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

TERTIARY STUDENT ASSOCIATION FEES

PUBLIC RULING – BR PUB 03/02

Note (not part of ruling): This ruling is a modified version of public ruling BR Pub 99/1 which was published in TIB Vol 11, No 1 (January 1999). Its period of application is from 1 April 2002 to 31 March 2005. BR Pub 99/1 applied up until 31 March 2002.

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

Taxation Laws

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

This Ruling applies in respect of section KC 5 of the Act.

The Arrangement to which this Ruling applies

The Arrangement is the payment by a student at a tertiary institution, of a tertiary student association fee as a membership fee to that tertiary student association.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The payment of a tertiary student association membership fee is not a gift for the purposes of section KC 5(4) where **any** rights arising from membership are conferred by the payment, and/or where the payment is compulsory. Accordingly, a rebate will not be available under section KC 5.

The period for which this Ruling applies

This Ruling will apply for the period 1 April 2002 to 31 March 2005.

This Ruling is signed by me on the 14th day of April 2003.

Martin Smith

General Manager (Adjudication & Rulings)

COMMENTARY ON PUBLIC RULING BR PUB 03/02

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in public ruling BR Pub 03/02 ("the Ruling").

For the purposes of this commentary, reference to "associations" includes reference to societies, institutions, associations, organisations, trusts or funds.

Background

Section KC 5 of the Income Tax Act 1994 ("the Act") provides a rebate to a donor of a gift of money in certain circumstances, where the recipient of the gift is a non-profit body whose funds are applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purpose(s) within New Zealand.

The issue dealt with in the Ruling is whether a tertiary student association membership fee is a "gift" within the meaning of section KC 5 of the Act.

The subject matter was previously dealt with in public ruling BR Pub 99/1, which expired on 31 March 2002. This public ruling replaces BR Pub 99/1, effective 1 April 2002. The previous ruling concluded that if a student pays a single fee to the student association to become a member of the student association, and the fee as a whole confers some rights on members, the payment is not a gift for the purposes of section KC 5(4). As the payment of the fee is not a gift, the student is not entitled to a rebate under section KC 5.

Legislation

Section KC 5 provides:

> (1) A taxpayer, other than an absentee or a company or a public authority or a Mäori Authority or an unincorporated body, or a trustee liable for income tax under sections HH 3 to HH 6, HK 14, and HZ 2, is allowed as a rebate of income tax the amount of any gift (not being a testamentary gift) of money of $5 or more made by the taxpayer in the income year to any of the following societies, institutions, associations, organisations, trusts, or funds (being in each case a society, an institution, an association, an organisation, a trust, or a fund in New Zealand), namely:
>
> (aa) A society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual and the funds of which are, in the opinion of the Commissioner, applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purposes within New Zealand:
>
> (ab) A public institution maintained exclusively for any one or more of the purposes within New Zealand specified in paragraph (aa):
>
> (ac) A fund established and maintained exclusively for the purpose of providing money for any one or more of the purposes within New Zealand specified in paragraph (aa), by a society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual:
>
> (ad) A public fund established and maintained exclusively for the purpose of providing money for any one or more of the purposes within New Zealand specified in paragraph (aa):
>
> (ae) - (bw) [provide a list of organisations.]
>
> (2) The rebates provided for in this section shall not, in the case of any taxpayer, in any income year exceed in the aggregate the smaller of—
>
> (a) $33^{1}/_{3}$% of the aggregate of all gifts described in subsection (1):
>
> (b) $500.
>
> (3) No rebate shall be allowed under this section in respect of any gift unless the taxpayer furnishes to the Commissioner in support of the taxpayer's claim for the rebate a receipt evidencing to the satisfaction of the Commissioner the making of the gift by the taxpayer.
>
> (3A) A refund may be made under this section only if section 41A of the Tax Administration Act 1994 is complied with.
>
> (3AA) Despite subsection (3), a rebate is allowed under this section if a tax agent makes an application for a refund under section 41A of the Tax Administration Act 1994 on behalf of a person and—
>
> (a) The tax agent sights the receipt evidencing the making of the gift for which a claim is being made; and
>
> (b) The person retains the receipt for 4 income years after the income year to which the claim relates.
>
> (4) In this section, "gift" includes a subscription paid to a society, institution, association, organisation, trust, or fund, only if the Commissioner is satisfied that the subscription does not confer any rights arising from membership in that or any other society, institution, association, organisation, trust, or fund.

Application of the Legislation

Under section KC 5, a taxpayer other than an absentee, company, public authority, Mäori authority, unincorporated body, or trustee liable for income tax (sections HH 3 to HH 6, HK 14, HZ 2), can claim a rebate if:

- that person makes a gift (not being a testamentary gift) of money of $5 or more;

- the gift is made to any of the associations listed in section KC 5(1);
- the recipient, in the opinion of the Commissioner of Inland Revenue ("the Commissioner"), applies its funds wholly or principally for charitable, benevolent, philanthropic, or cultural purposes, or is maintained (subparagraphs (ab) and (ac)) or established and maintained exclusively for one or more of those purposes (subparagraph (ad));
- the taxpayer furnishes to the Commissioner a receipt evidencing the making of the gift by the taxpayer to the recipient, or a tax agent makes the refund application on behalf of the taxpayer and the requirements of section KC 5(3AA) are satisfied; and
- section 41A of the Tax Administration Act 1994 is complied with.

Furthermore, if the gift is a subscription paid to any association specified in section KC 5(4), the Commissioner must be satisfied that the subscription does not confer any rights arising from membership in that or any other association.

Tertiary student association fees are considered "subscriptions" for the purposes of section KC 5(4), as students receive the services provided by the student association, and the rights attaching to membership of that association in return for the fee, or can be said to be applying to participate in the association. As such, **any** rights arising from membership, which are conferred by the payment of a tertiary student association fee, will preclude such fee from the definition of "gift" in section KC 5(4), and accordingly no rebate will be available under section KC 5.

The definition of "gift" in section KC 5(4)

Section KC 5(4) operates as an exhaustive provision with respect to when subscriptions will constitute "gifts" for the purposes of section KC 5, and includes only subscriptions paid to an association if the Commissioner is satisfied that the subscription does not confer any rights arising from membership in that or any other association.

In *Case M128* (1990) 12 NZTC 2,825, the Taxation Review Authority ("the Authority") noted that the Commissioner had allowed the general school activity fee paid to state schools as a deduction, because such fees came within the expanded definition of "gift". However, the Authority held that payments to a school for camp fees, a school trip, stationery, and a manual were not gifts, as they conferred particular rights on the pupil.

Tertiary student association fees will only be a "gift" for the purposes of section KC 5(4), and will only qualify for a rebate, if the Commissioner is satisfied that the payment does not confer **any** rights arising from membership. Such rights may include things such as rights to do anything, receive anything, or have access to anything in return for the payment. If no rights are received, the payment of a subscription is considered to be in the nature of a donation, because the payer does not get any direct rights in return for the payment. The requirement that a subscription confer no rights does not contain words of apportionment (ie "to the extent to which"), but is absolute in its terms. Accordingly, if any rights are conferred by any part of the subscription, section KC 5 does not apply, and no rebate is available. It should be noted that section KC 5(4) refers only to rights being conferred: the rights do not have to be exercised or enjoyed by the taxpayer.

Students attending tertiary institutions may pay a sum for membership of a student association or union. Tertiary student association fees will commonly give rise to the following types of rights or benefits:

- Access to advice, welfare, and counselling services.
- Access to liaison services between students and teaching staff.
- Access to newsletters and other information.
- Access to facilities on campus, such as library, health, or sport and recreation facilities.
- Discounts on various goods and services.
- Voting rights in respect of the election of association executives, and also at general meetings.

In addition, it may also be that the payment of a student association fee (or a substitute payment to a charity of the student's choice)[1] is one of a number of payments a student must make, or things a student must do, in order to qualify for enrolment at the particular tertiary institution. The payment of a student association fee may, therefore, confer a further right on students—the right to enrolment if the other conditions of enrolment are met.

Any of the above, or any other rights arising from membership, which are conferred by the payment of a tertiary student association fee will preclude such a fee from the definition of "gift" in section KC 5(4), and accordingly no rebate will be available under section KC 5.

[1] The Education Act 1989 provides that a student association may exempt any student from membership of the association on the grounds of conscientious objection; and, if exempted, the association must pay the student's membership fee to a charity of its choice.

The Education (Tertiary Students Association Voluntary Membership) Amendment Act 1998 ("the 1998 EAA"), which came into force on 11 August 1998, abolished compulsory student association membership, except where a referendum of students at an institution determined that membership of the association at that institution would be compulsory.

The 1998 EAA was subsequently repealed, from 8 July 2000, by the Education Amendment Act 2000 ("the 2000 EAA"). The 2000 EAA also inserted new provisions into the Education Act 1989, to the effect that tertiary student association membership is now *prima facie* compulsory, with the ability for a vote of all students at a particular institution to make membership of that association voluntary.

Where tertiary student association fees are voluntary, it may well be that some or all of the services listed earlier are available to all students, whether paying association members or not. However, students who pay association fees may also be accorded the right to vote to elect association executives, and at general meetings. Further, students who pay association fees may have access to discounts not available to non-paying students. As stated earlier, **any** rights arising from association membership, which are conferred by the payment of a tertiary student association fee will preclude such a fee from the definition of "gift" in section KC 5(4), and accordingly no rebate will be available under section KC 5.

Where tertiary student association fees are voluntary, it may be that there are in fact **no** rights arising from membership in that or any other association, conferred upon students who elect to pay association fees. It is only in this circumstance that the payment of such fees will constitute a gift within the meaning in section KC 5(4), and a rebate will be allowable accordingly, provided the other criteria of section KC 5 are satisfied. **Any** right conferred by the payment of student association fees will be sufficient to prevent the rebate from being available.

It should be emphasised that it will **only** be in the very limited circumstances detailed above that a rebate will be available.

In the event that there are in fact no rights arising from membership in a tertiary student association with compulsory fees, the payment of such fees will also not be considered a gift for the purposes of section KC 5(4), as it would fail to meet the fundamental precept that a gift must be something transferred **voluntarily**, and not as a result of a contractual or other obligation to transfer it[2]. Given that section KC 5(4) operates to **extend** the definition of the term "gift" to include certain subscriptions, the general common law requirement for a gift to be voluntary remains applicable, and it is only the common law consideration of whether any advantage or benefit of **material character** is received in return, which is modified by section KC 5(4).

Example 1

A student enrols at a university, the student association of which has compulsory membership. The student pays the association fees, and is able to use the gym facilities, counselling services, and the subsidised health care programme. The student association has charitable status.

As the payment of the student association fees confers certain rights upon the student, the payment does not qualify for a rebate as a donation to the student association.

However, if a person who is not a student makes a donation to the student association at the university and no rights are conferred because of the payment, a gift is made and a rebate is allowed.

Example 2

A student enrols at a polytechnic, the student association of which has voluntary membership. The student believes in and wishes to support the work of the association, and so elects to pay the association fees. The services provided by the association are available to all students at the polytechnic, regardless of whether they are paying members or not. No discounts are available to students who have contributed association fees. The association's Constitution deems all students at the polytechnic to be "members", and accordingly able to exercise all membership rights, for instance the right to vote at general meetings. The student association has charitable status.

As the payment of the student association fee does not confer **any** rights upon the student, a rebate will be available, provided the other criteria set out in section KC 5 are satisfied (these criteria are listed under the heading "Application of the Legislation", on page 5).

[2] In this regard, see for instance *Mills v Dowdall* [1983] NZLR 154, *Federal Commissioner of Taxation v McPhail* (1968) 117 CLR 111, *Lawson Klopper & Anor v Deputy Commissioner of Taxation* (1997) 97 ATC 4179, *Hodges v FC of T* (1997) 97 ATC 2158, *Australian Dairy Corporation v FC of T* (1998) 98 ATC 2059, and *Case J76* (1987) 9 NZTC 1,451.

ADVERTISING SPACE AND ADVERTISING TIME SUPPLIED TO NON-RESIDENTS—GST TREATMENT

PUBLIC RULING – BR PUB 03/03

Note (not part of ruling): This ruling replaces public ruling BR Pub 00/06, published in *Tax Information Bulletin* Vol 12, No 8 (August 2000) due to amendments to the Goods and Services Tax Act 1985. BR Pub 00/06 applied up until 30 November 2004. This ruling is essentially the same as BR Pub 00/06; however it addresses section renumbering and an amendment to the wording of the new section.

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

Taxation Laws

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

This Ruling applies in respect of section 11A(1)(k).

The Arrangement to which this Ruling applies

The Arrangement is the contractual supply of advertising space in a publication, or the supply of advertising time on radio or television (or other broadcasting service), by a GST-registered person to a non-resident person who is outside New Zealand at the time the services are performed.

For the purposes of this Ruling the supply of advertising space or advertising time means the service of communicating an advertising message, and includes all steps involved in providing this service by the supplier of the advertising space or time.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The contractually supplied service of providing advertising space in a publication or advertising time on radio or television (or other broadcasting service), to a non-resident who is outside New Zealand at the time the service is performed, is not supplied "directly in connection with" any land (or improvement thereto) or moveable personal property situated in New Zealand. Section 11A(1)(k) will apply to zero-rate the supply of services, provided that all the other requirements of section 11A(1)(k) are satisfied.

The period for which this Ruling applies

This Ruling will apply from 10 October 2000 for an indefinite period.

This Ruling is signed by me on the 28th day of April 2003.

Martin Smith

General Manager (Adjudication & Rulings)

COMMENTARY ON PUBLIC RULING BR PUB 03/03

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 03/03 ("this Ruling").

The majority of the subject matter covered in this Ruling was previously dealt with by BR Pub 00/06 that appeared in TIB Vol 12, No 8 (August 2000), at page 13. This Ruling applies from 10 October 2000 for an indefinite period.

Background

This public ruling considers the application of section 11A(1)(k) to advertising supplied to non-residents. New section 11A(1)(k) was introduced to replace the previous section 11(2)(e) regarding the zero-rating of services supplied to non-residents. Section 11A(1)(k) is almost identical to the previous provision except the words "for and" have been omitted from the phrase "services are supplied for and to a person who is not resident in New Zealand". Section 11A(2) replaces section 11(2A) with identical wording regarding the receipt of those services in New Zealand. Section 11A(3) replaces section 11(2B) with identical wording regarding the meaning of "outside New Zealand". The amended legislation came into force on 10 October 2000, the date from which this ruling applies. This commentary is designed to clarify the impact of the altered legislation in the context of cases decided under the previous legislation.

Legislation

Section 11A of the Goods and Services Tax Act 1985 is as follows:

(1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

……

(k) subject to subsection (2), the services are supplied to a person who is not resident in New Zealand and who is outside New Zealand at the time the services are performed, not being services which are—

(i) supplied directly in connection with—

(A) land situated in New Zealand or any improvement to the land; or

(B) moveable personal property, other than choses in action or goods to which paragraph (h) or (i) applies, situated in New Zealand at the time the services are performed; or

(ii) the acceptance of an obligation to refrain from carrying on a taxable activity, to the extent that the activity would have occurred within New Zealand; or

……

(2) Subsection (1)(k) and (1)(l) do not apply to a supply of services under an agreement that is entered into, whether directly or indirectly, with a person (person A) who is not resident in New Zealand if—

(a) the performance of the services is, or it is reasonably foreseeable at the time the agreement is entered into that the performance of the services will be, received in New Zealand by another person (person B), including—

(i) an employee of person A; or

(ii) if person A is a company, a director of the company; and

(b) it is reasonably foreseeable, at the time the agreement is entered into, that person B will not receive the performance of the services in the course of making taxable or exempt supplies.

(3) For the purpose of subsection (1)(k), (1)(l) and (1)(ma) and subsection (1)(n) as modified by subsection (4)(b), outside New Zealand, for a company or an unincorporated body that is not resident, includes a minor presence in New Zealand, or a presence that is not effectively connected with the supply.

…

Section 60 sets out the GST agency provisions. Section 60(2) states:

Subject to this section, for the purposes of this Act, where any registered person makes a taxable supply of goods and services to an agent who is acting on behalf of another person who is the principal for the purposes of that supply, that supply shall be deemed to be made to that principal and not to that agent:…

Application of the Legislation

The key features of section 11A(1)(k) are the phrases "services are supplied to a person who is not resident in New Zealand" and "directly in connection with".

"Services are supplied to a person who is not resident in New Zealand"

Section 11A(1)(k) omitted the words "for and" from the legislation which now reads "services are supplied to a person who is not resident in New Zealand". In *Wilson & Horton* v *CIR* (1995) 17 NZTC 12,325 the Court of Appeal held that the word "for" did not mean "beneficially for" and was only used to emphasise the word "to" as being "contractually to". Section 11A(1)(k) omitted the word "for" from the legislation as it was not required to interpret or emphasise "to" as being "contractually to". The purpose of this amendment was not to change the established meaning of the word "to" in this context nor was it to override the existing law. "To" continues to mean "contractually to". An important factor supporting this conclusion is the enactment of section 11A(2). The purpose of section 11A(2) is to protect the integrity of the tax base by ensuring that domestic consumption of services is subject to GST, even though a non-resident may have purchased the services. An example is where New Zealand educational institutions contract with non-residents to provide education for the non-resident's children in New Zealand. The section operates to ensure supplies of this type are standard rated for GST purposes. If a third party benefiting from these types of services was intended to be caught under section 11A(1)(k) then the enactment of section 11A(2) would have been unnecessary.

The following is an analysis of the cases considering the interpretation of section 11(2)(e) which is now section 11A(1)(k). As explained earlier the interpretation of section 11A(1)(k) is identical to that of the previous section 11(2)(e) as the removal of the words "for and" do not impact on the previous interpretation as set out below.

"For and to"

The Court of Appeal in *Wilson & Horton* rejected the High Court's interpretation of "for" in section 11(2)(e), as meaning "beneficially for" and held that the supply of the publication of advertisements by Wilson & Horton to non-resident clients qualified for zero-rating under the former section 11(2)(e), irrespective of whether a New Zealand resident obtains a benefit from the supply. The Court noted that many parties may potentially benefit from an advertisement placed by a non-resident, and that it was unlikely that the legislature would have intended a wide group of possible beneficiaries of a service to determine the GST treatment of the service.

In discussing the "for and to" wording in section 11(2)(e), the Court of Appeal examined the possible meanings of "for" and concluded that "for" in section 11(2)(e) was used for emphasis only. Justice Richardson noted that legislative drafters often convey emphasis through the use of a combination of words and said that (at 12,330):

> I am inclined to think that the framers of section 11(2)(e) employed both expressions to convey emphasis and perhaps to bring out the intent that the contract must be genuine and so the services must be supplied under that contract to and for the other contracting party.

As a matter of statutory interpretation, the Court said that section 11(2)(e) would have been worded quite differently if the intent had been to preclude zero-rating, unless a non-resident recipient of a supply was the only person who could benefit from the services supplied.

Penlington J considered that this result was consistent with one of the underlying themes of zero-rating—the preservation of New Zealand's competitiveness in world trade. It was also recognised that if advertised merchandise is sold in New Zealand, GST will be imposed on the sale at that time.

The Commissioner accepted the Court of Appeal's interpretation of "for and to" in *Wilson & Horton* for the purposes of section 11(2)(e). In that context, "for and to" was a composite phrase. "For" simply emphasised "to" and does not connote any requirement that services must be provided for the exclusive benefit of the recipient of the supply. If services are supplied pursuant to a contract with a non-resident and are for that non-resident, section 11(2)(e) would have applied to zero-rate the supply regardless of any other benefits also arising to a New Zealand resident (provided that the other requirements of the section are satisfied).

The Court of Appeal's interpretation of "for and to" is not restricted to the supply of advertising space in a newspaper. It also applies to the supply of advertising space in all forms of publication and to the supply of advertising time on radio or television (or other broadcasting service).

This Ruling deals with the application of section 11A(1)(k) to the supply of advertising space in publications, such as newspapers and magazines. The Ruling also covers the supply of advertising time on radio and television, or by way of any other broadcasting service, eg the internet. For the purposes of the Ruling, the supply of advertising space or advertising time means the service of communicating an advertising message, and includes all steps involved in providing this service by the supplier of the advertising space or time.

"Directly in connection with"

Previously the publishing industry had asked the Commissioner to clarify the application of the "directly in connection with" exclusion in section 11(2)(e) (now section 11A(1)(k)) in this context. This ruling brings up to date that clarification by taking into account recent legislative amendments.

A supply of services to a non-resident will not be zero-rated under section 11A(1)(k) if the services are supplied "directly in connection with" any land (or improvement to the land) or moveable personal property (other than choses in action and goods which are referred to in section 11A(1)(h) or (i)) situated in New Zealand at the time the services are performed.

There have not been any cases on the meaning of "directly in connection with" under the new provision (section 11A(1)(k)). However, given that the identical phrase has been used in the new provision the following case law that considered the earlier provision (section 11(2)(e)) is still relevant to the interpretation of the phrase.

Case law

The Court of Appeal in *Wilson & Horton* did not discuss the meaning of "directly in connection with" in section 11(2)(e), nor resolve whether advertising space is supplied directly in connection with the newspapers in which advertisements are placed. The High Court had accepted that the supply of advertising space in a newspaper was not "directly in connection with" the subject matter of the advertising. During the Court of Appeal hearing, the potential argument that the services are supplied directly in connection with the newspapers themselves was also raised. However, the Court of

Appeal did not allow the Commissioner to introduce this new line of reasoning, as it would have changed the basis upon which the assessment was made and objected to.

The determination of whether or not services are supplied "directly in connection with" land or moveable personal property depends on the circumstances in which the services are supplied. In *Case E84* (1982) 5 NZTC 59,441, Bathgate DJ considered the meaning of the phrase "in connection with" (it is to be noted that the word "directly" was not used) in the context of section 165 of the Income Tax Act 1976 (now section DJ 5 of the Income Tax Act 1994) and noted (at 59,444 and 59,446):

> It may be that only an empirical and common sense approach to the interpretation of the words can be applied in each particular case to determine where, if at all, the line should be drawn to allow or not allow expenditure 'in connection with' an assessment. However I believe that a narrow interpretation of the words '… any expenditure … in connection with … the assessment …' is the correct interpretation …
>
> …
>
> It is a matter of degree whether, on the interpretation of a particular statute, there is a sufficient relationship between subject and object to come within the words "in connection with" or not. It is clear that no hard and fast rule can be or should be applied to the interpretation of the words "in connection with". Each case depends on its own facts and the particular statute under consideration.

In the context of GST, the meaning of "directly in connection with" for the purposes of section 11(2)(a) [now section 11A(1)(a)], prior to its amendment in 1988 when the words "directly in connection with" were removed, has been judicially considered by the High Court in *Auckland Regional Authority v CIR* (1994) 16 NZTC 11,080 and the Taxation Review Authority (TRA) in *Case P78* (1992) 14 NZTC 4,532. Before amendment, section 11(2)(a) provided for zero-rating of services supplied "directly in connection with" transportation. The High Court and TRA cases concerned the application of section 11(2)(a) to various charges (landing dues, international terminal charges, and rubbish disposal charges) levied on overseas airlines.

The High Court and the TRA adopted similar interpretations of the words "directly in connection with" under section 11(2)(a). The *Auckland Regional Authority* case summarises the reasoning of the TRA in *Case P78* (at 11,084):

> There, the Taxation Review Authority, Judge Barber, held that "airport dues" were zero-rated for GST because passengers cannot realistically be transported to New Zealand by air unless a plane lands and parks on the tarmac; that charges for those services can be regarded as provided for international passengers who are in a sense "outside New Zealand" until they pass through customs. The services are fundamental to and directly connected with the transportation of passengers;

The High Court and the TRA focus on whether a supply of services is fundamental or integral to transportation to determine whether the "directly in connection with" test in section 11(2)(a) is satisfied. This reasoning is not strictly relevant for the purposes of interpreting "directly in connection with" in section 11A(1)(k). This is because the focus of section 11(2)(a) was on services directly connected with transportation services, and the identification of a direct connection between a service and another service, and a service and an item of property, involves different considerations.

In *Case S88* (1996) 17 NZTC 7,551 the TRA applied the proviso to section 11(2)(e) and considered the words "directly in connection with". The objector in *Case S88* purchased motor vehicles from its non-resident parent company and then sold the vehicles to independent dealers, who on-sold them to the public. The parent company provided a contractual warranty to the objector. The objector agreed with the dealers that if a vehicle was repaired under warranty the objector would reimburse the dealer. The objector would then register a claim with the parent company under the warranty and receive payment pursuant to that claim.

The TRA was required to consider whether the repair services provided by the objector pursuant to its contract with the non-resident parent were zero-rated under section 11(2)(e). The TRA concluded that section 11(2)(e) could not apply to zero-rate this supply as the services were supplied "directly in connection with" moveable personal property (the vehicles) situated in New Zealand at the time the services were provided. Although, the TRA did not examine the meaning of "directly in connection with" in great detail, it did state (at 7,558):

> The moveable personal property in question is the repaired vehicle. There is a direct relationship or connection between the service of the repairs and the vehicle. Accordingly, the said "proviso" to section 11(2)(e) must apply to the facts of this case and prevent the objectors from relying on the zero-rating provisions of section 11(2)(e). The repair service could not be performed but for the existence of the vehicle.

The TRA decision was appealed to the High Court in *CIR v Suzuki New Zealand Ltd* (2000) 19 NZTC 15,819. In dismissing the appeal Justice McGechan found that repairs to vehicles were "directly in connection with" the cars in New Zealand, at page 15,830:

> I have held S[uzuki]NZ provided a repair service to SMC. SMC was not resident in New Zealand. I have no doubt that repair services were carried out directly in connection with moveable personal property situated in New Zealand at the time the services were performed. Quite simply, they were repairs carried out on cars within New Zealand. The situation equates [to] "painting the ship". The nexus could not be closer…..I conclude that SNZ's supply of repair services to SMC was not zero-rated.

The High Court decision was appealed in *Suzuki New Zealand v CIR* (2001) 20 NZTC 17,096. The Court of Appeal agreed that the repairs were directly in connection with the motor vehicles and upheld the High Court's decision and dismissed the appeal.

The High Court in *Malololailai Interval Holidays New Zealand Ltd v CIR* (1997) 18 NZTC 13,137 also considered the words "directly in connection with" but in the context of section 11(2)(b) [now section 11A(1)(e)].

In *Case T54* (1998) 18 NZTC 8,410, the TRA considered whether the supply of video services for Japanese honeymoon couples to a Japanese company was zero-rated under section 11(2)(e).

The decisions in both of these cases are consistent with the cases mentioned above. There have been no further cases relating to the interpretation of the phrase "directly in connection with".

Therefore, the case law discussing "in connection with" and "directly in connection with" indicates that the interpretation of the test will be dictated by the particular context involved. The Commissioner considers that the "directly in connection with" proviso in section 11A(1)(k) should be interpreted narrowly (Judge Bathgate's words from *Case E84* quoted above support this), and that there must be a clear and direct relationship with moveable personal property or land in New Zealand before a supply will be standard-rated. This is consistent with the approach of the TRA in *Case S88* in identifying on the facts of that particular case a "direct relationship or connection" between the repair services and the vehicles under repair. This was supported by the Court of Appeal in *Suzuki* which held that:

> The repair services were obviously supplied in relation to goods, namely motor vehicles, which were situated in New Zealand. The supply of repairs could hardly be more directly connected with the motor vehicles.

Advertising space and advertising time

The supply of advertising space in a publication is the supply of the service of communicating an advertising message, involving all the steps required to achieve communication of the advertisement. This service is not supplied directly in connection with the **subject matter of the advertisement**. In the words of the High Court in *Wilson & Horton v CIR* (1994) 16 NZTC 11,221 (at 11,224):

> The supply of space and services rendered by Wilson & Horton are directly connected with the advertising but not with the goods advertised. The goods are, as it were, at least one step removed from the services supplied by the newspaper proprietor.

The Commissioner agrees with this view. There is no direct relationship or connection between the provision of advertising space and the subject matter of the advertisement. The same reasoning also applies to the supply of advertising space in all types of publication as well as advertising time on radio or television (or other broadcasting service). The supply of advertising space or time in these media cannot be described as "directly in connection with" the advertised commodity.

Similarly, when advertising space is supplied in a publication, the services are not supplied directly in connection with the **publication** in which the advertisements are published. The High Court judgment in *Wilson & Horton* concluded that the provision of advertising space was supplied directly in connection with (if anything) the advertising itself. The advertised goods were considered to be at least one step removed from the services. The Commissioner considers the same logic applies in respect of a newspaper or other publication. The service of communicating an advertising message is directly connected with that message and not the publication. The publication is at least one step removed from the service and is merely the medium in which the advertising message is publicised. Accordingly, the service is not supplied directly in connection with the publication produced by the publishers.

Consequently, the supply of advertising space in either a publication or by way of broadcast will be treated in the same way for GST purposes. The supply will qualify for zero-rating, provided that the services are supplied to a non-resident who is outside New Zealand at the time the services are performed.

Supplies through agents

The application of section 60(2) may also need to be considered to determine whether a supply is zero-rated under section 11A(1)(k). Section 60(2) deems a taxable supply of goods and services made by a registered person to an agent who is acting on behalf of a principal to be a supply made to the principal.

Therefore, if a supply of advertising space or time is made to a New Zealand resident person who is acting as an agent for a non-resident principal, section 60(2) deems the supply to be made to the non-resident principal and not the resident agent. Section 11A(1)(k) will apply to zero-rate the supply of services, provided that all the other requirements of section 11A(1)(k) are satisfied. A common example of this is where a resident advertising agency acts as an agent for a non-resident person in purchasing advertising space or time in New Zealand.

Conversely, if a supply is made to a non-resident person who is acting as an agent for a New Zealand resident in relation to the supply, section 11A(1)(k) will not apply to zero-rate the supply even if the criteria in section 11A(1)(k) are otherwise satisfied. The supply will be deemed to be made to the resident principal and it will not be to a non-resident person.

Section 11A(2)

Section 11A(2) (formerly section 11(2A)) was introduced to deal with situations where services are provided to non-residents and persons in New Zealand receive the performance of these services. Section 11A(2) will not affect the provision of advertising services to non-residents in the circumstances covered by the arrangement described in this Ruling. The performance of these services is **not** received in New Zealand by other persons.

Examples

For the purposes of these examples, it is assumed that:

- A person referred to as a resident is a "resident" as defined in section 2 of the Goods and Services Tax Act 1985. The converse applies to non-residents; and
- If the services are supplied to a non-resident, the non-resident is outside New Zealand at the time of performance of the services.

Example 1

A UK resident manufacturing company contacts a New Zealand magazine publisher and books advertising space for a newly developed product. The UK company has a GST registered subsidiary in New Zealand that sells the advertised product.

The supply of advertising space by the magazine publisher to the UK manufacturer is zero-rated under section 11A(1)(k). This is because:

- The publisher supplies the services contractually to a non-resident. The fact that the New Zealand resident subsidiary potentially may benefit from the supply through increased sales does not preclude zero-rating.
- The services are not supplied directly in connection with either the products for sale in New Zealand or the magazines in which the advertisements are shown.

Example 2

A US resident distributor of soft drinks contracts for the supply of radio time on a national radio station in New Zealand. The soft drinks are available from all chains of supermarkets throughout New Zealand.

The supply of radio time by the New Zealand radio station to the US distributor is zero-rated under section 11A(1)(k). This is because:

- The radio station supplies its services contractually to a non-resident. The fact that New Zealand resident retailers throughout New Zealand may potentially benefit from the supply through increased sales does not preclude zero-rating.
- The services are not supplied directly in connection with the products for sale in New Zealand.

Example 3

An Australian computer distributor plans to advertise its product range in New Zealand. The computers will be available through all major computer distributors in New Zealand. The Australian company contacts a New Zealand resident advertising agency to arrange an advertising campaign. The agency, acting in the capacity as agent for the Australian company, purchases air time on a New Zealand resident television channel.

The supply of air time by the television station to the Australian company is zero-rated under section 11A(1)(k). This is because:

- The television channel supplies the air time services contractually to a non-resident. Section 60(2) deems the supply to be made to the Australian company, as principal. The New Zealand resident advertising agency receives the supply as agent only.
- The fact that New Zealand resident distributors may potentially benefit from the supply through increased sales does not preclude zero-rating.

The services are not supplied directly in connection with the products for sale in New Zealand.

INTERPRETATION STATEMENTS

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

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

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

TAX TREATMENT OF PAYMENTS RECEIVED BY PETROL RETAILERS IN RETURN FOR TRADE TIES

In *Public Information Bulletin 178* (February 1989), in an item entitled "*Petrol Retailers – Inducement Payments Paid by Oil Companies*" the Commissioner outlined his views regarding the general position on the income tax treatment of payments received by petrol retailers in return for trade ties. In particular, the item stated that lump sum payments made in return for trade ties would not be assessable.

The Court of Appeal in *Birkdale Service Station v CIR* (2000) 19 NZTC 15,981 has reiterated that for income tax purposes the method of payment does not determine whether an amount received by a petrol retailer is capital or revenue. Accordingly, the Commissioner advises that the item in PIB 178 (referred to above) is withdrawn, as it is not consistent with the approach the Court of Appeal has set out for determining whether a lump sum amount is capital or income.

Taxpayers and agents should refer to the commentary below for general assistance concerning the proper character of trade tie payments received by petrol retailers.

Birkdale Service Station v CIR (2000) 19 NZTC 15,981

The relevant taxpayers in the *Birkdale* case were five retail service station proprietors and one used vehicle dealer and the case considered whether lump sum trade tie inducement (or compensation) payments made to the taxpayers by an oil company were capital or income. While the precise nature of the commitments differed, each case involved a written contract stipulating that certain payments, called inducement or compensation payments, would be made by the oil company in consideration for the retailers entering into an exclusive supply (trade tie) agreement. The Commissioner assessed the payments as income under section 65(2)(a), section 65(2)(e) and section 65(2)(l) of the Income Tax Act 1976 (the present equivalent sections are CD 3, CD 4 and CD5 of the Income Tax Act 1994).

The taxpayers indicated that while there were differences in the specific provisions contained in the different contracts between the oil company and each of them, those factual differences did not produce a requirement to distinguish between them. The broad facts of each case were that the retailers entered into a series of interrelated agreements; including a standard inducement agreement, a retail supply agreement and an equipment loan contract, in return for inducement payments. In each case there were two separate inducement payments, the first being for an initial agreement, and then a second payment for an agreement negotiated following the expiry of the first. However, in one case the trade tie was secured by a 15 year lease of the premises and land to the oil company, and a sub-lease back to the retailer.

In that case, at any time during the 15 year term the oil company had the right to call upon the retailer to enter into a redevelopment of the site, and if the retailer did not within a short time negotiate satisfactory terms with the oil company, the oil company could pay the retailer the value of the site improvements and take a 20 year lease at ground rent, again with a corresponding sublease back to the retailer. There was also a restrictive covenant preventing the retailer and its shareholders from trading in competition with the outlet from other premises within a 10 kilometre radius of the premises during the lease term.

The correct approach

The judgment of the Court of Appeal was delivered by Blanchard J, and began by stating that the High Court (*Birkdale Service Station v CIR* (1999) 19 NZTC 15,493) followed the correct approach (at p. 15,987):

> Laurenson J in the High Court adopted the correct approach in order to determine whether the lump sum payments were capital or income. It was that followed by the Privy Council in *Wattie* and to be found in the following passage from the advice of the Privy Council delivered by Lord *Pearce* in *BP Australia v Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 224 at p 264:
>
> > The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One

> consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a commonsense appreciation of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, the line of distinction is often hard to draw in border line cases; and conflicting considerations may produce a situation where the answer turns on questions of emphasis and degree. That answer:
>
>> "depends on what the expenditure is calculated to effect from a practical and business point of view rather than on the juristic classification of the legal rights, if any, secured employed or exhausted in the process": per Dixon J in Hallstroms Pty Ltd v Federal Commissioner of Taxation (1946) 72 CLR 634, 648.

The Court of Appeal then noted that in applying the above approach, the background to the transaction was of "considerable importance". In the context of the actual case, the Court recognised that there were no multi-brand retailers in New Zealand at the time of the relevant agreements, and that the contractual freedom of the retailers was thus in practical terms limited to their ability to make a choice between four wholesalers and to negotiate the term and amount. Further, the Court noted that the businesses of the retailers were described by one witness as "marginal" and that if they were minded to continue to operate their business in the deregulated environment they had in reality no choice but to tie themselves to one of the four major wholesalers (at p. 15,988).

Other trade tie cases discussed in Birkdale

The appellants referred the Court to three cases in particular where lump sum payments made in return for trade ties had been characterised as capital. The cases were: *Commrs of IR v Coia* 1959 SC 89, *Dickenson v FCT* (1958) 98 CLR 460 and *C of IR v Dunlops (Wanganui) Ltd* [1970] NZLR 1125. These cases were briefly discussed in the judgment of Blanchard J.

In *Coia* the retailer gave up being a multi-brand outlet, and accepted a payment in return for a 10 year tie with an oil company. In the leading judgment Lord Clyde observed that the retailer had expended the monies on capital outlays. However, he also stated that the payment was made in return for a trade tie, the acceptance of which required the retailer to give up his unrestricted freedom to trade as he wished and required him to accept petrol at the oil company's posted prices. Lord Patrick concurred, stating that the retailer had given up a valuable asset of a capital nature in ceasing to be a multi-brand retailer and accepting the payment in return for a trade tie of 10 years.

In *Dickenson* the taxpayer accepted payment in return for a 10 year trade tie with an oil company, having been a multi-brand retailer prior to entering into the tie. The oil company's rights were also secured by a 10 year lease and sub-lease (similar to the arrangement in the case of one of the retailers in *Birkdale*). The majority of the High Court of Australia found that the payments were of a capital nature. *Dixon* CJ said that:

> The appellant's business constituted a profit-yielding organisation of a definite structure under his control and he received the money as part of an inducement to change a feature in it. The feature to be changed was the use of a plurality of petrols and oils, and this was replaced by a restriction to the purchase and sale of the products of one company. (p. 474)

The Chief Justice added that there was nothing recurrent in the nature of the payment. It was not a normal or natural incident of carrying on such a business and it did not represent a purpose for which such a business was carried on. In addition, Kitto J stated that the payment seemed to be made in return for a substantial and enduring detraction from pre-existing rights, and the restriction took a substantial piece out of the ordinary scope of business activities in which the taxpayer would otherwise have been engaged:

> But a lump sum payment for a restriction of a garage and its proprietor to one brand of petroleum products for a period of ten years, effectuated by means of a lease and sub-lease of the premises as well as by personal covenants, seems in the nature of a sale price for a substantial and enduring detraction from pre-existing rights. The restriction does not strike my mind as an obligation undertaken incidentally to the carrying on of the business. Rather it does take a substantial piece out of the ordinary scope of business activities to which otherwise the appellant might apply himself and for which he might use his premises….(p. 492)

The *Dunlops* case was a decision of the New Zealand Court of Appeal. In this case the taxpayer had, until 1961, sold all available brands of petrol. In that year an oil company offered a lump sum payment if the company would sell that company's petrol only. North P concluded that the payment had been made in consideration of the retailer giving up a part of its business and confining itself to a more limited field. The other members of the Court agreed.

Following the discussion of these cases in *Birkdale*, Blanchard J stated that:

> The question of whether the payment for an asset is received as capital or income turns in our view upon the nature of the asset in the hands of the seller. Is it sold as a capital asset or is the seller disposing of it in the carrying on of the operations of a business or in pursuance of a particular venture? Are the retailers in their particular circumstances to be seen as having disposed of a part of their businesses, as the retailers did in *Coia, Dickenson* and *Dunlops*, or did they accept the sums of compensation as an incident of the carrying on of their businesses without any change of a structural nature having occurred? In other words, the question is what the retailers' acceptance of Mobil's payments effected from a practical and business point of view, to adapt *Dixon* J's words in *Hallstroms*. (p. 15,991)

Relevant factors to consider

In the *Birkdale* case the Court of Appeal considered the following factors to be relevant in determining what the trade tie payments effected from a practical and business point of view:

1. the fact that little was surrendered by the retailers,
2. the length of the trade ties, and
3. the proper accounting treatment.

1. Little was surrendered by the retailers

In this regard the Court stated:

> …the appellant's apparent freedom to contract as they wished for purchases of motor spirits was illusory. In reality, each had no choice, if it wished to remain in business, other than to accept a tie to one of the four oil companies. It was merely a matter of choosing for which one of them the retailer would become an "agent" and negotiating the period of the tie, the amount of the payment to be received upfront and the applicable conditions. The details of the arrangements were not likely to vary much at all as between the oil companies, for the reasons already stated. There is no doubt that Mobil imposed quite severe restrictions and controls, including the right of first refusal. But the effect of these on the pre-existing business structure had to be measured against the situation in which the retailers found themselves upon deregulation of the industry.

Importantly in this case therefore, the retailers in reality had no choice but to tie themselves to one of four oil companies. This point "readily distinguished the present case from the three cited to us by the appellant, [being] *Coia, Dickenson* and *Dunlops*" (at p. 15,992) all of which involved the retailers giving up the ability to continue as a multi-brand retailer.

The Court found that in addition to not giving up any significant freedom, the structure of the business of the appellants had hardly changed, stating:

> Therefore, in accepting the trade tie payments, the appellants were not giving up a significant freedom. In addition, the other features of the structure of the business had hardly changed. There was no alteration in the ownership of the land or the chattels employed in the conduct of the business, nor in their nature.
>
> …
>
> The manner of conducting the business of the retailer may have changed because of the contractual requirements imposed by Mobil on service station operations. But that involved the way in which the revenues were to be derived rather than an alteration in the structure from which they were derived.(at p. 15,992)

The degree of structural alteration the Court considered significant enough to render the transaction an affair of capital can be seen in the judgment relating to the Kenlock 2 arrangement. In this regard, the Court stated:

> … Two factors, both singly and even more powerfully in combination, convince us that Kenlock 2 is different from the other arrangements. They are, first, that Mobil obtained security for its tie by means of a 15 year lease with a sublease to Kenlock on a back-to-back basis and, secondly, that the term for which Kenlock became committed to Mobil was potentially very substantially longer than 15 years…. There was also a restrictive covenant preventing Kenlock and its shareholders from trading in competition with the outlet from other premises within a 10 kilometre radius of the premises during the lease term.
>
> Even though the choices realistically open to Kenlock Motors were no greater than for the other retailers, or for itself when it entered into Kenlock 1, on accepting such terms of Kenlock 2, particularly by the granting of a long term interest in its land and buildings, we consider that Kenlock Motors was altering its business structure in such a material way that the payment it received in exchange has to be regarded as of a capital nature. (at p. 15,995)

2. The length of the trade ties

None of the initial ties in the *Birkdale* case were longer than five years. The Court noted the weight given to the length of the ties in the judgments in *Regent Oil v Strick (Inspector of Taxes)* [1966] AC 295, and cited a passage from *BP Australia v C of T* [1966] AC 224 (adapting the words to the position of a recipient rather than a payer):

> Length of time, though theoretically not a deciding factor, does in practice shed a light on the nature of the advantage [granted]. The longer the duration of the agreements, the greater the indication that a structural solution was being sought.

Blanchard J additionally said:

> The length of the trade ties also distinguishes the present case from the three cited to us by counsel for the appellants. In the present case, in no instance was the initial tie for a period of more than five years and in two cases it was as short as three years. Although, in theory, at the end of that period the retailer could switch to another wholesaler, the best that could actually be hoped for was the renegotiation of a further package either with Mobil or possibly with one of the other oil companies.
> (p. 15,993)

3. The proper accounting treatment

The Court noted that the evidence showed that proper accounting treatment showed the payments should be taken into the revenue account of the retailer. Although it was stated that such a requirement was not determinative, the Court stated it did provide a minor degree of support for the view that the payments were revenue in nature.

Conclusion

In the *Birkdale* case, the background and commercial context of the transactions pointed towards a conclusion that the payments were received in the ordinary course of business. The lack of structural alterations to the business structure of the retailers (in all but the case where the tie was secured by a long term interest in the land and buildings of a retailer and accompanied by restrictive trading covenants) additionally supported the conclusion that the payments were revenue, and the length of the ties was insufficient to change this result.

In finding the payments to be of a revenue nature, the Court stated:

> In the end, the decision in this case comes down to the impression created by the combination of circumstances, including the length, and thus potential for recurrence in the short and medium term, of each tie, and the insignificant nature of the supposed freedom given up by the appellants.(p. 15,994)

Tax treatment of payments made to petrol retailers in return for trade ties

The decision in *Birkdale* reinforces the point that, in considering the character of a payment or receipt a conventional capital/revenue analysis should be undertaken. As was stated by the Privy Council in *Wattie* (1998) 18 NZTC 13,991 (and reiterated in *Birkdale*), the correct characterisation of a particular transaction depends upon what the transaction was calculated to effect, from a practical and business point of view. The nature of the asset in the hands of the seller is the primary consideration. Is the asset sold as a capital asset or is it sold in the carrying on of the operations of a business or in pursuance of a particular venture?

The relevant consideration is therefore the nature of the payment and what is provided in return. In considering the background to the transaction in *Birkdale* and the recurrent nature of the agreements, the Court of Appeal discussed the argument that the receipt of a trade tie was an ordinary incident of business:

> The recurrent nature of each transaction is obvious and there is much force in the Commissioner’s argument that the receipt of payments in return for a trade tie ought therefore to be seen as an incident of the motor spirits retailing business… It may not be going too far, on the evidence, to say that by the time the second ties were entered into by the retailers in this case ties to wholesalers were a universal experience in New Zealand. Certainly they were common. And it is worth noting that repetition of a tie involved no change at all to the business structure, other than in relation to length of term in instances where that was different from the retailer’s first tie with Mobil. In short, the further tie and any longer period have to be considered in that context. (p. 15,993)

A combination of circumstances, including the length of each tie and the insignificant nature of the supposed freedom given up by the appellants, led to the payments in *Birkdale* (in all cases except where the tie was secured by the long term interest in land and buildings) being revenue in nature as they were ordinary incidents of business in the commercial environment of one brand motor spirits retailing.

In its focus upon the background of each transaction the Court of Appeal in *Birkdale* distinguished the *Coia, Dickenson* and *Dunlops* cases, making some general observations regarding the treatment of trade ties in the current commercial environment as it applies to petrol retailers. Of particular note in this emphasis upon the commercial reality of petrol retailing is the recognition that there is no multi-brand trading. In addition, the relative lack of competition between the four main oil companies also appears to have contributed to the Court’s view that the retailers were not giving up any significant freedoms in return for accepting a trade tie.

The outcome in the *Birkdale* case suggests that the ability to enter into an exclusive supply contract is in fact a revenue “asset” in the hands of the retailer. Of note in particular is that the Court of Appeal did not consider the significant restrictions placed upon the retailers to effect any “structural” alterations to the retailers’ businesses. Unless other factors are strongly indicative of a capital character, in particular significant structural alterations effected to the business (rather than its trading operations), the case suggests the Court will find such payments to be received in the ordinary course of business.

Factors to consider in analysing whether a payment received by a petrol retailer in return for a trade tie is capital or revenue in nature

In determining the tax treatment of payments received by petrol retailers in return for trade ties, each case will necessarily depend on its facts (rather than merely the nature of the payment).

The relevant question in any case is what is the payment for, ie what is provided in return for the payment? Primarily, the context of commercial operations in the petrol industry means payments received in return for entering into a trade tie will be received in the ordinary course of business (and therefore will be revenue in nature), unless other factors are strongly indicative of a capital character. These factors include:

- Whether the retailers have given up anything significant in return for the tie, and in particular, whether they have made structural alterations to their overall business operations. [Note that in *Birkdale* the Court considered the retailers in question had no choice but to accept a trade tie with one of the four oil companies, and this was noted by the Court in the course of its finding that the retailers (except for Kenlock 2 who entered into the lease/sub-lease agreement) had not given up anything significant in return for the tie, nor had they made any significant structural alterations to their businesses.]

- The length of the trade ties, which will be relevant in considering the significance of any structural alterations (as the length of the trade tie can indicate the nature of the advantage gained).
- The correct accounting treatment, while not decisive in itself, can provide support for a particular characterisation of a receipt where this is indicated by the other factors above.

In the context of an agreement in the nature of a trade tie, it is the Commissioner's view that the presence or absence of a dedicated use to which a receipt must be put is not necessarily determinative of the character of the receipt, because it is the totality of the circumstances in which the payment is received which need to be taken into account in determining the nature of that receipt in the hands of a petrol retailer.

The *Birkdale* case makes it clear that it is not the "lump sum" nature of the payment that determines its tax consequences, as is stated in PIB 178. The nature of the payment in the hands of the recipient will be determined by what is provided in return, rather than the form of payment. In the current context of commercial operations, some retailers have little choice but to accept a tie to one of four oil companies. This appears to be an important point of difference between the cases heard prior to the issue of PIB 178 and the *Birkdale* case, as the earlier cases concerned trade ties where the industry context was such that these arrangements were not the norm.

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.

GENERAL DEPRECIATION DETERMINATION DEP50

This determination may be cited as "Determination DEP50: Tax Depreciation Rates General Determination Number 50".

1. Application

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

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

2. Determination

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

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

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

- Amending the "Wire (trawl)" asset class in the "Fishing" industry category by substituting the estimated useful life, and diminishing value and straight-line depreciation rate below:

Asset class	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Wire (trawl)	1	100	100

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

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

3. Interpretation

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

This determination was signed by me on the 28th day of April 2003.

Martin Smith
General Manager (Adjudication and Rulings)

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.

INCOME EQUALISATION DEPOSITS AND REFUNDS IR-SPS GNL-400

INTRODUCTION

This Standard Practice Statement (SPS) sets out the Commissioner's practice in regard to the statutory powers to:

- accept income equalisation deposits for an accounting year outside the specified period.
- accept refund applications for an accounting year outside the specified period.

Application

This SPS applies to income equalisation deposits and refunds made in respect of the 2003 and subsequent income years, including deposits and refunds made under section EI 17 of the Income Tax Act 1994. It does not apply to the Adverse Event Income Equalisation Scheme nor does it apply to refunds made under sections EI 5 to EI 8 of the Income Tax Act 1994.

This SPS replaces the policies in respect to income equalisation deposits and refunds as published in Public Information Bulletin nos. 108, 114 and 142 and any subsequent amendments through Inland Revenue technical rulings.

Summary

Deposits

Beyond the specified period for an accounting year, the Commissioner will allow a taxpayer to make an income equalisation deposit for that accounting year by the date that the Commissioner sets under the discretion accorded in the legislation (hereafter referred to as "the required date"). The taxpayer must elect in writing at the time of making the deposit, that it is to be deemed to be made in respect of that accounting year.

The required date is the earlier of:

- one month from the date of filing the return of income for that accounting year; or
- one month from the date that the relevant return of income is due to be filed.

The due date for filing a return will include any extension of time arrangements agreed to by Inland Revenue.

The Commissioner will consider, on a case by case basis, requests to make a deposit for an accounting year after the required date. The merits of the taxpayer's particular situation will be considered and a decision made on whether to accept the deposit after taking full account of the taxpayer's particular circumstances.

Deposits made after the required date and not accepted by the Commissioner as applying to the requested accounting year, may still be accepted by the Commissioner and applied to the accounting year in which the deposit is made. The Commissioner will first contact the taxpayer to give them the option of continuing with the deposit or having it refunded to them.

A deduction will be allowed for the accounting year in which the deposit is deemed to have been made and once the deposit is physically received by Inland Revenue.

Refunds

Beyond the specified period for an accounting year, an application for a refund from the Income Equalisation Scheme for that accounting year will be accepted by the Commissioner if that application is made by the required date. The taxpayer must elect in the application that the refund be deemed to be made in respect of that accounting year.

The required date is the earlier of:

- one month from the date the return of income for the accounting year is filed; or
- one month from the date the return is due to be filed.

The Commissioner will consider, on a case by case basis, applications for a refund for an elected accounting year after the required date. The merits of the taxpayer's particular situation will be considered and a decision made on whether to accept the application for the refund after taking full account of the taxpayer's particular circumstances.

A refund deemed to be made from an elected accounting year, is gross income to the taxpayer for that accounting year.

Applications for refunds made after the required date and not accepted by the Commissioner as applying to the elected accounting year, may still be accepted by the Commissioner and applied to the accounting year in which the application is made. The Commissioner will first contact the taxpayer to give them the option of continuing with or withdrawing the application for a refund. A refund in this instance is gross income to the taxpayer in the accounting year that the application for the refund is received.

Background

The income equalisation scheme was introduced in 1965. At the time of introduction of the scheme it was stated that it would:

- enable farmers to iron out rates of tax due to rises and falls in income;
- encourage farmers to put aside part of their income in good years and to use this money for farm development in years when farm income falls;
- help to remove a cause of inflation and therefore help to maintain a steadier rate of economic growth.

The scheme enables an eligible taxpayer to make income equalisation deposits with the Commissioner and claim a deduction against their gross income in the year the deposit is made or deemed to be made. When a refund is made from the scheme, the amount is included as part of the taxpayer's gross income in the accounting year the application for refund is received or in the accounting year that the taxpayer elects that the refund is deemed to be made and this election is accepted by the Commissioner.

If a taxpayer makes a deposit or applies for a refund in relation to an accounting year within the specified period (as defined by the legislation) or within such later time as the Commissioner may allow, then the taxpayer may elect in writing that the deposit or the refund be deemed to be made in respect of that accounting year.

Since the implementation of the scheme, Use of Money Interest (UOMI) has been introduced. Farmers are usually not in a position to know their final financial position until after liability for UOMI applies. Also many farmers do not receive the bulk of their income until near the end of their accounting year meaning that they have not had the use of that money throughout the year. The income equalisation scheme provides an avenue for farmers to limit their exposure to UOMI.

Legislation

The relevant sections of Part EI of the Income Tax Act 1994 are set out below:

EI 1 Income Equalisation Deposits

(1) Subject to this section, any taxpayer engaged in any farming or agricultural business on any land in New Zealand or in any business of fishing or any taxpayer (not being a company, or a public authority, or a Mäori authority, or an unincorporated body) who derives gross income from forestry in New Zealand may during any accounting year make payments to the Commissioner by way of income equalisation deposits in respect of that accounting year:

Provided that where a taxpayer makes any payment by way of deposit under this section during the specified period in relation to an accounting year, or within such later time as the Commissioner may allow in any case or class of cases, that payment shall, if the taxpayer so elects by notice in writing given to the Commissioner at the time of making the payment, be deemed to have been made in respect of that accounting year:

Provided also that where a refund has been made to a taxpayer in respect of an accounting year in accordance with section EI 4, no payment by way of deposit shall subsequently be made under this section by the taxpayer in respect of that accounting year except where the Commissioner is satisfied that the amount of the refund has, before the making of the subsequent payment by way of deposit, been wholly applied for the purposes of the development or expansion of the business.

(2) Every amount received by the Commissioner from any taxpayer under this section shall be deemed to be public money and shall be paid into a Crown Bank Account in accordance with the Public Finance Act 1989, such account to be known as the Income Equalisation Reserve Account, and shall be entered in an income equalisation account to be kept by the Commissioner in the name of the taxpayer. No other amounts, except interest payable under section EI 2, shall be entered in the taxpayer's income equalisation account. No amount entered in such account shall be paid to any person except by way of refund as provided in this Act.

(3) No taxpayer shall be entitled to make any payment by way of deposit under this section in respect of any accounting year which –

(a) Is less than $200 or the amount that will increase the aggregate amount of all payments by way of deposits previously made by the taxpayer under this section in respect of that accounting year to the taxpayer's maximum deposit in respect of that year, whichever amount is the smaller; or

(b) Is greater than the amount that will increase the aggregate amount of all payments by way of deposits previously made by the taxpayer under this section in respect of that accounting year to the taxpayer's maximum deposit in respect of that year.

(4) Subject to sections EI 7 and EI 8, where the amount, or the aggregate of all amounts, received by the Commissioner from any taxpayer under this section in respect of any accounting year exceeds the taxpayer's maximum deposit in respect of that accounting year, the Commissioner shall, as soon as possible after ascertaining the amount of that excess, refund the amount of the excess to the taxpayer. Nothing in sections EI 3 to El 6 or section EI 9 or section EI 10 shall apply to any amount refunded under this subsection.

(5) No amounts entered in any taxpayer's main income equalisation account shall be in any way assigned or charged or (except by reason of the bankruptcy of the taxpayer) pass to any other person by operation of law, or (except by reason of the bankruptcy of the taxpayer) be assets for the payment of the taxpayer's debts or liabilities or (in the event of the taxpayer's death) of the debts or liabilities of the taxpayer's estate, at any time before they have been duly refunded in accordance with this Act.

EI 3 Deposits to be allowed as deduction

Where any taxpayer makes any payments by way of deposits under section EI 1 in respect of any accounting year in respect of the taxpayer's farming, agriculture, or fishing business or in respect of the taxpayer's gross income from forestry, the taxpayer is allowed as a deduction in that year the aggregate amount of those payments or the amount of the taxpayer's maximum deposit in respect of that accounting year, whichever amount is the smaller.

EI 4 Refunds from main Income Equalisation accounts

(1) Subject to this section, any taxpayer may at any time apply in writing to the Commissioner for a refund of the whole or any part of any amounts deposited under section EI 1.

(2) Subject to this section and to sections EI 5 to EI 10, no refunds shall be made of any amount that has been deposited under section EI 1 less than 12 months before the date of the application for the refund.

(3) Notwithstanding subsection (2), a refund shall be made of any amount deposited under section EI 1 for 6 months or more before the date of the application for a refund in any case where the Commissioner is satisfied that the refund is required -

(a) To enable the taxpayer to undertake, immediately after the refund is made, planned development or maintenance work in relation to the taxpayer's farming, agricultural, or fishing business or forestry operations; or

(b) To enable the taxpayer to purchase, immediately after the refund is made, livestock for use in the taxpayer's farming business; or

(c) To avoid the suffering by the taxpayer of serious hardship; or

(d) For any other purpose or purposes for which the Commissioner may at any time determine in a case or class of cases the refund should so be made.

(4) Notwithstanding subsection (2), a refund shall be made of any amount deposited under section EI 1, whether or not so deposited for 6 months or more before the date of the application for a refund, in any case where the Commissioner is satisfied that the refund is required -

(a) To enable the taxpayer to purchase, immediately after the refund is made, livestock for use in the taxpayer's farming business, that livestock being in replacement of livestock sold or otherwise disposed of or lost as a result of the occurrence of a self-assessed adverse event; or

(b) To avoid the suffering by the taxpayer of serious hardship; or

(c) For any other purpose or purposes for which the Commissioner may at any time determine in any case or class of cases the refund should so be made.

(5) Subject to sections EI 5 to EI 10, every refund of the whole or any part of any amount deposited under section EI 1 shall be deemed to have been made in respect of the accounting year in which the application for the refund is received by the Commissioner, and the amount of the refund shall be deemed to be gross income derived by the taxpayer in that accounting year:

Provided that where an application is received by the Commissioner in the specified period in relation to an accounting year or within such later time as the Commissioner may allow in any case or class of cases, any refund made under that application shall, if the taxpayer so elects in that application, be deemed to have been made in respect of that accounting year, and the amount of the refund shall be deemed to be gross income derived by the taxpayer in that accounting year.

EI 17 Deposits by forestry companies in respect of gross receipts from thinning operations—

(1) Where a company carrying on a forestry business on any land in New Zealand derives during any accounting year gross income from carrying out thinning operations on the land, the company may make payments to the Commissioner by way of deposits in respect of that year in accordance with this section.

Sections EI 1 to EI 4, EI 8, and EI 10, as far as they are applicable and with any necessary modifications, shall apply to any deposits made by a company under this section in respect of any accounting year, as if—

(a) The company, in carrying out the thinning operations, carried on a farming or agricultural business on land in New Zealand during that accounting year; and

(b) The deposits made under this section in respect of that accounting year were made under section EI 1; and

(c) The company's maximum deposit in respect of that accounting year were an amount equal to the gross receipts from carrying out thinning operations on the land derived by the company during that accounting year.

(3) Where a company makes payments by way of deposits under this section and also makes payments by way of deposits under section EI 1, separate reserve accounts shall be kept in respect of deposits under this section and deposits under section EI 1.

(4) In this section—

"Gross receipts from carrying out thinning operations", in relation to an accounting year and to a company carrying on a forestry business on any land in New Zealand, means the gross income that was derived by the company during that accounting year from carrying out thinning operations on the land.

"Thinning operations" means operations by means of which a felling is made in an immature stand of trees for the purpose of improving the growth and form of the trees remaining, without permanently breaking the canopy.

Section OB 1 of the Income Tax Act 1994 provides:

OB 1 Specified Period

(a) In sections EI 1 to EI 10, in relation to an accounting year of a taxpayer, means the shorter of the following 2 periods –

(i) The period of 6 months immediately following the end of that accounting year:

(ii) The period from the end of that accounting year to the date one month after the date by which the taxpayer is required, in accordance with section 37 of the Tax Administration Act 1994, to furnish the taxpayer's return of income for that accounting year:

(b) In paragraph (a) of the definition of "specified income", in the definition of "net specified income", and in Part KD and section OB 4, means any unbroken period in any income year, whether that period consists of some or all of the days in the income year:

Discussion

All legislative references are to the Income Tax Act 1994.

The following is a discussion of the issues surrounding income equalisation deposits and refunds.

Section EI 1(1) allows an eligible taxpayer to spread their gross income for any accounting year by making an income equalisation deposit.

Eligible taxpayers are:

- taxpayers engaged in any farming or agricultural business on land in New Zealand;
- taxpayers engaged in any business of fishing;
- taxpayers (not a company, or a public authority, or a Mäori authority, or an unincorporated body) who derive gross income from forestry in New Zealand.

An eligible taxpayer may make a payment to the income equalisation scheme at any time during the accounting year.

The first proviso to section EI 1(1) also allows a taxpayer to make a deposit during the specified period in relation to an accounting year, or within such later time as the Commissioner may allow and that deposit shall, if the taxpayer so elects in writing at the time of making the deposit, be deemed to have been made in respect of that accounting year.

Section EI 3 allows the taxpayer a deduction for any deposits to the income equalisation scheme for the applicable accounting year.

Section EI 4 allows a taxpayer at any time, subject to certain restrictions, to request in writing a refund from sums deposited in the scheme. Section EI 4(5) deems the refund to have been made in respect of the accounting year that the application for refund is received by the Commissioner.

The proviso to section EI 4(5) states where an application for a refund is received in the specified period in relation to an accounting year, or within such later time as the Commissioner permits, any refund made, if the taxpayer so elects, is deemed to have been made in respect of that accounting year and the amount of that refund is deemed to be gross income for that accounting year.

On a case by case basis, a taxpayer can still request the Commissioner to accept a deposit of income equalisation or make an application for a refund, in respect of an accounting year, outside the specified period or beyond the required date. Where such a request or application had not been accepted by the Commissioner, the deposit or refund may, with consultation with the taxpayer, be applied to the accounting year in which the deposit or application for refund is made and any allowable deduction or deemed gross income similarly applied.

Specified Period

"Specified period" is defined in section OB1. It is the shorter of 6 months immediately following the end of the accounting year and the period from the end of that accounting year to the date one month after the date by which a taxpayer is required to file their return.

This is demonstrated by the following examples:

Example 1

30 June 2003 balance date (with extension of time arrangement to 31 March 2004). The specified period is the earlier of:

- 6 months from balance date—31 December 2003
- 1 month after return is due—30 April 2004

Example 2

30 June 2003 balance date (without extension of time arrangement). The specified period is the earlier of:

- 6 months from balance date—31 December 2003
- 1 month after the return is due—7 November 2003 (being 1 month after return filing date of 7 October 2003)

In the first example the specified period ends on 31 December 2003, whereas in the second example the specified period ends on 7 November 2003.

Commissioner's Discretion

The discretion given to the Commissioner to accept a deposit or an application for refund for a particular accounting year outside the specified period is broad; up to "such later time as the Commissioner may allow" in any case or class of cases. What needs to be considered is how the Commissioner should exercise that discretion.

Case law has determined that a statutory power conferred to a public authority (eg a discretion) cannot be unfettered or arbitrary. Also, a discretion must be used reasonably. In *Roberts v. Hopwood* [1925] AC 578, Lord Wrenbury stated:

> "A person in whom is vested a discretion must exercise his discretion upon reasonable grounds. A discretion does not empower a man to do what he likes merely because he is minded to do so – he must in the exercise of his discretion do not what he likes but what he ought. In other words, he must, by the use of his reason, ascertain and follow the course which reason directs. He must act reasonably."

An authority can fail to exercise its discretion lawfully by failing to give its mind to each case; each case needs to be considered on its own merits. Blindly dismissing cases as being not within policy is an abuse of power. Making policies is permitted but they cannot be over-rigid. This is highlighted in *Gisborne Mills Ltd v CIR* (1989) 11 NZTC 6,194; (1989) 13 TRNZ 405 in which Robertson J found that the Commissioner had failed to exercise a discretion which Parliament had given him. By failing to discharge a statutory responsibility, an abuse has arisen and subject to review by the Court.

In a recent case, *Lawton v Commissioner of Inland Revenue* (2003) 21 NZTC 18042, the Court of Appeal held that the Commissioner had not properly exercised the discretion in section 30(2) of the Income Tax Act 1976, which deals with acceptance of a late objection. This decision has implications on how the Commissioner should consider requests for deposits and refunds outside the dates that are set.

Glazebrook J, delivering the unanimous judgment of the Court, reiterated the dicta of the Court in *CIR v Wilson* (1996) 17 NZTC, 12,512, in which it was held that "the merits of a proposed [late] objection must be considered unless the explanation for the lateness of the objection is so inadequate that this is unnecessary."

In *Lawton* it was held that the taxpayer had given a full and credible explanation for the lateness of the objection. "In such a case", the Court held, "unless [the] explanation was palpably untrue or quite unjustified, it would be rare for the explanation to be deemed so inadequate that the merits need not be examined."

The *Lawton* case is the most recent comment of the Court of Appeal on the manner in which the Commissioner should exercise discretions of this kind. In considering whether to accept a request for a deposit or refund outside the specified dates, the Commissioner is obliged to consider the merits of the explanation given for the lateness of the request. The request cannot simply be dismissed. The Commissioner, after considering the merits of the explanation, may or may not accept the deposit or refund for the elected accounting year.

What is reasonable?

Section EI 1(1) allows an eligible taxpayer to make payments, during any accounting year, to the income equalisation scheme in respect of that accounting year. The effect of the first proviso to EI 1(1) is to allow the taxpayer a specified time into the next accounting year to make a deposit of income equalisation. It also grants the Commissioner discretion to extend this time.

Commonly, it will not be until the taxpayer's set of accounts and tax return are completed before the taxpayer's financial situation for an accounting year will be known. From this, the decision on whether to make a deposit, and of how much, would be made.

Taking this into consideration, it would be reasonable to expect a taxpayer to make a deposit to the scheme (for that particular accounting year) at the time of filing their return, provided the return is filed by the return filing due date. This date could potentially be 31 March of the following income year if the taxpayer has an extension of time arrangement.

However it may not be possible or practicable for the deposit to be sent in with the return. An example is E-filed returns and it may also take a tax agent sometime to arrange the sending in of the deposit. Therefore a reasonable period of time should be allowed passed the return filing date to enable the deposit to be forwarded to Inland Revenue. The legislation allows one month after the due date for filing a return in the definition of a specified period and this seems a reasonable amount of time in these cases. No deduction will be allowed until the deposit is physically received by Inland Revenue. The return will be reassessed to allow the deduction when the deposit is received.

The two following examples illustrate the effect of this practice:

Example 3

> A taxpayer has a tax agent. For the 2003 income year, the tax agent has an extension of time arrangement till 31 March 2004. The tax return for the taxpayer is filed 31 October 2003. For an income equalisation deposit to be accepted for the 2003 income year, the deposit should be made by 30 November 2003.
>
> In the same scenario except for the fact that the return is filed on 1 May 2004, a deposit would need to be paid by 30 April 2004.

For taxpayers without extension of time arrangements, deposits in respect of an accounting year will generally be accepted up to the end of the specified period, which is the shorter of 6 months immediately following the end of the accounting year and 1 month after the return is required to be filed.

This is illustrated by the following examples:

Example 4

> A taxpayer with a 30 June 2003 balance date will be required to file their return by 7 October 2003. Any deposit made in respect of that accounting year must be paid by 7 November 2003, which is the shorter of:
>
> - 1 month after the return is due—7 November 2003; and
> - 6 months from balance date—31 December 2003.

Example 5

> A taxpayer with a 30 November 2003 balance date will be required to file their return by, 7 July 2004. Any deposit made in respect of that accounting year must be paid by 31 May 2004, which is the shorter of:
>
> - 1 month after the return is due—7 August 2004; and
> - 6 months from balance date—31 May 2004.

For taxpayers who do not have a tax agent and require an extension of time to file their income tax return, please refer to Standard Practice Statement RDC-1, Extension of time applications from taxpayers without tax agents.

Beyond this, and in line with the principles of the use of a discretion, the Commissioner will consider, on a case by case basis, requests for a deposit for an accounting year after the filing due date, taking into account the merits of the taxpayer's situation and the reasons why the deposit was not made before the required date. Reasons could include but are not limited to incorrect advice from the taxpayer's tax agent or a sudden or unexpected change in circumstances. However these examples are not indicative of situations when a request for a late deposit will automatically be accepted. All factors must be considered and each case will be decided on its own merits.

The same principles discussed earlier, as to what is reasonable in relation to when a deposit of income equalisation should be made, equally apply to when an application for refund should be made.

Standard Practice

The following standard practice has been developed from the same principles.

Deposits

Taxpayers may make a deposit to the income equalisation scheme for any accounting year at any time during that respective accounting year.

A deposit made during the specified period in relation to any accounting year (as defined above) will be deemed to be made in respect of that accounting year.

Outside the specified period, the Commissioner will allow a taxpayer to make a deposit for that accounting year by the required date. The required date is the earlier of:

- one month from the date of filing the return of income for that accounting year; or
- one month from the date that the relevant return of income is due to be filed.

The due date for filing a return includes all extension of time arrangements agreed to by Inland Revenue A taxpayer must elect in writing at the time of making the deposit that the deposit is to be deemed as belonging to the applicable accounting year.

A deduction will be allowed for the accounting year in which the deposit is deemed to have been made and once the deposit is physically received by Inland Revenue.

Generally, the Commissioner will not accept a deposit for an accounting year after the required date. However, the Commissioner will consider, on a case by case basis, requests after the required date, taking into account the merits of the taxpayer's particular situation and the taxpayer's circumstances and make a decision whether to accept the deposit for the elected accounting year.

Deposits made after the required date and not accepted by the Commissioner as applying to the requested accounting year, may still be accepted by the Commissioner and applied to the accounting year in which the deposit is made. The Commissioner will first contact the taxpayer to give them the option of continuing with the deposit or having it refunded back to them.

Refunds

Generally a refund is deemed to be made in the accounting year in which the application for the refund is received by the Commissioner and the amount of the refund is deemed to be gross income derived in that accounting year.

Where an application for a refund is received in the specified period in relation to any accounting year or by the required date any refund made, if the taxpayer so elects, is deemed to have been made in respect of that accounting year and the amount of that refund is deemed to be gross income for that accounting year.

The required date is the earlier of:

- one month from the date the return of income for the accounting year is filed; or
- one month from the date the return is due to be filed.

The due date for filing a return includes all extension of time arrangements agreed to by Inland Revenue.

Generally, the Commissioner will not accept an application for a refund for an elected accounting year after the required date. However, the Commissioner will consider, on a case by case basis, applications made after the required date, taking into account the merits of the taxpayer's particular situation and the taxpayer's circumstances and make a decision whether to accept the application for the refund.

Applications for refunds made after the required date and not accepted by the Commissioner as applying to the requested accounting year, may still be accepted by the Commissioner and applied to the accounting year in which the application is made and shall be deemed to be gross income for that accounting year. The Commissioner will first contact the taxpayer to give them the option of continuing with or withdrawing the application for a refund.

This Standard Practice Statement was signed by me on 24 April 2003.

Margaret Cotton
National Manager
Technical Standards

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.

DEPRECIATION OF INTANGIBLE PROPERTY

Case	Trustees of the CB Simkin Trust and the Trustees in the NC Simkin Trust v CIR
Decision date	5 March 2003
Act	Income Tax Act 1994
Keywords	depreciation, trademark, right to use, ownership, intangible property

Summary

The taxpayers' claims for depreciation of trademarks, while the rights to use were exclusively licensed out, was disallowed on the basis they were not entitled to do so as they did not own the rights to use the trademarks.

Facts

This was an appeal by the taxpayer from the decision of Young J of the High Court, reported at (2002) 20 NZTC 17,611, wherein the High Court upheld the Commissioner's disallowance of claims by the two trusts for depreciation of intangible property.

The issues are the same for both trusts. Each purchased trademark(s) from companies engaged in businesses which used the trademark(s). While the purchases did not include goodwill, they did expressly include "the absolute right of use" of the trademarks.

Simultaneously, the Trusts licensed the trademark(s) back to the respective vendor companies, granting exclusive rights to use the trademarks for seven years.

The Trusts then sold what the Court has termed their "residual" rights in the trademarks, with those sales to take effect at the expiration of the seven year licence term.

The Trusts then claimed depreciation in the 1996 and 1997 years, in relation to the trademarks, on the basis they were the owners of the trademarks, and inherent in that was the right to use the marks, whereas the licensees had a purely contractual right of use and were not owners.

The Commissioner disallowed the claims, on the basis the Trusts were not entitled to claim depreciation as they did not own the right to use the trademarks.

Decision

In a judgment delivered by Gault P, the Court of Appeal agreed with Young J (High Court decision) and the Commissioner, that it is the owner of depreciable property who is entitled to deduct depreciation, and finding the ownership rights the Trusts sought to depreciate were not the rights to use referred to in item 7 of Schedule 17 of the ITA 94.

This was held to be a matter of construction. The Court of Appeal found the specific inclusion (in items 3 (patents) and 6 (copyright in software) of Schedule 17) of the property that may be used as well as the right of use, compared with the other items listed in that Schedule being limited to the right of use, was representative of clear drafting intent and reflected deliberate policy:

> The right of use, if separate from the patent or copyright, must be a right of someone other than the patent or copyright owner—clearly a licensee. If the right to use were merely that inherent in the ownership of the patent or software copyright there would be no need to specify it separately.

The policy behind including the property in some items (such as patent and copyright) and not in others (such as trademarks) is consistent with the view patents and copyright in software have finite useful lives that can be estimated with a reasonable degree of certainty from the date of creation or acquisition (as per the definition of "depreciable intangible property" in section OB 1 of the Income Tax Act 1994).

The Court dealt with the argument that a licensee cannot own the right of use by considering the right to use land: while the owner of the land has a right of use (subject to the lease), it is not incorrect to describe the lessee as owning the lease. This analogy was extended to intellectual property rights, where a licensee acquires, under a licence, the right of use.

The Court held the right to use a trademark in Schedule 17 is the right in fact to use. In this case, the right to use is enjoyed by the licensees, not the licensors (the Trusts), because the rights to use have been granted exclusively to the licensees during the term of the licenses.

The Court also upheld the view that trademarks are not property which might reasonably be expected to decline in value (contrary to the definition of "depreciable property" in section OB 1), being of potentially indefinite duration and tending to increase in value when used. And therefore, would not otherwise be depreciable intangible property.

SUPPLY BY UNINCORPORATED BODY

Case:	TRA 003/02 and TRA 004/02
Decision date:	4 April 2003
Act:	Goods and Services Tax Act 1986
Keywords:	taxable supply; value of supply, sections 10(3) and 76; deemed supply by unincorporated body, section 57; input tax deductions; section 20(3)(b)(i), requirement to hold tax invoice, section 24.

Summary

The TRA found Inland Revenue had incorrectly assessed output tax, and wrongly denied an input tax deduction.

Facts

On 5 February 1986, JCM completed an acknowledgment recording he held the legal title of a commercial building in Auckland ("Property 1") as agent for CI, a syndicate, the members of which were himself as to a 50% share, his wife as to a 33 1/3% share and the family trust as to a 16.67% share. Property 1 was sold in 1991.

In 1992 and 1993 respectively, JCM became registered proprietor of two more commercial buildings in Auckland ("Property 2" and "Property 3"). No further acknowledgments were completed, but it was common ground that JCM, his wife and the family trust owned Property 2 and Property 3 in the same stated shares.

For GST purposes, CI was registered as an unincorporated body pursuant to section 57 of the Act, and accounted for GST on rents as required.

The case is concerned with the correct GST treatment of a transaction by which the interests of JCM and his wife in Property 2 and Property 3 were transferred to the family trust. The transaction took place in two stages.

First Stage – Transfer 5 October 1997

The first stage of the transaction was evidenced by a transfer dated 5 October 1997, by which JCM transferred a 33.33% share to his wife and a 16.67% share to PJM and JM, the trustees of the family trust, for a consideration of one peppercorn.

Second Stage – Agreements and Transfers dated 22 May 1998

The second stage involved two parallel transactions. Under the first, JCM entered an agreement for sale and purchase with the trustees of the family trust. The agreement is dated 22 May 1998.

Under the agreement, JCM sold his 50% share in Property 2 and Property 3 for $615,000. The agreed settlement date was 30 January 1998, ie a date four months before the agreement was entered into.

The purchase price was to be satisfied by an executed first mortgage over the one half share in Property 2 and Property 3. JCM also executed a transfer by which he transferred his 50% share to the trustees for a consideration of $615,000. The mortgage was dated 30 July 1998.

Under the second transaction, JCM's wife entered an agreement with the trustees for sale and purchase of her 33.33% share in Property 2 and Property 3 for $410,000. In all other respects this transaction was identical.

Both JCM and his wife executed a transfer dated 22 May 1998 transferring their respective interests to the family trust.

The transactions were not documented so as to comply with the old section 11(1)(c) of the Act. If they had been, the parties could have agreed to treat the second stage of the transactions as zero-rated.

Taxpayer's GST Treatment

JCM and his wife were unregistered persons, and treated the transactions as supplies of secondhand goods. CI did not account for output tax. The family trust claimed an input tax credit in its taxable period ended 31 January 1998.

The Assessments

Inland Revenue assessed CI with output tax, and applied a shortfall penalty of 100% for taking an abusive tax position.

Inland Revenue declined to reopen the family trust GST return for the period ended 31 January 1998 to allow the input tax credit. It did this on two grounds.

The first was that under section 20(3)(b)(i), a deduction can only be made by payments-based taxpayers to the extent a payment has been made *during that taxable period*. In this case, no payment was made until 30 July 1998 at the earliest, being the date of the mortgage. The second ground was that no tax invoice was held at the time the claim was made.

It was not disputed by Inland Revenue that an input tax credit would be allowable in a subsequent taxable period, once these two requirements were complied with.

Decision

AAP Willy ("the TRA") heard a challenge to the output tax assessment and shortfall penalties assessment by CI, and a challenge by the family trust to the denial of its input tax credit. Both proceedings were heard together.

The TRA found the output tax assessment was wrong. He also found at paragraph 65 of the decision that the sale of the vendor's interest was a supply of secondhand goods, so an input tax credit cannot be denied on the grounds a tax invoice was not held.

The TRA also found against the Commissioner's alleged argument that there was no payment for the GST period under review: paragraph 97. The actual argument was that there was no payment in the taxable period in which the input was claimed, and therefore section 20(3)(b)(i) prohibits the deduction.

It followed from the finding that the supply was a supply of secondhand goods that the TRA also found that JCM and his wife as unregistered persons were not required to supply a tax invoice under section 24.

Accordingly, the TRA found the family trust is entitled to receive the input tax credit, and in his view, no question of a shortfall penalty to CI arises.

Inland Revenue Comment on Decision

Inland Revenue considers the decision fails to determine a number of key issues.

Firstly, there is no finding as to whether the transfer dated 5 October 1997 constitutes a supply for goods and services tax purposes. This was a crucial step in resolving the problem.

Inland Revenue considers the transfer does not make a supply for goods and services tax purposes, because the transferees already owned the stated shares in the land in equity.

If the TRA had found a supply was made, then Inland Revenue raised two alternative provisions, section 10(3) and section 76 of the Act which Inland Revenue considers independently require the conclusion that any such supply must be valued at open market value.

On one view, it is possible to conclude the TRA did find a supply was made pursuant to the 5 October transfer, because paragraph 72 of the decision refers to that transfer as evidencing a sale. In that case, it was essential to determine whether or not section 10(3) of the Act applied, but the TRA did not consider this issue at all.

It is also noted there are problems with the view that the TRA did make a finding that the transfer amounts to a supply. For instance, paragraph 72 refers to the transfer of 5 October 1997 being a transfer from JCM and his wife when it was only a transfer from JCM, thus raising the possibility that the TRA really intended to refer to the two transfers dated 22 May 1998, which were from JCM and his wife as stated.

If this latter view is correct, the position remains that the TRA has made no finding on whether the 5 October transfer amounts to a supply.

The TRA did make a finding that section 76 of the Act does not apply. The TRA found the setting-up of the family trust in 1965, which purchased the two properties in 1998, and the execution of the acknowledgment dated 5 February 1986 was not part of an arrangement to avoid tax. Unfortunately, this was not the basis on which Inland Revenue asserts section 76 of the Act applied.

The omission of the TRA to determine whether or not a supply was made for goods and services tax purposes pursuant to the transfer dated 5 October 1997 leaves it unclear whether section 76 of the Act was even relevant, as Inland Revenue only relied on section 10(3) and section 76 of the Act as alternative arguments.

If the TRA had found the transfer dated 5 October 1997 does not create or evidence a supply for goods and services tax purposes, Inland Revenue contended the sale of the interests in the two buildings by JCM and his wife is a *deemed* supply by CI, the unincorporated body, pursuant to section 57(2)(b) of the Act.

The TRA decision fails to determine whether or not section 57 of the Act applied.

Under section 57(2)(b), any supply made in the course of carrying on the taxable activity of a body is *deemed* made by the body, in this case the syndicate. Under section 6(2), anything done in connection with the commencement or termination of a taxable activity is deemed to be carried out *in the course of* that taxable activity.

On this basis, Inland Revenue contends that the supply of the interests of JCM and his wife to the family trust, was a taxable supply *by the body*. It is not a supply of second hand goods by JCM and his wife, both unregistered persons. Accordingly, it was submitted CI must return output tax on the transaction.

The TRA finds at paragraph 87 that the syndicate CI made no taxable supplies to the trustees of the family trust, but the TRA does not address the deemed supply provision (section 57(2)(b)).

The omission to address section 57(2)(b) led to a further finding, this time in respect of the challenge by the family trust, which Inland Revenue considers to be incorrect. The finding was that the supply was made by JCM and his wife, and as unregistered persons they are not required to supply a tax invoice under section 24.

The TRA also failed to consider and determine the Inland Revenue argument that section 20(3)(b)(i) of the Act applied to prevent the input tax deduction.

Inland Revenue has filed an appeal against the decision to the High Court.

ASSESSMENTS ISSUED UNLAWFULLY? TIME BAR ISSUE

Case	Vela Fishing Limited v CIR
Decision date	14 April 2003
Act	Income Tax Act 1976
	Tax Administration Act 1994
Keywords	Time bar, transitional provisions, repealed provisions

Summary

The CIR was successful: this judgment confirms the Court of Appeal decision (*CIR v Vela Fishing Limited* [2002] 1 NZLR 49) which allowed the CIR's appeal from the adverse High Court decision of Penlington J (*Vela Fishing Limited v CIR* [2001] 1 NZLR 437).

Facts

The taxpayer was subject to an audit. In February 1998 the 31 March time bar was approaching for the 1991 year. The taxpayer signed a waiver, extending time to 30 September 1998. Inland Revenue reassessed on 30 September 1998. The taxpayer then contended that the waiver was ineffective and so the assessment was out of time.

Decision

There was only one judgment, delivered by Lord Walker of Gestingthorpe.

The Board held that section 227(4) TAA required the reference to the 1994 time bar provision (section 108 TAA) in section 108B TAA (the provision authorising waivers) to be read as also a reference to the 1976 time bar provision (section 25 ITA 76). Therefore the waiver extended the period for the CIR to assess in this case.

Their Lordships found this for two different reasons:

- First, at paragraphs 16 and 17, the new version of section 108 TAA (as substituted for the original in 1996) was a "corresponding provision" (as that term is employed in section 227(4) TAA) to section 25 ITA 76. The Court of Appeal was right to follow *Winter v Ministry of Transport* [1972] NZLR 539 in so deciding.
- Second, at paragraph 18, that section 108B (the provision authorising waivers) applied in terms to both old and new versions of section 108 TAA. Old section 108 TAA was certainly a "corresponding provision" to section 25 ITA 76 (it is virtually identical, apart from some modest "plain English" changes).

Their Lordships also dealt shortly with two of the Appellant's arguments.

Vela had argued that the CIR's case raised the status of section 277(4) TAA from a transitional provision to an amending provision. At paragraph 18 the Board consider that is an incomplete analysis. Section 227(4) remains a classic transitional provision. But its function is to extend the scope of current legislation to include past (and not dissimilar) provisions dealing with the same subject matter. The relevant amendment was section 108B TAA, and section 227(4) TAA simply extended its operation to the ITA 76.

Vela had also argued that even while the four-year pre-time bar period was running, it had a contingent right to a time bar, and should not be deprived of that right without clear words. At paragraph 19 the Board said that Vela could not sensibly be described as having any sort of right to a time bar while the four-year period was running. Moreover, it was not the amending provision that prevented Vela from obtaining the benefit of the time bar on 31 March 1998; it was Vela's own decision to sign a waiver. "Section 108B is a benefit and not a burden to taxpayers".

Costs (now to be agreed, or failing agreement, set by the Board) to the CIR.

SOVEREIGNTY ARGUMENTS

Case	CIR v P W Rupe
Decision date	15 April 2003
Act	Goods and Services Tax Act, Tax Administration Act.
Keywords	Sovereignty, tax, Parliament, taxpayer, resident, name, Mäori.

Summary

The taxpayer opposed the Commissioner's action to recover a GST debt. He claimed immunity from the operation of the taxing statutes (and all other laws of New Zealand). The District Court held that the taxpayer was a New Zealand resident and referred to established authority regarding similar sovereignty arguments.

Facts

The Commissioner commenced proceedings for the recovery of GST amounts owing by the defendant Mr Rupe. The assessments in question were based on GST returns submitted by Mr Rupe. The original sum for which judgment was sought was $17,986. Since proceedings were commenced in February 2000, the addition of penalties and interest has increased the claim to $33,007.83.

Mr Rupe originally filed a statement of defence and counterclaim. The counterclaim was dismissed by the Court. Mr Rupe also sought to strike out the CIR's claim and that was also dismissed. The basis of both applications and the defendant's defence in the present hearing was that of jurisdiction; Mr Rupe claimed not to be subject to New Zealand's taxing statutes by virtue of the Treaty of Waitangi, Mäori sovereignty, the Bill of Rights (unspecified), and his status as a Christian. Various other arguments such as whether the CIR addressed him by his proper name, were also canvassed.

Decision

His Honour Judge IB Thomas dispensed with most of the defendant's arguments by reference to the precedents of New Zealand Courts set out in CIR's submissions. The "not a taxpayer" argument had been raised and dismissed by the High Court in *Boyton v CIR* [2002] 20 NZTC 17,615.

> "I adopt the reasoning in that decision. It is clear that … the defendant is resident in New Zealand, and he has derived income in New Zealand, and he is a taxpayer"

Regarding the impact of the Treaty of Waitangi on the tax acts, his Honour noted that:

> "… obviously there is a debate at the moment about the import or otherwise of the Treaty into statute law, but there is no reference to the Treaty or room for its implication in the taxation statutes, and since it has not been incorporated by statute, therefore the submission is not valid"

As far as sovereignty was concerned, his Honour noted that the argument had been raised many times before and referred to the decision of Penlington J in *Warren v Police* 9 February 2000, High Court Hamilton AP 133/99, as setting out the relevant principles:

- Parliament is empowered to make legislation.
- Acts of Parliament do not derive authority from the Treaty or the earlier Declaration of Independence.
- Acts of Parliament are binding on both Mäori and Pakeha.
- Courts are subservient to Parliament.
- Courts have no authority to go behind such Acts and enquire as to how they were made. *Berkett v Tauranga District Court* [1992] 3 NZLR 206.

The Court then clearly had jurisdiction, and a duty to deal with the present application.

Mr Rupe referred to a number of scriptural quotations purporting to exempt Christians from the "law of the land". The Commissioner (having noted that several of Christ's followers were tax collectors), referred to Luke 20:22 where certain provocateurs asked Christ whether they ought pay taxes to Caesar. Judge Thomas repeated Christ's answer:

> "Render therefore unto Caesar the things that are Caesar's and to God the things that are God's."

The Commissioner has indicated to the Court that he will receive an application for relief from Mr Rupe if he is able to demonstrate "hardship" in terms of sections 176,177 TAA 94.

NEW LEGISLATION

TAXATION (MÄORI ORGANISATIONS, TAXPAYER COMPLIANCE AND MISCELLANEOUS PROVISIONS) ACT
TAXATION (ANNUAL RATES OF INCOME TAX 2002-03) ACT 2003
STUDENT LOAN SCHEME AMENDMENT ACT 2003
CHILD SUPPORT AMENDMENT ACT 2003

The Taxation (Annual Rates, Mäori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill was introduced into Parliament on 14 May 2002, receiving its first reading on 22 May 2002 and its second reading on 4 March 2003. The bill was split into four at the Committee stage of proceedings, and the resulting bills passed their final stages on 25 March 2003. They received Royal assent on 26 March 2003.

The four new Acts amend the Income Tax Act 1994, Tax Administration Act 1994, Goods and Services Tax Act 1985, Income Tax Act 1976, Injury Prevention, Rehabilitation and Compensation Act 2001, Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002, Student Loan Scheme Act 1992 and Child Support Act 1991.

NEW RULES FOR MÄORI AUTHORITIES

New Parts HI and MK and other sections of the Income Tax Act 1994, and various sections of the Tax Administration Act 1994

Introduction

Amendments to the Income Tax Act 1994 and the Tax Administration Act 1994 modernise the specific tax rules that apply to Mäori authorities and to individuals who derive distributions from them. These changes represent the most significant reform of tax law affecting Mäori organisations since 1952.

The new rules share many features of the company imputation rules. They will relieve much of the unnecessary complexity and restrictions that the previous Mäori authority rules imposed, and will remove the potential for Mäori authority income to be double taxed. They will apply only to eligible entities that elect to be Mäori authorities. Twelve types of eligible entities are listed in the Act on the basis that they manage communally owned assets whose ownership and administration are subject to certain statutory restrictions or government processes.

Background

The first specific tax rules for Mäori authorities appeared in 1939. These rules were intended to apply to the various "working" organisations that administered large blocks of farmland owned in common by Mäori (and not in private ownership). These organisations were the first to become known as Mäori authorities. They included the Board of Mäori Affairs, the Mäori Trustee, the Mäori land boards, special statutory trusts (such as the East Coast Commissioner) and various land trusts under the Mäori land legislation.

Although the rules were largely concerned with the taxation of income from Mäori land, they also applied to any income earned by an organisation that administered property, income or reserves in trust for the benefit of Mäori. Thus the essential character of all the organisations covered by the term "Mäori authority" was that of trustee for the individual members.

The 1939 rules were replaced in 1952 as a result of the recommendations of a Commission of Inquiry. The Commission had been established to ascertain whether certain Mäori farming operations were fully complying with their tax obligations and whether the law on this could be made clearer. Before the review that led to the recent changes, this was the last time the Mäori authority rules were reviewed.

Over time the 1952 rules became outdated. They did not mesh well with current tax law, involved considerable complexity and cost for contemporary Mäori authorities and their members, and in some cases double taxed Mäori authority income. There were claims that the Mäori authority rules hindered Mäori economic and social development, and over the years there were repeated calls from various Mäori groups for them to be reviewed.

In August 2001 the government released the discussion document *Taxation of Mäori Organisations,* which contained policy options for modernising the Mäori authority tax rules and simplifying the personal income tax requirements for individuals who derive benefits from these organisations. Public submissions generally supported replacing the previous rules (which were based on a dividend deduction model) with an imputation model similar to company imputation. A possible final tax model was rejected because of its potential for under-taxation and over-taxation and inability to correct these discrepancies.

Once it was established that there was a continued need for specific rules for Mäori authorities, the issue of the appropriate tax rate to apply to the income of Mäori authorities arose. The tax rate issue was not canvassed in the discussion document. Instead, when the bill giving effect to the current legislation was introduced it proposed that Mäori authorities should be subject to a tax rate of 19.5% (reduced from 25%), matching the statutory tax rate of the vast majority of Mäori authority members.

The government review that led to these changes involved consultation through the generic tax policy process, which in this case required a significant level of consultation with the Mäori community.

Key features

The main provisions giving effect to the new Mäori authority rules are contained in new Parts HI and MK. The new rules incorporate and mirror many of the provisions relating to company imputation and provide that:

- The income of Mäori authorities will be taxed in the year the authority earns it, at an income tax rate of 19.5%. (Schedule 1, Part A, clause 2).
- The tax paid by or on behalf of Mäori authorities will be credited to an account known as the "Mäori authority credit account" and this tax will give rise to Mäori authority credits. (New Part MK).
- Mäori authorities will be able to attach these credits to "taxable distributions" they pay to their members. (New sections HI 4 and HI 5).
- Mäori authority members can then use these credits to offset their own individual tax liabilities (new section HI 7). Any unused credits will be refunded to the recipient members who are New Zealand resident for tax purposes (new section LD 3B).

Definition of "Mäori authority"

The definition of "Mäori authority" is provided for in new sections HI 2 and HI 3, and section OB 1. The definition gives certain entities the choice of applying the Mäori authority rules or the general tax rules, depending on their entity type.

Section HI 2 contains a list of persons who are eligible to make an effective election to apply the new Mäori authority provisions. The list of "eligible persons" is limited to trustees of trusts and companies that manage communally owned assets whose ownership and administration are subject to certain statutory restrictions or government processes. Thus an eligible person cannot be an individual, an unincorporated body (other than a trustee of a trust), or a corporate body that is not subject to the specified restrictions or processes.

Section HI 3 sets out the requirements that an eligible person must satisfy in order to make an effective election. An eligible person that does not elect to apply the Mäori authority rules will be required to apply the general tax rules that are applicable to its entity type.

Entities that are currently taxed as Mäori authorities will need to make an election to be a Mäori authority from the 2004-05 income year if they are eligible and wish to apply the new rules.

Taxation of Mäori authority distributions

Under new sections HI 4 and HI 5, Mäori authorities can make taxable distributions and non-taxable distributions. Taxable distributions can have Mäori authority credits attached (new section MK 6), or can have resident withholding tax deducted from them if they are not fully credited (new section NF 8B). Non-taxable distributions cannot have credits attached, nor will they be subject to resident withholding tax.

Maintaining a "Mäori authority credit account"

Mäori authorities will be required to establish and maintain a "Mäori authority credit account" in accordance with the rules set out in new Part MK.

This account will operate in a similar way to the imputation credit account that companies are required to operate and will be subject to similar rules. Like the imputation credit account, the balance in the Mäori authority credit account determines the level of credits that Mäori authorities may attach to taxable distributions they pay to their members.

Anti-streaming rules for distributions and credits

Mäori authorities will be subject to anti-streaming rules similar to those that apply to companies that operate imputation credit accounts. These rules are necessary to deal with potential problems relating to "streaming" of Mäori authority distributions or tax credits to members. (New sections GC 27B, HI 6 and MK 7).

Transitional rules for movements in and out of the Mäori authority rules

New sections HI 8 and HI 9 provide transitional rules for trusts and companies electing to be or ceasing to be Mäori authorities. They ensure that when companies or trusts enter or exit the Mäori authority rules no additional tax consequences will arise.

Removing the "Mäori authority exclusion" from the definition of "company"

The definition of "company" in section OB 1 has been amended to remove the Mäori authority exclusion. Effectively, this amendment allows Mäori authorities whose legal form is that of a company to be taxed as Mäori authorities under new Part HI and also to apply certain income tax provisions that relate to companies.

New section HI 1(2) limits the circumstances in which corporate Mäori authorities can avail themselves of the company provisions that relate to loss grouping, amalgamations, consolidation and co-operative companies. The general rule is that unless otherwise stated, the company provisions of the Income Tax Act 1994 and the Tax Administration Act 1994 apply to corporate Mäori authorities.

The definition of "continuity provisions" in section OB 1 has been amended so that corporate Mäori authorities (not trusts) will be required to satisfy the shareholder continuity tests in situations that require the measuring of a shareholder's economic interests in Mäori authorities. For example, this test will need to be satisfied in relation to maintaining the Mäori authority credit account.

Specific agent rules of the Mäori Trustee

The specific agent tax rules applying to the Mäori Trustee, which were contained in section HK 14, have been repealed. New section HI 2 includes in the list of eligible persons, the Mäori Trustee in its capacity as agent for owners of land subject to the Te Ture Whenua Mäori Act 1993 (Mäori Land Act 1993).

Donations deduction for Mäori authorities

Section DI 2 has been amended to allow Mäori authorities to take deductions for gifts of money to organisations with "approved donee status" or to Mäori associations. Previously, the deduction was permitted only for gifts of money to Mäori associations. To qualify for "approved donee status" an organisation must be established for charitable, benevolent, philanthropic, or cultural purposes within New Zealand or must be specifically listed in section KC 5.

Application date

The new Mäori authority rules generally apply from the 2004-05 income year. The extension to the specific donations deduction for Mäori authorities applies from the 2003-04 income year.

Detailed analysis

Clarifying the operation of the Mäori authority rules – section HI 1(1)

Section HI 1(1) states that all provisions relating to Mäori authorities in the Income Tax Act are subject to new Part HI.

Section HI 1(2) clarifies the circumstances in which corporate Mäori authorities may use the loss grouping, amalgamation, consolidation and co-operative company rules. (See discussion on Removal of the Mäori authority exclusion in the definition of "company".)

New definition of "Mäori authority" – sections HI 2, HI 3 and OB 1

Section OB 1 defines a "Mäori authority" to mean a person who has made an effective election under section HI 3.[1]

List of "eligible persons"

Section HI 2 contains a list of persons that are eligible to make an effective election under section HI 3:

Mäori incorporations[2] are included in the eligibility criteria under paragraph (a), and ahuwhenua trusts, kai tiaki trusts, putea trusts, whanau trusts and whenua topu trusts are included in the eligibility criteria under paragraph (b). These organisations are constituted by orders made by the Mäori Land Court under Te Ture Whenua Mäori Act 1993 (also known as the Mäori Land Act 1993). Companies or trusts that own land subject to Te Ture Whenua Mäori Act 1993 may also be eligible entities. The other eligible entities are established under specific legislation or as part of Treaty of Waitangi settlement processes.

The list identifies those organisations that are eligible to apply the new Mäori authority rules. It provides greater certainty for organisations seeking Mäori authority tax status and also removes the ambiguity caused by archaic and confusing terminology that was used in the language of the previous definition of "Mäori authority".

The list approach also ensures that the specific tax rules are confined to those organisations that encounter the constraints and restrictions that justify the continuation of the specific tax framework.

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[1] The legislation as enacted refers to a non-existent reference to section HI IC but it should refer to section HI 3. The error is expected to be corrected in a future bill.

[2] Some Mäori incorporations were established by Order in Council under the Mäori Reserved Lands Act 1955. Their status has been preserved under Te Ture Whenua Mäori Act 1993.

HI 2 Eligibility to be Mäori authority

The following persons are eligible to be a Mäori authority:

(a) a company that is established by an order made under Te Ture Whenua Mäori Act 1993 (Mäori Land Act 1993):

(b) the trustees of a trust that is established by an order made under Te Ture Whenua Mäori Act 1993 (Mäori Land Act 1993):

(c) a company that owns land that is subject to Te Ture Whenua Mäori Act 1993 (Mäori Land Act 1993):

(d) the trustees of a trust who own land that is subject to Te Ture Whenua Mäori Act 1993 (Mäori Land Act 1993):

(e) the Mäori Trustee in the Mäori Trustee' capacity as an agent for an owner of land that is subject to Te Ture Whenua Mäori Act 1993 (Mäori Land Act 1993):

(f) a Mäori Trust Board, as defined in section 2 of the Mäori Trust Boards Act 1955:

(g) the Crown Forestry Rental Trust, established by deed in accordance with section 34 of the Crown Forest Assets Act 1989:

(h) the Treaty of Waitangi Fisheries Commission, established under the Mäori Fisheries Act 1989:

(i) a company that, on behalf of beneficiaries under the Deed of Settlement between the Crown and Mäori dated the 23rd day of September 1992, receives and manages assets that are distributed to the company by the Treaty of Waitangi Fisheries Commission:

(j) the trustees of a trust who, on behalf of beneficiaries under the Deed of Settlement between the Crown and Mäori dated the 23rd day of September 1992, receive and manage assets that are distributed to the trustees by the Treaty of Waitangi Fisheries Commission:

(k) a company that—
  (i) on behalf of Mäori claimants, receives and manages assets that are transferred by the Crown as part of the settlement of a claim under the Treaty of Waitangi; and
  (ii) is contemplated by the deed of settlement of the claim as performing the functions referred to in subparagraph (i):

(l) the trustees of a trust who—
  (i) on behalf of Mäori claimants, receive and manage assets that are transferred by the Crown as part of the settlement of a claim under the Treaty of Waitangi; and
  (ii) are contemplated by the deed of settlement of the claim as performing the functions referred to in subparagraph (i).

Entities that are excluded from the list but which may be eligible to apply the Mäori authority rules will need to approach the government and seek to be added to the list. This will allow the government to assess whether a person satisfies the policy criteria to be taxed as a Mäori authority. The process for seeking to be added to the list of eligible persons is still being finalised.

Election requirements to be a Mäori authority

- Section HI 3(1) to (4) set out the rules that an eligible person must comply with in order to elect to be a Mäori authority:
- An eligible person must give an election notice to the Commissioner of Inland Revenue stating that it wishes to make an election to be a Mäori authority.
- If the Commissioner accepts the election notice, the Commissioner must give to the eligible person a notice accepting the election.
- An election will take effect from the date advised in the notice from the Commissioner accepting the election.
- An election will cease when the eligible person either gives notice to the Commissioner that the election is cancelled or no longer meets the criteria set out in section HI 2, whichever occurs earlier.
- An election is required to be made only by those eligible persons that wish to be a Mäori authority. If an eligible person chooses not to make an election its tax treatment will be determined under the general tax rules according to its entity type.

Section HI 3(5) provides that a person will cease to be a Mäori authority at the end of the 2003-04 income year unless that person:

- is an eligible person at the beginning of the 2004-05 income year; and
- gives to the Commissioner a notice of an election to become a Mäori authority, which the Commissioner accepts at or before the end of the 2004-05 income year.

This election process should provide sufficient time for Mäori authorities to properly consider whether or not they wish to enter the new rules in the 2004-05 income year. It is also flexible enough to deal with cases when an organisation becomes eligible to be a Mäori authority part-way through an income year but did not exist before the beginning of the income year. In this case, provided the Commissioner agrees, the election may take place in respect of the income year in which the person becomes eligible to be a Mäori authority. This will avoid the problem of taxpayers being taxed according to two sets of tax rules in respect of the same income year.

Taxation of Mäori authority distributions – sections HI 4, HI 5 and OB 1

Definition of "distribution"

Section HI 4(1) defines the term "distribution" for the purposes of the Mäori authority rules. "Distribution" means all sums in money that are paid, credited or advanced by a Mäori authority for the benefit of one of its members. The term also includes property transfers between Mäori authorities and their members to the extent that the consideration paid does not equal the true value of the property.

The definition should accommodate the wide range of financial and non-financial benefits that Mäori authorities provide to their members.

Because of the wide nature of the definition of "distribution", it will be possible for Mäori authority members to receive both a dividend payment (if the authority is a Mäori incorporation) and an education scholarship or some other assistance grant. Even so, section HI 4(2) clarifies that if a distribution would otherwise be a "dividend" in the hands of a member it must be regarded as a "distribution" to the member instead, unless it is an exempt dividend under section CB 10.

Definition of a "member" of a Mäori authority

The definition of a "member" in section OB 1 has been amended for the purposes of the Mäori authority rules to mean a person or a group of persons who are shareholders of a Mäori authority (if the authority is a company); or beneficiaries of a Mäori authority (if the authority is a trust).

Taxable distributions and non-taxable distributions

Mäori authorities will be able to make two types of distributions: taxable distributions and non-taxable distributions.

A "taxable Mäori authority distribution" is a distribution that is made from:

- gross income of the authority derived in the 2004-05 or subsequent income year, and
- gross income of the authority that is not exempt from tax.

Section HI 5 deems a taxable Mäori authority distribution to be gross income of the Mäori authority member. This means that Mäori authority members that meet the return filing requirements must include this income in their tax returns or personal tax summaries at the end of the year.

It follows from the definition of "taxable Mäori authority distribution" that a non-taxable distribution is a distribution of:

- income earned under the previous rules (before the 2004-05 income year);
- income that is exempt from tax in the hands of the authority irrespective of when it arose, or
- tax-paid income sources to which section HI 8 applies. Section HI 8 provides that when companies elect to be Mäori authorities, subsequent distributions of retained earnings (which represent the company's accumulated tax paid income) will constitute non-taxable distributions. Similarly, when trusts elect to be Mäori authorities, any distributions of trustee income (which the trust derived before becoming a Mäori authority) will be treated as non-taxable distributions.

Non-taxable distributions are exempt from tax in the hands of Mäori authority members.

Table 1 summarises the tax consequences of distributions made from various income sources derived in the pre-reform and post reform periods.

Table 1: Tax consequences of Mäori authority distributions

Distributions made from:	Derived in the 2003-04 or earlier income year - Pre-reform	Derived in the 2004-05 or subsequent income year - Post-reform
Tax exempt income of the authority	Non-taxable distribution to member	Non-taxable distribution to member
Taxable income of the authority	Non-taxable distribution to member	Taxable Mäori authority distribution

Mäori authority credits – sections KC 1(4), HI 7, LB 1(1), LD 3B and OB 1

Section HI 7 provides that the gross income of Mäori authority members includes the value of a Mäori authority credit attached to a taxable Mäori authority distribution.

Section OB 1 defines "Mäori authority credit" to mean the amount attached to a distribution by a Mäori authority in accordance with section MK 6 or treated as being attached to the distribution under section NF 8B. Section NF 8F deems the resident withholding tax deductions made from taxable Mäori authority distributions to be Mäori authority credits.

For discussion on the resident withholding tax implications of taxable Mäori authority distributions see "Application of the resident withholding tax rules – Part NF", later in this article.

Determining Mäori authority credits in certain circumstances

Amendments to section LB 1 provide for the determination of an amount of Mäori authority credit in certain circumstances:

- Section LB 1(1)(eb) determines the level of credit when the Mäori authority credit attached to a distribution has a base ratio greater than the maximum base ratio. In this case, the credit is equal to the maximum base ratio computed under section MK 7.
- Section LB 1(1)(m) determines the level of credit when the Mäori authority credit has been determined to be part of an arrangement to obtain a tax advantage under section GC 27B. In this case, the credit is equal to the amount of the credit which remains after it is reduced by the amount referred to in section GC 27B(6)(b).
- Section LB 1(3) determines the level of credit in relation to a beneficiary of a trust who derives a dividend with a Mäori authority credit attached. In this case the credit is equal to the amount calculated in accordance with the formula in section LB 1(1)(a)[3].

[3] A consequential amendment to section LB 1(1)(a) has not been made to reflect the fact that it now applies to Mäori authority credits. The error is expected to be corrected in a future bill.

Mäori authority credits refundable

New section LD 3B ensures that Mäori authority members are able to claim a credit of tax of an amount equal to the Mäori authority credits attached to taxable Mäori authority distributions. This is so even if a member derives income that is exempt under section CB 4(1). If the credit more than satisfies the member's income tax obligations, that member is entitled to a refund of any surplus credits under section MD 1 and under the Tax Administration Act 1994.

Low-income rebate

An amendment to section KC 1(4) ensures that taxable Mäori authority distributions received by Mäori authority members are taken into account in the calculation of income for the purposes of determining the low-income rebate.

Anti-streaming rules for distributions – sections GC 27B, HI 6 and MK 7

Mäori authorities will be able to make distributions from either taxable or non-taxable sources. Therefore it is possible that, since most members may benefit more from a non-taxable distribution, a Mäori authority might wish to direct its income from non-taxable sources to those members best able to use them. This is known as "streaming". The risk here is that, for tax purposes, some members might be treated more favourably than others unless safeguards are in place to mitigate this risk.

For example, a Mäori authority proposes to grant two scholarships as part of its education scholarship programme. The funding for this initiative comes from both taxable and non-taxable sources. A member on a 33% tax rate will pay no further tax if he or she receives a non-taxable distribution. However, if the member receives a taxable distribution, there will be further tax to pay.

To address this potential streaming issue, section HI 6 provides that when a distribution is made to members, all recipients will be treated as having received a proportionate share of the taxable or tax-exempt amounts distributed. This rule aims to ensure parity among recipient members while allowing Mäori authorities to continue to make distributions from different sources. For example, if a Mäori authority distributes education scholarship money, the successful recipients must receive a proportionate share of any taxable or tax-exempt amounts available for distribution.

Section GC 27B provides an anti-avoidance rule to deal with streaming that forms part of an arrangement to obtain a tax advantage. This is similar to the rule for imputation streaming. The definitions of "tax advantage", "tax credit advantage" and "account advantage" in section OB 1 have been consequentially amended to reflect the insertion of new section GC 27B.

Section MK 7 will require that every taxable Mäori authority distribution is attributed with Mäori authority credits at the same level, unless the authority advises the Commissioner that the distribution is not being credited at a different level as part of an arrangement to obtain a tax advantage.

Transitional rules for companies and trusts electing to be or ceasing to be a Mäori authority – sections HI 8 and HI 9 and Table HI 8

As previously mentioned, companies and trusts may choose to apply the general tax rules, if they meet the requirements of those rules, at any time from the beginning of the 2004-05 income year. Accordingly, they will need to consider what rules will regulate their exit or entry from the Mäori authority rules. These transitional rules are set out in section HI 8 and Table HI 8. They are designed to ensure that eligible persons moving into or out of the Mäori authority rules will not be subject to any additional tax consequences.

For example, if a company becomes a Mäori authority, the company must apply row 1 of Table HI 8. The tax consequence of this change means that the company must cease to be an imputation credit account company and the rules relating to a company ceasing to be an imputation credit account company will apply. When the company makes any subsequent distributions from its retained earnings, accumulated profits or capital reserves such distributions will not be treated as taxable Mäori authority distributions.

Companies or trusts re-entering the Mäori authority rules

Section HI 9 deals with situations where a company or a trust re-enters the Mäori authority rules. The purpose of this provision is to treat the trust or company as realising its assets at market value and subsequently re-acquiring them at market value. This measure ensures that before a company or trust re-enters the Mäori authority rules, any tax liability on property such as trading stock is incurred at the company or the trust tax rate.

For depreciation purposes, however, the cost of the property is the lower of the market value of the property on the deemed acquisition date or the original cost of the property to the company or the trust. This rule ensures that the Mäori authority does not receive an uplift in the base price of the property for depreciation purposes.

For example, if a trust ceases to be Mäori authority and then subsequently elects to become a Mäori authority again, the trust must apply row 6 of Table 8. The tax consequence of this change is that market value calculations must be made in accordance with section HI 9 and the trust must also apply row 2 of Table 8.

If a Mäori authority company has elected out of the Mäori authority rules to amalgamate and then the amalgamated company elects to be a Mäori authority again, it is treated as re-entering the Mäori authority rules and must apply section HI 9. The tax consequence of this change is prescribed by row 5 of Table 8.

Allowing Mäori authorities to re-enter the Mäori authority tax rules provides flexibility for governing boards and trusts to cope with changes in the nature of a Mäori authority's operations over time. This measure also means that Mäori authorities can avoid the costs associated with winding up the authority and reconstituting a new entity.

Mäori authority credit account – new Part MK

New Part MK governs the operation of the Mäori authority credit account and is largely modelled on the existing imputation credit account provisions.

Mäori authorities required to maintain a "Mäori authority credit account" – section MK 1

Unless otherwise excluded, Mäori authorities are required to establish and maintain a Mäori authority credit account for each imputation year or specified period.

"Imputation year" is defined in section OB 1 as the period from 1 April to the following 31 March. Mäori authorities with non-standard balance dates are required to operate the account on a 1 April to 31 March basis.

Under section MK 1(2), some Mäori authorities will not be required to operate a Mäori authority credit account. They are:

- a Mäori authority whose constitution prohibits distributions of any kind being made to any shareholder or beneficiary of the authority, and
- a Mäori authority that solely derives exempt income (other than exempt dividend income under sections CB 10 and CZ 4).

Account balances – sections MK 2 and MK 3

All Mäori authorities that operate a Mäori authority credit account must record as their opening balance on 1 April in each year the amount of the closing balance as at the previous 31 March. The opening balance as at 1 April 2004 will be nil.

Table HI 8

Row	If	becomes	and reverts to being	then
1	a company	a Mäori authority		(a) the company ceases to be an imputation credit account company and the rules relating to a company ceasing to be an imputation credit account company apply; and (b) retained earnings, accumulated profits and capital reserves are treated as an amount from which may be made a distribution that is not a taxable Mäori authority distribution.
2	a trust	a Mäori authority		trustee income is treated as an amount from which may be made a distribution that is not a taxable Mäori authority distribution.
3	a Mäori authority	a company that is not a Mäori Authority		(a) the Mäori authority may transfer a credit balance in the Mäori authority credit account to the company's imputation credit account, and section MK 8 applies in respect of a debit balance in the Mäori authority credit account; and (b) taxable income derived by the Mäori authority in the 2003-04 or an earlier income year is available subscribed capital.
4	a Mäori authority	a trust that is not a Mäori authority		taxable income derived by the Mäori authority in the 2003-04 or an earlier income year is treated as being trustee income.
	If	**becomes**	**and reverts to being**	**then**
5	a Mäori authority	a company that is not a Mäori authority	a Mäori authority	(a) market value calculations are required in accordance with section HI 9[4]; and (b) the company must apply row 1
6	a Mäori authority	a trust that is not a Mäori authority	a Mäori authority	(a) market value calculations are required in accordance with section HI 9; and (b) the trust must apply row 2.

How to use this table. *Read columns from left to right according to the row that fits your situation*

Credits to the Mäori authority credit account – section MK 4

Section MK 4 sets out the circumstances in which credits arise to the Mäori authority credit account in an imputation year and the timing of those credit entries for that year. The following amounts arise as credits to the Mäori authority credit account:

- New Zealand income tax paid during the imputation year to meet a provisional tax obligation or to satisfy an income tax liability under section BC 9. The credit arises on the date the tax is paid. However, a credit does not arise in relation to:
  - income tax payable for the 2003-04 or an earlier income year,
  - income tax paid on income derived before the company or trust made an effective election to be a Mäori authority part-way through the imputation year,
  - income tax paid by way of crediting under section LB 2(2), or
  - income tax paid by way of crediting of further income tax under section MK 8(5).
- Provisional tax offsets within a wholly-owned group under section MB 9(5).
- Further income tax under section MK 8. A credit of further income tax is equal to the debit balance in the Mäori authority credit account at 31 March and arises on the date the tax is paid.
- Mäori authority credits attached to distributions received by Mäori authorities. The credit arises on a date the distribution is made.

[4] In Table HI 8 there are two incorrect references to HI 7, these should refer to section HI 9. The errors are expected to be corrected in a future bill.

- Imputation credits attached to a dividend received by Mäori authorities. The credit arises on a date the dividend is paid.
- Dividend withholding payment credits attached to dividends received by Mäori authorities that do not operate a dividend withholding payment account. A corporate Mäori authority has the option of operating a dividend withholding payment account under Part MG. If it chooses not to do so any withholding payment credits attached to dividends which it receives give rise to a credit at the time the dividend is paid.
- A credit to offset a previous debit for an arrangement to obtain a tax advantage. If the Commissioner determines that Mäori authorities have entered into an arrangement to obtain a tax advantage and determines the amount of the credit which is subject to the arrangement, a debit arises to the account of that amount. If the matter is subsequently resolved in favour of the authority, a credit arises of the amount previously debited on a date that the debit arose.
- The amount of any resident withholding tax deduction deemed to have been derived by the Mäori authority in terms of section NF 12(b). The credit arises on the date that the resident withholding tax is deducted.

These credits increase the amount available for allocation to taxable Mäori authority distributions paid to Mäori authority members, while credits allocated to those distributions are debited to the Mäori authority credit account. The timing of when these credits arise is prescribed in section MK 4(2).

Inability to transfer dividend withholding payment – credit balances to the Mäori authority credit account

Under the imputation rules, companies can transfer all or part of the end-of-year credit balances in their dividend withholding payment account to their imputation credit account. However, no such provision exists for corporate Mäori authorities to transfer the credit balance in a dividend withholding payment account to their Mäori authority credit account.

The reason is that if a corporate Mäori authority should cease to be a Mäori authority any credit balance in the Mäori authority credit account must be transferred to the imputation credit account (in accordance with section HI 8(3)). Because excess imputation credits are not refundable, whereas excess dividend withholding payment credits are, the conversion of dividend withholding payment credits to imputation credits would penalise companies ceasing to be Mäori authorities.

The ability of a corporate Mäori authority to continue to maintain a dividend withholding payment account avoids the compliance costs associated with tracing dividend withholding payment credits and debits in a Mäori authority credit account, to allow for the crediting and debiting of the dividend withholding account when Mäori authorities become companies.

Debits to the Mäori authority credit account – section MK 5

Section MK 4 sets out the circumstances in which debits arise to the Mäori authority credit account in an imputation year and the timing of those debit entries for that year. Debits arise to the Mäori authority credit account in the following circumstances:

- Mäori authority credits attached to distributions paid by the Mäori authority. If a Mäori authority attaches a Mäori authority credit to a distribution to one of its members, a debit equal to the amount of the credit arises on the date the distribution is made.
- The amount of any provisional tax allocated by the Mäori authority to an underpaid company under section MB 9(5). This debit arises on the date the tax is paid.
- If a Mäori authority receives a refund of income tax, a debit arises on the date of payment of the refund. However, there are exceptions to this rule—no debit arises for refunds of tax paid:
  - In relation to the 2003-04 or earlier income year.
  - In relation to an income year or part of an income year during which the Mäori authority did not maintain a Mäori authority credit account. In respect of part of the income year, the debit to the account is apportioned to the number of days in which the authority was a Mäori authority.
- An allocation debit under section MK 7(4). Section MK 7(4) requires Mäori authorities to attach credits at the same ratio to all distributions made during an imputation year. If there has been a breach of this rule, an allocation debit must be entered into the account on 31 March of the year in which the authority was in breach of the rule.
- Refunds of dividend withholding payments paid to the Mäori authority. If a Mäori authority does not operate a dividend withholding payment account and receives a dividend withholding payment refund, a debit arises equal to the amount of the refund on the date the refund is paid.
- A debit arises if there is a loss of continuity of shareholding beyond the specified level. This debit arises on the date there is the loss of continuity. (See following discussion, "Loss of continuity – section MK 5(3) and 5(4)".)
- A debit arises for any refund of income tax paid if the refund is less than the debit that is created as a result of a loss of continuity.

- If the Commissioner has determined that there has been a tax advantage in terms of section GC 27B and has determined the amount which is the subject of the arrangement, a debit of that amount arises at the end of the year in which the arrangement commenced.
- If a company ceases to be a Mäori authority, a debit arises to the account of an amount of the credit balance in the account immediately before the company ceased to be a Mäori authority.
- Any overpaid income tax applied by the Commissioner in satisfaction of tax liabilities, other than income tax or provisional tax instalments, except to the extent that the amount applied:
  - relates to income tax paid for the 2003-04 or earlier income year, or
  - relates to income tax paid before the date that a debit arose owing to a breach in continuity of shareholding and is no more than the debit that arose on that date.

The timing of when the debits arise is prescribed in section MK 5(2).

Loss of continuity – section MK 5(3) and 5(4)

Section MK 5(3) provides that corporate Mäori authorities cannot carry forward Mäori authority credits unless a continuity of shareholding test is satisfied. As with companies, this test limits the carry-forward of Mäori authority credits for subsequent use to situations where at least 66% of those persons who will benefit from such use bore the tax liability that gave rise to the credit.

In order to achieve this result, section MK 5(3) ensures that if the continuity of shareholding test is not satisfied, credits in the Mäori authority credit account are cancelled by a debit entry in the account. The debit entry arises on the day there is a loss of continuity.

Any debit can only be taken into account once for the purpose of determining whether a credit balance has been cancelled out. A credit cancelled out before the loss of continuity by a debit (irrespective of whether the debit arises before or after the credit) is not affected.

Section MK 5(4) provides that for the purpose of section MK 5(1)(f) the minimum voting interest or market value interest that a person holds in a Mäori authority will be equal to the lowest voting interest or market value interest held by that person during the period.

These measures are designed to support the allocation rules contained in section MK 7. Effectively, they ensure that Mäori authority credits cannot be retained in a Mäori authority company that is sold.

Attaching a Mäori authority credit to a distribution – section MK 6

Section MK 6 allows a Mäori authority that is required to operate a Mäori authority credit account to attach a Mäori authority credit to taxable distributions. This is done at the time of the payment of the distribution.

Allocation rules – section MK 7

Section MK 7 provides that a Mäori authority may not attach Mäori authority credits to a taxable Mäori authority distribution at a "base ratio" which exceeds:

Tax rate/1-Tax rate

> Where:
>
> "Tax rate" is the Mäori authority tax rate (expressed as a percentage) for the income year that is concurrent with the imputation year in which the distribution is made.

This formula computes the "maximum base ratio" at which distributions may have credits attached.

The term "base ratio" means an amount calculated according to the formula:

Mäori authority credit/distribution

> Where:
>
> "Mäori authority credit" is the amount of the credit attached to the distribution and, if no credit is attached that amount is zero.
>
> "distribution" is the amount of the distribution by the Mäori authority excluding any credit attached.

Therefore the maximum base ratio allowed for the 2004-05 income year is $19.50/$80.50. If the authority makes a distribution with a base ratio in excess of the maximum base ratio that distribution is treated as having a base ratio equal to the maximum base ratio (section LB 1(1)(eb)).

Allocating credits at different ratios during the year – section MK 7(2)

Section MK 7(2) requires that every distribution during an imputation year must carry credits at the same base ratio. This rule is aimed at preventing "streaming" of Mäori authority credits to Mäori authority members.

The first taxable Mäori authority distribution paid by an authority during the imputation year is referred to as the "benchmark distribution". All subsequent distributions paid during that year must carry credits at the same base ratio as the benchmark distribution unless a "base ratio change declaration" is made. For example, if no credits are attached to the benchmark dividend, every subsequent dividend paid in that year should also have no credits attached.

Base ratio change declaration – section MK 7(4)

A base ratio change may only occur if a Mäori authority completes a statutory declaration to the effect that a subsequent distribution is not being credited at a different base ratio to the benchmark distribution as part of an arrangement to obtain a tax advantage. The base ratio change declaration must be delivered to the Commissioner before the subsequent distribution is paid. This declaration is provided for in section MK 7(4).

Allocation debit – section MK 7(5)

If an authority is in breach of section MK 7(2), a debit (known as the "allocation debit") arises to the Mäori authority credit account of an amount calculated according to the formula:

(distributions x ratio) – credits

Where:

"distributions" is the amount of all taxable Mäori authority distributions made by the authority during the imputation year (excluding credits attached to the distributions).

"ratio" is the lesser of:
highest base ratio of all the distributions made during that year
the maximum base ratio allowable for that year

"credits" is the amount of all Mäori authority credits attached to distributions made by the authority for that year.

The effect of the debit to the Mäori authority account is to assume that all distributions paid during the imputation year are credited at the highest base ratio.

Further income tax, end of year debit balance – section MK 8

Mäori authorities may, during an imputation year, attach credits to distributions in anticipation of credits subsequently arising in the Mäori authority credit account. The account may, therefore, run into debit.

Section MK 8(1) and (2) provide that if there is a debit balance at the end of 31 March, the authority is required to pay to the Commissioner, on or before 20 June following the end of the imputation year in which there was the debit balance, an amount equal to that debit balance. This is an amount of tax by way of further income tax.

Section MK 8(3) and (4) provide that if there is a debit balance immediately before a Mäori authority stops being a Mäori authority, the authority is liable to pay to the Commissioner further income tax of an amount equal to the debit balance in the Mäori authority credit account. This amount must be paid to the Commissioner no later than the last day on which the authority is still a Mäori authority.

Section MK 8(5) provides that payments of further income tax may be used to offset a future income tax liability or any instalment of provisional tax in accordance with section MB 10.

If this amount is not paid by the due date, the usual penalty provisions for non payment of income tax apply. (See later discussion on Mäori authority distribution penalty tax.)

Credits and debits incorrectly recorded – section MK 9

The Commissioner can make corrections to the Mäori authority credit account and unless the authority establishes that the Commissioner is wrong, the account must be corrected accordingly.

Limits on refunds of tax to Mäori authorities – section MD 2B

Refunds of income tax to Mäori authorities will be limited to the credit balance in the Mäori authority credit account.

The amount of credits attached to distributions in each imputation year should not exceed the credits in the Mäori authority credit account (after taking into account further income tax) as at 31 March.

If a Mäori authority allocated credits in year one and in year two was entitled to a refund of income tax paid in year one, the Commissioner would, if the authority had a nil or debit balance in its Mäori authority credit account, effectively be refunding an amount which had already been passed on by way of credits to members.

Section MD 2B, therefore, imposes a limit on the amount of income tax which may be refunded to a Mäori authority. The amount to be refunded must not exceed the credit balance in the account at the previous 31 March. Any excess which is not refunded may be offset against a future income tax liability.

If a Mäori authority has ceased being a Mäori authority and becomes entitled to a refund of income tax in accordance with section MD 1, the refund to be paid to the authority cannot exceed the credit balance that arose as a debit under section MK 5(1)(i).

Mäori authority income tax rate of 19.5% – schedule 1, Part A, clause 2

The income tax rate applying to the income of Mäori authorities has been reduced from 25% to 19.5%. One reason for the lower tax rate is that most members of Mäori authorities will be on the statutory tax rate of 19.5%.

Resident withholding tax non-declaration rate on distributions over $200 – schedule 14, clause 3

An amendment to schedule 14—rate of resident withholding tax deductions, requires Mäori authorities to deduct from taxable distributions over $200 resident withholding tax at the rate of 39% if they do not have a record of the tax file number of the member to whom the distribution is being made.

This treatment is consistent with the rules that apply to resident withholding tax on interest income. Mäori authority members can claim a refund of any resident withholding tax over-deducted by filing a tax return or a personal tax summary.

New information requirements for Mäori authority members under the Tax Administration Act 1994

New section 33(1B) allows charities and other exempt entities that are members of Mäori authorities and receive taxable distributions to file returns at the end of the year in order to claim a refund of their Mäori authority credits.

The non-return filing requirements in section 33A have been amended to specifically cover distributions from Mäori authorities that have Mäori authority credits attached or have had resident withholding tax deducted from them.

New section 33A(1)(a)(iv) ensures that Mäori authority members whose total income exceeds $38,000 will be required to request a personal tax summary or file a tax return if they also receive a taxable Mäori authority distribution greater than $200.

New information requirements for Mäori authorities under the Tax Administration Act 1994

Keeping of business records

Section 22(2) has been amended to require Mäori authorities to maintain for seven years records relating to the Mäori authority credit account. This rule is the same for companies that operate an imputation credit account.

Member distribution statement

Section 31 has been amended to require Mäori authorities to provide their members with information about any distributions they receive so that their members can comply with their tax obligations. The information must be provided at the time the payment is made and must show:

- the name of the Mäori authority
- the date the distribution is made
- the name and address, and the tax file number if the number is known by the Mäori authority, of the member to whom the distribution is made
- the amount of the distribution made to the member, including what portion is a taxable distribution and what portion is a non-taxable distribution
- the amount of a Mäori authority credit attached to the distribution or treated as being attached to the distribution under NF 8B, and
- such other information as the Commissioner may require.

Annual returns of income

Section 57 has been amended to require Mäori authorities to furnish an annual tax return showing a complete statement of their taxable income.

Mäori authority distribution statement

Section 68B requires Mäori authorities to furnish a distribution statement to Inland Revenue for an income year. The statement must show the following details:

- the date on which the distribution is made
- the total amount of distribution made
- the total amount of Mäori authority credits attached to the distribution (to be shown as a nil amount if Mäori authority credits have not been attached)
- the base ratio of the distribution, and
- such further information as the Commissioner may require.

The distribution statement is to be forwarded to the Commissioner no later than the time allowed by section 37 of the Tax Administration Act 1994 for furnishing a return of income for an income year.

Annual Mäori authority credit account return required to be furnished

New section 69B requires Mäori authorities to furnish a Mäori authority credit account return that shows a record of the debits and credits to, and the opening and closing balances of, its Mäori authority credit account for each imputation year.

This annual return must be provided to the Commissioner no later than the time allowed by section 37 for furnishing a return of income for an income year that corresponds with the relevant imputation year covered by the Mäori authority credit account return.

In addition, the authority should show in the return the amount of further income tax payable (under section MK 8 of the Income Tax Act 1994) and the amount of any Mäori authority distribution penalty tax payable.

Under new section 70B the Commissioner can require Mäori authorities to file a Mäori authority credit account return at any time in respect of an imputation year or a specified period. For instance, the Commissioner may require a return to be furnished if there is reason to believe that entries in the account are not correct.

If a Mäori authority ceases to be a Mäori authority (for example, if it no longer owns land that is subject to the Te Ture Whenua Mäori Act 1993) the authority is required to furnish within two months of its ceasing to be a Mäori authority, a Mäori authority credit account return for the period from the beginning of the imputation year until the date it ceased to be a Mäori authority.

Mäori authority distribution penalty tax provisions – sections 97B, 140CB, 143DB and 181B of the Tax Administration Act 1994

Section 97B allows the Commissioner to make an assessment of Mäori authority distribution penalty tax.

Section 140CB provides that a Mäori authority that is liable to pay further income tax under section MK 8 of the Income Tax Act 1994 for an end-of-year debit balance is also liable to pay a special tax known as "Mäori authority distribution penalty tax". The amount of this penalty tax is 10% of the amount of further income tax (in other words, 10% of the debit balance at 31 March) and is due by the following 20 June. This penalty tax is intended to be a disincentive for Mäori authorities to be in debit at the end of the year.

Section 143DB clarifies the application of the other tax provisions in relation to the Mäori authority penalty tax.

Section 181B outlines the circumstances in which the Commissioner will remit Mäori authority penalty tax imposed under section 140CB.

Consequential amendments to the imputation provisions – sections LB 2(3), ME 1(2)(j), ME 4(1) and ME 5(1)

Credit of tax for imputation credits

Section LB 2(3) has been amended so that any unused portion of an imputation credit which forms part of the gross income of a Mäori authority is converted to a loss using the Mäori authority tax rate of 19.5%.

Mäori authorities not required to maintain an imputation credit account

Section ME 1(2)(j) ensures that corporate Mäori authorities that are required to establish and maintain a Mäori authority credit account under section MK 1 are prevented from also operating an imputation credit account.

Credits arising to the imputation credit account

Section ME 4(1)(e) applies to companies that receive taxable distributions with Mäori authority credits attached. The amendment ensures that companies that are required to operate an imputation credit account can include Mäori authority credits attached to such distributions as a credit in their imputation credit account. Section ME 4(2)(cb) provides that the credit arises on the date that the distribution is made.

Section ME 4(1)(k) ensures that companies that stop maintaining a Mäori authority credit account during an imputation year can include a credit in their imputation credit account equal to the credit balance that existed in the company's Mäori authority credit account. Section ME 4(2)(i) provides that the credit arises on the date that a debit entry is made to the Mäori authority credit account under section MK 5.

This amendment ensures that corporate Mäori authorities can transfer credit balances in the Mäori authority credit account to the imputation credit account as required by section HI 8 and row 3 of Table HI 8.

Debits arising to the imputation credit account

Section ME 5(1)(k) includes as a debit entry in the imputation credit account an amount equal to the credit balance of the imputation credit account if, during the imputation year, the company establishes a Mäori authority credit account. Section ME 5(2)(jb) provides that the debit arises on the date immediately before the company becomes a Mäori authority.

This provision is necessary to close off an imputation credit account which is in credit balance when a company elects to be a Mäori authority.

Removal of the "Mäori authority exclusion" in the definition of "company" – sections HI (1) and OB 1

Corporate Mäori authorities were previously prevented from using the company income tax provisions because Mäori authorities were specifically excluded from the definition of "company".

The definition of "company" in section OB 1 has been amended to remove the Mäori authority exclusion. Effectively, this means that the income tax provisions that relate to companies will now apply to Mäori authorities whose legal form is that of a company.

However, section HI 1(2) limits the circumstances in which corporate Mäori authorities can use the loss grouping, amalgamation, consolidation and co-operative company rules. Other specific provisions may also limit the extent to which corporate Mäori authorities can avail themselves of certain company provisions.

Section HI 1(2) clarifies that a Mäori authority may only:

- offset losses (or income) against the income (or loss) of another Mäori authority
- amalgamate with another Mäori authority whose legal form is that of a company
- be part of a consolidated group that comprises Mäori authorities only, and
- be a co-operative company if all of its shareholders are Mäori authorities.

This amendment ensures that the loss grouping, consolidation, and amalgamation rules apply to Mäori authority companies only or ordinary companies only, and not to combinations of Mäori authority companies and ordinary companies. This is to avoid the risk that companies not eligible to apply the Mäori authority rules could obtain unintended tax advantages.

A number of specific amendments have been made to incorporate the new Mäori authority rules into various provisions relating to companies. These amendments are briefly outlined below.

Provisions relating to co-operative companies

Section HI 4(3) allows Mäori authorities that are cooperative companies to attach Mäori authority credits to cash distributions or notional distributions in the same way as an imputation credit under section ME 5.

Section HI 5(3) states that a cash distribution made be a Mäori authority that is a cooperative company to its members will constitute a taxable Mäori authority distribution if the authority:

- makes the distribution in respect of a notional distribution, and
- has made a determination under section ME 35 in respect of that notional distribution.

The formula contained in section ME 36(1), which determines the amount of imputation credit that may be attached to a cash distribution made by a Mäori authority that is a co-operative company, has been amended to take account of the basic rate of income tax applying to Mäori authorities.

The formula contained in section ME 38(1), which determines the amount of the notional distribution deemed to have been paid by a corporate Mäori authority to its shareholders, has also been amended to reflect the new Mäori authority tax rate.

Dividend withholding payments provisions – Part NH

The formula in section NH 2(1), which computes the level of deduction of dividend withholding payment, has been amended to reflect the new Mäori authority tax rate.

Branch equivalent tax accounts of companies – Part MF

The formula contained in section MF 4(1)(b), which computes a credit to be recorded in the branch equivalent tax account of a company, has been amended to take account of the new Mäori authority tax rate.

The formula contained in section MF 8(2)(b), which computes a credit to be recorded in the branch equivalent tax account of a consolidated group, has also been amended to take account of the new Mäori authority tax rate.

Application of the resident withholding tax rules – Part NF

A number of amendments have been made to the resident withholding tax rules to provide for the deduction of resident withholding tax from taxable Mäori authority distributions.

Section NF 1(2)(c) ensures that the resident withholding tax rules apply to "taxable Mäori authority distributions" made by Mäori authorities to their members so that deductions of resident withholding tax can be made under new sections NF 2(1)(e) and (f).

Section NF 2(1)(e) provides for the calculation of resident withholding tax in respect of cash taxable distributions. Section NF 2(1)(f) applies to the calculation of resident withholding tax in respect of non-cash taxable distributions.

Section NF 2(4(b)(iv) requires Mäori authorities to make deductions of resident withholding tax from payments of taxable Mäori authority distributions.

Section NF 2(7) has been amended to cover the payment of taxable Mäori authority distributions. This provision exempts Mäori authorities from the obligation to deduct resident withholding tax from distributions if the recipient member holds a valid certificate of exemption from resident withholding tax and this certificate has been sighted by the authority and is in fact valid. For details about how to apply for this exemption status see *Tax Information Bulletin* Vol 6, No 5, January 1995.

Section NF 2B requires a company to notify interest payers that they are a company when they become entitled to receive a payment of resident withholding income. This section has been amended to exclude corporate Mäori authorities from this requirement.

Section NF 4(4) has been amended to require Mäori authorities who deduct resident withholding tax from distributions it makes to their members to pay all deductions of resident withholding tax to Inland Revenue on a monthly basis. The deductions made during any month must be paid to Inland Revenue no later than the 20th of the following month.

Section NF 6(2) has been amended so that resident withholding tax deductions can be varied to correct errors in previous deductions in respect of taxable Mäori authority distributions.

New section NF 8B ensures that the amount of the deduction of resident withholding tax from a taxable Mäori authority distribution is treated as a Mäori authority credit attached to the distribution.

Schedule 14 has been amended in the 2004-2005 income year to provide that the tax rate to be used in the calculation of resident withholding tax deductions from taxable Mäori authority distributions will be 19.5%. However, if such distributions are greater than $200 and the authority does not have a record of the tax file number of the member to whom the distribution is made, the applicable tax rate will be 39%.

Meaning of Mäori authority rules

There is a new meaning of "Mäori authority rules" in section OZ 1(1). Mäori authority rules mean Parts HI and MK, sections GC 27B, LD 3B and MD 2B, and Schedule 1, Part A, clause 2 of the Income Tax Act 1994. These rules also include 31, 57, 68B, 69B, 70B, 97B, 140CB, 140DB, and 181B of the Tax Administration Act.

Standardising the tax rules for the Mäori Trusts – section HK 14 repealed

The specific agent provision that applied to the Mäori Trustee in section HK 14 has been repealed.

The Mäori authority rules contained in new subpart HI apply to the taxation of income derived by the Mäori Trustee in respect of all of its agencies relating to assets administered under Te Ture Whenua Mäori Act 1993.

The Mäori Trustee also acts as trustee of a large number of trusts constituted by order of the Mäori Land Court in accordance with Te Ture Whenua Mäori Act 1993. These trusteeships are also covered by the Mäori authority rules.

Thus the Mäori authority rules will apply to the Mäori Trustee in all situations where the Trustee's agencies or trusteeships involve land subject to the provisions of the Te Ture Whenua Mäori Act 1993.

Each trust or agency of the Mäori Trustee will be taxed separately under the Mäori authority rules.

A number of consequential amendments have also been made to remove references to section HK 14 throughout the Income Tax Acts.

Donations deduction for Mäori Authorities – section DI 2

Until now, Mäori authorities have been entitled to claim a deduction for donations made to any Mäori association (within the meaning of the Mäori Community Development Act 1962). Any donation to a Mäori association was able to be deducted up to a maximum of 5% of the net income of the Mäori authority claiming the deduction. Net income is calculated after taking into account all deductions except the donations deduction.

Section DI 2 has been amended to extend the donations deduction to include donations to organisations with "approved donee status". The maximum level of deduction remains at 5% of the authority's net income.

To qualify for approved donee status, an organisation must be established for charitable, benevolent, philanthropic, or cultural purposes within New Zealand or must be specifically listed in section KC 5. As only organisations can qualify for donee status, Mäori authorities would not be able to claim this deduction for distributions to individuals.

This deduction is similar to the deduction for donations paid by companies in section DJ 4. If a corporate Mäori authority makes a donation to an organisation with approved donee status it will only be permitted to claim a deduction for that donation under section DI 2 (and not section DJ 4).

This change applies from the income year 2003-04.

TAXPAYER COMPLIANCE, STANDARDS AND PENALTIES

GOOD BEHAVIOUR

Section 141FB of the Tax Administration Act 1994

Introduction

An amendment to the Tax Administration Act 1994 gives effect to the recommendations outlined in the discussion document *Taxpayer compliance, standards and penalties: a review*, released in August 2001, that taxpayers' past compliance should be taken into account when imposing shortfall penalties.

The amendment halves the rate of shortfall penalties if within the previous two years, in the case of GST, fringe benefit tax, PAYE and resident withholding tax, or four years, in the case of all other taxes, the taxpayer has not been liable to pay a shortfall penalty on a tax shortfall identified during an audit.

There is no probation period in the case of evasion. All subsequent breaches by a taxpayer who has previously evaded tax will be penalised at the higher rate.

Background

In 1999 the Finance and Expenditure Committee recommended that:

> …a past record of "good behaviour" be taken into account when deciding whether to impose a penalty[5]

The Committee of Experts on Tax Compliance also considered this issue. Its report recommended that:

> …the government should specifically require the review team to report on:
>
> whether the government's performance expectations of taxpayers are reasonable;

[5] *Inquiry into the Powers and Operations of the Inland Revenue Department: Report of the Finance and Expenditure Committee*, New Zealand House of Representatives, October 1999, page 4 – recommendation 7 and page 27.

> whether, and to what extent, a past record of 'good behaviour' should be taken into account in deciding to impose penalties or to escalate enforcement;…[6]

This matter was also considered by the Ministerial Panel on Business Compliance Costs. In its report it stated:

> The policy of imposing tax collection obligations on employers/small businesses, and then punishing them with penalties for getting it wrong builds strong resentment from those that have good 'track records'.[7]

The government addressed all of these concerns in its discussion document *Taxpayer compliance, standards and penalties: a review*. The discussion document noted that applying a test for good behaviour and determining whether taxpayers had met that test would incur considerable compliance and administrative costs. The government was also concerned as to how such a test could be applied consistently to all taxpayers.

As a way of taking into account good behaviour at low compliance and administrative costs, the discussion document proposed that the shortfall penalty for lack of reasonable care be reduced to 10% if the breach was the taxpayer's first breach of that standard. Submissions on the discussion document recommended that "good behaviour" be taken into account when imposing all shortfall penalties. As a result, when the Taxation (Annual Rates, Mäori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill was introduced the proposal was extended to apply also to unacceptable tax positions.

Submissions on the bill again recommended that the amendment be extended to apply to all shortfall penalties. The amendment was therefore extended to all shortfall penalties, with the benefits of doing so expected to be as follows:

- Taxpayers would see that those taxpayers who repeatedly offend are more harshly penalised, reflecting their failure to begin complying voluntarily.
- The change would address the concern that the shortfall penalty rates were excessive. (This was particularly the cases with voluntary disclosures, where the rules were seen as penalising taxpayers who were attempting to comply.)
- The shortfall penalty rate for first time evasion would be aligned with the rate for evasion in Australia and Canada.

The main concern was that the measure reduces the shortfall penalty applying to evasion from 150% to 75% for a "first offence" and, therefore, this measure could be seen as softening the seriousness of this offence. However, a 75% penalty is still substantial. Further, the legislation now provides that increased penalties apply to those who re-offend, the four-year good behaviour period does not apply in the case of evasion and when the penalty for evasion is halved it is equal to the penalty imposed in Australia and Canada.

Submissions on the discussion document also expressed concern that the proposal could discourage voluntary disclosures for tax shortfalls. To resolve this problem, the original proposal was amended so that if a taxpayer voluntarily discloses a tax shortfall, disclosure of that shortfall does not lead to higher rates of shortfall penalties applying to subsequent breaches, whether those subsequent offences are voluntarily disclosed or not. It is only when the taxpayer has been audited and a shortfall penalty is imposed that the probation period begins.

Probation period

The probation period needs to be sufficiently long to indicate that the taxpayer's behaviour has changed, yet short enough to be not overly burdensome on the taxpayer. The discussion document *Taxpayer compliance, standards and penalties: a review*, proposed that the probation/good behaviour period be seven years. Following consideration of the submissions on the discussion document, when the bill was introduced this period was reduced to four years. The measure was further extended by providing that in the case of GST, fringe benefit tax, PAYE and resident withholding tax, a two-year period is sufficiently long for a regular taxpayer to demonstrate improved compliance behaviour.

Key features

Under section 141FB, the rates of all shortfall penalties have been halved, if within the previous two years, in the case of GST, fringe benefit tax, PAYE and resident withholding tax, or four years in the case of all other taxes, the taxpayer has not been liable to pay a shortfall penalty on a tax shortfall identified during an audit. An exception to this general rule has been made in relation to the shortfall penalty for evasion when there is no probation period. In other words, once tax has been evaded, the evasion shortfall penalty is imposed at the rate of 150%.

Breaches of the lack of reasonable care and unacceptable tax position standards do not count as first offences for gross carelessness, abusive tax position or evasion. But a first offence for these higher penalties does count as a breach of good behaviour in relation to the lower penalties.

Tax shortfalls are grouped and effectively treated as one offence. For example, if a taxpayer who has never had a

[6] *Tax Compliance*, Committee of Experts on Tax Compliance, December 1998, paragraph 12.7.

[7] *Finding the Balance: Maximum Compliance at Minimum Cost, Final Report of the Ministerial Panel on Business Compliance Costs*, July 2001, page 121.

shortfall penalty imposed is audited, and several breaches of the lack of reasonable care and gross carelessness standards are ascertained, all of the tax shortfalls are treated as the first offence and penalised at the appropriate reduced rates. The reason for this is to prevent disagreement as to which shortfall was the "first", and it wanted to ensure that where a taxpayer makes the same mistake in several periods, all are penalised at the same rate.

The amendment applies separately for each type of tax, such as PAYE, income tax and GST. Therefore a penalty imposed in relation to one tax does not mean that the taxpayer automatically faces a higher penalty rate for another tax. For example, a breach of the lack of reasonable care standard in relation to GST does not mean that the taxpayer will be penalised at the higher rate for a breach of the same standard in relation to income tax.

Voluntary disclosures do not count against good behaviour. It is only when the taxpayer has been audited and a shortfall penalty is imposed that the probation period begins. If this were not the case, taxpayers could be discouraged from voluntarily disclosing tax shortfalls, as once they have made a voluntary disclosure they face higher penalties on subsequent tax shortfalls for two or four years.

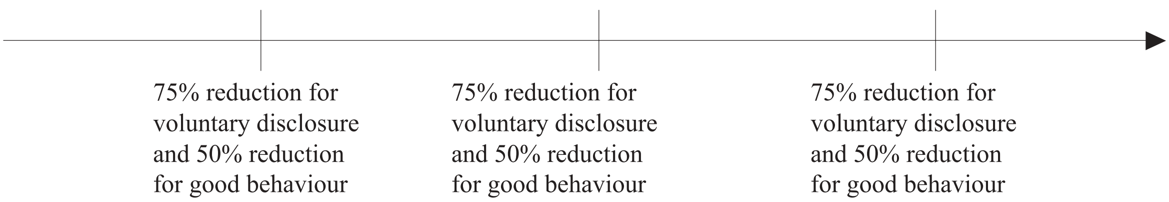
Application date

The amendment applies to tax positions taken on and after 1 April 2000, apart from those cases where a taxpayer is liable to pay a shortfall penalty before the date of Royal assent of the Act, 26 March 2003, in which case the higher penalty rate stands. This date was chosen to ensure that tax shortfall identified after the date of enactment but relating to tax periods after 1 April 2000 benefit from the "good behaviour" provision. It ensures that the reduced penalty rates take effect as soon as possible.

All taxpayers start with a "clean slate". If a taxpayer has had a shortfall penalty imposed under the old rates, that penalty is not taken into account in determining the rate of penalty to be charged under these new rules.

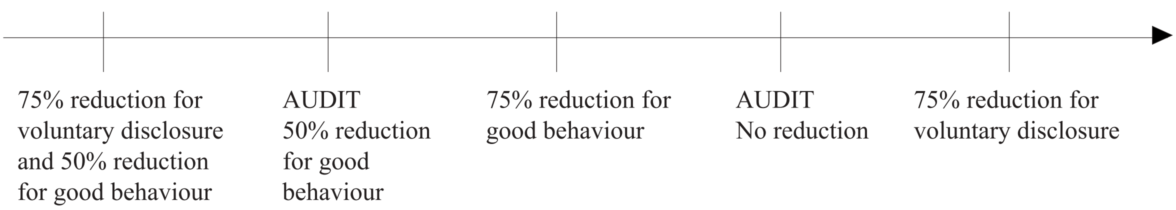
Example one

A taxpayer files an income tax return and omits income from a particular source. After filing the return the taxpayer voluntarily discloses that he has omitted the income—the taxpayer has evaded tax and the shortfall penalty is reduced by 75% for the voluntary disclosure and 50% for good behaviour. The taxpayer is not audited. In the next two returns the taxpayer omits income and subsequently discloses the omission. On both occasions the shortfall penalty is reduced by 75% for the voluntary disclosure and 50% for good behaviour.



Example two

Inland Revenue decides to audit the period following the first voluntary disclosure, and a shortfall penalty for evasion is imposed. This shortfall penalty is reduced by 50% for good behaviour. In the subsequent period the taxpayer makes a voluntary disclosure and the shortfall penalty is reduced by 75% because of the disclosure. Again, Inland Revenue audits the period following the disclosure, and a shortfall penalty for evasion is imposed. This shortfall penalty is not reduced. In a subsequent period the taxpayer voluntarily discloses omitted income, and the shortfall penalty is reduced by 75% because of the disclosure.



PENALTIES FOR UNACCEPTABLE TAX POSITIONS

Sections 3, 141A(4), 141B, 141C, 141D(1), 141D(4), 141D(7)(a) and 141H of the Tax Administration Act 1994

Introduction

The Tax Administration Act has been amended to provide that a shortfall penalty for not having a tax position that is "as likely as not to be correct" can be imposed in cases where the taxpayer has not interpreted the law. The amendment prevents taxpayers choosing not to "interpret" the legislation to avoid possible shortfall penalties. To avoid any confusion, the name of the shortfall penalty has been changed from "unacceptable interpretation" to "unacceptable tax position".

Background

The shortfall penalty for unacceptable interpretation is intended as a signal to taxpayers. It indicates that they should take extra care and that, when viewed objectively, their interpretations should be as likely as not to be correct.

However, the interpretation given to "unacceptable interpretation" allowed taxpayers to avoid making reasonable efforts to determine what the law is. The concern was that taxpayers could choose not to interpret the legislation on a complex tax issue, as a means of avoiding possible shortfall penalties. The need to have an interpretation weakened the standard that larger taxpayers were required to meet, and made a penalty more difficult to impose in cases where it is fair that it be imposed.

In 1999 the Finance and Expenditure Committee had recommended that:

> The Inland Revenue Department reinforce both publicly and internally that if a taxpayer or adviser has not interpreted legislation a penalty for unacceptable interpretation cannot apply.[8]

Some submissions on the discussion document and the bill noted that the amendment was contrary to the recommendation of the Finance and Expenditure Committee following its inquiry in 1999 into the powers and operations of Inland Revenue. However, as noted in the discussion document, the current interpretation of the legislation allows taxpayers to avoid making reasonable efforts to determine the law.

Some submissions also recommended that if taxpayers have not interpreted the legislation and should have done so, the shortfall penalty that should be imposed is the lack of reasonable care penalty, not the unacceptable interpretation penalty. The government agreed with submissions that in some cases if a taxpayer has not interpreted the legislation a shortfall penalty for lack of reasonable care could be imposed. However, there is concern that there could be cases where a penalty cannot be imposed. For example, a taxpayer investing in a scheme might ask the promoter if an interpretation is necessary on a particular point and the promoter says that the point is very clear and an interpretation is not necessary; the taxpayer has taken reasonable care and no shortfall penalty can be imposed.

Key features

Section 141B has been amended to change the name of the shortfall penalty for "unacceptable interpretation" to "unacceptable tax position". This amendment ensures that the penalty applies to tax positions that do not meet the criteria, regardless of whether the taxpayer has considered the legislation or not.

The thresholds in section 141B at which the penalty may apply have been increased.

The minimum threshold increases from $10,000 to $20,000 and the maximum threshold from $200,000 to $250,000. This means that before the penalty can be imposed, the total amount of the tax shortfall must exceed $20,000 and 1% of the total amount of tax the taxpayer has returned for the period. It can be imposed in all cases when a tax shortfall exceeds $250,000 and the tax shortfall is due to the position taken not being as likely as not to be correct.

New sections 141A(4) and 141B(1B) clarify that a taxpayer has not taken an unacceptable tax position if a tax shortfall is the result of calculation mistake or by mis-recording numbers in a return. It was never intended that the unacceptable tax position penalty apply to calculation or processing mistakes. Rather, this penalty applies when a tax shortfall arises because a tax position is not as likely as not to be correct, whether or not the taxpayer actually interpreted the law. If a mistake is of such a magnitude that the mistake breaches the reasonable care standard that shortfall penalty applies.

Application date

The amendment applies to tax positions taken on and after 1 April 2003.

[8] *Inquiry into the Powers and Operations of the Inland Revenue Department: Report of the Finance and Expenditure Committee, New Zealand House of Representatives*, October 1999, page 4 – recommendation 9 and page 28.

CAPPING SHORTFALL PENALTIES

Section 141JAA of the Tax Administration Act 1994

Introduction

The Tax Administration Act has been amended to impose a monetary cap on the shortfall penalty for lack of reasonable care and unacceptable tax position. The cap has been set at $50,000 per tax position and applies to those shortfalls identified through voluntary disclosure or Inland Revenue audit within a certain period from the due date of the return, being the greater of:

- three months, and
- the lesser of one return period and six months.

The amendment is designed to ensure that the shortfall penalty is not out of step with the offence if identified speedily.

Background

The discussion document *Taxpayer compliance, standards and penalties: a review*, released in August 2001, recommended that a monetary cap on the shortfall penalty for lack of reasonable care be introduced. The government was concerned about the application of the lack of reasonable care penalty to very large errors that are speedily identified and corrected. In some cases, the size of the penalty may have been excessive and may, in fact, have discouraged voluntary compliance.

Submissions on the discussion document recommended that the monetary level of the cap be reduced and that the period of time in which to identify the shortfall be extended. The government declined both these submissions as it considered that implementing them would greatly reduce the incentives on taxpayers to take reasonable care.

Submissions on the bill recommended that the cap should apply in respect of other penalties and, in particular, to the unacceptable tax position penalty. Generally, the cap should not apply to unacceptable tax positions because when taxpayers take the position they should be aware as to whether or not the position is as likely as not to be correct. However, with the extension of the unacceptable tax position penalty, in that it will now apply in cases where no interpretation has been made, it is possible that at the time a taxpayer took the position the taxpayer was not aware that the position did not meet the standard of being as likely as not to be correct.

Key features

A new section 141JAA provides a $50,000 cap on the shortfall penalties for lack of reasonable care and unacceptable tax position, in cases where the shortfall is identified either by the taxpayer or Inland Revenue within a certain period from the due date of the return, being the greater of:

- three months, and
- the lesser of one return period and six months.

Application date

The amendment applies to tax positions taken on or after 1 April 2003.

PROMOTER PENALTIES

Sections 3, 141(12A), 141D(3B), 141EB, 141EC, 141G(1), 141I(1), 141K1(1) and 141L(1) of the Tax Administration Act 1994

Introduction

The amendment gives effect to the proposal in the discussion document *Taxpayer compliance, standards and penalties: a review*, released in August 2001, for a new penalty on promoters of certain "tax arrangements".

If an arrangement is offered, sold, issued or promoted to ten or more people in an income year and it involves an abusive tax position, the promoter will be liable for a promoter penalty. The penalty will be the sum of the tax shortfalls resulting from the arrangement. The penalty is aimed at reducing the number of such investments by holding the people responsible for the design and sale of tax arrangements directly accountable for their actions.

Background

As noted in the discussion document *Taxpayer compliance, standards and penalties: a review*, if a taxpayer becomes a party to an arrangement that is considered by Inland Revenue to involve an abusive tax position, a shortfall penalty is imposed on the taxpayer. Although the compliance and penalties legislation penalised promoters in their capacity as taxpayers, it imposed no civil sanctions on promoters in their capacity as promoters of "arrangements". It therefore provided no incentive for promoters to ensure that the tax effects they claim for their arrangements are correct. Furthermore, offer documents in some cases restrict taxpayers from taking legal action against the promoter.

The discussion document stated that promoters of such arrangements should be held clearly accountable for their actions. The promoter is usually the party with the greater knowledge of the arrangement's tax effects. Often, the true tax impact of an arrangement may be determined by features that the promoter is aware of but the investor is not. These undisclosed features may place the investor at risk of significant penalties.

The discussion document recommended that the introduction of a penalty on promoters as the best way to ensure that they are held clearly accountable for their actions. The penalty was to apply to arrangements that involved breaches of an anti-avoidance provision or results in an investor having a shortfall penalty for an abusive tax position. Submissions on the discussion document were concerned that it is often difficult to determine whether an arrangement has involved tax avoidance. As a result, the amendment applies only when an arrangement involves an abusive tax position.

Key features

New sections 141EB and 141EC provide for the imposition of a civil penalty on promoters, in cases where investment in an arrangement leads to the investor having a shortfall penalty for an abusive tax position imposed.

Under section 141D(3B), taxpayers whose tax shortfalls are less than $50,000 and who have independent advice that the arrangement does not involve an abusive tax position will have the shortfall penalty imposed at 20%, rather than the normal 100%.

When the bill was drafted one of the first tests for imposing the penalty on the promoter was "if a taxpayer invests in the arrangement and a shortfall penalty for an abusive tax position is imposed on the taxpayer as a result of the investment". Submissions on the bill expressed concern about the meaning of "invests". As a result, the legislation now refers to investors claiming "tax-related benefits as a result of the arrangement". Such benefits could include tax deductions, tax losses, input tax credits, deferred output tax. For example, in relation to an arrangement involving upfront deductions, the tax-related benefit is the claiming of the deductions early.

Another test relating to the imposition of the promoter penalty is that "the arrangement is offered, sold, issued or promoted to five or more persons in an income year". Submissions on the bill expressed concern that the threshold was too low. As a result, the threshold was raised to ten or more persons.

The penalty on the promoter is based on the tax shortfalls resulting from the arrangement. This ensures that the promoter faces a penalty that reflects the total tax impact of the arrangement. Under section 141EB(4)(c), the penalty is based on the maximum taxation-related benefits that the arrangement would produce. This means, for example, that if the arrangement was based around income tax, the tax rate used to calculate the promoter penalty would be 39 cents in the dollar as that rate produces the maximum tax-related benefit; if the arrangement involves a GST transaction the rate used to determine the promoter penalty would be 12.5%.

The definition of "promoter" includes:

- a person who is a party to, or is *significantly* involved in formulating, a plan or programme from which an arrangement is offered, or
- a person who is *aware of material and relevant aspects of the arrangement* and who sells, issues, or promotes the selling or issuing of the arrangement, whether or not for remuneration.

The promoter penalty is imposed in tandem with the shortfall penalty, generally as one penalty—but if additional taxpayer shortfalls are detected, further penalties will be imposed.

Application date

The amendment applies to arrangements entered into on or after 26 March 2003.

ONUS OF PROOF

Section 138P of the Tax Administration Act 1994

Introduction

An amendment to the Tax Administration Act provides that if a taxpayer can prove on the balance of probabilities that an assessment is wrong by a specific amount, the court must reduce the assessment by that specific amount. This allows taxpayers to correct assessments they show to be wrong in part.

Background

The Committee of Experts on Tax Compliance noted that a taxpayer who wishes to challenge an assessment is required to prove not only that the Commissioner of Inland Revenue's assessment is wrong, but also by how much it is wrong. It recommended that the law be clarified to provide that if a taxpayer proves, on the balance of probabilities, that the assessment is excessive by a specified amount, the court should reduce Inland Revenue's assessment by that amount.[9] The proposal was included in the discussion document *Taxpayer compliance, standards and penalties: a review*, released in August 2001.

[9] *Tax Compliance*, Committee of Experts on Tax Compliance, December 1998, paragraphs 10.12 and 10.13.

Key features

A new subsection (1A) has been added to section 138P to provide that if a taxpayer proves on the balance of probabilities that the assessment is excessive by a specified amount, the court must reduce the assessment by that amount.

Application date

The amendment applies to challenges brought on or after 26 March 2003.

TAX IN DISPUTE

Sections 128, 128A, 138E, 138I and 138J of the Tax Administration Act 1994

Introduction

The Tax Administration Act has been amended so that it is no longer necessary for taxpayers to pay 50% of the tax in dispute at the beginning of the dispute. The rationale for requiring the payment was removed with the introduction of use-of-money interest on overpaid and underpaid tax.

However, Inland Revenue has been given the power to require payment of the entire amount in dispute when it considers that there is a significant risk that the amount will not be paid if the taxpayer's dispute is not successful.

Background

As noted in the discussion document *Taxpayer compliance, standards and penalties: a review*, the Tax Administration Act requires that the taxpayer pay the non-deferrable tax relating to the amount in dispute—that is, 50% of the amount of tax that is being disputed. The justification for requiring payment, however, was significantly reduced with the introduction of two-way use-of-money interest.

To reduce the risk to the revenue, Inland Revenue has been given the power to require payment of all of the tax in dispute when there is a risk that that amount will not be paid—for example, if a taxpayer has entered a dispute merely to delay payment of tax before leaving the country.

Submissions on the bill expressed concern that the provision allowing Inland Revenue to require full payment of the debt when it considered there was a "risk to the revenue" could be used by Inland Revenue to require payment of the entire amount being disputed when there was a large amount in dispute. This outcome was never intended. The amendment now applies where "there is a significant risk that the tax in dispute will not be paid should the taxpayer not succeed in objection proceedings."

Key features

Sections 128(1), 128A, 138I(1) and 138J of the Tax Administration Act have been repealed, thus removing the requirement to pay 50% of the tax in dispute at the beginning of the dispute.

Sections 128(2b) and 138I(2) have been amended to give Inland Revenue the power to require payment of all of the tax in dispute when there is a significant risk that the amount will not be paid if the taxpayer's dispute is not successful.Application date

The amendment applies on or after 1 April 2003.

SMALL BALANCE WRITE-OFF

Section 174AA of the Tax Administration Act 1994

Introduction

The provision allowing Inland Revenue not to collect small amounts of tax has been amended to allow Inland Revenue to write off those small balances that are not collected.

Background

Section 174AA of the Tax Administration Act allows Inland Revenue to refrain from collecting tax if the amount payable is less than $20. The section allowed Inland Revenue not to collect the amount but the debt remained outstanding. This amendment means that the debt is written off permanently.

Key features

Section 174AA of the Tax Administration Act has been amended allowing Inland Revenue to write off small amounts not collected.

Application date

The amendment applies from 1 April 2003.

APPLICATION DATE FOR THE TAXPAYER FINANCIAL RELIEF RULES

Sections 3(1), 125(j)(iv), 138E(1)(e)(iv), 139B and 177CA of the Tax Administration Act

Introduction

Amendments clarify that the taxpayer financial relief rules introduced in the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002 apply from 1 December 2002.

Background

The taxpayer financial relief rules were introduced in the Taxation (Relief, Refunds and Miscellaneous Provisions) Bill in December 2001. The bill's progress was interrupted by the pre-election dissolution of Parliament in June 2002 and the convening of the new Parliament in late August. As a result of the delay, the application date of the rules had to be amended to apply from 1 December 2002 rather than 1 July 2002. Several dates were omitted in error, and this amendment clarifies that the rules apply from 1 December 2002.

Key features

Sections 3(1), 125(j)(iv), 138E(1)(e)(iv), 139B and 177CA of the Tax Administration Act have been clarified to reflect the 1 December 2002 application date for the taxpayer financial relief rules.

Application date

This amendment applies from 1 December 2002.

INLAND REVENUE'S INFORMATION-GATHERING POWERS

Sections 16, 16B, 17 and 87 of the Tax Administration Act 1994

Introduction

Inland Revenue's information-gathering powers contained in sections 16 and 17 of the Tax Administration Act 1994 (the Act) have been extended and clarified. The amendments will improve the Commissioner's ability to access the necessary information to confirm taxpayers' correct tax positions. These amendments recognise that information is, in many cases, almost exclusively within the possession and control of taxpayers, and the value of the audit process is compromised if Inland Revenue cannot independently verify a taxpayer's tax position.

The amendments themselves and Inland Revenue's administrative guidelines will also place a number of controls around the use of these new powers.

Background

In December 1998 the Committee of Experts on Tax Compliance reported to the then government. The committee identified a number of deficiencies in Inland Revenue's information-gathering powers and made several recommendations that have formed the basis of these amendments. The amendments have also been subject to public consultation as part of the discussion document *Taxpayer compliance, standards and penalties: a review,* which was released in August 2001.

Key features

The amendments to Inland Revenue's main information-gathering powers in sections 16 and 17 of the Tax Administration Act 1994:

- clarify that third parties can be required to give reasonable assistance and facilities when Inland Revenue is exercising its powers to access premises
- clarify who may be given authority to enter a person's premises
- allow warrants to enter private dwellings to be exercised by Inland Revenue officers in general
- allow Inland Revenue to remove documents from premises to copy
- allow Inland Revenue to requisition from New Zealand residents information held by offshore entities controlled by the New Zealand residents, and
- give Inland Revenue the discretion to require documents to be sent to a particular Inland Revenue office.

Application date

These amendments, other than the amendments to section 16(5), apply from the date of enactment. The amendment to section 16(5), which relates to access warrants to private dwellings, applies from 15 May 2003.

Detailed analysis

Reasonable assistance from third parties

Uncertainty previously existed over whether third parties such as bank employees were required to give reasonable assistance in an investigation or to answer questions relating to an investigation. An amendment has been made to section 16(2) to ensure that an occupier of any place must provide Inland Revenue with all reasonable assistance and facilities and answer questions to enable the effective exercise of Inland Revenue's access powers under section 16. This amendment was recommended by the Committee of Experts on Tax Compliance, which said that, in principle, third parties should be required to give reasonable assistance and answer questions because the information being sought can be requisitioned under section 17.

Authority to enter a person's premises

The ability to have other persons accompany Inland Revenue officers onto taxpayers' premises is necessary as those other persons may have specialist skills not possessed by Inland Revenue officers, such as computer forensic skills. The ability also to have the Police accompany officers may be necessary to discourage physical violence. Accordingly, section 16(2A) has been inserted to allow persons whom an authorised Inland Revenue officer considers necessary for the effective exercise of access powers, under section 16, to accompany Inland Revenue officers to any place.

Either the consent of the occupier or a judicial warrant must be obtained before Inland Revenue officers can enter a private dwelling. Previously, judicial warrants were required to specify the individual investigator entering a private dwelling. This created practical difficulties when circumstances necessitated an Inland Revenue officer not named in the warrant to take part in the investigation. This requirement was also inconsistent with customs and fisheries legislation, which allowed officers in general to enter the premises.

Section 16(3) to (5) has been amended to allow warrants to authorise Inland Revenue officers, in general, and other persons accompanying an officer under the new section 16(2A), to enter a private dwelling. The Tax Administration (Form of Warrant) Regulations 1995 have been replaced, accordingly, to give effect to changes made to section 16. The new regulations—the Tax Administration (Form of Warrant) Regulations 2003—reflecting these amendments apply to warrants issued on or after 15 May 2003.

Section 87 has been amended to clarify that the confidentiality obligations apply to persons accompanying Inland Revenue officers onto premises under the authority of new section 16(2A).

Removing documents for copying

Section 16(1) gives authorised Inland Revenue officers full and free access to all premises to inspect and copy any books, documents or anything else that Inland Revenue considered necessary or relevant for tax purposes. Previously, there was no authority to remove books or documents for copying elsewhere. The Committee of Experts on Tax Compliance was concerned that this inability to remove documents for copying could create problems in cases where it was not possible or practicable to make copies of documents on the taxpayer's premises. In particular, the Committee considered that a power to remove documents for copying is necessary to address the risk in certain cases of documents being destroyed, removed or tampered with if an ordinary section 17 requisition is made for them. Section 16B has been inserted to provide Inland Revenue with the power to remove books or documents for copying. A copy of a book or document certified by or on behalf of the Commissioner is admissible in evidence in court as if it were the original.

Controls on power

Section 16B(2) provides that copies of books or documents removed must be made, and the books or documents returned, as soon as practicable. Section 16B(4) gives the owners of the removed documents a right to inspect and copy the documents at the Inland Revenue office where the documents are held. This statutory right is able to be exercised at all reasonable times, including specifically at the time the documents are removed to the Inland Revenue office. This right is designed to ensure that the exercise of the power to remove documents does not unduly disrupt a taxpayer's business.

Inland Revenue's administrative guidelines will place the following controls on the use of the Commissioner's new power to remove documents from premises for copying:

- Documents will only be removed from a person's premises if the Inland Revenue officer considers that it is not practicable to make copies on the premises.
- When documents are removed from a person's premises for copying, the person will be given a receipt briefly outlining what documents have been removed.
- Inland Revenue will provide persons from whose premises documents are removed with a copy of any removed documents that are copied (unless all the documents removed have been copied in which case the person will be told this).

There is also the overriding requirement under administrative law that all public powers must be exercised in good faith.

Example

Set out below is a step-by-step example of the application of the new power to remove documents from a person's premises for copying together with the various controls (contained in both legislation and the department's administrative guidelines) that are placed around this power.

Inland Revenue is investigating whether a taxpayer company has complied with the tax laws. Inland Revenue investigators exercise their long-standing power under section 16(1) to enter the taxpayer's premises as part of the investigation. The investigators, during their review of the taxpayer's records, come across bank statements relating to an undisclosed offshore account of the taxpayer, the funds in which may be from income that has not been returned by the taxpayer.

There is no photocopier on the taxpayer's premises, which means that it is not possible to copy the bank account statements on the premises. (As explained above, administrative guidelines require Inland Revenue staff to make copies of records on a taxpayer's premises, instead of removing those records, where this is reasonably practicable.)

The Inland Revenue investigators consider that there is a risk that the bank account statements may be removed or destroyed if an ordinary requisition under section 17 is made to the taxpayer to provide them to the department.

The Inland Revenue team leader for the investigation decides that it is necessary to remove the bank statements from the taxpayer's premises for copying at an Inland Revenue office under the power contained in new section 16B(1). The issue of legal professional privilege does not arise in this case because this privilege cannot attach to bank account statements.

When the Inland Revenue investigators remove the bank account statements from the taxpayer's premises they give a receipt listing the documents they have removed.

The taxpayer exercises its statutory right, under section 16B(4), to inspect and copy the removed documents at the Inland Revenue office where the documents are held. This statutory right can be exercised at all reasonable times, including specifically at the time the bank account statements are removed to the Inland Revenue office. (This statutory right should ensure that the exercise by the department of its power to remove documents does not unduly disrupt the taxpayer's business and will enable the taxpayer to prepare a defence if necessary.)

Inland Revenue investigators copy the bank account statements on the following day and return the records at the end of that day to the taxpayer's premises. The investigators inform the taxpayer that all of the bank account statements removed have been copied by the department.

Requisition of information held by offshore entities controlled by New Zealand residents

Under section 17(1) Inland Revenue has the ability to require a person to produce for inspection any records under the control of that person. Previously, there was uncertainty over the meaning of "control" and whether documents could be regarded as being under the control of a New Zealand resident if that resident has control of an offshore company which has those documents in its possession. The Committee of Experts on Tax Compliance recommended an amendment to ensure that New Zealand residents could be required to produce such records for inspection in New Zealand.

New section 17(1B) allows Inland Revenue to requisition from New Zealand residents information or documents held by offshore entities controlled by the New Zealand residents. The amendment provides that where a non-resident is controlled, directly or indirectly, by a New Zealand resident, any information or document held by the non-resident are treated as being held by the New Zealand resident.

For the purpose of applying new section 17(1B), new section 17(1C) treats anything held by a person who is resident in New Zealand or a controlled foreign company, and is associated with the New Zealand resident, as being held by the New Zealand resident.

The definition of associated persons for the purposes of this amendment is a combination of the definitions found in sections OD 7 and OD 8(3). The exception to this is that for the purposes of applying the associated persons test pertaining to relatives in section OD 7, two degrees instead of four degrees of relatives will be taken into account.

For the purpose of allowing Inland Revenue to requisition from New Zealand residents information or documents held by offshore entities controlled by them, new section 17(1C) also provides that foreign laws relating to the secrecy of information must be ignored. This amendment recognises comments made by the Committee of Experts on Tax Compliance, which noted that foreign secrecy laws are an important reason for some companies establishing subsidiaries in certain countries in the first place so as to exploit such laws to frustrate investigations by tax authorities in their home countries. Countries such as Australia and the United States already have such provisions for ignoring foreign secrecy laws.

Documents to be sent to a specified Inland Revenue office

The Committee of Experts on Tax Compliance noted that section 17 required a person to produce documents for inspection only at the person's premises. The Committee considered that it could be more efficient in some cases for documents to be sent to a particular Inland Revenue office. Therefore it recommended that section 17 be amended to give Inland Revenue the discretion to require that documents be sent to a particular Inland Revenue office. Section 17(1D) has been inserted to give effect to this recommendation.

Administrative guidelines will provide that if a significant amount of documentation is required, Inland Revenue will agree to a taxpayer's request to send the documents to the nearest Inland Revenue office, which will arrange the forwarding of the documents to the Inland Revenue office conducting the relevant investigation.

OTHER POLICY ISSUES

DOUBLE TAX AGREEMENTS AND EXCHANGE OF INFORMATION

Section BH 1 of the Income Tax Act 1994

Introduction

Section BH 1 has been amended to clarify that New Zealand can enter into double tax agreements with other countries that provide for the exchange of information between the two countries in relation to all taxes.

Background

The change enables New Zealand to follow the most recent OECD Model Tax Convention, which the OECD updated in 2000 to allow for exchanges of information in relation to all taxes, not just income tax.

New Zealand double tax agreements that are based on the earlier OECD model allow exchange of information only for income tax purposes. The change will allow future double tax agreements to contain a wider exchange of information provision.

Key features

The amendment to section BH 1 clarifies that double tax agreements can be entered into that provide for the exchange of information in relation to taxes defined in paragraphs (a)(i)–(v) of the definition of "tax" in the Tax Administration Act 1994.

Application date

The amendment applies from 26 March 2003.

INCOME TAX EXEMPTION FOR SUPERYACHT CREW

Sections CB 2(1)(f), CB 2(3B) and CB 2(4) of the Income Tax Act 1994

Introduction

New rules exempt non-resident crew members on visiting superyachts from paying New Zealand income tax on income derived from services performed in New Zealand in relation to a superyacht while it is in New Zealand.

Without this change, visiting crew members would be required to pay New Zealand tax on the income they derive while in New Zealand once they had been in the country for more than 92 days, or 183 days if the crew member was from a country with which New Zealand has a double tax agreement.

Background

The government announced on 28 May 2002 that the legislation would be amended, effective from that date, to exempt crew members of visiting superyachts from paying New Zealand income tax. The measure was added to the bill at the select committee stage of proceedings.

There has been a recent increase in the number of superyachts coming to New Zealand. They represent important economic opportunities for New Zealand, but the yachts themselves do not enter into the commerce of New Zealand during their stay. Their purpose is private, domestic and temporary. The crew aboard these yachts have a very tenuous link with New Zealand in that they are employed on a boat temporarily located in New Zealand for tourism or refit purposes.

Although short visits would, in most cases have been covered by the general 92-day and 183-day exemptions, longer visits required for refits and maintenance, especially when combined with holidays, were not accommodated by the general exemptions.

Key features

- The exemption applies to income derived by non-resident crew members from services performed in New Zealand for a non-resident in relation to a pleasure craft while it is in New Zealand.
- The crew member must be a non-resident for tax purposes. The residence of a crew member for the purposes of this provision is determined solely by the permanent place of abode test as contained in section OE 1(1) of the Income Tax Act 1994. For the purposes of this provision a crew member cannot be deemed a resident by the time-based test in section OE 1(2) of that Act.
- The crew-member must not be in New Zealand for more than 365 days in any 24-month period.
- The crew member must not be in New Zealand unlawfully. This means that the crew member must have immigration authorisation to enter and be present in New Zealand.
- Eligible crew members must be a crew member of a pleasure craft as defined by the Maritime Transport Act 1994. A requirement of this definition is that the vessel must not be offered or used for hire or reward.
- The pleasure craft must be a temporary import within the meaning of the Customs and Excise Act 1996, meaning it must have received a temporary import entry from the New Zealand Customs Service on arriving in New Zealand.
- The pleasure craft must not be owned by a New Zealand resident or a New Zealand controlled foreign company.

As described above, one of the requirements of the exemption is that a crew member must not be in New Zealand for more than 365 days in any 24-month period. For example, a crew member who is in New Zealand for 365 days cannot take advantage of the exemption again until he or she has been outside New Zealand for a further 365 days. A crew member who is in New Zealand for 300 days in year one and then leaves New Zealand can return to New Zealand only for a further 65 days in year two. In year three the crew member may spend a maximum of 300 days in New Zealand.

Application date

The new rules apply from 28 May 2002.

TAX CHANGES RELATING TO CHARITIES

Sections CB 4(1)(c) and (e), DI 2, DJ 4, KC 5, and OB 3B of the Income Tax Act 1994

Introduction

A variety of changes affect the income tax treatment of charities and donations to charities and similar organisations. These changes were announced in 2001-02 as part of the reviews of the tax treatment of charities and the tax treatment of organisations that manage communally owned Mäori assets.

The changes are:

- The maximum donations rebate for individual donors has been increased, to \$630, in line with inflation since 1990.
- There is now only one threshold for deductibility of corporate donations, namely, a maximum of 5% of net income.
- Mäori authorities are now able to claim a comparable deduction.
- The blanket prohibition on deductions for donations made by close companies has been relaxed for those companies that are listed on a recognised exchange.
- The legislation is now quite clear that to qualify for the income tax exemption, an entity's charitable purposes have to be carried out in each year the tax exemption is claimed.
- The public benefit requirement inherent in the concept of charitable purpose has been liberalised with regard to blood ties, and
- In certain circumstances a marae can have a charitable purpose which means that the body administering that marae may be exempt from income tax.

Background

Most of these changes were first canvassed in the government discussion document *Tax and Charities*, released in June 2001. That document dealt with a range of tax issues. It was the first major review of the charities tax legislation since the Working Party on Charities and Sporting Bodies report of 1989.

One of the key issues was whether there should be a registration, reporting and monitoring system for charities that claim the exemption from income tax. Another significant issue discussed in the document was whether the definition of "charitable purpose" was still appropriate given that it had evolved out of a 1601

English statute. A number of specific tax issues were also discussed, including the provisions that enable donors a rebate or deduction for their donations to charities.

There was significant public interest in the proposals, with over 1600 submissions being received. In response, the government proposed a package of changes and set up a working party comprising charitable sector representatives, to provide recommendations on a registration, reporting and monitoring system for charities.

The working party provided its recommendations in early 2002, the prime recommendation being that registration, reporting and monitoring should be carried out by a new entity, a charities commission. At the time the tax bill was introduced, the government was still considering its response to those recommendations and so the bill did not contain any legislative changes relating to a registration, reporting and monitoring system for charities.

Nevertheless, the government decided to proceed with the increase in the maximum rebate level and the simplification of the company deduction thresholds. It also decided to proceed with the technical clarification that to qualify for the income tax exemption, an entity's charitable purposes have to be carried out in each year the tax exemption is claimed. This change removes any argument that an entity only has to demonstrate a charitable purpose when it is established.

The government has since announced that it intends to introduce separate legislation later this year establishing the charities commission. That legislation would include any consequential tax changes.

On whether changes should be made to the definition of "charitable purpose", the government decided to await the outcome of reviews in a number of countries with similar legal frameworks who have been considering the same question, with two exceptions: the public benefit requirement has been liberalised in relation to blood ties and certain marae are now included.

Blood ties and the public benefit requirement

The public benefit requirement must be satisfied before an entity qualifies as a charity, except in the case of a charity for the relief of poverty. Although the question of whether the public benefit requirement is satisfied is considered on the facts of each case, the courts have developed a number of general tests for determining whether the group benefiting constitutes the public or an appreciably significant section of the public. Through cases such as Re Compton[10] and Oppenheim v Tobacco Securities[11] it has been established that the number of beneficiaries must not be negligible. In addition, even if the number of beneficiaries is large, if those beneficiaries are determined on the basis of a personal relationship such as blood or contractual ties, the entity will not be for the public benefit. Rather it will be for the benefit of private individuals and, therefore, not charitable.[12]

The House of Lords (Lord Cross) in Dingle v Turner[13] has questioned the Re Compton and Oppenheim tests, suggesting that the existence of a personal connection such as blood ties or a contract should not be determinative of whether an entity provides a public rather than a private benefit. Rather, consideration should also be given to the nature of the entity and the charitable purpose for which it was established, the number of beneficiaries and the degree of connection between the beneficiaries. Although the Re Compton and Oppenheim tests have continued to be applied in the English courts, Lord Cross's comments have been noted with approval in two recent New Zealand cases.[14] Consequently, there has been a degree of uncertainty in New Zealand as to whether trusts for the benefit of persons who are determined by either a blood or contractual relationship will satisfy the public benefit requirement.

The inability of an entity to qualify for charitable status when its beneficiaries are determined on the basis of bloodlines was raised by the Mäori community as a major concern, although it is by no means an issue limited to Mäori. Although Mäori organisations often provide benefits of a charitable nature to iwi and hapu, they might not qualify for an exemption because their benefit extends to a specified group of people connected by blood ties. This issue has been addressed as part of the recent legislative changes.

Marae and charitable income tax exemption

The tax status of marae and their ability to qualify for an income tax exemption as charities was also raised as a significant issue for Mäori during the review of the taxation of organisations that manage communally owned Mäori assets.

Although marae are used to carry out similar functions to churches and public halls, the entities administering them were unable to gain the same charitable tax exemption as these institutions because of the public benefit requirement and the uncertainty about whether maintaining marae was a charitable purpose at common

[10] [1945] 1 All ER 198

[11] [1951] 1 All ER 31

[12] In Oppenheim's case a gift for the education of the children of the employees and former employees of the company and its subsidiaries failed to qualify as a charity because the employees of a firm were not a public class. This was in spite of the fact that at the testator's death the number of employees exceeded 110,000.

[13] [1972] AC 601

[14] New Zealand Society of Accountants v CIR [1986] 1 NZLR 147, Educational Fees Protection Society Incorporated v CIR(1991) 13 NZTC 8,203.

law. This issue became a matter of priority for marae that wished to access funding from other charitable entities such as community trusts. If marae did not have this exemption, they generally did not gain access to this funding.

This issue was first raised in the discussion document *Taxation of Mäori Organisations*, released in August 2001.

Key features

Donations rebate

The maximum rebate able to be claimed by an individual donor under section KC 5(2) (b) is to be changed from \$500 to \$630. Since the rebate rate is 33.33 cents in the dollar, this increase means that the maximum amount of donations qualifying for the rebate increases from \$1500 to \$1890.

The rebate applies to gifts of \$5 or more to a range of organisations and funds carrying out charitable, benevolent, philanthropic or cultural purposes within New Zealand. Additional criteria apply to organisations carrying out such purposes overseas, and such organisations are specifically named in section KC 5(1).

Donations deduction for companies

Section DJ 4 has been completely rewritten. The old section DJ 4(a) limit of the greater of 1% of net income or \$4000 on donations by companies to individual organisations referred to in section KC 5(1) has been removed, as has the \$1000 limit in the old section DJ 4(b)(i). This just leaves one limit—the aggregate limit of all gifts made in any one year of 5% of net income (the old section DJ 4(b)(ii)). These changes were made to simplify the limits.

Mäori authorities' donations

Mäori authorities are also now able to claim a comparable deduction, through an amendment to section DI 2. This point is discussed in the chapter on the tax changes in relation to Mäori authorities.

Close companies listed on recognised exchange

The rewritten section DJ 4 also enables a close company to deduct its donations if its shares are quoted on the official list of a recognised exchange. Previously, all close companies were precluded from deducting their donations to protect minority shareholders, as well as provide some level of protection for the tax base. The restriction is unnecessary in the case of companies listed on the stock exchange given directors' fiduciary duties to shareholders, and the public scrutiny and disclosure requirements to which listed companies are subject.

Both "close company" and "recognised exchange" are defined terms in section OB 1 of the Income Tax Act. A "close company" is essentially a company that is controlled by five or fewer natural person shareholders through their having a combined interest in the company of more than 50%.

"Recognised exchange" basically means any recognised exchange market anywhere in the world that is a medium for bringing willing buyers and sellers of shares or options together to determine arm's length prices which are likely to prove fair and reasonable. Such factors as the number of participants and the frequency of trading are taken into account. The New Zealand Stock Exchange is an example.

Charitable purposes to be maintained

Amendments have also been made to sections CB 4(1)(c) and (e) to verify the continuing nature of the requirement to be carrying out a charitable purpose, by adding the words "and maintained" after "established". However, it is not intended that a charity must distribute all of its income in each year to achieve a continuing purpose. Funds, for example, may be invested pending some major item of expense which may be a reasonable accumulation for (ultimate) charitable purposes.

Although the intention is that charitable purposes need to be maintained by trusts as well as societies and institutions, arguably the previous wording already achieved this in the case of trusts. This is because the tax exemption applies to income derived for charitable purposes—in other words, at the time the income is derived the trust must have charitable purposes. In that sense the words "and maintained" do not need to specifically apply to trusts. Those words do, however, need to apply to other societies and institutions. This is because the previous legislation arguably conferred a tax exemption on a society or institution "established for charitable purposes" whether or not it was still maintaining those purposes at the time the relevant income was earned. This situation has been clarified in the Income Tax Bill, which is before Parliament.

Blood ties and the public benefit requirement

A new section OB 3B(1) clarifies that the purpose of a trust, society or institution is a charitable purpose under the Income Tax Act if it would satisfy the public benefit requirement apart from the fact that the beneficiaries of the trust, or the members of the society or institution, are related by blood.

The change applies to all New Zealand organisations, but it is especially relevant to Mäori organisations as many define their beneficiary class by a personal relationship (through blood ties) to a named person.

In determining whether a trust, society or institution meets the public benefit requirement, other factors will still be relevant, such as the nature of the entity, the activities it undertakes, the potential beneficiary class, the relationship between the beneficiaries and the number of potential beneficiaries. These factors were enumerated in the Dingle v Turner decision.

Marae with charitable purposes

New section OB 3B(2) specifies that in certain circumstances marae can have a charitable purpose, which means that the entity that administers that marae may qualify for an income tax exemption under section CB 4(1)(c) and (e). Donations made to them would also qualify for rebates and deductions under, respectively, sections KC 5 and DJ 4.

A trust, society or institution that administers a marae that is situated on a Mäori reservation may qualify for an exemption provided it only uses its funds:

- for charitable purposes, and/or
- to administer and maintain the marae's physical structure or land. (This would include any capital improvements to the physical structure or the land.)

A Mäori reservation is an area of land that is set aside for specific purposes, such as a marae, in accordance with the process set out in section 338 of Te Ture Whenua Mäori 1993 (Mäori Land Act 1993).

Entities administering marae that are not situated on Mäori reservations may still qualify for an exemption from income tax under the general charitable purposes definition, in the same way as entities administering churches and public halls.

Application dates

- The changes to the donations rebate and deduction provisions take effect from the 2002-03 income year.
- Mäori authorities can deduct their donations from the 2003-04 income year.
- The change verifying that charitable purposes have to be continuing to qualify for the income tax exemption applies from the 2003-04 income year.
- Liberalisation of the public benefit requirement in relation to blood ties applies from the beginning of the 2003-04 income year.
- The change in relation to certain marae having "charitable purposes" applies from the 2003-04 income year.

ORGANISATIONS APPROVED FOR CHARITABLE DONEE STATUS

Section KC 5(1) of the Income Tax Act 1994

The following organisations have been granted charitable donee status from the 2002-2003 income year:

- Open Home Foundation International Trust
- Register of Engineers for Disaster Relief New Zealand
- The Hillary Himalayan Foundation, and
- Together for Uganda.

Donations made to these organisation will entitle individual taxpayers to a rebate of 33$^{1}/_{3}$% of the amount donated. The maximum rebate for all donations is $630 per annum. A non-closely held company, or a closely held company which is listed on a recognised stock exchange, will be entitled to a deduction from its net income to a maximum of 5% of that income.

Another organisation *Save the Children New Zealand*, which already has donee status, was previously known as *The Save the Children Fund*. A change has been made to reflect the correct name and the structure under which it now operates.

PAYE BY INTERMEDIARIES

Sections LD 1, NBB 1 to NBB 8, NC 2, NC 5, NC 12A, NC 15, NC 18 to NC 20, OB 1, and OZ 1 of the Income Tax Act 1994

Sections 24, 36A, 48, 120OB, 120OC, 139AA, 141JB, 156A, 157, 167, 168, 169, 173MB, 185B of the Tax Administration Act 1994

Sections 2, 19, 24, 25, 51, 67 and 77 of the Student Loan Scheme Act 1992

Sections 147, 165 and 166 of the Child Support Act 1991

Sections 6, 221, 316 and schedule 4 of the Injury Prevention, Rehabilitation, and Compensation Act 2001

Introduction

Amendments to the various Inland Revenue Acts allow employers the option of using accredited intermediaries to largely assume an employer's obligations under the PAYE rules. Under the changes, the intermediary would be responsible for calculating PAYE, paying it to Inland Revenue, and filing returns. The transfer of these obligations to PAYE intermediaries will mean that employers who meet the requirements to provide basic payroll information and the gross salary or wages of their employees to intermediaries in a timely manner will not face any penalties for the incorrect application of the PAYE rules.

Background

The "PAYE by intermediaries initiative" was raised in the government discussion document *More time for business*, in response to two main compliance issues raised by employers: the time spent keeping up to date with PAYE requirements and the risk that PAYE deductions are not available to be paid to Inland Revenue when due.

Small businesses, in particular, face a disproportionate cost in applying the PAYE rules as the compliance cost of employing the first employee is higher than the cost of employing each additional employee (with the marginal cost reducing significantly with each extra employee). Although employers are allowed to retain the tax they deduct on behalf of employees for a while, this benefit is not significant for many small businesses owing to the small size of the deductions. More importantly, small businesses without well managed budget processes run the risk that funds will not be available when PAYE is required to be paid to Inland Revenue.

To resolve these problems, some employers already delegate their PAYE obligations to third parties such as payroll firms. However, in the past, the cost of transferring information created a barrier to many small businesses using these firms, and employers had statutory responsibility for applying the PAYE rules, even if they used a third party to calculate and pay tax. This effectively meant that employers carried the risk that their obligations under the PAYE rules were not met in all instances.

The new legislation is intended to remove the obstacles to payroll firms (and other interested parties) acting as intermediaries between employers and Inland Revenue, and therefore the barriers that discourage employers from using specialists to do this work. Under the changes, intermediaries would be responsible for calculating PAYE, paying it and filing returns. The transfer of these obligations to PAYE intermediaries will mean that employers who meet the requirements to provide basic payroll information and the gross salary or wages of their employees to intermediaries in a timely manner will not face any penalties for the incorrect application of the PAYE rules. Equally, if an intermediary defaults on the payment of PAYE to Inland Revenue, the intermediary, not the employer, will be responsible for making up the shortfall.

Key features

The main change is new sub-part NBB of the Income Tax Act 1994. As well as describing the purpose of the new legislation and recognising a PAYE intermediary as an entity in the PAYE rules, it contains the rules in relation to:

- the accreditation of PAYE intermediaries by the Commissioner of Inland Revenue
- the Commissioner's approval of employer arrangements with PAYE intermediaries and the obligations on employers who enter into such arrangements
- the obligations on PAYE intermediaries
- how the gross salary or wages of employees, paid over by employers, and held on trust by PAYE intermediaries are to be applied, and
- the termination of employer arrangements with PAYE intermediaries.

The PAYE rules previously focussed on the actions of employers. Under the "PAYE by intermediaries" initiative, a number of consequential amendments have been made to the PAYE rules (in sub-part NC) to extend the scope of the rules to include intermediaries. Generally, this has involved including references to "PAYE intermediary" (defined in section OB 1 of the Income Tax Act 1994) in instances which previously referred only to "employer". Changes have not been made, however, to extend the references to "employer", which relate to the underlying employment relationship: employees will still receive gross salary or wages (source deduction payments) from the employer, regardless of the fact that it may actually be paid through a PAYE intermediary. The employer, and not the PAYE intermediary, will be responsible for the underlying payment to employees.

Changes have also been made to the penalties and use-of-money interest rules in the Tax Administration Act 1994 to reflect the new role of PAYE intermediaries. Employers who provide gross salary or wages and the correct payroll information to the intermediary within specified or mutually agreed upon times will not be liable for penalties for any breach of the PAYE rules.

Changes have been made to the Injury Prevention, Rehabilitation, and Compensation Act 2001, the Student Loan Scheme Act 1992 and the Child Support Act 1991 to allow PAYE intermediaries to also make a number of other statutory deductions from employees' gross salary or wages. These include deductions in respect of ACC levies, student loan repayments, and child support, respectively, which are typically returned with PAYE.

Application date

Sub-part NBB of the Income Tax Act 1994 applies from 15 January 2004. This is to allow interested parties sufficient time to apply to the Commissioner to be accredited as a PAYE intermediary before the effective application date of the new rules—1 April 2004. A PAYE intermediary will be able to enter into an arrangement with an employer only in respect of pay periods beginning on or after this date.

Detailed analysis

Accreditation of intermediaries

Section NBB 2 of the Income Tax Act 1994 sets out the administrative process for applying to be accredited as a PAYE intermediary, the criteria to be used by the Commissioner to accredit, and the rules for revoking accreditation. Employers who wish to transfer their PAYE obligations to a third party will be able to transfer them only to an accredited PAYE intermediary.

When applying to be accredited as a PAYE intermediary, notice will need to be given to the Commissioner that an applicant:

- has established a trust account to hold the gross salary or wages to be paid over by employers (and providing the details of the account)
- has administration and information technology systems that will keep employer and employee payroll and payment information safe and secure, and
- is not a discharged or undischared bankrupt, has not been convicted of an offence involving fraud, and is eligible to be a company director. These criteria will apply to any officers or principals of the applicant.

The Commissioner may accredit the applicant as a PAYE intermediary if the Commissioner is satisfied that the applicant will comply with the PAYE rules and has the administration and information technology systems to make tax payments and file returns in a prescribed format (for example, electronically). Accreditation, if given, will last for a specified period.

Inland Revenue will revoke the accreditation of a PAYE intermediary if the intermediary:

- fails to comply with the PAYE rules, or
- has been made bankrupt, convicted of a fraudulent offence, put into liquidation or receivership, or (if a company) ceases to be registered in New Zealand.

Once notice is given to a PAYE intermediary (and any employer who has entered into an arrangement with the intermediary) that accreditation has been revoked, arrangements entered into must end within 14 days of the notice being issued.

Obligations on employers

Section NBB 3 and NBB 4 outline the responsibilities of employers who wish to enter into arrangements with an accredited PAYE intermediary to transfer their PAYE obligations to the intermediary.

To administer the new system and verify that a person engaged by an employer is accredited as a PAYE intermediary, Inland Revenue will need to know from the employer, in advance of an arrangement, the identity of the intermediary, the period for which the intermediary will act on the employer's behalf, and into which bank account employees' gross salary or wages will be deposited (the intermediary's trust account details). An arrangement will only become valid once the Commissioner approves the arrangement and gives notice to the employer of this fact. An arrangement can then begin, at the earliest, from a pay period starting 14 days after the notice approving the arrangement has been issued.

Employers, for the term of an arrangement with a PAYE intermediary, will be required to pay the gross salary or wages of their employees into the intermediary's trust account, by the date specified by the intermediary. They will also be required to provide basic employee and payroll information requested by the intermediary within the time agreed by both the employer and the intermediary. If an employer meets these obligations, the PAYE intermediary will bear responsibility for calculating PAYE, filing the appropriate returns and making tax payments on time.

Employers will still be required to keep records of gross salary or wages paid so that Inland Revenue can verify that intermediaries have appropriately distributed the funds received from employers.

Obligations on PAYE intermediaries

Section NBB 5 sets out the main obligations on PAYE intermediaries. Before entering into an arrangement with an employer, an intermediary will be required to inform the employer that Inland Revenue does not guarantee the payment of net salary or wages to employees of the employer (if the intermediary were to default on this responsibility). The intermediary will also be required to provide the employer with a copy of the notice sent to the Commissioner, when applying to be accredited.

The main obligations on PAYE intermediaries will be to calculate and pay PAYE, meet filing requirements, and keep records of these functions as though they were the employer. Intermediaries will also be able to make amended returns for an employer, relating to periods before the PAYE intermediary arrangement began. This is to address situations where an employer, before engaging a PAYE intermediary, may have struggled to comply with its PAYE obligations. Consequently, the PAYE intermediary may wish to correct any past errors made by the employer as part of taking over the employer's PAYE obligations. Here, the intermediary will be responsible for filing a correct, amended return. Any underlying tax liability (as well as penalties) resulting from the amended return will, however, be the responsibility of the employer.

Gross salary or wages to be held on trust

Section NBB 6 sets out the requirements for setting up and operating the trust account into which employers must deposit gross salary or wages. Deposits to an intermediary's trust account will be limited to:

- the gross salary or wages of employees
- refunds of PAYE by the Commissioner, and
- interest earned on monies held in the account.

Under section NBB 7, the Commissioner will be able to refund PAYE paid by an intermediary if the underlying payment (of gross salary or wages) by an employer into the intermediary's trust account has been dishonoured. Interest earned on funds held on trust will accrue to the intermediary.

Withdrawals from an intermediary's trust account will be limited to:

- payment of net salary or wages to employees
- payment of PAYE and other statutory deductions to Inland Revenue
- non-tax deductions on behalf of employees, and
- interest earned on the account.

In addition to their PAYE role, intermediaries will also be able to make and remit deductions required under the Injury Prevention, Rehabilitation, and Compensation Act 2001, the Student Loan Scheme Act 1992 and the Child Support Act 1991. They will also be able to make non-tax deductions on behalf of employees that would otherwise be made by the employer, such as union fees, healthcare and life insurance premiums, and superannuation contributions. Interest will be available to be withdrawn by intermediaries.

Terminating arrangements between employers and PAYE intermediaries

Section NBB 8 sets out the rules for ceasing arrangements between employers and PAYE intermediaries. Either party to the arrangement can terminate it by giving notice to the other and the Commissioner. Equally, the Commissioner will be able to terminate an arrangement by revoking the accreditation of a PAYE intermediary.

To ensure certainty in arrangements between employers and PAYE intermediaries, termination will need to be prospective, with any funds held by an intermediary at the time an arrangement ceases being dealt with as if the arrangement was still in effect (meaning the intermediary will retain responsibility for application of the PAYE rules in respect of those amounts, including filing returns and paying deductions). This is important given the possible time lag between the deposit of gross salary or wages and the dates when payment of net salary or wages and deductions occur.

The penalties and interest rules for PAYE intermediaries

Various changes have been made to Part IX of the Tax Administration Act 1994 to reflect the responsibility of PAYE intermediaries for applying the PAYE rules. Under section 141JB, intermediaries will be liable for late filing, late payment and shortfall penalties if employers have provided gross salary or wages and the correct payroll information to the intermediary within the time specified or agreed to by the parties. Changes to section 139AA mean that PAYE intermediaries will also be subject to the non-electronic filing penalty if they fail to file returns (such as employer monthly schedules) in the prescribed electronic format.

Sections 120OB and 120OC have been added to Part VII to extend the use-of-money interest rules to PAYE intermediaries. This section will impose interest on intermediaries who fail to meet their PAYE payment obligations by the appropriate due date. Use-of-money interest will be payable to PAYE intermediaries who overpay PAYE.

A number of consequential changes have also been made to the tax and penalty recovery provisions in Part X. For example, changes to sections 167 to 169 provide that if a PAYE intermediary receives gross salary or wages and the relevant information from an employer but fails to make the deductions, these amounts can be recovered from the intermediary. Similarly, changes to sections 156A and 157 allow the Commissioner to recover any penalties imposed, from intermediaries.

Part XI has been amended to extend the remission criteria for late filing and late payment penalties to include PAYE intermediaries. Similarly, provisions dealing with the cancellation of interest and the payment of refunds when tax is overpaid have been amended to apply to PAYE intermediaries as well.

Other statutory deductions

Employers may be required by statute to make a number of non-tax deductions from employees' gross wages and to remit them with PAYE. If an employer enters into an arrangement with a PAYE intermediary to transfer its PAYE obligations to the intermediary, the intermediary will also be responsible for making these other statutory deductions.

Those deductions include the earner levy under the Injury Prevention, Rehabilitation, and Compensation Act 2001, student loan repayment deductions under the Student Loan Scheme Act 1992, and child support under the Child Support Act 1991. A number of amendments have been made to these Acts to ensure that PAYE intermediaries are able to make the relevant deductions and are liable if these obligations are not met.

TAX POOLING

Part MBB, and sections NF 1(2) and OB 1 of the Income Tax Act 1994

Sections 36BB, 120C, 120OD and 157(10) of the Tax Administration Act 1994

Introduction

Amendments to the Inland Revenue Acts allow taxpayers to pool their provisional tax payments with those of other taxpayers, with the result that underpayments may be offset by overpayments within the same pool.

Background

The tax pooling proposal was raised in the discussion document *More time for business*, issued in May 2001, in response to taxpayer concerns over difficulties in calculating provisional tax and the resulting exposure to use-of-money interest.

Often the amount of provisional tax due is uncertain, since taxpayers often base their payments on an estimate of expected income over the next year. Those who, as a result, underpay their provisional tax must pay use-of-money interest on the difference; those who overpay receive use-of-money interest on the difference. The problem is exacerbated by the fact that many taxpayers consider that the rate of interest the government pays on tax overpayments to be too low and the rate it charges on underpayments too high, although the rates are based on market principles.

Tax pooling will allow businesses to pool provisional tax payments, offsetting underpayments by overpayments within the same pool, thereby reducing use-of-money interest exposure. The pooling arrangement will be made through a commercial intermediary, who will arrange for participating taxpayers to be charged or compensated for the offset—participating taxpayers will pay or receive interest on their tax underpayments or overpayments.

Intermediaries will be able to pay a higher rate of interest to taxpayers who have overpaid their tax into the pool, and charge a lower rate of interest to those who have underestimated their tax, and have therefore borrowed from the pool, than the rates of use-of-money interest. The commercial intermediaries make their money by arbitraging the interest rate differential between the government's rates and their own (lower) financing costs.

Key features

The main change is introduction of the new Part MBB in the Income Tax Act 1994. This Part sets out the rules relating to the establishment and operation of a tax pooling account, including:

- requirements to be met by a person wishing to become a tax pooling intermediary (hereafter referred to as the "intermediary") and the person's continuing responsibilities in maintaining a tax pooling account
- rules governing the making of deposits to, and transfers from, a tax pooling account, and
- rules governing the winding up of a tax pooling account.

Several further, minor, amendments have also been made to the Inland Revenue Acts. These, in conjunction with Part MBB, will ensure that the correct rules apply with respect to the application of the resident withholding tax rules, the provision of information to the Commissioner by an intermediary, the application of the rules relating to use-of-money interest and the recovery of tax in default.

Application date

The tax pooling provisions apply from 1 April 2003.

Detailed analysis

Changes to Income Tax Act 1994

Purpose of proposal

Section MBB 1 provides that the purpose of tax pooling is to allow taxpayers to manage their provisional tax payment risks by:

- reducing use-of-money interest on underpaid tax, and
- increasing use of money interest on overpaid tax.

Section MBB 2 provides for the mechanism by which a taxpayer may do so. It states that a taxpayer may agree with a person who holds a tax pooling account that the person will act as an intermediary between the taxpayer and the Commissioner, in using funds from the tax pooling account to meet the taxpayer's obligations to pay provisional tax.

Requirements for establishing a tax pooling account

Section MBB 3 sets out the requirements to be met by a person wishing to establish a tax pooling account.

Subsection (1) provides that the person must firstly apply to the Commissioner for approval, providing certain information and giving the following assurances:

- that they have administration and information technology systems capable of allowing them to meet their continuing responsibilities in maintaining a tax pooling account

- that they have established a trust account into which they will pay amounts that they receive from taxpayers for the purposes of tax pooling
- that they have no history of bankruptcy or offences involving dishonesty; and that they would be eligible to be a company director
- that, before acting as an intermediary for a taxpayer, they will:
  - inform the taxpayer that the Commissioner is not required to oversee or audit the operation of the tax pooling account
  - inform the taxpayer that the Commissioner is not liable for any loss that the taxpayer may suffer by virtue of intermediary default, and
  - ensure that the taxpayer is aware of all the matters concerning which they have given assurances to the Commissioner.

Subsection (2) provides that, if the Commissioner is satisfied that all of the requirements have been met by the applicant, the Commissioner may give written approval for the applicant to establish a tax pooling account.

Operation of a tax pooling account

Section MBB 4 sets out a number of rules governing the continuing operation of a tax pooling account. Subsection (2) provides that, once established with Inland Revenue by an intermediary, a tax pooling account does not relate to a particular income year, and continues until it is wound up. (The new legislation includes rules governing winding up—these are discussed under section MBB 8.)

Importantly, subsection (3) provides that an intermediary who accepts a payment from a taxpayer for deposit in a tax pooling account must give notice to the taxpayer that the payment does not, at that stage, satisfy the taxpayer's tax obligations. The amount will not become "tax paid" until a transfer is made from the tax pooling account to the taxpayer's individual tax account with Inland Revenue (discussed under section MBB 6). The intermediary must ensure that the taxpayer is given notice of this fact.

If default on the part of an intermediary does result in a taxpayer's provisional tax payment obligations not being met, the taxpayer will have recourse to the usual legal avenues for obtaining compensation from the intermediary. Additionally, section 183A of the Tax Administration Act 1994 provides for the remittance of late payment penalties where reasonable cause exists. Where an intermediary has failed to transfer a taxpayer's payment to the department as requested, the taxpayer would be able to obtain relief under this section.

In order to ensure that the taxpayer's privacy interests are protected in the operation of the tax pooling account, subsection (4) provides that the intermediary must maintain and operate administration and information technology systems that protect the confidentiality of the taxpayer's personal information and payment details. Additionally, the systems must record the amount that has been deposited by the taxpayer to the account, at any particular time.

Specific provision is made, in subsection (5), that the Commissioner is not required to oversee or audit the operation of a tax pooling account. Additionally, subsection (6) provides that the Commissioner is not liable for any loss that the taxpayer may suffer through intermediary default.

Deposits to a tax pooling account

Section MBB 5 sets out a number of rules governing the making of deposits to a tax pooling account. These are largely designed to protect the interests of taxpayers participating in a tax pool.

Subsection (1) provides that, when a deposit is made to a tax pooling account by an intermediary, certain information must be supplied to the Commissioner, by electronic means—the intermediary must supply the name and tax file number of each taxpayer who has contributed to the amount deposited, and the amount contributed. This provides Inland Revenue with sufficient notice that the taxpayer will be participating in a tax pooling arrangement. It also enables taxpayers to check with the department that their payment has been deposited correctly by the intermediary.

Subsection (1B) provides that, upon receiving the deposit and the accompanying information, the Commissioner will supply the intermediary with confirmation of receipt and the account into which the deposit has been paid. This will also enable taxpayers to check with their tax pooling intermediary whether their payment has been deposited correctly.

If the intermediary does not supply this information to the Commissioner within five working days of the deposit, subsection (2) provides that it must be refunded to the intermediary.

This combination of provisions ensures that, at any particular point in time, a taxpayer's contribution and continuing interest in a tax pool can be confirmed and identified. To provide additional security for taxpayers' deposits, subsection (3) states that a deposit to a tax pooling account is held by the intermediary in trust for the contributing taxpayer, until it has been dealt with on behalf of the taxpayer.

As noted earlier, the purpose of tax pooling is to allow taxpayers to manage their provisional tax payment risks by reducing use-of-money interest on underpaid tax and increasing use-of-money interest on overpaid tax. It is important, therefore, that the legislation clearly sets out the way use-of-money interest is to apply to amounts deposited to and transferred from a tax pooling account.

Subsection (3B) provides that an amount deposited in a tax pooling account accrues use-of-money interest, to the benefit of the intermediary, from the date the deposit was made. This interest is payable to the intermediary up to either:

- the effective date of the credit of the amount to another account with the Commissioner (being a taxpayer's individual tax account), or
- the date that the amount is refunded by the Commissioner back to the intermediary.

To further reinforce that an amount deposited to a tax pooling account will not become "tax paid" until a transfer is made from the account to a taxpayer's individual tax account, subsection (4) specifically provides that such an amount is only treated as "tax paid" by the intermediary for the purpose of calculating use-of-money interest—and for no other purpose.

Transfers from a tax pooling account

Section MBB 6 sets out a number of rules governing transfers from a tax pooling account to a taxpayer's individual tax account.

Subsection (1) provides that an intermediary may, at any time, request that the Commissioner transfer an amount in the tax pooling account to a taxpayer's individual tax account. There must, however, be sufficient funds in the tax pooling account on the date to which the amount is to be transferred. Additionally, the taxpayer to whom the transfer is to be made must be a client of the intermediary—this is to ensure that the tax pooling rules cannot be used to undermine the rules governing the transfers of overpaid tax, which were enacted in 2001.

Subsection (1B) provides that transfers from a tax pooling account will be credited to a taxpayer's individual tax account as at the effective date elected by the intermediary. The only exception to this is where a taxpayer's terminal tax date has passed by 60 days, and the taxpayer to whom the transfer is to be made is exposed to penalties for failing to meet their minimum provisional tax obligations. In this case, a request for a transfer will be treated as being made at the date of the intermediary's request, not the effective date.

The purpose of the pooling rules is to enable taxpayers to better manage their provisional tax payments and to reduce their use-of-money interest costs. This purpose must, however, be balanced against the need to ensure that taxpayers maintain reasonable compliance with the provisional tax rules. When taxpayers fail to meet their minimum provisional tax obligations on a continuing basis, they should not be able to gain an unfair advantage from the proposal.

For these taxpayers, at a certain point in time, the ability to offset resulting use-of-money interest and penalties should cease. This point is reached within a reasonable period beyond a taxpayer's terminal tax date—by this stage the taxpayer should have met provisional tax payment obligations for the income year.

Subsection (1B) provides, therefore, that once a period of 60 days beyond their terminal tax date has passed, if taxpayers are exposed to penalties for failing to meet their minimum provisional tax payment obligations, a request for a transfer will be treated as being made at the date of the request, not the effective payment date, for both use-of-money interest and penalty purposes.

If taxpayers have complied with their minimum obligations, but beyond 60 days following terminal tax date still find themselves owing tax (that is, after a reassessment) they will be able to usee the tax pooling rules to offset any potential penalties and use-of-money interest.

Subsection (2) provides that, when an intermediary requests a transfer from a tax pooling account, it must supply the Commissioner with the following details, by electronic means:

- the details of the taxpayer to whom the transfer is to be made to
- the amount of the transfer
- the date the amount is to be transferred, and
- the effective date to which the transfer is to be made.

Subsection (4) provides the Commissioner cannot action a request for a transfer if these details have not been provided. Likewise, under subsection (3), the Commissioner cannot do so if the available funds in the pooling account comprise deposits concerning which the intermediary has not provided the information required by section MBB 5 (discussed earlier).

Once an amount has been transferred from the tax pooling account to an individual taxpayer's account, subsection (5) provides that the Commissioner must supply a statement to the intermediary and the taxpayer confirming that the action has been taken. Subsection (6) confirms that an amount so transferred to an individual taxpayer's account is income tax paid to meet a provisional tax obligation.

Subsection (7) deals with the interaction of the imputation credit account rules with tax pooling.

Subsection (8) is a general anti-avoidance provision. It provides that the Commissioner may refuse to accept a request for a transfer, or may reverse a previously actioned transfer, if the Commissioner considers that the request for the transfer is or was made for the purpose or effect of tax avoidance.

Refunds from a tax pooling account

Section MBB 7 provides that an intermediary may request a refund of all or part of the balance in their tax pooling account, at any time.

Winding up of tax pooling account

Section MBB 8 sets out a number of rules governing the winding up of a tax pooling account.

Subsection (1) provides that an intermediary may wind up its tax pooling account at any time. Subsection (2) provides that the Commissioner may instigate a winding up, if the Commissioner considers that:

- the intermediary is preventing taxpayers from managing their liability to pay provisional tax and use-of-money interest, or
- the intermediary is, or has been, in breach of any statutory obligations, or
- the tax pooling account has gone into deficit, or
- there is, or is likely to be, consistently fewer than 100 taxpayers contributing at any one time to the tax pool, or
- the intermediary has been made bankrupt, or has been convicted of an offence involving dishonesty, or would not be eligible to be a company director, or
- the intermediary has been placed into liquidation or receivership.

If the Commissioner intends to instigate a winding up because that there are, or are likely to be, consistently fewer than 100 taxpayers contributing at any one time to the tax pool, subsection (3) provides that he must first give 30 days' notice to the intermediary. This is to give the intermediary time to bring the number of taxpayers back to the required level before the winding up action is instigated.

When a tax pooling account is wound up, subsection (4) provides that the Commissioner may refund the funds in the tax pooling account to the intermediary. However, the subsection also provides that, if the Commissioner has reason to believe that the tax pooling account funds may not be distributed back to the contributing taxpayers in the correct amounts, the Commissioner may apply to the court for directions as to the redistribution of the funds.

Income tax treatment of payments of interest

Section MBB 9 provides that, for the purposes of the Act's deductibility provisions, payments made either to an intermediary by a client taxpayer, or by an intermediary to a client taxpayer, that are in the nature of interest are deductible.

Resident withholding tax treatment of payments of interest

An amendment to section NF 1(2)(a) ensures that the resident withholding tax treatment of interest paid to and by an intermediary mirrors that applied to use-of-money interest generally—that is, intermediaries are required to withhold the tax from interest payments made to taxpayers, but taxpayers are not required to withhold the tax when making interest payments to intermediaries.

Changes to Tax Administration Act 1994

Format of information to be supplied to the Commissioner

A new section 36BB provides that information to be supplied by the intermediary, in relation to deposits made under section MBB 5(1) and transfers made under section MBB 6(2), must be in an electronic format approved by the Commissioner.

Deduction of outstanding tax

An amendment to section 157 includes amounts paid by a taxpayer to an intermediary for the purposes of tax pooling as "income tax" for the purposes of this section. This ensures that Inland Revenue has recourse to these funds, if necessary, to offset outstanding tax owed by the taxpayer.

GST treatment of intermediaries

No specific GST treatment for intermediaries is provided on the basis that the current law is sufficient. Part of the service provided by an intermediary may be subject to GST: namely, the provision of the trustee structure, the establishing and maintaining of customer accounts, and the clearing and settlement processes. Services relating to the tax deposits made to Inland Revenue may be a debt security and thereby fall within the definition of a financial service, and hence be exempt from GST.

CONFIRMATION OF ANNUAL INCOME TAX RATES FOR 2002–2003

Schedule 1, Income Tax Act 1994

The income tax rates for the 2002-2003 income year have been confirmed as follows:

Policyholder income	33 cents for every $1 of schedular taxable income
Mäori authorities	25 cents for every $1 of taxable income
Undistributed rents, royalties and interest of the Mäori Trustee income	25 cents for every $1 of taxable
Companies, public authorities and local authorities income	33 cents for every $1 of taxable
Trustee income (including that of trustees of superannuation funds) income	33 cents for every $1 of taxable
Trustees of group investment funds	33 cents for every $1 of schedular taxable income in respect of category A income
Taxable distributions from non-qualifying trusts distribution	45 cents for every $1 of taxable
Other taxpayers (including individuals)	
– Income not exceeding $38,000	19.5 cents for every $1 of taxable income
– Income exceeding $38,000 but not exceeding $60,000	33 cents for every $1 of taxable income
– Income exceeding $60,000	39 cents for every $1 of taxable income
Specified superannuation contribution	39 cents for every $1 of the withholding tax contribution where the employee has made an election under section NE 2AA 33 cents for every $1 of contribution where no such election is made.

The income tax rates confirmed are the same rates that applied for the 2001-02 income year. The rates apply for the 2002-2003 income year.

REQUIREMENT TO DISCLOSE CHANGES IN IMPUTATION RATIOS

Former sections 69(2), 69(3) and 69(4) of the Tax Administration Act 1994

Introduction

The requirement to disclose changes to imputation ratios if the ratios have increased or decreased by more than 20% from the previous year, and to furnish an explanation for the change, has been removed.

Background

The reason for requiring companies to disclose significant variation in these ratios was to identify cases where an arrangement may have been entered into to obtain a tax advantage. However, the information required to calculate the relevant ratios is already provided to Inland Revenue in the company income tax and imputation return. It is, therefore, possible for the Commissioner to calculate the ratios and to determine whether there has been a change of more than 20% between years. If the Commissioner determines that there has been a variation that warrants further investigation, the company can then be required to provide an explanation for the change.

This change was recommended by the Finance and Expenditure Committee, in its consideration of the bill.

Key features

Sections 69(2), 69(3) and 69(4) of the Tax Administration Act 1994 have been repealed. Section 69(2) required a company to disclose in its annual imputation account if the ratio of imputation and dividend withholding payment credits to total dividends paid, and the ratio of debits to credits in the imputation credit account changed by more than 20% over the preceding year. Section 69(2) also required an explanation for the change to be furnished.

Section 69(3) contained the formulae for the ratios, and section 69(4) described the impact of conduit tax relief on the ratios.

Application date

The change applies from the 2002-03 imputation year.

GST AND TELECOMMUNICATIONS SERVICES

Sections 2, 8(3)–(4), 8A, 11A(5), 11AB and 51(1)(e) of the Goods and Services Tax Act 1985

Introduction

The GST treatment of cross-border supplies of telecommunications services has been clarified by inserting a new place of supply rule, zero-rating provisions and definitions.

Although in policy terms it is clear that supplies of telecommunications services should be subject to GST in New Zealand when they are consumed in New Zealand, the general place of supply rule and zero-rating provisions in the Goods and Services Tax Act 1985 were not easily applied to cross-border supplies of telecommunications services. This led to uncertainty as to when supplies of telecommunications services were subject to GST in New Zealand, and when they were not.

The amendments reduce this uncertainty by inserting provisions dealing specifically with cross-border supplies of telecommunications services.

Background

The nature of telecommunications services means that it can be difficult to state with certainty where the services are performed. Determining where services are performed is important as in many instances the GST Act (for instance, former section 8(2)(a) and section 11A(1)(j)) looks to where a service is physically performed to determine its treatment.

The concept of physical performance does not fit well with the nature of telecommunications services. Overseas case law suggests that the physical performance of telecommunications services takes place where the telecommunications equipment (such as satellite dishes and exchanges) used to provide the service is situated.[15]

The physical performance test can be particularly difficult to apply in cases where cross-border telecommunications services are supplied, as in many instances the supplier of the services will have equipment located in both countries (such as a satellite station) to complete the "circuit" needed for a telephone call.

There can also be uncertainty as to who is receiving the supply of telecommunications services. For example, in an international call between two consumers, either fixed line or mobile, there will be component supplies of telecommunications ("connection" services) between telecommunications companies to link the two consumers in different jurisdictions combining to make the "whole" of the call between the consumers.

Certain provisions of the GST Act were, therefore, difficult to apply to cross-border supplies of telecommunications services, including:

- former section 8(2)(a)(ii): the taxation of services physically performed in New Zealand
- section 11A(1)(j): the zero-rating of services physically performed outside New Zealand, and
- section 11A(1)(k): the exclusion from zero-rating where services are provided directly in connection with movable personal property in New Zealand.

The provisions in this bill reduce these uncertainties by enacting specific provisions in relation to cross-border telecommunications services.

Key features

The new provisions determine to whom a supply of telecommunications services is made and the circumstances in which it is subject to GST in New Zealand. These rules are in addition to the general place of supply rule in section 8(2), which is based on the residence of the supplier.

New place of supply rule

New section 8(6) deems there to be a supply of services in New Zealand when a person physically in New Zealand (other than a telecommunications supplier) initiates (including on behalf of another person) a supply of telecommunications services from a telecommunications supplier outside New Zealand (the "physical location" test). This will require an offshore telecommunications supplier who makes more than $40,000 of supplies to persons in New Zealand, in a 12-month period, to register for GST here. New section 8(7) provides that section 8(6) does not apply to supplies between telecommunications suppliers.

When use of the physical location test is impractical for a class of customer or service, new section 8A deems there to be a supply of services in New Zealand when a person with a billing address in New Zealand initiates (including

[15] *British Sky Broadcasting* [1996] BVC 1107

on behalf of another person) a supply of telecommunications services from a telecommunications supplier outside New Zealand (the "billing address" test).

New section 8A(3) requires the billing address test, if used for a member of a class of customer or service, to be used consistently for all members of that class of customer or service.

New sections 8(3) and 8(4) are re-enactments of sections 8(2)(a) and 8(2)(b) respectively, and new section 8(5) ensures that sections 8(3) and (4) do not apply to supplies of telecommunications services.

New section 8(8) inserts an equivalent to section 8(4) for telecommunications services to ensure that unless the supplier and the recipient agree otherwise, a supply of telecommunications services from a non-resident to a registered person in New Zealand for which the New Zealand recipient would be entitled to an input tax credit are not subject to GST

The initiator test

Determining which party has initiated a supply is fundamental to the operation of both the physical location test and the billing address test for the place of supply of telecommunications services. New section 8(9) sets out factors to help determine which party to a supply of telecommunications services has initiated the supply. The initiator test lists the following factors:

- who pays for the services
- who begins the supply
- who terminates the supply, and
- who contracts for the supply.

Registration

New section 51(1)(e) provides that non-resident telecommunications suppliers do not have to register for GST solely as a result of making supplies that section 8(6) or 8A treats as being made in New Zealand to persons who are not resident, but who are physically in New Zealand. This ensures that non-resident cellular phone companies do not have to register for GST in New Zealand solely because they make supplies of telecommunications services to non-resident customers "roaming" in New Zealand.

Zero-rating

The amendments introduce a code for zero-rating cross-border supplies of telecommunications services. New section 11AB zero-rates supplies of telecommunications services made:

- by New Zealand telecommunications suppliers to non-resident telecommunications suppliers when a telecommunications service is initiated outside New Zealand (section 11AB(a)), and
- to non-resident persons, other than telecommunications suppliers, when a telecommunications service is initiated outside New Zealand (section 11AB(b)).

New section 11A(5) ensures that supplies of telecommunications services can be zero-rated only under section 11AB.

Definitions

For purposes of clarification, definitions of "telecommunications services", "content" and "telecommunications supplier" are inserted into the Act. These terms are defined as:

Telecommunications services: "means the transmission, emission or reception, and the transfer or assignment of the right to use capacity for the transmission, emission or reception, of signals, writing, images, sounds or information of any kind by wire, cable, radio, optical or other electromagnetic system, or by a similar technical system, and includes access to global information networks but does not include the content of the telecommunication."

Content: "means the signals, writing, images, sounds or information of any kind that are transmitted, emitted or received by a telecommunications service."

Telecommunications supplier: "means a person whose principal activity is the supply of telecommunications services."

Application date

The amendments apply from 1 July 2003.

Note

A more detailed explanation of the operation of the new rules, in particular the initiator test, will be included in a forthcoming *Tax Information Bulletin* article.

GST ON DOMESTIC LEGS OF INTERNATIONAL PASSENGER CRUISES

Section 11A of the Goods and Services Tax Act 1985

Introduction

A new provision zero-rates the domestic leg of international passenger cruises if either the first place of departure or the final place of destination of the cruise is outside New Zealand. An international voyage therefore includes one that involves stops at one or more New Zealand ports.

Background

Before this amendment, the legislation was not clear as to whether an international cruise that visits a number of New Zealand ports should be considered as one supply, or as a series of individual supplies between ports.

To make a distinction between the international and domestic aspects of the one sea voyage would be impractical, regardless of how many New Zealand ports were visited. This is because this would require an apportionment of the fee charged for the cruise to determine the portion of the cruise that is consumed in New Zealand which would be extremely difficult.

Because of the compliance and administrative costs associated with apportioning the domestic and international legs of an international cruise, the legislation has been amended to zero-rate the domestic portion of an international journey. This recognises that the supply of the voyage is likely to be predominantly international and therefore consumed overseas.

Key feature

Section 11A(1) of the Goods and Services Tax Act (GST Act) has been amended to provide that an international cruise that visits a number of New Zealand ports, and in respect of which the first place of departure or the final place of destination is outside New Zealand, is zero-rated for the purposes of GST.

Example

Two types of voyages that may be zero-rated under the new provision

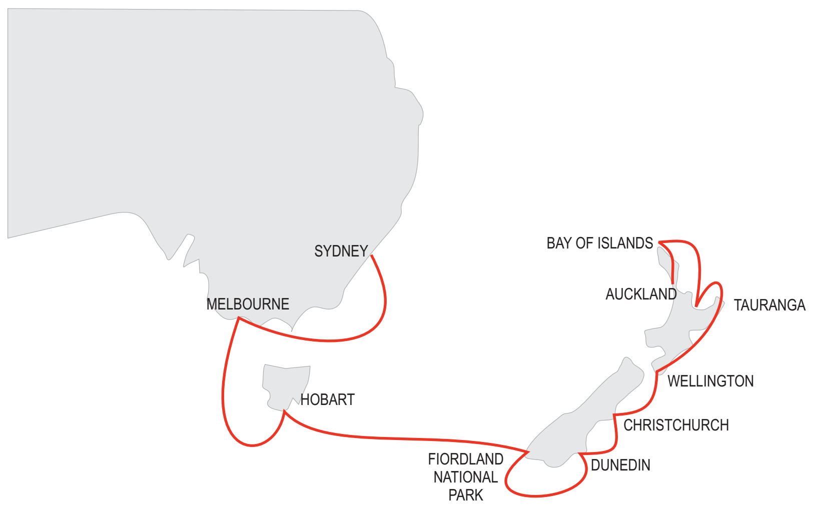
Other types of cruises not illustrated in figures 1 or 2 which may visit a number of New Zealand ports but which, say, either leave from or depart to a single destination offshore require similar clarification in the legislation. The effect of this amendment is that since these types of cruises are not easily distinguished from other international cruises, they will be zero-rated in the same manner

Application date

The amendment applies from 26 March 2003.

Figure 1

Figure 2



REMEDIAL AMENDMENTS

DEPRECIATION RULES ON AMALGAMATION

Section EG 17, section FE 5 and new section FE6B of the Income Tax Act 1994, and new section 191WF of the Income Tax Act 1976.

Introduction

The application of rules dealing with transactions between associated persons has been clarified in respect of the transfer of depreciable property on a non-qualifying amalgamation.

When depreciable property is transferred between companies in a non-qualifying amalgamation, the cost of the property to the new owner, for depreciation purposes, is generally deemed to be market value. However, when the old owner and the new owner are associated, then the depreciation base cost is the lower of the cost to the old owner and the cost to the new owner. This "associated persons rule" takes precedence over the market value rule.

An oversight in the rules that govern depreciation on a qualifying association has also been corrected. Companies that amalgamate in a qualifying amalgamation will be able to claim depreciation deductions in the year of amalgamation, for the period up to the date of amalgamation.

Background

Tax rules governing the amalgamation of companies were introduced following reforms to company law in 1993. The interaction of these rules with the depreciation provisions has given rise to two problems. The first relates to the associated persons rule in section EG 17, the second to the basic depreciation rule in section EG 1.

Associated persons rule and non-qualifying amalgamations

The amalgamation provisions provide concessionary tax treatment for the transfer of property on a qualifying amalgamation (essentially one between resident companies). Property is deemed to be acquired by the amalgamated company at tax book value, rather than at market value.

Because the provisions are concessionary, taxpayers can elect that they do not apply. The amalgamation is then non-qualifying, and property is deemed to be acquired by the amalgamated company at market value, following section FE 5.

Section EG 17 prevents taxpayers who are associated from increasing depreciation deductions by transferring a depreciable asset between them at a price above its original cost. The base value of the asset to the new owner is limited to the cost of the asset to the old owner.

The restriction in section EG 17 should apply to property transfers between associated companies in an amalgamation. Otherwise, a company which holds depreciable assets with a market value above their original cost could obtain increased depreciation deductions simply by amalgamating with another company without changing the substantial ownership of the asset, and electing for the amalgamation to be non-qualifying so that the assets are treated as transferred at market value. It was never the intention of the amalgamation provisions that associated companies should be able to avoid section EG 17 in this way.

It was not entirely clear that the rule in section EG 17 took priority over the rule in section FE 5. Section EG 17 has now been amended to put this beyond doubt. Section FE 5 has also been amended to counter an argument that section EG 17 could not apply on a non-qualifying amalgamation because there is no acquisition from an associate, the amalgamating company having ceased to exist at the time the acquisition is deemed to occur under section FE 5.

Basic depreciation rule

Under section EG 1(2), no depreciation deduction is allowed for most classes of depreciable property in the year in which the property is disposed of. In the year of disposal there is a square-up of depreciation deductions, so that in total, over the period of ownership, the taxpayer deducts only the difference between the purchase and the sale price.

When depreciable property passes between companies on a qualifying amalgamation, however, it passes at tax book value. In effect, this means that there is no square-up. Because of section EG 1(2), the old owner cannot claim a depreciation deduction for the period up to the amalgamation. The new owner can claim only in respect of the period following amalgamation. The effect is that depreciation for the period of the year up until the date of amalgamation remains locked away until the asset is finally disposed of.

The amalgamation rules have been amended so that depreciation can be deducted for the period up to amalgamation.

Key features

Primacy of the associated persons rule

New subsection EG 17(3B) says that the associated persons rule in EG 17(1) applies in the case of a non-qualifying amalgamation. The market value determined under section FE 5 is an ingredient in the associated persons test in EG 17(1), and not necessarily the final cost for depreciation purposes.

The two companies are treated as associated, as the 100% owner of Company A (Alice) owns 67% of the new Company B. Assets transferred from Company A are subject to the associated persons rule.

Measuring association

New subsection FE5(2) applies the test of association by comparing the old owner with the new owner, as if the old owner existed at the time the amalgamating company acquires the property. This means that the associated person test may apply not only when two associated companies amalgamate, but also in some cases when two previously unassociated companies amalgamate. This ensures that there is no uplift in the cost base of depreciable property without a real change in the property's ownership. The associated persons rule will not apply if the ownership of the asset changes by more than 50%.

The two companies are not treated as associated, as the 100% owner of Company B (Bill) owns only 33% of the new Company A. Assets transferred from Company B are not subject to the associated persons rule.

Depreciation in the year of amalgamation

New section FE 6B allows a depreciation deduction to be claimed in the year of disposal when the disposal occurs on a qualifying amalgamation. The deduction covers the part-year up to amalgamation. (A parallel amendment to the Income Tax Act 1976 is made by new section 191WF..

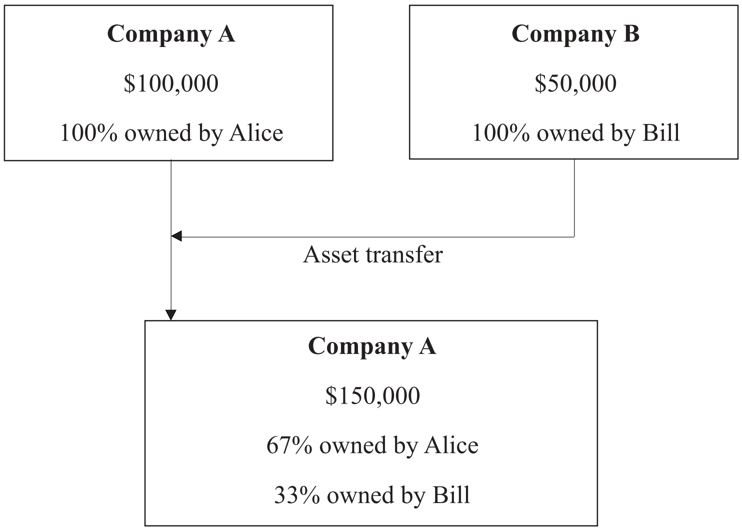
Application date

The amendments relating to non-qualifying amalgamations and the associated persons rule apply to property transferred on and after 14 May 2002.

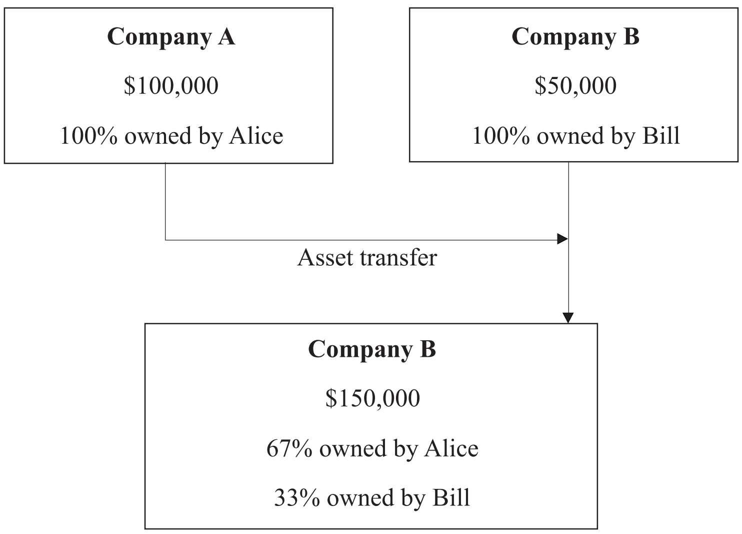
The new rule relating to qualifying amalgamations and deductions in the year of disposal is retrospective to 1 July 1994, except where a deduction has already not been claimed in a return filed before 14 May 2002.

For example:

Example 1 - Amalgamation of Companies A and B, Company A continuing



Example 2 - Amalgamation of Companies A and B, Company B continuing



The two companies are treated as associated, as the 100% owner of Company A (Alice) owns 67% of the new Company B. Assets transferred from Company A are subject to the associated persons rule.

INTEREST COMPONENT OF REIMBURSEMENT FOR FILM PRODUCTION EXPENDITURE

Section EO 4(2B) of the Income Tax Act 1994

Introduction

A new provision rectifies a recently identified technical problem regarding the inter-relationship between the interest rules enacted in 2001 and the rules applying to the reimbursement of film production expenditure. It makes clear that the reimbursement of interest expense can qualify as film production expenditure.

Background

In 2001 the Income Tax Act was amended to allow certain types of companies to deduct interest expenses more simply. The amendments included verification that the timing of interest deductions is determined by the accrual rules rather than other timing rules in that Act. Transitional exceptions were provided for taxpayers that had been applying the other timing rules.

Under section EO 4(1) when a person reimburses another party for film production expenditure, that person can deduct that reimbursement as if it were film production expenditure they had incurred themselves. Conceivably, the amount reimbursed could cover interest as well as other, more direct film production expenses.

An inadvertent result of clarifying that interest deductions have to be timed under the accrual rules was that, arguably, section EO 4(1) could not apply to any reimbursement of interest expenses. Consequently, while the rest of the reimbursement would be deductible in the later of the year it was incurred or the year the film was completed under the timing rule applying to the costs of producing a film, the reimbursement of interest expenses would likely not be deductible until the film was sold, under another timing rule.

Key features

The new section EO 4(2B) indicates that if a taxpayer reimburses another person for any expenditure on interest incurred by that other person in producing a film, the taxpayer may treat the reimbursement as film production expenditure.

The purpose of this amendment is purely to remove the anomaly and thereby clarify what most taxpayers will have already been doing since 1997-98. It does not require the reimbursed interest expenses to be treated as film production expenditure as the change is permissive (it refers to "may treat"). Accordingly, taxpayers that have not treated reimbursed interest expenses as film production expenditure will not be required to make any change as a result of the amendment.

Application date

Because the amendment verifying that the timing of interest deductions is determined by the accrual rules applied from the 1997-98 income year, the new section EO 4(2B) has been backdated to apply also from the 1997-98 income year

INTERNATIONAL TAX – REMEDIAL ISSUES

Sections FH 3(3), MF 4(1B), MF 8(2)(a), MF 8(2A), MF 8(2B),MF 8(4)(a), MF 10(2)(a), MF 10(5)(c) and OB 1 of the Income Tax Act 1994

Introduction

Amendments have been made to the conduit, branch equivalent tax account and provisional tax rules to clarify that:

- the non-resident shareholding percentage used when receiving conduit relief is the same percentage used in the conduit excess interest allocation rules
- only one branch equivalent tax account credit can be created when a company offsets losses against its net income and also pays income tax, and
- the definition of "residual income tax" excludes debit offsets from a branch equivalent tax account.

The consolidated group provisions for branch equivalent tax accounts have also been aligned with the equivalent provisions for individual companies, by ensuring that branch equivalent tax account credits and debits are calculated before any conduit relief is given.

Background

Conduit rules

The conduit rules aim to relieve New Zealand tax on foreign sourced income of New Zealand resident companies to the extent they have non-resident shareholders. These rules are buttressed by interest allocation rules to prevent excessive interest deductions being taken against New Zealand-sourced income, while the foreign income has tax relieved from it.

The conduit excess interest allocation rules initially compare the company's group debt to asset ratio with a safe harbour threshold of 66%. Before making this comparison, the foreign assets of the company that receive conduit relief are reduced by the non-resident shareholding percentage in order to measure the debt that generates New Zealand tax deductions against the assets that generate taxable income.

To ease compliance costs, there are a number of dates that a company receiving conduit relief may choose to calculate its non-resident shareholding percentage in a year. Additionally, a listed company may choose any date in a year, if for commercial reasons it would normally calculate its non-resident shareholding percentage on that date.

It was always the government's policy intent that the non-resident shareholding percentage that applied to the calculation of conduit relief would be the same one that applied to reducing the assets when calculating whether the conduit excess interest allocation rules applied. An amendment has been made to clarify this intent.

Branch equivalent tax accounts

The branch equivalent tax account rules aim to prevent double taxation of foreign income that is subject to income tax under the controlled foreign company or foreign investment fund rules, as well as subject to dividend withholding payment when the underlying income is received as a foreign dividend. The intention is that regardless of which income stream occurs first, tax will only be paid once.

The branch equivalent tax account mechanism provides that if income tax has been paid first, a branch equivalent tax account credit arises which offsets the liability to dividend withholding payment. Alternatively, if a dividend had been paid in advance of the income being earned in the controlled foreign company with dividend withholding payment being paid first, a branch equivalent tax account debit arises which can offset the liability to income tax.

A branch equivalent tax account credit can also be created when losses from New Zealand sources have been offset against attributed foreign income and so no liability to income tax arises.

It was never the intention that when a company paid income tax and also used losses from New Zealand sources that the credits created would exceed the value of the tax rate multiplied by the attributed foreign income for the year, adjusted for foreign tax credits and branch equivalent tax account debit offsets. An amendment has been made to limit the credits accordingly.

Residual income tax

The provisional tax rules aim to tax income that has not had tax deducted from or credited to it in any form in the year it is earned. Its calculation is based around "residual income tax" which is the tax liability on income in the previous year that did not have tax paid or deducted from it.

As noted in the discussion of branch equivalent tax accounts, the payment of dividend withholding payment generates a branch equivalent tax account debit that can be used to offset a liability to income tax.

Although a company may use a branch equivalent tax account debit to meet its income tax liability on attributed foreign income, the previous definition of residual income tax did not take into account branch equivalent tax account debit offsets. This meant the previous law required a company to pay provisional tax on income from which dividend withholding payment had already been deducted, contrary to the aim of the provisional tax rules.

The amendment clarifies that branch equivalent tax account debit offsets by a company are excluded from the definition of "residual income tax" within the provisional tax rules.

Key features

- Section FH 3(3), within the conduit excess interest allocation rules, has been amended to ensure that the non-resident shareholding percentage is the same as either the one used to calculate conduit relief under KH 1 or the average of the percentages used to receive conduit relief under NH 7.
- Sections MF 4(1B) and MF 8(2B) have been added to limit the branch equivalent tax account credits that arise under MF 4(1)(a) and (b) and MF 8(2)(a) and (b) respectively. When a company pays income tax as well as uses losses from New Zealand operations to reduce its taxable income, the credits will be limited to attributed foreign income multiplied by the company tax rate, adjusted for foreign tax credits and branch equivalent tax account debit offsets.
- Sections MF 8(2)(a), MF 8(4)(a), MF 10(2)(a) and MF 10(5)(c), have been amended to ensure that consolidated group branch equivalent tax account debits and credits are calculated before any conduit relief is calculated. This aligns the branch equivalent tax account provisions for consolidated groups with those for individual companies.
- Paragraph (kb) has been added to the definition of "residual income tax", in section OB1 to clarify that the definition excludes debit offsets from the branch equivalent tax account made under sections MF 5(4) or MF 10(3).

Application dates

The amendments to:

- the conduit rules apply from the 1998-99 income year except when a taxpayer has a filed an income tax return based on the previous law before 14 May 2002, when it applies from the next income year or 2002-03 whichever is earlier

- the branch equivalent tax account credit rules applies from 1 April 1995 except when a taxpayer has filed an income tax return for an income year based on the previous law before 14 May 2002, when it applies from the next income year
- the definition of "residual income tax" applies from the 1995-96 income year except when a taxpayer has a filed an income tax return based on the previous law before 14 May 2002, when it applies from the next income year or 2002-03 whichever is earlier
- the alignment of the branch equivalent tax account provisions for consolidated groups with those for individual companies applies to the 1998-99 and subsequent imputation years.

RATIONALISATION OF TERMINAL TAX PAYMENT DATE PROVISIONS

Sections HG 12, MC 1, OB 1 and Schedule 13 of the Income Tax Act 1994; sections 102, 103, 104, 105, 125, 138E, 142 of the Tax Administration Act 1994; section 193 and Schedule 4 of the Injury, Prevention, Rehabilitation and Compensation Act 2001

Introduction

The terminal tax payment date provisions for income tax have been rationalised by reducing the three former such provisions to a single provision. A number of consequential amendments have also been made to the tax Acts and other legislation. These amendments do not result in a policy change to terminal tax payment dates.

Background

Terminal tax is the difference between a taxpayer's tax credits (such as provisional tax, PAYE and imputation credits) and the taxpayer's income tax liability for an income year. There were previously three separate provisions in the Income Tax Act 1994 covering the payment dates for terminal tax: section NC 17, applying to employees (other than non-filing taxpayers); section MC 1, applying to provisional taxpayers; and section MC 2, applying to persons generally.

The previous existence of separate terminal tax payment date provisions for employees and provisional taxpayers in sections NC 17 and MC 1 was for historical reasons only. PAYE and provisional tax were implemented in 1958 as self-contained legislative codes with their own recovery, penalty, assessment and payment date provisions. Many of these separate provisions have been replaced by more generic provisions in the Tax Administration Act 1994 and the Income Tax Act 1994 (for example, the penalty provisions). The separate terminal tax payment date provisions for employees and provisional taxpayers were, therefore, an unnecessary residue of the original separate legislative codes for PAYE and provisional tax.

Key features

The previous three separate terminal tax payment date provisions in the Income Tax Act 1994 have been combined into one provision. This will make it easier for taxpayers to determine their terminal tax payment dates. It also allows the drafting of other provisions that refer to terminal tax payment dates to be significantly simplified.

The rationalisation of the terminal tax payment date provisions has been mainly achieved by repealing the specific payment date provisions in sections NC 17 and MC 1 of the Income Tax Act 1994, applying to employees and provisional taxpayers. The following related amendments have also been made:

Minor amendments have been made to the general terminal tax payment date provision in section MC 2 (re-enacted as new section MC 1) so that it can apply to all persons.

- The definition of "terminal tax date" in section OB 1 has been amended so that it refers to the date determined under new section MC 1 for payment of terminal tax for an income year by a person. If a person does not have to pay terminal tax for an income year, new section MC 1 will apply as if the person does have terminal tax for the year. This ensures that all persons can be treated as having a terminal tax date—for example, persons whose tax credits equal or exceed their income tax liability. This amendment allows the definition to be used more widely in other provisions, thereby making them more concise.
- Part A of Schedule 13, which specifies the months for payment of provisional tax and terminal tax, has been amended to clarify that persons (such as employees) who do not have the Commissioner's permission to use a non-standard balance date have a March balance date. A non-resident company that does not have a fixed establishment in New Zealand is also treated as having a March balance date for the purpose of determining its provisional tax or terminal tax payment dates. (This continues the treatment of such companies under former section MC 2(1).)
- Section MC 3, which authorised regulations to be made to allow taxpayers with outstanding tax liabilities to make instalment payments, has been repealed because it was redundant. There are no such regulations in existence and the function of allowing taxpayers in arrears to make instalment payments is covered by the taxpayer relief provisions in the Tax Administration Act 1994.

- A number of consequential amendments have been made to the tax Acts and other legislation to cater for the combining of the three former terminal tax date payment provisions into one provision.

The following provisions in former sections MC 1 and NC 17 have not been re-enacted as part of the single terminal tax payment date provision in new section MC 1 because they were unnecessary:

- Former sections MC 1(3) and NC 17(2)(c), which allowed the Commissioner to specify an earlier terminal tax date for a particular taxpayer. Although these provisions had a revenue protection purpose, they were unnecessary because there are other provisions with a similar function that are more effective, in particular, section 44 of the Tax Administration Act 1994, which allows tax to be assessed and payable on demand in high-risk situations such as when a person is about to leave New Zealand.
- Former section NC 17(1), which contained a separate assessment provision for employees. The general income tax assessment provision in section 92 of the Tax Administration Act 1994 can apply to all taxpayers, and there is no reason for having a separate assessment provision for employees. (The separate assessment provision for provisional taxpayers was repealed in 1996.)
- Former section NC 17(3), which provided that income tax payable under an income statement that is treated as an assessment, under section 92 of the Tax Administration Act 1994, was due on the dates specified in section NC 17(2). This provision was originally enacted because section NC 17(2) applied only to income tax payable under an assessment made under section NC 17(1). Because the separate assessment provision in section NC 17(1) has not been retained, section NC 17(3) also become unnecessary.

Application date

The amendments rationalising the terminal tax payment date provisions apply from the 2002-03 income year.

FRINGE BENEFIT TAX AMENDMENT

Section ND 1(4) and (5) of the Income Tax Act 1994

Introduction

Section ND 1(4) and (5) has been amended to correct a number of section references.

Background

Legislation enacted by section 59 of the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002, which allowed employers to change the basis of calculating their fringe benefit tax liability under the multi-rate fringe benefit tax rules contained a number of incorrect section references.

Key features

Section references in section ND 1(4) and (5) of the Income Tax Act 1994 have been corrected so that they refer to subsection (2) instead of subsection (1).

Application date

The amendment applies with effect from 17 October 2002, the date of enactment of the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002.

INCLUSION OF MATERIAL FACTS IN PRIVATE AND PRODUCT RULINGS

Section 3(1) of the Tax Administration Act 1994

Introduction

The definition of "arrangement" in the Tax Administration Act 1994 has been altered to clarify that the Commissioner of Inland Revenue can include in private and product rulings facts that the Commissioner considers to be material, or relevant as background or context, to any of the matters on which the private or product ruling is sought. Such facts will form part of the "arrangement" that is the subject of a ruling. Consequently, they will become subject to the provisions that determine that a ruling ceases to apply if the arrangement is materially different from the arrangement identified in the ruling. The amendment reduces the extent to which private and product rulings may have a wider application than intended.

Background

Private and product binding rulings are made in respect of an "arrangement". The word "arrangement" has been defined as "any contract, agreement, plan, or understanding (whether enforceable or unenforceable), including all steps by which it is carried into effect".

The legislation prescribes that when a private or product ruling is issued, the particular arrangement to which the ruling applies must be specified as part of the ruling. It also provides that if the actual arrangement subsequently proves to be materially different from that specified in the ruling, then the ruling will not apply.

Inland Revenue often includes in a ruling numerous facts describing an arrangement that are considered to be relevant as background or as context to the transaction proposed. However, it was possible that, on a strict interpretation, while the facts were highly relevant, they did not form part of the "arrangement" as such. Excluding these facts potentially made the ruling of more general application than intended.

It is therefore important that Inland Revenue can set out these facts in rulings without giving rise to the technical issue of whether the facts are part of the "arrangement" identified in the ruling.

Key features

The definition of "arrangement" in section 3(1) of the Tax Administration Act 1994 has been amended to duplicate the definition of "arrangement" contained in section OB 1 of the Income Tax Act 1994, and to include, for the purposes of the private and product rulings legislation, facts that are material, or relevant as background or context, to any of the matters on which a private or product ruling is sought.

This allows the Commissioner to include facts that may not technically be part of the "arrangement" (as currently defined in section OB 1) that is the subject of a ruling, but nevertheless are important as background or as context to the transaction proposed.

Such facts will become subject to the ruling non-application tests contained in sections 91EB(2)(a) and 91FB(2)(a) of the Tax Administration Act 1994. The tests provide that if the arrangement is, in reality, materially different from the arrangement identified in the ruling, then the ruling does not apply.

The amendment does not affect the Commissioner's existing ability to include facts in private and product rulings that are, under the existing definition of "arrangement", unambiguously part of the arrangement that is the subject of the ruling.

Application date

The amendment applies from 26 March 2003.

MINOR TECHNICAL AMENDMENTS

A number of minor technical amendments have been made to the tax Acts, none of which results in a policy change. Most of these amendments relate to income tax self-assessment, the main provisions for which were enacted by the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001. Unless otherwise stated, these amendments apply from the 2002-2003 income year, which is the same application date as the main self-assessment provisions.

Definition of "assessment"

Section 3 of the Tax Administration Act 1994

An amendment relocates the previous definition of "assessment" in section OB 1 of the Income Tax 1994 to section 3 of the Tax Administration Act 1994. The Income Tax Act 1994 now cross-refers to the new assessment definition in the Tax Administration Act.

The previous definition of "assessment" in section OB 1 of the Income Tax Act 1994 was enacted by the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001. There were several problems with this definition that arose because of its location in the Income Tax Act instead of the Tax Administration Act. For example, the opening reference to "tax" in the former Income Tax Act definition was meant to refer to all types of tax, not just income tax. However, "tax" is defined in section OB 1 of the Income Tax Act as meaning only income tax, whereas "tax" is defined in the Tax Administration Act to mean all types of tax. It was intended that the latter, wider meaning was to apply in the assessment definition.

Removal of redundant term

Section 39 of the Tax Administration Act 1994

Section 39(4) of the Tax Administration Act 1994, relating to adjustments on a change in a return date, has been amended to replace the reference to "year or years of assessment" with a reference to an "income year". This amendment is consequential to the main self-assessment amendments made in 2001, which removed the year of assessment concept because for many years a year of assessment had been the same as an income year.

New date for payment of tax

Section 142A of the Tax Administration Act 1994

Section 142A of the Tax Administration Act 1994, relating to new dates for payment of tax following increases by the Commissioner, has been amended to cater for withholding tax cases where there may not be an original assessment.

The Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001 amended section 142A of the Tax Administration Act with the intention of making this section consistent with self-assessment. Part of this 2001 amendment included repealing former section 142A(1)(b), which required the Commissioner to set a new due date where the liability to pay tax was increased from that calculated by taxpayers in their returns. This 2001 amendment went further than intended because it meant that section 142A applied only if an assessment was already in existence, whereas this may not be the case with withholding taxes such as non-resident withholding tax where the Commissioner makes an assessment in limited cases only (for example, following an audit).

Section 142A has therefore been amended to ensure that it can apply in withholding tax cases where there may not be an original assessment by requiring the Commissioner to set a new due date where the liability to pay tax is increased from that calculated by the taxpayer in their return.

Recovery of excess tax credits allowed

Section 165A of the Tax Administration Act 1994

An amendment has been made to re-enact the effect of former section 165A of the Tax Administration Act 1994, which allowed the Commissioner to recover an excess tax credit previously allowed as if it were income tax payable under the Income Tax Act 1994. Former section 165A of the Tax Administration Act was repealed as a consequential amendment to the main self-assessment amendments made in 2001.

Former section 165A of the Tax Administration Act was repealed in 2001 because the only explicit reference to that section in the tax credit provisions (section LC 3) had been removed by an earlier amendment and, therefore, it was assumed that section 165A was redundant. However, this assumption was not correct. Although not explicitly referred to in other tax credit provisions in Part L of the Income Tax Act, section 165A allowed the recovery of certain excess tax credits previously allowed, such as resident withholding tax credits and imputation credits. These provisions previously contained their own excess tax credit recovery provisions which were repealed in 1996 when section 165A was originally enacted.

Section 165A has now been re-enacted to give the Commissioner a general power to recover any excess tax credit previously allowed. This provision is subject to the specific excess credit recovery provisions in sections LC 3, LC 4(11) and LD 1(6) of the Income Tax Act 1994.

Income equalisation accounts

Section EI 14 of the Income Tax Act 1994

Section EI 14(3) of the Income Tax Act 1994, which relates to refunds from adverse event income equalisation accounts, has been amended to replace the reference to “one calendar year” with “twelve months”. This minor clarifying amendment has been made to ensure that the provision works as intended. This amendment applies from 26 March 2003.

Removal of redundant lost determination references

Sections IE 2, IE 3, IE 4 and II 1of the Income Tax Act 1994

A number of provisions in the Income Tax Act 1994 dealing with the treatment of net losses (sections IE 2(5A), IE 3(1), IE 4(1) and II 1(1)) have been amended by removing references to section 92 of the Tax Administration Act 1994. These references were redundant because they relate to determinations of net losses, which were removed from the tax Acts as part of the main self-assessment amendments made in 2001.

Income Tax Act definition of “taxable supply”

Section OB 1 of the Income Tax Act 1994

The definition of “taxable supply” in section OB 1 of the Income Tax Act 1994 has been amended to cross-refer directly to the definition of that term in section 2 of the Goods and Services Tax Act 1985. Previously, the definition of “taxable supply” in section OB 1 referred to the definition in section ED 4(7), but that provision was amended in 2002 to remove its taxable supply reference.

Removal of redundant definition

Section OB 1 of the Income Tax Act 1994

Section OB 1 of the Income Tax Act 1994 has been amended by repealing the definition of “European”. That term was redundant because it was not used anywhere in the Income Tax Act 1994. This amendment applies from 26 March 2003.

REGULAR FEATURES

DUE DATES REMINDER

June 2003

3 FBT return and payment due

5 Employer deductions and employer monthly schedule

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

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

Employer deductions and employer monthly schedule

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

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

30 GST return and payment due

July 2003

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

Employer deductions and employer monthly schedule

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

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

21 Employer deductions

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

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

Employer deductions and employer monthly schedule

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

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

FBT return and payment due

31 GST return and payment due

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