TAX INFORMATION BULLETIN

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This TIB has no appendix

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

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

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THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft item is available for review/comment this month, having a deadline of 14 February 2003.

Ref.	Draft type	Description
ED0037	Standard practice statement	Income equalisation deposits and refunds

Please see page 21 for details on how to obtain a copy.

The following draft items are available for review/comment this month, having a deadline of 28 February 2003

Ref.	Draft type	Description
COR0050	Statement of policy withdrawal and revised interpretation	Time for new companies to make QC elections —where EOT arrangements with tax agents exist
XPB0007	Draft public ruling	Tertiary student association fees

Please see page 21 for details on how to obtain copies of these.

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 02/20

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 PSIS Limited ("PSIS").

Taxation Laws

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

This Ruling applies in respect of sections CD 5, CE 1(1)(a), CE 1(1)(b), the definition of "dividends" in section CF 2(1), and the definition of "interest" in section OB 1.

This Ruling does not consider how (if at all) section HF 1 applies to or affects the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is that PSIS will charge account holders monthly transaction fees, subject to terms and conditions which state that account holders will be exempt from transaction fees where they meet certain stated criteria. Further details of the Arrangement are set out in the paragraphs below.

1. PSIS operates as a financial services organisation, offering depositors interest bearing accounts and borrowers interest bearing loans.

2. In January 1996, PSIS introduced transaction fees because it had small or low activity deposit accounts whose transaction and maintenance costs exceeded the benefit or advantage that PSIS gained from these accounts.

3. The fees were introduced to discourage account holders from undertaking multiple small transactions as the processing of these transactions was a significant cost to PSIS on an annualised basis. Account holders who undertake a certain level of business with PSIS (referred to as "valued customers") are not liable for these fees. This policy is in line with a number of PSIS's competitors, being the major trading banks.

4. Under PSIS's company constitution there is a requirement that all account holders subscribe for a single share in PSIS. Accordingly, all account holders are shareholders of PSIS.

5. Presently, PSIS applies transaction fees to the following transactions (set out in the Fees Brochure, dated July 2002):

Transaction type
ATM - withdrawal - balance enquiry - declined withdrawal
Bill payment - electronic - telephone banking - internet banking
EFTPOS - purchase/withdrawal - decline purchase/withdrawal
Cash withdrawal
Direct debit
External automatic payment
Personal cheque withdrawal
Transfer withdrawal

6. However, the following categories of account holders are exempt from transaction fees:

   (a) account holders who maintain deposit account balances at minimum monthly levels (where the balance is held in one account or more of any account types). The minimum levels are:

• Current account(s)	$500
• Current account(s) with personal cheque facility	$1,000
• Savings account(s)	$2,000
• Term deposit(s) and bond account(s)	$5,000
• Capital note(s)	$2,500
• Loan(s) (excludes Creditline and Overdraft balances and limits, see Fees Brochure Notes, no. 2)	$50,000

   The transaction fee exemptions apply to one or more account types associated with one customer/membership number (Fees Brochure Notes, no 1).

   For the purposes of the fee exemption, a month runs from the 26th day of a calendar month to the 25th day of the following calendar month (Fees Brochure Notes, no. 3), or

   (b) account holders who are 65 years or older (from the month following the 65th birthday); or

   (c) account holders who have their New Zealand Superannuation Retirement Income or Veterans pension credited, in full, to a PSIS account; or

   (d) account holders under 18 years of age who elect to have restricted account use as determined by PSIS (i.e. deposits, cash and cheque withdrawals, ATM and EFTPOS facilities). Fees will be charged from the month following the account holders 18th birthday;

   (e) account holders who are full-time tertiary students, 18 years or older undertaking a course with a minimum duration of one year (the customer must present their current student identification card to qualify and continue to present a current student identification card at the beginning of each academic year to renew the exemption (see Fees Brochure Notes, no. 4)).

7. PSIS keeps a running monthly total of prima facie transaction charges. No charges are made until the 25th of each month. At this stage, the decision as to whether account holders meet the criteria for an exemption is made. Account holders that do not meet the criteria for an exemption from transaction fees are charged monthly in arrears on the 25th of each month.

8. Where an account holder meets the criteria for an exemption set out above for a given month, the fees that are applicable to the transactions undertaken are not charged.

9. There are no other collateral contracts, agreements, terms, or conditions, written or otherwise, that have a bearing on the conclusions reached in this ruling.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) the current commercial rate of interest is paid by PSIS in respect of all its accounts, regardless of whether any benefit or advantage is given to particular account holders in terms of an exemption from transaction fees, and

b) the criteria for the exemption from transaction fees are not dependent on the account holder's status as a shareholder of PSIS.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any assumption or condition stated above, and the qualification in respect of section HF 1, under the heading "Taxation Laws", the Taxation Laws apply to the Arrangement as follows:

- The benefit of being exempt from transaction fees is not gross income of those account holders under section CD 5.
- Such benefits are not interest under section CE 1(1)(a) or (b).
- Such benefits are not dividends under section CF 2(1).

The period or income year for which this Ruling applies

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

This Ruling is signed by me on the 31st day of October 2002.

Martin Smith

General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 02/21

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 Fletcher Challenge Forests Limited.

Taxation Laws

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

This Ruling applies in respect of:

Section CD 3;

Section CD 4;

Section CD 5.

The Arrangement to which this Ruling applies

The Arrangement is the consolidation of every five existing ordinary and preference shares of Fletcher Challenge Forests Ltd ("FCF") into one such ordinary and preference share respectively pursuant to the authorisation conferred by clause 2.12 of the Constitution of FCF and:

(i) implemented by a resolution passed by the Board of FCF on 13 November 2002; and

(ii) a consequential amendment to FCF's Constitution being approved by a special resolution passed at the annual meeting of shareholders of FCF on 13 November.

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

1. FCF has the following two classes of share on issue:

   - 929,507,897 ordinary shares; and
   - 1,859,015,794 preference shares.

   The ordinary shares were issued both before and after 1 July 1994, the commencement date of the Companies Act 1993, and the preference shares were issued and placed over the period December 2000 to March 2001.

2. Currently the available subscribed capital of the ordinary shares totals $979,362,685 (or $1.0536 per share). As at 1 July 1994, the commencement date of the Companies Act 1993, that available subscribed capital was $489,871,903. At present the available subscribed capital of the preference shares total is $487,253,948 (or $0.2621 per share).

3. FCF has re-registered under the Companies Act 1993. The terms of the preference shares (set out in clauses 2.2 and 2.3 of the Constitution of FCF) are as follows:

   2.2 **Rights of Existing Preference Shares** Subject to clause 2.3, each Preference Share existing at the date of adoption of this Constitution confers on the holders, in addition to the rights set out elsewhere in this Constitution and the Act (except where such rights are negated, altered or added by this Constitution) the same rights, and ranks equally with, the Ordinary Shares and holders of Preference Shares will vote with the holders of Ordinary Shares on all matters except on a vote relating to a liquidation of the Company, in which case a separate vote of the holders of Preference Shares will be required.

   2.3 **Rights of Shares in the Event of Liquidation** In addition to the rights set out in clause 2.1 and, in the event of liquidation of the Company, clause 2.2

   (a) the Preference Shares rank ahead (to the amount of NZ$0.25 per Preference Share) of the Ordinary Shares.

   (b) the Ordinary Shares will be entitled to the next NZ$0.25 per Ordinary Share, and

   (c) thereafter, holders of Preference Shares and Ordinary Shares will share equally in any remaining surplus.

   On 15 December 2005 (the fifth anniversary of the first allotment of the preference shares as a class) the preference rights on liquidation attached to the preference shares will lapse and the preference shares will automatically convert to ordinary shares: clause 2.4 of the Constitution.

4. The ordinary and preference shares of FCF are listed on the New Zealand Stock Exchange ("the Stock Exchange") and the Australian Stock Exchange. The ordinary shares and the preference shares are also listed on the New York Stock Exchange ("the NYSE") in the US where they are listed and traded in the form of American Depository Receipts ("ADRs"). Each ADR represents 10 ordinary or preference shares of FCF, conferring on the holder the appropriate dividend, voting and other shareholder entitlements commensurate with the underlying shares and administered through the depositary of the ADR programme.

5. It is a condition of listing on the NYSE that shares must have a minimum share price of $US1 over a 30-day trading period. The requirement is applicable to the ADRs. The trading range of the shares of FCF in recent times has been such that there has been a breach of this requirement. On 22 January 2002 the NYSE notified FCF of the breach and required FCF to take steps to cure the deficiency or be subject to suspension or delisting procedures.

6. The board of FCF proposes to consolidate the shares of the company in order to ensure compliance with listing requirements of the NYSE. The depositary of the ADR programme will undertake a consequential consolidation of the ADRs such that the ADR:share ratio remains 1:10. FCF considers that with fewer shares on issue, and the consequential consolidation of the ADRs, there should be compliance with the requirement that the ADR share price must not fall below $US1 per share. A further reason for the consolidation is that the current share price gives rise to large percentage swings for each one cent of price movement and is not market efficient because swings in the share price create too big a hurdle for many buyers and sellers, essentially creating illiquidity.

7. Under clause 2.12 of its Constitution, the board of FCF has the power to consolidate and divide or subdivide, all or any of its shares (whether of one or more classes). "Share" is defined in the Annexure to the Constitution as follows:

> an Ordinary Share or a Preference Share as the case may be

8. The board proposes to pass a resolution which will have the effect that all existing ordinary shares and all existing preference shares of FCF will be consolidated. The draft of the directors' resolution (including the preamble) reads as follows:

> **Noted:**
>
> Subject to shareholder approval of the consequential amendment to the Company's constitution, the Board proposes to consolidate the ordinary and preference shares of the Company on a five-for-one basis and, consistent with New Zealand market practice, fractional entitlements following the consolidation will be rounded up to the nearest whole number. The consolidation is intended primarily to ensure that the Company's American Depositary Receipt ("ADR") programme complies with the New York Stock Exchange quantitative continuous listing standard that requires the average closing price of the Company's American Depositary Shares ("ADSs") to be not less than US$1.00 over a consecutive 30-day trading period. The share consolidation, taken together with the consequential consolidation of the ADSs, should result in an increase in the market price of the ADSs to a level that remedies the breach of the New York Stock Exchange's quantitative listing standard.
>
> In consolidating the ordinary and preference shares, the ordinary ADSs and Series A ADSs ratios of 1 ordinary ADS or Series A ADS for every 10 underlying securities will remain unchanged. The effect of the consolidation is therefore to require a five for one consolidation of the ordinary ADSs and Series A ADSs. Consistent with United States market practice and in line with the terms of the deposit agreement governing the Company's ADS programme in similar circumstances, Citibank, N.A. (as depositary) has advised that it will round down any fractional entitlements to an ordinary ADS or Series A ADS following the consolidation of the ordinary ADSs and Series A ADSs to the nearest whole number. Citibank, N.A. will sell the underlying securities represented by those fractional entitlements, and the proceeds paid to the relevant holder.
>
> Citibank, N.A., as holder of the Company's shares that underlie the ADR programme, will have those shares consolidated in the same manner as each other shareholder in the Company.
>
> If approved by shareholders at the Company's annual shareholders' meeting, following the consolidation, clause 2.3 of the constitution of the Company will be amended to maintain the current entitlements of the preference shareholders on liquidation of the Company.
>
> **Resolved**:
>
> 1. Subject to the approval by special resolution of the amendments to clause 2.3 of the Company's constitution, pursuant to the power conferred on the Board by clause 2.12 of the constitution of the Company, with effect from 5.00 pm (New Zealand time) on [29] November 2002 (the **Record Time**):
>
>   (a) All existing ordinary and preference shares of the Company are consolidated on a five-for-one basis such that every five ordinary shares and every five preference shares in the Company registered in the name of a shareholder at the Record Time will be consolidated into one ordinary or preference share in the Company respectively, with the intent that:
>
>   (i) all existing rights, privileges and restrictions attaching to the existing ordinary and preference shares of the Company continue in existence and remain unaltered;
>
>   (ii) each of the shares shall remain fully paid and the amount of subscribed capital attributable to each ordinary and preference share shall remain the same; and
>
>   (iii) the consolidation is merely a reformatting of all existing ordinary and preference shares and is not a cancellation of existing shares followed by a new issue of shares.
>
>   (b) If, in effecting the consolidation referred to in paragraph (a) above, a holder of ordinary shares or preference shares in the Company does not have a number of ordinary shares or preference shares exactly divisible by five, in calculating the number of shares held by such holder following consolidation, a fraction of a share will be rounded up to the nearest whole number.
>
> 2. That any one of the Chief Executive, the Chief Financial Officer or the Company Secretary be authorised to execute and deliver on behalf of the

> Company (whether before or after the date of these resolutions) any requests, notices or other communications, and to take any such action on behalf of the Company as may be contemplated by, or necessary or expedient under or in connection with, the consolidation approved in resolution 1, including the giving of instructions to the Company's share registrar to record the consequential changes to the Company's share register.

9. The Board has considered the substance of the consolidation. It is intended that this matter will be part of the business at a meeting of the board on 13 November 2002 and at the annual general meeting of shareholders, which is also to be held on that date.

10. The objective of the consolidation is that, as from [29 November 2002], every five ordinary shares and every five preference shares presently held by a shareholder will be consolidated into one such ordinary share or preference share, as the case may be. In respect of the holders of ADRs the number of ADRs on issue will be consolidated on a one for five basis to enable the American Depository Receipt ratio of ten shares in the company per ADR to remain unchanged.

11. If a holder of ordinary or preference shares does not have a number of ordinary shares or preference shares exactly divisible by five, in calculating the number of shares to be held by such a holder following the consolidation, a fraction of a share will be rounded up to the nearest whole number. On the basis of the share register as at 31 July 2002 and assuming a share price of 22 cents for both classes of shares and an average rounding of 0.5 of a share for each shareholder with a shareholding not divisible by five, the rounded-up fractions of post-consolidation shares would result in an additional post-consolidation:

    - 24,228 ordinary shares; and
    - 12,078 preference shares.

    In such circumstances the total dollar value of the rounding to shareholders would be $19,967 (36,306 x $1.10 x 50%). This represents 0.00325% of FCF's current market value. On the basis that the pre-consolidation shares convert post-consolidation into 185,901,579 ordinary shares and 371,803,158 preference shares the percentage change in shareholding as a result of rounding up would be: 0.00261% for ordinary shares and 0.00085% for preference shares (total 0.00130%). An affected shareholder will be conferred with an "addition" to shareholding ranging from 0.2 to 0.8 of a share. (In other words, as rounding up will be required only where a shareholder holds a number of shares which is not equally divisible by five, no shareholder will receive more than 0.8 of a share as a consequence of the rounding up.) FCF were advised by its financial advisors, First NZ Capital Group Ltd, to round up fractions. First NZ advised that although this would favour some shareholders over others, based on a share price of $0.25, the maximum differential between shareholders would be only $1 per shareholder.

12. Implementation of the five-for-one consolidation will require the appropriate adjustment of the 25 cent preferences. Under the existing share count a preference shareholder has a total preference of $1.25 for every five shares. If parity is to be maintained the preference needs to be consequentially adjusted to $1.25 for every share under the consolidation share count.

13. The rights associated with the preference shares are incorporated in the Constitution, which may be amended only by a special resolution passed by shareholders in general meeting. Under section 32(2) of the Companies Act the power to alter the Constitution is vested in the shareholders of FCF.

14. Therefore, in conjunction with the proposed board resolution and in order to complete the implementation of the consolidation, shareholders will be asked to pass a special resolution at the annual meeting of shareholders (on 13 November 2002) to amend the Constitution of FCF. The amendment will increase the preference in liquidation from 25 cents per share to $1.25 per share. A draft of the shareholders' resolution reads as follows:

    > That, with effect from the date the shares in the Company are consolidated on a one for five basis pursuant to a resolution of the Board of the Company, the constitution of the Company be amended by deleting the two references to "NZ$0.25" in clause 2.3 and replacing them with "NZ$1.25".

    If the resolution is approved by the shareholders, the Effective Time will be 29 November 2002.

15. The directors' resolution and the shareholders' resolution are effectively subject to favourable binding rulings being given in respect of the consolidation. FCF desires to have certainty on its ASC position.

16. If the shareholders do not approve the proposed amendment to the Constitution or if binding rulings satisfactory to the company are not given, the Board intends, as soon as is practicable, to alter the number of the company's shares represented by each ADR so that each ADR would represent 50 underlying shares. This should remedy the breach of the NYSE quantitative continuous listing standard. Any alteration to the number of the company's shares represented by each ADR, using this method of consolidation, will only affect the holders of ADRs.

17. FCF recognises that it will need to advise the various stock exchanges of the proposed consolidation. For example, the New Zealand Stock Exchange Listing Rules (the Listing Rules) require that any proposal to consolidate shares must be notified to the Stock Exchange as soon as the information is first available: section 10.8.1. In addition an appendix 7 notice concerning "notice of event affecting securities" will need to be given to the Stock Exchange no later than 10 business days prior to record date. FCF is not expecting to be required to give the Stock Exchange notice of the cancellation of securities in accordance with section 7.12.1 of the Listing Rules because no securities will be cancelled. The Australian Stock Exchange requires reciprocal notification of all matters notified to the New Zealand Stock Exchange.

Condition stipulated by the Commissioner

This Ruling is made subject to the following condition:

- The resolutions passed by the Board and the shareholders of FCF are not materially different from draft resolutions set out in this ruling.

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 consolidation does not result in a sale or disposition for the purpose of sections CD 3, CD 4 or CD 5.

The period or income year for which this Ruling applies

This Ruling will apply for the period 8 November 2002 to 31 March 2003.

This Ruling is signed by me on the 8th day of November 2002.

Martin Smith

General Manager (Adjudication & Rulings)

NEW LEGISLATION

STUDENT LOAN SCHEME – REPAYMENT AND INTEREST WRITE-OFF THRESHOLDS FOR 2003-04

The student loan scheme repayment threshold, which sets the income level at which compulsory repayments begin, will increase from its current level of $15,496 to $15,964 for the 2003-04 income year.

The student loan scheme interest write-off threshold, which sets the level of income that part-time or part-year students may have and still be entitled to a full interest write-off, will increase from its current level of $25,378 to $25,909 for the 2003-04 income year.

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

Student Loan Scheme (Repayment Threshold) Regulations 2002 and Student Loan Scheme (Income Amount for Full Interest Write-off) Regulations 2002

LEGISLATION AND DETERMINATIONS

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

GENERAL DEPRECIATION DETERMINATION DEP48 – PRINTS (INCLUDING LIMITED EDITION PRINTS), PAINTINGS AND DRAWINGS

A General Depreciation Determination has been issued that inserts into the industry categories "Hotels, motels, restaurants, cafés, taverns and takeaway bars", "Residential rental property chattels" and "Shops", and into the asset category "Office equipment and furniture", in the appropriate alphabetical order, the following asset classes:

General asset class	Estimate useful life (years)	DV banded dep'n rate (%)	SL equiv banded dep'n rate (%)
Paintings and drawings, in either case being property which might reasonably be expected in normal circumstances to decline in value	20	9.5	6.5
Prints (including limited edition prints)	10	18	12.5

The new depreciation determination also consequentially deletes the asset class "Prints" from the industry category "Hotels, motels, restaurants, cafés, taverns and takeaway bars".

The rate for "Prints (including limited edition prints)" is the same as the deleted rate for prints. The reference to limited edition prints is intended to avoid any doubt.

The general asset class "Paintings and drawings, in either case being property which might reasonably be expected in normal circumstances to decline in value" is a new introduction. It encompasses works (including painted or drawn reproductions) in a variety of media and on a variety of substrates.

The qualification "…, in either case being property which might reasonably be expected in normal circumstances to decline in value" is, strictly, unnecessary in that it merely paraphrases a legislative requirement that must be satisfied in any case. However comments on the exposure draft of this determination indicated concern that "Paintings and drawings" (the asset class description originally proposed) would encompass much property that would not reasonably be expected in normal circumstances to decline in value when used or available for use in deriving gross income or in carrying on a business for the purpose of deriving gross income. It was suggested that the proposed description might mislead some taxpayers into claiming depreciation deductions in respect of paintings and drawings that are not depreciable property.

The qualification is intended as an aid to compliance for any user of the determination (and of published tables based on it) who might not be familiar with the relevant tax law. There might be circumstances where expert advice on whether property might be expected to decline in use will be useful in deciding whether the definition of "depreciable property" is met. However in the normal course it is not reasonable to expect property to decline in value when used or available for use in deriving gross income or in carrying on a business for the purpose of deriving gross income if its value is significantly affected by:

- Its artistic qualities; or
- Its collectability due to its rarity, antiquity, or association with a person, place or event, or any other reason

and these characteristics are not diminished in the use of the property.

It was suggested that providing a depreciation rate for paintings and drawings will increase compliance and administrative costs, as taxpayers and the Commissioner may find it necessary to take expert advice if disputes should arise. This possibility is acknowledged. However it is a consequence of the availability of the depreciation allowance and more particularly of the annual accounting cycle in which depreciation deductions are available. The intention of the legislature would be frustrated if the Commissioner were to attempt to deny the depreciation allowance by declining to determine an annual depreciation rate for such property. The possibility of such costs was implicitly acknowledged in *Tax Information Bulletin* Vol 10, No 9 (September 1998), which said in relation to original paintings that "a valuation opinion may be sought to independently and objectively satisfy the test of whether an item is depreciable property or not under section OB 1". However it is expected that instances where expert opinion is required will be very rare if the factors referred to above are taken into account.

Determination DEP48: Tax Depreciation Rates General Determination Number 48 applies to "depreciable property" other than "excluded depreciable property" for the 2002/2003 and subsequent income years. The Commissioner's views expressed in the earlier article

"Prints and original paintings" in *Tax Information Bulletin* Vol 10, No 9 (September 1998) dealt with the law, including depreciation determinations, that applied at that time. Those views do not apply for the 2002/2003 and subsequent income years.

The determination is reproduced below.

General Depreciation Determination DEP 48

This determination may be cited as "Determination DEP48: Tax Depreciation Rates General Determination Number 48".

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 2002/2003 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:

- Deleting from the industry category "Hotels, motels, restaurants, cafés, taverns and takeaway bars", the general asset class, estimated useful life, diminishing value depreciation rate and straight-line depreciation rate listed below:

General asset class	Estimate useful life (years)	DV banded dep'n rate (%)	SL equiv banded dep'n rate (%)
Prints	10	18	12.5

- Inserting into the industry categories "Hotels, motels, restaurants, cafés, taverns and takeaway bars", "Residential rental property chattels" and "Shops", and into the asset category "Office equipment and furniture", in the appropriate alphabetical order, the general asset classes, estimated useful lives, diminishing value depreciation rates and straight-line depreciation rates listed below:

General asset class	Estimate useful life (years)	DV banded dep'n rate (%)	SL equiv banded dep'n rate (%)
Paintings and drawings, in either case being property the value of which might reasonably be expected in normal circumstances to decline in value	20	9.5	6.5
Prints (including limited edition prints)	10	18	12.5

3. Interpretation

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

This determination is signed by me on the 13th day of December 2002.

Martin Smith

General Manager (Adjudication & Rulings)

LEGAL DECISIONS – CASE NOTES

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

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

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

LEGAL FEES PARTIALLY INCURRED FOR PRINCIPAL PURPOSE, NO ARRANGEMENT IN PLACE, INCOME NOT RETURNED, SHORTFALL PENALTIES FOR EVASION AND LACK OF REASONABLE CARE

Case: TRA19/2002

Decision date: 22 October 2002

Act: Goods and Services Tax Act 1985

Tax Administration Act 1994

Keywords: input credit, legal fees, shortfall penalties, evasion, lack of reasonable care, PAYE, income, arrangement

Summary

The taxpayer's challenge sought an input credit for legal fees, that shortfall penalties not be imposed, and asserted an arrangement was in place. Challenge failed for the most part: held to have failed to return income; some legal fees incurred for principal purpose of making taxable supplies, and others for defending taxpayer from a crime; evasion shortfall penalty imposed for failing to account for PAYE; and lack of reasonable care shortfall penalty imposed for failing to return income.

Facts

At the relevant times, the taxpayer was practising as a chartered accountant. There were five issues:

1. The taxpayer had prepared tax returns for four clients, and as a result of Police investigation, was charged under the Crimes Act 1961. The taxpayer engaged a lawyer to defend those charges. The taxpayer was convicted of all eight charges. He appealed the convictions, but the appeal was dismissed.

   The taxpayer claimed an input credit for the legal fees in his GST returns.

2. The taxpayer was registered as an employer with the Commissioner. Payments of PAYE were dishonoured and an investigation identified discrepancies. The Commissioner sought to impose a shortfall penalty for evasion.

   The taxpayer argued his cashflow problems were due to the Commissioner withholding the above GST refund claim, as well as incurring legal fees to assist clients with fraud charges, and a matrimonial severance which prevented him from accessing capital.

3. The parties had endeavoured to enter into an arrangement. The taxpayer made various payments, arguing they were made to ensure an arrangement was in place and thus enable penalties to be remitted. The Commissioner argued the proposed arrangement required all outstanding tax returns to be filed, which did not happen.

4. The taxpayer was registered for GST on an invoice basis and failed to return amounts invoiced to clients. The taxpayer argued he had written these off as bad debts, and had not actually invoiced them.

5. The Commissioner sought to impose a shortfall penalty for gross carelessness, and in the alternative, for lack of reasonable care in preparing his tax return for that period.

Decision

1. Legal fees

His Honour found the taxpayer had been obliged to incur at least half the legal fees for the protection of his reputation and business as a chartered accountant. His Honour did not think the fees paid to protect the taxpayer's business and/or business reputation were too indirect to be a business GST input, but also found that fees paid to defend the taxpayer from a crime cannot have the principal purpose of making taxable supplies.

2. Evasion

His Honour held a shortfall penalty for evasion (in respect of PAYE) under section 141E was payable (less 75% reduction already allowed by the CIR).

His Honour found the taxpayer knew the PAYE was outstanding, had not, and did not make any attempt to pay the outstanding PAYE (other than the application of a tax credit to part of the debt), and applied the PAYE deductions for a purpose other than in payment to the Commissioner.

There had been no cause beyond the taxpayer's control which led to his failure to account for PAYE.

His Honour confirmed again that the amount of every tax deduction made under the PAYE rules must be held in trust by the employer for the Crown; the money is no longer that of the employer.

3. Arrangement

His Honour found there was no arrangement: The Commissioner had a clear policy requiring outstanding returns to be filed before an arrangement can be entered into and to ensure that any such arrangement remains valid. The taxpayer was found to have not complied with his obligations, to have failed to meet those conditions.

4. Income not returned

His Honour found the additional income had not been not returned.

While sections 25 and 26 of the GST Act 1985 allow for credit notes to be issued and bad debts to be written off, the taxpayer was unable to satisfy the evidential requirements of those sections that he had done so in respect of the income not returned.

Credit notes had not been issued and there were no grounds on which the Commissioner could determine credit notes were not required. His Honour reiterated that while there is no one formula for writing off a bad debt, there needs to be evidence the debts have actually been written off.

5. Lack of reasonable care

Shortfall penalty for lack of reasonable care payable.

His Honour found there could not be gross carelessness where an accountant, under the pressures being experienced by the taxpayer, thought he did not need to return income which he did not intend to collect and which he knew would not be recovered. However, His Honour found this amounted to not taking reasonable care and took into account that the taxpayer is an experienced accountant from whom one would expect good accounting and record keeping practices (more so than of other individuals).

This decision has not been appealed.

TAX AVOIDANCE CORRECTLY ADDRESSED AND COMMISSIONER'S ASSESSMENT CONFIRMED

Case:	Dandelion Investments Limited v CIR
Decision date:	5 December 2002
Act:	Section 99 Income Tax Act 1976
Keywords:	tax avoidance, scope of administrative law issues in proceedings at the TRA

Summary

Unsuccessful appeal by taxpayer. Court of Appeal affirmed the Commissioner's assessment based on application section 99. Administrative law issues on objection limited to showing assessment incorrect. Hearing before the TRA cures any procedural defects. If the assessment is correct, alleged procedural defects by the Commissioner of no importance. Scope of administrative law inquiries limited by the objection. TRA cannot enter into a quasi-judicial review "fishing expedition" in the guise of administrative law enquiry.

Facts

This was an appeal by the taxpayer for the judgment of Tompkins J at the High Court (reported (2001) 20 NZTC 17,293) which was a successful appeal by the CIR from the TRA (reported *Case U11* (1999) NZTC 9,100)

In the 1986 tax year the taxpayer paid interest of $570,080 on a loan to enable a subsidiary to acquire shares. By means of a circular flow of money the taxpayer received back (tax-free) some $484,000. The taxpayer claimed a deduction of $570,080. The Commissioner applied section 99 to disallow the deduction.

The taxpayer objected and was successful at the TRA before Willy J on the basis of an alleged flawed process of re-assessment and on time bar (the TRA did accept the existence of a tax avoidance scheme). The Commissioner successfully appealed to the High Court. The taxpayer appealed to the Court of Appeal

Decision

The Court of Appeal rejected the appeal.

1. McGrath J giving judgment for the Court noted that the issue of the taxpayer's ability to object being constrained by the Commissioner's failure to prove the grounds of assessment was outside the scope of the appeal as the framing of the objection was not before the High Court on appeal and thus not before the Court of Appeal (par 53 to 54)

But he went on to consider the matter in obiter comments. On the facts it was considered the taxpayer had been able to frame an effective objection (para 59). It was considered that any defects in the Commissioner's assessment and objection processes had been cured by the extensive hearing before the TRA (para 60 to 63).

2. On the time bar issue the Court considered that *Hyslop v CIR* [2001] 2 NZLR 329 at par 20 established that it was not necessary for a taxpayer to receive a notice of assessment prior to the time bar for the assessment to be valid (para 71).

   The Court further rejected the suggestion that the notice (dated 26 March 1991) had been fraudulently backdated noting there was no evidence to support the allegation (para 71).

3. The Court rejected the taxpayer's reliance on the Commissioner's Policy Statement on section 99 ("CPS") referring to the Privy Council in *O'Neil* (2001) 20 NZTC 17,051 (para 73-74). The Court also rejected that the CPS raised any legitimate expectation that it would be followed saying that there was "limited scope for application of the principles of legitimate expectation to confine the Commissioner in the exercise of statutory duties in relation to assessment functions" (at para 75).

4. The Court rejected the suggestion that the arrangement was not one for tax avoidance. It considered the test of arrangement in *CIR v BNZI* had been met (para 77). It rejected suggestions that the arrangement was a normal business transaction or that the Commissioner had failed to tax other parties to the arrangement saying of the latter that the liability to tax of other parties was "highly speculative" and lacking any bearing on the question of the purpose of the arrangement. (at para 83). The Court concluded: "in reality there was no true business purpose to be achieved by the appellant in entering into the transaction other than to obtain the benefit of a deduction…of $570,080… which was to be offset by a tax free dividend receipt of $484,000" (at para 85). The Court considered this to be tax avoidance.

   An argument by the taxpayer that the Commissioner's use of section 99(3) to remove the deduction from the taxpayer was invalid because some other adjustment under section 99(4) had not been done was also rejected as the Court did not accept the adjustment contended for was necessary (at para 86).

Finally the Court took the opportunity to remind the TRA of the scope of its jurisdiction:

> "As we have said the function of the Authority was to hear and determine the objection disallowed by the Commissioner by conducting a fresh hearing into the matters raised in the objection, in which questions of validity as well as correctness of the assessment could be considered. But the Authority's role remained one which was concerned with the correctness of the assessment. It did not extend to conducting what was effectively a broad based judicial review of the process leading up to the Commissioner's assessment and disallowance of the objection and subsequent conduct of the proceeding before the Authority" (para 90).

A general overview of the distinction between judicial review and the statutory objection process was made (par 91 to 94) with the Court observing that the power to consider validity issues in the statutory process did not justify a "fishing expedition" into Department process and concluded:

> "In the course of the statutory procedure the administrative decisions of the Commissioner are challenged in a manner that enables the correct decision on the taxpayer's liability to prevail, if necessary through the appeal process. In the end, if it is determined that the taxpayer was initially assessed by a genuine exercise of judgment as to the assessable income and, ultimately, was correctly assessed, the respective principles underlying the statutory review scheme and judicial review are in harmony. Importantly, as well, the integrity of the tax system in the eyes of the public is maintained" (at para 94).

MORTGAGEE SALES

Case: Christchurch Readymix Concrete Ltd v Rob Mitchell Builder Ltd (in liquidation)

Decision date: 17 December 2001

Act: Goods and Services Tax Act

Keywords: GST liquidation mortgagee debt agency

Summary

The Court held that the proceeds of the sale of property by a mortgaged registered person, which is commenced by the mortgagee and completed by a liquidator, are to be paid to the mortgagee, minus costs of sale. GST is not a cost of sale in such circumstances as section 42 of the GST Act gives it a specific ranking.

Facts

The liquidators of the defendant company, Rob Mitchell Builders Ltd ("RMB") applied to the court for directions as to the ownership of the balance of proceeds of sale of a property at Taylors Mistake Rd, Christchurch ("the property"). The Commissioner was invited by the court to be heard in the proceedings and elected to do so.

RMB was a registered person carrying on business as a builder. The property was owned by RMB and accounted for in its financial records as stock. By agreement for sale and purchase dated 27 February 2002, RMB agreed to sell the property for $430,000 incl. GST. The agreement became unconditional on 2 April 2002 and a deposit was paid by the purchaser and applied for the benefit of the company.

On 15 April 2002, RMB was placed in liquidation by the plaintiff (who took no part in the proceedings). The sale was settled on 1 May 2002, with the mortgagee giving a discharge of first mortgage to allow the sale to proceed. Insufficient funds were available from the settlement to repay both the first mortgagee and the GST component of the sale. The liquidators considered they had an obligation to account for GST to the CIR whereas the bank considered the entire proceeds after real estate agents costs, solicitors' costs and rates, to be due to the bank. The GST of $47,777 was held in trust by agreement between the parties to allow settlement to proceed. The liquidators then brought these proceedings under section 284 of the Companies Act 1993.

Decision

The bank argued that as the agreement became unconditional and a deposit was paid prior to liquidation, the supply is deemed by the GST Act to have been made by RMB, with the liquidators merely effecting settlement. As such, the liquidators were not liable to pay GST on the sale (section 58 (1D) GST Act) and the bank was entitled to apply the entire proceeds of sale in repayment of its mortgage.

The Commissioner argued that the obligation to pay GST (as opposed to when the liability arises) occurs at the end of a taxable period, in this case, the date of liquidation. As however, the matter was then in the hands of the liquidators, the supply could not continue until the liquidator so decided. Upon liquidation, a company's secured creditors have three options under section 305 Companies Act 1993:

- realise the property
- value it and claim in liquidation for the balance due, or
- surrender it for the benefit of all creditors and claim in liquidation for the debt.

The bank made no claim in liquidation and the Commissioner submitted that it had therefore realised the property by agency of the liquidator. It was submitted that, as such, the supply is deemed to be by the principal, and the bank or the liquidators were required to file a return under section 17(1) GST Act.

Venning J reviewed the scheme of the GST Act carefully, noting that:

- GST is a statutory liability that accrues pursuant to the Act.
- GST is not a portion of the price, but is calculated by reference to that price.
- GST is not a sum held in trust, but is a debt due to the Crown.
- A GST debt owed by a company in liquidation has a priority set by the Seventh Schedule to the Companies Act 1993 ("the Seventh Schedule").

His Honour dismissed the Commissioner's argument that, but for the liquidation, RMB would have accounted for GST to the Commissioner and only the balance of the proceeds would have been available to the bank. He noted that the bank was always entitled to full repayment and that, in practice, had the bank not provided the necessary discharge to allow the sale to proceed, settlement would not have occurred and "there would have been no money payable to the Commissioner for GST".

His Honour also rejected the Commissioner's argument that the liability to pay the GST did not arise until the end of the GST period:

> "Although the amount of tax payable for the period could not be calculated until the end of the period, the liability to pay GST in respect of the sale of the Taylors Mistake property arose on the [deemed] supply of the goods, which occurred on 3 April 2002." [prior to the liquidation]

The crux of the Court's decision was the finding that the liquidators were not acting as the bank's agent in completing the sale. At the point of liquidation, equity in the property had passed to the purchasers and the company was left with bare legal title and an interest in personalty. This meant that the liquidator was from that point on only responsible for the GST on supplies made after the date of liquidation (section 58(1D)) and as the supply in dispute was prior to the liquidation, it became a GST debt caught by the ranking provisions of section 42 of the GST Act.

The Commissioner's argument that the GST was also a necessary disbursement of the liquidators was dismissed in like fashion. The Commissioner relied on the House of Lords decision *Re Toshoku Finance UK plc (in liq)* [2002] 1 WLR 671 (HL), as being analogous to the present matter. His Honour noted the distinguishing feature as being that the corporation tax at issue in *Toshoku* "…was not specifically included in the relevant statutory list of claims to be paid in priority." GST on the other hand is given a post-liquidation ranking by section 42(2)(b) in accordance with the Seventh Schedule.

Having found that the sale was made by the mortgagor pre-liquidation, the section 104 LTA "expense occasioned by sale" argument was also dismissed as it related only to sales made by or on behalf of a mortgagee. Similarly, the recent decision of the Court of Appeal in *Edgewater Motels* was not relevant.

REGULAR FEATURES

DUE DATES REMINDER

February 2003

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

7 End-of-year income tax

7 February 2003, 2002 end-of-year income tax due for people and organisations with a March balance date and who do not have an agent

20 Employer deductions

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

28 GST and return payment due

March 2003

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

7 Provisional tax instalments due for people and organisations with a March balance date

20 Employer deductions

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

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

Employer deductions and employer monthly schedule

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

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

31 GST and return 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 standard practice statement	*Comment deadline*
☐	ED0037: Income equalisation deposits and refunds	14 February 2003

	Draft statement of policy withdrawal and revised interpretation	*Comment deadline*
☐	COR0050: Time limits for new companies to make QC elections—where EOT arrangements with tax agents exist	28 February 2003

	Draft public ruling	*Comment deadline*
☐	XPB0007: Tertiary student association fees	28 February 2003

Items are not generally available once the comment deadline has passed

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