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NEW LEGISLATION

TAX EFFECTS OF THE REMUNERATION AUTHORITY (MEMBERS OF PARLIAMENT) AMENDMENT ACT 2002

Introduction

The legislation governing the tax treatment of the remuneration of members of Parliament has been amended as a result of the Remuneration Authority (Members of Parliament) Amendment Act 2002, which was enacted on 18 December 2002. The Act itself arose from recommendations made in recent reviews of members' remuneration and expenses, and sets out rules for their administration and clarifies their tax treatment. It has also made minor amendments to clarify members' employment status for taxation purposes.

Background

The Remuneration Authority (Members of Parliament) Amendment Bill was introduced into Parliament on 11 June 2002.

Certain benefits to be subject to fringe benefit tax

During its passage through Parliament, the bill was amended to provide that the private use or enjoyment component of services provided to members in relation to travel, accommodation, attendance or communications would be made subject to fringe benefit tax.

Remedial amendments

In 1998 the Income Tax Act 1994 was amended to ensure that remuneration and expenses paid to members of Parliament would receive the same tax treatment as similar payments made to employees. The Remuneration Authority (Members of Parliament) Amendment Act 2002 has amended the changes introduced in 1998, in order to further clarify this intended policy.

Key features

Certain benefits to be subject to fringe benefit tax

The Income Tax Act 1994 has been amended to provide that the private element of services provided to members for travel, accommodation, attendance or communications is subject to fringe benefit tax. This treatment will apply irrespective of whether the services are provided to the member direct, or by way of a cash payment to reimburse the member for expenditure incurred.

The definition of "fringe benefit" contained in section CI 1 has been extended to include these services, thereby rendering them subject to fringe benefit tax. They have also been included within the list of exempt public office income contained in section CB 7, to ensure that they are not also subject to income tax.

Remedial amendments

The Income Tax Act 1994 has been amended to clarify the policy intent that members are to receive the same tax treatment as employees in relation to income derived from their office.

The changes amend the definitions of "salary or wages" and "employment" contained in section OB 1 of the Income Tax Act 1994. The definition of "salary or wages" has been extended to include payments of salary or allowances made to members. The definition of "employment" has been extended to include the activities of a Member of Parliament which give rise to an entitlement to the receipt of a source deduction payment. A consequential amendment removes members from the section OB 1 definition of "specified office holder".

Application dates

The fringe benefit tax amendments to sections CB 7 and CI 1 of the Income Tax Act 1994 apply from 1 April 2003, the date of effect of the Remuneration Authority (Members of Parliament) Amendment Act 2002.

The remedial amendments to section OB 1 of the Income Tax Act 1994 apply from 1 April 2002.

STUDENT LOAN SCHEME – INTEREST RATES FOR 2003-04

The total Student Loan Scheme interest rate for the 2003-04 income year will remain at 7.0%.

The total interest rate has two components—the base interest rate and the interest adjustment rate. These are 5.1% and 1.9% respectively for the 2002-03 income year. From 1 April 2003 the base interest rate will decrease to 4.2% and the interest adjustment rate will increase to 2.8%.

Student Loan Scheme (Interest Rates) Regulations 2003

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.

CLARIFICATION OF STANDARD PRACTICE STATEMENT IR – SPS RDC 620 – WRITING OFF TAX DEBT REDUCTION OF NET LOSSES WHEN WRITING OFF A DEBT

Standard Practice Statement IR-SPS RDC 620—Writing off tax debt, originally published in *Tax Information Bulletin* Vol 14, No. 11 (November 2002), states the Commissioner's practice in relation to writing off tax debts.

Section 177C(5) of the Tax Administration Act 1994 provides that if the Commissioner writes off a debt for a taxpayer who has a net loss, all or part of the net loss must be extinguished by dividing the amount written off by 33% and reducing the net loss by that amount.

IR-SPS RDC 620 states "If an amount is written off and the taxpayer has tax losses, all or part of the net loss will be reduced by the amount of the write-off grossed up by 33%". It has been brought to our attention that the above wording may lead to an incorrect calculation of the amount of loss reduction. For example: If the amount written off was $100,000 and this was multiplied by 33% this would result in a loss reduction figure of $133,000. In this scenario, the correct calculation is $100,000 divided by 33% giving a correct loss reduction of $303,303.30.

It is possible for this calculation to result in the amount of loss reduction being higher than the current net loss. In this situation, the net loss is to be extinguished in accordance with section 177C(5).

Standard Practice Statement RDC 620 will continue to apply until such time as it is withdrawn.

LEGISLATION AND DETERMINATIONS

This section of the TIB covers items such as recent tax legislation, accrual and depreciation determinations, livestock values and changes in FBT and GST interest rates.

LIVESTOCK VALUES – 2003 NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK

The Commissioner of Inland Revenue has released a determination, reproduced over the page, setting the national standard costs for specified livestock for the 2002/2003 income year.

These costs are used by livestock owners as part of the calculation of the value of livestock on hand at the end of the income year, where they have adopted the national standard costs (NSC) scheme to value any class of livestock.

Farmers using the scheme apply the one-year NSC to stock bred on the farm each year, and add the rising two-year NSC to the value of the opening young stock available to come through into the mature inventory group at year-end. Livestock purchases are also factored into the valuation of the immature and mature groupings at year-end, so as to arrive at a valuation reflecting the enterprise's own balance of farm bred and externally purchased animals.

NSCs are developed from the national average costs of production for each type of livestock farming based on independent survey data. Only direct costs of breeding rearing rising one- and two-year livestock are taken into account. These exclude all costs of owning (leasing) and operating the farm business, overhead costs of operating non-livestock enterprises (such as cropping) and costs associated with producing and harvesting dual products (wool, fibre, milk and velvet).

For bobby calves, information from spring 2002 is used while other dairy NSCs are based on survey data for the year ended 30 June 2002. For sheep, beef cattle, deer and goats, NSCs are based on survey data for the year ended 30 June 2001 which is the most recent available for those livestock types at the time the NSCs are calculated.

The NSCs calculated for the year ended 31 March 2003 have increased for most livestock classes, with the main exceptions to this being the NSC for rising two-year dairy cattle which fell marginally, and the NSC for purchased bobby calves which fell by 13% due to the significant reduction in the cost of milk-based feed in spring 2002.

Total expenditure on most farm types increased in the survey year on which the NSCs are based. The increase in costs is mainly a result of improved incomes permitting additional expenditure. While much of this expenditure increase is aimed at producing more of the dual products (particularly milk), and is consequently excluded from the NSCs calculated, some of the increase in costs flow to the higher average cost of producing livestock.

The new NSCs struck each year only apply to that year's immature and maturing livestock. Mature livestock valued under this scheme effectively retain their historic NSCs until they die or are sold, albeit through a first in, first out (FIFO) or inventory averaging system as opposed to individual livestock tracing.

One-off movements in expenditure items are effectively smoothed within the mature inventory grouping, by the averaging of that year's intake value with the carried forward values of the surviving livestock in that grouping. For the farm-bred component of the immature inventory group, the NSC values will appropriately reflect changes in the costs of those livestock in that particular year.

The NSC scheme is only one option under the current livestock valuation regime. The other options are market value, the herd scheme and the self-assessed cost (SAC) option. SAC is calculated on the same basis as the NSC but uses a farmer's own costs rather than the national average costs.

NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK DETERMINATION 2003

This determination may be cited as "The National Standard Costs for Specified Livestock Determination, 2003".

This determination is made in terms of section EL 3A of the Income Tax Act 1994. It shall apply to any specified livestock on hand at the end of the 2002-2003 income year where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EL 3A of the Income Tax Act 1994 the national standard costs for specified livestock, for the 2002-2003 income year, are as set out in the following table.

Kind of livestock	Category of livestock	National standard cost $
Sheep	Rising 1 year	21.50
	Rising 2 year	13.90
Dairy cattle	Purchased bobby calves	143.00
	Rising 1 year	612.00
	Rising 2 year	97.10
Beef cattle	Rising 1 year	202.00
	Rising 2 year	117.00
	Rising 3 year male non-breeding cattle (all breeds)	117.00
Deer	Rising 1 year	64.40
	Rising 2 year	32.50
Goats (meat and fibre)	Rising 1 year	16.30
	Rising 2 year	11.20
Goats (dairy)	Rising 1 year	96.90
	Rising 2 year	15.80
Pigs	Weaners to 10 weeks of age	83.40
	Growing pigs 10 to 17 weeks of age	65.70

This determination is signed by me on the 30th day of January 2003.

Martin Smith
General Manager (Adjudication & Rulings)

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

GENERAL DEPRECIATION DETERMINATION DEP49

In *Tax Information Bulletin* Volume 14, No 12 (December 2002) on page 50 we published a draft general determination proposing the setting of general depreciation rates for compact disc players, digital versatile disc players, and related assets.

We received three submissions on the draft. No submission raised an issue on the proposed rates. However, one submission suggested that compact disc recorders and digital versatile disc recorders should also be included in the determination. After careful consideration, we have decided that due to the nature of these assets they should be the subject of a separate determination.

The general depreciation determination inserts 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. The determination also inserts new asset classes into the "Hotels, Motels, Restaurants, Cafes, Taverns and Takeaway Bars" and "Residential Rental Property Chattels" industry categories.

The general determination is reproduced here. The 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 DEP49

This determination may be cited as "Determination DEP49: Tax Depreciation Rates General Determination Number 49".

1. Application

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

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 below:

Audio and Video Recording Studios and Professional Photography	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Digital versatile disc players (DVD players)	5	33	24
Digital versatile discs (DVDs)	2	63.5	63.5
Video cassette recorders and/or players (VCRs)	5	33	24
Video game players	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 players	5	33	24
Digital versatile disc players (DVD players)	5	33	24
Digital versatile discs (DVDs)	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 players	2	63.5	63.5
Compact discs	1	100	100
Digital versatile disc players (DVD players)	2	63.5	63.5
Digital versatile discs (DVDs)	1	100	100
Video cassette recorders and/or players (VCR)	2	63.5	63.5
Video game players	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 rate (%)	SL equivalent banded dep'n rate (%)
Compact disc players	5	33	24
Digital versatile disc players (DVD players)	5	33	24
Video game players	3	50	40
Digital versatile discs (DVDs)	2	63.5	63.5
Video game discs	1	100	100
Compact discs	1	100	100

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 27th day of February 2003.

Martin Smith

General Manager (Adjudication and 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.

TAXPAYER "PERSON AFFECTED" BY TAX AVOIDANCE ARRANGEMENT; CIR'S ASSESSMENTS UPHELD

Case: CIR v Peterson and Peterson v CIR

Decision date: 19 February 2003

Act: Income Tax Act 1976

Keywords: "person affected"

Summary

The taxpayer was a person affected by a tax avoidance arrangement and his tax affairs could be reconstituted under section 99. It was irrelevant that he did not know the extent of the tax avoidance arrangement and that he was not one of the persons in the required "meeting of minds" necessary to constitute an arrangement.

Facts

These were cases taken by the taxpayer in relation to two film investments made in the 1980s. The films were "Lie of the Land" and "Utu". In both cases the Commissioner concluded that the expenses of the films were inflated by means of non-recourse loans and circular funding. This increased the depreciation deduction apparently available to the taxpayer but for which there was no actual liability as the circular funding had already repaid the loans. The Commissioner disallowed the depreciation deduction to the extent of the inflated expenses.

The taxpayer objected and the cases were heard at the TRA. The taxpayer won one (Lie of the Land) and the Commissioner the other. Both TRA decisions were appealed to the High Court where the taxpayer won one again and the Commissioner the other (see (2002) 20 NZTC 17,583 and 17,761). Both decisions were appealed.

The main issue was the proper application of section 99 ITA 1976 to the taxpayer. The taxpayer argued that as he was not part of the "meeting of minds" necessary for an arrangement under section 99 (the test from *BNZI* [2002] 1 NZLR 450) then section 99 could not be applied to him. Further it was argued that the taxpayer entered a fixed price contract and this was the cost to him of the investment regardless of what consequently occurred outside his knowledge.

The Commissioner argued that section 99 could be applied to the taxpayer as there was an arrangement meeting the *BNZI* test even though the taxpayer was not one of those involved in the necessary "meeting of minds" and he was a "person affected by that arrangement" (per section 99(3)). The Commissioner also placed weight upon the phrase "whether or not any person affected by that arrangement is a party thereto" (section 99(2)).

Decision

The Court considered the Commissioner had acted correctly by adjusting the assessments.

The bulk of the reasoning is in *CIR v Peterson* which is summarised below.

The Court distinguished these cases from *BNZI* by noting the Commissioner's argument "is that because of the inclusion at the end of subsection (2) of the phrase "whether or not any person affected by that arrangement is a party thereto" and subsection (3) empowers the Commissioner to adjust the assessable income of "any person affected", the adjustment to the assessable income of the taxpayer … was not erroneous" whereas the Commissioner's argument in *BNZI* was that BNZI was a party with knowledge to the arrangement (paragraph 29-30).

The Court considered that as the loan had been repaid (via the circular funding) the TRA and the High Court had erred by not focussing on the repayment: "Plainly the correct focus must be on whether the loan was repaid, not on what the taxpayer knew" (paragraph 33). The Court considered that as the loan had been repaid the deductions were not available regardless of section 99 (paragraph 34).

The Court turned to consider section 99. It was satisfied there was an arrangement (pointing out the architect of the arrangement had the necessary mutuality in his differing capacities (paragraph 37), but went on to consider whether the section allowed the Commissioner to "adjust the taxable income of the taxpayer who was not a party to the arrangement and had no knowledge of it" (paragraph 38).

The Court referred to the following passage by Blanchard J in *BNZI*:

> "[175] As the principal judgment records paragraph [42], there are three successive inquiries. The first is as to the extent of the arrangement; the second is as to whether it has the purpose or effect of tax avoidance and the third, which arises only where the second is answered affirmatively, is as to the adjustment to be made to counteract the tax advantage. *The adjustment can be made against both a party to the arrangement and a person affected, who is not necessarily a party. But it can be made only where a tax advantage has been obtained "under that arrangement".* The Commissioner therefore cannot make an adjustment as against someone who is not a party merely because that person has received a payment subsequent to the operation of an arrangement but outside the arrangement…." (Emphasis added)

And commented on that paragraph:

> "First, it clearly recognises that an adjustment can be made to the assessable income of a person affected though not a party to the arrangement. Secondly, it reflects the Judge's view that BNZ Investments obtained any tax advantage not from or under the "downstream" tax avoidance arrangement, but by another "upstream" arrangement. In our case, however the tax advantage obtained by the taxpayer was derived directly from the very arrangement in which the loan funds were included in the cost to the partnership of the film." (paragraph 42)

It was recognised that deciding whether a tax advantage was derived from a tax avoidance arrangement was a matter of fact and degree:

> "There will be circumstances in which questions will be raised as to the degree of proximity necessary to qualify as a person affected for the purposes of section 99(3). This will be another aspect of line drawing… so as to distinguish between a tax advantage that may legitimately retained and one that is vulnerable to adjustment. But we do not see…this case…as even approaching the line." (paragraph 44)

The argument advanced by the taxpayer that he had a fixed price contract and had paid that price so he was entitled to a deduction was dismissed. In support of this the taxpayer relied upon *Cecil Bros* (1964) 111CLR 430 and *Europa Oil* [1976] 1 NZLR 546, 556. The Court considered the argument was essentially that the Commissioner could not "second guess" the value of services provided and said that the Commissioner was not precluded from declining to recognise costs not truly incurred. As such the cases referred did not apply (paragraph 46).

Peterson v CIR largely followed the reasons in the companion case. However in this case the non-recourse loans were entirely fictitious (paragraph 4, and did not occur at all, as opposed to the circular funding in the other case). The Court again said the costs not truly incurred should not be deduced (notwithstanding section 99) but regardless of that view section 99 applied again. (paragraph 13). Even if the loans had been incurred, section 99 would apply as the loans were repaid so liability (if any) was extinguished (paragraphs 13, 15).

ANOTHER CASE TRANSFERRED FROM THE TRA TO THE HIGH COURT

Case: CIR v D H McIlraith

Decision date: 19 February 2002

Act: Tax Administration Act 1994

Keywords: Transfer of proceedings, section 138N of the Tax Administration Act 1994

Summary

High Court grants Commissioner's application to have proceeding transferred from the TRA to the High Court.

Facts

In 2001 the respondent brought proceedings in the High Court against the Commissioner challenging an assessment for the 1996 year, and seeking judicial review and compensation under the NZ Bill of Rights Act.

In 2002 he brought proceedings in the TRA challenging an assessment for the 1997 year on very similar grounds, also alleging bias, abuse of power, and bad faith against IRD officers.

Because of the overlap between the issues in the two proceedings, the Commissioner applied to have the TRA proceeding transferred to the High Court and consolidated with the High Court case.

Decision

The Court held that the application was correctly brought under section 138N of the TAA which authorised it. It was a straightforward procedural application not requiring a statement of claim.

The Court found that the application should be granted for two main reasons:

- The substantial overlap, legally and factually, between the proceedings as they related to the correctness of the assessments;
- The inappropriateness of the TRA as a forum for deciding serious allegations of bad faith and abuse of power.

The recent Court of Appeal decision in *Dandelion Investments Ltd v CIR* (CA204/01, 5 December 2002) determined that the TRA's role was concerned with the correctness of the assessment and "did not extend to conducting what was effectively a broad-based judicial review of the process leading up to the Commissioner's assessment …". The Court also referred to the criteria listed in the recent Court of Appeal decision in *CIR v Erris Promotions* (CA175/02, 7 November 2002), and discussed these briefly in relation to the present case.

The Court found that the respondent would not be prejudiced by the transfer and granted the application. The transfer was made conditional on preserving the respondent's strike out application of the TRA proceeding, although it was not accepted that the application had any merit. It was decided that the two proceedings should be heard together rather than consolidated.

DOCUMENTS NOT PREPARED WITH A DOMINANT PURPOSE OF LITIGATION

Case: Glenharrow Holdings v CIR

Decision date: 13 February 2003

Act: Tax Administration Act 1994

Keywords: Discovery, litigation privilege, legal professional privilege

Summary

The High Court held that litigation privilege did not apply to documents prepared by and for the Commissioner's experts prior to the issuing of the Commissioner's statement of position.

Facts

This was an interim interlocutory decision relating to the interaction between litigation privilege and legal professional privilege and the disputes process in Part IVA of the Tax Administration Act 1994. This is the second interlocutory decision relating to this taxpayer. The first is reported at *Glenharrow Holdings Ltd v CIR* (2002) 20 NZTC 17,792. In this dispute the plaintiff sought an order for discovery of all documents in respect of which the Commissioner had claimed litigation privilege, up to 6 December 2000 (the date the Commissioner issued his statement of position), on the basis that litigation was not reasonably in contemplation until after that date.

The plaintiff also made a similar claim in relation to documents the Commissioner contended were covered by legal professional privilege.

The Commissioner had instructed four experts prior to 6 December 2000. The Commissioner and each of the experts had produced a list of documents, all of which made claims of privilege.

The substantive issue relates to a disallowed input tax credit arising from the purchase of a mining licence.

Decision

Justice Panckhurst set out some of the legislation relating to the disputes resolution procedure, and a chronology of the facts. His Honour noted a potential conflict between the concept of litigation privilege and the "all cards on the table" philosophy of the disputes process. The Judge decided that it was not "necessary or appropriate to decide the privilege exclusion question with reference to Part IVA generally", but that the "appropriate course is to reach a decision tailored to these circumstances and not seek to determine the more general question."

Justice Panckhurst noted that the test for the availability of legal professional privilege was a two-step process. Firstly there is a threshold requirement that litigation must be in train or at least reasonably apprehended. Secondly the relevant document must be one which was prepared to enable legal advice to be received in relation to that litigation.

His Honour concluded that litigation was reasonably apprehended by December 2000. However, he did not accept the Commissioner's contention that the dominant purpose for which the relevant documents were prepared was to advise in relation to apprehended litigation. Rather, Panckhurst J considered that the dominant purpose must have been to enable the Commissioner to prepare and issue his statement of position, a statutory requirement. Litigation privilege was not available up to and including 6 December 2000.

In respect of solicitor-client privilege, Panckhurst J noted that the Commissioner had claimed the privilege in relation to a large number of documents. His Honour stated (paragraph [45]):

> "Many appear to be communications emanating from the Commissioner's legal advisors where a claim to legal professional privilege is unsurprising. In relation to these aspects of the claim to privilege I see no grounds to go behind the privilege claim made in the list itself, supported as it is by affidavit evidence."

However, in relation to solicitor-client privilege claims by the Commissioner's experts Panckhurst J indicated that he would like to inspect a sample of the documents to see whether privilege properly applied. His Honour ordered the parties to confer to see what documents should be provided to him to inspect. After such inspection a final judgment would be issued. The Commissioner is not appealing this decision.

TAXPAYER'S OBJECTION PROCEDURALLY FLAWED; TRA LACKS JURISDICTION TO DETERMINE OBJECTION.

Case: TRA 026/01 Decision 002/2003

Decision date: 30 January 2003

Act: Income Tax Act 1994
Tax Administration Act 1994
TRA Regulations 1994 and 1998

Keywords: Objection not disallowed, case stated request invalid, points of objection notice invalid, challenge proceedings

Summary

The taxpayer's case stated request was invalid as the objection had not been determined and it was not made in time. The taxpayer's points of objection notice (PON) was also invalid as it was not provided within the statutory time frame.

Facts

This was a J G Russell related matter. In 1996 assessments for the tax years 1985 to 1996 were issued. Those assessments relied upon sham as the basis of assessment although later section 99 ITA 1976 was added as a ground of assessment.

The taxpayer objected on 22 November 1996 however that objection has not been determined by the Commissioner.

Subsequently (20 November 2000) two notices of proposed adjustments (NOPAs) were issued covering the tax years 1985 to 2000 which relied on different bases of proposed reassessment. Those NOPAs expressly proposed to reverse the assessments made in 1996 and to replace them with new assessments. The taxpayer replied with two notices of response (NORs) expressly accepting the adjustment to cancel the 1996 assessments but rejecting the balance of the proposed adjustments. Since then one NOPA has been abandoned and the other has proceeded via a statement of response (SOP) to Adjudication.

The taxpayer purported to request a case be stated on 21 January 2002 (received by the Commissioner on 25 January 2002) using the NOPAs as the alleged determination of the objection. A (PON) dated 18 April 2001 was then received from the taxpayer at the Wellington Service Centre on 30 April 2001 (received by Litigation Management on 2 May 2001).

This case was focussed on the preliminary issues of whether the case could proceed given the objection had not been determined. The taxpayer argued that the NOPA in effect decided the objection and that triggered the right to request a case stated. The taxpayer also argued that the Commissioner had failed to file a timely case stated.

Decision

Barber J concluded that there was no jurisdiction for the case to continue:

> "It seems to me that there is no jurisdiction for this Case Stated to proceed because there has never been a disallowance of the objection. The issue and service of the NOPAs, which is all the objector could rely upon, did not trigger off an event permitting the objector to request that the objection be heard and determined by a Taxation Review Authority." (paragraph 42)

In those circumstances Barber J stayed the case. While he considered the case invalid as the objection was not determined he thought it "prudent" to leave it at the TRA Registry until the Adjudication process ended on the later NOPA and NOR (paragraph 50).

While his Honour considered the delay in addressing the objection "thoroughly unsatisfactory" he also recognised the difficulties in addressing the Russell template and the need for "care and thought due to extensive consequences" (paragraph 51).

He also rejected an allegation the Commissioner had failed to file a timely case stated. His Honour was taken through the various timeframes of the objection procedure and concluded that if the Commissioner's NOPA was a determination of the objection (which it was not) then:

- The request for a case stated was not notified to the Commissioner within the relevant statutory timeframe and the objection was at an end (paragraph 46 to 56). This was a timeframe the Authority had no jurisdiction to enlarge (paragraph 54). In considering this the Authority rejected the application of any deemed receipt by the Commissioner under the TRA Regulations or the District Courts Rules or the Postal Services Act 1998 (paragraphs 58 to 64).
- The PON was not timely and therefore invalid (paragraphs 66, 73).
- Using the PON date of receipt by the Commissioner the case stated (if it had been necessary: assuming the taxpayer's steps had been timely and valid) was received by the TRA within time (paragraph 66).

In concluding His Honour noted the probable invalidity of the assessments but concluded he lacked jurisdiction to deal with that issue but considered it moot anyway in light of the Disputes Resolution procedure that was underway (paragraph 76-78). Finally he reiterated his earlier call for a Commission of Inquiry into the Russell template (paragraph 84).

FUNDAMENTAL VARIATION

Case: TRA Decision 003/2003

Decision date: 26 February 2003

Act: Goods and Services Tax Act 1985

Keywords: Supply, cancellation, alteration, fundamental variation, contract, insolvency, liquidation, credit note

Summary

The Disputant entered contracts to buy land and claimed input credits in respect of the supplies. The vendor became insolvent and the mortgagees exercised their rights of sale. The contracts were not completed, neither were they expressly cancelled. The liquidator did not issue credit notes but the Commissioner considered the supplies to have been cancelled and reversed the input credits to the disputant. The TRA held that the Commissioner was entitled to do so.

Facts

The disputant, MHL, entered into contracts with KIL for the purchase of two townhouses. GST input tax claims were made for the full purchase price of each unit. Prior to settlement of the purchases, KIL went into liquidation, and the mortgagees exercised their powers of sale to sell the units to third parties. The department considered that the supplies had been cancelled. As a result, a dispute arose as to whether the taxpayer was required to account for the GST originally claimed as input tax. MHL ultimately did this in its GST return for the two-month period ended 29 February 2000.

MHL then issued a Notice of Proposed Adjustment proposing that the debit adjustment of $56,667.67 made in its GST return for the period ended 29 February 2000 was incorrect. The grounds for the adjustment proposed were that the contracts had not been cancelled as neither party to the contracts had served the notices required to cancel the contracts. The department disagreed with the adjustment proposed by the taxpayer, and the dispute proceeded to Adjudication.

The department accepted that MHL correctly claimed the original input tax credits on the payment of the deposits for the properties, having received tax invoices for both purchases. The department contended however, that because the supplies have been cancelled or fundamentally varied or altered, an adjustment is required under section 25 of the GST Act.

Evidence was given for the Commissioner by the department's investigator and the liquidator of KIL. An employee adviser of the disputant company gave evidence for the disputant.

Decision

The Authority reviewed the agreed facts and the evidence brought by the parties and concluded:

> "…in any event there cannot now be specific performance of the contracts. The most the disputant could hope for is damages for the vendor's breach and possibly a claim against the mortgagee. The vendor has ceased to exist. A claim against the mortgages might conceivably have included a claim for the GST but even if possible cannot alter the legal relationships between the Commissioner and the taxpayer. At best it could only indemnify the taxpayer from any claim the Commissioner may have."

And:

> "…it was open to the disputant to cancel the contracts when the vendor failed in its obligation to build the units. On the facts as I find them to be it failed to do so, and any rights to cancel it may have had under the Contractual Remedies Act has long since expired."

The Authority then reviewed the scope of section 25 of the GST Act and concluded that the provisions therein contemplated the situation before the court:

> "Because the agreements for sale and purchase to the knowledge of the disputant have been cancelled, the disputant therefore knows that the tax invoices issued to it by the vendor are "incorrect" for the purposes of section 25(4). The disputant has therefore made a "*deduction of an amount of input tax … to which that other knowledge … relates*" and therefore it is obliged to repay to the Commissioner the amount by which "*the input tax deducted exceeds the output tax properly charged*"."

He concluded by noting:

> "The fact the vendor company in liquidation did not issue a credit note and the liquidator refused to do so does not assist the disputant. In those circumstances the Commissioner is entitled to invoke section 25(3B). He was satisfied from the records available to him that there was a sale to the disputant which did not proceed and therefore a "*credit note is not required to be issued*". Section 25(3B) is clearly intended to break what would otherwise be a procedural impasse to the implementation of section 25, and was property invoked for the purpose in this case."

OTHER ITEMS OF INTEREST

STATEMENT OF POLICY WITHDRAWAL AND REVISED INTERPRETATION

Time limits for new companies to make qualifying company elections – where extension-of-time arrangements with tax agents exist – previous policy withdrawn

The Commissioner has reviewed the position on the time limits for new companies to make qualifying company or loss attributing qualifying company elections that will apply from the commencement of the company's first income year. The previous policy was set out at pages 4 to 6 of *Tax Information Bulletin (TIB)* Vol 6, No 13 (May 1995).

The legislative requirement for qualifying company elections is that they be filed for newly-formed companies within the time allowed by section 37 of the Tax Administration Act 1994 for filing a tax return if the election is to take effect on the first day of the company's first income year.

For taxpayers who do not have extension-of-time (EOT) arrangements for filing their tax returns through tax agents, this means that if a company's return is filed before 7 July, which is the last day for companies to file their tax returns if there are no extension-of-time arrangements, then shareholders and directors will still have until 7 July to file any QC elections. In cases where the company has a late balance date, the date for the filing of the return will differ from 7 July and it will be that date which will apply in place of 7 July.

This left some uncertainty, however, in relation to the required date for filing elections where taxpayers did have EOT arrangements in respect of tax returns—ie whether those elections had to be filed by the same time as the tax return or whether the taxpayer had until the end of the extension period of 31 March (or some other date that may be given pursuant to the Commissioner's discretion) to file the election even if the return had been filed at an earlier date.

The view taken in the 1995 statement was that after 7 July the election was required to be filed no later than the filing of the income tax return under those EOT arrangements. In other words, a post-7 July election filed subsequent to the filing of the income tax return was not accepted.

As a result of the review, the Commissioner no longer considers that the previous policy where a company is subject to an EOT arrangement correctly states the law. The previous policy (as set out in *TIB*, Vol 6, No 13, pages 5 and 6, under the heading "Last date for elections for newly-formed companies on an agency listing") is hereby formally withdrawn.

The Commissioner now considers that, on both the current and previous versions of section 37 of the Tax Administration Act 1994, in conjunction with the provisions of sections HG 3(3), HG 4(5), and HG 14(c) of the Income Tax Act 1994, the time allowed for filing elections is the same as the time permitted for the taxpayer to file an income tax return—regardless of whether or not the tax return is filed prior to the filing of elections. For taxpayers subject to a tax agent's EOT arrangement, this will generally be 31 March of the year following the income year to which the first income tax return relates.

Consistent with what was foreshadowed in the AGENTSanswers of March 2002, this revised interpretation will be applied from the 2001 and subsequent income years.

REGULAR FEATURES

DUE DATES REMINDER

April 2003

7 Employer deductions and employer monthly schedule

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

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

End-of-year income tax

7 April 2003, 2002 end-of-year income tax due for clients of agents with a March balance date

22 Employer deductions

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

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

Employer deductions and employer monthly schedule

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

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

30 GST and return payment due

May 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

20 Employer deductions

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

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

Employer deductions and employer monthly schedule

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

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

30 GST and return payment due

These dates are taken from Inland Revenue's Smart business tax due date calendar 2003 - 2004

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