the first. The rates reduce as the depreciation on the vehicle reduces. If the customer does not renew, it does not get the benefit of reduced rates. However, there is no obligation on LeasePlan to provide vehicles for subsequent FlexiPlan Leases and no obligation on Lessees to enter into a subsequent lease.

(i) *Valuation of vehicles*

Prior to the new lease commencing, an agent of LeasePlan may inspect the vehicle, determine the mileage, and review the condition of the vehicle. This information is used to calculate the new rental. It also allows LeasePlan to determine the market value of the vehicle at the end of the previous lease period and therefore the commencement of the new lease period. LeasePlan advises Lessees of the market valuation of the vehicles, and also provides market value forecasts for subsequent periods for indicative purposes only. Market values are always reviewed prior to the commencement of subsequent leases (if any) to ensure whether the forecasts are accurate or need to be changed in any way.

(j) *Wash-up calculation*

At the end of the lease, LeasePlan undertakes a wash-up calculation. The wash-up calculation involves comparing the costs paid or incurred by LeasePlan in connection with the leased motor vehicle with budgeted costs and the disposal proceeds of the vehicle with the budgeted residual value. If a vehicle is not sold, then a deemed disposal value is used for wash-up calculation purposes. Whenever a FlexiPlan Lease expires the wash-up calculation is carried out and the results for each expired FlexiPlan Lease is debited or credited to the "Hire Account". The balance of the Hire Account is carried forward and at the anniversary of the Master Agreement, if nine or more vehicle leases have expired, then the balance of the Hire Account is reviewed. If it is in credit, then LeasePlan pays the Lessee the credit balance. If the amount is in debit, then LeasePlan will bear the cost and return the Hire Account balance to zero, less any excess kilometre charge and less any repairs and maintenance required to restore the vehicles to a proper working condition.

If nine vehicle leases have not yet expired, then LeasePlan may move the settlement date to when the ninth vehicle lease reaches its expiry date.

The Hire Account has no effect on subsequent leases entered into by a Lessee and LeasePlan. The balance of the Hire Account at any particular time is not taken into consideration in any way in negotiating the terms of any subsequent lease.

12. Clause 2 of the Master Agreement allows LeasePlan, if the Lessee so wishes, to acquire vehicles from a Lessee and then hire those vehicles back to the same Lessee. In such a situation a composite Schedule is prepared by LeasePlan and executed by both LeasePlan and the Lessee.

13. Where it is included in the Schedule, LeasePlan will bear the cost of FBT reporting. FBT reporting is an optional service provided by LeasePlan. LeasePlan liaises with the Lessee's drivers directly and obtains the details necessary to carry out the FBT calculation, for example confirming the days when the vehicle was not available for private use. The information is then provided to the Lessee in a user friendly report to enable them to complete their FBT returns in respect of the motor vehicles.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The motor vehicles leased by the Lessee under this Arrangement are leased for business and private use and enjoyment of the Lessee's employees or made available for the private use or enjoyment of such employees.

b) No contract, agreement, plan, or understanding (whether enforceable or unenforceable) is entered into between LeasePlan and the Lessee in relation to the Arrangement, other than the Master Agreement, the Schedule and the Order.

c) Any rental rate for the Lessee for a subsequent lease period is the same rental rate that would be offered to any other customer for that particular vehicle and lease period (taking into account the customer credit rating, customer fleet size, kilometre allowances, and general service components of the lease including vehicle maintenance) irrespective of whether a previous lease for that vehicle was entered into by that Lessee.

d) There is no contract, agreement, arrangement, plan, undertaking or understanding (whether formal or informal, and whether intended to be legally unenforceable or not) at the time of entering into any lease under this Arrangement:

- that any party will, or will if requested, renew, extend or vary the Lease Term;
- that the parties will enter into a further lease in respect of the vehicle; or
- that there will be penalties for choosing not to enter into a further lease in respect of the vehicle.

e) There is no other documentation, agreements, or contracts that concern or affect the terms of the leases entered into under this Arrangement apart from the Master Agreement, the Schedule and the Order.

f) All calculations, factors, and/or projections which are taken into account in formulating the rental rates applying to each lease are not in any way based on a lease of the relevant motor vehicle for more than the relevant lease period.

g) No Lessee is associated with LeasePlan within the meaning of section OD 7.

h) The lease periods are not less than six months and not more than 75% of the estimated useful life of the vehicle.

i) Where a vehicle has previously been leased by the same Lessee, the cumulative total of the various lease terms entered into by LeasePlan and the employer is not greater than 75% of the estimated useful life of the vehicle.

j) The Lease is not a "finance lease" as defined in section OB 1.

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 market value of a motor vehicle under this arrangement, for the purposes of calculating the fringe benefit value of that vehicle under section CI 3(1) and Schedule 2, Part A, Clause 1(c), is determined on the date on which each new lease commences.
- Section GC 15 does not apply to the Arrangement.
- Section GC 17 does not apply to the Arrangement.
- Section BG 1 does not apply to negate or vary the conclusions above.

The period or income year for which this Ruling applies

This Ruling will apply for the period from 30 October 2002 to 30 October 2005.

This Ruling is signed by me on the 30th day of October 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/19

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 LeasePlan New Zealand Limited ("LeasePlan").

Taxation Laws

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

This Ruling applies in respect of sections CI 3(1), GC 15, GC 17 and BG 1.

The Arrangement to which this Ruling applies

The Arrangement is the lease pursuant to a FlexiPlan Lease of a motor vehicle from LeasePlan to an employer ("the Lessee") and the provision of that motor vehicle by the employer to an employee for their business and private use and enjoyment. Further details of the Arrangement are set out in the paragraphs below.

1. LeasePlan conducts a fleet management and leasing business. The company offers motor vehicle leases to customers with terms varying from six months to 75% of the estimated useful life of the motor vehicle. Customers may enter into short-term leases, for example for a year or 15 months, with the possibility of entering into further short term leases. However, the consecutive leases never exceed a period greater than 75% of the estimated useful life of the motor vehicle. These leases are known as "FlexiPlan Leases". In the case of commercial vehicles, the period may be greater than 45 months, as commercial vehicles may have an estimated useful life of greater than 5 years.

2. The Contract Hire FlexiPlan Lease calculates, at the end of the Lease, the actual kilometres travelled by the vehicle. If the amount of kilometres travelled exceeds the agreed number of kilometres, the Lessee must pay LeasePlan an excess kilometre charge. This charge is calculated by multiplying the excess by the agreed excess charge per kilometre. Any excess kilometre charge is not taken into account in the terms of any subsequent lease entered into between the Lessee and LeasePlan.

3. The lease from LeasePlan to the employer is made under the terms and conditions contained in the Long Term Hire Agreement ("the Master Agreement"), the Contract Hire Quotation and Order ("the Order"), and the Contract Hire Supplement Schedule to the Master Agreement ("the Schedule").

4. The documentation used is generic. The only details that change are the name of the party (the Lessee), the term of the contract, and the details of the vehicle involved.

5. Each Lessee enters into one Master Agreement and Schedules are annexed to that Agreement which relate to the individual motor vehicles leased.

6. The leases are operating rather than finance leases for income tax purposes.

7. Employers find the FlexiPlan Lease product appealing because of its flexibility. There are no penalties payable as a result of a customer choosing not to take up a further lease of the vehicle concerned. At the expiry of each relevant period, lease obligations have been met under the FlexiPlan product.

8. By comparison, if a customer terminated a 45 month lease after 12 months, LeasePlan is entitled to charge its losses in a wash-up adjustment under its early termination arrangements.

9. The flexibility provided by the FlexiPlan Lease product is particularly valuable when employers are unsure of the number of employees for whom they will require vehicles or are unsure of the type of vehicle the employees may wish to have available. As a result, the employers prefer short lease terms so that they are not required to either continue renting vehicles that they do not require or pay significant penalties for early termination.

10. LeasePlan offers leases that are at least six months long. The lease term for FlexiPlan Leases is not longer than 75% of the estimated useful life of the vehicle. The total of the various lease periods in respect of any vehicle leased to the same employer would not exceed 75% of the vehicle's estimated useful life. A specific period will be agreed to in every case at the outset of the Lease and will be included as a term of the Lease.

11. The leasing of the motor vehicles comprises the following steps:

(a) Initial lease enquiry

This is the initial contact from the potential customer enquiring about leasing vehicles from LeasePlan.

(b) Marketing response

This involves the initial meeting, promotional material etc.

(c) Lease quote

LeasePlan provides the customer with a "Lease Quote". This is not a contractual document. It provides an example of the terms and conditions on which LeasePlan can provide particular vehicles to Lessees.

(d) Credit application

If the Lessee wishes to proceed, the Lessee's credit application is completed and assessed.

(e) Motor vehicle leasing terms and conditions

When a Lessee commences dealings with LeasePlan, the company then provides the Lessee with the Master Agreement. This document sets out the general terms and conditions for motor vehicles to be subsequently leased from LeasePlan. There is no specific reference to actual vehicles in the Master Agreement.

(f) Vehicle quotation, order and acceptance

LeasePlan provides a detailed quote to the Lessee, which incorporates the standard terms and conditions contained in the Master Agreement. Under clause 1.1 of the Master Agreement, the Lessee may sign this and submit it to LeasePlan. If LeasePlan agrees to supply the vehicle, the offer is accepted and a copy of the executed Order form is returned to the Lessee. A contract exists at this point in time. The Order is completed prior to the commencement of each new lease and reflects the details for that lease only.

In all cases, the contract between the Lessee and LeasePlan contains the following terms and conditions:

- The term of the lease.
- There is no provision for automatic renewal of the term of the lease and no option conferred on the Lessee to renew, extend or vary the term of the lease.
- There is no provision for an incentive to the Lessee if it takes up a further lease of the vehicle.
- There is no penalty on the Lessee if it does not take up a further lease of the vehicle.

(g) Vehicle Schedule

LeasePlan issues a Supplement Schedule to the Master Agreement once an invoice from the supplier is received (per clause 1.2 of the Master Agreement), in the event that a new vehicle is being acquired for the lease. Where a vehicle already owned by LeasePlan is made available to the Lessee, the Schedule is issued shortly after the Vehicle Order is signed. Both parties sign the Schedule.

The Schedule contains certain further information, such as the registration number of the vehicle supplied, confirmation of the market value, and confirmation of the total rent.

(h) *Procedure at end of lease*

The lease will cease once the full lease term is completed.

As standard practice, LeasePlan advises the Lessee of the status of the lease three months prior to the expiration of the lease term, and provides several options for the Lessee to consider in meeting its future leasing requirements. A short time before the expiry of the lease, if the Lessee has not yet outlined their intentions, then LeasePlan sends out a quote for entering into a new lease. LeasePlan then determines whether the Lessee wishes to lease the vehicle for a further lease term, or wishes to take up one of the other options offered, such as leasing a new vehicle. If the Lessee does not wish to enter into a new lease for the existing vehicle (or does not respond to LeasePlan's correspondence), the vehicle is returned to LeasePlan upon expiry of the lease. If the Lessee wishes to retain the vehicle, a new lease is entered into for a further period.

This new lease is assigned a separate and distinct number or record in LeasePlan's computer system, which is used to manage vehicles leased using its FlexiPlan product. In all cases, the old record for the previous lease is noted as having terminated. In addition, a new Order and Schedule are required for the new lease. Again, the general conditions set out in the Master Agreement are incorporated into that new lease agreement.

The rental rates for the subsequent period or periods are lower than the first. The rates reduce as the depreciation on the vehicle reduces. If the customer does not renew, it does not get the benefit of reduced rates. However, there is no obligation on LeasePlan to provide vehicles for subsequent FlexiPlan Leases and no obligation on Lessees to enter into a subsequent lease.

(i) *Valuation of vehicles*

Prior to the new lease commencing, an agent of LeasePlan may inspect the vehicle, determine the mileage, and review the condition of the vehicle. This information is used to calculate the new rental. It also allows LeasePlan to determine the market value of the vehicle at the end of the previous lease period and therefore the commencement of the new lease period. LeasePlan advises Lessees of the market valuation of the vehicles, and also provides market value forecasts for subsequent periods for indicative purposes only. Market values are always reviewed prior to the commencement of subsequent leases (if any) to ensure whether the forecasts are accurate or need to be changed in any way.

(j) *Excess kilometre charge*

Pursuant to clause 17 of the Master Agreement, on the expiry of the lease period, LeasePlan will calculate whether the actual kilometres travelled by the vehicle during the lease period exceeds the agreed number of kilometres to be travelled by the vehicle. If the actual kilometres travelled exceeds the agreed kilometres, then the Lessee must pay to LeasePlan an excess kilometre charge, calculated by multiplying the excess by the agreed excess charge per kilometre.

12. Clause 2 of the Master Agreement allows LeasePlan, if the Lessee so wishes, to acquire vehicles from a Lessee and then hire those vehicles back to the same Lessee. In such a situation a composite Schedule is prepared by LeasePlan and executed by both LeasePlan and the Lessee.

13. Where it is included in the Schedule, LeasePlan will bear the cost of FBT reporting. FBT reporting is an optional service provided by LeasePlan. LeasePlan liaises with the Lessee's drivers directly and obtains the details necessary to carry out the FBT calculation, for example confirming the days when the vehicle was not available for private use. The information is then provided to the Lessee in a user friendly report to enable them to complete their FBT returns in respect of the motor vehicles.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The motor vehicles leased by the Lessees under this Arrangement are leased for business and private use and enjoyment of the Lessee's employees or made available for the private use or enjoyment of such employees.

b) No contract, agreement, plan, or understanding (whether enforceable or unenforceable) is entered into between LeasePlan and the Lessee in relation to the Arrangement, other than the Master Agreement, the Schedule and the Order.

c) Any rental rate for the Lessee for a subsequent lease period is the same rental rate that would be offered to any other customer for that particular vehicle and lease period (taking into account the customer credit rating, customer fleet size, kilometre allowances, and general service components of the lease including vehicle maintenance) irrespective of whether a previous lease for that vehicle was entered into by that Lessee.

d) There is no contract, agreement, arrangement, plan, undertaking or understanding (whether formal or informal, and whether intended to be legally unenforceable or not) at the time of entering into any lease under this Arrangement:

- that any party will, or will if requested, renew, extend or vary the Lease Term;
- that the parties will enter into a further lease in respect of the vehicle; or
- that there will be penalties for choosing not to enter into a further lease in respect of the vehicle.

e) There is no other documentation, agreements, or contracts that concern or affect the terms of the leases entered into under this Arrangement apart from the Master Agreement, the Schedule and the Order.

f) All calculations, factors, and/or projections which are taken into account in formulating the rental rates applying to each lease are not in any way based on a lease of the relevant motor vehicle for more than the relevant lease period.

g) No Lessee is associated with LeasePlan within the meaning of section OD 7.

h) The lease periods are not less than six months and not more than 75% of the estimated useful life of the vehicle.

i) Where a vehicle has previously been leased by the same employer, the cumulative total of the various lease terms entered into by LeasePlan and the employer is not greater than 75% of the estimated useful life of the vehicle.

j) The Lease is not a "finance lease" as defined in section OB 1.

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 market value of a motor vehicle under this arrangement, for the purposes of calculating the fringe benefit value of that vehicle under section CI 3(1) and Schedule 2, Part A, Clause 1(c), is determined on the date on which each new lease commences.
- Section GC 15 does not apply to the Arrangement.
- Section GC 17 does not apply to the Arrangement.
- Section BG 1 does not apply to negate or vary the conclusions above.

The period or income year for which this Ruling applies

This Ruling will apply for the period from 30 October 2002 to 30 October 2005.

This Ruling is signed by me on the 30th day of October 2002.

Martin Smith

General Manager (Adjudication & Rulings)

DISPOSITIONS WHERE THE TRANSFEROR RESERVES OR RETAINS A BENEFIT OR ADVANTAGE IN REAL PROPERTY – GIFT DUTY AND INCOME TAX IMPLICATIONS

Note (not part of Rulings):

The nine rulings BR Pub 02/02 – 02/10 replace both Public Ruling BR Pub 96/1 and Public Ruling BR Pub 96/2A. BR Pub 96/1 was published in TIB Vol 7, No 8 (February 1996), and applied up until 31 March 1999. BR Pub 96/2A was published in TIB Vol 8, No 10 (December 1996), and applied up until the end of the 1998-99 income year. Rulings BR Pub 02/02-02/10 cover the application of the Estate and Gift Duties Act 1968 and the Income Tax Act 1994 to nine different arrangements. Some of the conclusions in those earlier rulings have changed as a result of the House of Lords decision in *Ingram v IRC* [1999] 1 All ER 297. The rulings and commentary also supersede the view given in a "Question we've been asked" item in TIB Vol 9, No 8 (August 1997).

Nine separate binding rulings have been issued covering both the income tax and gift duty implications of similar but separate arrangements. This provides greater certainty to taxpayers over a range of possible arrangements. However, a single commentary applies to all nine rulings.

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING A GRANT OF A LIFE ESTATE THE BALANCE IS TRANSFERRED TO ANOTHER PERSON – GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING BR PUB 02/02

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 1994 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CE 1 (1)(e) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor grants a life estate (including a lease for life) to him or herself, and then subsequently transfers the balance of the property to another person.

For the purposes of this Ruling:

- A "person" includes a person or persons acting in their capacity as trustees of a trust.
- An interest in land referred to as a "lease for life" is an estate in land giving exclusive possession and enduring for the life of a particular person. It excludes a periodic tenancy.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The life estate (including a lease for life) granted by the transferor is a retention and not a reservation for the purposes of section 70(2) of the EGDA.
- The retention of the life estate (including a lease for life) does not give rise to gross income to the transferor or the transferee under section CE 1(1)(e) of the ITA.

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 1999 to 31 March 2005.

This Ruling is signed by me on the 29th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING A GRANT OF A LEASE THE BALANCE IS TRANSFERRED TO ANOTHER PERSON – GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING BR PUB 02/03

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 1994 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CE 1 (1)(e) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor grants a lease for a term to him or herself, and then subsequently transfers the balance of the property to another person.

For the purposes of this Ruling, a "person" includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The lease granted by the transferor is a retention and not a reservation for the purposes of section 70(2) of the EGDA.
- The retention of the lease does not give rise to gross income to the transferor or the transferee under section CE 1(1)(e) of the ITA.

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 1999 to 31 March 2005.

This Ruling is signed by me on the 29th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING THE TRANSFER TO ANOTHER PERSON A LIFE ESTATE IS GRANTED BACK – GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING BR PUB 02/04

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 1994 (ITA).

This Ruling applies in respect of section 70 of the EGDA and sections CE 1 (1)(e) and OB 1 (definitions of "lease" and "leasehold estate") of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor transfers property to another person, and under the arrangement the other person subsequently grants a life estate (including a lease for life) back to the transferor out of the property transferred.

For the purposes of this Ruling:

- In determining whether the transfer is for inadequate or no consideration, the value of the life estate granted back is included as consideration.
- A "person" includes a person or persons acting in their capacity as trustees of a trust.
- An interest in land referred to as a "lease for life" is an estate in land giving exclusive possession and enduring for the life of a particular person. It excludes a periodic tenancy.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The life estate (including a lease for life) granted back to the transferor is a reservation for the purposes of section 70(2) of the EGDA.

- The life estate (including a lease for life) granted back to the transferor is not a lease for the purposes of section CE 1(1)(e), and the grant back of the life estate (including a lease for life) does not give rise to gross income to the transferor or the transferee under section CE 1(1)(e) of the ITA.

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 1999 to 31 March 2005.

This Ruling is signed by me on the 29th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING THE TRANSFER TO ANOTHER PERSON A LEASE IS GRANTED BACK – GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING BR PUB 02/05

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 1994 (ITA).

This Ruling applies in respect of section 70 of the EGDA; and sections CE 1 (1)(e), EB 1 (1), EB 2, and OB 1 (definitions of “lease” and “leasehold estate”) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor transfers property to another person and under the arrangement the other person subsequently grants a lease for a term back to the transferor out of the property transferred:

- where:
    - the transferor reduces the price of the property first transferred; or
    - the transferor reduces a debt owed by the transferee to the transferor; or
    - the transferor otherwise pays the transferee; and
- the amount of the reduction in price, reduction in the debt or the payment is attributable to the lease granted back to the transferor.

For the purposes of this Ruling:

- In determining whether the transfer is for inadequate or no consideration, the value of the life estate granted back is included as consideration.
- A “person” includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The lease granted back to the transferor is a reservation for the purposes of section 70(2) of the EGDA.
- The amount of the reduction in price, reduction in the debt or the payment is gross income to the transferee under section CE 1(1)(e) of the ITA.
- The grant of the lease does not give rise to gross income to the transferor under section CE 1(1)(e).

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 1999 to 31 March 2005.

This Ruling is signed by me on the 29th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING THE TRANSFER TO ANOTHER PERSON A LICENCE IS GRANTED BACK – GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING BR PUB 02/06

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 1994 (ITA).

This Ruling applies in respect of section 70 of the EGDA; and sections CE 1 (1)(e), EB 1 (1), EB 2, and OB 1 (definitions of “lease” and “leasehold estate”) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor transfers property to another person and under the arrangement the other person subsequently grants a licence back to the transferor out of the property transferred:

- where:
  - the transferor reduces the price of the property first transferred; or
  - the transferor reduces a debt owed by the transferee to the transferor; or
  - the transferor otherwise pays the transferee; and
- the amount of the reduction in price, reduction in the debt or the payment is attributable to the licence granted back to the transferor.

For the purposes of this Ruling:

- In determining whether the transfer is for inadequate or no consideration, the value of the life estate granted back is included as consideration.
- A “person” includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The licence granted back to the transferor is a reservation for the purposes of section 70(2) of the EGDA.
- The amount of the reduction in price, reduction in the debt or the payment is gross income to the transferee under section CE 1(1)(e) of the ITA.
- The grant of the licence does not give rise to gross income to the transferor under section CE 1(1)(e).

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 1999 to 31 March 2005.

This Ruling is signed by me on the 29th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE THE TRANSFEROR PURPORTS TO GRANT HIM OR HERSELF A LICENCE TO OCCUPY AND TRANSFER THE BALANCE – GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING BR PUB 02/07

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 1994 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CE 1 (1)(e) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where:

- the transferor purports to grant to him or herself a licence to occupy; and
- the transferor then purports to transfer the balance of the property to another person; and
- the transferee then grants a licence back to the transferor.

For the purposes of this Ruling, a “person” includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- As a transferor cannot legally grant him or herself a licence to occupy, the full property interest will be transferred to the transferee.
- The licence granted back to the transferor is not a reservation for the purposes of section 70(2) of the EGDA.
- The grant of the licence does not give rise to gross income to the transferor or the transferee under section CE 1(1)(e) of the ITA.

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 1999 to 31 March 2005.

This Ruling is signed by me on the 29th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE THERE IS A "SIMULTANEOUS" GRANT OF A LIFE ESTATE AND TRANSFER OF THE BALANCE TO ANOTHER PERSON – GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING BR PUB 02/08

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 1994 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CE 1 (1)(e) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor grants him or herself a life estate (including a lease for life) and simultaneously transfers the balance of the property to another person.

A simultaneous transfer includes the situation where it is the intention of the transferor that only the balance or interest in reversion in the property is transferred, even though in conveyancing law terms the whole property initially transfers; and

- there is an immediate equitable obligation on the transferee to grant back the life estate (including a lease for life); and
- the transferor does not obtain any benefit out of the balance or interest in reversion that was transferred; and
- the transferor's intention to retain the life estate (including a lease for life) is evidenced in the documents and in the surrounding circumstances.

For the purposes of this Ruling:

- A "person" includes a person or persons acting in their capacity as trustees of a trust.
- An interest in land referred to as a "lease for life" is an estate in land giving exclusive possession and enduring for the life of a particular person. It excludes a periodic tenancy.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The life estate (including a lease for life) granted by the transferor is a retention and not a reservation for the purposes of section 70(2) of the EGDA.
- The retention of the life estate (including a lease for life) does not give rise to gross income to the transferor or the transferee under section CE 1(1)(e) of the ITA.

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 1999 to 31 March 2005.

This Ruling is signed by me on the 29th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE THERE IS A "SIMULTANEOUS" GRANT OF A LEASE AND TRANSFER OF THE BALANCE TO ANOTHER PERSON – GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING BR PUB 02/09

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 1994 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CE 1 (1)(e) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor grants him or herself a lease for a term and simultaneously transfers the balance of the property to another person.

A simultaneous transfer includes the situation where it is the intention of the transferor that only the balance or interest in reversion in the property is transferred, even though in conveyancing law terms the whole property initially transfers; and

- there is an immediate equitable obligation on the transferee to grant the lease back; and
- the transferor does not obtain any benefit out of the balance or interest in reversion that was transferred; and
- the transferor's intention to retain the lease is evidenced in the documents and in the surrounding circumstances.

For the purposes of this Ruling, a "person" includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The lease granted by the transferor is a retention and not a reservation for the purposes of section 70(2) of the EGDA.
- The retention of the lease does not give rise to gross income to the transferor or the transferee under section CE 1(1)(e) of the ITA.

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 1999 to 31 March 2005.

This Ruling is signed by me on the 29th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE THE TRANSFEROR PURPORTS TO "SIMULTANEOUSLY" GRANT A LICENCE AND TRANSFER THE BALANCE TO ANOTHER PERSON – GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING BR PUB 02/10

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 1994 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CE 1 (1)(e) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where:

- the transferor purports to grant to him or herself a licence to occupy; and
- the transferor simultaneously purports to transfer the balance of the property to another person; and
- the transferee grants a licence back to the transferor.

A simultaneous transfer includes the situation where it is the intention of the transferor that only the balance or interest in reversion in the property is transferred, even though in conveyancing law terms the whole property initially transfers; and

- there is an immediate equitable obligation on the transferee to grant the licence back; and
- the transferor does not obtain any benefit out of the balance or interest in reversion that was transferred; and
- the transferor's intention to retain the licence is evidenced in the documents and in the surrounding circumstances.

For the purposes of this Ruling, a "person" includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- As a transferor cannot legally grant him or herself a licence to occupy, the full property interest will be transferred to the transferee.
- The licence granted back to the transferor is not a reservation for the purposes of section 70(2) of the EGDA.
- The grant of the licence does not give rise to gross income to the transferor or the transferee under section CE 1(1)(e) of the ITA.

The period for which this Ruling applies

This Ruling will apply for the period from 1 April 1999 to 31 March 2005.

This Ruling is signed by me on the 29th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

COMMENTARY ON PUBLIC RULINGS BR PUB 02/02 TO 02/10

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in public rulings BR Pub 02/02-02/10 ("the Rulings").

The commentary deals first with the gift duty implications under the Estate and Gift Duties Act 1968 of each of the arrangements in the public rulings, and secondly with the income tax implications under the Income Tax Act 1994. These rulings are all variations on a theme, where a transferor wishes to transfer real property but wishes still to have some interest in the property. An example is a person who transfers a house to a family trust, keeping the right to occupy the property. These rulings cover different ways in which this can be achieved, and specify situations in which the transactions will give rise to a liability for gift duty and income tax and the situations in which they will not.

All legislative references are to the Estate and Gift Duties Act 1968 (EGDA), the Income Tax Act 1994 (ITA), or the Property Law Act 1952 (PLA).

PART ONE: GIFT DUTY

Background

The rulings are concerned with the situation where someone gives away some property that is subject to gift duty, and takes something back from the gift. Section 70(2) of the EGDA prevents the value of any benefit or advantage reserved from a gift, being deducted from the value of the dutiable gift. If the transferor reserves an interest in the property, the transferor is assessed for gift duty on the value of all of the property transferred, including the interest reserved.

The aim of section 70(2) is to prevent the transferor arguing that the liability for gift duty is reduced. Without section 70(2), the transferor might argue that when an interest in property gifted has been reserved, the transferee has given value to the transferor for the gift in the form of an interest in the property gifted.

If the transferor *reserves* part of the property transferred, that part of the property *is* included in determining whether or not there is a dutiable gift, and whether or not section 70(2) applies. Property is reserved if, under the arrangement, some of the property gifted is to be given back. If the transferor *retains* part of some property and transfers the rest of the property, the part of the property retained is *not* included in determining whether or not there is a dutiable gift, and whether or not section 70(2) applies.

It is important, therefore, to distinguish between reservations and retentions, as apparently similar transactions are treated quite differently. The analysis in this commentary particularly focuses on the distinction between reservation and retention.

The new rulings and commentary apply from 1 April 1999 to 31 March 2005. The previous ruling on this matter, Public Ruling BR Pub 96/1, applied to dispositions of real property made between 1 April 1996 and 31 March 1999. It was published in *Tax Information Bulletin* Vol 7, No 8 (February 1996). An issue arising from the previous ruling, which was discussed in a "Question we've been asked" item in *Tax Information Bulletin* Vol 9, No 8 (August 1997), is dealt with in this commentary, and so is superseded by this commentary.

Because of recent developments in the law on reservations and retentions, particularly the House of Lords decision in *Ingram v IRC* [1999] 1 All ER 297, which came after the previous ruling, the Commissioner's view of the law has been refined to reflect that decision.

Another change from the previous ruling is that the Commissioner now considers that there needs to be a gift for section 70 to apply. The Commissioner no longer takes the view that section 70 can apply to create a gift.

These points are discussed in the commentary. In other respects the law relating to the gift duty aspects, and the Commissioner's view of that law, has not changed.

The arrangements

In order to provide for a comprehensive range of situations, the Commissioner has developed nine separate arrangements, BR Pub 02/02-02/10. These arrangements are dispositions of property for inadequate consideration where:

1. A transferor grants a life estate to him or herself, and then subsequently transfers the balance of the property to another person.
2. A transferor grants a lease to him or herself, and then subsequently transfers the balance of the property to another person.
3. A transferor transfers the property to another person, and under the arrangement that other person later grants a life estate back to the transferor out of the property transferred.

4. A transferor transfers the property to another person, and under the arrangement that other person later grants a lease back to the transferor out of the property transferred.

5. A transferor transfers the property to another person, and under the arrangement that other person later grants a licence to occupy back to the transferor out of the property transferred.

6. A transferor purports to grant him or herself a licence to occupy, and transfers the balance of the property to another person.

7. A transferor grants him or herself a life estate and simultaneously transfers the balance of the property to another person.

8. A transferor grants him or herself a lease, and simultaneously transfers the balance of the property to another person.

9. A transferor purports to grant him or herself a licence to occupy, and simultaneously transfers the balance of the property to another person.

It is important to recognise that with section 70(2) of the EGDA such seemingly minor differences in arrangements may significantly change the parties' respective rights and obligations, and the revenue law implications.

The words "grant" and "transfer" are often used interchangeably. For the purposes of this commentary, "grant" refers to the conveyance of the carved-out estate (such as the life interest or lease) and "transfer" refers to the conveyance of the balance of, or reversionary interest in, the property. Some of these arrangements may apply to taxpayers other than individuals. The arrangements specifically include trustees. Because of the nature of the arrangements, the focus is on individuals and trusts, although the same reasoning may apply in some instances to other entities.

Other references

Note that generally speaking, gift duty is payable only when the value of the total amount of gifts made in a year exceeds $27,000. The Commissioner has published two booklets, *Gift duty (IR 194)* (April 2002), explaining the general features of gift duty, and *Gift duty – a guide for practitioners (IR 195)* (May 1999) which covers some issues in more detail. These are available from Inland Revenue's website **www.ird.govt.nz** or by phoning **INFOexpress** on 0800 257 773. The Commissioner has also published items on various aspects of gift duty in the *Tax Information Bulletins*.

Summary of conclusions

The following bullet points summarise the different ways of transferring interests in property, the Commissioner's view of whether there is a reservation or retention, and therefore whether section 70(2) of the EGDA applies. In each of these situations, the property must be disposed of for inadequate consideration.

- Where a transferor grants an interest in property to him or herself, and later transfers the balance or reversionary interest in the property to another person, there is no reservation for the purposes of section 70(2) of the EGDA and the section does not apply. The most obvious example is a person who grants him or herself a life estate or a lease, and then subsequently disposes of the balance of his or her interest to another person. The life estate or lease is, in law, a distinct interest in the property separate from the balance of or reversionary interest in the property that is transferred and is not part of the gift. Gift duty is concerned with what is gifted. The focus is on the balance transferred, not the life estate or lease that the transferor kept throughout (BR Pub 02/02 and BR Pub 02/03).

- Where a transferor transfers property to another person, and the parties intend that all the property rights in the property be transferred and then later an interest be granted back, there is a reservation by the transferor of the interest granted back to him or her. If the transfer of the property is a dutiable gift, the transferor would not be able to deduct the value of the reserved interest from the value of the gift, because of the operation of section 70(2) of the EGDA (BR Pub 02/04-02/06).

- Where a transferor grants a property right to him or herself, and simultaneously transfers the balance or reversionary interest of the property to a transferee, it is considered that there is no reservation of a benefit for the purposes of section 70(2) of the EGDA.

  A simultaneous transfer will include the situation where it was the intention of the parties that only the net property interest was to be given away, but because of conveyancing rules, the transfer had to be effected by a transfer of all of the property, and then the net property interest being transferred back. In this situation, nothing has been reserved out of the subject matter of the gift. This point was stated in the 1999 House of Lords decision in *Ingram*, and the Commissioner has incorporated the point in the rulings and in this commentary. It is, however, consistent with the New Zealand case *Commissioner of Stamps v Finch* (1912) 32 NZLR 514 (CA) (BR Pub 02/07-02/10).

Legislation

Gift duty is imposed under the EGDA by part IV of that Act. The key definitions and provisions relating to gift duty follow.

Section 2(2) defines "gift" as:

> "Gift" means any disposition of property, wherever and howsoever made, otherwise than by will, without fully adequate consideration in money or money's worth passing to the person making the disposition:
>
> Provided that where the consideration in money or money's worth is inadequate, the disposition shall be deemed to be a gift to the extent of that inadequacy only.

"Disposition of property" is also defined in section 2(2):

> "Disposition of property" means any conveyance, transfer, assignment, settlement, delivery, payment, or other alienation of property, whether at law or in equity; and, without limiting the generality of the foregoing provisions of this definition, includes— ...

Therefore, for a gift to exist, there must be a disposition of property without fully adequate consideration. A gift exists only to the extent of the inadequate consideration.

Section 61 of the EGDA imposes gift duty on dutiable gifts, at rates set out in section 62. Section 63 provides a definition of dutiable gift. A gift is a dutiable gift if the donor is domiciled in New Zealand or is a body corporate incorporated in New Zealand, or the property which is the subject of the gift is situated in New Zealand.

Under section 66 of the EGDA, a gift is valued at the date it is made. Section 67 allows the Commissioner to value property in such manner as he thinks fit, subject to restrictions in sections 68A-G, 69 and 70.

Section 70 of the EGDA states:

(1) For the purposes of this section-

"**Ascertainable**" means ascertainable as at the date of the disposition to the satisfaction of the Commissioner:

"**Benefit or advantage**" means any benefit or advantage whether charged upon or otherwise

affecting the property comprised in the disposition or not, and whether—

(a) By way of any estate or interest in the same or any other property; or

(b) By way of mortgage or charge; or

(c) By way of any annuity or other payment, whether periodical or not; or

(d) By way of any contract for the benefit of the person making the disposition; or

(e) By way of any condition or power of revocation or other disposition; or

(f) In any other manner whatever;—

but does not include any annuity or other payment, whether periodical or not, if and so far as the annuity or payment—

(g) Is of a fixed or ascertainable amount in money payable over a fixed or ascertainable period, or for life, or at a fixed or ascertainable date or dates, or on demand; and

(h) Is secured to the person making the disposition—

(i) By a mortgage or charge over the property comprised in the disposition; or

(ii) By an agreement for the sale and purchase of land comprised in the disposition; or

(iii) By an agreement in writing to lease land comprised in the disposition; or

(iv) By deed,—

in each case executed by the person acquiring the beneficial interest under the disposition.

(2) Where any disposition of property is, in whole or in part, a dutiable gift, and is made in consideration of, or with the reservation of, any benefit or advantage to or in favour of the person making the disposition, no deduction or allowance shall be made in respect of that benefit or advantage in calculating the value of the dutiable gift.

(3) Notwithstanding anything in section 78 of this Act, the Commissioner may permit the cancellation or alteration of any instrument creating or evidencing a disposition of property to which this section applies, if application in writing is made by the parties to the instrument within 6 months after the date of the instrument, or within such extended time as the Commissioner thinks fit to allow in the special circumstances of the case. On evidence to his satisfaction being produced of any such cancellation or alteration, the disposition shall not constitute a dutiable gift except to the extent to which the transaction as altered constitutes a dutiable gift.

Therefore, after imposing gift duty the Act provides a valuation regime, including certain prohibitions for deductions when valuing property.

Section 76 allows relief for gift duty for the subsequent gift of a reserved benefit where section 70(2) has applied. The section states:

When the donor of a dutiable gift to which section 70 of this Act applies (in this section referred to as the original gift) subsequently makes a dutiable gift of the whole or any part of the benefit or advantage (as defined in that section) created or reserved on the making of the original gift, there shall be deducted from the gift duty otherwise payable in respect of that subsequent gift (so far as that gift duty extends) an amount calculated in accordance with the following formula:

$$\frac{a}{b} \times c$$

where—

a is the value of that benefit or advantage comprised in that subsequent gift, either at the date of the gift, or at the date of the original gift, whichever is the less; and

b is the value of the original gift; and

c is the amount of gift duty paid on the original gift.

Application of the legislation

The object of section 70(2)

Section 2(2) of the EGDA states that a gift is only a gift to the extent of the amount of the inadequacy of consideration. Section 70(2) requires that any amount "reserved" to the donor of a gift is not to be taken into account as being consideration. This means that in determining the inadequacy of consideration, any reservation is not included as consideration.

The intention behind section 70(2) was discussed by Chapman J of the Court of Appeal in *Finch*:

> If a donor could give a farm or a house to his son, and take back some kind of estate or interest in or charge representing part of the value of some other kind of property of the son, such as a life estate or mortgage, it would be easy to annihilate the taxable value of the gift: therefore that device is barred.

This view is also taken in Adams and Richardson's *Law of Estate and Gift Duty* (5th ed., 1978, Wellington, Butterworths), in which the authors say (p 205):

> Section 70 is aimed at certain types of benefit or advantage which, if they were taken into account as a consideration in calculating the value of a gift, might be used to make a gift appear to be a grant for valuable consideration, thus avoiding or at least postponing the gift duty.

These statements indicate that the policy behind section 70(2) is to prevent donors from arguing that the amount of a gift should be reduced by the value of anything reserved from a disposition of property, with a consequent reduction in the amount of gift duty payable. Instead, a gift with a reservation is valued without taking into account the value of the reservation.

Section 70 only applies to gifts

Section 70 does not operate to create a gift. Section 70 only applies to a gift. If the consideration, including any benefit or advantage reserved is not inadequate, section 70 does not apply. If the total consideration is inadequate, section 70 applies, and the reserved amount is not deducted in determining the amount of the gift. So if property worth $100 with a reservation of $40 is transferred, and the transferee gives consideration of $100, there is no gift and section 70 does not apply. If, instead, property worth $100 with a reservation is transferred and the transferee gives consideration of $90, there is a gift and section 70 applies. The amount of the gift is $10. As section 70 applies, the value of the gift is not reduced to reflect the reservation.

This view was taken by the Court of Appeal in *Commissioner of Stamps v Finch*. At p 318, Stout CJ said:

> In interpreting this section 9 [of the Death Duties Amendment Act 1911, now section 70(2)] it has to be noted that the section begins by stating "when any gift". The transaction has to be a gift. If it was an out and out sale it could not be construed as a gift. In a previous statute, namely section 6 of the Stamp Acts Amendment Act, 1895, the provision was very different. That section began thus: "In order to prevent the avoidance or evasion of duties by family arrangements or otherwise, the definition of 'deed of gift' in section 7 of the Stamp Acts Amendment Act, 1891 is hereby extended to include every deed or instrument whereby any person directly or indirectly conveys, transfers or otherwise disposes of property to or for the benefit of any person connected with him by blood or marriage," etc.
>
> There is in this section 9, no definition of what a gift means. In such a case the Court must ascertain if the word "gift" is interpreted in the Act itself.
>
> …
>
> If for example it had declared that what was not a "gift" was to be deemed a gift, as was the case in section 6 of the Act of 1895, then the Court would have been bound to interpret section 9 as charging duty on a disposition of property that was not in effect a gift. But there is no such provision in section 9.

In this passage, Stout C.J. notes that section 9 (now section 70) only applies if there is a gift without its operation. He then contrasts the section with the previous "very different" wording of the provision which did not require that there is first a gift before the section applied.

This earlier form of the section was applied in *In re Deans* (1910) 29 NZLR 1089. In that case a widow transferred various lands to her four children. In consideration, they paid her some annuities. The actuarial value of the annuities was equivalent to the capital value of the land. The section was held to apply and the value of the annuities was ignored. Gift duty was charged on the capital value of the land. Chapman J said at p 1,098:

> It is argued that this is still limited to transactions which are gifts in some sense. The contrary is, however, plainly declared when the clause refers to transfers made "in consideration or with the reservation" of any benefit or any advantage to or in favour of the transferor or his nominee in that or any other property in the shape of an annuity or benefit of the like class.

Adams and Richardson say in *Law of Death and Gift Duties in New Zealand* at p 205:

> Before s 70(2) can apply there must first be a disposition of property which is "in whole or in part a dutiable gift". If the consideration for a disposition is fully adequate there is no dutiable gift and consequently the section does not apply. But if the consideration is inadequate, even to the smallest degree, there is a dutiable gift involved and s 70(2) can be applied.

How section 70(2) works

The purpose of section 70(2) is to prevent the value of a gift subject to gift duty being reduced if the transferee gives a part of the gifted property back to the person making the gift. For example, a person might gift her house but agree with the recipient that the recipient will later give the transferor the right to continue to live in the house until she dies. If not for section 70(2), the transferor might then claim that the amount of gift duty payable should be reduced. The transferor might argue that the value of the gift is not the value of the house, but the value of the house reduced by the value of the life interest the transferee has agreed to. In these circumstances, section 70(2) will apply so that the value of the life interest is not treated as consideration from the transferee to the transferor.

Therefore, in determining whether or not the transferee has given adequate consideration, and whether section 70(2) applies, the following three-step analysis is required:

- Identify the property that the transferor transfers to the transferee. Does the transferor transfer all the property to the transferee with the transferee granting some property back to the transferor (a reservation of the part given back), or does the transferor transfer only part of his or her property to the transferee, and retain part of the property (a retention of the part not given)?
- Identify the value of the property transferred to the transferee.
- Identify the consideration given by the transferee for that property (the value of any benefit reserved by the transferor is included as consideration in determining whether the consideration given by the transferee for the property transferred is inadequate).

If the transferee's consideration for the property is less than the value of the property, the definition of "gift" in section 2(2) is triggered, and assuming the general requirements in section 63 are met, there is a dutiable gift. The dutiable value of the gift is the difference between the value of the property gifted, less any consideration given. However, at this step, section 70 provides that the value of any interest reserved is not treated as consideration in determining the amount of the dutiable gift.

The first of the three steps in the bullet points is very important, because section 70(2) will apply when there is a reservation of a benefit or advantage from property, and not when there is a retention.

Difference between retaining an interest and reservation of a benefit or advantage

The focus of the arrangements in the public rulings is on the distinction between a reservation of property, and a retention of property. Case law has established that section 70(2) applies if there is a "reservation" of a benefit or advantage to the transferor, but not where there has been a retention of some property.

"Reservation" is not defined in the EGDA. The *Concise Oxford Dictionary* (10th ed. 1999) defines "reservation". The most appropriate definition is:

> **3** a right or interest retained in an estate being conveyed.

The definition implies that a reservation is something kept or retained while an estate is conveyed. The fact that the right or interest must be kept in the estate "being conveyed" may suggest that the reservation of the interest should occur at the same time as the conveyance.

While this dictionary definition may convey the ordinary usage of the word "reservation", the cases dealing with estate and gift duty legislation (including overseas equivalent legislation) have held (as discussed below) that "reservation" has a very narrow, technical meaning. Whether or not there is a reservation will depend on the particular transaction entered into.

In the Court of Appeal case *Lees v CIR* (1989) 11 NZTC 6,079, Richardson J stated the test for whether there is a reservation (in the context of section 12, a provision related to estate duty), at p 6,081:

> The test in that regard is whether the disponor disposed of the whole interest reserving an interest out of that which was disposed of, or whether the disponor disposed of a particular interest and merely retained the remaining interest in the property.

In *Finch,* the only New Zealand case on section 70(2) or its predecessors, Chapman J in the Court of Appeal drew the same distinction:

> ... I do not find that any of the language is apt to describe something which is not and never was reserved out of the gift or the value of the gift, but is an independent item of property retained by the donor.

These statements emphasise the importance of the distinction between a reserved interest and one that is merely retained. While it may be quite proper in ordinary usage to say that they are both reserved and retained, it is clear from the case law that, legally, the difference is an important one, particularly in terms of section 70(2).

In *Finch,* the Commissioner of Stamps assessed gift duty on the transfer of an undivided moiety (ie half share) of land to the transferor's two sons as tenants in common in equal shares. The transferor retained the remaining moiety. The value of the whole land was about £2,200, each moiety being worth just less than £1,100. The sons paid the father £100 in cash to ensure the value of the gift was less than £1,000, which at that time was the exemption level for gift duty. The Commissioner assessed gift duty on the whole value of the land, arguing that the moiety the transferor retained was a reservation of a benefit or advantage in the land. Alternatively, the Commissioner argued that if the gift was only the moiety transferred, the £100 was a reservation of a benefit or advantage. The transferor argued that the moiety retained was not a reservation of a benefit, nor was the £100 payment.

The five judges in the Court of Appeal all found for the transferor on both counts. All agreed that the transferor had not "reserved" a benefit or advantage in the land by retaining his moiety. The Court held that there is a reservation when a benefit or advantage is reserved from the interest actually given, not the entire estate from which the interest came.

A number of Australian and United Kingdom cases discuss whether there is a reservation of a benefit or advantage from the disposition of property. Two (originating from Australia) concern estate duty rather than gift duty, but they do discuss the meaning of "reservation".

In *Oakes v New South Wales Commissioner of Stamp Duties* [1953] 2 All ER 1563 (PC), the Privy Council considered a case where the transferor declared by deed of trust that he held farmland on trust for his children. He used the profits for the children's maintenance and education. He also claimed remuneration for his work as trustee, which he was entitled to do under the trust deed.

The Privy Council held that the remuneration to the transferor was a "benefit or advantage", even though it was provided for in the trust deed and that, therefore, there was a reservation of a benefit within the meaning of the section. Lord Reid stated at p1567:

> In their Lordships' judgment, it is now clear that it is not sufficient to bring a case within the scope of these sections, to take the situation as a whole and find that the settlor has continued to enjoy substantial advantages which have some relation to the settled property: it is necessary to consider the nature and source of each of these advantages and determine whether or not it is a benefit of such a kind as to come within the scope of the section.

Lord Reid also confirmed the distinction between "reservation" and "retention" at p 1571 where he said:

> The contrast is between reserving a beneficial interest and only giving such interests as remain, on one hand, and, on the other hand, reserving power to take benefit out of, or at the expense of, interests which are given…

Lord Reid is saying that when a transferor has retained a pre-existing interest, this is not the same as a reservation of a benefit. The Court's opinion was consistent with previous authority including *Earl Grey v Attorney-General* [1900] AC 124; [1900-3] All ER Rep 268 (HL).

Applying these same principles, a number of Australian and United Kingdom cases have found, on the facts, that there was not a reservation from the disposition of property. One of these is *Munro v Commissioner of Stamp Duties (NSW)* [1934] AC 61; [1933] All ER Rep 185 (PC). In that case the transferor entered into a partnership with his six children, and the partnership farmed the transferor's land. Four years later he gifted a portion of the land to each of the children. On the transferor's death the Commissioner attempted to assess death duty on the gifted land. The Privy Council held that the gifted property could not be brought back into the deceased's estate. In the speech of the Privy Council, Lord Tomlin said (p188 of the All ER Rep report):

> It is unnecessary to determine the precise nature of the right of the partnership at the time of the transfers. It was either a tenancy during the term of the partnership or a licence coupled with an interest. In either view what was comprised in the gift was, in the case of each of the gifts to the children and the trustees, the property shorn of the right which belonged to the partnership, and ... the benefit which the donor had as a member of the partnership in the right to which the gift was subject was not ... a benefit referable in any way to the gift.

This finding is consistent with *Commissioner of Stamp Duties (NSW) v Perpetual Trustee Co Ltd* [1943] AC 425; [1943] 1 All ER 525 (PC) and *Re Cochrane* [1906] 2 IR 200 (CA).

Simultaneous transfers

The case law discussed so far has distinguished between a reservation, where some property is gifted and then an interest in that property is gifted back; and a retention, where a transferor creates an interest out of some property which he or she owns, and gifts the balance or reversionary interest in that property. Recent case law has raised the issue of whether there is a reservation or a retention when an interest is created in property (for example, a life estate in the property) and the balance or reversionary interest is transferred at the same time, or in terms of the legal theory in relation to conveyancing transaction, shortly afterwards. These cases, which will be discussed below, are the House of Lords decision in *Ingram*, and the United Kingdom High Court and Court of Appeal decisions in *Nichols*.

New Zealand courts have held that what is in effect a simultaneous transaction, is not a reservation. In *Finch*, as discussed above, a father transferred an undivided half share in land. The Court of Appeal did not explicitly conclude that the transfers were simultaneous. However, the facts do not disclose any action on the part of the father to grant his half to himself before transferring the other half to his sons. He did not retain something he always had. He had owned the fee simple in the land, and after the transfer, he owned a different estate in the land which was a half share as a tenant in common. The father's moiety appears to have been created at the same time as the other moiety was transferred to the sons. Therefore, the transfers can be viewed as simultaneous transfers.

The Court concluded that there was no reservation of a benefit or advantage, because no interest was granted back to the donor. The father had not reserved an interest out of property that was given, but had retained an independent item of property which was not given to his sons.

The only New Zealand case where the transfers have explicitly been held to be simultaneous is *Lees*. In that case, the transferor created a life interest and transferred the reversionary interest in the property by documents executed on the same day. The Court held that there was a reservation of a benefit to the transferor.

However, the case was concerned with a different provision from section 70(2). Section 12(1)(b) (now repealed) of the EGDA concerned estate duty, and allowed the reservation of a benefit to *accompany* the disposition of property. It has been noted in some cases that the meaning of this phrase is unclear (*Overton's Trustees v CIR* [1968] NZLR 872), and may be inconsistent with the meaning of the word "reservation" in the context of gift duty. In that statutory context, the Court held that a simultaneous transfer is a reservation. The case is relevant to section 70, however, not for that finding, but because it was held that transfers may sometimes be simultaneous.

The *Ingram* case—when is a transfer simultaneous?

The English courts have more recently considered the issue of simultaneous transfers, in the trilogy of cases involving Lady Ingram. The High Court decision ([1995] 4 All ER 334) was appealed to the Court of Appeal ([1997] 4 All ER 395), which resulted in a further appeal to the House of Lords. The judgments in the case focused on the meaning of "reservation" in section 102 of the Finance Act 1986 (UK). That provision states that a gift that comes within it will be a "gift with reservation" and may be subject to inheritance tax. The test is whether or not the property gifted continues to be enjoyed by the donor in any way.

In the original (High Court) decision, it was concluded that the transfers were simultaneous and, therefore, there was no reservation of a benefit to the transferor. However, a majority of the Court of Appeal held that there was a grant back and a reservation. The House of Lords held that the transfers were simultaneous, and that there was no reservation.

The facts

In the *Ingram* case the transaction was structured as follows:

> 29 March – Lady Ingram transfers property absolutely to her solicitor.
>
> 29 March – solicitor declares he holds the property on trust for Lady Ingram and is acting on her direction.
>
> 30 March – solicitor grants Lady Ingram two 20-year rent free leases.
>
> 31 March – solicitor transfers property (subject to the leases) to the two sons and grandson of Lady Ingram (the trustees).
>
> 31 March – the trustees declared themselves to be the trustees of a settlement of the property for the benefit of certain beneficiaries. Lady Ingram is not a beneficiary.

The House of Lords observed that the series of transactions was structured, in part, to make the benefit to Lady Ingram a retention rather than a reservation so that inheritance tax would not be payable. However, in practice, this was more difficult in the United Kingdom than it would be in New Zealand. The United Kingdom has no equivalent provision to section 49 of the NZ Property Law Act 1952, allowing a lease to be granted to oneself. As Lady Ingram was unable to grant a lease to herself, it was necessary for her to transfer the property to someone else—her solicitor—so he could grant the lease to her.

The reasoning of the House of Lords

The House of Lords held that there was no reservation. The Law Lords held that section 102 of the Finance Act 1986 (UK) only applied where the benefit was derived from the interest given away. They held that, in this case, the trustees and beneficiaries had never had anything more than the freehold of the property subject to the lease. This property (the freehold less the leasehold interests) was not enjoyed by Lady Ingram in any way. She enjoyed only the leasehold interests. There was no reservation because the interest retained by Lady Ingram had been defined with the necessary precision, whether the leases were technically valid or not. Her intention was evidenced by the documents that gave effect to the transaction.

The Court of Appeal had held that the leases were not valid, and so the whole property must have transferred to the transferees and then a reservation was made back to Lady Ingram. The Court of Appeal also said that even if the leases were valid, that it is not conceptually possible for a lease to come into existence until the lessor has acquired the freehold interest. Therefore, the gift must have comprised the freehold interest and the lessor must have then given a lease back.

The House of Lords concluded that the leases granted by the solicitor to Lady Ingram were valid. However, the Law Lords also stated that they did not need to decide the validity of the leases in order to decide the case. They stated that, even if the leases were not valid, it was clear that the intention of the parties was for Lady Ingram to keep the leasehold rights and only give the other rights in the property away. This intention was evidenced by the documents. Lord Hoffman recognised that under conveyancing law, the whole property must pass before a lease can be granted. However, his Lordship considered that conveyancing form could not apply to make the transfer a reservation when it would otherwise not be. Lord Hoffman stated that (p 303):

> It is true that as a matter of conveyancing, no lease can come into existence until the freehold has been vested in the intended lessor. But s. 102 is concerned not with conveyancing but with

beneficial interests. It uses words like ‘enjoyment’ and ‘benefit’. In *A-G v Worrall* 1 [1895] QB 99 at p. 104, a case on a predecessor of s. 102, Lord Esher MR began his judgment with the words:

> ‘It has been held that in cases of this kind the Court has to determine what the real nature of the transaction was, apart from legal phraseology and the forms of conveyancing.’

If one looks at the real nature of the transaction, there seems to me no doubt that Ferris J [in the High Court] was right in saying that the trustees and beneficiaries never at any time acquired the land free of Lady Ingram’s leasehold interest. The need for a conveyance to be followed by a lease back is a mere matter of conveyancing form. As I have said, she could have reserved a life interest by a unilateral disposition. Why should it make a difference that the reservation of a term of years happens to require the participation of another party if the substance of the matter is that the property will pass only subject to the lease?

Lord Hoffman considered it important to look at the real nature of the transaction and not just the conveyancing form. The rights and obligations of each party should be examined to determine whether or not the transactions are within the section.

The Law Lords decided that it was the intention of the parties that only the net property interests be given away. They considered that the way the section was written focused on benefits. They held that Lady Ingram did not receive any benefits from the net property interest, but only from the leases, which were not part of the subject matter of the gift. At no time did the donees hold the property free from Lady Ingram’s leasehold interest. Therefore, she was not within the provision as she had not reserved a benefit out of the property the subject of the gift.

The Law Lords identified three aspects of the transaction which persuaded them that this was a situation where the transferor only ever intended that the net property interest be transferred, and not the whole property with a subsequent grant back. First, the House of Lords noted that Lady Ingram had defined very precisely the rights she intended to give away. She had never intended to grant the lease to the trustees, only the freehold shorn of the leasehold interests.

Secondly, the creation and existence of the leases was not dependent on the concurrence of the trustees and beneficiaries. It was never intended that the trustees would receive the whole property and then grant a lease back. This finding was supported by the fact that Lady Ingram had gone to such lengths to grant the lease before transferring the balance of the property.

Thirdly, because of the first two reasons, the House of Lords looked at the equitable rights and obligations of the parties, assuming that the leases were not valid. The Law Lords stated that equity would give Lady Ingram a right to the leases. Where the intention of the parties is clear that it was intended that the transfers be simultaneous, or it was intended that some rights never be given away, then this would give rise to equitable rights and obligations as between the parties. Therefore, in equity, the trustees were regarded as never having received the leasehold interests. From the moment they received the property they were subject to an equitable obligation to grant the leases. The only part of the property they ever received was the freehold less the leasehold interests. Therefore, the subject matter of the gift was the property shorn of the leasehold interests.

These equitable rights would arise from the time of transfer. They would have the effect of making the transfers simultaneous, notwithstanding that in legal theory or under conveyancing rules, the whole property would need to be transferred prior to there being a grant back. This means that the transfers may sometimes be simultaneous where there is (at least under legal theory) a grant back of a right.

The effect of *Ingram*

Following *Ingram* (HL), in a situation where the parties to the transactions never intend that the leasehold interests should be part of the subject matter of the gift, and they structure the arrangement with the necessary precision so that equitable rights arise simultaneously, the law will give effect to the parties’ intention. The transaction should not be viewed as involving an instant of time for property to be transferred and then an interest granted back, in order that conveyance formality be met. The House of Lords in *Ingram* stated that the need for an instant of time was only necessary for conveyancing theory, whereas the particular provision under consideration was more concerned with the rights, benefits and obligations that resulted from the transactions, and with determining enjoyments and benefits of the property interests. The Commissioner’s view is that section 70(2) should be interpreted the same way. Discounting the notion of an instant of time between the transfer and the grant back has the result that some transfers, previously considered to be a post transfer grant back, would now be considered to be simultaneous transfers.

It could be argued that the reasoning of the House of Lords judgments in *Ingram* is more sensible than the law as it was before the decision, because the law now will not require such fine distinctions to be made. Before *Ingram* (HL), if a transferor attempted to retain an interest at the same time property was transferred, there was a potential gift duty liability, whereas if the transferor’s interest in the land was created a moment before the transfer, there was no potential liability. The House of Lords held that all of these types of transactions (where the transferor wishes to give away property rights while retaining some right of occupation), in circumstances where the transferor defines precisely the rights he or she wishes to give away, have the same end result and that, therefore, there should be no reservation.

The *Nichols* case

In coming to its conclusion, the House of Lords endorsed the approach of Walton J in the High Court decision of *Nichols v IRC* ([1973] STC 278). That case concerned a father who wished to gift the family home and surrounding land to his son. However, the parents wished to continue living on the property. Therefore, they arranged for the property to be transferred to the son, and for the son to execute a lease in their favour.

Walton J in the High Court held that in principle, where property passes which has an immediate equitable obligation on the transferee to grant a lease back, the transaction can amount to a retention of the leasehold interest. Walton J considered that there is no legal impediment to regarding simultaneous transactions as only giving the transferee the property shorn of the leasehold interest. The House of Lords agreed with this approach, and not the Court of Appeal decision in *Nichols* which had reversed Walton J's judgment. The House of Lords in *Ingram* considered it was conceptually possible for a lease to come into existence before the lessor acquires the leasehold interest.

A simultaneous transfer is not always a retention

However, a simultaneous transfer and grant back will not always be outside the scope of section 70(2). Lord Hoffman in the House of Lords indicated that if the leasehold interest held by Lady Ingram had contained benefits that she did not have before the property was transferred, then it may not be possible for the transfer to be a retention of the leasehold.

Lord Hoffman took this point from the Court of Appeal judgment in *Nichols*. Although the House of Lords disapproved of the Court of Appeal judgment in *Nichols*, the disagreement was on the central issue of whether a simultaneous transfer and a lease back could be a retention.

In *Nichols*, a father had given his son his land, and as part of that transaction, the son was required to give a lease back. Under the lease, the son gave a covenant to undertake any repairs. The Court of Appeal held that existence of the covenants made the transaction a reservation, and it could not be a retention. The right to have the buildings repaired under the covenant did not exist before the transfer, and therefore could not be something not given (p 285).

A retention must be a retention of property that the transferor had prior to the transfer of the balance of the property. If, for example, the transferor has a leasehold interest as a result of a transfer of property, and the leasehold interest gives the transferor rights that he or she did not already have, then that leasehold interest could not have been something retained. It can only be something given by someone else. Therefore, if the transferor has a property interest as a result of a transfer that he or she could not have had before the transfer, then the transaction will be a transfer with a grant back, and will be a reservation.

Other points to come from the House of Lords judgment in *Ingram*

The House of Lords judgment held that it is possible in England to create a property interest prior to transferring the balance of the property, by the use of a nominee. Prior to this decision, it had been the view that it was not possible to retain an interest to oneself in England because of the common law rule that one can not grant a property interest to oneself (*Rye v Rye* [1962] 1 All ER 146). That rule has been overridden (at least partly) in New Zealand by section 49 of the Property Law Act 1952. The judgments of both Lord Hutton and Lord Hoffman concluded that, at least in English law, it was possible for a nominee to grant a lease to his or her principal. The implication is that a transferor can now retain a property interest prior to transfer, through the use of a nominee.

Following the House of Lords decision, it seems that the British Parliament decided that legislation was the only way to ensure clarity. As a result of the case, amendments have been made to add new sections into the Finance Act 1986 (UK), setting out specifically and in great detail when a gift will be a "gift with reservation" and when it will not. In the Budget Press Release of 9 March 1999 it was declared that:

> Loopholes which result in the avoidance of inheritance tax are to be closed … the changes which confirm the Government's determination to stamp out tax avoidance, relate to what is often referred to as making a 'gift with reservation'. This is when, for example, someone gives away his/her house but continues to live in the property. The change restores the tax position as it was understood to be prior to the House of Lords' ruling in the case of *Ingram v IRC*.

The Commentary to the Bill also stated that it was a specific anti-avoidance measure designed to counter *Ingram*-type schemes, and that no attempt was being made to rewrite the basic wording of the gift with reservation rules.

Meaning of "reservation" in section 70(2) after *Ingram*

The law established by the cases

The cases discussed above establish that:

- Property is retained when the transferor retains an interest in property and disposes of the balance or reversionary interest in the property (*Lees*).
- Property is reserved when the transferor disposes of the whole interest and reserves an interest out of that which was disposed of (*Lees*).
- The case of *Finch* distinguishes between a reservation and a retention of a benefit or advantage.

There is a reservation when a benefit or advantage is reserved from the interest actually given. There is merely a retention of the benefit or interest if the benefit or interest is held before the transfer of the balance of the property, or if the grant and transfer occur at the same time. See also *Munro*, *Oakes*, and *Ingram*.

- The House of Lords decision in *Ingram* recognises that the transfers may sometimes be simultaneous. The House of Lords concluded that when the transfers are simultaneous, in circumstances where it was never the intention of the parties that the whole property be disposed of, there will be no reservation. This is because the transferor will have received no benefit arising from the subject matter of the gift.
- The House of Lords judgment in *Ingram* stated that the courts should look at the intention of the parties to the transaction. The House of Lords held that section 102 of the United Kingdom Finance Act, a comparable provision to New Zealand's section 70(2), is concerned with the transfer of benefits and advantages, not the transfers of property which must take place for legal reasons. Sometimes equitable rights will come into effect which will make transfers simultaneous, notwithstanding the requirements of the rules of conveyancing that there be a certain sequencing of transactions. The parties' intentions will be evidenced by the documents of the transaction.
- Simultaneous transfers will include the situation where the transferring of the legal rights does not happen precisely at the same time, where the transfers are part of the one transaction, provided that it was never the intention of the parties that the whole property is transferred, and provided also that equitable rights arise simultaneously (*Nichols* (HC) and *Ingram* (HL)).
- If an apparently simultaneous transfer results in the donor having an interest in property that includes rights that he or she did not have before the transfer, the transfer will be a reservation, and not a retention of property the transferor already had (*Nichols* (CA) and *Ingram* (HL)).

Which types of real property do the rulings apply to?

The rulings apply to real property. Real property includes dwelling houses, farms and commercial buildings. After the previous ruling was issued, the Commissioner was asked whether the arrangements only apply to dwelling houses. In a "Question we've been asked" item, published in *Tax Information Bulletin* Vol 9, No 8 (August 1997), the Commissioner gave the view that real property includes all forms of real property. The Commissioner's view on this issue has not changed.

Application of section 70(2) to the specific arrangements

Pre-transfer grant of a life interest, a lease or a licence to occupy

A pre-transfer grant occurs where the transferor creates an interest in the property and grants that interest to him or herself before transferring the rest of the property interest to a third party (for example, a family trust). If the separation of the interest occurs before the transfer to the other person, the subsequent transfer is treated as the transfer of one interest while retaining another.

If an arrangement is a pre-transfer grant, it does not involve a reservation of interest by the transferor. Section 70(2) does not apply, and accordingly any duty payable will be based on the value of the balance or reversionary interest in the property transferred less the amount of any consideration paid.

This analysis applies to BR Pub 02/02 and BR Pub 02/03.

Life interests granted to oneself

The Property Law Act 1952 (PLA) gives the transferor authority to grant a life estate to him or herself. Under section 49 of the PLA, the transferor may transfer an estate or interest in land to him or herself individually or jointly with others. Section 66A of the PLA provides that covenants in a transfer by the transferor to him or herself (under section 49 of the PLA) are enforceable.

Example 1

A creates a life estate in a property, and then transfers the balance of the property to the trustees of his family trust. A's property is worth $175,000. The value of the life estate is $60,000. The price for the reversionary interest is $100,000. This is outstanding as an unsecured debt owed by the trust to A.

Section 70(2) does not apply. There is a gift because the consideration paid by the trust ($100,000 for property worth $115,000) for the interest in reversion is inadequate. The Commissioner will assess A for gift duty on the $15,000 gifted under section 61, the section which imposes gift duty, assuming other gift duty thresholds and requirements are met. However, section 70(2) does not apply to include the $60,000 life interest in the dutiable amount, because that interest was retained by the transferor and not gifted to the transferor.

Leasehold interests granted to oneself

A transferor can grant a lease to him or herself in New Zealand. At common law a person could not grant a lease to him or herself, *In re Nichol* [1931] NZLR 718, 727, *Rye v Rye* [1962] AC 496; 1 All ER 146. However, because a lease is an estate or interest in land, this rule has been abrogated in New Zealand by sections 49 and 66A of the PLA (*Harding v CIR* [1977] 1 NZLR 337; 2 NZTC 61, 145).

At common law, when the same person owned the freehold and the leasehold interest in a property, a merger of the interests occurred and the lesser interest (the lease) ceased to exist. In equity, merger depended on the intention of the parties. Section 30 of the PLA adopts the equitable rule, so there will only be merger where the parties intend it to occur. Usually, when a person creates a lease and grants it to him or herself, the intention is for the estates to remain separate.

Example 2

B creates a lease for fifty years in her own favour over her property, and then transfers the balance of the property to her only child, C. B's property is worth $250,000. The value of the lease is $100,000. The value of the balance of the property is $150,000. The price to be paid for the balance is $90,000. This price is outstanding, as an unsecured debt owed by C to B.

There is a gift under section 61, the section which imposes gift duty, assuming other gift duty thresholds and requirements are met. The gift is the amount of $60,000, being the inadequacy of consideration for the property transferred worth $150,000, less the $90,000 paid. Accordingly, there is potentially gift duty payable on the $60,000.

Section 70(2) has no application because there is no reservation from the disposition of property to C. Therefore, the Commissioner will not include the $100,000 value of the lease in the dutiable value of the gift.

Licences to occupy purported to be granted to oneself

However, the provisions of the PLA do not extend to a licence to occupy. A licence, unlike a lease, is not an estate or interest in land. A licence is a personal permission to enter land and use it for a particular purpose. As Gresson P said in *Baikie v Fullerton-Smith* [1961] NZLR 901, 906 in a land law context, a licence is basically an authority that prevents the individual to whom it is granted from being regarded as a trespasser on someone else's property. Therefore, a licence must be granted from a licensor to a licensee. In the absence of comparable provisions to sections 49 and 66A of the PLA applying to licences, a landowner cannot license him or herself to be a licensee.

The arrangement in BR Pub 02/07 is the situation where a transferor purports to grant him or herself a licence to occupy before transferring the remaining property interest. The purported grant of the licence will be invalid for conveyancing purposes, and all the rights in the property will be transferred to the transferee. One of two results will occur.

Firstly, the transferee could keep ownership of all the rights to the property. If all property rights are kept, there will be no grant back to the transferor (at any time) and no reservation. However, gift duty will be payable to the extent of the inadequacy of the consideration.

Secondly, the transferee could transfer the licence back to the transferor once the third party has been granted the rights in the property. This is acceptable in land law. Under land law, the grant back would take place after the transfer. This is the situation covered in BR Pub 02/07.

Following *Ingram* (HL), the Commissioner considers that this second situation should not be analysed as a post-transfer grant. *Ingram* established that the focus of section 102 of the Finance Act 1986 (UK) is on the transfer of benefits as a result of the transaction. In the Commissioner's view, section 70(2) should be interpreted the same way. So although a transfer is invalid under legal conveyancing theory, it still may create equitable rights and obligations as between the parties. In this situation, if the intention of the parties was that the licence be taken out of the property before the transfer, then following the equitable maxim "equity, regarding as done what ought to be done", effect will be given to such an agreement for the transfer of land, and equitable rights and obligations will accrue to each party with effect from the moment of transfer. In this situation, the transferee never acquires the property free from the obligation to transfer back the licence the transferor intended to retain. The result will be that from the moment of the transfer, the transferor will have an equitable right to the licence and the transferee will have an equitable obligation to grant it. This has the effect of making the transfers simultaneous.

If the transaction is simultaneous, it will not be a reservation subject to section 70(2). (The other arrangements which are simultaneous transfers are discussed below.) The documents to the transaction will be evidence of the intention of the parties (as in *Ingram* (HL)). They should be used to ascertain what the parties intended was to be the subject matter of the gift.

The first situation mentioned above, where the transferee does not grant a licence back, is not similar in nature to the other arrangements ruled on. Therefore, the Commissioner has not ruled on that arrangement.

Summary of the consequences of pre-transfer grants

Where a pre-transfer grant of a life estate or a lease occurs, there is no reservation of a benefit under section 70(2) (BR Pub 02/02 and BR Pub 02/03). Therefore, the amount of the life estate or lease is not included in the amount of the gift.

A licence to occupy cannot be structured as a pre-transfer grant. The result will either result in no licence, or a simultaneous transfer. Neither of these will be a reservation. Simultaneous transfers are discussed more under a following heading.

Post-transfer grant back of a life estate, a lease, or a licence to occupy

A post-transfer grant back occurs where the transferor transfers property to a transferee subject to the transferee granting an interest (any of a life interest, a lease or a licence to occupy) back to the transferor.

If an arrangement is a gift involving a post-transfer grant, it will be a reservation of an interest by the transferor. Section 70(2) will apply, and accordingly the duty payable will be calculated on the value of the whole of the property transferred, without deducting the value of the reservation, less the amount of any consideration paid.

This analysis applies to BR Pub 02/04-02/06.

Example 3

A transfers property worth $200,000 to B, as she is going overseas for three years and no longer wants to have property in New Zealand. B pays A $100,000 for the property. However, A and B agree that B will grant A a lease for the property when she returns, in three years time. The lease has a value of $50,000. A and B have documents drawn up to this effect. In this case, it is clearly the intention of the parties that the whole property interest is transferred, and at a later time a lease be granted back. The gift is the difference between the value of the property ($200,000) and the consideration paid ($100,000). The value of the lease is a reservation, and so is not deducted from the value of the gift.

Example 4

D has decided to transfer ownership of her family home to a family trust. She wishes to ensure that she has a right to occupy the property for the rest of her life. She intends to transfer the full property interest to the trustees of the trust, and at a later stage, for the trustees to grant her a licence to occupy. In accordance with this arrangement, the trustees later grant D a licence to occupy. The documents are consistent with the parties' intentions.

The property has a market value of $200,000. The licence to occupy is valued in accordance with the provisions of the EGDA at $50,000. The transfer price of the property is $100,000, which D leaves owing as a debt, repayable on demand.

The property is disposed of without fully adequate consideration ($150,000 compared with the market value of $200,000), so the Commissioner will assess D for gift duty under section 61 assuming other gift duty thresholds and requirements are met. The licence is a reservation, because under the arrangement, it is transferred back out of the property gifted. Section 70(2) applies, so the value of the licence is not deducted from the value of the gift. The amount on which gift duty is calculated is $100,000 (being the licence reserved and the extent of the inadequate consideration).

Simultaneous transfers of a life estate, a lease, or a licence to occupy

Life estates and leases

A simultaneous transfer of property occurs where the transferor transfers property to a transferee and simultaneously the transferee grants back an interest in that property (whether a life estate or a lease).

As discussed earlier, the House of Lords in *Ingram* considered that the focus of section 102 of the Finance Act 1986, the comparable section to New Zealand's section 70(2), was on the benefits actually reserved, and not the legal form of the transactions. Where it is clearly the intention of the parties that the net property interest only be transferred, but conveyancing rules would say that the whole property must be transferred before the other interest can be transferred back, the transferor has equitable rights in the interest transferred back from the moment the first transfer is made. It is not necessary to regard there being an instant of time between the transfers, even though it may be required in conveyancing theory. Therefore, the transfers will be simultaneous, and there will be no reservation.

If an arrangement is a simultaneous transfer and grant, no reservation of interest by the transferor is involved. Section 70(2) does not apply, and accordingly any duty payable will be based on the value of the balance or reversionary interest in the estate transferred less the amount of any consideration paid.

This analysis applies to BR Pub 02/08 and BR Pub 02/09.

Licences to occupy and other transactions intended to be pre-transfer grants

As mentioned above under pre-transfer grants, it is not possible for land owners to grant themselves a licence to occupy their land. Therefore, if a person purports to grant him or herself a licence to occupy and then transfers the balance of the land to someone else, that transaction will not, in terms of conveyancing law, be a pre-transfer grant. However, following the House of Lords decision in *Ingram*, where it is the intention of the parties that only the net property interest is to be given away, conveyancing rules should not mean that the transaction is carried out in some other way. Where rights cannot be validly self-granted, but it was clearly the intention of the parties that those rights should not be part of the transfer, equity will give effect to those rights as though they were valid from the time of transfer. If the original transfer is invalid for some other reason, this reasoning may also apply.

The effect of this is that grants of rights that cannot be validly self-granted will often now be simultaneous transfers rather than post-transfer grants back. Therefore, in the case of the arrangement in BR Pub 02/07, it is not possible to grant a licence to oneself. However, the parties' intention to transfer only the net property is evidenced by the documents in which the transferor attempts to grant the licence to him or herself. If that was the parties' intention, equity will demand that the transferee grant the licence back. These equitable rights will arise from the moment of transfer. Therefore, in the Commissioner's view, the arrangement in BR Pub 02/07 will now be treated as a simultaneous transfer rather than a post-transfer grant back, if it is the parties' intention, evidenced by the documents and the circumstances of the transfer, that only the net property interest transfers. Consequently, it will be a retention of the licence and not a reservation.

The arrangement in BR Pub 02/10 is similar to the arrangement in BR Pub 02/07. The arrangement in BR Pub 02/10 is the situation where the parties intend that the transferor will grant a licence to him or herself simultaneously as the balance of the property is granted to someone else. Even though the parties attempt to make the transaction simultaneous, it still amounts to an attempt to grant oneself a licence, and legally the transaction will consist of property passing and a licence being granted back. The documents relevant to the attempt to grant a licence to him or herself will be evidence that only the net property interest was intended to pass. In the Commissioner's view, *Ingram* applies, and this arrangement will be treated as a simultaneous transfer of the licence and the net property, and it will be a retention and not a reservation.

On the other hand, if it is clear from the documents that the whole property interest was intended to be the subject-matter of the gift followed by a grant back, and there is no intention for an interest to be retained, then equity will not intervene to create rights and obligations as between the parties, and there will be a post-transfer grant back. In this situation, there is a reservation of a benefit to the donor.

Transactions that may appear to be post-transfer grants may be simultaneous transfers

It may in some situations be difficult to distinguish between a simultaneous transfer and a post-transfer grant. Both may involve the same legal steps of property transferring and a lesser interest transferring back.

The essential difference between the two is that in a simultaneous transfer, the parties only ever intend the net property interest to pass. In a post-transfer grant, the parties intend the whole property to pass, and the lesser interest subsequently to pass back. The documents relevant to the transaction will be important in establishing the legal nature of the transaction and the parties' intention.

Requirements of a simultaneous transfer needed to satisfy the Commissioner

The Commissioner will be satisfied that a simultaneous transfer amounts to a retention (ie pre-transfer grant) and not a reservation (ie a post-transfer grant), if there is sufficient evidence that the parties never intended that the whole property in question pass to the transferee. This evidence would usually include the following elements, taken from *Ingram* (HL).

- The transferor defines very precisely the rights he or she intends to give away.
- The documents relevant to the transaction support the claim that the parties intend that only part of the property, as defined, is to be given away.
- There is never a time, in equity, when the transferee holds the whole property free of the interest that the transferor seeks to retain.
- The retention is not dependent on the concurrence of the transferee[s], including beneficiaries where the property is transferred to a trust.
- The transferor does not receive an interest in the property that includes something more than he or she previously had, eg covenants by the transferor/lessor to repair the property.

Summary of simultaneous grants

Where there is a simultaneous grant and transfer (BR Pub 02/07-02/10) there is no reservation.

Example 5

H wishes to provide for her children by making sure that they will own her house when she dies. She draws up a document, which gifts the house to the children while at the same time creating a life estate for herself. It was always intended, as evidenced by the documents, that the life estate be created and kept by H. She does not gain any extra rights that she did not have before the gift.

The house is worth $250,000 and the amount of the life estate is estimated to be $45,000.

The amount of the life interest will not be a reservation within the meaning of s 70(2), meaning that H will only be liable for gift duty under section 63 on the amount that is given away, being $205,000.

Other sections of the EGDA affecting reservations

Sliding value clauses

Commonly, documents evidencing the disposition of property provide that the consideration shall be a fixed amount or such higher amount as the Commissioner accepts will not give rise to a gift for gift duty purposes. If:

- the consideration is bona fide; and
- the obligation to pay it is fulfilled; and

- the consideration is a genuine attempt to approximate the market value of the property;

the Commissioner accepts that where section 70(2) might otherwise apply, and the parties use the sliding value clause to increase the consideration so there is no gift, gift duty will not be payable.

Amendment of documents

Under section 70(3), the Commissioner may permit the cancellation or amendment of any instrument creating or evidencing a disposition of property to which section 70 applies. Application in writing must be within six months of the date of the instrument, or within such extended time as the Commissioner thinks fit to allow in the special circumstances of the case. Documents that are amended or redrawn will be reconsidered to see whether section 70(2) applies to them.

Valuation of retained interests

Section 66 of the EGDA requires every dutiable gift to be valued as at the date of the making of the gift. Section 67 gives the Commissioner a general discretion as to how property is valued, subject to sections 68A to 68G, 69 and 70, which include methods for valuing particular property.

Particularly relevant to this commentary are sections 68A and section 68F. Section 68A prescribes how land is valued. Section 68F provides that the tables of life expectancies in the Second Schedule to the Act are used to value life interests, except in one instance. The Commissioner has some discretion in determining the life expectation of a person suffering from a terminal illness. In practice, in determining the life expectancy of a person suffering from a terminal illness, the Commissioner will generally use Table D. Table D gives the present value of an annuity or other interest for a period other than life, or expectant on an event other than death. The Commissioner will generally apply it for the period which the Commissioner accepts as the actual or expected life expectancy of the person.

When there is more than one transferor, and all are entitled to a life estate or a lease for life, the value of the right should take account of the longest remaining life expectancy of the transferors. The value of the right relates to the time the transferees are out of possession of the property. If all transferors have a right of occupation until their respective deaths, the discount of the property's value to the transferees relates to the longest expected occupation of any of the transferors.

Subsequent gift of reserved benefit

Where gift duty has been paid on a gift valued under section 70, any gift duty on a subsequent gift of the benefit or advantage reserved, or any part of it, may be reduced, under section 76. A deduction from the gift duty on the subsequent gift is calculated as follows:

$$\frac{a \times c}{b}$$

Where:

a is the value of the benefit or advantage comprised in the subsequent gift, either at the date of the gift, or at the date of the original gift, whichever is less; and

b is the value of the original gift; and

c is the amount of gift duty paid on the original gift.

Example 6

	$	$
Assume A transfers property worth $42,000 to B and reserves a life interest in it.	42,000.00	
A is a male aged 48 years at date of transfer. The present value of income on capital of $1 for life for a male aged 48, from Table A is 0.71201. The present value of the life interest is therefore 0.71201 x $42,000 = $29,904.42		
The value of the reservation is therefore	29,904.42	
And the value of the balance of the gift is	12,095.58	
A has to pay gift duty on both under section 70		
– value of the balance of the gift	12,095.58	
– value of the reservation	29,904.42	
Total value of gift	42,000.00	
Duty on $42,000		
on $36,000 at set rate	450.00	
on $6,000 at 10%	600.00	
	1,050.00	
Assume 10 years later A surrenders the life interest. The property previously worth $42,000 is now worth $48,000. A is now aged 58 years at the date of surrender. The present value of income on capital of $1 for the life of a male age 58 from Table A is 0.57617. The present value of the life interest is therefore 0.57617 x $48,000 = $27,656.16		
A makes another gift of $30,000 at the same time.		
The aggregate gift is therefore:	30,000.00	
	57,656.16	
Duty on $57,656 is calculated as follows:		
on $54,000 at the set rate	2,250.00	
on $3,656 at 20%	731.20	
Gross gift duty	2,981.20	

Section 76 applies to give relief for the gift duty already paid. The gross gift duty is reduced by the relief given under section 76 where:

(a) is original gift of reservation $29,904.40
subsequent gift value of reservation $27,656.16
whichever is less

(b) value of the original gift $42,000

(c) gift duty on the original gift $ 1,050

$$\frac{27{,}656.16}{42{,}000.00} \times 1{,}050.00 = \$691.40$$

Maximum relief under section 76 = $691.40

Apportionment of the gift duty between the two gifts

		$
Gift $30,000 = $\frac{30{,}000}{57{,}656} \times 2{,}981.20$ =		1,551.20
Gift $27,656 = $\frac{27{,}656}{57{,}656} \times 2{,}981.20$ = $1,430.00		
Less relief under section 76 (1,430.00 − 691.40 = $738.60)		738.60
Gift duty collectable on subsequent gift		2,289.80

PART TWO: INCOME TAX

Background

Section CE 1(1)(e) of the ITA includes within a person's gross income all rents, fines, premiums, or other revenues derived by a land owner from:

- any lease, licence, or easement affecting the land; or
- the grant of a right to take profits of the land.

This section considers the application of section CE 1(1)(e) to the arrangements.

The new rulings and commentary apply from 1 April 1999. The previous ruling and commentary on the income tax aspects of this matter, Public Ruling BR Pub 96/2A, applied to dispositions of real property made up until the end of the 1998-1999 year. It was published in *Tax Information Bulletin* Vol 8, No 10 (December 1996).

The Commissioner's view of the income tax aspects of the arrangements has not changed from the expired rulings. However, more analysis is provided to support aspects of the Commissioner's view.

Summary of conclusions

Pre-grant transfer

If a transferor grants an interest in property to him or herself, and later grants the balance or reversionary interest in the property to another person, the interest kept by the transferor does not constitute gross income of the transferee or the transferor under section CE 1(1)(e).

Post-grant transfer

If a transferor transfers property to another person, reserving an interest in the property which the transferee later grants back to the transferor, the transferee may derive gross income under section CE 1(1)(e).

The transferee will derive gross income if the transferee grants a lease or a licence back to the transferor, and an amount is derived by the transferee which is attributable to the lease or licence.

Simultaneous transfer

If a transferor grants him or herself a property interest, and simultaneously transfers the balance or reversionary interest to another person, the interest granted to the transferor does not constitute gross income to the transferee or the transferor under section CE 1(1)(e).

Legislation

Under section CE 1(1)(e) of the Income Tax Act 1994, a person's gross income includes:

All rents, fines, premiums, or other revenues (including payment for or in respect of the goodwill of any business, or the benefit of any statutory licence or privilege) derived by the owner of land from any lease, licence, or easement affecting the land, or from the grant of any right of taking the profits of the land**.**

Section OB 1 contains definitions for the purposes of the Act. Section OB 1 begins:

In this Act, unless the context otherwise requires,—

"Lease", "leasehold estate" and "estate" are defined in section OB 1:

"**Lease**" —

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

…

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

…

"Estate", or **"interest"**, in relation to land, means any estate or interest in land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and includes any right to the possession of land or to the receipt of the rents or profits from the land, or to the proceeds of the sale or other disposition of the land, whether immediate or through a trustee, or otherwise; but does not include a mortgage:

Application of the legislation

Section CE 1(1)(e) deems a person's gross income to include all rents, fines, premiums, or other revenues derived by a land owner from any lease or licence affecting the land. Amounts derived from certain transfers of land, where an interest in land is transferred back to the transferor, may be included in gross income.

Pre-transfer grant of an interest in land

Where a lease or a licence is created before land is transferred, an income tax liability will not arise under section CE 1(1)(e).

Pre-transfer grants – implications for the transferee

If a transferor obtains an interest in land transferred before the balance or reversionary interest in the land is transferred, the transferee does not derive gross income as a result of the transaction. He or she never owns the interest that the transferor keeps, so does not derive income from that land. Therefore, he or she cannot derive a rent, fine, premium, or other revenue from that lease or licence as a result of the transfer.

Pre-transfer grants – implications for the transferor

The transferor also does not derive income from the transaction. The transferor does not derive a rent, fine, premium, or other revenue from a lease, licence, easement, or profits from his or her land. Instead, the owner has simply kept an interest in the land.

This analysis applies to BR Pub 02/02 and BR Pub 02/03.

Example 7

Taxpayer A creates a lease in a property, and then transfers the reversionary interest to the trustees of his family trust. A's house is worth $175,000. The value of the lease is $60,000. The price to be paid for the reversionary interest is $175,000 less the $60,000. This price of $115,000 is outstanding as an unsecured debt owed by the trust to A.

The Commissioner will not assess A or the trustees for income tax under section CE 1(1)(e) on the $60,000 value of the lease. Section CE 1(1)(e) does not apply because neither A nor the trustees derive any rent, fines or premiums from the lease.

Licences to occupy

A transferor can grant him or herself a life interest or lease over land, before disposing of the balance or reversionary interest in the property to another person. However, it is not legally possible for a transferor to grant a licence to occupy to him or herself. A licence is not an estate or interest in land. A licence is a personal permission to enter land and to use it for a particular purpose. A licence must be granted from a licensor to a licensee.

Consistent with the conclusions relating to gift duty, the Commissioner will treat a purported grant to oneself of a licence as a simultaneous transfer. This point is discussed further below.

Post-transfer grant back of an interest in land

Where land is transferred subject to a lease or a licence later being transferred back, an income tax liability may arise under section CE 1(1)(e).

Post-transfer grants – implications for the transferee

If the transferor transfers land, and reserves an interest in the land by receiving a grant of an interest from the transferee, section CE 1(1)(e) may apply to any gross amount derived by the transferee in relation to that transaction.

There are three parts to section CE 1(1)(e) that are relevant to the arrangements:

- There must be a rent, fine, premium, or other revenue.
- The income must be derived by a land owner.
- The income must be derived from a lease or a licence.

Requirement 1 – amounts that are "rents, fines, premiums, or other revenues"

Section CE 1(1)(e) will apply if, by granting an interest back to the transferor, the transferee derives an amount that is within the words "rents, fines, premiums, or other revenues". The arrangements potentially subject to section CE 1(1)(e) (the arrangements in BR Pub 02/5 and BR Pub 02/06) are concerned with situations where property is gifted for inadequate consideration, subject to an interest being granted back to the transferor by the transferee. If the transferee derives an amount that is attributable to the interest granted by the transferee back to the transferor, the transferee may derive gross income if the other two requirements of section CE 1(1)(e) are met (which are discussed below).

An amount is derived even if there is no direct payment

Income is derived by the transferee, even though there may be no payment made to the transferee. Under section EB 1(1) of the ITA, a person derives income, even where it has not been received, when an amount has been, for example, credited in account or otherwise dealt with in the person's interest or behalf. A netting off of obligations is an example of this, and so the transferee "derives" the income. So the amount in the following situations may be income to the transferee:

- the transferor reduces the price (if any) payable by the transferee for the initial transfer of property; or
- the transferor reduces a debt owed by the transferee to the transferor; or
- the transferor otherwise pays the transferee; and

the amount of the reduction in price, reduction in the debt or the payment is attributable to the lease or licence granted back to the transferor.

Whether the amounts derived under the lease or licence arrangements are rents, fines, premiums, or other revenues

The amounts derived under the arrangements in BR Pub 02/05 and BR Pub 02/06 will be subject to section CE 1(1)(e) if they are within the words "rents, fines, premiums, or other revenues". The words of the section are now examined to see when amounts derived under the arrangements are within these words. The lease arrangement in BR Pub 02/05 is discussed first.

"Rent" has been characterised as the contractual sum payable for the use of the leased premises: *United Scientific Holdings Ltd v Burnley BC* [1978] AC 904. A similar definition was used in *Samuel v Salmon* [1945] 2 All ER 520. Rent does not only relate to leases. For instance, the term "rent" or "rent-charge" may be used when a purchaser of land pays periodic sums rather than a lump sum for the land. A "fine" is technically a sum of money payable by the tenant on the renewal of a lease (Hinde, McMorland & Sim, para. 5.086), but is sometimes loosely used to refer to a premium (*B G Utting & Co Ltd v Hughes* [1939] 2 All ER 126). A "premium" is a lump sum paid for the acquisition of a lease by a lessee: *Regent Oil Co Ltd v Strick* [1965] 3 All ER 174 at p 197. In *King v Earl Cadogan* [1915] 3 KB 485, at p 492, Warrington J said that

> … a premium is a payment representing the capital value of the difference between the actual rent and the best that otherwise might be obtained… It is in fact the purchase money which the tenant pays for the benefit which he gets under the lease.

The amount derived under the lease arrangement, that is potentially subject to section CE 1(1)(e), arises when one person transfers property to another, and the transferee grants a lease back, and there is either:

- a reduction by the transferor of the price of the property first transferred;
- a reduction of a debt owed by the transferee to the transferor; or
- any other payment by the transferor to the transferee;

where the amount is attributable to the lease granted back to the transferor. This payment arises where the transferor transfers property to another person and the other person later grants a lease back to the transferor.

Under this arrangement, it is not specified whether the consideration is a premium, ie a payment for the acquisition of the lease, or rent, ie a payment made for the use of the property, or a fine, ie a payment for the renewal of a lease.

A premium is a payment for the granting of a lease. In the arrangement, it is specifically stated that the amount is attributable to the lease granted back. In the Commissioner's view, the payment under the arrangement is best characterised as consideration for the granting of the lease and is therefore a premium.

The amount may also be rent, especially if it is quantified on the basis of the current value of rental payments appropriate to the value of the use of the land under the lease. It is least likely to be a fine, because the arrangement involves the granting of a new lease, and not the renewal of a lease. However, if "fine" also means premium, it may be a fine.

In the Commissioner's opinion, the amount derived under the arrangement is either a premium or rent, or a payment for both. Premiums and rents cover between them any payment for the granting of a lease and any payment made during the lease for the use of the property. The amount must be either one of these two types of amounts. Therefore, an analysis of the words of the section supports the conclusion that a one-off payment for a lease is a premium and/or rent.

Section CE 1(1)(e) also applies to amounts of goodwill. The Commissioner considers that the amounts derived under the arrangements are clearly not payments of goodwill. Goodwill is the benefit and advantage of the good name, reputation and connection of a business: *Inland Revenue Commissioners v Muller & Co's Margerine Ltd* [1901] AC 217. There is no business element in the arrangements.

Other revenues

If the amount derived is not a rent, fine, or a premium, the Commissioner's view is that the amount derived under the arrangement comes within "other revenues" in section CE 1(1)(e). The issue in interpreting these words is whether "other revenues" means amounts that are revenue in nature. The amounts derived under the arrangements are lump sums received in relation to the transfer of ownership of interests in land. If "revenues" in the context of section CE 1(1)(e) means revenue in nature, then it could be argued that the amounts derived under the arrangement are capital in nature and not subject to the section.

The ordinary meaning of "revenues" and dictionary definitions suggest that "revenues" means revenue in nature (see the *Concise Oxford Dictionary*, 10th ed., 1999).

The issue, which is discussed next and under the following headings, is not the meaning of "revenues" in isolation, but its meaning in the context of section CE 1(1)(e).

Miller v IRC

The meaning of "revenues" as used in section 88(1)(d) of the Land and Income Tax Act 1954 (which was the same as section CE 1(1)(e)) was considered in *Miller v IRC* 10 AITR 122 (SC). The Court was concerned with a payment received by a land owner for two purposes. It was paid for the right to remove coal from the land owner's land. It was also accepted by the owner as payment in full satisfaction of compensation for damage to the land, which would otherwise be payable under a previous agreement. Henry J made the following comment:

> The word "revenue" in its ordinary import in relation to the owner of land connotes the incomings which arise therefrom: *London, Midland and Scottish Rail Co v Anglo-Scottish Railways Assessment Authority, London and North-Eastern Rail Co v Anglo-Scottish Railways Assessment Authority* (1933) 150 LT 361 (HL) per Lord Tomlin at p 367.

His Honour held that the monthly payments payable to the objector came within the words "other revenues" because they were paid for the use of land. This finding suggests that the purpose of the section is to capture payments made for the use of land.

In finding that the payment was not compensation, and so the section could apply, it could be argued that the case also supports the view that section 88(d) (and section CE 1(1)(e)) only applies to payments that are revenue in nature. The Commissioner's view is that the case does not go that far. The key finding was that the payments were made for the use of land, and so were within the section. Although Henry J said that a payment for compensation would not be within the section, he did not go so far as to rule out the possibility that capital payments may be within section CE 1(1)(e).

In considering the meaning of "revenue" in *Miller*, Henry J referred to the House of Lords decision in *London, Midland and Scottish Rail Co*. The House of Lords said that the word "revenue" in relation to a business means those incomings of the business which are the products of or are incidental to the normal working of the business. It is arguable that *London, Midland & Scottish Railway Co* is authority for the proposition that "revenues" means amounts received in the course of a business. However, in the Commissioner's view, *London, Midland and Scottish Rail Co* is not direct authority for the meaning of "revenues" in the context of section 88(1)(d), i.e CE 1(1)(e), as the statutory contexts are quite different. In *London Midland*, Lord Tomlin was defining "revenue" in relation to a business. Section CE 1(1)(e) is concerned with amounts derived for the use of land. Even the form of the word is different—"revenues" in section CE 1(1)(e) and "revenue" in the Railways Act.

In summary, although there are arguably indications in *Miller* and *London, Midland and Scottish Rail Co* that "revenue" in section CE 1(1)(e) may mean revenue in nature, in the Commissioner's opinion *Miller* establishes only that payments for the use of land are within the section. Henry J in *Miller* did not hold that capital payments could never come within the section.

The context of the section

The context of the word "revenues" within section CE 1(1)(e) supports the conclusion that the intention is to capture a wide range of payments related to the use of land, and that the section is not limited to payments that are revenue in nature. "Revenues" is preceded by the words "rents, fines, premiums". In the Commissioner's opinion, the common theme of the specific words listed is that they are payments made in relation to land. This approach is supported also by considering the other words in the section:

> (e) All rents, fines, premiums, or other revenues (includingpayment for or in respect of the goodwill of any business, or the benefit of any statutory licence or privilege) derived by the owner of land from any lease, licence, or easement affecting the land, or from the grant of any right of taking the profits of the land.

The section clearly deals with payments for rights relating to land. Types of interests in land or rights relating to land are listed, and further, these interests or rights are only included if they affect the land. In discussing goodwill in *Romanos Motel Limited v CIR* [1973] 1 NZLR 435, the Court of Appeal said that the aim of the section is to include in income receipts from land (p 438).

The opening words of the section "rents, fines, premiums" are not linked because they are revenue in nature. Clearly premiums are generally capital in nature. Goodwill, which forms part of this group of words by coming within parentheses after "other revenues", is also usually capital in nature. Given that, it can be concluded that Parliament intended to include at least some capital payments in the section.

The Australian High Court in *Clarke v FC of T* (1932) 6 ALJ 241 interpreted the comparable Australian section as having the broad intention to capture all payments derived from a lease.

Case T8

Case T8 (1997) 18 NZTC 8,044 arguably supports the view that "revenues" in section CE 1(1)(e) means revenue in nature. Barber DJ held on the facts that a payment paid by a lessee was not an option payment but a payment to obtain a lease. Given this finding, in his opinion it was a premium or other revenue derived by the owner of land from a lease affecting the land, and within section 65(2)(g) of the Income Tax Act 1976 (now section CE 1(1)(e)). His Honour made the following comment about section 65(2)(e):

> Also, if the $22,000 was genuinely part of a sale of realty transaction, then s 65(2)(e) would not apply because it assesses revenue from land and not capital derived or relating to land.

Barber DJ could be interpreted as taking the view that the section is aimed at amounts that are revenue in nature. The Commissioner considers in making this comment, his Honour was not asserting that section 65(2)(e) (section CE 1(1)(e)) only assesses revenue and not capital. Clearly some capital items are assessed under section CE 1(1)(e)—premiums are generally capital in nature, as the Privy Council said in *Commissioner of Inland Revenue v Wattie* (1998) 18 NZTC 13,991, at p 13,999, and goodwill is generally capital in nature.

The Commissioner considers that this comment is best interpreted as meaning that the section does not apply to income from the sale of land. If the amount received by the taxpayer had been for an option to purchase the motel, then it would have been for the sale of an interest in land, and such a fee would probably not be within section CE 1(1)(e). Therefore, in the Commissioner's view, Barber DJ's comment is not authority that no capital payments are caught within section CE 1(1)(e).

Commentators' views

The Report of the Taxation Review Committee 1967 (usually known as the "Ross Report") said that the section treats goodwill as being equivalent to additional rent calculated over the term of the lease but payable at the commencement of the lease. Similarly the Valabh Committee in its December 1989 report *Consultative Document on the Taxation of Income from Capital* said:

> Section 65(2)(g) [now section CE 1(1)(e)] is an attempt to avoid allowing taxpayers to transform lease payments (which would generally be taxable payments received on revenue account) into a non-taxable receipt received on capital account. For that reason, section 65(2)(g) includes in assessable income premiums as well as goodwill received by a lessor.
>
> …
>
> These provisions demonstrate how it has been found necessary to move the traditional capital/revenue boundary to hinder the ability of taxpayers to transform otherwise assessable income into income on capital account which would not be subject to tax.

These commentators consider that the policy intention is to include in section CE 1(1)(e) payments that are revenue in nature but disguised as capital. Note that that intention does not mean that the section is restricted to capturing disguised rent. The Court of Appeal in *Romanos* rejected the submission by counsel that only disguised rents for the lease of land, as opposed to a payment for what is really a lease of the goodwill of a business, are taxable under the section. As the Valabh Committee says, a decision has been made to include capital payments in section CE 1(1)(e). Thus the Ross and Valabh Committees considered that genuine premiums and goodwill payments, as well as attempts to disguise rent as premiums or goodwill, are within section CE 1(1)(e).

Conclusion as to the issue of whether only receipts that are revenue in nature are income under section CE 1(1)(e)

The Commissioner's opinion is that section CE 1(1)(e) is intended to capture amounts that are paid in relation to use of land, and that payments that have capital attributes may be included in section CE 1(1)(e). The words of the section and the decision in *Miller*, in particular, support this view. *Romanos* and *Clarke* also support the view that the intention of the section is to include in income payments for the use of land. The arguments that would support the contrary view are that *Miller* is not conclusive authority that "revenues" means incomings and not income in nature. The authority relied on by Henry J—*London Midland and Scottish Rail Co.*—appeared to find that "revenue" means revenue in nature.

In the Commissioner's view, the contrary arguments are less persuasive than the arguments supporting the view that "revenues" means incomings from land and includes receipts of a one-off nature. Therefore, the Commissioner's view is that the amounts derived under the lease arrangement are not excluded from the words "other revenues" on the basis that payments that are capital in nature are not included in those words.

Reliance on the case of Capel v CIR

In the commentary to BR Pub 96/2A, the following was stated:

> A payment for buying a licence to occupy, or a lease, would also normally be considered a capital sum. However, *Romanos* and *Capel* are authority for the proposition that such a payment is included within the term "premiums, or other revenues".

The main issue in *Capel* was whether any of a number of goodwill payments received by a taxpayer setting up burger bar businesses, was for goodwill attached to a site, or for personal goodwill. *Romanos Motel* had established that only goodwill attached to a site is included within section CE 1(1)(e) (then section 88 1(d) of the Land and Income Tax Act 1954).

The Commissioner now relies primarily on the arguments already discussed, which support the conclusion that capital payments that are not specifically included within section CE 1(1)(e), are in fact intended to be included in the section. *Capel* does gives some support for this view, in that the Court held that a payment that is capital in nature was within section CE 1(1)(e). Similarly the Court of Appeal in *Romanos* held that a capital payment for goodwill was subject to section CE 1(1)(e).

Comments on technical submissions received

Submissions received included two arguments that section CE 1(1)(e) applies to amounts that are revenue in nature. The first of these is that section CE 1 uses both the words "income" and "revenues" leading to the inference that to distinguish these two words, "revenues" must be taken to mean revenue in nature. The Commissioner prefers the view that the word "income" at the beginning of the section is part of the defined term "gross income", and so inferences cannot be drawn from the use of the word in section CE 1(1)(e). The term gross income is used in the Act as a machinery provision to ensure that the provisions of the Act combine to identify a taxpayer's taxable income. When the section was first enacted, the term "assessable income" was used for the same purpose. Therefore, the term "gross income" should be viewed as a defined term used for a specific purpose, and the substantive meaning of the word "income" is not relevant in determining the meaning intended for "revenues".

The second argument is that the Income Tax Act treats premiums and fines as revenue items. Previously, premiums and fines could be deducted under section EZ 6. The Commissioner does not consider that an examination of section EZ 6 assists in the interpretation of section CE 1(1)(e).

Conclusion as to whether amounts derived under the arrangement involving a lease are subject to section CE 1(1)(e)

In summary, the conclusions are that the amounts derived in relation to a lease (the fourth arrangement) are subject to section CE 1(1)(e), because

- The amount is rent or a premium; or
- The amount is included within "other revenues" because it is an incoming from land, and
- The statutory intention is to capture a wide range of amounts derived from a lease, and
- The words "other revenues" do not mean other things that are revenue in nature; instead, they mean incomings from land.

Is the licence arrangement subject to section CE 1(1)(e)?

The discussion so far has related to the application of section CE 1(1)(e) to the arrangement involving a lease. The other arrangement to which section CE 1(1)(e) applies involves a licence—the arrangement in BR Pub 02/06. The words listed in section CE 1(1)(e)—"rents, fines, premiums" apply most commonly to leases and not licences. That raises the issue of whether the amount derived under the licence arrangement is subject to the section.

The first point to note is that section CE 1(1)(e) applies to certain receipts derived by the owner of land from "any lease, licence, or easement affecting the land". Clearly, the section applies to licences.

The arrangement involving a licence is described in the ruling as follows:

> The Arrangement is the disposition of real property for inadequate consideration, where a transferor transfers property to another person and under the arrangement the other person later grants a licence back to the transferor out of the property transferred:
>
> - where:
>   - the transferor reduces the price of the property first transferred; or
>   - the transferor reduces a debt owed by the transferee to the transferor; or
>   - the transferor otherwise pays the transferee; and
> - the amount of the reduction in price, reduction in the debt or the payment is attributable to the licence granted back to the transferor.

In summary, an amount is paid under the arrangement as consideration for the licence granted back to the transferor.

Are the payments derived under the arrangement included in the words "other revenues" in section CE 1(1)(e)?

The Commissioner considers that an amount derived in respect of a licence is included in the words "other revenues" in section CE 1(1)(e). For the reasons discussed above in relation to the lease agreement, the Commissioner does not consider that the words "other revenues" means "revenue in nature". Instead, the Commissioner considers that these words are intended to mean amounts derived in relation to the use of land.

Requirement 2 – the income must be derived by a land owner

The discussion has been about the first requirement of section CE 1(1)(e), that is, whether there are "rent, fines, premiums, or other revenues" under the arrangements.

The second requirement is that income must be derived by an owner or land. In the arrangements in BR Pub 02/05 and BR Pub 02/06, a transferee granting either a lease or a licence back to the transferor is the owner of the land out of which that interest is granted.

Requirement 3 – income derived from a lease or a licence

If the transferee grants the transferor a lease or a licence, and the transferee derives an amount that is attributable to the lease or licence, then the requirement that the income is derived from any lease or licence is satisfied. Accordingly, the transferee is subject to income tax on an amount equal to the value of the amount attributable to the grant of the lease or licence.

This analysis applies to BR Pub 02/05 and BR Pub 02/06.

Example 8

Taxpayer B has decided to transfer her family home to a family trust. She wishes to ensure that she has a right to occupy the house for the rest of her life. She transfers the house to the trustees of the trust. A condition of the transfer is that the trustees subsequently grant B a licence to occupy. The trustees comply with this condition.

The house has a market value of $200,000. A valuer and actuary value the licence to occupy at $50,000. The house is transferred for $175,000, reduced by $50,000 to $125,000 to take into account the value of the licence to occupy. The $125,000 is left owing by the trustees as a debt repayable on demand.

The trust has derived gross income under section CE 1(1)(e) of $50,000, being the value of the licence to occupy.

Life estate

If the transferee grants the transferor a life estate, the transferee is not subject to section CE 1(1)(e). The reason is that section CE 1(1)(e) only applies to leases, licences, easements affecting land, and the grant of a right to take profits from land.

This analysis applies to BR Pub 02/04.

Lease for life

Generally, an arrangement referred to as a 'lease for life' is not a lease, but a life estate. An essential characteristic of a lease is that is has a certain term: *Prudential Assurance Co Ltd v London Residuary Body* [1992] 3 All ER 504. A lease that is based on the duration of a person's life does not have a duration that is certain. It is a freehold estate in the nature of a life estate—see *Amalgamated Brick & Pipe Co Ltd v O'Shea* (1966) 1 NZCPR 580.

In some instances, what is referred to as a lease for life may have a certain duration, and therefore will be a lease. For example, a lease expressed to be for say 200 years or for the life of A, is a valid lease. Although it is not known when A will die, and that A will die before 200 years have passed and the lease will terminate at A's death, the lease has in law a certain duration.

A tenancy with the power of each party to determine the tenancy at the end of any period by giving the appropriate notice, called a periodic tenancy, is a lease because any particular term can be made certain, even though it is impossible at the outset of the tenancy to say for what period the terms will last: *Amalgamated Brick*.

Example 9

C and D decide to transfer their home to a family trust. They wish to ensure that they have a right to occupy the house for the rest of their lives. They transfer the house to the trustees of the trust. A condition of the transfer is that the trustees later grant C and D life estates in the property. The trustees comply with this condition.

The house has a market value of $250,000. The life estates are worth $75,000. The price of the house is $250,000, which C and D leave owing as a debt, repayable on demand. The debt is reduced by $75,000 upon the grant of the life estates.

The trust will not have derived gross income under section CE 1(1)(e), because the grant of a life estate is not income derived from a lease, licence, easement, or the right to take profits from land.

Post-transfer grants – income tax implications for the transferor

There are no income tax implications for the *transferor* under section CE 1(1)(1). Section CE 1(1)(e) applies to rents, fines, premiums, or other revenues derived from land. When a transferor transfers land, the person no longer owns the land, so cannot receive any rents, fines or so on from it. Any amount paid by the transferee for the transfer, in the arrangements covered by the rulings, will be consideration for a sale of land.

Simultaneous transfer of a lease or a licence

Where the grant and the transfer of a lease or a licence occur simultaneously, no income tax liability under section CE 1(1)(e) will arise as a result of the transaction.

Purported grant of a licence to oneself

The Commissioner's view is that if a person purports to grant him or herself a licence, whether before or at the same time as the property is transferred to the transferee, that action should be interpreted as an intention to retain rights over the property before the transfer of the balance of the property. Following the House of Lords decision in *Ingram*, discussed above in relation to gift duty, the Commissioner considers that this situation should be treated as a simultaneous transfer.

Simultaneous transfers – implications for the transferee

The transferee is the owner of the property interest transferred from the transferor. Where the transfers are simultaneous, the transferee does not grant anything out of the interest he or she receives, as he or she receives the property interest at the same time as it becomes subject to the obligation to grant an interest in the land back to the transferor. Accordingly, the transferee does not receive any rents, fines, premiums, or other revenues as a result of receiving the property interest.

As this commentary has explained, a simultaneous transfer includes the situation where the requirements of conveyancing mean that the whole property must be transferred before the other interest can be transferred back. Such a situation will be treated as simultaneous, when the intention of the parties, as evidenced by the documents and surrounding circumstances, is for the transferor to retain an interest in the property transferred, and for the transferee never to obtain the property free of the transferor's interest.

Simultaneous transfers – implications for the transferor

The transferor does not have an income tax liability, because the transferor does not derive any rents, fines, premiums, or other revenues from a lease or a licence in respect of the property kept or the property transferred.

This analysis applies to BR Pub 02/07-02/10.

Spreading income

When a taxpayer derives income under section CE 1(1)(e), section EB 2(1) of the ITA allows the person to apportion that income between the income year in which it is derived and up to five subsequent income years.

NEW LEGISLATION

FRINGE BENEFIT TAX RATE ON LOW-INTEREST, EMPLOYMENT-RELATED LOANS

The prescribed rate of interest used to calculate fringe benefit tax for low-interest, employment-related loans has decreased from 7.98% to 7.83% for the quarter that began on l October 2002.

The rate is reviewed regularly to ensure it is in line with the results of the Reserve Bank's regular survey of first mortgage interest rates.

Although the rate for the same quarter had previously been set at 7.98%, up from 7.5%, the most recent results of the Reserve Bank's survey indicated that the rate should now be 7.83%. The change was approved by Order in Council on 18 November 2002.

Income Tax (Fringe Benefit Tax, Interest on Loans), Amendment Regulations (No 4) 2002

TAX STATUS OF SPORTS AND RECREATION NEW ZEALAND/ HIGH PERFORMANCE SPORTS CENTRE TRUST

The Sport and Recreation New Zealand Act 2002 was enacted on 17 October 2002. The Act sets up the Sports and Recreation New Zealand Agency and deems the agency to be a public authority for the purposes of the Inland Revenue Acts and therefore exempt from income tax.

The Hillary Commission will be dissolved with effect from 1 January 2003. The reference to the Hillary Commission in section KC 5 of the Income Tax Act 1994, which provides a rebate to individuals for gifts of money paid to specified organisations, has been replaced with a reference to Sports and Recreation New Zealand. This ensures that the new organisation retains the donee status previously provided to the Hillary Commission.

The Act also exempts from income tax the High Performance Sports Centre Trust where all the trustees of this trust are appointed by the Sports and Recreation New Zealand Agency and none of the purposes of the trust are amended without the prior written consent of the agency.

Section 73 of the Estate and Gift Duties Act 1968 has also been amended to ensure that gifts to the Sport and Recreation New Zealand Agency do not constitute dutiable gifts and therefore do not attract gift duty.

The Sport and Recreation New Zealand Act 2002 comes into force on 1 January 2003.

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation, accrual and depreciation determinations, and livestock values.

GRADERS (CAPSICUMS)

DEPRECIATION DETERMINATION DEP47

In *Tax Information Bulletin*, Volume 14, No. 9 (September 2002) on page 61, we published a draft depreciation determination proposing the setting of a general depreciation rate for graders (capsicums). We received only one submission on the draft querying why the proposed depreciation rate for capsicum graders differs from other types of graders. The reason for the difference is that capsicum graders are more lightly built and have a shorter economic life than most other graders.

The Commissioner has now issued the determination. It is reproduced below and may be cited as "Determination DEP47: Tax Depreciation Rates Determination General Determination No. 47". The determination inserts a new asset class "Graders (capsicums)" into the "Agricultural, Horticulture and Aquaculture" and "Food Processing" industry categories. It is based on an estimated useful life (EUL) of 8 years and a residual value of 13.5%.

GENERAL DEPRECIATION DETERMINATION DEP47

This determination may be cited as "Determination DEP47: Tax Depreciation Rates General Determination Number 47".

1. Application

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

This determination applies to "depreciable property" other than "excluded depreciable property" for the 2002/03 and subsequent income years.

2. Determination

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

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

Asset class	Estimate useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Grader (capsicums)	8	22	15.5

3. Interpretation

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

This determination was signed by me on the 4th day of December 2002

Martin Smith

General Manager (Adjudication and Rulings)

EXPOSURE DRAFT – FOR COMMENT AND DISCUSSION ONLY

FISHING NETS

DRAFT GENERAL DEPRECIATION DETERMINATION

Please quote reference: DDG00065

We have been asked to review the basic economic depreciation rate applying to the "Bridles", "Lines (fishing)", "Nets (fishing)", "Sweeps", "Trawl boards" and "Wire (trawl)" asset classes under the "Fishing" industry category.

These are presently treated as "expense" items in Determination DEP1: Tax Depreciation Rates General Determination Number 1 (with the exception of trawl boards treated as having an estimated useful life of 3 years). This is not technically correct as it suggests that they should be immediately deducted for tax purposes as an ordinary expense, rather than capitalised and depreciated in the usual way for capital assets. Depreciation of capital assets should be expressed as a percentage per annum rate. In addition, if it were correct, it would follow that taxpayers would have to calculate the "unexpired portion" of their fishing nets at each balance date under the accrual expenditure provisions in section EF 1 of the Income Tax Act 1994. It is not clear that taxpayers relying on the published depreciation description appreciate that section EF 1 would need to be applied.

The Commissioner proposes both to correct and clarify the position by issuing a general depreciation determination which will insert two new asset classes "Nets (fishing) bottom trawl, complete with accessories" and "Nets (fishing) other, complete with accessories" into the "Fishing" industry category. It is also proposed to remove the existing asset classes mentioned above from the same industry category. The "Nets (fishing) bottom trawl, complete with accessories" will have a depreciation rate of 100% DV (100% SL), based on an estimated useful life of 1 year, while the depreciation rate for "Nets (fishing) other, complete with accessories" will be fixed at 63.5% DV (63.5% SL), based on an estimated useful life of 2 years.

While this may require most nets acquired to be depreciated over two years, this would not be materially different to taxpayers adding back "unexpired portions" of fishing net expenditure under section EF1 over the life of the nets. Consequently, it is considered that the correct position should be reflected in an updated general depreciation determination.

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

GENERAL DEPRECIATION DETERMINATION DEP[X]

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

1. Application

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

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

2. Determination

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

- Deleting from the "Fishing" industry category, the asset classes, estimated useful life, and diminishing value and straight-line depreciation rates listed below:

Asset class	Estimate useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Bridles		expense	expense
Lines (fishing)		expense	expense
Nets (fishing)		expense	expense
Sweeps		expense	expense
Trawl boards	3	50	40
Wire (trawl)		expense	expense

- Inserting into the "Fishing" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

General asset class	Estimate useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate %
Nets (fishing) bottom trawl, complete with accessories	1	100	100
Nets (fishing) other, complete with accessories	2	63.5	63.5

3. Interpretation

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

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

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

We need to receive your submission by 21 February 2003 if we are to take it into account in finalising the determination.

Draft items produced by the Adjudication & Rulings Business Group represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

EXPOSURE DRAFT – FOR COMMENT AND DISCUSSION ONLY

COMPACT DISC PLAYERS, DIGITAL VERSATILE DISC PLAYERS, VIDEO GAME PLAYERS, AND RELATED ASSETS

DRAFT GENERAL DEPRECIATION DETERMINATION

Please quote reference: DDG00072

The Commissioner proposes to issue a general depreciation determination that will insert new asset classes into the "Audio and Video Recording Studios and Professional Photography" and "Leisure" industry categories and the "Hire equipment (short-term hire of 1 month or less)" asset category. It is also proposed to insert new asset classes into the "Hotels, Motels, Restaurants, Cafes, Taverns and Takeaway Bars" and "Residential Rental Property Chattels" industry categories.

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

GENERAL DEPRECIATION DETERMINATION DEP XX

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

1. Application

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

This determination applies to "depreciable property" other than "excluded depreciable property" for the 2002/03 and subsequent income years.

2. Determination

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

- Inserting into the "Audio and Video Recording Studios and Professional Photography" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed in the next column.

Audio and Video Recording Studios and Professional Photography	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n (%)
Digital versatile disc player (DVD player)	5	33	24
Digital versatile disc (DVD)	2	63.5	63.5
Video cassette recorder and/or player (VCR)	5	33	24
Video game player	3	50	40
Video game discs	2	63.5	63.5

- Inserting into the "Leisure" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

Leisure	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Compact disc player	5	33	24
Digital versatile disc player (DVD player)	5	33	24
Digital versatile disc (DVD)	2	63.5	63.5
Video game players	3	50	40
Video game discs	2	63.5	63.5

- Inserting in the "Hire equipment (Where on short-term hire of 1 month or less only)" asset category the general asset classes, estimated useful lives, and diminishing value and straight-line rates listed below:

Hire equipment (Where on short-term hire of 1 month or less only)	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent dep'n rate (%)
Compact disc player	2	63.5	63.5
Compact discs	1	100	100
Digital versatile disc player (DVD player)	2	63.5	63.5
Digital versatile disc (DVD)	1	100	100
Video cassette recorder and/or player (VCR)	2	63.5	63.5
Video game player	1	100	100
Video game discs	1	100	100

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

"Hotels, Motels, Restaurants, Cafes, Taverns and Takeaway Bars" and "Residential Rental Property Chattels" industry categories	Estimated useful life (years)	DV banded dep'n (%)	SL equivalent banded dep'n (%)
Compact disc player	5	33	24
Digital versatile disc player (DVD player)	5	33	24
Video game player	3	50	40

3. Interpretation

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

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

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

We need to receive your submission by 21 February 2003 if we are to take it into account in finalising the determination.

Draft items produced by the Adjudication & Rulings Business Group represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

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.

REMISSION OF PENALTIES AND INTEREST – IR - SPS RDC 600

Introduction

This Standard Practice Statement states the Commissioner's practice on granting remission of penalties and interest pursuant to sections 183A and 183D of the Tax Administration Act 1994 (TAA).

Application

This Standard Practice Statement applies to remission requests received on or after 4 December 2002. It replaces Standard Practice Statement RDC 2.1 originally published in *Tax Information Bulletin* Vol 11, No 8.

This Standard Practice Statement does not apply to shortfall penalties or penalties and interest charged on payments by non-custodial or custodial parents under the Child Support Act 1991 or student loan repayments.

Summary

1. When considering the remission provisions of penalties and interest, the Commissioner considers it important to have in mind fair treatment for both the taxpayer requesting the remission as well as all other taxpayers. A lenient remission practice penalises complying taxpayers and may ultimately affect voluntary compliance. However, allowing an unfair penalty to stand will also impact on voluntary compliance. Inland Revenue recognises that penalising a taxpayer for a small non-compliant action is counterproductive and may actually reduce voluntary compliance.
2. Applications for remission must be made in writing and should be accompanied by supporting information.
3. Late filing penalty, non-electronic filing penalty, initial and incremental late payment penalties, imputation penalty tax and dividend withholding payment penalty tax will be remitted under section 183A of the TAA if the Commissioner is satisfied that the non-compliance has been caused by an event or circumstance that provides reasonable justification or excuse for the omission, and the omission was rectified as soon as practicable.
4. Late filing penalty, non-electronic filing penalty, initial and incremental late payment penalties and interest will be remitted under section 183D of the TAA if the Commissioner is satisfied that remission is consistent with his duty to collect over time the highest net revenue that is practicable within the law. Generally, the Commissioner will grant remission of penalties where there was a genuine oversight, a one off situation, or incorrect advice was given by Inland Revenue which led to the taxpayer not filing their return or paying the tax on time.
5. Interest will be remitted in limited circumstances such as where an Inland Revenue officer has given incorrect advice to the taxpayer, and that advice has directly resulted in the non-compliance. However, this is not the only situation in which remission of interest may be granted. Each case must be considered on its own merits.
6. Remission applications under section 183A will only be considered when the returns relevant to the remission requests have been filed and/or the tax has been paid. Remission applications under section 183D will generally only be considered when the returns relevant to the remission requests have been filed and/or tax paid.

7 Sections 183A and 183D do not permit remission to be granted for financial reasons. Requests for financial relief are dealt with under sections 176 and 177. For further detail refer to Standard Practice Statements RDC 610 *Instalment arrangements for payment of tax debt*, and RDC 620 *Writing off tax debt*.

8. All legislative references in this Standard Practice Statement are to the Tax Administration Act 1994 unless otherwise specified.

Background

Taxpayers have an obligation to pay their taxes by the due date. Penalties provide an incentive to all taxpayers to comply with the law. Use-of-money interest provides compensation for the time value of money and compensates the taxpayer or the Commissioner for the use of money over time.

Remission provisions are needed to allow the Commissioner to accommodate circumstances in which charging a penalty or interest is not appropriate. The procedures Inland Revenue use should ensure taxpayers have been justly treated, regardless of the outcome. Inland Revenue will weigh the particular circumstances that exist in each taxpayer's case against the standard practice.

Legislation governing remission of penalties and interest is contained in sections 183A and 183D. These sections do not apply to penalties and interest charged on payments by custodial or non-custodial parents, student loan repayments or to shortfall penalties.

The legislation governing imposition and non-imposition of penalties is contained in part IX of the TAA. For further detail regarding non-imposition of penalties please refer to Inland Revenue's Standard Practice Statement RDC 610 *Instalment Arrangements for payment of tax debt*.

Remission occurs when the tax, penalty or interest is correctly charged at the time but a decision has been made to relieve the taxpayer of the liability to pay. Cancellation occurs when the tax, penalty or interest was correctly charged at the time but a provision of the legislation relieves the taxpayer from the obligation to pay, such as the successful completion of an instalment arrangement. Reversal occurs when the tax, penalty or interest should not have been charged in the first place.

Legislation

Sections 183A and 183D of the Tax Administration Act 1994 provide as follows:

183A Remission for Reasonable Cause

(1) This section applies to a late filing penalty, a non-electronic filing penalty, a late payment penalty, and imputation penalty tax imposed by section 140B, and a dividend withholding payment penalty tax imposed by section 140C.

(1A) The Commissioner may remit the penalty if the Commissioner is satisfied that-

- (a) A penalty to which this section applies arises as a result of an event or circumstance beyond the control of the taxpayer; and
- (b) As a consequence of that event or circumstance the taxpayer has a reasonable justification or excuse for not furnishing the tax return or an employer monthly schedule, or not furnishing an employer monthly schedule in a prescribed electronic format, or not paying the tax on time; and
- (c) The taxpayer corrected the failure to comply as soon as practicable.

(2) Without limiting the Commissioner's discretion under subsection (1), an event or circumstance may include-

- (a) An accident or a disaster; or
- (b) Illness or emotional or mental distress.

(3) An event or circumstance does not include-

- (a) An act or omission of an agent of a taxpayer, unless the Commissioner is satisfied that the act or omission was caused by an event or circumstance beyond the control of the agent-
  - (i) That could not have been anticipated; and
  - (ii) The effect of which could not have been avoided by compliance with accepted standards of business organisation and professional conduct; or
- (b) A taxpayer's financial position.

183D Remission Consistent with Collection of Highest Net Revenue Over Time

(1) The Commissioner may remit-
- (a) A late filing penalty; and
- (aa) A non-electronic filing penalty; and
- (b) A late payment penalty; and
- (c) Interest under Part VII-

payable by a taxpayer if the Commissioner is satisfied that the remission is consistent with the Commissioner's duty to collect over time the highest net revenue that is practicable within the law.

(2) In the application of this section, the Commissioner must have regard to the importance of the late payment penalty, the late filing penalty and interest under Part VII in promoting compliance especially voluntary compliance, by all taxpayers with the Inland Revenue Acts.

(3) The Commissioner must not consider a taxpayer's financial position when applying this section.

Standard Practice

Remission for Reasonable Cause

Section 183A applies to late filing penalty, non-electronic filing penalty, initial and incremental late payment penalties, imputation penalty tax, or any dividend withholding payment penalty tax. Section 183A does not apply to interest or to shortfall penalties.

Remission will occur if the taxpayer is able to provide reasonable justification for the late filing, non-electronic filing, or late payment, and the taxpayer filed the return and/or paid the tax as soon as practicable after the event or circumstance.

The term "reasonable" must be applied to the event or circumstance. This is an objective test, which requires that it be reasonable for a person in the taxpayer's position not to have complied.

Case law has determined that whether an event or circumstance provides a taxpayer with reasonable justification for failing to meet their obligations, the event or circumstance relied on by the taxpayer must firstly be identified. It must then be determined whether the event or circumstance was beyond the control of the taxpayer, and whether the event or circumstance provides the taxpayer with reasonable justification. See *CIR v Fuji Xerox New Zealand Limited* (2001) 20 NZTC 17,470.

Section 183A expressly excludes a taxpayer's financial position from the definition of event or circumstance. Requests for financial relief are dealt with under section 177.

In deciding whether remission is appropriate the Commissioner will consider the following:

1. Has the penalty been correctly charged?
2. Has the taxpayer paid the tax (and/or filed the return) in question?
3. Why did the taxpayer pay or file late, or not file (electronically or otherwise)?
4. Was the non-compliance caused by an event or a circumstance that was beyond the control of the taxpayer? An event or circumstance **may** include –
   - an accident or a disaster
   - illness or emotional or mental distress

   When considering the above-mentioned events or circumstances, the Commissioner will use the following definitions:

   - accident – an event that is without apparent cause or is unexpected
   - disaster – sudden or great misfortune or a calamity
   - illness – state of being ill
   - emotional distress – disturbance of the mind, mental sensation or state
   - mental distress – of the mind, done by the mind, affected with mental disorder.
5. Has this event or circumstance occurred before? Where appropriate, have measures been put in place by the taxpayer to ensure that this situation does not recur in the future?
6. Was the tax paid or return filed as soon as practicable (as soon as is feasible and realistic)? This will depend on the circumstances of each case. Specifically, was the default corrected as soon as possible after the event or circumstance passed?
7. Was the non-compliance the result of an act or omission of the taxpayer's agent? Did an event or circumstance beyond the control of the agent cause the non-compliance? Could the default have been avoided by compliance with accepted standards of business organisation and professional conduct?
8. Any other information that the Commissioner considers relevant in assessing the application.

Examples

Emotional or mental distress (late filing penalty)

Taxpayer's return was due on 7 July. The return was near completion and the taxpayer's previous compliance history was exemplary. However, leading up to the due date his daughter became seriously ill and was hospitalised. Her condition steadily deteriorated and the family spent a great deal of time at the hospital where she was in intensive care until the first week in September.

During this time a reminder notice had been issued advising the taxpayer that a late filing penalty would be charged if his current year's income tax return was not filed within 30 days. He ignored the notice but filed the overdue return in the middle of October, along with documentation verifying his daughter's illness/ hospitalisation, after the penalty had been charged.

In these circumstances, the taxpayer filed the return three months after the due date, but given the "events and circumstances" this would be considered a "practicable" time-frame.

Circumstances beyond the taxpayer's control (non-electronic filing penalty)

An employer is set up for, and has been sending, electronic monthly schedules for the last six months. A fire destroys the work premises on the date before it was planned to transmit the current month's schedule. As a back-up to the computer system, the employer has a printed copy of the file stored off-site. The employer decides to copy these details onto a paper-based schedule so that the schedule and payment would reach Inland Revenue on time. Any non-electronic filing penalty would be remitted as the event was "beyond the control" of the taxpayer.

Circumstance beyond agent's control (late payment penalty)

An agent was entrusted to pay a client's income tax by the due date of 7 April, as the taxpayer would be overseas at the due date. The cheque was made out for the correct amount, signed and post-dated. The cheque was given to the agent and placed in the office safe. The night before 7 April the office was burgled and the safe and its contents were destroyed. The client's agent produced supporting documentation. This is considered to be an event beyond the agent's control.

Remission consistent with collection of highest net revenue over time

Section 183D applies to late filing penalty, non-electronic filing penalty, initial and incremental late payment penalties and interest payable under Part VII. It does not apply to shortfall penalties. There is no requirement to remit all of the penalties and interest. Each case will be considered on its own merits.

The Commissioner is required by law to collect the highest net revenue over time, having regard to Inland Revenue's resources, the importance of promoting voluntary compliance and compliance costs incurred by taxpayers. The Commissioner recognises that pursuing the collection of penalties in some circumstances will not meet his legal duty. Those circumstances are where one of the above-mentioned penalties is imposed because of:

- a genuine error; or
- a "one-off" situation; or
- incorrect advice given by Inland Revenue which has directly resulted in the non-compliance.

Section 183D is the primary provision under which interest can be remitted. Section 183E also provides for remission of interest but only where the underlying tax is remitted.

Under section 183D, the Commissioner may exercise his discretion to remit the total interest payable or part of the interest payable. Section 183D expressly prevents a taxpayer's financial circumstances being taken into account.

Interest will be remitted in limited circumstances such as where an Inland Revenue officer has given incorrect advice to the taxpayer, and that advice has directly resulted in the non-compliance. However, this is not the only situation in which remission of interest may be granted. Each case must be considered on its own merits.

When considering remission under this section, the taxpayer's financial situation cannot be taken into account. It was not intended that this section be used to remit penalties and interest remaining from long standing arrears when the taxpayer has financial difficulties and eventually can only pay the core tax or the core tax plus minimal penalties. These cases are dealt with under sections 176 and 177. Refer to Standard Practice Statements RDC 610 *Instalment arrangements for payment of tax debt* and RDC 620 *Writing off tax debt*.

The core tax should be paid and/or the return filed prior to the request for remission.

In deciding whether remission is appropriate the Commissioner will consider the answers to the following:

1. Has the penalty or interest been correctly charged?
2. Has the taxpayer paid the tax (or filed the return) in question?
3. Why did the taxpayer pay (or file) late, or not file electronically?
4. Whether the non-compliant action was the result of a genuine oversight or a one-off situation? Remitting a penalty for a taxpayer who has not complied due to a genuine oversight or "one-off" situation recognises that penalising a taxpayer for a small failure to comply is counter-productive and may actually reduce voluntary compliance.

   Requests for remission because of a genuine oversight or a one-off situation apply to penalties only. The Commissioner will not remit interest in these cases as interest is compensation to the Revenue for the use of the money over time.

   Interest charged because of a third party default will generally not be considered for remission. In these situations the Commissioner considers the taxpayer should look to that third party for compensation.
5. Has Inland Revenue given incorrect advice to the taxpayer, or was there an error in an Inland Revenue publication, which has resulted in the non-compliance? If an officer of Inland Revenue has given incorrect advice, the imposition of the penalty may adversely affect future compliance by the taxpayer or other taxpayers, eg where the taxpayer has been given the incorrect date, or amount, for payment and can substantiate to Inland Revenue's satisfaction that they were given the incorrect advice. Similarly, a penalty imposed because a taxpayer followed an incorrect instruction in an Inland Revenue publication would have a detrimental effect.

   Has Inland Revenue contributed to the quantum of interest as a result of excessive delay (such as computer processing problems)? If there have been computer delays in the issuing of a statement of account and the taxpayer has made a payment including interest based on their own calculations the additional interest accrued may be remitted in full or in part.
6. Any other information that the Commissioner considers relevant in assessing the application.

Examples

One-off situation (late filing penalty and late payment penalty)

An employer has a computer payroll package set up to prepare the employer monthly schedule for ir- filing. A serious virus is detected on the 4th August when the schedule is due for transmission on the 5th. The software developer is called but the problem is not fixed until the 7th when the schedule was prepared and transmitted. On the same day the remittance slip and payment were also sent. The late filing and late payment penalties would be remitted, as this would be a situation beyond the taxpayer's control.

Genuine oversight (late payment penalty)

A new office person had been hired by an employer as a wages clerk. The new person's duties included preparing the wages, maintaining the wage records and preparing the employer monthly schedules and remittances.

The new person arrived in early March and found the wage records in a terrible mess. The person completed and balanced the employer monthly schedule and forwarded it to Inland Revenue by 20 April, and had intended to enclose the monthly remittance for March in the same envelope. Unfortunately, the remittance and the cheque were caught up in some papers and were not discovered until 24th April. The remittance and cheque were promptly delivered to the nearest Inland Revenue office with supporting documentation and an accompanying letter requesting remission. Remission of the late payment penalty would be granted under section 183D as a genuine oversight.

Incorrect advice (late payment penalty)

A small business person registered for GST and was a six-monthly payer. However as business improved the person elected to file GST returns two-monthly. The person sought the advice from the nearest Inland Revenue office but unfortunately confusion arose over the date the next return was due to be filed, resulting in the imposition of a late payment penalty. Remission of the late payment penalty would be granted under section 183D due to incorrect information being given by Inland Revenue.

Incorrect advice (interest)

A taxpayer is advised of an incorrect date for PAYE and incurs a late payment penalty and interest. As the late payment penalty and interest were caused by Inland Revenues error, both the late payment penalty and interest would be remitted. However, the taxpayer would be expected to provide evidence to support that incorrect information was given by Inland Revenue.

Incorrect advice (partial remission of interest)

A taxpayer rang Inland Revenue to find out what interest was accruing on their 2001 income tax account, as they had just received a statement of account showing some interest payable, but the due date for the actual income tax was shown as 7 February 2002. They were advised that interest was not accruing so the taxpayer didn't make payment immediately. Subsequently, the taxpayer was charged further interest. Remission was applied for on the grounds that they would have paid immediately had they known of the ongoing liability. Remission of interest was granted in part—the interest that had accrued until the time the taxpayer telephoned Inland Revenue was still payable. However, the taxpayer would be expected to provide evidence to support that incorrect information was given by Inland Revenue.

No right of objection or challenge

There is no statutory right to challenge or object to any decision of the Commissioner to grant or decline remission under section 183A or section 183D. [1]

However, if a taxpayer does not agree with the Commissioner's decision not to grant remission, 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 4 December 2002.

Colin Hutchins
National Manager

Technical Standards

[1] Section 138E(1)(e)(iv) Tax Administration Act 1994

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.

APPLICATION TO TRANSFER CASES TO HIGH COURT.

Case:	CIR v Erris Promotions & Ors, Wilson Black Associates Limited v CIR, CIR v West Coast Developments Limited
Decision date:	7 November 2002
Act:	Tax Administration Act 1994
Keywords:	Transfer application, Test case designation, Application to stay

Summary

The Commissioner's application to transfer six representative cases from the TRA to the High Court was successful. The facts of the case pointed strongly towards the transfer, even without test case designation. On this basis it was inappropriate for similar cases to proceed in the TRA.

Facts

The substantive proceedings concerned the investors in the Actonz Joint venture ("the joint venture"). The dispute between the CIR and the investors relates to the tax treatment of computer software. The CIR considers the statutory requirements are not satisfied, that the sale and purchase agreements are shams and that the anti-avoidance provisions apply.

Once the disputes resolution procedure under the Tax Administration Act 1994 ("the TAA") was complete, Erris Promotions Limited and five other investors ("the Erris cases") filed challenges in the Taxation Review Authority ("the TRA"). These six investors were agreed upon to be representative of all investors in the joint venture. The cases had been set down for hearing on the 25 November 2002.

The CIR applied to the High Court ("the HC") under s138N(2)(a)(ii) of the TAA to have these cases transferred from the TRA to the HC. This application was refused by Hammond J on 15 August 2002. The CIR appealed against that decision. The CIR's application for consolidation of the Erris cases and the Actonz GST case was also refused by Hammond J. The CIR did not appeal that decision.

Since the decision of Hammond J, a group of 123 (now 112) investors filed proceedings in the HC on 23 August 2002—the Wilson Black Proceedings ("WB"). On the 23 September 2002 the CIR designated the Erris cases test cases under s138Q of the TAA. The Wilson Black proceeding was stayed.

West Coast Development Limited ("WCD") was filed in the TRA several weeks ago and a notice of stay was issued by the CIR. WCD issued a notice under s138R(3) to the CIR requiring there be no stay. The CIR applied to the HC under s138R(4) that the challenge be stayed. The application was removed to the Court Appeal ("the CA") by consent.

WB applied to the HC that its case be transferred to the TRA. An application to remove that application to the CA was denied by Master Gendall and upheld by Young J. WB appealed against that decision.

Decision

1. Whether test case designation was valid?

The CIR may designate a test case if he considers the challenge is likely to be determinative of all or a substantial number of issues involved in other challenges. As the parties agreed the Erris cases would be determinative of all issues for all investors, the statutory requirement for test case designation is met.

Opposition to test case designation was made on the basis that designation had been made to late. It was argued that Rule 431 of the District Court Rules provides no step can be taken in a proceeding without leave once a case is set down for hearing. The CIR argued test case designation could only occur after the filing of the WB challenge. The CA accepted the CIR's argument. Requiring the leave of the Court for test case designation was inconsistent with s138Q. It was a statutory power not governed by rules or recognised Court practice. The exercise of such a statutory power could be subject to judicial review, but was not before the Court. The designation was valid and s138Q(2) required test cases to be heard in the HC.

2. Whether CIR's appeal of Hammond J should be allowed?

As the designation was valid it was not strictly necessary for the CA to deal with the appeal of Hammond J's decision. However, it did make several observations.

Legislation

A taxpayer can file a challenge in the TRA or the HC. If proceedings are filed in the TRA the CIR can apply to the HC under s138N(2)(a)(ii) to transfer the challenge to the HC. Section 138N(2)(a)(ii) of the TAA contains no statutory guidelines as to when transfer should be granted. In contrast, the old disputes resolution regime contained in s136(4) required the Court be of the opinion that it should be heard by the HC due to reasons of the amount of tax, the general or public importance of the matter, its extraordinary difficulty or for any other reason. Section 138O also provided factors for the CIR to meet in order to apply to transfer from small claims to the TRA. The CA considered the lack of statutory criteria did not imply a legislative intent to change the role of the TRA or the HC in taxation disputes, nor did it exclude the criteria set out in s136(4) and 138O.

The legislation provides for two first instance courts, the TRA and the HC. While the TRA is specialist there is no presumption that tax disputes be dealt there in first instance. The HC is the court of first instance for major litigation. While the taxpayer has the initial choice of forum, the Court must consider the factors relied upon by the CIR and the legislative scheme.

In the present case it was agreed the Erris cases would resolve the position for all investors. The parties regarded the Erris cases as test cases, even though a formal designation had not been done. This strongly suggested the HC is the appropriate forum.

Hammond J's decision

Hammond J considered the transfer section provided a broad general discretion and that the onus of satisfying the Court was on the proponent. Although he acknowledged the sums at stake in the present case were large, he considered they were not of real moment as the sum in issue was of itself a poor measure of difficulties likely in a case. He also considered that the taxpayer's choice of forum should be respected unless there is a case to the contrary. He further considered the specialist nature of the TRA.

He considered the main issue in the Erris cases was tax avoidance. However, this would only be at issue should the CIR fail at his first two arguments concerning depreciation and sham. The HC deals with these issues regularly in its general jurisdiction.

A large amount of revenue is at stake. While this does not necessarily equate with complexity, chances of appeal are more likely. While the TRA provides for an earlier hearing date, the added level of appeal will not mean less delay in resolving the case.

3. Whether the CIR's application to stay WCD should be allowed?

WCD opposed this application on the grounds the Erris cases will be heard in the HC if the test case designation is allowed. A HC fixture may not be available until June 2003 and the investors wanted their cases heard expeditiously.

The CA considered it inappropriate that similar cases proceed in the TRA when they had indicated the Erris cases should be heard in the HC. To allow WCD to continue in the TRA would subvert the test case procedure. The purpose of the procedure is to prevent duplicate litigation thereby saving resources. Strong reasons would be needed for a stay not to be ordered.

4. Whether the taxpayer's appeal of Young J should be allowed?

Young J refused to transfer WB's application for transfer to the TRA to the CA. The CA considered the Erris cases should be heard first, and to allow any other cases to be heard in the TRA first would subvert the test case procedure.

MORTGAGEE SALE

Case: CIR v Edgewater Motel Ltd & Ors

Decision date: 18 November 2002

Act: Goods & Services Tax Act 1985

Keywords: Mortgagee sale, sale of goods in satisfaction of debt, priority, liability, expense occasioned by sale.

Summary

The Court of Appeal held that a mortgagee exercising its powers of sale was required to pay GST on the sale price to the Commissioner prior to its own or any other charge. The GST is a personal liability on the selling creditor and is thus an expense occasioned by the sale.

Facts

The plaintiffs ("Edgewater") were collectively second mortgagees of a property known as Westwood Meadows ("Westwood"). The first mortgagee ("Belman") sold the property in satisfaction of debts owed by Westwood. At no stage was Westwood in liquidation or receivership.

Following the sale, Belman paid out of the proceeds the GST of $117,000 to the Commissioner along with form GST 121; "Return for Goods Sold in Satisfaction of Debt". The form was endorsed in handwriting in two places: "Payment made under protest". Having paid the GST, Belman retained the balance of the proceeds which was $12,000 short of the amount which it was owed. No part of the proceeds was left to pay Edgewater.

Edgewater wrote to the Commissioner claiming an immediate refund of the $117,000 paid by Belman. The Commissioner replied that he considered the GST properly payable by Belman and that no issue of priority arose as there was a clear liability on the part of a mortgagee selling in satisfaction of a debt (sections 5, 17 GST Act). Edgewater issued a Notice of Proposed Adjustment ("NOPA") which the Commissioner denied they had a right to do. He replied with a rebuttal of the argument and rejected Edgewater's entitlement to invoke the disputes provisions of the Tax Administration Act 1994 ("TAA").

After further correspondence regarding Edgewater's standing to invoke the disputes resolution process, Edgewater commenced proceedings seeking summary judgment for the sum paid to the Commissioner by Belman. The Commissioner opposed the application and sought orders striking out Edgewater's claim.

In the High Court, Baragwanath J held that the clear words of section 17 of the GST Act were subordinated by the priority given mortgagees in section 104 Land Transfer Act 1952 ("LTA"). In so finding he further held:

- section 5(2) and section 17(1) of the GST Act are to be read in the same way as section 42(2)(b) and (ba) of the GST Act, and section 104 LTA, which accord priority to mortgagees.
- The mortgagee is liable to the Commissioner for GST to the extent of any surplus on sale, thereafter the Commissioner must seek the balance from the mortgagor.
- The Commissioner has the option under section 27(1) GST Act to pursue either the person deemed to supply or any person required to furnish any return.
- section17 is essentially a machinery provision "giving effect to the general policy of section104 and the GST Act".
- Such a construction however, must be taken to amend section 104 in part by imposing an obligation on the mortgagor to account for GST after discharging all mortgages.
- The above conclusion requires a strained interpretation of the GST Act which should be redrafted with "language that deals clearly and simply with the various contingencies".

The Commissioner appealed the decision on the substantive issue of the liability to pay GST, of a creditor selling goods in satisfaction of a debt.

Decision

The priority issue

The plaintiffs argued that section 104 of the Land Transfer Act 1952 ("LTA") overrides the plain words of section 17 GST Act. The former states:

104 Application of purchase money

(1) The purchase money to arise from the sale by the mortgagee of any mortgaged land, estate, or interest shall be applied—

(a) Firstly, in payment of the expenses occasioned by the sale:

(b) Secondly, in payment of the money then due or owing to the mortgagee:

(c) Thirdly, in payment of subsequent registered mortgages or encumbrances (if any) in the order of their priority:

(d) Fourthly, the surplus (if any) shall be paid to the mortgagor.

Whereas the GST Act, having deemed by section 5(2), any such seller to be supplying goods in the course or furtherance of the mortgagor's taxable activity, states at section 17(1)(b) that the seller must "pay to the Commissioner the amount of tax charged on that supply".

The Court effectively disposed of the matter in two paragraphs, the remainder of the decision dealing with the Respondents' and the High Court's reasoning in some detail:

> "[4] It might be thought reasonably plain from these two provisions that the burden of the GST liability on a mortgagee sale is shifted from the mortgagor to the mortgagee:
>
> - A sale of land of a mortgagor under a power exercisable by a mortgagee is deemed to be a supply in the course of a taxable activity carried on by the mortgagor (which is deemed a registered person) unless either of the situations in section 5(2)(a) or (b) applies (which they did not in the present case);
> - The mortgagee is obliged:
>   (i) to furnish a return covering the matters specified in section 17(1)(a);
>   (ii) to pay to the Commissioner the whole of the tax charged on the supply;
>   (iii) to furnish the mortgagor with the information in the return;
> - The tax is to be excluded from any other GST return of either party; and
> - The tax is recoverable as a debt due to the Commissioner from the party which is obliged to pay it, namely the mortgagee.
>
> [5] Further, it is plain—the respondents conceding the point in their oral submissions in this Court—that, if the mortgagee is obliged by s17 to pay the whole of the GST charged in relation to the sale, that payment constitutes an expense "occasioned by the sale" and, as such, is payable in priority to the mortgage moneys under section 104(1)(a) of the Land Transfer Act 1952, which dictates the application of the proceeds of a mortgagee sale of land:"

The Respondents had argued in the High Court that section 27(1) entitled the Commissioner to assess any party for the tax payable on any such sale, and Baragwanath J had agreed, stating that this allowed the mortgagees to be paid in full and any tax deficiency could be recovered from the mortgagor if necessary. The respondents did not pursue this argument in the Court of Appeal, rightly, as the court noted:

> "The mortgagor is not, in terms of para (a) of that subsection, a person required to furnish a return. Indeed, the final portion of section 17(1) states the contrary – that the person whose goods were sold shall exclude from any return the tax charged on the supply of goods under the mortgagee sale. And, under para (d) of section 27(1), which is concerned with an assessment in relation to goods deemed to be supplied by a person (the mortgagee) under section 5(2), the Commissioner is empowered to make an assessment of tax payable by the person selling the goods (again, the mortgagee) *or* the person whose goods are sold (the mortgagor); but this can be done against the mortgagor only if any written statement supplied by the mortgagor under section 5(2)(a) is judged by the Commissioner to be incorrect."

Similarly, arguments based on other provisions of the Act which it was said, render section 17 a mere 'machinery' provision for the collection of tax, were dismissed.

There was therefore, no need for any straining of the words of the GST Act in order to give effect to section 104 of the LTA, the latter being not an overarching principle but "… a general provision which gives priority to expenses occasioned by the sale". The GST Act which imposes a tax on any sale "… creates an expense of sale which ranks under section 104 ahead of the mortgage debt."

The issue regarding the standing of Edgewater to bring such a claim against the Commissioner in the first place was not pursued by consent between the parties.

TRUST FOR CHARITABLE PURPOSES TAXABLE DUE TO TRUSTEE AND DEEMED SETTLOR

Case: Leslie Jane Dick and Bruce Maxwell Grierson v CIR

Decision date: 14 October 2002

Act: Income Tax Act 1976 section 61(27) ITA 1976

Keywords: charitable trust, "settlor"

Summary

A successful appeal by the CIR regarding the taxation of a trust established for charitable purposes where the deemed settler and a trustee were found to be able to direct benefits from the trust to themselves.

Facts

This is an appeal from a decision of Glazebrook J (reported at (2001) 20NZTC 17,396).

The taxpayers are (or were) the trustees of the Vocation Education Foundation, a charitable trust. Another instigator of the trust was Mr Sloan who provided finance for the trust to purchase gaming machines (from himself) and then to purchase commercial properties. Mr Grierson also purchased a residential property on trust for the Trust and then purchased the property from the Trust for himself.

The Commissioner formed the view that Mr Sloan was in fact a settlor of the Trust and was able to benefit personally from the trust as a consequence of his status as settlor. As result of this potential (but not actual benefit) benefit, the Trust lost the benefit of tax exempt income and the income was assessable. Further it was considered Mr Grierson also received a benefit from the trust as a result of his position as trustee.

Before the TRA the taxpayers were successful in challenging the Commissioner's conclusions and the assessments were cancelled.

Before the High Court the Commissioner's appeal was successful. It was considered that "settlor" in the relevant legislation had a wide meaning and caught Mr Sloan as the "instigator" of the trust. Further he had provided loans to the Trust that had to be repaid. After examining the Trust Deed the High Court judge concluded Mr Sloan had the legal capacity to benefit from the trust (as well as the practical ability) and therefore the tax exempt status of the income was lost. She also considered Mr Grierson had the same legal and practical capacity. She then referred the matter back to the TRA to quantify the tax payable.

The taxpayer appealed

Issues

Was Mr Sloan a "settlor" of the Trust and if so did he have the ability (in a legal and practical sense) to benefit personally from the Trust. If so, did he in fact so benefit and if he did what effect did this have on the tax exempt status of the Trust's income?

Did Mr Grierson, as trustee, have the ability to influence the gaining of a benefit to himself? If so, did he in fact so benefit and if he did what effect did this have on the tax exempt status of the Trust's income?

Decision

The Court if Appeal largely adopted the High Court's approach.

Looking at the relevant section (section 61(27) ITA 1976) the Court of Appeal said the purpose of the section (or more correctly one of its provisos)"…is to prevent tax exemptions from being obtained in cases where those in particular positions of influence in respect of the charity are able to derive benefits for themselves" (at par 49).

The Court rejected an argument by the taxpayers that the section only applies to the extent of actual benefits received. The Court found the section covered the whole of the income received (at par 51)

The Court accepted that the Trust Deed enabled settlers and trustees to legally obtain benefits from the trust (at par 53). It also accepted the Trust did conduct a business, rejecting a submission that passive holding of property could not amount to a business (at par 55, 58).

They then turned to consider the position of Mr Sloan in relation to the Trust. Weight was placed upon Mr Sloan's provision of money to the Trust. Money is an asset (par 62) and Mr Sloan disposed of it by providing it to the Trust. Thus Mr Sloan was in fact a settlor of the Trust (at par 63).

Further Mr Sloan became a settlor when the ordinary meaning of the settlor is used. The Court cautioned against the approach by Justice Glazebrook in using the definition at section 226 to interpret the word "settlor" in sec 61(27), rather it was appropriate to use the ordinary meaning of the word (par 67-69). Thus Mr Sloan's settling of assets on the trust (money) made him a settlor.

Still further Mr Sloan was considered to be a settler due to his ownership of shares in VEF Holdings (at par 75).

Having determined Mr Sloan was a settlor, the Court turned to whether or not any benefit accrued to him as a consequence of that status. The Court emphasised the issue was not did he receive any benefit but was he in a position to be ABLE to influence the gaining of a benefit (par 78, 82, 84).

Finally the Court concluded that Mr Grierson was, as trustee, ABLE to influence the gaining of a benefit in the tax years he was a trustee and thus the tax exempt treatment of trust income was lost.

The Court considered it could not deal with the quantum issues and accepted the High Court's approach of referring the matter back to the TRA

STRUCK-OFF COMPANIES UNABLE TO PROCEED WITH THEIR OBJECTIONS

Case: TRA 21/02 and TRA 22/02

Decision date: 11 November 2002

Act: Tax Administration Act 1994

Keywords: Objections, struck-off companies

Summary

As both objectors had been struck off the Companies Register they were unable to proceed with their objections. The objections were therefore dismissed.

Facts

These two cases had been adjourned by consent from July 1993 until 17 May 2001 pending decisions in precedent cases.

When the cases came before the Taxation Review Authority on 11 November 2002 (pursuant to a timetable agreed to on 9 August 2002) it was confirmed that the two objectors had not been restored to the Companies Register. The objectors had been reminded on 9 August 2002 that they would have to apply to the High Court for restoration in order for their objections to proceed

Decision

As both objectors were struck-off companies they had no status or legal capacity and were therefore unable to proceed with their objections. The amended assessments were confirmed.

Judge Barber noted that the objectors could possibly be reinstated to the Register at some future date. If that occurred it would be for the objectors to decide whether these proceedings could be revived in any way, however, this did not concern the Authority at this time.

During the hearings an argument was raised for the first time that the objectors had assigned their objection rights so that their lack of legal capacity did not matter. However, the Authority was presented with no evidence of such an assignment and, in any event, "a tax assessment, (and any right of objection) is so personal a thing that it would not seem to be assignable at least vis-à-vis the Commissioner of Inland Revenue".

TRANSFER OF PROCEEDINGS

Case: CIR v Taxpayer 740/02

Decision date: 25 November 2002

Act: Tax Administration Act 1994

Keywords: Application to transfer proceedings from Taxation Review Authority to the High Court

Summary

The Commissioner's application was successful as the case was held to be on all fours with the recent Court of Appeal decision in *CIR v Erris*.

Facts

This taxpayer and 22 others are involved with a joint venture ("the joint venture") which through a company acting as its agent ("the agent") entered into various contracts with a company ("the Company"). Under these arrangements the Company entered into an agreement which provided that the Company grant the agent (as agent for the joint venture) a licence to use property owned by the Company to grow one rotation of Douglas fir trees.

The joint venture is required to pay an annual fee of $50 per plantable hectare to the Company, and in addition, a further fee of $2,050,518 per plantable hectare at the end of the 50 year term.

There is also an arrangement described as an insurance policy. The parties to this agreement are a company incorporated in the British Virgin Islands, the joint venture and the Company. The joint venture pays a premium of $1,307 per plantable hectare up front and $32,791 per plantable hectare payable at the end of the 50 year period.

The taxpayer has claimed a deduction for depreciation of a proportion of the licence fee, amortised over the 50 years of the licence. For the 1997 tax year this deduction was for one month only, but in subsequent years deductions related to the full 12-month period. The taxpayer has also claimed a deduction for the full amount of the deferred insurance premium in the 1997 tax year.

The CIR says that the depreciation deduction is not allowable because the right acquired is not depreciable property, and that the insurance premium deduction is not available as no genuine insurance was effected. The CIR also says that the arrangement constitutes tax avoidance. There are additional matters of contention in relation to the taxpayers who are the tax practitioners who are said to have devised the scheme.

The CIR's evidence is that the arrangement involving the taxpayer and the other 22 respondents is part of a wider scheme involving similar arrangements with related companies of the Company, and relating to plantations of Douglas fir trees on other areas of land. The evidence was that the amount of tax involved with the taxpayer and the other 22 respondents is between $320 and $370 million, and that over the 50 year life of the scheme the total fiscal impact could be between $3.2 and $3.7 billion, taking into account the other schemes. However, future legislative change may remove future deduction entitlements, although deductions claimed to 31 March 2001 are approximately $190 million.

The 23 taxpayers were the first to be assessed (because of time-bar, their cases did not proceed to Adjudication) and they filed proceedings in the Taxation Review Authority. The CIR applied to transfer them to the High Court.

Decision

The recent Court of Appeal decision in *CIR v Erris* was considered to be on point and to justify a transfer order being made. The difficulty of the issues, the precedential effect of the case, and the money involved were of similar orders of magnitude.

Any adjournment application on *Alpe* grounds could be dealt with as efficaciously in the High Court as the TRA, and so this was not a factor to count against transfer.\\

As a consequential order, new Statements of Claim were ordered to be filed by 16 December: the CIR must file Statements of Defence in response by 28 January 2003.

Costs reserved.

REGULAR FEATURES

DUE DATES REMINDER

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)* due

20 **Employer deductions**

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

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

Employer deductions and employer monthly schedule

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

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

January 2003

15 **GST return and payment due**

Employer deductions and employer monthly schedule

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

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

20 **Employer deductions**

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

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

Employer deductions and employer monthly schedule

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

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

FBT return and payment due

31 **GST return and payment due**

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

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

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

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	Draft interpretation statement	*Comment deadline*
☐	IS0056: Tax treatment of payments received by petrol retailers in return for trade ties	14 February 2003
	Draft Standard Practice Statement	
☐	ED0037: Income equalisation deposits and refunds	14 February 2003

Items are not generally available once the comment deadline has passed

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