TAX INFORMATION BULLETIN

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CONTENTS

Get your TIB sooner on the internet 2

This month's opportunity for you to comment 2

Binding rulings

Product ruling – BR PRD 04/13 3

Interpretation statements

Income tax treatment of Treaty of Waitangi settlements 8

Travel by motor vehicle between home and work – deductibility of expenditure and FBT implications 31

Legislation and determinations

General depreciation determination DEP52 52

New legislation

GST guidelines for working with the new zero-rating rules for financial services 54

GST guidelines for recipients of imported services 71

Payments for protecting native forests 80

Legal decisions – case notes

Russell loses judicial review of interlocutory decision in summary prosecution
J G Russell v District Court (Manukau) and CIR 81

Supply of a going concern
TRA decision 010/03 82

Liability of directors for a company's tax debt
Kim Spencer and Susan Spencer v CIR 83

Legal fees not deductible
CIR v Fullers Bay of Islands Limited, CIV2004-404-1731 84

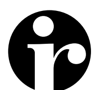
Tenancy details omitted – not a going concern
TRA decision 026/2004 85

ACC late payment interest not income
Decision no 028/2004 (TRA 092/03) 86

Regular features

Due dates reminder 88

Your chance to comment on draft taxation items before they are finalised 90



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This *Tax Information Bulletin* is also available on the internet in PDF. Our website is **www.ird.govt.nz**

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

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THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft items are available for review/comment this month, with a deadline of 14 January 2005.

Ref.	Draft type	Description
IS0081	Interpretation statement	Reliance on a binding ruling after company amalgamation
QB0033	Question we've been asked	Payments made in addition to financial redress under Treaty of Waitangi settlements—income tax treatment
IS0053	Interpretation statement	Shortfall penalty for not taking reasonable care
IS0055	Interpretation statement	Shortfall penalty—unacceptable interpretation and unacceptable tax position

The following draft item is also available for review/comment this month, with a deadline of 31 January 2005

Ref.	Draft type	Description
ED0067	Standard practice statement	Income Tax Act 2004—transitional provisions and penalties and interest arising from unintended legislative changes

Please see page 90 for details on how to obtain a copy.

BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently.

The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates tax liability based on it.

For full details of how binding rulings work, see our information booklet *Adjudication & Rulings, a guide to binding rulings (IR 715)* or the article on page 1 of *Tax Information Bulletin* Vol 6, No 12 (May 1995) or Vol 7, No 2 (August 1995).

You can download these publications free from our website at **www.ird.govt.nz**

PRODUCT RULING – BR PRD 04/13

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Air New Zealand Limited ("Air New Zealand").

Taxation Laws

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

This Ruling applies in respect of sections CD 3, CD 4, CD 5, CH 3, CI 1 and CI 2(1).

The Arrangement to which this Ruling applies

The Arrangement is the accruing by a Member of the Air New Zealand Airpoints Programme of Airpoints Dollars provided by Air New Zealand as a result of expenditure incurred by the Member's employer on the Member's work-related travel (including Airpoints Dollars derived from the conversion of airpoints earned under Air New Zealand's previous airpoints scheme in respect of work-related travel), and the redemption of those Airpoints Dollars for air travel and other rewards ("Rewards").

The Arrangement does not include employees of Air New Zealand and its subsidiaries (as they are not entitled to accrue Airpoints Dollars in respect of work-related travel).

Further details of the Arrangement are set out in the paragraphs following. Capitalised terms are defined in the Airpoints Members' Guide as provided to the Commissioner on 28 September 2004.

1. Air New Zealand currently operates an airpoints scheme, but plans to implement some major changes to the way in which it operates. The proposed new form of the scheme is referred to in this Ruling as the Programme ("the Programme"). Under the Programme, Airpoints Dollars will accrue to Members by reference to the value of the fare paid and region of the world travelled, and Airpoints Dollars will have a value identical to dollars on redemption for Rewards. Airpoints Dollars may also accrue to Members from expenditure incurred on goods and services sold by scheme partners ("Partners"), for example hotels and hire car companies.
2. Airpoints Dollars accruing to or accumulated by a Member can be used by them to purchase an equivalent dollar value of travel or to purchase other Air New Zealand products (such as Koru Club membership), or hotel accommodation, travel insurance, car hire and other rewards ("Rewards").
3. The new terms and conditions of the Programme will be contained in the Airpoints Members' Guide as provided to the Commissioner on 28 September 2004 ("the Terms and Conditions").

Employees of Air New Zealand's commercial customers

4. Employees of Air New Zealand's commercial customers may accrue Airpoints Dollars on travel undertaken for work purposes and paid for by their employer. The employer may pay for this travel by paying Air New Zealand for the tickets which are issued to the employee, or by reimbursing the employee for payments made by them. Any such employees wishing to accrue Airpoints Dollars would first need to become an Airpoints Member.
5. Airpoints Dollars accrue to Members by virtue of a Member's individual membership. The employer may pay the $50 membership fee, by either reimbursing the employee or paying on behalf of the individual.
6. Members' employers will not provide any consideration to Air New Zealand for Airpoints Dollars provided to those Members. Air New Zealand will not provide discounts (other than an ordinarily available discount for corporate

customers provided for reasons unrelated to Airpoints Dollars) to corporate customers who request that Airpoints Dollars not be issued to their employees in respect of work-related travel.

7. Employers have no influence over the Airpoints Dollars to be provided to Members (except to the extent that they purchase air travel). Airpoints Dollars will accrue to Members on the basis provided for in the Terms and Conditions, regardless of whether travel is undertaken for private purposes or for work-related purposes and regardless of who pays for the travel. Airpoints Dollars accrue and are redeemed for Rewards on the same basis for any Member of the Programme, irrespective of the Member's employer.

Airpoints Membership

8. Airpoints Membership is available to residents of all countries.

9. The Membership joining fee is a cost of NZ$50 for New Zealand residents and AU$50 for Australian Members. Residents of all other countries will be charged the local currency equivalent of NZ$50. This fee may not be paid for using Airpoints Dollars and must be paid for in cash.

10. Complimentary Membership is available to eligible first class and business class passengers who have paid for and travelled first class or business class on Air New Zealand operated flights for international sectors. Complimentary Membership is available to current fully paid-up members of Air New Zealand Koru Club.

11. Each Member may maintain only one Account. Membership is not transferable.

12. No individual Member's Account information or details will be discussed or amended or transacted unless the Member's correct Membership number along with their Personal Access Code is first quoted.

13. The Membership Card is used to assist in the earning of Airpoints Dollars and to obtain access to or the provision of Rewards. The Member agrees that his/her signing of a card and/or quoting his/her Membership number to Air New Zealand or to any of its Partners, employees or agents for the purposes of the Airpoints Programme means that he/she has read and understood the Terms and Conditions of the Airpoints Programme and accepts them.

14. Air New Zealand reserves the right to cancel a Member's Membership in the Programme at any time without notice and without giving a reason for so doing. Air New Zealand will not provide any consideration for Airpoints Dollars earned but not redeemed at the time of termination of Membership.

15. Membership will terminate on the death of a Member. Airpoints Dollars or any other benefits earned but not redeemed at the time of death will be cancelled with no consideration. Transfer of Airpoints Dollars on the death of a Member is permitted in the situation set out in clause 1.4.5 of the Terms and Conditions (see paragraphs 25 to 27 below).

Earning Airpoints Dollars

16. Airpoints Dollars may be earned through expenditure on Air New Zealand and Partner Airline flights and on goods and services purchased from non-airline Partners (including car rental, hotel accommodation, GlobalPlus accounts, travel insurance and currency exchange). Transfer of credit card points/credits into Airpoints Dollars is available in some cases. Airpoints Dollars are provided by Air New Zealand regardless of whether the entitlement arises from the purchase of Air New Zealand or Partners' goods and services.

Using Airpoints Dollars

17. Rewards may be paid for using Airpoints Dollars. One Airpoints Dollar has the equivalent value of $1 in relation to the number of Airpoints Dollars required to acquire Rewards. A combination of Airpoints Dollars and cash for the acquisition of a Reward is not permitted, unless otherwise specified in writing by Air New Zealand.

18. Airpoints Dollars may be used to obtain Reward flights with Air New Zealand and Partner Airlines. Any Reward ticket which is cancelled and is refundable will be refunded by a re-crediting of Airpoints Dollars. Taxes, levies, or surcharges cannot be paid for using Airpoints Dollars and must be paid for in cash. The only exception to this is where the published fare is inclusive of taxes, levies and/or surcharges, for example on Air New Zealand operated flights within New Zealand or where the published fare is inclusive of insurance and fuel charges.

19. Non-flight and non-airline Rewards are available, subject to the applicable Partner's terms and conditions where those Rewards are not provided by Air New Zealand. Rewards include Koru Club membership, car hire, hotel accommodation, holiday packages, and travel insurance. GlobalPlus credit card customers may have the ability to redeem their Airpoints Dollars on a limited range of other non-airline products (such as holiday passes, wine and CD vouchers).

Non-convertibility

20. Under the Terms and Conditions, Airpoints Dollars and Rewards cannot be redeemed, sold, assigned, gifted or otherwise transferred by a Member for cash

or other consideration. The relevant clauses of the Terms and Conditions in this respect are as follows:

Clause 3.1.22 of the Terms and Conditions states:

> In accepting a Reward, you agree that (subject to these Terms and Conditions and in particular the Gifting provisions and clauses 3.4.3.12 and 3.4.4.11) you won't combine any Rewards with anyone else or sell, assign or otherwise transfer the right to a Reward to any person. Air New Zealand has the right to ask you for proof that you have complied with this clause in addition to any evidence required in accordance clause 10.

Clause 3.1.23 of the Terms and Conditions states:

> Rewards offered by Partners will be on the applicable Partner's terms. If you redeem a Reward in conjunction with any other loyalty programme (where such programme has our consent to use Airpoints Dollars) you agree that you won't combine any Rewards with anyone else or sell, assign or otherwise transfer Rewards for Cash or anything else. Air New Zealand and Air New Zealand Link are not responsible for Reward offers by Partners or their conditions, or for Partners' performance or provision of such Rewards.

Clause 4.1.9 of the Terms and Conditions states:

> You must not receive any Cash or other consideration as payment for any Rewards you gift.

Clause 9.7 of the Terms and Conditions states:

> Notwithstanding any other provision in these Terms and Conditions or the terms and conditions of any other loyalty programme that is offered by a Partner and/or authorised by Air New Zealand, you can't redeem for Cash or sell your Airpoints Dollars and/or Rewards or assign or transfer them for Cash or any other consideration.

Clause 13.5 of the Terms and Conditions states:

> Airpoints Dollars may not be used to acquire any goods or services other than in conjunction with:
>
> - the Air New Zealand Airpoints Programme in accordance with these Terms and Conditions.
> - any other loyalty programme, that we have given written consent to use Airpoints Dollars and in accordance with such loyalty programme's terms and conditions.

Clause 13.6 of the Terms and Conditions states:

> Airpoints Dollars are not convertible into Cash. Any Rewards offered by Partners or any use of Airpoints Dollars in conjunction either with the Programme or with any other loyalty programme that we have authorised the use of Airpoints Dollars in conjunction with, are subject to the restriction that you can't sell, assign or transfer any Rewards or Airpoints Dollars for Cash or any other consideration.

21. If a Member cancels a refundable ticket, then in accordance with clause 3.1.15 the refund will be a re-credit of the Airpoints Dollars to the Member's Account. Airpoints Dollars may also be re-credited if an Upgrade for which Airpoints Dollars were redeemed is not available.

Gifting

22. Gifting is the process whereby a Member authorises the deduction of Airpoints Dollars from his/her account where such Airpoints Dollars are redeemed to provide a person resident in the same household as the Member with a ticket for Reward Travel or for Non-Airline Rewards. Companion Tickets may not be gifted.

23. Gold Elite Members (Members who have accrued a specified number of Airpoints Dollars from qualifying flights) are additionally entitled to nominate as giftees two individual persons who do not need to reside in the same household as the Gold Elite Member.

24. Air New Zealand will monitor each Member's Gifting Register to ensure that no fraudulent activities occur.

Transfer of Airpoints Dollars

25. Transfer of Airpoints Dollars between Members' Accounts is only permitted in the following circumstances.

26. Clause 1.4.5.2 of the Terms and Conditions provides, subject to certain qualifications, for Members who have a joint GlobalPlus credit card, joint GlobalPlus Home Loan Account or a joint BNZ Gold credit card to transfer 50% of the Airpoints Dollars accrued via these accounts to the other person involved in the joint account in the situation of a marriage separation or divorce.

27. Clause 1.4.5.3 of the Terms and Conditions provides, subject to certain qualifications, on the death of a Member who has a joint GlobalPlus Home Loan Account, joint BNZ credit card or joint BNZ Gold credit card, for the transfer of 100% of the Airpoints Dollars accrued via these accounts to the other person involved in the joint account.

Combining Airpoints Dollars

28. A Member may be permitted by Air New Zealand, at Air New Zealand's sole discretion, to combine his/her Airpoints Dollars with another Member's Airpoints Dollars for the purpose of booking a rental car Reward and/or a hotel Reward for a period in each case of two or more consecutive days, provided that each Member has sufficient Airpoints Dollars to redeem a rental car Reward for a minimum of one day and/or a hotel Reward for a minimum of one night.

Monitoring

29. Air New Zealand will monitor Airpoints Membership Accounts and the Programme. In particular, clause 10.3 of the Terms and Conditions states:

> If you commit fraud in connection with Airpoints Dollars or abuse your Airpoints Dollars accumulation or Rewards use or breach these Terms and Conditions, you'll be subject to appropriate administrative and/or legal action by Air New Zealand that includes, but is not limited to, Membership termination, Membership suspension, the forfeiture of all accumulated Airpoints Dollars and unused Rewards and an action to recover the monetary value of the Airpoints Dollars and credits concerned.

Termination

30. A Member may terminate his/her Membership in the Programme at any time by giving notice in writing and returning the Membership Card to Air New Zealand.

31. Partners may discontinue their participation in the Programme and their provision of Rewards at any time without notice.

32. Air New Zealand gives no warranty as to the continuing availability of the Programme and reserves the right to terminate the Programme upon giving not less than six months' notice to Members, or at any time without notice if Air New Zealand ceases to operate as an airline. Air New Zealand will not provide any consideration for Airpoints Dollars earned but not redeemed at the time of termination of the Programme.

Access to other benefits

33. Under no circumstances are the Terms and Conditions interchangeable with those of the Air New Zealand Koru Club or any other club or loyalty programme operated by Air New Zealand or any of its Partners. Membership of the Programme does not give access to the benefits of any other Air New Zealand club, facility or loyalty programme unless so stated in the conditions of membership of such other club, facility or loyalty programme.

Changes to the Programme

34. The Terms and Conditions may be amended at any time, pursuant to clause 9.1 of the Terms and Conditions.

Ruling not applicable to other loyalty programmes

35. This Ruling does not consider or rule on the tax treatment of airpoints under any Air New Zealand scheme prior to the introduction of the Programme.

36. This Ruling does not consider or rule on the tax treatment of any other loyalty programme to which, in accordance with clauses 13.5 and 13.6 of the Terms and Conditions, Air New Zealand has given written consent to use Airpoints Dollars in accordance with the terms and conditions of that other loyalty programme.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

(a) Under no circumstances will the Terms and Conditions allow Airpoints Dollars or Rewards (including any goods or services received from redeeming Rewards such as vouchers) to be redeemed for cash or sold, assigned or transferred by a Member for cash or other consideration.

(b) In any circumstance where a Reward is cancelled or unavailable or where for any other reason the Member is entitled to a refund of Airpoints Dollars, the refund is by way of a re-crediting to the Member's Account with the Airpoints Dollars redeemed by the Member for that Reward.

(c) Membership of the Programme is a contract between a Member and Air New Zealand. Employers are not entitled to enter into that contract on behalf of their employees.

(d) The membership fee payable to Air New Zealand constitutes a legal liability owed by the applicant to Air New Zealand.

(e) Where the Member is an employee of a Partner or a Partner Airline, the Member does not redeem Airpoints Dollars for any Reward offered by that Partner or Partner Airline.

(f) Where the employer has either paid the membership fee on behalf of the employee or reimbursed the employee for that fee, the receipt or the possibility of the receipt by the employee of Airpoints Dollars or Rewards is not taken into account by the employer in determining that employee's remuneration (whether by the relative reduction of remuneration or otherwise).

(g) Where the employer has either paid the membership fee on behalf of the employee or reimbursed the employee for that fee, the employer, when purchasing travel in respect of which that employee derives Airpoints Dollars, does not pay substantially more for that travel than the cost of equivalent air travel services with a more than incidental purpose of the provision of Airpoints Dollars or Rewards to that employee.

(h) No changes to the Programme are made pursuant to clause 9.1 of the Terms and Conditions that are material to the tax treatment of Airpoints Dollars and Rewards derived by employees in respect of work-related travel.

How the Taxation Laws apply to the Arrangement

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

- No gross income arises to the Member under sections CD 3, CD 4, CD 5, or CH 3 when they receive Airpoints Dollars or Rewards.
- The employer of the Member is not liable under sections CI 1 or CI 2(1) for FBT on any benefits obtained by the Member as a result of receiving Airpoints Dollars or Rewards.

The period or income year for which this Ruling applies

This Ruling will apply for the period 3 November 2004 to 2 November 2007.

This Ruling is signed by me on the 3rd day of November 2004.

Howard Davis
Senior Tax Counsel

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.

INCOME TAX TREATMENT OF TREATY OF WAITANGI SETTLEMENTS

Introduction

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

The Crown has entered into settlements of claims in relation to historical breaches of the Treaty of Waitangi ("the Treaty") with a number of Mäori claimant groups and is in the process of negotiating settlements with other claimant groups. Generally the purpose of a Treaty settlement is to provide redress and compensation to Mäori claimant groups for wrongs suffered as a result of historical breaches of the Treaty by the Crown.

A Treaty settlement generally includes:

- An agreed statement of the background to the claim, summarising the key facts about the history of the claim, an acknowledgement by the Crown of the wrongs done and an apology by the Crown for past injustices suffered by the claimant group and for breaches of the Treaty.
- Cultural redress which is intended to meet the cultural rather than economic interests of the claimant group. Cultural redress may be made by a variety of means including gifting back sites of special significance to the claimant group, the recognition of the claimants' mana by changing place names, a Deed of Recognition acknowledging the claimants' association with a particular area and requiring consultation with the claimant group on specified matters.
- Financial redress which may include cash, the return of land owned by the Crown and the right of first refusal to purchase specific Crown properties within a defined geographical area.

As part of the settlement the Mäori claimant group generally agrees to give certain undertakings (for example, to support the passing of the settlement legislation by Parliament) and agrees that the Treaty settlement will be in full and final settlement of the claimant group's Treaty grievances.

The Crown also provides funding for negotiations to claimant groups through the Office of Treaty Settlements ("the OTS"), which negotiates Treaty settlements on behalf of the Crown, to claimant groups who enter into direct negotiations with the Crown.

The purpose of this Interpretation Statement is to consider:

- Whether financial redress received by Mäori claimant groups as compensation for historical breaches of the Treaty in settlement of claims lodged with the Waitangi Tribunal (whether as a result of the Crown's acceptance of a recommendation of the Waitangi Tribunal or following direct negotiations with the Crown) are income; and
- Whether funding for settlement negotiations provided by the Crown through the OTS is income.

The Interpretation Statement does not address the income tax treatment of amounts subsequently derived from Treaty settlement payments, nor will it address other funding provided to claimant groups (such as funding provided by the Crown Forestry Rental Trust). This Interpretation Statement also does not deal with the question of whether any amount paid in addition to the financial redress agreed between the Crown and the claimants where there is a delay between settlement being reached and the financial redress being paid is income.

Summary

- Financial redress under a Treaty settlement is not income under section CD 3. Treaty settlement negotiations are not businesses in themselves and, in the event that any claimant groups are carrying on a business, Treaty settlements are not amounts derived from such a business.
- Financial redress under a Treaty settlement is not income under ordinary concepts in terms of section CD 5.

- Under section CB 5(1)(n) compensation paid under the Crown Forestry Assets Act 1989 to the successful claimants (except compensation based on market stumpage) is exempt income under section CB 5(1)(n) to the extent that in the absence of that provision the payments would be income. Compensation under the Crown Forestry Assets Act 1989 paid to the successful claimants on the return of Crown forestry land is not income under sections CD 3, CD 5, CE 1(1)(a) or (e), CE 2 or CJ 1.
- Where the payment of the financial redress agreed under a Treaty settlement is delayed until settlement legislation is enacted, such redress is not gross income under section CE 1(1)(c).
- Claimant funding provided by the Crown through the OTS is not income under ordinary concepts (section CD 5), nor is it an amount derived from a business (section CD 3). Claimant funding is not a payment to which section DC 1 applies as claimant funding is not provided in respect of any business carried on by claimant groups.

Background

In 1840 the Treaty was signed between the Crown and the Chiefs of the Confederation of United Tribes of New Zealand and a number of independent chiefs of New Zealand. Under the Treaty the Crown guaranteed to Mäori "the full exclusive and undisturbed possession of their Lands and Estates Forests Fisheries and other properties which they may collectively or individually possess so long as it is their wish and desire to retain the same in their possession".

The Crown has accepted that this obligation was breached in some instances and that land was acquired from Mäori in ways that breached the principles of the Treaty. A publication by OTS, *Healing the Past, Building a Future – a Guide to Treaty of Waitangi Claims and Negotiations with the Crown* ("the OTS publication") says that:

> Most historical Treaty claims involve one or more of the following types of land loss and alienation:
>
> - purchases of Mäori land by the Crown before 1865 (this includes pre-Treaty purchases later investigated and validated ("Old Land Claims"), Crown purchases and post-Treaty private purchases through the Crown's waiver of its pre-emptive right),
> - confiscation of Mäori land by the Crown under the New Zealand Settlements Act 1863, and or
> - transactions under the various Native Land Acts after 1865. (p 41)

A great deal of historical research has been done in respect of the three types of land claim by the Waitangi Tribunal, the Crown Forestry Rental Trust and the Crown, as a result of which the Crown has a good understanding of the types of land-based historical claims in every area of the country and the amount of land that was lost to Mäori: see pp 4–42 OTS publication. The OTS publication says that the Crown expects that for most claims involving large natural groups the research already completed will provide a sufficient basis to begin negotiations. However, extra research may need to be undertaken if the Crown and claimant negotiators need to agree whether particular breaches of the Treaty and its principles occurred (for example, because the claimants want the Crown to apologise for a particular action but the Crown does not initially accept that there has been a breach). Further research may also be needed on specific issues arising from a claim (for example, where more than one group is making claims over the same area or a particular site) (see pp 42–43). The OTS publication also says:

> Because the Crown acknowledges that widespread breaches of the principles of the Treaty have occurred, it is now willing, if claimants wish to negotiate settlements of claims that include purchases before 1865, confiscation, and the operation and impact of the Native land laws after 1865. Claimants who want to negotiate to settle such claims do not need to go through Waitangi Tribunal Hearings or provide detailed research on each and every Crown action that they consider breached the principles of the Treaty. However, they do need to show the link between the Crown's acts or omissions and the harm to their tupuna (ancestors).
>
> …
>
> Although the impact of land loss on Mäori society was often similar regardless of the way land was lost, the culpability (extent to which a party is wrong or to blame) of the Crown does differ from case to case. The Crown believes that the seriousness of each type of breach is different and redress should reflect that, but this is a matter for discussion during negotiations. (p 42)

The Crown has entered into settlements in respect of historical breaches of the Treaty with a number of Mäori claimant groups and is in the process of negotiating other settlements. Historical breaches relate to the Crown's actions or omissions up to 21 September 1992. The significance of that date is that it is the date on which Cabinet agreed on the general principles for settling Treaty claims.

Settlement process

The Waitangi Tribunal ("the Tribunal") was established under the Treaty of Waitangi Act 1975. The purpose of the Treaty of Waitangi Act 1975 ("the TOWA") is "to provide for the observance, and confirmation of the principles of the Treaty of Waitangi". The Tribunal has exclusive authority to determine the meaning and effect of the Treaty as embodied in the Mäori and English texts and to decide issues raised by differences between them: section 5(2) TOWA. The Tribunal's main function is to inquire into and make recommendations to the Crown on claims submitted to the Tribunal by Mäori: section 5 TOWA.

Any Mäori may make a claim to the Tribunal: section 6 TOWA. The Tribunal has jurisdiction to consider the claim if the claim alleges a breach by the Crown of the principles of the Treaty that is alleged to affect the claimant prejudicially, either individually or by affecting a group of Mäori of which the claimant is a member: section 6(1) TOWA. If the Tribunal finds that a claim is well-founded, it may recommend to the Crown that action be taken to compensate for or remove the prejudice or prevent other persons from being similarly prejudiced in the future: section 6(3) TOWA. The Tribunal can recommend both monetary compensation and the return of Crown land taken from Mäori in breach of the principles of the Treaty and is required to identify the Mäori or group of Mäori to whom the land is to be returned: section 8(2) TOWA.

Claimant groups may have claims investigated by the Waitangi Tribunal or they may pursue negotiations with the Crown. Claims must be lodged with the Tribunal before the Crown will begin negotiating with a claimant group but once a claim is lodged, the claimants can immediately seek negotiations with the Crown. Alternatively, the claimants may choose to have their claims heard by the Tribunal before entering negotiations: OTS publication p 38.

Some claimant groups have carried out direct negotiations with the OTS which is responsible for negotiating Treaty settlements on behalf of the Crown. The four steps of a direct negotiations process claim (as set out in the OTS publication) are as follows:

Preparing a claim for negotiation

- An agreement by the Crown and the claimants to negotiate, which involves the Crown accepting that there is a well-founded grievance and the claimant group satisfying the Crown's preference to negotiate with large natural groups that represent tribal interests (generally an iwi);
- Conferral of the mandate of claimant group representatives by the claimant group and recognition of the mandate by the Crown;
- The establishment of processes for consultation by claimant group negotiators with claimant group members on settlement issues and the development of a register of members.

Pre-negotiations

- The signing of Terms of Negotiation which set out the ground rules for negotiations;
- Approval by the relevant Ministers of the funding to claimants as a contribution to the cost of negotiations;
- The claimant group identifying the areas or sites and Crown assets in which they are interested in seeking redress and the types of redress which they consider are appropriate in relation to those sites or areas.

Negotiations

- The commencement of formal negotiations;
- After sufficient progress in negotiations, the Minister in Charge of Treaty of Waitangi Negotiations may send a letter to the mandated representatives outlining the parameters of the Crown offer and seeking Agreement in Principle from the claimant group to the Crown offer. Alternatively, the Crown and mandated representatives can seek a more formal agreement (a Heads of Agreement) which outlines the Crown's settlement offer in more detail;
- If the Agreement in Principle or the Heads of Agreement are signed by the Crown and mandated representatives a formal Deed of Settlement is prepared for initialling by the mandated representatives.

Ratification and implementation

- Consultation with and ratification by members of the claimant group;
- Signing the Deed of Settlement;
- Implementation of the settlement, which normally requires the passing of settlement legislation. The members of a claimant group must agree on a governance entity for holding and managing settlement assets. The Crown cannot transfer settlement assets until the claimant group has a governance entity that has been considered and ratified by members of the group (pp 71–72 OTS publication).

Settlements

A Treaty settlement generally includes:

- An agreed statement of the background to the claim, summarising the key facts about the history of the claim, an acknowledgement by the Crown of its responsibility for breaches of the Treaty and its principles and recognition of their impact on the claimant group and an apology by the Crown for past injustices suffered by the claimant group and for breaches of the Treaty. The OTS publication says that it is considered that the Crown's apology lays the foundation for settling historical claims of the claimant group and is a significant step towards rebuilding the relationship between the Crown and claimant group (p 85);

- Cultural redress which is intended to meet the cultural rather than economic interests of the claimant group. The aim of cultural redress is to address historical grievances arising from the loss of ownership or guardianship of sites of spiritual or cultural significance, loss of access to traditional foods or resources and exclusion from decision-making on the environment or resources with cultural significance: see p 96 OTS publication. Cultural redress may be made by a variety of means including gifting back sites of special significance to the claimant group, the recognition of the traditional placenames and the return of moveable taonga (artefacts): see pp 98–99 OTS publication;
- Financial redress which may include cash and the transfer of commercial assets owned by the Crown and the right of first refusal to purchase specific Crown properties within a defined geographical area.

As part of the settlement, claimant groups are required to give certain undertakings (such as an undertaking to support the passing of settlement legislation in Parliament) or agreements (such as agreement that the settlement will be in full and final settlement of the claimant group's Treaty grievance). The Crown's policy is that Treaty settlements are final. The settlement legislation prevents the courts, the Tribunal or any other judicial body or tribunal from re-opening the historical claims. See p 32 OTS publication

Crown Forestry settlements

Crown forestry settlements are in a special category because of the settlement in respect of *New Zealand Mäori Council v AG* [1989] 2 NZLR 142 (the *Crown Forestry Assets* case). The terms of the settlement were ultimately enacted in the Crown Forestry Assets Act 1989 ("the CFAA"). The case was one of a series of cases taken under section 9 of the State-Owned Enterprises Act 1986 ("the SOE Act"). Section 9 of the SOE Act provided that nothing in that Act shall permit the Crown to act in a manner which is inconsistent with the Treaty. In an earlier case (*NZ Mäori Council v AG* [1987] 1 NZLR 641 ("the *Lands* case")) the Court of Appeal had held that the relationship between the Crown and Mäori under the Treaty had created responsibilities analogous to a fiduciary relationship and that the Crown had an active duty to act to protect the Mäori people in the use of their lands (pp 663–664); therefore, in terms of section 9 of the SOE Act, the Crown was required to ensure that that Act was administered in a manner which ensured Mäori land claims were safeguarded. As a consequence, a system of memorials on land transferred to SOEs had been developed under the Treaty of Waitangi (State Enterprises) Act 1988 (provisions which are now contained in the SOE Act). Land sold with memorials on the titles for the land could be compulsorily re-acquired by the Crown following a decision by the Tribunal: section 27B SOE Act. This system applied to any land transferred by the Crown to Forestcorp Ltd.

However, the Government of the day accepted a recommendation of a Forestry Working Group (established to report to the Ministers of Finance and State-Owned Enterprises as to the appropriate form in which the Crown's forestry assets should be sold) that, instead of transferring land to Forestcorp, Crown forestry land be retained and a right to manage the land and to cut the trees on it for a specified period be sold; it was considered that this procedure would enable the value of Crown forestry assets to be maximised while taking into account the existence of Treaty issues in respect of Crown forestry assets: see summary of facts in the *Crown Forests Assets* case . If this procedure was followed, the memorial system would not have applied to Crown forestry land, as the memorial system applied only when the land was transferred. In the *Crown Forests Assets* case the Mäori Council sought leave from the Court of Appeal to take the matter back to Court under the leave reserved to do so in the *Lands* case. The Court of Appeal held that the Mäori Council's application was within the scope of the leave given and added the following observations (which indicated the Court's likely approach in any substantive hearing):

> It may be as well to add some observations, in the hope of helping resolution of the problem. In the judgments in 1987 this Court stressed the concept of partnership. We think it right to say that the good faith owed to each other by the parties to the Treaty must extend to consultation on truly major issues. That is really clear beyond argument. It seems that in relation to its new proposal the Government was in effect so advised by the Forestry Working Group in para 25 of their Report, already quoted. As yet the evidence before the Court does not indicate whether or not the Government accepted that recommendation. It is a matter which may be clarified if there has to be a further hearing of the case.
>
> Partnership certainly does not mean that every asset or resource in which Mäori have some justifiable claim to share must be divided equally. There may be national assets or resources which, even if Mäori have some fair claim other initiatives have still made the greater contribution. For example – and it is only an example – that might well be true of some pine forests. Moreover, the common interests may point to the sale of forestry rights, or some of them, to the best commercial advantage. But, as the Forestry Working Group recognised, it would be inconsistent with the principles of the Treaty to reach a decision as to whether there should be a general sale without consultation. (p 152)

Therefore, the court considered that the Crown had an obligation under the Treaty to consult with Mäori in relation to the Crown's proposals for the sale of the forests. The court also raised as a possibility that Mäori may not have a right under the Treaty to an equal share of exotic forests.

Following the judgment a settlement was negotiated. The settlement agreement was enshrined in the CFAA. In his speech in the debate on the introduction of the Crown Forest Assets Bill (NZPD Vol 499, 1989: 11626) the Minister of State-Owned Enterprises outlined the features

of the agreement between Mäori and the Crown and what it was intended to achieve as follows:

> The agreement acknowledges that the Crown will sell the existing exotic tree crop and forestry-related assets. Purchasers will be granted a right to use the land for a term that is "evergreen" – that is, it is extended automatically by a period of 1 year until notice of termination is given. The "evergreen" term – and the termination period, if triggered – will be of sufficient length to let any tree crop established by the purchaser reach maturity, and be harvested in accordance with accepted forestry practice.
>
> Consideration for the sale will comprise an initial capital payment for the existing tree crop and related assets, and an annual market-based rental for the use of the land, which remains in the ownership of the Crown. Should the Waitangi Tribunal recommend against resumption of the land the Crown's ownership and related rights will be confirmed. **If, however, the Tribunal recommends the return of the land and part or all of the tree crop to Mäori ownership, a number of options for compensation from the Crown will be open to Mäori**. It is important that the purchaser of the cutting rights and associated assets will in no way be involved in the compensation payment to the successful claimant, nor would the purchaser require compensation from the Crown.
>
> It is an important principle that the contract between the Crown and the purchaser remains unfettered. That principle will be met. In that way, any discount involved in the transaction for the perceived risk of successful land claims will be minimised, if not totally removed. From the time of the sale of the forest until a Waitangi Tribunal recommendation, land rental payments will be put into a fund administered by a trust known as the Rental Trust. Final beneficiaries of the trust will be the successful claimants, or, if the claim should be unsuccessful, the Crown.
>
> …
>
> The State forests were originally intended to be covered by the Treaty of Waitangi (State Enterprises) Act. The fact that they have not been covered by that Act is the result of an unusual set of circumstances resulting from the Government's decision not to transfer the Crown forestry assets to the Forestry Corporation. The Treaty implications of the forests are therefore unique. They are in no way a precedent for any other asset sale. The agreement is better for New Zealand – for the Government, for the taxpayers, for Mäori, and for pakeha – than using the Treaty of Waitangi (State Enterprises) Act. It has been estimated that without such an agreement the value of sales of the Crown's forestry assets might have been discounted by as much as 20% because of purchasers' concerns about tenure. [emphasis added]

In the second reading debate (NZPD Vol 502, 1989: 12997) the Minister of Forestry said:

> I come back to the part of the Bill in which the government has made provision to ensure that Mäori interests are fairly dealt with. That provision comes about after agreement with those persons who negotiated on behalf of the Mäori people and at the direction of the court. The effect of the provision is this: Crown licences will be tendered and Crown licences will be sold. If the Waitangi Tribunal should find subsequently that the land on which those forests stand ought to be returned to Mäori people the Crown undertakes that the land will be transferred to those Mäori people.
>
> In the meantime all of the annual rentals will be placed in a rental trust – not touched by the Government – and, in the event that the Waitangi Tribunal finds in favour of the Mäori people, the rental trusts and the moneys in them will be transferred to the Mäori people. After the finding of the Waitangi Tribunal, all further rents will accrue to the new owners, the Mäori people, but the rights of the purchaser of the forests – namely, of that person or company – are protected up to the stage at which their Crown licence ceases.

Under the CFAA (which reflects the terms of the agreement reached between Mäori and the Crown), Crown forestry land is to remain in Crown ownership but the Crown may issue forestry licences and "Crown forestry assets" (being forests that comprise principally exotic trees growing or standing on Crown forest land) can be transferred to the holders of such licences: sections 11 and 14 CFAA. Each licence must contain a provision that if the licensed land is required to be returned to Mäori, notice terminating the licence will be given at the end of 35 years from the 30 September after the end of the initial term (if notice is given during the initial fixed term) or at the end of 35 years from the 30 September next after the date of notice: section 17(4).

The Crown Forestry Rental Trust was established to hold all rents on forest land until Mäori claims to forests had been determined by the Tribunal: section 34 CFAA. Under the terms of the Trust, interest on the Trust's funds was to be applied in assisting Mäori claimants in the preparation, presentation and negotiation of their claims: see *Latimer v CIR* (2002) 20 NZTC 17,737.

If a claim is successful and the Tribunal's recommendation is accepted by the Crown:

- the forestry land will be returned subject to the relevant forestry licence;
- rentals under the licence held by the Crown Forestry Rental Trust and future rental will be paid to the successful claimants; and
- the Crown must pay compensation to the claimants, in accordance with Schedule 1 to the CFAA: section 36 CFAA.

Clause 1 of the First Schedule provides that compensation is to be paid on to Mäori to whom ownership of the land is transferred. Under clause 2 the amount of the compensation is to be:

(a) Five% of the specified amount calculated in accordance with clause 3 of this Schedule as compensation for the fact that the land is being returned subject to encumbrances; and

(b) As further compensation, the remaining portion of the specified amount calculated in accordance with clause 3 of this Schedule or such lesser amount as the Tribunal may recommend.

Clause 3 provides that the person to whom compensation is payable (that is, the successful claimants) may nominate any of the following amounts as the "specified amount" referred to in clause 2:

- The market value of the trees that may be harvested under the Crown forestry licence as at the time the recommendation for the return of land to Mäori ownership becomes final (clause 3(a)); or
- The market stumpage, determined in accordance with accepted forestry business practice, of wood harvested under the Crown forestry licence on the land to be returned to Mäori ownership from the date that the recommendation of the Tribunal for the return of the land to Mäori ownership becomes final under the TOWA (clause 3(b)). "Stumpage" is defined in the New Zealand Institute of Forestry Professional Handbook (May 1999) as follows:

  > The value of the standing tree. Usually expressed as the value per cubic metre (or tonne) of the logs by quality in the tree. Generally derived from the sale value of the log at a sale point (eg. "at mill", "at wharf gate" or "on skid") by deduction of all the costs incurred in getting the tree off the stump to that point of sale; or

- The net proceeds received by the Crown from the transfer of the Crown forestry assets to which the land to be returned relates, plus a return on those proceeds for the period between transfer and the return of the land to Mäori ownership (clause 3(c)). Clause 5 provides that for the purpose of clause 3(c) the return on the proceeds received shall be such amount as is necessary to maintain the real value of those proceeds during either of the following periods:
  - If the claim was filed before the transfer occurred, a period of not more than 4 years from the date of transfer;
  - If the claim was filed after the date of transfer, the period from the date of transfer to the expiration of 4 years after the claim was filed and for any period after the relevant period, an amount equal to the return on one year New Zealand Government stock measured on a rolling annual basis plus an additional margin of 4% per annum.

Funding for negotiations

The Crown, through the OTS, will provide a contribution to the costs of direct negotiations. The amount of the funding depends on the features of the claimant group (how big the claimant group is, how scattered, whether consultation will require hui, tribal structures) and the complexity of the claim. Any claimant funding provided by the OTS is granted for the purposes of negotiations only and not for reimbursing research costs: p 43 OTS publication.

Funding will not be provided to a claimant group unless the representatives of a claimant group have established that they have a mandate to represent the group but once mandating has been established, the Crown will consider reimbursement for mandating costs already incurred. Payments are then made by instalments of no more than $50,000 at a time. Each payment will be linked to the progress of negotiations and reaching the most important milestones. The OTS requires that audited accounts be provided to the OTS once the milestones relating to the claimant funding have been achieved. Audited accounts must be provided at least every twelve months regardless of whether the milestones have been achieved. Invoices must be provided for every tranche up to $50,000 before the tranche may be released.

Claimant funding does not represent an advance in respect of financial redress under a Treaty settlement. The funding provided will be over and above any money or other assets eventually given to the claimant group as redress for its historical Treaty claims. If a claimant group incurs costs over and above the amount of approved funding, in exceptional circumstances, the Crown may consider providing additional funding which is likely to be a payment "on account" of the final settlement. Once settlement has been reached, any approved claimant funding which has not been spent will be paid to the claimant group. Refer p 56 OTS publication.

Legislation

Section CB 5(1)(n) provides:

> To the extent that in the absence of this section the following amounts would be gross income, they are exempt income:
>
> …
>
> (n) Payments made to any person as compensation under the First Schedule (except clause 3(b)) of the Crown Forest Assets Act 1989.

Section CD 3 provides:

> The gross income of any person includes any amount derived from any business.

The definition of "business" in section OB 1 reads as follows:

> "Business"
>
> (a) Includes any profession, trade, manufacture, or undertaking carried on for pecuniary profit:
>
> (b) Is further defined in Schedule 6A for the purposes of that Schedule:

Section CD 5 provides:

> The gross income of any person includes any amount that is included in gross income under ordinary concepts.

Section CE 1(1)(a), (c) and (e) provide:

> The gross income of any person includes—
>
> (a) All interest, investment society dividends, and annuities:
>
> Provided that where any securities have been acquired by purchase otherwise during the income year, the Commissioner may, where the Commissioner considers it equitable so to do, apportion between the transferor and the transferee any interest due or accruing due at the date of the transfer and not then paid:
>
> …
>
> (c) Income derived under the accrual rules:
>
> …
>
> (e) All rents, fines, premiums, or other revenues (including payment for or in respect of the goodwill of any business, or the benefit of any statutory licence or privilege) derived by the owner of land from any lease, licence, or easement affecting the land, or from the grant of any right of taking the profits of the land.

Section CE 2 provides:

> Subject to sections CJ 1 and FF 7, the gross income of any person includes any amount derived from the use or occupation of any land:

Sections CJ 1(1) and (2) provide:

(1) The gross income of any person shall include any amount (including an amount deemed to have been realised under section FB 4 or section GD 1 or section GD 2) derived in any income year from—

> (a) The extraction, removal, or sale or other disposition of any minerals, flax, or timber; or
>
> (b) The sale or other disposition of any right to take timber,—
>
> whether by the owner of the land from or on which the minerals, flax, or timber are obtained or situated or by any other person.

(2) A sale or disposition of land with standing timber on the land, except to the extent that the timber is—

> (a) Timber comprised in ornamental or incidental trees; or
>
> (b) Subject to a forestry right (as defined in section 2 of the Forestry Rights Registration Act 1983) registered under the Land Transfer Act 1952; or
>
> (c) Subject to a profit à prendre granted before 1 January 1984,—

shall be deemed to include a sale or other disposition of timber for the purposes of this section (whether or not the sale or other disposition includes other land or other assets or the land and timber are assets of a business), and in every such case—

> (d) the part of the consideration attributable to the timber, including the amount determined under section FB 4, GD 1 or GD 2, is to be treated as the consideration paid for the timber; and
>
> (e) the amount of consideration under paragraph (d) is treated as—
>
> (i) gross income of the person selling or otherwise disposing of the land; and
>
> (ii) the cost of the timber to the person acquiring the land.

Section DC 1 provides:

(1) This section shall apply in respect of—

> (a) Any payment (in this section referred to as a "grant") made to any taxpayer in any income year by the Development Finance Corporation of New Zealand or the New Zealand Film Commission or by any department or instrument of the Executive Government of New Zealand or any local authority, being a payment in the nature of a subsidy or grant in respect of any business carried on by that taxpayer other than a payment to which section CC 3 or section DL 3 (except section DL 3(6)), applies:
>
> (b) Any expenditure in respect of which a grant is made.

(2) Where, and to the extent that, in any income year, a grant is made to any taxpayer in respect of expenditure incurred by the taxpayer (not being expenditure of any of the kinds referred to in subsection (3)) that is allowed as a deduction under this Act, the amount of the deduction otherwise allowed, in respect of that expenditure shall be reduced by the amount of that grant, and the amount of that grant shall be deemed not to be gross income of that taxpayer.

(3) Where, and to the extent that, a grant is made to any taxpayer in respect of expenditure incurred by that taxpayer in the acquisition, construction, installation, or extension of any asset (being an asset in respect of which a deduction for depreciation is allowed under this Act), the amount of that expenditure shall, for the purposes of determining the amount of any deduction allowed in respect of the depreciation of that asset, be deemed to be reduced by the amount of that grant, and the amount of that grant shall be deemed not to be gross income of the taxpayer.

(4) Subject to section DC 3, this section shall not apply to the amount of any payment in the nature of an advance or loan.

(5) For the purpose of giving effect to this section, the Commissioner may at any time amend any assessment, notwithstanding the time bar.

Section EB 1(1) provides:

(1) For the purposes of this Act an amount shall be deemed to have been derived by a person although it has not been actually paid to or received by the person, or already become due or receivable, but has been credited in account, or reinvested, or accumulated, or capitalised, or carried to any reserve, sinking, or insurance fund, or otherwise dealt with in the person's interest or on the person's behalf.

Section EH 21(1) provides:

The accrual rules apply to a person who is a party to a financialarrangement and who is a New Zealand resident.

"Financial arrangement" is defined in section EH 22(1) as follows:

(1) A financial arrangement is

(a) a debt or debt instrument, including a debt that arises by law;

(b) an arrangement (that may include a debt or debt instrument or an excepted financial arrangement) under which a person receives money in consideration for a person providing money to any person

(i) at a future time, or

(ii) when an event occurs in the future or does not occur (whether or not the event occurs because notice is or is not given).

Relevant provisions of the Crown Forests Assets Act 1989 ("the CFAA") are set out below

Section 11 of the CFAA provides:

(1) The responsible Ministers may, on behalf of the Crown, transfer Crown forestry assets to any person for such consideration, and on such terms and conditions, as the responsible Ministers may agree with that person.

(2) Crown forestry assets that are described in paragraph (a) of the definition of that term in section 2 of this Act may only be transferred to a person to whom it is proposed to grant a Crown forestry licence in respect of the land on which those assets are situated.

(3) Nothing in subsection (2) of this section prevents the transfer of any Crown forestry assets referred to in that subsection in compliance with—

(a) The terms of any contract that existed immediately before the commencement of this Act; or

(b) The terms of any contract that the responsible Ministers consider appropriate to enter into in accordance with current accepted business practice;

…

Section 13 of the CFAA provides:

Notwithstanding any Act or rule of law, Crown forestry assets growing or standing on, or fixed to, or under or over, any land may be transferred under section 11 of this Act, notwithstanding that neither the land nor any interest in the land is being transferred. For the purposes of that transfer, the assets and the land shall be regarded as separate assets each capable of separate ownership.

Section 17 of the CFAA provides:

(1) For the purposes of this section termination period means the period of 35 years at the end of which a Crown forestry licence terminates in relation to the licensed land or any part of it.

(2) Subject to this section, every Crown forestry licence that relates to Crown forest land that is situated in a district specified in the Schedule 3 to this Act, or on which a forest specified in that Schedule is located, shall comprise, as an initial fixed term, the term set out opposite that district or forest, as the case may be, in that Schedule, and shall then run from year to year by way of automatic extension.

(3) Subject to this section, every other Crown forestry licence shall run from year to year by way of automatic extension.

(4) Every Crown forestry licence shall provide that if a recommendation is made under section 8HB(1)(a) of the Treaty of Waitangi Act 1975 that becomes a final recommendation under that Act for the return of the licensed land, or any part of it, to Mäori—

(a) The responsible Ministers shall give notice to the licensee that the recommendation has become a final recommendation:

(b) Notice shall be given to the licensee terminating the licence, or terminating the licence in so far as it relates to part of the licensed land, as the case may be,—

(i) If the notice is given during the initial fixed term, at the expiration of a period of 35 years commencing on the 30th day of September next after the end of that term; or

(ii) If the notice is given after the initial fixed term, or if the licence does not comprise an initial fixed term, at the expiration of a period of 35 years commencing on the 30th day of September next after the date on which the notice is given:

(c) In relation to the licensed land, or that part of it to which a notice of termination applies, as the case may be,—

(i) During the termination period the rights of the licensee under the licence in respect of that land shall be restricted to protecting, managing, harvesting, and processing the tree crops standing on that land at the commencement of that period; and

(ii) The licensee shall exercise those rights in accordance with accepted forestry business practice; and

(iii) The licensee shall, during the termination period, from time to time in accordance with the licence, give notice to the licensor of those parts of that land, including buildings and other fixed structures, roads, tracks, and access ways, that are no longer required by the licensee for exercising the licensee's rights under the licence during that period; and

(iv) The licensor shall take possession of any land referred to in subparagraph (iii) of this paragraph notified as being no longer required, and the licence shall cease to apply to that land except for provisions that relate to the rights and obligations of the parties during the balance of the termination period.

(5) Every Crown forestry licence shall provide that if a recommendation is made under section 8HB(1)(b) or section 8HB(1)(c) or section 8HE of the Treaty of Waitangi Act 1975 that the licensed land, or part of it, not be liable to be returned to Mäori ownership,—

(a) The licence shall, as regards the licensed land or any part of it to which the recommendation relates, be deemed to have been granted for an initial fixed term of 35 years whether or not the licence comprised an initial fixed term in accordance with subsection (2) of this section and whether or not the licence has been in force for the whole or part of that term:

(b) Notice may be given to the licensee terminating the licence—

(i) If the notice is given during the initial fixed term, at the expiration of a period of 35 years commencing on the 30th day of September next after the end of that term; or

(ii) If the notice is given after the expiration of the initial fixed term, at the expiration of a period of 35 years commencing on the 30th day of September next after the date on which the notice is given:

(c) Subject to the terms and conditions of the licence and to any enactment or rule of law, the licensee shall have the right, while the licence remains in force, to use the licensed land for any purpose whether or not it relates to the harvesting, planting, management or processing of trees on the licensed land.

Section 36 of the CFAA provides:

(1) Where any interim recommendation of the Waitangi Tribunal under the Treaty of Waitangi Act 1975 becomes a final recommendation under that Act and is a recommendation for the return to Mäori ownership of any licensed land, the Crown shall—

(a) Return the land to Mäori ownership in accordance with the recommendation subject to the relevant Crown forestry licence; and

(b) Pay compensation in accordance with the Schedule 1 to this Act.

(2) Except as otherwise provided in this Act or any relevant Crown forestry licence, the return of any land to Mäori ownership shall not affect any Crown forestry licence or the rights of the licensee or any other person under the licence.

(3) Any money required to be paid as compensation pursuant to this section may be paid without further appropriation than this section.

Schedule 1 of the CFAA reads as follows:

1. Compensation payable under section 36 of this act to the Mäori to whom ownership of the land concerned is transferred.

2. That compensation shall comprise—

(a) Five% of the specified amount calculated in accordance with clause 3 of this Schedule as compensation for the fact that the land is being returned subject to encumbrances; and

(b) As further compensation, the remaining portion of the specified amount calculated in accordance with clause 3 of this Schedule or such lesser amount as the Tribunal may recommend.

3. For the purposes of clause 2 of this Schedule, the specified amount shall be whichever of the following is nominated by the person to whom the compensation is payable—

(a) The market value of the trees, being trees which the licensee is entitled to harvest under the Crown forestry licence, on the land to be returned assessed as at the time that the recommendation made by the Tribunal for the return of the land to Mäori ownership becomes final under the Treaty of Waitangi Act 1975. The value is to be determined on the basis of a willing buyer and willing seller and on the projected harvesting pattern that a prudent forest owner would be expected to follow; or

(b) The market stumpage, determined in accordance with accepted forestry business practice, of wood harvested under the Crown forestry licence on the land to be returned to Mäori ownership from the date that the recommendation of the Tribunal for the return of the land to Mäori ownership becomes final under the Treaty of Waitangi Act 1975. If notice of termination of the Crown forestry licence as provided for under section 17(4) of this Act is not given at, or prior to, the date that the recommendation becomes final, the specified amount shall be limited to the value of wood harvested as if notice of termination had been given on that date; or

(c) The net proceeds received by the Crown from the transfer of the Crown forestry assets to which the land to be returned relates, plus a return on those proceeds for the period between transfer and the return of the land to Mäori ownership.

4. For the purposes of clause 3(c) of this Schedule, if the land to be returned is included within an area that was offered for sale as a single lot, the transfer proceeds in relation to each hectare of land returned to Mäori ownership shall be not less than an amount equal to the average price per hectare of the forest lot specified in the selling process; except that—

(a) Where a bid is accepted for a number of lots as one parcel, the average price shall be based on the price for the total parcel; and

(b) Where the lot concerned had an average age of less than 5 years, the average price applied shall be the average price of all lots transferred within the same Crown Forestry Management Limited administrative district existing at the time of transfer.

5. For the purposes of clause 3(c) of this Schedule, the return on the proceeds received by the Crown shall be—

(a) Such amount as is necessary to maintain the real value of those proceeds during either—

(i) In the case where the claim was filed before the transfer occurred, a period of not more than 4 years from the date of transfer of the Crown forestry assets; or

(ii) In the case where the claim was filed after the date of transfer of the Crown forestry assets, the

period from the date of transfer of the Crown forestry assets to the date of expiration of 4 years after the claim was filed; and

(b) In respect of any period after the period described in subparagraph (i) or subparagraph (ii) of paragraph (a) of this clause (as extended under clause 6 of this Schedule), equivalent to the return on one year New Zealand Government stock measured on a rolling annual basis, plus an additional margin of 4% per annum.

For the purposes of this clause, a claim shall be deemed to be filed on such date as is certified by the Registrar of the Tribunal.

6. The period of 4 years referred to in clause 5 of this Schedule may be extended by the Tribunal where the Tribunal is satisfied—

(a) That a claimant with adequate resources has wilfully delayed proceedings in respect of a claim; or

(b) The Crown is prevented, by reasons beyond its control, from carrying out any relevant obligation under the agreement made on the 20th day of July 1989 between the Crown, the New Zealand Mäori Council, and the Federation of Mäori Authorities Incorporated.

7. All payments under this Schedule, other than payments for the purposes of clause 3(b) of this Schedule, shall be made within 2 months after the date of the Tribunal's recommendation, or such later date as the Tribunal may direct, or the parties may agree.

8. All payments for the purposes of clause 3(b) of this Schedule shall be calculated at 3 monthly intervals and shall be paid within one month of the relevant 3 monthly period.

9. Payments under this Schedule, other than payments made for the purposes of clause 3(c) of this Schedule on which interest is payable in accordance with clause 5(b) of this Schedule, shall not bear interest.

"Crown forestry assets" is defined in the CFAA as follows:

Crown forestry assets means—

(a) Every forest that comprises principally exotic trees growing or standing on Crown forest land; and

(b) All improvements on, or associated with, Crown forest land and, without limiting the generality of the foregoing, includes:

(i) All buildings and other structures affixed to that land; and

(ii) All roads, tracks, accessways, firebreaks, bridges, culverts, irrigation works, erosion works, water-races, drainage works, water storage, and all works and services related to the prevention, detection, or fighting of fire; and

(c) All plant, equipment, vehicles, tools, logs, consumable supplies, raw materials, forest produce and stores used or associated with the management of other Crown forestry assets; and

(d) The forest stand records of the Crown; and

(e) All rights (whether vested or contingent) under leases, licences, agreements for sale and purchase, profits à prendre, easements (including easements in gross), rights to take standing timber and growing crops, and any other form of right to occupy or use land other than Crown forest land; and

(f) All patents, trademarks, copyright, and other intellectual property rights (whether protected by registration or other formal process, or not) and all planning and other statutory consents used in connection with the management of Crown forestry assets or Crown forest land; and

(g) Shares or other securities in companies holding Crown forestry assets and shares or other securities held by the Crown for forestry purposes; and

(h) All contracts entered into by the Crown in respect of Crown forestry assets referred to in the preceding paragraphs of this definition or the use of Crown forest land—

but does not include contracts that are not capable of assignment by the Crown and the leases or licences specified in the Schedule 2 to this Act:

Analysis

Whether amount derived from any business – section CD 3

A business includes "any profession, trade, manufacture, or undertaking carried on for pecuniary profit". For there to be a business there must be a genuine intention to make a profit. In order to determine whether the activity is carried on with the intention of making a profit, the taxpayer's subjective evidence of intention is relevant but must be tested against objective evidence. It is, therefore, necessary to consider both the nature of the taxpayer's activities and the intention of the taxpayer in engaging in those activities. Factors that may be relevant in considering whether a taxpayer is carrying on a business include: the nature of the activity, the period during which the activity is engaged in, the scale of operations and the volume of transactions, the commitment of time, money and effort, the pattern of activity and the financial results. The fundamental concept of a business is that it is an activity that is carried on in an organised, systematic and coherent manner that is directed at the end result of obtaining a profit. See *Grieve v CIR* (1984) 6 NZTC 61,682.

Not every receipt by a taxpayer who carries on a business is income under section CD 3. Section CD 3 applies to amounts derived "from any business". The amount in question must be income and it will be income if it is derived from the current operations of the business, ie it is "an ordinary incident of the business" or derived "in the ordinary course of the business". In *CIR v City Motor Service Ltd* [1969] NZLR 1010 Turner J said:

> … in my opinion in the words "from the business" of the company something more is meant than merely "as a result of the fact that the company was carrying on this business". I think that *from the business* must mean *from the current operations of the business.*"
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> …remembering that Income Tax is always a tax on Income I conclude without difficulty that the words "from any business" in an Income Tax Act must mean "from the current operations of any business" and no more. They are not, in my opinion, apt to include accretions to the capital assets of the taxpayer which although they may result from the fact of his carrying on business, yet do not arise from the actual operations of that business. (p 1017)
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> …
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> But income tax being "always a tax on income", the crucial question in New Zealand must therefore in result be the same as that in Australia. Is the receipt income or capital? If it is gains or profits from a business, then the question reduces itself to whether these were derived from the *current* operations of the business, and therefore income, or whether no more than can be contended, as regard their connection with the business, than that without the existence of the business they would not have accrued. If no more than this last can be proved, the gains cannot be assessable income, and simply because they are not derived from the current operations of the business. (pp 1017-1019)

In order to determine whether amounts are income from a business it is necessary to consider the nature of the business and the relationship of the transactions under which the amounts are received to the business. In *AA Finance Ltd v CIR* (1994) 16 NZTC 11,383 Richardson J said:

> Whether gains produced in a business are revenue or capital depends on the nature of the business and the relationship of the transactions producing the gain to the conduct of the business. The classic statement in that regard is that of the Lord Justice Clerk in *California Copper Syndicate Ltd (Limited and Reduced) v Harris (Surveyor of Taxes)* (1904 5 TC 159 at p 166 that:
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>> "… enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or conversion of investment, but an act done in what is truly the carrying on, or carrying out, of a business."
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> Liability to tax does not depend on showing that the taxpayer is carrying on a separate business of dealing in investments. A transaction may be part of the ordinary business of the taxpayer or, short of that, an ordinary incident of the business activity of the taxpayer although not its main activity. A gain made in the ordinary course of carrying on the business is thus stamped with an income character. (p 11,391)

Whether the pursuit of a Treaty settlement is a business in itself

A claimant group is normally a tribal-based group. A Treaty settlement is negotiated and entered into by representatives of that group on behalf of the members of the group and must be ratified by the members before it is binding on the claimant group. Financial redress negotiated under a Treaty settlement is transferred to and managed by the claimant group's governance entity. Before the Crown transfers financial redress, the Crown must be satisfied that the claimant group's governance entity is fully accountable to the members.

Under the Treaty the Crown guaranteed to Mäori property rights existing as at the date of the Treaty. The breach of that obligation forms the basis for Treaty claims for financial redress. The purpose of the financial redress is to compensate the claimants for the economic losses resulting from the Crown's breaches of the Treaty. The OTS publication says:

> Financial and commercial redress also recognise that where claims for the loss of land and/or resources are established, the Crown's breaches of the principles of the Treaty will usually have held back the full economic development of the claimant group concerned. The Crown does not provide full compensation based on a calculation of total losses to the claimant group... but it does contribute to re-establishing an economic base as a platform for future development. (p 87)

In determining the quantum of redress that is offered, the Crown takes into account the amount of land lost to the claimant group through the Crown's Treaty breaches, the relative seriousness of the breaches involved, the benchmarks set by existing settlements for similar grievances. Secondary factors are the size of the claimant group today, whether there are any overlapping claims and any other special factors: refer OTS publication p 89.

A purpose of a Treaty claim is to obtain compensation for economic losses resulting from the Crown's breaches of its obligations under the Treaty. Those obligations include a guarantee of property rights held by Mäori as at the date of the Treaty: see *NZ Mäori Council v AG* [1989] 2 NZLR 142; *NZ Mäori Council v AG* [1994] 1 NZLR 513. Essentially the loss for which compensation is received is a loss of a capital nature.

A Treaty settlement also generally has a dimension beyond the compensation for economic losses. The other elements of a settlement are the Crown's apology and acknowledgement, and cultural redress. The Crown's acknowledgement and apology and cultural redress (which normally form part of the settlement reached) are intended to recognise non-economic losses of the claimant group.

Normally Treaty settlement deeds include a statement setting out the historical events giving rise to grievances, an acknowledgement by the Crown of acceptance of responsibility for the breaches and an apology by the Crown for its acts or omissions. The Crown's apology and acknowledgement are considered to be an important contribution to the settlement of Treaty grievances. The OTS publication states that it is recognised that excessive land loss had a harmful effect on Mäori social development and has been accompanied by the loss of

access to forests, waterways, food resources and places of spiritual and cultural value: p 18.

"Cultural redress" is intended to address concerns raised by claimant groups in negotiations regarding issues of cultural, rather than economic, significance to the claimant groups. Cultural redress includes provision for consultation on the management, control or ownership of sites, areas or customary resources on Crown-owned land with which the claimant group has traditional and cultural associations and recognition of traditional place names. The OTS publication says that issues of cultural significance have often been raised by claimant groups in negotiations with the Crown.

Under the test in *Grieve* both the taxpayer's intention, and the nature and scale of the activity carried on by the taxpayer, are relevant in determining whether the taxpayer is carrying on a business. A Treaty settlement is a one-off event as the Crown seeks a comprehensive settlement of all claims of a claimant group and the Crown's policy is that all settlements are to be final. A Treaty claim does not involve regular and recurrent transactions by claimant groups but the pursuit of a Treaty claim is carried on in an organised, systematic and coherent manner, generally over a period of years, with a view to obtaining a significant amount under a Treaty settlement. However, the Commissioner considers that the making of a Treaty claim is not for that reason a business. A Treaty claim is carried on with the intention of recovering compensation for past wrongs, in the form of economic redress, cultural redress and also an acknowledgement and apology from the Crown for its breaches of the Treaty, rather than with the intention of profit. A Treaty claim is not a purely commercial activity. The acknowledgement and apology and the cultural redress are regarded as important aspects of settlements. A Treaty claim is undertaken in order to recover compensation for a past loss rather than to make a profit.

Whether financial redress under a Treaty settlement is an amount derived from another business

The governance entities which receive Treaty settlement assets on behalf of claimant groups may either be existing entities or entities established for the purpose of receiving Treaty settlements. Some governance entities may carry on activities outside the Treaty claim and such activities may be businesses.

It is also possible that individual members of the claimant group, on whose behalf the settlement assets are received, may be carrying on a business and the individual members of a claimant group may be deemed by section EB 1 to have derived the settlement payment, on the basis that settlement payments have been dealt with in their interest or on their behalf by the entity which has received the settlement. (However, in some cases the settlement legislation has expressly provided that the settlement is for the benefit of the claimant group and not for the benefit of any individual, particular marae or particular hapu, except to the extent determined otherwise after the settlement by the governance entity: see section 467 Ngai Tahu Claims Settlement Act 1998; section 17 Pouakani Claims Settlement Act 2000.)

The Commissioner considers that even if the claimant group or individual members of the group were carrying on a business, a Treaty settlement is not an amount derived from any business carried on by such persons. A Treaty claim does not involve regular or recurrent transactions. The Crown's policy is that settlements are to be final settlement of all historical claims of the claimant group. A Treaty settlement is not a transaction that is entered into as part of the ordinary operations of any business carried on by a claimant group. The Treaty itself is not an ordinary commercial contract and is regarded as having constitutional significance: see *NZ Mäori Council v AG* [1994] 1 NZLR 513.

The majority of claims involve land claims. The basis for financial redress under a Treaty settlement is that land or other resources have been lost to the claimant groups as a result of the Crown's Treaty breaches. The OTS publication indicates that financial redress under Treaty settlements recognises that Treaty breaches resulting in loss of land or other resources have had a detrimental effect on the overall economic position of claimant groups. The OTS publication says that:

> Commercial and financial redress recognises that where claims for the loss of land and/or resources are established, the Crown's breaches of the principles of the Treaty will usually have held back the full economic development of the claimant group concerned. …
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> It is impossible to put a precise value on the economic losses resulting from most Treaty breaches. This is because so much time has passed, and because the effects of various causes on the economic status of the claimant group today is such a complex matter European settlement has also brought benefits to Mäori that cannot be easily expressed in money terms. However, many commentators estimate that the losses to Mäori amount to tens of billions of dollars. (p 87–89)

Financial redress under a Treaty settlement is paid to compensate for the loss of land or other resources held at the time that the Treaty was signed. Evidence was given by the Mäori applicants in "the Lands case" and accepted by the court that land has a special significance in Mäori culture. Richardson J commented:

> The uncontested evidence in this case… amply justifies and supports conclusions of historians as to the crucial importance of land in Mäori culture. The New Zealand Mäori Council in its paper *Kaupapa – Te Wahanga Tuatahi* expresses it in this way:
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> > "It [Mäori land] provides us with a sense of identity, belonging and continuity. It is proof of our continued existence not only as a people, but as the tangatawhenua of this country. It is proof of our tribal and kin group ties. Mäori land represents turangawaewae.

> It is proof of our link with ancestors of our past, and with the generations yet to come. It is an assurance that we shall forever exist as a people, for as long as the land shall last." (p 674)

Given that evidence, the Commissioner considers that it is unlikely that land in respect of which compensation is paid under Treaty settlements would be treated as an asset of a revenue nature.

Compensation payments take the character of that which they replaced: *London and Thames Haven Oil Wharves Ltd v Attwooll* [1967] 2 All ER 124 and *Burmah Steamship Co Ltd v CIR* (1930) 16 TC 67. In *Burmah Steamship*, where a shipowner had received damages for breach of contract by a late delivery of a ship (which was, therefore, unavailable for trading operations), the damages were held to be business income as the damages were compensation for loss of trading receipts. Lord Clyde said:

> In the present case there can be no doubt that, when the Appellant entered into the contract with the repairers, the consequences of a failure by the latter to deliver punctually, which were in the contemplation of both parties at the time, were that the Appellant would be deprived of the opportunity of putting the vessel to immediate profitable use in his business. It was in respect of this deprivation that the damages were recovered. The contemplated "hole" in the Appellant's profits was unfortunately made, and in my opinion the damages recovered must go, as a matter of sound commercial accounting, to fill that "hole", and therefore constitute a proper item of profit in the Appellant's profit and loss account. (p 136)

The *London & Thames Haven Oil Wharves Ltd* case concerned an insurance payment made to the owner of a wharf damaged by one of its shipping company clients. Part of the insurance payments related to consequential damage for loss of the use of the wharf (that is, the loss of profits from destruction of trading stock). Diplock LJ held that that part of the insurance payment was income from the taxpayer's business. He said:

> Where, pursuant to a legal right, a trader receives from another person compensation for the trader's failure to receive a sum of money which, if it had been received, would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the time when the compensation is so received, the compensation is to be treated for income tax purposes in the same way as that sum of money would have been treated if it had been received instead of the compensation. The rule is applicable whatever the source of the legal right of the trade to recover the compensation. It may arise from a primary obligation under a contract, such as a contract of insurance; from a secondary obligation arising out of non-performance of a contract, such as a right to damages, either liquidated, as under the demurrage clause in a charterparty, or unliquidated; from an obligation to pay damages for tort, as in the present case; from a statutory obligation; or in any other way in which legal obligations arise. (p 134)

The principle set out in those cases was applied in *Case S104* (1996) 17 NZTC 7,662 and in *Case T47* (1998) 18 NZTC 8,319. In those cases taxpayers who had been prevented from logging a native forest by a Government regulation had received a settlement payment from the Government. In both cases the TRA considered that the payment was income from the partnership's business, being compensation for loss of the profit that they would have derived from logging the forest.

However, in *The Glenboig Union Fireclay Co Ltd v IR Commissioners* (1922) 12 TC 427, where a taxpayer in the business of manufacturing fire clay goods and selling raw clay had received a payment for ceasing to work fire clay fields over which it had mining rights, it was held that the compensation payment was a receipt of a capital nature being an amount received for sterilisation of a capital asset. The fact that the amount of the compensation was determined having regard to profits that would have been earned from the fire clay left unworked was not relevant. The issue was whether the compensation was paid to compensate for a loss of a revenue or of a capital nature. Lord Clyde said:

> In truth the sum of money is the sum paid to prevent the [taxpayer] obtaining the full benefit of the capital value of that part of the mines which they are prevented from working by the Railway Company. It appears to me to make no difference whether it be regarded as a sale of the asset out and out, or whether it be treated merely as a means of preventing the acquisition of profit that would otherwise be gained. In either case the capital asset of the Company to that extent has been sterilised and destroyed, and it is in respect of that action that the sum of £15,316 was paid. It is unsound to consider the fact that the measure, adopted for the purpose of seeing what the total amount should be, was based on considering what are the profits that would have been earned. That, no doubt, is a perfectly exact and accurate way of determining the compensation ... But there is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the application of that test. I am unable to regard this sum of money as anything but capital money ... (pp 463–464)

Compensation paid to replace amounts that would have been receipts of a revenue nature from a business carried on by a claimant group would prima facie be income. The Commissioner considers that financial redress under Treaty settlements is paid to compensate for a loss of a capital nature, being assets held by Mäori at the time the Treaty was signed. Therefore, financial redress under Treaty settlements is not income on that basis.

Conclusion

The Commissioner considers that the pursuit of a Treaty settlement in respect of historical breaches of the Treaty is not a business in itself and that even if a claimant group carries on another activity which constitutes a business, financial redress under Treaty settlements is not an amount derived from a business carried on by the claimant group or by members of the claimant group.

Whether financial redress under Treaty settlements is income under ordinary concepts – section CD 5

Amounts which are income under ordinary concepts are gross income: section CD 5.

Whether or not a particular payment is income under ordinary concepts depends upon its quality in the hands of the recipient. There is no necessary connection between the character of a payment in relation to the payer and its character as a receipt by the payee: *Scott v C of T* (1966) 117 CLR 514; *The Federal Coke Company Ltd v FCT* 77 ATC 4255; *Reid v CIR* (1985) 7 NZTC 5,176.

Periodicity, regularity or recurrence of payments may indicate that the payments are income, but this factor is not conclusive. It is necessary to consider the relationship between the payer and payee and the purpose for which the payment is made. In *Reid v CIR* (1985) 7 NZTC 5,176 Richardson J commented as follows:

> There may be difficulty in marginal cases in determining what are the ordinary concepts and usages of mankind in this regard and to assist in that determination there has been much discussion in the cases of criteria which bear on the characterisation of receipts as income in particular classes of case. The major determinant in many cases is the periodic nature of a payment (*FC of T v Dixon* (1952) 86 CLR 540; and *Asher v London Film Productions* [1944] 1 All ER 77). If it has that quality of regularity or recurrence then the payments become part of the receipts upon which the recipient may depend for his living expenses, just as in the case of a salary or wage earner, annuitant or welfare beneficiary. But that in itself is not enough and consideration must be given to the relationship between payer and payee and to the purpose of the payment, in order to determine the quality of the payment in the hands of the payee. (p 5,183)

The approach in *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 was described by Richardson J as exemplifying the governing approach in New Zealand for determining whether a receipt of an expense is of a capital or revenue nature: see *CIR v Thomas Borthwick & Sons (Australasia) Ltd* (1992) 14 NZTC 9,101, 9,103. In *CIR v Wattie* (1998) 18 NZTC 13,991 Lord Nolan confirmed that similar principles apply to both expenditure and receipts and that the *Hallstroms* approach is to be adopted in determining whether a receipt is capital or revenue:

> It is well settled that in considering whether a particular item of receipt or expenditure is of a capital or revenue nature the approach to be adopted should be that described by Dixon J in *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 and p 648 where he said that the answer to the question:-
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> > "…depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process."
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> Dixon J was speaking in terms of expenditure but it is familiar law that within the context of the same business, similar principles will apply to payments and to receipts. This appears from the general discussion of the earlier cases by Lord Macmillan in *Van Den Berghs Ltd v Clark* [1935] AC 431 at pp 438 to 41, and from the *Borthwick* case itself, which was concerned with the character of a receipt. (p 13,997)

In determining whether a receipt is capital or revenue, the issue is the consideration provided for the payment. Where the recipient does not provide consideration for the payment it is appropriate to consider the purpose of the payment. In *The Federal Coke Company Ltd v FCT* 77 ATC 4255 Brennan J said:

> When a recipient of moneys provides consideration for the payment, the consideration will ordinarily supply the touchstone for ascertaining whether the receipt is on revenue account or not. The character of an asset which is sold for a price, or the character of a cause of action discharged by a payment will ordinarily determine, unless it be a sham transaction, the character of the receipt of the price or payment. The consideration establishes the matter in respect of which the moneys are received. The character of the receipt may then be determined by the character, in the recipient's hands, of the matter in respect of which the moneys are received. Thus, when moneys are received in consideration of surrendering a benefit to which the recipient is entitled under a contract, it is relevant to enquire whether or not that benefit was a capital asset in his hands. To adapt the words of Lord *Macmillan* in *Van den Berghs Ltd. V. Clark* (1935) A.C. at p 443, and of *Williams* J. in *Bennett v. F.C. of T.* (1947) 75 C.L.R. 480 at p 485, the enquiry is whether the congeries of the rights which the recipient enjoyed under the contract and which for a price he surrendered was a capital asset.
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> When a recipient gives no consideration for a receipt, it is not possible to identify the matter in respect of which the moneys are received by reference to rights which the recipient surrenders. Nevertheless, an enquiry into the "how and why" of the receipt may reveal the matter in respect of which the payment is received. If there be a consensus between the payer and the payee, their common understanding may identify the relevant matter. The intention or understanding of the payer alone is insufficient for "it would plainly be unsound to allow a determination of the character of a receipt in the hands of the recipient to be affected by a consideration of the uncommunicated reasoning which led the payer to agree to pay it" (*McLaurin v. F.C. of T.* (1961) 104 C.L.R. 381 at p 391). (p 4,273)

Therefore, the character of the asset sold for the payment or the character of the cause of action discharged by the payment will ordinarily determine the character of the payment.

Treaty settlements do not involve a gain from property, nor do they involve the provision of services. Treaty settlements are one-off events. Although it is possible that Treaty settlement payments could be made in instalments, regularity or recurrence of itself does not indicate that the payments are income. It is also necessary to consider the relationship between the payer and payee and the purpose of the payment in order to

determine whether the payments are income: see *Reid v CIR* (1985) 7 NZTC 5,176. Treaty settlements may include the giving of undertakings by the claimants (such as an agreement that the settlement is full and final settlement of claims under the Treaty). However, the settlements are not paid *for* such undertakings. The undertakings are part of the procedure by which a Treaty claim is settled. Financial redress under a Treaty settlement is paid in order to provide compensation for historical breaches of a Treaty between the Crown and the ancestors of the members of claimant groups.

Where compensation is paid for the deprivation of an asset of a capital nature, the compensation will also be a receipt of a capital nature: see *Burmah Steamship Co Ltd v IRC* (1930) 16 TC 67. In *Burmah Steamship* Lord Clyde said:

> It is true that the measure by which the amount of damages or compensation is ascertainable is no criterion of the capital or revenue character of the sum recovered for the purpose of adjusting an Income Tax account of profits and gains (*Glenboig Union Fireclay Coy. v Inland Revenue,* 1921 S.C. 400, 1922 S.C. (H.L.) 112). But, as the case just referred to shows, it is very relevant to enquire whether the thing in respect of which the taxpayer has recovered damages or compensation is deprivation of one of the capital assets of his trading enterprise, or — short of that — a mere restriction of his trading opportunities.

The purpose of the financial redress made under a Treaty settlement is to compensate the claimants for a loss caused by breaches of the Treaty. Such a loss is a loss of a capital nature, being assets held by Mäori at the time the Treaty was signed.

Conclusion

Given the above, the Commissioner considers that financial redress provided to settle historical Treaty grievances is not income under ordinary concepts in terms of section CD 5.

Crown forestry land settlements

- Generally, compensation payments made to settle historical Treaty grievances (including compensation payments made on the return of Crown forestry land to Mäori ownership) are not income under section CD 3 or section CD 5.
- In some circumstances Treaty settlement payments in respect of Crown forestry land are also exempt under section CB 5(1)(n). The circumstances in which Crown forestry settlement payments are exempt under section CB 5(1)(n) are discussed in detail below.
- Although the Commissioner considers that section CD 3 and section CD 5 would not apply to Treaty settlements in respect of Crown forestry land, a number of other provisions could apply to such Crown forestry settlement payments as are not exempt under section CB 5(1)(n). These provisions (which are discussed below) are: sections CE 1(1)(a) and (e), CE 2 and CJ 1.

Exemption under section CB 5(1)(n) in respect of compensation payments made under the CFAA

The consequences when Crown forestry land is returned to Mäori ownership under a Treaty settlement are set out in the CFAA.

The Crown has sold forests on Crown forestry land and has granted licences in respect of Crown forestry land to the licensees. If Crown forestry land is returned to Mäori ownership, it will be returned subject to a licence, which will terminate at the end of the notice period (35 years from the applicable date): see section 13(5) CFAA. Forests on the land are not returned to the successful claimants, the forests having previously been transferred to the licensees. During the termination period the licensees will continue to have the right to harvest trees growing on the land at the time the land is returned. The land will be resumed progressively by the claimants as trees growing on the land at the time of its return are harvested.

On the return of Crown forestry land to Mäori ownership, the Crown must pay compensation to the Mäori to whom ownership of the land is transferred in accordance with the First Schedule to the CFAA: section 36 CFAA; clause 1 First Schedule. There are two aspects to the compensation paid under the CFAA:

- First, in every case where Crown forestry land is returned to Mäori an amount equal to 5% of the "specified amount" (however the specified amount is calculated) must be paid in order to compensate for the fact that the land is returned "subject to encumbrances" (that is, subject to the right of licensees to continue to harvest trees standing on the land until the end of the termination period): clause 2(b) First Schedule CFAA.
- Secondly, the Crown is required to pay further compensation, being the balance of the specified amount or such lesser amount as the Tribunal may recommend: clause 2(b) First Schedule CFAA. Section 8HB of the TOWA (which empowers the Tribunal to hear claims in relation to land licensed under the CFAA) does not indicate what matters the Tribunal is to take into account in determining the further compensation to be paid. However, the function of the Tribunal is to inquire into and make recommendations to the Crown on claims alleging a breach by the Crown of the principles of the Treaty. In *NZ Mäori Council v AG* [1994] 1 NZLR 513 the Privy Council commented on the meaning of "principles of the Treaty" as follows:

  > In their Lordships' opinion the "principles" are the underlying mutual obligations and responsibilities which the Treaty places on the parties. They reflect the intent of the Treaty as a whole and include, but are not confined to, the express terms of the Treaty…. With the passage of time, the "principles" which underlie the Treaty have become much more important than its precise terms.

> Foremost amongst those "principles" are the obligations which the Crown undertook of protecting and preserving Mäori property, including the Mäori language as part of taonga, in return for being recognised as the legitimate government of the whole nation by Mäori. The Treaty refers to this obligation in the English text as amounting to a guarantee by the Crown. This emphasises the solemn nature of the Crown's obligation. It does not however mean that the obligation is absolute and unqualified. This would be inconsistent with the Crown's other responsibilities as the government of New Zealand and the relationship between Mäori and the Crown. (p 517)

Therefore, on the return of Crown forestry land the successful claimants will receive at least 5% of the "specified amount" calculated in accordance with clause 3 and could receive as further compensation, an amount up to the balance of the "specified amount", unless the Tribunal determines that a lesser amount should be paid. Each of the amounts referred to in clause 3 are measures of the value of the forests on the land returned. Under clause 3 of the First Schedule the "specified amount" is whichever of the following amounts is nominated by the successful claimants:

- The market value of trees on land returned as at the time of the recommendation to return the land becomes final (clause 3(a) of the First Schedule CFAA);
- The market stumpage harvested under the licence from trees on the land returned from the date that the recommendation to return the land becomes final; (clause 3(b) of the First Schedule CFAA).
- The net proceeds received by the Crown from the sale of the forests on the land to be returned "plus a return on those proceeds for the period between the transfer and the return of the land to Mäori ownership" (clause 3(c) of the First Schedule CFAA).

The Income Tax Act 1976 was amended with effect from 25 October 1989 by the addition of section 61(62) (now section CB 5(1)(n)). Under section CB 5(1)(n) to the extent that in the absence of that provision, the payments would be gross income, payments of compensation under the First Schedule (except clause 3(b)) of the CFAA are exempt income. Therefore, compensation paid under the CFAA would be exempt income under section CB 5(1)(n), unless it is calculated under clause 3(b), that is, by reference to the market stumpage.

Whether compensation payable under the CFAA would be gross income in the absence of section CB 5(1)(n)

Section CB 5(1)(n) exempts compensation payments under the CFAA "to the extent that in the absence of that section" they would be gross income. The Commissioner considers that compensation payments made under the CFAA to claimant groups on the return of Crown forestry land to Mäori ownership would not (in the absence of section CB 5(1)(n)) be gross income under sections CD 3, CE 1(1)(e), CE 2, CJ 1, CE 1(1)(a) or CD 5. These provisions are discussed as following.

(a) *Amounts derived from a business – section CD 3*

For the reasons outlined previously, the pursuit of a Treaty settlement in respect of Crown forestry land is not a business in itself and if the successful claimants carry on another activity which constitutes a business, compensation payments under the CFAA are not amounts derived from such a business.

(b) *Payments for use of land – section CE 1(1)(e)*

Section CE 1(1)(e), which refers to amounts derived by the owner of land from a lease, licence or easement in respect of land or from the grant of a right of taking profits of the land, does not apply to the compensation payments for the following reasons:

- The payments are not received by the claimants as owners of the land, nor are they received from a licence or for the grant of cutting rights in respect of timber on the land. The payments would be received on the transfer of ownership of Crown forestry land to the successful claimants. Under the terms of the Crown Forestry Rental Trust on the return of any licensed land to Mäori ownership, the successful claimants are entitled to receive the rental received by the trustees in respect of that land from the commencement of the licence until resumption and to receive future rental direct from the licensee: clause 11.1 of the Deed of Trust. Therefore, past and future rental payments are distinct from and are payable to the successful claimants in addition to the compensation paid under the First Schedule of the CFAA.
- The payments are not received for the grant of a right to take profits of the land. Any grant of cutting rights made in respect of Crown forestry assets is made by the Crown and not by the successful claimants.
- The Crown does not act on behalf of the successful claimants in granting the licences and selling the forests. In the C*rown Forests Assets* case the court considered that the Crown had an obligation under the Treaty to consult with Mäori (as the other party to the Treaty) about the proposed sale of the forests. The consultation led to the agreement which specified how Crown forestry land and Crown forestry assets were to be dealt with pending resolution of claims under the Treaty and the consequences once a claim was resolved. The Mäori Council and the Federation of Mäori Authorities consented to the creation of the licences and the sale of the forests but until a recommendation of the Tribunal that the land be returned to the successful claimants is accepted by

the Crown, the claimants have no rights in respect of the land other than inchoate rights under the Treaty.

(c) *Amounts derived from the use or occupation of any land – section CE 2*

Section CE 2 refers to amounts derived from the use or occupation of land. In *Smith v CIR* [1969] NZLR 565 it was held that section 91(a) of the Land and Income Tax Act 1954 (which included in the definition of income "all profits or gains derived from the use or occupation of land") did not apply to a profit derived from the assignment of a right to cut timber. Although that right was an interest in land, the court considered that neither the original grantee nor the assignees acquired any property in the land. The court considered that section 91(a) was limited to the gain derived from the use or occupation of the land in the sense of a tangible, physical thing. Haslam J said:

> Mr Carroll also rested part of his argument upon the submission that the term "land" embraced all estates or interests therein, and referred to the definition of the phrase "owner of land" in s. 2 of the Act, which applies "unless the context otherwise requires". The word "land" itself is defined, with an even stronger qualification about inconsistency in the context, in s. 4 of the Acts Interpretation Act 1924 as including ". . . messuages, tenements, hereditaments . . .". While the right created by the grant under review would fall within the relevant passage in either statutory definition, I think that in the context of s. 91 the term "land" should be read in its primary connotation. I read the section as designed to clarify and extend the incidence of taxation in relation to profits and gains derived from the use and occupation of land. If this word be considered in its setting in s. 91 (1) (a), then emphasis is given to the financial yield derived by virtue of use or occupation by the taxpayer…. I conclude therefore that in s. 91 this word bears its everyday sense of a solid part of the earth's surface, and does not include estate or interest in realty.
> (p 568-569)

The Commissioner considers that section CE 2 applies to amounts derived from agricultural use of the land. The Commissioner considers that section CE 2 does not apply to compensation payments made under the CFAA. Clause 2 of the First Schedule to the CFAA recognises that the land is returned subject to rights of the licensees which effectively prevent the claimants from having full use of the land while the licensees retain the right to cut trees situated on the land. The compensation is, in part, compensation for the fact that the land is returned subject to the use or occupation by the licensees. However, for section CE 2 to apply, the amounts must be derived from the actual physical use of the land by the successful claimants rather than as a consequence of the successful claimants having an interest in the land.

Section CE 2 is expressed to be "subject to" section CJ 1. Therefore, section CJ 1 prevails over section CE 2 where the receipts in question are amounts derived from the sale of timber: refer *C & J Clark Ltd v IRC* [1971] 1 WLR 905.

(d) *Amounts derived from the sale of timber or right to take timber – section CJ 1*

The Commissioner considers that the compensation payments are not income under section CJ 1(1) or (2) for the following reasons:

- Under section CJ 1(1) amounts deemed to have been derived under section FB 4, GD 1 or GD 2 from the sale or disposition of timber or the right to take timber are income. Sections FB 4, GD 1 and GD 2 would apply where the timber is trading stock. Even if these provisions were relevant, a claimant group to which Crown forestry land is returned would not derive any amounts from the sale of timber or the right to take timber. The grant of the licence and the sale of forests are made by the Crown and not by the claimants. When forestry land is returned to Mäori claimants, the forests standing on that land are not returned to them. The forests have been transferred outright to licensees and in terms of section 13 of the CFAA, for the purposes of the transfer, the forestry assets and the land are regarded as separate assets each capable of separate ownership. On the return of the land to Mäori ownership the rights of the licensee are preserved. Timber harvested from Crown forestry land that is subject to a licence is sold by the licensee, not by the claimants.
- In terms of section CJ 1(2) the sale or disposition of standing timber is gross income except:
  - Timber that is comprised in ornamental or incidental trees; or
  - Timber that is subject to a forestry right;
  - Timber that is subject to a profit à prendre granted before 1 January 1984.

The compensation is not paid for the sale of standing timber as the forests are not owned by the successful claimants. The forests are sold by the Crown to the licensees before the return of the land to Mäori.

(e) *Interest – section CE 1(1)(a)*

The "specified amount" under clause 3(c) of the First Schedule includes a return on the net proceeds received by the Crown from the transfer of Crown forestry assets to which land to be returned to Mäori ownership relates.

Under the common law, interest is the consideration for the use of a sum of money owed to or belonging to another person: *Re Euro Hotel (Belgravia) Ltd* [1975] 3 All ER 1075.

The true character of the payment is not determined by its description in the agreement or the legislation. In *Riches v Westminster Bank Ltd* [1947] AC 390 Viscount Simon commented:

> The real question, for the purpose of deciding whether the Income Tax Acts apply, is whether the added sum is capital or income, not whether the sum is damages or interest. (p 396)

Viscount Simon went on to say:

> I come then to the second stage and ask what is the character of interest allowed under section 28 of the [Civil Procedure] Act of 1833. Here the argument is that, call it interest or what you will, it is damages and, if it is damages, then it is not interest in the proper sense' or 'interest proper', expressions heard many times by your Lordships. This argument appears to me fallacious. It assumes an incompatibility between the ideas of interest and damages for which I see no justification. It confuses the character of the sum paid with the authority under which it is paid. Its essential character may be the same, whether it is paid under the compulsion of a contract, a statute or a judgment of the court. In the first case it may be called 'interest' and in the second and third cases "damages in the nature of interest" or even "damages". But the real question is still what is its intrinsic character, and in the consideration of this question a description due to the authority under which it is paid may well mislead. (p 406)

A distinction has been drawn in case law between an amount paid to compensate for a loss of a capital nature that is calculated by reference to interest (which remains a receipt of capital) and an amount paid to compensate for a delay in payment of compensation once the amount of the compensation has been determined (which is income under ordinary concepts). The application of this principle is illustrated by *Simpson v Executors of Bonner Maurice as Executor of Edward Kay* (1949) 14 TC 580. The *Bonner Maurice* case concerned a UK resident and national who, at the outbreak of the First World War, owned German stocks and shares which were deposited with banks in Germany. The dividends and interest were collected by the banks. During the war money could not be sent from Germany to the UK so that the dividends and interest accumulated in the banks. In 1917 some of the dividends and interest were paid to an official called the Treuhander. After the end of the war the money was returned to the representatives of the original owner under the Treaty of Versailles. They also received payments under a provision of the Treaty of Versailles which provided that nationals of the Allied and Associated Powers should be entitled to "compensation in respect of damage or injury inflicted upon their property, rights or interests" in Germany. That compensation was calculated on the basis of interest at 5% over the amount handed over to the Treuhander. Rowlatt J held that the compensation was not income:

> The Treuhander did not receive this money subject to any liability to hold it as interest. No doubt the German law recognised it as remaining the property of [the British national], but not so as to bear interest. The Treaty did not give [the British national] any right to interest, nor did it declare the Treuhander a trustee so as to found any consequential claim for interest; it did not empower the tribunal to give interest as such, or to make any declaration as to the character of the purpose for which the Treuhander had held the money. The Treaty gave compensation, and the tribunal which assessed the principal sum has assessed it on the basis of interest. I think this sum first came into existence by the award, and no previous history or anterior character can be attributed to it. It is exactly like damages for detention of a chattel, and unless it can be said that damages for detention of a chattel can be called rent or hire for the chattel during the period of detention, I do not think this compensation can be called interest. (pp 592–593)

In *Raja's Commercial College v Gian Singh & Co Ltd* [1977] AC 312, the Privy Council explained the *Bonner Maurice* case. Lord Fraser, who gave the judgment of the Privy Council, commenting on the above passage from the judgment in that case, said at p 322:

> The last sentence of that passage is no doubt quite accurate in relation to chattels which, if not detained, would have been used by the owner for his own purposes but it is not applicable to chattels which the owner would have let out on hire, for example a motor-car belonging to a car rental firm or a TV set owned by a rental company. In the Court of Appeal Lord Hanworth MR said that the compensation was for preventing the British national from exercising the power of disposition over his property and he went on to say, at p 602:
>
> > "The way to estimate that compensation or damages – the sensible way no doubt – would be by calculating a sum in terms of what interest it would have earned. That has been done, but the sum that was paid has not been turned into interest so as to attach income tax to it. It remains compensation and, for these reasons, it appears to me that it is not a sum which attracts or attaches income tax to it."

Refer also *Public Trustee v CIR* [1960] NZLR 365; *Marshall v Commissioner of Taxes* [1953] NZLR 335; *Whitaker v FCT* 98 ATC 4823.

The Commissioner considers that the situation in the *Bonner Maurice* case is analogous in that compensation under clause 3(c) is compensation for a loss of a capital nature which is calculated by reference to interest. The entitlement of the successful claimants to the amount would come into existence if their claim was successful but they have no previous entitlement to the payment of an amount representing a return on the net proceeds received by the Crown from the transfer of the Crown forestry assets to which the land returned relates.

The statutory definition of "interest" refers to a payment made "in respect of or in relation to money lent" except repayment of the principal sum: section OB 1. At its widest, "money lent" includes an "amount paid to, or for the benefit of, or dealt with in the interest of or on behalf of, any other person in consideration for an agreement or a promise to pay by the other person, where that amount is exceeded by the amount payable to the person in accordance with the agreement or the promise": para (d), definition of "money lent" in section OB 1. The Commissioner considers that a Treaty settlement in respect of Crown forestry land does not involve the successful claimants paying an amount to the Crown in consideration for an agreement by the Crown to pay a greater amount.

Therefore, the Commissioner considers that where compensation payments are determined under clause 3(c) and an imputed return is added to the net proceeds of sale in order to calculate the specified amount under clause 3(c), compensation payments would not (in the absence of section CB 5(1)(n)) be interest.

(f) *Income under ordinary concepts – section CD 5*

Whether a payment is of a capital or revenue nature depends on what the payment is calculated to effect from a practical and business point of view: *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634. The character of the asset transferred for the payment or the character of the cause of action discharged by the payment will ordinarily determine the character of the payment: *The Federal Coke Company Ltd v FCT* 77 AT 4255.

The stated purpose of the compensation paid under clause 2(a) of the First Schedule (that is, an amount equal to 5% of the "specified amount") is that it compensates for the fact that the land is returned subject to the rights of the licensee to continue to harvest trees on the land. A payment which represents compensation for the loss in value of land, that is a capital asset, or for interference with the ability of the claimants to use the land, is a payment of a capital nature: *Barrett v FCT* 15 ATD 149 and *Nullaga Pastoral Co Pty Ltd v FCT* 78 ATC 4329.

The Commissioner considers that payments of compensation under clause 2(a) of the First Schedule to the CFAA are not income as they are paid in order to compensate for the fact that the claimants do not immediately have full use of the land. The payments do not constitute consideration for a right to take something from the land, this right having previously been granted by the Crown to the licensee.

The successful claimants may also receive further compensation of an amount up to the balance of the specified amount. Settlements in respect of Crown forestry land and Crown forestry assets are settlements of claims for compensation in relation to historical breaches by the Crown of its obligation under the Treaty to protect the Mäori people in the use of their lands and other assets held at the time that the Treaty was signed. The CFAA applies only to forests which are principally exotic forests standing on Crown forestry land. In the *Crown Forests Assets* case the Court of Appeal referred to the possibility that the principles of the Treaty may not entitle Mäori to share equally in the ownership of exotic forests. The settlement (which is reflected in the CFAA) appears to acknowledge that possibility as, in terms of clause 2(b) of the First Schedule of the CFAA, the successful claimants would receive less than 100% of the value of the forests (the specified amount), if the Tribunal so determines.

The Commissioner considers that compensation under the First Schedule to the CFAA (however it is calculated) relates to capital assets of the claimants. The Commissioner, therefore, considers that the compensation payments are not income under ordinary concepts.

Conclusion

The issue of whether compensation under Crown forestry settlements is interest has been considered because it is not clear why compensation in relation to Crown forestry land settlements was exempt income in some cases but not others. Whether compensation under the CFAA is exempt income depends on the method used to calculate the amount of the compensation. One of those methods appeared to include an amount based on the time value of money: clause 3(c) Schedule to the CFAA. Compensation payments under the CFAA (except compensation calculated under clause 3(b), that is, compensation calculated by reference to market stumpage) are exempt income under section CB 5(1)(n). The question of whether compensation under the CFAA would be income in the absence of section CB 5(1)(n) has been considered in an attempt to ascertain the policy underlying the exemption.

Section CB 5(1)(n) applies to the extent that in the absence of that provision Crown forestry compensation payments would be gross income. Section CB 5(1)(n) does not, however, provide that such payments are income. The CFAA and section CB 5(1)(n) reflect the terms of the settlement between the Crown and the Mäori Council. It appears that the predecessor of section CB 5(1)(n) was enacted in order to confirm what the parties to the settlement considered was the existing position. The Commissioner considers that the better view is that the exclusion was not intended to alter the existing position, which was that compensation payments (however calculated) would not have been gross income under the predecessors of sections CD 3, CD 5, CE 1(1)(a) or (e), CE 2 or CJ 1. Compensation in relation to Crown forestry settlements would not be gross income under sections CD 3, CD 5, CE 1(1)(a) or (e), CE 2 or CJ 1 in the absence of section CB 5(1)(n).

Whether financial redress under Treaty settlements is income under the accrual rules

In most cases settlement legislation is required in order to ensure the finality of a Treaty settlement, to provide for Statutory Instruments, to remove statutory memorials from land titles in the claim area and to vest land in the claimant group, if normal administrative land transfer processes would not be appropriate. Therefore, there may be a delay between the settlement being agreed and payment being made. Settlements may be conditional upon the passing of settlement legislation.

For the accrual rules to apply there must be a financial arrangement. Paragraph (a) of the definition of "financial arrangement" in section EH 22(1) refers to a debt or debt instrument. The Commissioner considers that where a settlement is conditional on the passing of legislation to give effect to the settlement, the settlement does not give rise to a debt or debt instrument in terms of paragraph (a) of the definition of "financial arrangement", as the obligation to make payment will not be unconditional.

To be a debt or debt instrument, there must be an unconditional obligation to make payment: *Case Q2* (1993) 15 NZTC 5,005. In *Case Q2* Judge Willy said:

> The 1987 report of the Consultative Committee, Exhibit 3, contained an information release from the Office of the Minister of Finance relevant to this matter. In explaining the definition of "financial arrangement" the Minister says:
>
> > "The definition includes within the umbrella term financial arrangement or debt instrument. The term debt instrument has been used as it describes most financing arrangements involving the provision of credit in money or monies worth. The term debt instrument is intended to apply to every conceivable type of the [sic] provision of credit including all forms of Government commercial paper, Government stock, Treasury Bills, Kiwi Bonds and so on. And whether or not secondary market operators reconstruct split or hybridise such instruments. It is intended to include everything that is not equity and to avoid artificial distinctions based on technical legal rather than economic or substantial differences."
>
> It should be noted at this point that in law a "debt" is usually defined as a sum of money payable in respect of a liquidated money demand recoverable by action; *Rawley v Rawley* [1886] 1 QBD 460 or as it was put in *Ogdens Limited v Weinberg* (1906) 95 TLR 567 by Lord Davey.
>
> > "The word debt no doubt means something recoverable by an action for debt and nothing can be recovered in an action for debt except what is ascertained or can be ascertained. A claim for an amount which is uncertain and cannot be adjusted in an account cannot I think be justly called a debt."
> >
> > > In *Words and Phrases Legally Defined*, 3rd Edition, it is said that the legal definition of a debt is "a sum of money due by certain and expressed agreement". (p 5014)

This aspect of the judgment was not discussed in the appeal of the case (*CIR v Dewavrin Segard (NZ) Ltd* (1994) 16 NZTC 11,048).

For there to be a financial arrangement in terms of paragraph (b) of the definition, there must be:

- An arrangement;
- Under which [the Crown] receives money;
- In consideration for the Crown providing money to the claimant group at a future time.

The definition of "money" in section OB 1 includes "money's worth" whether or not it is convertible into money. In *McElwee v CIR* (1997) 18 NZTC 13,288 the High Court held that although a benefit need not be convertible into money to be "money's worth" for the purposes of the accruals provisions, it must be able to be valued. Therefore, the court held that a guarantee for no consideration was not a financial arrangement. The High Court accepted the following comments by Glazebrook & Oliver in *The New Zealand Accrual Regime – a practical guide* (1989) at p 51:

> The second operating principle of accrual income and expenditure calculations is that all benefits received and provided under a financial arrangement which are included in accrual calculations must be convertible into monetary equivalents. This principle is not explicit in the legislation but can be inferred from the fact that the accrual rules operate on what are essentially cash flow calculations. If a benefit is not given a monetary equivalent, it cannot be included in the accrual calculation. This is not to say that a benefit must in practice be convertible into money.... What is required is that the benefit be able to be assigned a monetary value.

The Commissioner considers that a Treaty settlement is not a financial arrangement under paragraph (b) of the definition of that expression as the payment made by the Crown is not "in consideration for" a benefit received by the Crown. Treaty settlement payments are made to compensate the claimants for past economic losses suffered as a result of the Crown's breaches of the Treaty rather than in return for anything provided to the Crown under a Treaty settlement. Undertakings or agreements given by the claimants under a Treaty settlement are merely part of the process by which settlement is effected.

Conclusion

The Commissioner considers that a Treaty settlement where payment is delayed until the passing of settlement legislation is not a financial arrangement. Where a Treaty settlement is conditional upon the passing of settlement legislation, the settlement is not a "debt or debt instrument". A Treaty settlement is also not a "financial arrangement" in terms of paragraph (b) of the definition of that term.

Claimant funding

The first stage in a direct negotiation with the Crown is that representatives of the claimant group must establish that they have a mandate to represent the members of the group and the Crown must accept that there is a well-founded grievance. Once that stage has been reached, the claimant group may apply to the Crown for reimbursement of the costs incurred in seeking a mandate (locating, registering and informing members of the claim). The claimant group can also apply for further funding for the cost of negotiating the Terms of Negotiation and for the costs of negotiating the final Deed of Settlement. The OTS publication says that the Crown will not necessarily provide full funding for negotiations. In assessing the amount of the Crown's contribution the OTS will take into account the following matters:

- The complexity of the claim;
- Whether there are any overlapping claims or interests that need to be taken into account;
- Whether there is consensus within the claimant group regarding the negotiations;

- The size of the claimant group and whether the members are scattered throughout the country;
- Whether consultation is likely to require hui to be arranged outside the main city centres.

The funding for the negotiation process is paid in instalments. Periodicity, recurrence and regularity are indicators that receipts are income but these factors are not conclusive: *Reid v CIR*. In order to determine the character of a payment in the hands of the recipient it is necessary to establish what is the consideration provided for the payment and if no consideration was given for the payment, the circumstances in which the payment is received must be considered: *Federal Coke*.

Although the timing of the payment of instalments is linked to milestones in the settlement negotiations, there is no obligation to repay instalments already received if milestones are not met. The OTS publication also makes it clear that the Terms of Negotiation and the Heads of Agreement are entered into on a "without prejudice" basis. Neither party is bound until the Deed of Settlement is finally executed following ratification.

At the time when funding is approved the Crown accepts that the claimant group has suffered from breaches of the Treaty and its principles. No funding is provided before the claimant group has established that it has a mandate because the Crown does not wish to be seen to take sides. The negotiations relate to the content of the settlement package, including what is to be included in the Crown's acknowledgement and apology, the nature of cultural redress and the nature or quantum of the assets or cash that are to be transferred to the claimants: see p 84 OTS publication.

The funding is provided by the Crown in order to facilitate the settlement of Treaty grievances. The benefit sought by the Crown from the provision of funding is comprehensive and lasting settlements. Comprehensive and lasting settlements are not possible unless they are supported by the members of the claimant group and unless all historical grievances are addressed in the settlement. Funding is provided to claimant groups to enable them to consult with their members and in order to enable all grievances to be dealt with in the settlement. The amount of the funding is determined by the complexity of the Treaty claim and by the degree of difficulty likely to be encountered by the claimant group in consulting with members and obtaining ratification of the settlement.

The Commissioner considers that claimant funding does not represent consideration for any income earning activity carried on by claimant groups and is not income under ordinary concepts. The funding is not a payment for a product or a service supplied by the claimants and is not income from a business. The funding is not made available for the provision of research to the Crown. Normally direct negotiations are undertaken in circumstances where sufficient historical research has already been carried out to enable the Crown to determine that there has been a breach. The OTS publication specifically says that the Crown does not provide funding for research (p 43 OTS publication). The negotiation process is not a business in itself and is not part of the ordinary business operations of a business carried on by a claimant group. Claimant funding is provided when it is accepted that there is a basis for a Treaty claim and the funding is provided in order to facilitate the comprehensive and lasting settlement of Treaty grievances by enabling claimant groups to consult with their members and by enabling all grievances to be addressed in the settlement.

Payment in the nature of a subsidy or grant in respect of a business carried on by claimant groups – section DC 1

Section DC 1(2) applies to a payment in the nature of a subsidy or grant in respect of any business carried on by a taxpayer made to the taxpayer by the Development Finance Corporation New Zealand or the New Zealand Film Commission or any department or instrument of the Executive Government of New Zealand and to expenditure in respect of which such a grant is made: section DC 1(1). The effect of section DC 1(2) is that any deduction allowable in respect of the expenditure incurred by the taxpayer in respect of which such a grant is made is reduced by the amount of the grant and the amount of the grant is deemed not to be gross income. Therefore, if section DC 1(2) applied, the expenditure equivalent to the amount of the claimant funding would not be an allowable deduction and the amount of the claimant funding would not be income.

The test of whether an entity is an instrument of the Executive Government of New Zealand is the degree of control which Ministers or central government agencies exercised over the entity: *CIR v Medical Council of NZ* (1997) 1 NZTC 13,088. The OTS which is subject to a high degree of control from its Minister and Cabinet is an instrument of the Executive Government of New Zealand. However, the Commissioner considers that even if claimant funding was a payment in the nature of a grant or subsidy, the claimant funding is not a grant made in respect of any business carried on by claimant groups. As outlined previously, the negotiation of a Treaty settlement is not a business, or part of any other business carried on by the claimant group or individual members of the claimant group. Therefore, section DC 1 does not apply to funding towards negotiating costs provided to claimant groups by the OTS.

Conclusion

The Commissioner considers that funding provided to claimant groups to cover the costs of negotiating a Treaty settlement is not an amount derived from any business carried on by a claimant group (section CD 3) and is not income under ordinary concepts (section CD 5). As the funding is not a payment in respect of any business carried on by a claimant group, section DC 1 does not apply.

Conclusions

The Commissioner considers that:

1. Financial redress paid by the Crown to a claimant group as compensation for historical breaches of the Crown's obligations under the Treaty:

    - is not gross income under section CD 3. The pursuit of a Treaty claim is not a business in itself as a Treaty claim is made to recover compensation for a loss for both economic losses and non-economic losses rather than with the intention of making a profit. Although some claimant groups or individual members of a claimant group may carry on a business, the payment would not be an amount derived from any business carried on by the claimant group as the payment is made to compensate for a loss of a capital nature, and

    - is not gross income under section CD 5 as the payments are made to compensate the claimant group for the loss of an asset of a capital nature. The payments do not involve a gain from property, do not involve the provision of services and are not made for undertakings given by the claimant group.

2. Compensation paid under the First Schedule to the CFAA on the return of Crown forestry land to a claimant group is exempt income under section CB 5(1)(n) where the amount of the compensation is calculated under clauses 3(a) and 3(b) of the First Schedule, that is, by reference to the market value of forests on the land returned or by reference to the net proceeds received by the Crown from the sale of the forests. In the absence of section CB 5(1)(n) compensation paid under the First Schedule to the CFAA (including compensation calculated by reference to market stumpage in terms of clause 3(b)) would not be income as the compensation:

    - is not gross income under section CD 3 as a Treaty claim does not constitute a business in itself and the compensation would not be an amount derived from any business that may be carried on by the claimant group or the members of a claimant group;

    - is not gross income under section CE 1(1)(e). The compensation is not an amount derived by the claimants from a licence or for the grant of cutting rights in respect of timber on the land or for the grant of a right of taking profits of the land. Licences and cutting rights are granted by the Crown to the licensees before the return of any Crown forestry land to a claimant group under a Treaty settlement. Past licence payments in respect of the land are held by the Crown Forestry Rental Trust for the benefit of the claimant group and future licence payments would be made to the claimant group in addition to compensation under the CFAA.

    - is not gross income under section CE 2. The compensation is not derived by the claimant group from the use or occupation of land. The compensation is paid, in part, as compensation for the fact that the claimant group does not immediately have the use and occupation of the land as the land is returned subject to the rights of the licensees.

    - is not gross income under section CJ 1. The compensation is not derived from the sale of timber, the right to take timber or standing timber. The right to take timber is sold by the Crown to the licensees before the return of the land to the claimant group.

    - where compensation is calculated under clause 3(c) of the First Schedule to the CFAA and includes an imputed return on the net proceeds of sale received by the Crown from the sale of the forests on the land, the compensation does not include interest which is gross income under section CE 1(1)(a). The compensation is not consideration for the use of money owed to or belonging to the claimant group, and is not paid in respect of "money lent", as defined in section OB 1.

    - is not gross income under section CD 5 as the payment is paid as compensation for the fact that the land is returned subject to the rights of the licensees (so that the ability of the claimant group to use the land is impeded) and as compensation in respect of capital assets of the claimant group.

3. Where the payment of financial redress under a Treaty settlement is delayed until settlement legislation is enacted, the financial redress will not be gross income under section CE 1(1)(c). A Treaty settlement does not constitute a financial arrangement as:

    - A settlement that is conditional upon the passing of settlement legislation is not a debt or debt instrument in terms of paragraph (a) of the definition of "financial arrangement"; and

    - A Treaty settlement does not constitute an arrangement under which the Crown receives money in consideration for the Crown providing money to the claimant group because any benefit received by the Crown under the settlement is an intangible benefit and is not, therefore, "money's worth".

4. Funding provided by the Crown through the OTS to a claimant group to enable the claimant group to carry out direct negotiations with the Crown in

respect of a Treaty settlement is not gross income under sections CD 3 or CD 5. The benefit sought by the Crown from the provision of the funding is the promotion of comprehensive and lasting settlements by enabling the claimant groups to consult with their members and by enabling all issues to be addressed in the settlement. The funding is not an amount derived from a business carried on by the claimant group as the negotiation process is not a business in itself and is not part of the ordinary business operations of the claimant group. The funding is not income under ordinary concepts as it is not consideration for any product or service provided by the claimant group.

TRAVEL BY MOTOR VEHICLE BETWEEN HOME AND WORK – DEDUCTIBILITY OF EXPENDITURE AND FBT IMPLICATIONS

This item contains guidelines for determining whether travel between home and work is deductible and when travel between home and work will be treated as work-related use (rather than private use or enjoyment) for FBT purposes. While this interpretation statement focuses on travel by taxpayers who provide services, the Commissioner has re-considered and confirms the statements in the booklet on *Rental income* (IR 264) relating to deductibility of travel expenditure incurred by taxpayers who rent out property.

The Commissioner's views in *Tax Information Bulletin* Vol 4, No 8 (April 1993), page 3 –"Shareholder Employees and FBT on Company Vehicles" on how it can be established that a vehicle provided by a company to a shareholder-employee is not available for private use remain unaltered.

This item supersedes an item on how travel between home and work should be categorised when business calls are made en route. See *Tax Information Bulletin* Vol 6, No. 9 (February 1995) and an item on "Travelling Expenses Between Two Places of Business – Position Explained" – *Public Information Bulletin* No 12 (July 1964).

Introduction

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

This item addresses:

- The circumstances in which expenditure on travel between home and work will be deductible;
- The interpretation of the expressions "business purposes" and "business use" in sections DH 1 to DH 4; and
- The circumstances in which travel between home and work will be treated as work-related use rather than "private use or enjoyment" for FBT purposes.

Summary

Deductibility of expenditure on home to work travel

The general rule is that travel between home and work is private travel and expenditure on such travel is not an allowable deduction as such expenditure is expenditure of a private or domestic nature. A deduction is allowable under section BD 2(1) for expenditure incurred in deriving income or necessarily incurred in the course of carrying on a business for that purpose, but expenditure that is of a private or domestic nature is not an allowable deduction: section BD 2(2)(a).

For travel between home and work to be deductible it is necessary to establish that:

- The need for the work to be performed partly at the home (and, therefore, the need for the travel) arises from the nature of the work; and
- The travel is in the course of performing work ("on work").

In cases relating to deductibility of travel expenditure between home and work (some of which relate to taxpayers who are employees), the following broad factual situations have been identified as circumstances where travel between home and work is regarded as business or work-related travel:

- Where a vehicle is essential for transport of goods or equipment necessary for the performance of employment duties at the home and elsewhere;
- Where the taxpayer carries on an "itinerant occupation" (that is, the taxpayer does not work from a fixed workplace and the home is the taxpayer's base of operations);
- Where the taxpayer is required to be accessible at the home for employment duties and is required to undertake travel in response to emergency calls; and
- Where the travel is "on work" between two workplaces, one of which is also the taxpayer's home.

FBT – private use or enjoyment

An employer who has provided or granted a fringe benefit to an employee is liable to pay fringe benefit tax ("FBT"): section ND 1. A benefit consisting of the private use or enjoyment (or the availability for private use) of a motor vehicle owned, leased, or rented by the person who makes it available to an employee is a fringe benefit: section CI 1. FBT is calculated according to the number of days on which a benefit consisting of the "private use or enjoyment" of a motor vehicle is provided: section CI 3(1).

"Private use or enjoyment" means travel that confers a benefit of a private or domestic nature. The definition of "private use or enjoyment" specifically includes travel to or from the person's home and any other travel that confers on the person a benefit of a private or domestic nature.

The fundamental issue is whether a private benefit has been conferred. The concept of private use or enjoyment imports a concept of a distinction between private use and work-related use. The provision of a vehicle for work-related use only does not constitute a benefit of a private nature. See *CIR v Schick* (1998) 18 NZTC 13,738.

For FBT purposes (as for deductibility purposes) travel between home and work will be private use unless:

- The need for the work to be performed partly at the home (and, therefore, the need for the travel) arises from the nature of the work; and
- The travel is "on work".

The fact that work is performed at the home (whether or not under a contractual obligation) is not sufficient. Travel between home and work would be private travel if the work is performed at the home because of the personal circumstances or personal preferences of the taxpayer.

The fact that a vehicle is taken to an employee's home for security reasons does not in itself mean that travel between the home and work is work-related travel.

Note: Even if travel between home and work is work-related travel (so that the use of a motor vehicle for that purpose is not private use) and there is no actual private use of the motor vehicle, the employer must establish that the vehicle is not available for private use. (The requirements necessary to establish that a vehicle is not available for private use are discussed in more detail below.)

Purpose of travel

The record-keeping requirements necessary to establish the proportion of business use of a motor vehicle are set out in sections DH 1 to DH 4. A deduction is permitted for the proportion of the expenditure which reflects the proportion of the business use of the vehicle to the total use of the vehicle: section DH 1(3). To be "business use" or use for "business purposes", the travel must be undertaken solely for a business reason. A journey is classified either as business use or not business use rather than the journey being apportioned on a mileage basis. Travel between home and work in the circumstances outlined above will be travel undertaken for a business reason.

For both deductibility and FBT purposes, where a journey undertaken for business purposes or work-related purposes includes a private component, the private travel would be disregarded and the entire journey would be classified as business travel in the following circumstances:

- The private benefit received is incidental to a journey that has been undertaken solely for business purposes or work-related purposes (being a private benefit that necessarily results from a journey undertaken for such purpose); or
- The private travel is de minimis (being a deviation for a private reason in the course of a journey undertaken for business purposes or in the course of performing employment duties that is a minor or insignificant part of the journey).

The circumstances in which an incidental private benefit or de minimis private travel will be disregarded (so that the entire journey is treated as business use) are discussed in more detail below.

Common principles relating to deductibility of motor vehicle expenditure and FBT

The test for determining whether travel expenditure is deductible and the definition of "private use or enjoyment" for FBT purposes are expressed in different terms. However, the tests raise essentially the same issues and require consideration of the same factors.

For both deductibility and FBT purposes:

- The fact that work is performed at the home is not sufficient. The need for the work to be performed partly at the home (and, therefore, the need for the travel) must arise from the nature of the work. Travel between home and work would be private travel if the work is performed at the home because of the personal circumstances or personal preferences of the taxpayer. For travel to be work-related travel, it is not sufficient that the employer and employee have contracted on the basis that employment duties would be performed partly at the home; and
- There is a distinction between travel undertaken to enable a person to commence work and travel on work. The exceptions to the general rule (that travel between home and work is private travel for deductibility purposes) relate to situations where the travel is on work rather than travel in order to commence work or travel from work. Travel by an employee in such situations would be travel for work-related purposes and would not constitute private use or enjoyment.

Legislation

Deductibility of travel expenditure

Section BD 2 provides:

(1) An amount is an allowable deduction of a taxpayer

(a) if it is an allowance for depreciation that the taxpayer is entitled to under Part E (Timing of Income and Deductions), or

(b) to the extent that it is an expenditure or loss

(i) incurred by the taxpayer in deriving the taxpayer's gross income, or

(ii) necessarily incurred by the taxpayer in the course of carrying on a business for the purpose of deriving the taxpayer's gross income, or

(iii) allowed as a deduction to the taxpayer under Part C (Income Further Defined), D (Deductions Further Defined), E (Timing of Income and Deductions), F (Apportionment and

Recharacterised Transactions), G (Avoidance and Non-Market Transactions), H (Treatment of Net Income of Certain Entities), I (Treatment of Net Losses), L (Credits) or M (Tax Payments).

(2) An amount of expenditure or loss is not an allowable deduction of a taxpayer to the extent that it is

(a) of a private or domestic nature, or

(b) incurred in deriving exempt income under Part C (Income Further Defined), D (Deductions Further Defined) or F (Apportionment and Recharacterised Transactions), or

(c) incurred in deriving income from employment, or

(d) incurred in deriving schedular gross income subject to final withholding, or

(e) of a capital nature, unless allowed as a deduction under Part D (Deductions Further Defined) or E (Timing of Income and Deductions), or

(f) disallowed as a deduction under Part D (Deductions Further Defined), E (Timing of Income and Deductions), F (Apportionment of Recharacterised Transactions), G (Avoidance and Non-Market Transactions), H (Treatment of Net Income of Certain Entities), I (Treatment of Net Losses), L (Credits) or M (Tax Payments).

Section DH 1 provides:

(1) Except as provided in this section, no deduction is allowed in relation to expenditure incurred by a taxpayer in respect of or in relation to a motor vehicle used in deriving gross income of a taxpayer.

(2) Nothing in this section or in sections DH 2 to DH 4 shall apply to disallow any deduction or allowance by way of depreciation—

(a) In relation to a motor vehicle that is not used for any purpose other than—

(i) The deriving of gross income; or

(ii) A purpose that constitutes a fringe benefit; or

(b) To a taxpayer who is—

(i) A company; or

(ii) A person whose sole income is income from employment.

(3) Where in any income year a motor vehicle is used by a taxpayer partly for business purposes and partly for other purposes, there shall be allowed as a deduction in that income year the proportion of all expenditure incurred by the taxpayer in relation to the motor vehicle that reflects the proportion of business use of the vehicle to its total use in that income year, as that business use proportion is determined in accordance with sections DH 2 to DH 4.

The phrases "business purposes" and "business use" are defined in section OB 1 as follows:

"Business purposes", or "business use", in sections DH I to DH 4, in relation to the use of a motor vehicle and to a taxpayer, means travel undertaken by the vehicle wholly and exclusively in deriving gross income of the taxpayer.

FBT – private use or enjoyment

Section ND 1(1) provides:

Subject to section CI 5, an employer who has provided or granted a fringe benefit to an employee is liable to pay a special tax by way of an income tax to be known as fringe benefit tax.

The definition of "fringe benefit" in section CI 1 includes:

…any benefit that consists of—

(a) The private use or enjoyment, in relation to the employee, at any time during the quarter or (where fringe benefit tax is payable on an income year basis under section ND 14) income year, of a motor vehicle owned, leased, or rented by the person who makes the motor vehicle available to the employee:

(b) The availability for the private use or enjoyment of the employee, at any time during the quarter or (where fringe benefit tax is payable on an income year basis under section ND 14) income year, of a motor vehicle that is so owned, leased, or rented:

being, as the case may be, private use or enjoyment, availability for private use or enjoyment, a loan, subsidised transport, a contribution to a fund referred to in paragraph (e), a specified insurance premium or a contribution to an insurance fund of a friendly society, a contribution to a superannuation scheme, a service referred to in paragraph (ga), or a benefit that is used, enjoyed, or received, whether directly or indirectly, in relation to, in the course of, or by virtue of the employment of the employee (whether that employment will occur, is occurring, or has occurred) and which is provided or granted by the employer of the employee;

The definitions of "benefit" and "private use or enjoyment" in section OB 1 read as follows:

"Benefit", in the definitions of "private use or enjoyment", "specified insurance premium", and "work-related vehicle", and in the FBT rules, includes the availability, for the private use or enjoyment of any person, of a motor vehicle that is owned, leased, or rented by another person:

"Private use or enjoyment", in the definitions of "benefit" and "work-related vehicle" and in the FBT rules, in relation to a motor vehicle and to any person, includes travel by the person in the motor vehicle in the course of proceeding to or from the person's home; and also includes any other travel by the person in the motor vehicle where that travel confers on the person a benefit of a private or domestic nature:

Provided that—

(a) Where the motor vehicle is required to be used by the employee for the purpose of making an emergency call in the course of the employee's employment, the day on which the employee departs from home to make that emergency call shall not be counted as a day on which the motor vehicle is available for the private use or enjoyment of the employee:

(b) Where an employee is required by the employer of the employee to use a motor vehicle in the course of the employment of the employee and the nature of the employment of the employee regularly requires the

> employee to be absent from home in the course of the employee's employment, the whole of each day in which that motor vehicle is used by the employee, while so absent from home, in the course of the performing of the activities of which that employment consists, where the period of absence is not less than 24 hours continuously, shall not, for the purposes of section CI 3, be counted as a day in which the motor vehicle was available for the private use or enjoyment of the employee,—

and, for the purposes of this proviso, the expression "day" means the continuous period of 24 hours ending at midnight:

Analysis

Income tax

General rule

A deduction is allowable under section BD 2(1) for expenditure incurred in deriving income or necessarily incurred in the course of carrying on a business for that purpose, but expenditure that is of a private or domestic nature is not an allowable deduction: section BD 2(2)(a).

Expenditure on travel between home and work is generally considered to be expenditure on private travel: see *Ricketts v Colquhoun* [1925] AC 1. The historical background to the general rule is explained by Lord Denning in *Newsom v Robertson* [1952] 2 All ER 728. Lord Denning noted that when income tax was introduced most people lived and worked in the same place. Therefore, it was considered that the need for travel between a taxpayer's home and work was dictated by the taxpayer's choice to live at a location different from the taxpayer's place of work. Lord Denning acknowledged that in the twentieth century generally taxpayers had limited choice as to whether to live "over their work". In *FCT v Collings* 76 ATC 4254 Rath J noted that the view that home and work is private travel because such travel relates to a taxpayer's choice of living in a location different from the taxpayer's place of work was based on history rather than reason. However, changes in the way people live and work have not resulted in the general rule established in case law being overruled. In *Lunney v FCT* 11 ATD 404 Dixon CJ commented:

> Both in Australia and in England the view has always prevailed that expenses of travelling from home to work or business and back again are not deductible. An explanation of how this rule came about in England is given by Denning LJ in *Newsom v Robertson*.
>
> ….
>
> The relevant provisions of the English Income Tax Acts are not in the same terms as those of the Australian law, but the whole course of English authority involves a like conclusion. To escape from the course of reasoning on which they proceed requires the taking of refined and rather insubstantial distinctions. I confess for myself, however, that if the matter were to be worked out all over again on bare reason, I should have misgivings about the conclusion. But this is just what I think the Court ought not to do. It is a question of how an undisputed principle applies. Its application was settled by old authority long accepted and always acted upon. If the whole subject is to be ripped up now it is for the legislature and not the Court to do it. (p 405)

Exceptions to the general rule

The exceptions to the general rule were summarised by Northrop J in *FCT v Genys* 87 ATC 4875 as follows:

However, the general proposition laid down in *Lunney*, notwithstanding that it remains good law, is not exhaustive. In *Garrett v FCT* 82 ATC 4060, the Supreme Court of New South Wales constituted by Lusher J held that it had no application to the following situations:

(a) where the taxpayer keeps necessary equipment or instruments at his home which he needs for the purpose of performing his work, and by reason of its bulk, such equipment needs to be transported by vehicle from the home to his place or places of work *and* where the equipment is used at home;

(b) where the taxpayer incurs expenses for travel between two places of business or work; and

(c) where the employment can be construed as having commenced at the time of leaving home.

A fourth situation, not enunciated in *Garrett,* is where the taxpayer travels between home and shifting places of work, ie an itinerant occupation. (para 28)

There is some overlap between the categories referred to in *Genys*. In *Garrett v FCT* 82 ATC 4060 Lusher J said:

> … where the nature of the employment or income earning activity can be construed as having commenced at the time of leaving the home, the expenditure on travel is a proper deduction. This can be illustrated by the commercial traveller whose engagement provides that his duties commence when he leaves his home with his samples which are kept there as part of his employment. Similarly, where equipment is transported from the home to the place of work by the taxpayer but the taxpayer's activities by which he earned income under a contract could be regarded as having been embarked upon either before or when he left his home so that the home in that sense became his base of operation from which he carried on his income earning activities the expenses become deductible. Expressed in other terms the contractual activities and requirements, by reason of their nature, in this sense are construed as being moved back anteriorly from the place of substantial performance to the earlier point or to the point of commencement of the journey. (p 4062)

Principles relating to deductibility of travel expenditure

The general rule (that travel between home and work is private travel) will apply unless :

- The need for the work to be performed partly at the home (and, therefore, the need for the travel) arises from the nature of the work; and
- The travel is "on work".

Work performed at the home for business reasons

For expenditure on travel between home and work to be deductible, the need for the travel must arise from the nature of the income earning activity carried on by the taxpayer and not from the personal circumstances or personal preferences of the taxpayer. Although the minority in the House of Lords in *Taylor v Provan* [1975] AC 194 disagreed on the proper inference to be drawn from the facts in that case, there was no disagreement that this was the correct principle to be applied.

Lord Reid (who was in the majority) said:

> *Ricketts* decided that if the place where a man resides is his personal choice he cannot claim with regard to expenses made necessary by that personal choice. **If the holder of an office or employment has to do part of his work at home the place where he resides is generally still his personal choice. If he could do his home work equally well wherever he lived then I do not see how the mere fact that his home is also a place of work could justify a departure from the *Ricketts* ratio.**
>
> I do not find it easy to discover the ratio decidendi of *Pook's* case. But that does not diminish the authority of the decision. I am sure that the majority did not intend to decide that in all cases where the employee's contract requires him to work at home he is entitled to deduct travelling expenses between his home and his other place of work. Plainly that would open the door widely for evasion of the rule. There must be something more.
>
> I think that the distinguishing fact in *Pook's* case was that there was a part time employment and that it was impossible for the employer to fill the post otherwise than by appointing a man with commitments which he would not give up. It was therefore necessary that whoever was appointed should incur travelling expenses. (p 208) [emphasis added]

(*Pook's* case (*Owen v Pook* [1970] AC 244) is discussed in detail below.) Lord Simon (who was in the minority) said:

> Applying the rule in *Ricketts v Colquhoun* [1926] AC 1 ie that the obligation to incur the expenses of travelling in question must arise out of the nature of the office or employment itself, and not out of the circumstances of the particular person appointed to the office or employed under the contract of employment - two different classes of travelling expenses readily come to mind. The first is where the office or employment is of itself inherently an itinerant one…. The second class of case is where the taxpayer has two places of work and is required by the nature of his office or employment to travel from one to the other. (p 221)

Lord Wilberforce (who was also in the minority) said:

> **To do any job, it is necessary to get there; but it is settled law that expenses of travelling to work cannot be deducted against the emoluments of the employment. It is only if the job requires a man to travel that his expenses of that travel can be deducted, ie if he is travelling on his work, as distinct from travelling to his work.** The most obvious category of jobs of this kind is that of itinerant jobs, such as a commercial traveller. It is as a variant upon this that the concept of two places of work has been introduced: if a man has to travel from one place of work to another place of work, he may deduct the travelling expenses of this travel, because he is travelling on his work, but not those of travelling from either place of work to his home or vice versa. **But for this doctrine to apply, he must be required by the nature of the job itself to do the work of the job in two places; the mere fact that he may choose to do part of it in a place separate from that where the job is objectively located is not enough**. The case of *Owen v. Pook* [1970] A.C. 244 brought out this distinction. The basis of the decision of the majority in that case (the minority holding the opposite) was that the nature of the office, or employment, of part-time anaesthetist and obstetrician required the doctor to work partly at his surgery and partly at the hospital. (p 215) [emphasis added]

Taylor v Provan does not relate to travel by vehicle, but the principle stated in that case (that the need for the travel must arise from the nature of the employment duties and not from the taxpayer's personal circumstances or personal preferences) is applicable generally. In *Burton v FCT* 79 ATC 4,318, where the taxpayer was a magistrate who was sometimes required to write judgments at his home at night, the court did not accept that expenditure on travel from and to his home was deductible as the work was performed at the home from personal preference:

> Necessity from the personal circumstances or the personal preferences of the taxpayer is not enough.
>
> A facet of the performance of the appellant's duties upon which counsel for the appellant placed some reliance was the practice of the appellant to write urgent reserved decisions at his home at night and the need to use his car to carry work associated written materials and books from his Beaufort Street chambers to his home to perform this task. There can be no doubt on the evidence that the appellant from time to time did write reserved decisions at his home but it is also clear that his chambers were available for his use at all times for this purpose. It was a matter of his personal preference that he performed this work at his home. (p 4,323)

Travel "on work"

A distinction has been drawn in case law between travel undertaken to enable a taxpayer to commence work and travel "on work" (travel in the course of performing work). In *Case F72* (1984) 6 NZTC 59,924 Judge Bathgate commented:

> Each case however must be related to its own facts, and usually involves consideration of when a taxpayer's work commences. Expenses incurred in the course of gaining or producing assessable income are deductible. The real question in the present context becomes whether the trip from one place to another (home to work) is travel "to one's work" and "from one's work" or is "on one's work." A dwellinghouse may be a place of work so that a trip from there to a place of work may be on one's work. This is all a question of fact. (p 59,928)

In *FCT v Payne* (2001) ATC 4027 the majority in the High Court noted that the test of deductibility did not permit a deduction for all expenses having some causal connection with the deriving of income and that what must be shown is a closer and more immediate connection. In *Lunney v FCT* 11 ATD 404 in the joint judgment of Williams J, Kitto J and Taylor J, it was said:

> It is, of course, beyond question that unless an employee attends at his place of employment he will not derive assessable income and, in one sense, he makes the journey to his place of employment in order that he may earn his income. But to say that expenditure on fares is a prerequisite to the earning of a taxpayer's income is not to say that such expenditure is incurred in or in the course of gaining or producing his income. (p 413)

Each of the exceptions referred to in *Genys* relate to situations where travel can be regarded in some sense as travel in the course of performing work rather than travel in order to commence work or travel from work.

Expenditure on travel which enables a taxpayer to commence income earning activities is not deductible but expenditure incurred on travel in the course of deriving income (travel "on work") is deductible: refer *FCT v Payne* 2001 ATC 4027. Travel costs are not deductible merely because the taxpayer cannot begin to perform work duties unless the travel is undertaken. For the costs of travel to be deductible, the journey between home and work must be undertaken "to complete some aspect of employment already under way when the journey commences" (see *FCT v Collings* 76 ATC 4254, 4262.

Therefore, generally travel from a taxpayer's home to the taxpayer's place of work (or to make the first business call of the day) and travel between the last business call of the day and the home would be private use, being travel to enable the taxpayer to commence work or after work has finished. Travel between the place where the first business call is made and the taxpayer's work base, or to make subsequent business calls, would be business use, being travel in the course of performing work.

Under the general rule it is irrelevant whether the travel is between the home and a regular workplace or between the home and a workplace that is not the taxpayer's regular workplace. In *Kirkwood v Evans* [2002] EWHC 30 Patten J commented that:

> …the costs of travelling directly from home directly to a temporary workplace would probably have fallen foul of the decision in *Ricketts v Colquhoun (Inspector of Taxes)* [1926] AC 1, that the choice of location of one's home was a matter of personal choice and not a necessity of the office or employment. That objection is no longer available to the Revenue provided that the employee or office holder needs to attend the temporary workplace, in order to perform his duties and the workplace is truly a temporary one. [para 15]

These comments indicate that in the absence of specific legislation, the general rule would apply to travel between the home and any temporary workplace (that is, such travel would be private travel although the travel is not to the taxpayer's regular workplace). (Under the UK Act, a deduction is not allowable for expenses of "ordinary commuting" or private travel: section 198(1) Income and Corporation Taxes Act 1988. Travel to a "temporary workplace" is not ordinary commuting.)

Circumstances where travel between home and work is not private travel

In cases relating to deductibility of travel expenditure between home and work (some of which relate to taxpayers who are employees) the following broad factual situations have been identified as circumstances where travel between home and work is "on work" rather than travel to enable the taxpayer to commence work:

- Where a vehicle is essential for transport of goods or equipment necessary for the performance of income earning activities at the home and elsewhere;
- Where the taxpayer carries on an "itinerant occupation" (that is, the taxpayer does not work from a fixed workplace and the home is the taxpayer's base of operations);
- Where the taxpayer is required to be accessible at the home for employment duties and is required to undertake travel in response to emergency calls; and
- Where the travel is for work purposes between two related workplaces, one of which is also the taxpayer's home.

1. *Vehicle essential for transport of goods or equipment*

Where a vehicle is used for the transport of goods or equipment necessary for the performance of income earning activities performed both at the home and at the taxpayer's normal workplace or workplaces, the use of the vehicle would be attributable to the transport of the goods rather than the transport of the taxpayer. For this exception to the general rule to apply:

- It is necessary (because of the nature of the income earning activity) to transport the goods or equipment to the taxpayer's home to enable the taxpayer to carry out the income earning activity at the home and to transport the goods or equipment to the taxpayer's usual workplace or workplaces; and
- A vehicle is required to transport such goods or equipment (because of their bulk or because the value, sensitivity or other special characteristics of the items transported make it impractical to transport such items without the use of a car). "Bulky" in this context means cumbersome. Whether an item or set of equipment is bulky will generally depend on the weight of the equipment and the relative ease of transporting or carrying it.

An example is *FCT v Vogt* 75 ATC 4073, where the taxpayer was a professional musician who performed at a number of venues and who was required to provide his own instruments and equipment. The taxpayer kept his instruments and equipment at his home and practised there. The taxpayer required a vehicle to transport his instruments (trumpet, flugelhorn, acoustic bass, electric bass and amplifiers) to performance venues because of their bulk. Waddell J held that the expenditure was deductible. He took into account the following matters:

> Firstly, the expenditure was incurred as part of the operations by which the taxpayer earnt his income. Secondly, it was essential to the carrying on of those operations: there was no other practicable way of getting his instruments to the places where he was to perform. Thirdly, in a practical sense, the expenditure should be attributed to the carriage of the taxpayer's instruments rather than to his travel to the places of performance. The mode of his travel was simply a consequence of the means which he employed to get his instruments to the place of performance, that is by carrying them in the motor vehicle which he drove.
> (p 4078)

The term "bulky" was used in the *Vogt* case. In *Crestani v FCT* 98 ATC 2219 the AAT discussed the meaning of that word. The AAT said:

> 7. ….I do not think that the term "bulky'' should be construed to refer only to an article which is of large size, such as the musical instruments which were the subject of the decision in *FC of T v Vogt* 75 ATC 4073. The term is, in my view, more aptly to be construed as similar to "cumbersome'' in the sense that it is not easily portable

In *Gaydon v FCT* 98 ATC 2328 the AAT said:

> 22. The question whether an item or set of equipment is bulky will generally depend on the weight of the equipment and the relative ease of transporting or carrying it.

In *Scott v FCT (No 3)* 2002 ATC 2,243 the AAT considered that this exception to the general rule was not limited to items that require special transport arrangements because of their physical characteristics. The AAT considered that the value, sensitivity or other special characteristics of the items transported may also make it necessary to transport such items by car. The AAT said:

> 15. I think the exception is broader than that. A taxpayer may think it is necessary to make special arrangements to transport essential items to his workplace for reasons other than their size or weight. An item that is essential to a business might have other features or attributes that make special transport arrangements appropriate. The simplest example is valuable items, like jewellery or cash. But it is easy to imagine items that are awkward to transport. Items that have a noxious smell, or which are offensive or which might scandalise or embarrass other people might require special arrangements for their transport. The taxpayer may be uncomfortable transporting the items in the usual way, and could therefore justify making a claim for the cost of transporting those items through alternative means. He or she is free to "hitch a free ride to work'' on those items: *U107* at 652.

The *Scott* case concerned a dentist who was required to transport confidential patient files and wax denture moulds between his home and a secondary surgery which did not have much equipment. Because of the size and shape of the moulds, it was not possible to carry the items in a briefcase or a box that could be sealed. The AAT accepted that transport costs were deductible on the basis that special arrangements were necessary to transport the items because of their sensitivity and value:

> 16. Dr Scott carried cash (although not in large amounts) and patient files including, on some occasions, x-rays. The files were confidential. The wax moulds were also grotesque. He said a patient would be disturbed if she knew that her dentures were being ogled by the dentist's fellow passengers on a bus.
>
> 17. While it is easy to imagine better examples of items that might be regarded as awkward to transport in the sense that I have described, I am satisfied Dr Scott should be able to claim the cost of making the special arrangements for transporting the goods in his own vehicle. He was carrying items that were sensitive and valuable. He (and his fellow travellers were he to use public transport, and his patients) might feel distinctly uncomfortable were the contents of the box to spill or be observed by others. Since the evidence suggests the contents of the box might be visible to others because it often could not be sealed, special arrangements for its transport were justified. It follows that the cost of those arrangements should be an allowable deduction.

2. *Itinerant occupations*

An occupation would be regarded as an itinerant one if the following conditions are satisfied:

- The taxpayer's home is the taxpayer's base of operations. (In *Taylor v Provan* [1975] AC 194 Lord Wilberforce regarded a situation where a taxpayer had two fixed workplaces, one of which was the home, as a variation of a situation where a taxpayer carries on an "itinerant occupation"); and
- The nature of the taxpayer's income earning activity is such that travel is essential to the carrying out of the activity; and
- The taxpayer is required to undertake work at a number of workplaces during the course of a day or the sequence of workplaces and the periods of time spent by the taxpayer at each workplace vary and are unpredictable so that it is impractical for the taxpayer to carry out the income earning activity without the use of a car; and
- The taxpayer can be regarded as travelling in the performance of the taxpayer's work from the time of leaving home.

These criteria are drawn from the following cases on deductibility of travel expenditure: *Horton v Young* [1971] 3 All ER 412; *Gaydon v DFC of T* 98 ATC 2328; *FCT v Wiener* 78 ATC 4006; *FCT v Genys* 87 ATC 4875.

In *Wiener*, the taxpayer was a teacher who taught at five different schools from Monday to Thursday. On Friday she taught at one school and did the administrative work associated with the teaching programme. The court considered that the taxpayer's employment was an itinerant one. The nature of the job made travel in the performance of the duties essential and it was an implied term of her employment that she provide her own means of transport. A motor vehicle was necessary to enable the taxpayer to comply with her teaching timetable. The taxpayer could be said to be travelling in the performance of her duties from when she left home to when she returned home.

In *Genys*, the court did not accept that the fact that the taxpayer (a nurse who was employed at various hospitals through an employment agency) did not have permanent employment at one hospital was sufficient for her occupation to be an "itinerant" one. The court considered that the taxpayer's duties did not commence until she arrived at the hospital. She merely drove from home to work and back again. The court considered that if the taxpayer in *Wiener* had been employed at one school on each day of the week, each school would have been regarded as a fixed place of work: see p 4883.

3. *Travel in response to emergency calls*

That an employee travels to and from work in response to a telephone call is not sufficient to make the travel work-related travel. For example, it was considered that the work duties of an airline pilot who was on call did not begin until the pilot arrived at the airport and travel between the pilot's home and work was private travel: *Nolder v Walters* 15 TC 380. Also, travel by the taxpayer in *Genys* was private travel as the taxpayer was not obliged to accept the work offered and her duties did not commence until her arrival at the hospital.

If an employee elects to carry out some work duties at home and is consequently required to travel to the employee's usual workplace in response to a call, travel between the employee's home and work would still be private travel. The requirement for the employee to perform work duties at the home and to be accessible at the home for emergency calls must be a consequence of the nature of the employee's duties. Examples of such a situation are: *Owen v Pook* [1970] AC 244 and *FCT v Collings* 76 ATC 4254.

In *Owen v Pook*, a doctor (who was in practice as a GP and who was also employed part-time by a hospital for emergency cases) was required to be accessible by telephone at home. On receipt of a phone call from the hospital the taxpayer gave instructions to the hospital staff before leaving for the hospital or advised treatment by telephone. The majority in the House of Lords considered that the taxpayer carried out his duties in two places, namely, at the hospital and at his home and that the taxpayer had commenced his employment duties at the home before travel commenced. Lord Guest said:

> In *Ricketts v. Colquhoun* there was only one place of employment, Portsmouth. It was not suggested that any duties were performed in London. In the present case there is a finding of fact that Dr. Owen's duties commenced at the moment he was first contacted by the hospital authorities. This is further emphasised by the finding that his responsibility for a patient began as soon as he received a telephone call and that he sometimes advised treatment by telephone ... There were thus two places where his duty is performed, the hospital and his telephone in his consulting room. If he was performing his duties at both places, then it is difficult to see why, on the journey between the two places, he was not equally performing his duties ... It follows that he had to get from his consulting room to the hospital by car to treat the emergency. The travelling expenses were, in my view, necessarily incurred in performance of the duties of his office. [pp 256–257]

In *Collings*, the taxpayer was employed as a computer consultant who had been sent to the US for special training in relation to a major conversion in computer facilities of her employer. Her normal hours of work were from 8.30 am to 5.30 pm, but she was also required to be on call for the remainder of the 24 hours of the day and on weekends. It was normal for her to receive calls and to give telephone advice to workers at the office at any time of the day or night. The taxpayer was provided with a computer which was connected to the office computer, in order to assist in diagnosing and correcting computer faults from home. If the problem could not be dealt with at home, the taxpayer was required to go into the office.

The taxpayer did not claim that her normal daily journeys between home and work were business journeys. The issue in the case was whether expenditure relating to the "special journeys" in response to calls for assistance was deductible. However, the following passage from the judgment indicates that if the court had been required to determine whether expenditure on the normal daily journeys was deductible, the court would have considered that such expenditure was private expenditure:

> **It seems to me that the proposition that expenses of travel between the taxpayer's residence and his place of work are not allowable deductions under sec. 51 has its basis in a specific viewpoint that such expenses are of a private nature, and not in any compulsion of the words "incurred in gaining or producing the assessable income" or in any of the criteria formulated for applying those words in particular cases. That such expenses are essentially of a private nature has derived from a view that a man's choice of a home in a location different from work is a decision relating to his private living.** The historical origins of this view, and the anomalies inherent in it, are explained by Denning LJ (as he then was) in *Newsom v Robertson* [1953] 1 Ch 7 at p 17). The relevant passages are quoted in the joint judgment in *Lunney's* case (100 CLR at p 499–500) and are referred to by Dixon CJ (at p 485).

> Thus the question in the present case resolves itself into whether a principle, that appears to be grounded in history rather than reason, should be extended to a case such as the present when a business element is present in the journey from home to work, if not from work to home. **I am not concerned with those normal daily journeys that have their sole relation to a person's choice of his place of residence; I am concerned with journeys which begin as a result of performance of duties of the employment at the taxpayer's home**. (p 4262) [emphasis added]

Rath J considered that expenditure on travel undertaken by the taxpayer between home and work in order to resolve a problem or malfunction of the employer's computer was deductible as the expenditure was incurred in the course of performing employment duties commenced at the home ("on work"). Expenditure on the special journeys was, therefore, deductible. Rath J commented:

> There were two separate and distinguishable facets of her employment. On the one aspect she commuted regularly to her work; on the other she had a different set of functions, namely to be ready at call at all other times, night or day or on weekends to work at problems of malfunctioning of the computer, with the aid of such information as she could obtain on the telephone, and with or without the aid of her portable terminal. Lord *Reid* said (in *Taylor v. Provan*) that it was necessary, in *Owen v. Pook,* that whoever was appointed should incur travelling expenses. Similarly it would, in a practical sense, be necessary for any person on duty 24 hours a day seven days a week to incur travelling expenses. Adapting the words of Lord *Morris* (p 211), the journeys to and from home were made necessary by the very nature of the employment and of the taxpayer's duties. The taxpayer here, as much as in *Taylor v. Provan,* had a "very special" employment (cp. p 212). She was not really in a position similar to those "thousands of employees" that Lord *Donovan* referred to (in *Owen v. Pook,* p 261) who have to be on stand-by duty at their homes and are required to obey a summons to cope with some emergency. It may or may not be that those "thousands of employees" cannot deduct the expenses of emergency travel; but the case of the present taxpayer is clearly different, for she was engaged upon a special assignment, and was continuously on duty, wherever she was. **The taxpayer is not in this case choosing to do part of the work of her job in two separate places (cp. Lord *Wilberforce* in *Taylor v. Provan,* at p 215). Unless she were to spend all her time in the office with the computer, she must have more than one place of work. Hers is not the freedom of choice of a barrister who does some of his work at home (*Newsom v. Robertson* (1953) 1 Ch. 7). Her double work-location is not only not merely colourable, but the two places of work are a necessary obligation arising from the nature of her special duties (cp. Lord *Simon,* p 222)**. The taxpayer's employer had gone to the expense of having the taxpayer specially trained in the United States so as to be capable of effecting and supervising the computer conversion. The employer had to have her, as a person so uniquely qualified, available at all times for the conversion. It seems to me that the circumstances of this case are closer to those of *Taylor v. Provan* than to those of *Owen v. Pook,* and are thus more strongly in favour of the taxpayer (cp. Lord *Salmon,* p 227). None the less the analogy with *Owen v. Pook* is close. When called at her home, the taxpayer immediately had the responsibility of correcting the malfunction in the computer. She might there and then diagnose the trouble, and provide the remedy; or she might decide that she would have to make the journey to the office, and if she took this course she was during the journey on duty in regard to the particular problem that had arisen. The circumstances of her case contrast sharply with the case of the airline pilot on call (*Nolder v. Walters* 15 T.C. 380). In that case the expenses of the pilot's telephone were also disallowed, and here again there is a contrast between the pilot's use of the telephone and the use that the taxpayer in the present case makes of the telephone. *Rowlatt* J. said (p 388):
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> > "He has to be at the office, wherever he has to start from, and I think the telephone is in the same position. It is a mere question of communicating with him with a view to him coming to the office to do his duties, which begin when he gets there; and, of course, when I say the office I mean in this case the aerodrome; the place of employment. That is all it is, and it seems to me that both those heads are clearly outside the rule." [emphasis added] (p 4268)

In each case it is necessary to consider whether the taxpayer's work commenced at the home. Travel by the taxpayer in *Collings* in response to emergency calls was travel to complete work commenced at the home but the taxpayer's normal daily travel was travel to put the taxpayer in the position of being able to commence work and was private travel.

The mere fact that a taxpayer is required to be accessible at the home to receive business calls is not sufficient. The taxpayer in *Nolder v Walters* was required to travel to the airport in order to commence work there but did not travel between home and work in the course of performing work. In *Pitcher v DFC of T* 98 ATC 2190 (which concerned a radiographer who was required to be on-call after hours but was not paid to be on-call) the AAT said:

> As the Applicant accepted, she received the calls and in response to them travelled to the hospital to perform her duties there. Unlike the taxpayers in *Collings* and *Owen v Pook*, her home could not be described as a place at which work was performed; it was by contrast merely the place at which she received the calls. (para 14)

A second journey to the workplace after an evening meal or travel undertaken at the weekend is not business travel merely because the travel is undertaken outside normal business hours. In *Case M99* 80 ATC 691 the taxpayer was a public servant whose duties involved the carrying out of independent research. The taxpayer's ordinary hours of work were a minimum of 36¾ hours a week to be worked between 8 am and 6 pm, Monday to Friday. However, the taxpayer often returned to work in the evenings and worked on weekends in order to do something that had to be done at that particular time for the success of his research. The AAT held that the weekend and evening journeys had the same character as the usual morning and afternoon journeys. The AAT said:

> 10. There is no doubt that that principle applies where a person chooses to travel to his home for his midday meal, and then to travel back to the place of work. By analogy that principle applies also where, say a barrister finds it is essential for him to return at night to his city chambers for a conference after he has had his evening meal at his suburban residence. Thus the application of *Lunney and Hayley* is not excluded where the journey is merely any daily journey from home to work and return; nor is it excluded where the second such journey is, in the opinion of the claimant, a compulsory one for the proper conduct of work.

The taxpayer in *Case M99* was not travelling in the course of performing work but was merely travelling to work and from work. The travel to the home in the evening was for a private purpose (to have dinner) and the travel back to work was no different from the normal daily journey.

4. *Travel between two workplaces (one of which is the taxpayer's home)*

It is not sufficient to establish that the home is a workplace. For expenditure to be deductible, the need for the work to be performed at the home and, therefore, the need for the travel must arise from the nature of the work and not from the personal choice or personal circumstances of the taxpayer: see *Ricketts v Colquhoun* [1926] AC 1; *Taylor v Provan*; *Burton v FCT* 79 ATC 4,318; *Miners v Atkinson* [1995] STC 58; *Kirkwood v Evans* [2002] STC 231 (discussed in more detail below).

There is also a distinction between travel to enable the taxpayer to commence work and travel in the course of performing work. Travel to enable the taxpayer to commence work is not deductible. Travel between home and work would be travel "on work" rather than travel to enable the taxpayer to commence work in the following circumstances:

- If the taxpayer had commenced work at the time of leaving the home or before the taxpayer leaves the home to travel to work; or
- Where travel to the home is undertaken in the course of performing work in order to complete the work at the home.

Travel between a workplace at the home and another workplace would be work-related travel only where the two workplaces relate to the same income earning activity. In *FCT v Payne* 2001 ATC 4027 the taxpayer was employed as an airline pilot and also operated a deer farming business at a property where he lived with his family. By a majority, the High Court of Australia held that expenditure incurred in travelling between the farm and the airport was not deductible. Travel between a workplace relating to one income earning activity and a workplace relating to a different income earning activity was no different from travelling from home to work in order to enable a taxpayer to commence work:

> 14. When, as here, the travel is between two places of unrelated income derivation, the expense cannot be said to be incurred "in the course of" deriving income from either activity. As the majority of the Full Court [99 ATC 4391 at 4399] recognised in this case:
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> "…The expenditure was incurred before [the taxpayer] began to perform his duties as a pilot, or after he had fulfilled those duties. Similarly, in relation to the deer farming business." [99 ATC 4391 at 4399]
>
> The expenditure was, as the majority of the Full Court rightly said, "not incurred in the course of his employment as a pilot, nor in the course of his deer-farming business". The taxpayer's travel occurred in the intervals between the two income-producing activities. The travel did not occur while the taxpayer was engaged in either activity. To adopt and adapt the language used in *Ronpibon*, neither the taxpayer's employment as a pilot nor the conduct of his business farming deer occasioned the outgoings for travel expenses. These outgoings were occasioned by the need to be in a position where the taxpayer could set about the tasks by which assessable income would be derived. In this respect they were no different from expenses incurred in travelling from home to work. (pp 4030-4031)

The Commissioner now considers that the item "Travelling Expenses Between Two Places of Business" in *Public Information Bulletin* No 12 (July 1964) does not correctly state the position. The item, which is based on *A v Commissioner of Inland Revenue* 6 AITR 47, is not consistent with the view of the Court of Appeal in *CIR v Banks* (1978) 3 NZTC 61,236 that for expenditure to be deductible it must be incurred in the course of deriving income. The consequence of that approach is that a distinction is drawn between travel to put a taxpayer in the position of being able to commence work and travel "on work" (travel in the course of deriving income). *FCT v Payne* is an example of a case where the court drew that distinction, with the result that a deduction was not allowed for travel between workplaces relating to different income-earning activities. See also the comments of Judge Bathgate in *Case F72* (1984) 6 NZTC 59,924 referred to above, where the judge considered that to determine whether travel expenditure was deductible generally consideration was required of when work commenced.

Record keeping requirements – sections DH 1 to DH 4 of the Income Tax Act 1994

Motor vehicle expenses are not deductible except as provided in section DH 1. Sections DH 1 to DH 4 (which concern the record-keeping requirements necessary to establish the proportion of business use of a motor vehicle that is used partly for business purposes and partly for other purposes) do not apply to companies or to taxpayers whose sole income is income from employment, nor do they apply in relation to a motor vehicle that is used only for the deriving of income or for a purpose that constitutes a fringe benefit: section DH 1(2)(a).

Section DH 1(3) requires apportionment of expenditure in relation to a motor vehicle that is used partly for business purposes and partly for other purposes. A deduction is permitted for the proportion of the expenditure which reflects the proportion of business use of the vehicle relative to the total use of the vehicle: section DH 1(3). The business use proportion of a vehicle, for the purpose of section DH 1(3), is determined in accordance with sections DH 2 to DH 4. Under sections DH 2 and DH 3, the business use proportion may be established from:

- Complete and accurate records of the reasons for and distance of journeys undertaken by a motor vehicle for business purposes and such other details as the Commissioner may require; or
- A logbook including these details which is maintained for a test period: section DH 2(2).

Where a taxpayer has not maintained actual records for any period or the logbook test period provision does not apply, the business use proportion of the vehicle for that period would be limited to the lesser of the proportion of actual business use and 25% of the total use of the vehicle during that period: section DH 4.

"Business use" or use for "business purposes"

"Business use" or use for "business purposes" is travel undertaken wholly and exclusively in gaining or producing the taxpayer's gross income: see definition of "business purposes" or "business use" in section OB 1. To be "business use" or use for "business purposes" the travel must be undertaken *solely* for a business reason. In circumstances where (in line with the principles outlined above) travel between home and work is business travel, such travel would be "business use" or use for "business purposes".

In each case, the question is: what was the objective to be served by the travel. See *Bentleys Stokes and Lowless v Beeson* (1952) 33 TC 491; *Mackinlay v Arthur Young McClelland Moores & Co* [1990] 2 AC 239. To be travel undertaken "wholly and exclusively in deriving gross income", the advantage gained or sought to be gained from the travel must be the deriving of gross income and no other purpose. A journey is classified either as business use or not business use rather than the journey being apportioned on a mileage basis. This follows from the "wholly and exclusively" test. A journey undertaken for a business purpose which includes a material deviation for a private reason is not "travel undertaken …wholly and exclusively in deriving gross income of the taxpayer". Section DH 2, which requires taxpayers to maintain details of the reasons for and distance of journeys undertaken by a vehicle for business purposes, also contemplates that a particular journey will be either business use or not business use.

Travel undertaken *solely* for a business reason which necessarily also results in an incidental private benefit being received by the taxpayer would still be "business use" and the costs of the travel would be deductible: see *Bentleys Stokes and Lowless v Beeson* (1952) 33 TC 491; *Mallalieu v Drummond* 57 TC 330. A private benefit received by a taxpayer would be disregarded where travel has been undertaken solely to achieve a business objective but the travel also has an effect of providing a private benefit to the taxpayer. Such an incidental private benefit would arise where the transport of the taxpayer is a necessary consequence of travel undertaken for business purposes. For example, if it is essential for a taxpayer to use a vehicle to transport business goods or equipment (because of their bulk, weight or other special characteristics) between home and work in the course of carrying out income earning activities, the journey would be "business use", notwithstanding that the taxpayer is also transported. An incidental private benefit could also arise where a taxpayer is able, in the course of a journey undertaken for business purposes, to also go to a private destination without travelling any additional distance to do so. For example, if a taxpayer, who is travelling to a business destination, must pass a dairy in order to reach the business destination and stops at the dairy for personal shopping, the private benefit received would be incidental to the business use of the vehicle for the purpose of sections DH 1 to DH 4 and the costs of the journey would still be deductible.

Conversely, the performance of incidental tasks such as picking up mail or newspapers or making a business call on the way to work (when travel between home and work is not business travel) would not make the trip business travel. In *Sargent v Barnes* [1978] STC 321 the taxpayer was a dentist who had a laboratory one mile from his home and 11 miles from his surgery. The laboratory was maintained for the purpose of the repair, alteration and making of dentures. Each morning on his way to the surgery the taxpayer spent about ten minutes at the laboratory to collect completed work. Each evening after closing his surgery the taxpayer called at the laboratory to deliver dentures and other articles to the technician working there. Oliver J considered that the journey was essentially a private journey (travel between home and work) and the intermediate stop did not alter the character of the travel and, therefore, expenditure on such travel was not incurred wholly and exclusively for business purposes:

> In seeking to assess, on the facts as found by the commissioners, the taxpayer's purpose in incurring the expenditure here in question, counsel for the taxpayer points to the fact that he paused in his progress to the surgery to discuss matters with the technician and that he sometimes spent up to an hour with him in the evening, even carrying out work on dentures himself. But the interruption of a journey, whether for five minutes or for a longer period, does not alter the quality of the journey, although it may add to its utility. At highest, as it seems to me, it merely furnishes an additional purpose.

> Of course, it is right to say that if I notionally interrupt the taxpayer's journey at an intermediate point between the laboratory and the surgery and ask myself the question 'Why is he on this particular road at this particular time?' I may come up with the answer that he is taking that particular route because it passes the laboratory. But, as counsel for the Crown points out, that is not the right question**. What the court is concerned with is not simply why he took a particular route (although that may be of the highest relevance in considering the deductibility of any additional expense caused by a deviation) but why the taxpayer incurred the expense of the petrol, oil, and wear and tear and depreciation in relation to this particular journey."** (p 328) [emphasis added]

In each case the question is: what is the real purpose of the journey? If travel between home and work is private travel but the taxpayer plans a journey so as to incorporate a deviation through a place of work where the taxpayer has no business to do, the deviation would not alter the nature of the journey. In *Sargent v Barnes* Oliver J made the following comments in relation to the taxpayer's argument that once it was established that the laboratory was a place of business, a deduction was allowable:

> Now the assumption here is that the expense of travel between two places of business is always and inevitably allowable, and counsel for the taxpayer bases himself on this passage in the judging of Lord Denning MR in *Horton v Young* [1971] 3 All ER 412 at 415, [1972] Ch 157 at 168, 47 Tax Cas 60 at 71:
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> > "If the commissioners were right it would lead to some absurd results. Suppose that Mr Horton had a job at a site 200 yards away from his home, and another one at Reigate, 45 miles away. All he would have to do would be to go for five minutes to the site near home and then he would get his travelling expenses to and from Reigate. I can well see that he could so arrange his affairs that every morning he would have to call at a site near home. Instead of going to that absurdity, it is better to hold that his expenses to and from his home are all deductible.'
>
> I question, however, whether, in that passage, Lord Denning MR intended to suggest that by deliberately planning your journey to your place of work so as to incorporate a deviation through another place of work where you actually have no business to do you alter the quality of the journey. (p 327)

Example 1

A taxpayer has two places of work. One workplace (A) is situated in a town which is 20 km from the taxpayer's home. The other workplace (B) is located 2 km from the taxpayer's home. Normally, on four days of the week the taxpayer works from A and on the other day the taxpayer works from B. Sometimes the taxpayer travels between A and B during the day. The taxpayer travels from A to the taxpayer's home but chooses to deviate through B, although there is no business reason for the taxpayer to do so.

The travel between home and work would generally be private travel as the taxpayer cannot alter the character of the journey by deliberately planning the journey to the taxpayer's place of work so as to incorporate a deviation through another place of work where the taxpayer has no business to do: see *Sargent v Barnes.*

A journey undertaken for business purposes which involves a deviation of no significant distance for a private reason would be classified as business travel. The broad principle to be applied is that to be business use, any additional distance travelled for a private reason in the course of a journey undertaken for business purposes must be insignificant in comparison with the total journey. Both the additional distance travelled for a private reason and the proportion of the total journey which the private use represents need to be taken into account. Where a significant proportion of the journey involves travel undertaken for private purposes, the journey would not be business travel (even if the private component involves only a short distance). As a guideline, the Commissioner considers that private travel that represents the lesser of approximately 2 km or approximately 5% of the journey would be minor or insignificant.

Example 2

A taxpayer is a self-employed plumber whose home is his base of operations. He goes to the gym on his way home at the end of the day. The stop at the gym involves the taxpayer travelling an alternative route from the last job of the day to the home work base which adds 1 km to the journey. The total journey is 17 km. The travel to the gym (5.8% of the journey) would be minor or insignificant private use.

Example 3

A taxpayer is employed as a midwife. The taxpayer does not work from a fixed base and her duties require her to visit all of her clients at regular intervals during their pregnancy and to be present at the birth of their babies. On a particular day the journey from the taxpayer's last call of the day to her home would have been a distance of 3 km. However, instead of going direct to her home, the taxpayer travelled to a resthome to visit her father. The visit to the rest home added an additional distance of 2 km to the journey. The travel to the rest home (40% of the journey) is not minor or insignificant and the journey would not be minor or insignificant private use.

If there was a material deviation for a private reason (an additional distance travelled representing a significant proportion of the journey) the journey would not be business use for the purpose of section DH 1(3). However, in some cases travel involving an intermediate stop between two points could be two journeys rather than a single journey. Whether this is so depends on

what the real purpose of the journey is and whether the intermediate stop is incidental to the entire journey: see *Sargent v Barnes*. For example, if a taxpayer travels to the taxpayer's office in order to carry out substantive business activities there and then travels to another place for business purposes, there would be two journeys and (assuming that travel between the taxpayer's home and work is private travel) the first journey would be private.

Example 4

A taxpayer travels from home to the taxpayer's office to pick up some papers required for a meeting at a client's office and then travels to a client's office. The journey would be a single journey for one purpose, the stop at the taxpayer's office being incidental to the journey.

Example 5

A taxpayer travels from home to the taxpayer's office where the taxpayer has appointments with clients. Later in the day, the taxpayer travels to a supplier's premises for a meeting. The journey to the taxpayer's office and the journey to the supplier's premises are separate journeys.

To summarise, to be "business use" or use for "business purposes" the travel must be undertaken *solely* for a business reason. A journey is classified either as business use or not business use rather than the journey being apportioned on a mileage basis. Where a journey undertaken for business purposes includes a private component, the private travel would be disregarded and the entire journey would be classified as business travel in the following circumstances:

- The private benefit received is incidental to a journey that has been undertaken solely for business purposes (being a private benefit that necessarily results from a journey undertaken for such purpose). For example, if a taxpayer is required to transport heavy or bulky business equipment between home and work in order to perform income earning activities at the home and another workplace and a vehicle is essential for that purpose, the transport of the taxpayer would be incidental to the transport of the business equipment. If a taxpayer made a stop at a dairy on the way to a business destination and did not follow a particular route to enable the taxpayer to make the stop, the private benefit would also be incidental. However, if a taxpayer made a deviation on a business journey in order to pick up children from school, then the journey would be undertaken for both a private and a business reason and would not, therefore, be business use (being travel that is undertaken wholly and exclusively in deriving gross income of the taxpayer); or
- The private travel is de minimis (being a deviation for a private reason in the course of a journey undertaken for business purposes or in the course of performing employment duties that is a minor or insignificant part of the journey). (If the private travel is more than a minor or insignificant part of the journey, the journey would not be business use. However, in some cases travel involving an intermediate stop between two points could be two journeys rather than a single journey.)

FBT – private use or enjoyment

Distinction between private use and work-related use

FBT is chargeable where a fringe benefit consisting of the private use or enjoyment (or availability for private use or enjoyment) of a motor vehicle is provided by an employer to an employee.

In *CIR v Schick* (1998) 18 NZTC 13,738, Gallen J considered that the term "private use or enjoyment" imported the concept of a distinction between work-related use and private use. The fundamental issue is whether a private benefit has been conferred. A fringe benefit will not be conferred unless a private benefit is provided. Gallen J considered that the provision of a motor vehicle to an employee only for work-related travel would not constitute a private benefit and would not be "private use or enjoyment".

The definition of "private use or enjoyment" specifically includes "travel in the course of proceeding to or from … the home". However, in *Schick* the court considered that this part of the definition did not apply where the vehicle was used for travel between the home as a work base (rather than as a home) and another workplace. Therefore, the fact that the vehicles were used for travel starting from or ending at the home did not necessarily bring the travel within the definition.

No fringe benefit unless private benefit provided

In *Schick* Gallen J approved the reasoning in *Case Q25* (1993) 15 NZTC 5,124 that the definition of "private use or enjoyment" applied to travel that conferred a benefit of a private or domestic nature:

> The comments are interesting firstly because they put an emphasis on the purpose for which the vehicles were used as distinct from whether they merely travelled to or from home and secondly because he regarded the concept of benefit of a private or domestic nature, which qualifies the second part of the definition of private use or enjoyment, as applying also to the first part where it does not appear. I think in context there is justification for that particular view. The term "fringe benefit" itself in definition refers to benefit not only in the title, but in the first part of the definition. **The concept of private use or enjoyment where it appears in sub-para (a) and in the definition of that term itself, imports the concept of a distinction between a work-related use and a private use.**
>
> **It follows then that I agree with the Judge that the word "travel" where used in the definition of private use or enjoyment, is to be regarded as qualified by that qualification which appears in the second part of the definition and means travel which confers a benefit of a private or domestic nature**. (p 13,743) [emphasis added]

The taxpayers in *Schick* carried on business as transport operators and earthmoving contractors and had provided vehicles to their foremen who used the vehicles to transport themselves and fuel and grease and other equipment necessary for the operation of earthmoving equipment to remote worksites where the equipment was operated. The mechanic employed by the taxpayers used the van provided to him to service both the transport vehicles and the earthmoving equipment. The employees usually travelled direct from home to the worksites and were paid from the time that they left home to the time that they returned home. Also, the foremen were paid an extra half hour a day to do clerical work and were required to keep their daily records at home. At times the foremen kept oil or grease and a few tools at their homes. The foremen were given plastic cards that allowed them to purchase fuel, oil and grease and were expected to ensure that they had sufficient stocks of oil and grease to ensure the smooth running of the earthmoving equipment. The foremen had discretion to discuss the progress of work with customers.

Gallen J considered that a private benefit had not been provided to the employees in *Schick*. He accepted that the employees were working from the time they left home. They were paid from the time they left home, they were required to keep daily records at home and to be available there for consultation with clients. The employees and the vehicles were required to be available at the home for emergency call-outs. The provision of the vehicles was for the benefit of the employer in getting the employee to remote worksites in the quickest and most efficient way possible.

No private benefit provided where vehicle provided for work-related travel between work and home as a workplace

Gallen J considered that where the employee's home is also a workplace and where the vehicle was used for transport to and from work, a private benefit would not be provided:

> …The concept of "home" where it appears in the definition of "private use or enjoyment", does not apply where the home concerned is not used exclusively as a home, but also as a workplace. This is in accord with the view that the definition of "private use or enjoyment" is confined to a situation where there is a genuine benefit to the employee concerned which would occur where the vehicle was used for transportation to and from work. Where however transportation was from work to work, there is no room for the operation of the definition. (p 13,643)

Gallen J considered that it was open to the TRA to conclude on the facts that the home was also a workplace (Gallen J noted that different considerations would arise if the question being considered was whether deductions are allowable in respect of the home). The Commissioner had argued that whether a home was a workplace depended on the extent to which it was so used and that one or more of the following factors were satisfied:

- Whether there are sound business reasons for operating from home;
- Whether significant business activity actually occurs at home;
- Whether there is significant storage of business goods or equipment at home;
- Whether significant space is set aside and used for business-related activities conducted at home;
- Whether the activities conducted at the home are closely integrated with the taxpayer's business.

These factors were drawn from the facts of cases on "private use or enjoyment" decided before *Schick*: see *Case R37* (1994) 16 NZTC 6,208; *Case Q25* (1993) 15 NZTC 5,124; *Case S26* (1994) 17 NZTC 7,182 (discussed in more detail below). Applying these factors, the court in *Schick* concluded that the employees' homes were workplaces for FBT purposes. The court considered that three of the above factors had some application, and that these three factors taken together were sufficient for the home to be considered to be a workplace. The court made the following comments in relation to these factors:

- There were sound business reasons for working from home. The employees were required by their employers to keep their daily records at home. They were required to be available for consultation with clients and were required to be available for emergency purposes.
- The activities carried on at the home were an integral part of the taxpayers' business activities in that the employees effectively operated and managed the taxpayers' business from their homes to the actual worksites.
- The storage of the vehicles at the employees' homes would go some way towards establishing that there was significant storage of business goods and equipment at the homes. The court noted, however, that this factor should not be given too much weight given the issues in the case. In the context of the employers' business (which involved work carried out at remote worksites and which required the employees to be available at the home for consultation with clients or for emergencies), the vehicles were taken to the home and kept there to be available for work-related travel.

Relevance of Schick factors

In *Schick*, the employees' homes were considered to be workplaces, although the taxpayer could not establish that a significant proportion of the homes were set aside for business purposes or that significant business activity occurred at the homes and the only storage of business goods or equipment was the vehicles themselves. Whether the factors of significant storage of business goods or equipment at the home or significant space at the home being set aside for business purposes are

relevant and are to be given weight depends on the nature of the employment duties and whether the goods and equipment stored at the home are necessary for the performance of employment duties and the space requirements of the particular activity. The significant storage of business goods and equipment at the home and the setting aside of significant space at the home for business use will not in themselves make the home also a place of work or business. On the other hand, technological changes mean that significant space or significant storage of tangible goods may no longer be necessary for the carrying on of business activities at a home. Technology has also made it more feasible for employees to perform their employment duties outside the conventional factory or office environment. For these reasons, the Commissioner considers that the presence or absence of these three indicators will not necessarily determine whether travel between home and work is private travel or work-related travel.

A home still retains the characteristics of a home although business goods may be kept there and some employment duties may be performed there.

The approach in cases on deductibility of travel expenditure is that for expenditure on travel between home and work to be deductible it is necessary to establish:

- The need for the work to be performed partly at the home (and, therefore, the need for the travel) arises from the nature of the work; and
- The travel is "on work".

The Commissioner considers that the same approach is to be applied in determining whether travel between home and work is private travel for FBT purposes.

The first requirement is consistent with the two other indicators referred to in *Schick* (whether there are sound business reasons for operating from the employee's home and whether the activities conducted at the home are closely integrated with the employer's business). The Commissioner considers that for both FBT and deductibility purposes, in order to distinguish between business use and private use, it is necessary to consider the nature of the income earning activity and the relationship of the travel to that activity. Travel between home and work would be private travel if the work is performed at the home because of the personal circumstances or personal preferences of the taxpayer. For travel to be work-related travel, it is not sufficient that the employer and employee contracted on the basis that employment duties would be performed partly at the home.

However, it is not sufficient that employees carry out employment duties at home for business reasons. The *Schick* case establishes that the fundamental issue is whether a private benefit has been conferred. Under the FBT regime there is a presumption that the provision of a vehicle for travel between home and work confers a private benefit. The definition of "private use or enjoyment" specifically includes "travel … in the course of proceeding to or from the person's home". Generally travel between home and work is private travel as it enables employees to live away from their work and relates to a private decision (the employee's choice of location of residence). In *Lunney v FCT* in their joint judgment Williams J, Kitto J and Taylor J referred to *Newsom v Robertson* (which concerned a barrister who worked at his chambers or in court during the day and frequently took papers home to work for several hours after dinner) and commented:

> It should be mentioned that in this case the additional fact appeared that the taxpayer consistently performed some of his professional duties at his home and the case was put as one in which the facts disclosed that the expenditure was incurred, not merely in travelling between his home and place of business, but, rather, in travelling between one place of business and another. Yet the taxpayer's claim to a deduction was rejected both, in the first instance and in the Court of Appeal. None of the members of the latter Court were prepared to assent to the proposition that the taxpayer's journeys were for the "purpose" of his profession; in the language of Romer LJ:
>
> > "The object of the journeys between his home and place of work, both morning and evening, is not to enable the man to do his work but to live away from it."
>
> **The fact that few taxpayers are free to choose whether they will live at their place of work or away from it may appear to invest this statement with a degree of artificiality. But, even in these modern times, they still have, within limits, the right to choose where their homes shall be so that a taxpayer's daily journeys between his home and place of work are rendered necessary as much by his choice of a locality for his residence as by his choice of employment or occupation. And indeed the purpose of such journey [sic] is, at least, as much to enable him to reside at his home as to attend his place of work or business.** (p 413) [emphasis added]

Example 6

An employee is the manager of a foreign exchange dealing room of a bank whose head office is in Hong Kong. Many of the bank's clients are in different time zones from New Zealand. The manager often works at the home in the evenings or on Saturday mornings (when the US markets are still open), as the manager is required to be available to provide market information, or report to the bank's head office or to carry out currency dealing. The manager is sometimes required to travel back to the bank's premises or to a video conference facility for conference calls or video conferences.

Although FBT was introduced much more recently than income tax, the same philosophy underlies the classification of travel between home and work as private travel (that is, travel between home and work

is required because of the taxpayer's choice of location of residence). The normal daily travel by an employee does not cease to be private travel merely because employment duties are performed at the home. A second journey to participate in a video conference is no different from travel by an employee who chooses to travel home for lunch and then to travel back to work: see *Case M99* 80 ATC 691. Travel by an employee in such circumstances is undertaken to enable the employee to live away from the employee's workplace and remains travel to commence work. An employee who performs work duties at the home after normal working hours cannot be regarded as being continuously engaged in employment duties while travelling between home and work. The employee may be travelling to do work at the home but is not travelling on work. Unlike the taxpayer in *Collings*, the employee would not be travelling to complete an aspect of the employee's employment already under way when the journey began.

Both the normal daily journey between work and home and a second journey back to work for a video conference by the manager is travel of a private nature.

Example 7

A researcher works in an open plan environment at the employer's premises. Sometimes the researcher takes more complex and difficult work home. Because of disruptions at the employer's premises it is more efficient for the work to be carried out at home.

Travel between work and home would still be private travel where work is performed at home because of problems with facilities at work. The employee would be travelling to work rather than in the course of performing work duties. In *Warner v Prior* (2003) Sp C 353 a deduction was not allowed although it was accepted that the taxpayer performed the additional duties at her home because adequate facilities were not provided for her to carry out these duties at the schools where she taught.

Each of the FBT cases where travel between home and work has been found not to be "private use or enjoyment" falls into one or more of the exceptions referred to in *Genys*. Each of these exceptions involves situations where the travel is "on work" rather than travel in order to commence employment duties or travel from work. Travel by an employee in such situations would be travel for work-related purposes and would not constitute private use or enjoyment.

- *Vehicle essential for transport of goods or equipment*

In *Cases S26* and *Q25* one of the factors taken into account in reaching a conclusion that travel between home and work was not private use was that the vehicle was used for the transport of goods to the home for work to be performed on them. In *Case S26*, the taxpayer was a clothing manufacturing company. Finishing off work was carried out on the garments at the home of the shareholder-employees. The finishing work on garments was intricate and time-consuming and it was inconvenient to fit in such work during the day at the factory. The vehicle was used each night to transport the garments between the factory and the home, and the following day, after finishing work had been done, the garments were transported back to the factory or were delivered to customers. The company in *Case Q25* was also in the business of clothing manufacture. The home of the shareholders was fitted out for the storage of garments and up to 5,000 garments could be stored there at any time. The work performed at the home involved pressing garments, unpicking, and making good defective workmanship. The work carried out by the shareholders at the home was intended to minimise overheads. (In *Case Q25* the TRA also held that the vehicles were work-related vehicles within the meaning of section 336N(1) of the Income Tax Act 1976 (now contained in section OB 1 of the Act).) That aspect of the TRA's decision was upheld by the High Court: *CIR v Rag Doll Fashions (NZ) Ltd* (1995) 17 NZTC 12,104.)

- *Itinerant occupations*

The occupations of the employees in *Schick* can be regarded as itinerant occupations. The court considered that the employees operated the employers' business from their homes to the actual worksites where the work was performed. As previously mentioned, the employees were regarded as working from the time they left home. They were paid from the time they left home, they were required to keep daily records at home and to be available for consultation with clients. The employees and the vehicles were required to be available at the home for emergency call-outs. The vehicles were required to transport oil and grease necessary for the smooth running of the earthmoving equipment at remote worksites.

- *Travel between work and home as a workplace*

In *Case R37* (1994) 16 NZTC 6,208, it was held that travel from and to the home of the shareholder-employees was travel from and to a second business site. The company carried on the business of screen-printing. The actual printing and screening work was carried out at the company's factory. Continuous test washing of sample garments (to check the quality of adherence of ink and dyes on garments) was carried out at the home on most days, there being no washing facility at the factory. Preparation of art work and clerical work involving the confirmation of quotes given during the day and the issuing and payment of accounts was also carried out at the home (because it could not be established that the vehicle was not available for private use or enjoyment, the company was liable for FBT).

In *Case S26* the home was also considered to be a business site. The company's clothing manufacturing business had initially been conducted from the home and had later expanded to the factory. Although much of the manufacturing was carried out at the factory, finishing work continued to be done at the home. In *Case Q25* also, garments manufactured at the company's factory were taken to the home for finishing off work to be carried out on the garments. It was held that the vehicles were used for travel between the home and work for work-related purposes.

Case T39 (1997) 18 NZTC 8,261 concerned a company which carried on the business of cosmetic dentistry and employed its principal shareholder and director in that business. Vehicles owned successively by the main shareholder and director of the company were leased to the company during working hours. The shareholder carried on the taxable activity of car leasing. Two issues were considered in the case: whether a fringe benefit had been provided and whether the shareholder had acquired the vehicles for the principal purpose of making taxable supplies for GST purposes. The TRA accepted that the nature of the agreement between the shareholder and the company was that the company was entitled to use the vehicle only during the lease hours (being the company's hours of business). Because the vehicle was available to the shareholder for private use during those hours, the company was liable for FBT.

In relation to the GST issue, the TRA considered that travel between home and the surgery was business use, as the home was an ancillary place of business in relation to the dentistry business (as that business was carried on by the company, it appears that while the vehicle was used for travel between the surgery and the home, the vehicle was considered to be subject to the lease). The work performed by the shareholder involved examining the patient, taking X-rays, preparing a jaw record, and making models of teeth. The shareholder specialised in treating complicated cases. Patients were seen at the surgery and treatment plans were prepared at the home office. Written records, teeth models and an articulator (a machine which simulated the movement of the jaw) were moved between the surgery and the home. The equipment at the home office included an X-ray viewer and a Bunsen burner used to remodel with wax the models of teeth. Also, the practice laundry was done at the home and was transported from the surgery to the home for that purpose. The TRA accepted that the particular style of dental speciality required there to be available a place of business separate from the surgery where the shareholder could consider and plan the highly specialised form of treatment which the shareholder would recommend and apply to the practice's clients.

Travel between a workplace at the home and another workplace would be work-related travel only where the two workplaces relate to the same income earning activity: *FCT v Payne* 2001 ATC 4027. Therefore, applying the approach in *Payne*:

- If an employee had full-time employment and the employee's home was a place of work in relation to that employment, travel between the home to carry out employment duties in relation to a second job would be private travel.
- If an employee was employed full-time and carried on a part-time business at the employee's home, travel between the home and work would be private travel.

Common principles relating to deductibility and to FBT

The test for determining whether travel expenditure is deductible and the definition of "private use or enjoyment" for FBT purposes are expressed in different terms. However, the tests raise essentially the same issues and require consideration of the same factors. Expenditure on travel of a private nature cannot satisfy the test of deductibility. Conversely, if travel between home and work is "private use or enjoyment" (being travel which confers a benefit of a private or domestic nature"), expenditure on such travel would not be deductible.

The test of deductibility and the FBT test applied to the same facts (and assuming that the employee had incurred expenditure on travel and a deduction was allowable for expenditure incurred in gaining income from employment) would produce the same result. In each of the FBT cases where it has been found that travel between home and work is not private use would have satisfied the test of deductibility in relation to the employee.

For both deductibility and FBT purposes:

- It is not sufficient that work is performed at the home. The need for the work to be performed partly at the home (and, therefore, the need for the travel) must arise from the nature of the work; and
- There is a distinction between travel undertaken to enable a person to commence work and travel in the course of performing work ("on work"). Travel to enable a person to commence work is private travel.

For FBT purposes (as for deductibility purposes) a journey would be treated as work-related travel where:

- The private benefit received is incidental, being a private benefit that necessarily results from a journey undertaken for work-related purposes; or
- The private travel is de minimis (being a minor or insignificant proportion of a journey undertaken solely for work-related purposes).

Employment duties performed at home because of employee's personal circumstances

There may be cases where an employee has contracted on the basis that employment duties would be performed partly at the home. Technological and social changes have made such arrangements more common.

The House of Lords in *Taylor v Provan* considered that an employment contract stipulates the nature of the employment duties and where the employment duties must be performed. However, the contract must be bona fide. Their Lordships also considered that (applying *Ricketts v Colquhoun* [1926] AC 1) the travel must be necessitated by the nature of the employment duties and not from the personal circumstances of the employee: see pp 208, 212, 215–216, 221–222, 225, 226. Although the majority and the minority in *Taylor v Provan* did not agree on the proper inference to be drawn from the facts, there was no disagreement on the principles to be applied.

Therefore, the terms of an employment contract (provided these are bona fide) generally establish the nature of the employment duties and where these are to be performed. However, the fact that the home is a place where work is performed (whether or not under a contractual obligation) is not sufficient. The need for the travel must arise from the nature of the work and not from the personal choice or circumstances of the employee. Whether the need for travel arises from the nature of the work is determined objectively. These principles were applied in *Taylor v Provan*.

In *Taylor v Provan*, the taxpayer was a Canadian brewery magnate who was a director of several UK brewery companies with special responsibility for negotiating mergers and amalgamations. The position was created specifically for the taxpayer who was uniquely qualified for the position. The arrangement was that the taxpayer would provide his services in Canada or the Bahamas as far as possible and when necessary he would travel to the UK to visit breweries there. The taxpayer was not paid for his services but he was reimbursed for the cost of travelling between Canada or the Bahamas and the UK.

The Commissioner had assessed the taxpayer for income tax on the amounts reimbursed. The House of Lords held that the amounts were income but the majority (Lords Reid, Morris and Salmon) considered that the travel to and from the UK was not private travel and that, therefore, the expenses of such travel were deductible. It was not sufficient that the taxpayer had contracted to do most of the work outside the UK. *Taylor v Provan* is a case that involves exceptional circumstances. The distinguishing feature in the case was that the office was a unique one created to be held by a particular person with specialised skills and it was not possible for the company to get the work done by anyone else: see judgment of Lord Reid at p 208, Lord Morris at p 212–213, Lord Salmon at p 227. However, the minority (Lords Wilberforce and Simon) did not accept that the taxpayer was under a contractual obligation to carry out part of his duties in Canada or the Bahamas and even if there had been such an obligation, the minority considered the terms of the taxpayer's employment merely recognised the taxpayer's personal circumstances and were not required by the nature of the tasks involved in the office.

The above principles were applied in two cases which were decided comparatively recently: *Miners v Atkinson* [1995] STC 58 and *Kirkwood v Evans* [2002] STC 231.

In *Miners v Atkinson* the taxpayer was a computer consultant and director of his own company. The company contracted to provide the taxpayer's services to another company. The company's registered office was at the taxpayer's home, 80 miles away from the premises where the consulting services were performed. A distinction was drawn between services provided to the client and the taxpayer's duties as a director. There was no contract between the client and the taxpayer and, therefore, in all of the taxpayer's activities the taxpayer acted as a director of the company. It was accepted that the taxpayer's home was the base from which he worked, being the place where he carried out his duties as a director of the company. The taxpayer argued that once it was accepted that the home was the taxpayer's base of operations, it followed that expenses of travel between the home and the place where the consulting services were performed were necessarily incurred unless it could be shown that the taxpayer's choice of residence was unreasonable. It was held that the expenditure was not deductible as the taxpayer was working at home out of choice. It was not necessary for the work to be carried out at the taxpayer's home and the work could have been done anywhere.

In *Kirkwood v Evans* the taxpayer was a civil servant who chose to join a homeworking scheme provided by his employer. The scheme was available to approved employees and was not compulsory. Under the scheme the taxpayer was provided with a computer and other equipment but was required to provide his own office accommodation at his home. The taxpayer's home was his main workplace but he agreed to travel to Leeds (which was 135 miles away from the taxpayer's home) once a week in order to deliver work that he had done, to collect work and to download information from a database. While in Leeds the taxpayer was available to work there for the remainder of the day. It was held that the cost of travelling between the taxpayer's home and Leeds was not deductible. The fact that the taxpayer had two places of work was not sufficient as this was not required by the nature of the taxpayer's employment. Patten J said:

> [12] **I mean no disrespect to Mr Evans when I say that he was obviously not uniquely qualified for the work he did and he accepted that in argument**. The highest that he can put his case is that he was under the terms of the homeworking agreement with the CAS required to visit the office in Leeds to deliver and collect work and to update the information needed for his work. On the authorities this is not enough to make the travelling expenses ones which are necessarily incurred in the performance of those duties. Even accepting that the terms of his contract (whilst the homeworking agreement subsisted) required him to work four days in King's Lynn and one in Leeds his choice to live in

> King's Lynn rather than Leeds was historical and is unconnected with any term of his employment. The necessity of travelling to Leeds is dictated by his choice of the place where he lives and not by the nature and the terms of the job itself.
>
> [13] In para 10(b) of the case stated the reasoning and decision of the General Commissioners on this point is set out in the following terms:
>
> '(b) Having found as a fact that the taxpayer had two places of work, one his home in King's Lynn and the other at his employer's office in Leeds, the Commissioners determined that the taxpayer was obliged in respect of the performance of his work duties to travel from his King's Lynn office to Leeds and therefore the expense of so doing was necessary within the meaning of Section 198 of the 1988 Act, as was the expense relating to heating and lighting his King's Lynn office.'
>
> It seems to me that the commissioners considered that the mere fact that Mr Evans had two places of work (one being his home) and was required to travel between them was sufficient to bring the expenses involved within the provisions of s 198(1). For the reasons set out in the speech of Lord Reid in *Taylor v Provan* (*Inspector of Taxes*) this is not correct as a matter of law. **Unless it could be shown either that Mr Evans was uniquely qualified to do that job or that objectively the job could only be done by working at home in King's Lynn (as opposed to anywhere else) and at the office in Leeds the expenses cannot be said to have been necessarily incurred in the performance of Mr Evans' duties.** The Crown's appeal will therefore be allowed in respect of the travel expenses which relate to the year 1997–98.
>
> ....
>
> [16] ...The travel in question was between his home in King's Lynn and the CAS office in Leeds. **The fact that his home was also a 'workplace' does not prevent it from being his home**. [emphasis added]:

FCT v Collings 76 ATC 4254 also confirms that *Taylor v Provan* is to be regarded as an exceptional case. The *Collings* case concerned a computer consultant whose employer had undertaken a conversion of its computer system and who had been sent to the US for training in connection with the conversion. The taxpayer was required to be on call 24 hours a day. The court in *Collings* considered that the case was analogous with *Taylor v Provan* in that the taxpayer was uniquely qualified for the position.

Although the actual result in *Taylor v Provan* was not discussed in the following cases, the authority of *Taylor v Provan* was not questioned in these cases: *R v Deimert* [1976] CTC 301; *FCT v Wiener* 78 ATC 4006; *Garrett v FCT* 82 ATC 4060; *Case D19* (1979) 4 NZTC 60,553; *Case F47* (1983) 6 NZTC 59,801. In *R v Deimert* the court noted that *Taylor v Provan* did not detract from the authority of *Ricketts v Colquhoun*, which was distinguished on the facts: see para 39. In *Wiener* (a case concerning a taxpayer with an itinerant occupation) Smith J, adopting the approach in *Taylor v Provan*, focused on the nature of the taxpayer's employment.

Fitzpatrick v IRC [1994] SLT 836 also supports the view that a contractual obligation to undertake travel between a home workplace and another place of work would not mean that travel between the two places would be work-related travel. In that case the House of Lords confirmed that an expense is not deductible merely because it relates to an act which is required as a condition of employment.

Generally, if an arrangement is made for an employee to perform employment duties partly at the employee's home solely because of the employee's personal circumstances, such an arrangement would merely recognise the employee's personal circumstances and would not be required by the nature of the employment duties. In exceptional cases, where the business reason for the employer agreeing to employment duties being performed partly at the home is to obtain the services of the employee, travel between home and work may be regarded as work-related travel. This would be so where the position is a unique one for which the employee is uniquely qualified and it is not possible for the employer to fill the position otherwise. In order to decide whether a particular case is such an exceptional case, it is necessary to consider the employee's role in the employer's business and why the arrangement was agreed to by the employer.

Example 8

> An employee works at home because otherwise the employee would spend long periods travelling to work because of traffic jams. During the day the employee is required to call at the employer's premises in order to deliver documents or to pick up documents.
>
> Travel between the home and the employer's premises is private travel, being travel that is necessary because the employee lives at a distance from the employer's premises. The performance of work duties at the home is for the employee's convenience.

Vehicle taken to home for security reasons

The Commissioner considers that the fact that a vehicle is taken to an employee's home for security reasons would not in itself make the journey work-related travel (although this factor may be taken into account in conjunction with other factors). While the employer would receive a benefit from a car being taken home by an employee for security reasons, the employee would also receive a benefit from the use of the vehicle for travel to and from the home which is more than incidental to the benefit to the employer. Such travel would not be undertaken in the course of performing

employment duties. Rather the travel would be undertaken in order to travel from home to work or from work to home.

In *Schick*, it was acknowledged that the storage of the vehicle at home should not be given too much weight given that the issue being considered was whether the travel between home and work was private travel. Although in *Case Q25* the TRA appeared to give some weight to the evidence that the vehicle was taken home because it was unsafe to leave it at the factory, other factors were present in the case which led to the conclusion that travel between home and work was work-related travel.

The principle underlying the exceptions to the general rule that travel between home and work is private travel is that such travel will not be private travel where such travel is "on work" (in the course of performing work duties) rather than from work or to work. The Commissioner considers that an employee would not be travelling "on work" when travelling between work and home merely because the vehicle is stored at the employee's home. Where a vehicle is taken to the employee's home for storage, the private benefit derived by the employee (the transport of the employee) is not incidental to transport of work items.

Availability for private use or enjoyment

Even if travel between home and work is work-related travel (so that the use of a motor vehicle for that purpose is not private use) and there is no actual private use of the motor vehicle, the employer must establish that the vehicle is not available for private use. For a vehicle to be available for private use, the owner, lessor or hirer of the vehicle must have permitted the private use of the vehicle: *CIR v Yes Accounting Services Ltd* (1999) 19 NZTC 15,296. If a vehicle is physically available for private use by an employee, the vehicle would be regarded as being available for private use unless the employer can establish that:

- The employee is prohibited from using the vehicle for private purposes. If the employer has prohibited the private use of the vehicle it could not be said that the employer has made the vehicle available for private use, although the vehicle may be physically available for private use: *CIR v Yes Accounting Services Ltd* (1999) 19 NZTC 15,296. The prohibition against private use may be a general prohibition to employees contained in a human resources manual (or other formal employment policy document) or the prohibition may be part of an individual employee's terms of employment; and
- The prohibition on the private use of the vehicle is a genuine one. In *Case R37* (1994) 16 NZTC 6,208 letters had been written on behalf of the company by shareholder-employees to themselves in their capacity as employees of the company prohibiting the private use of the vehicle. However, the TRA found that the letters were not really intended to prevent the availability of the vehicles. Whether the employees have private motor vehicles available for private use will also be relevant in determining whether the prohibition is genuinely observed: see, for example, *Case S26* (1994) 17 NZTC 7,182; and
- The employer takes steps to ensure that the prohibition is observed. The employer in *Yes Accounting Ltd* carried out regular checks in order to enforce the prohibition.

The record keeping requirements necessary to establish that a vehicle is not available for private use are set out in *Tax Information Bulletin* Vol 4, No 8 (April 1993) – "Shareholder-Employees and FBT on Company Vehicles".

Comments on technical submissions received

Comments were received from parties external to Inland Revenue that:

- for FBT purposes it is sufficient to establish that the home is a workplace, and
- the *Schick* case establishes that the reasons that an arrangement is made for an employee to work at home are irrelevant.

The Commissioner does not accept that for FBT purposes it is sufficient to establish that a home is a workplace (on the basis of the five indicators outlined in *Schick*). As discussed above, the *Schick* case confirms that the fundamental issue in respect of FBT is whether a benefit of a private nature has been conferred and that a private benefit will not be provided where a vehicle is provided only for work-related travel. This item addresses the circumstances in which travel by an employee between home and work will be treated as work-related travel.

The Commissioner also does not accept that the *Schick* case establishes that the reasons that an arrangement is made for an employee to work at home are irrelevant. Two of the factors referred to in *Schick* were:

- There are sound business reasons for undertaking work at home, and
- The activities carried on at the home must be an integral part of the employer's business activities.

In each of the cases where it has been held that travel between work and home was travel between work and home as a workplace for FBT purposes, there were sound business reasons for undertaking work at the home and the activities carried on at the home were an integral part of the employer's business: see *Schick*; *Case R37* (1994) 16 NZTC 6,208; *Case S26* (1994) 17 NZTC 7,182. These factors require the nature of the employment duties and the relationship of the travel to those duties to be considered.

A comment was also made that the approach adopted in this Interpretation Statement fails to recognise technological and social changes which have resulted in greater numbers of employees performing work-related duties at home. There is recent case law which confirms that in spite of technological and other changes, the rule relating to deductibility of expenditure on travel between home and work remains a strict one: see *Miners v Atkinson* [1995] STC 58; *Kirkwood v Evans* [2002] STC 23. These cases confirm that:

- The fact that the home is a place where work is performed (whether or not under a contractual obligation) is not sufficient. The need for the travel must arise from the nature of the work and not from the personal choice or circumstances of the employee.
- Whether the need for travel arises from the nature of the work is determined objectively, and
- If the work could have been done anywhere but is done at the home from the taxpayer's personal choice or because of the taxpayer's personal circumstances travel between the home and another workplace is private travel.

It was also submitted that in some circumstances where an employee takes a vehicle home for storage purposes (such as where an employee has a private vehicle, lives close to the work premises and the vehicle is not available for private use other than travel between work and home) there may be little actual private benefit to the employee from using the vehicle for travel between home and work. However, liability for FBT and the valuation of the fringe benefit arising from the private use of a motor vehicle does not depend on its actual value to the employee.

LEGISLATION AND DETERMINATIONS

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

GENERAL DEPRECIATION DETERMINATION DEP52

This determination may be cited as "Determination DEP52: Tax Depreciation Rates General Determination Number 52".

1. Application

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

This determination applies to "depreciable property" other than "excluded depreciable property" for the 2003/2004 and subsequent income years.

2. Determination

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

- Deleting from the "Printing and Photographic" industry category the general asset class, estimated useful life, and diminishing value and straight-line depreciation rates listed below:

General asset class	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate(%)
Minilabs	8	22	15.5

- Inserting into the "Printing and Photographic" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed on the next page:

General asset class	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate(%)
Digital minilab machines being: • Fully integrated digital machines that consist of scanner, image processor, printer-paper processor components in a single all-in-one machine; or • Digital machines in which the scanner, image processor, and printer-paper processor components are not physically integrated into a single all-in-one machine but nevertheless operate as a matched composite unit; • But does not include a separate film processor machine.	5	33	24
Minilab machines (other than digital minilab machines)	8	22	15.5

3. Interpretation

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

This determination is signed by me on the 21st day of October 2004.

Martin Smith
Chief Tax Counsel

NEW LEGISLATION

GST GUIDELINES FOR WORKING WITH THE NEW ZERO-RATING RULES FOR FINANCIAL SERVICES

Introduction

The new rules

1. The Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003 amended the Goods & Services Tax Act 1985 (the GST Act) to allow supplies of financial services by a GST-registered person to another GST-registered person to be zero-rated. The changes integrate the supply of financial services more fully into the GST system by taxing such supplies at the rate of 0% and allowing financial services providers to deduct input tax in respect of those supplies.[1] This is in contrast to the "exempt" treatment of financial services, whereby GST is not charged and financial services providers cannot deduct input tax for GST paid on goods and services used in supplying financial services.

2. From 1 January 2005 the zero-rating rules[2] allow providers to elect to zero-rate supplies of financial services to customers who:

   - are registered for GST if the level of taxable supplies[3] made by the customer in a given 12-month period (including the taxable period in which the supply is made) is equal to or exceeds 75% of their total supplies for the period;
   - may not meet the 75% threshold but are part of a group that does meet the threshold in a given 12-month period (including the taxable period in which the supply is made) – for example, the treasury or finance function of a group of companies who receives financial services.

> **Note**: The treatment of financial services supplied to unregistered persons remains unchanged. Supplies to final consumers in New Zealand are still exempt supplies and cannot be zero-rated under these guidelines.

3. From 1 January 2005 the GST Act also provides an additional deduction from output tax for supplies of financial services made to another financial services provider, which in turn makes supplies to businesses that would qualify to receive zero-rated financial services.[4] The amount that can be deducted will be determined by the ratio of taxable to non-taxable supplies made by the recipient financial services provider.[5] The formula for calculating the value of the deduction is set out in these guidelines, but is generally based on the recipients' relative proportions of business and non-business customers.

4. These guidelines set out Inland Revenue's generally approved method for zero-rating supplies of financial services.[6]

5. They also set out the application of the various deductions allowed for financial services providers as input tax under the GST Act.[7]

What is a "financial service"?

6. Although many activities may be thought of as a "financial service", for the purposes of the GST Act, the term "financial services" generally applies to the following types of transaction:[8]

   - dealings with money;
   - certain dealings with securities;
   - the provision of credit and loans;
   - the provision of life insurance (including superannuation);
   - the provision of non-deliverable futures contracts and financial options;
   - the payment and collection of interest, principal, dividends and amounts relating to transactions involving securities; and
   - intermediation and brokerage services relating to the supply of debt, equity and life insurance.

7. Services that are not treated as financial services include debt collection, equipment leasing, credit control, sales ledger and accounting services, investment guidance, fire and general insurance and the provision of advice.

[1] See *Tax Information Bulletin* Vol 16, No 1 (February 2004), pp 23 to 31 for a discussion on the legislative amendments contained in the Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003.
[2] See sections 11A(1)(q) and (r).
[3] Excluding supplies of financial services zero-rated under sections 11A(1)(q) and/or (r).
[4] See section 20(3)(h).
[5] See section 20C.
[6] The authority for these guidelines is provided in section 20E.
[7] See section 20(3).
[8] See section 3.

Examples of financial services include:

- paying or collecting any amount of interest;
- providing or brokering mortgages and other loans;
- issuing securities such as stocks and shares;
- providing credit under a credit contract;
- exchanging currency (for example, changing US$ into NZ$).

Scope and purpose of the guidelines

8. These guidelines apply to financial services providers that are GST-registered, or liable to be registered for GST, who supply financial intermediation services. Financial intermediation services are those that bring together suppliers and consumers of financial services. Examples include deposit-taking intermediation, which involves bringing together suppliers and users of financial capital, and brokerage services involving the buying and selling of financial instruments and currencies.

9. The guidelines do not apply to persons that do not supply financial services as part of their normal business activity – for example one-off or isolated transactions that do not constitute a wider activity involving supplies to another person for a consideration, activities that involve only holding securities belonging to another entity, and the issue of capital in a company or trust. These activities are generally not considered on their own to constitute a taxable or exempt activity for GST purposes.[9] However, whether or not a particular financial service constitutes such an activity needs to be determined on a case-by-case basis. Any questions regarding whether or not a financial activity is a taxable or exempt activity should be directed to Inland Revenue or a tax advisor.

10. The application of the zero-rating rules requires providers to know, at a minimum, whether their customer is registered for GST and the ratio of taxable supplies to total supplies made by the customer. Under the GST Act, these tests must, in the first instance, be applied on a transaction-by-transaction basis. However, to recognise the costs that could arise in meeting these requirements, the GST Act allows providers to apply an alternative method approved by Inland Revenue, either generally or by specific agreement.

Alternative approaches

11. Providers may seek approval from Inland Revenue to use a different method from that specified in the guidelines for zero-rating supplies of financial services, provided it produces as fair and reasonable a result as identifying eligible customers on a transaction-by-transaction basis would.[10] Otherwise, providers may either apply these guidelines or zero-rate supplies of financial services on a transaction-by-transaction basis, as required by the GST Act.

12. Inland Revenue may also agree to an alternative method for determining the extent to which goods and services are applied for making taxable and non-taxable supplies for the purpose of adjusting deductions of input tax. Approval will always be dependent on the alternative producing a fair and reasonable result.[11]

Summary of guideline options

13. Providers have the following choices if they elect to use the zero-rating rules and deduct input tax for GST paid on making zero-rated supplies of financial services.

Topic		**Relevant sections in the GST Act**	**Options**		
			Option 1 Use these guidelines	**Option 2 Not use the guidelines**	**Option 3 Obtain a specific method**
Zero-rating		Sections 3 and 11A(1)(q) and (r)	See paragraphs 22 to 52	Zero-rate on a transaction-by-transaction basis	Apply in writing to Inland Revenue to use an alternative method
Deductions from output tax	**Principal purpose / change-in-use adjustments**	Sections 20(3)(e) and 21 to 21G	See paragraphs 56 to 77	Use the principal purpose test or direct attribution to deduct input tax	Apply in writing to Inland Revenue to use an alternative method
	Deduction for supplies between financial services providers	Sections 20(3)(h) and 20C	See paragraphs 78 to 90		

[9] See section 6 and also see *Taupo Iki Nui Body Corporate v Commissioner of Inland Revenue* (1997) 18 NZTC 13,147 and *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen* 1993 (Case C-60/90).

[10] See section 20E.

[11] See section 21A.

References

14. Unless otherwise specified, all section references are to the Goods and Services Tax Act 1985.

Election into the new GST rules

15. The GST Act requires providers to give written notice to Inland Revenue if they wish to zero-rate supplies of financial services and/or be eligible to deduct input tax for supplies of financial services made to other financial services providers.

16. This means if the compliance costs of zero-rating outweigh the benefits, providers can choose not to elect into the new provisions.

17. Elections will take effect from the first day of the taxable period in which Inland Revenue receives the written notice.

18. An election will cease from the end of the taxable period:

    - in which the provider ceases to carry on a taxable activity; or
    - that is nominated by the provider in a written notice, if the date nominated is after the taxable period in which Inland Revenue receives notice; or
    - in which Inland Revenue receives written notice if the provider does not nominate a taxable period.

19. Elections should be addressed to:

    Inland Revenue Corporates
    Financial Sector
    Private Bag 39984
    Wellington
    Fax 04 802-6192

Who to contact

20. Any questions in relation to these guidelines should be directed to Inland Revenue on 0800 377 776. Financial services providers who are companies or groups of companies with an annual turnover in excess of $100 million or whose industry is governed by specific tax legislation should call Inland Revenue on 0800 443 773.

Penalties and interest

21. Providers are responsible for complying with the various Inland Revenue Acts and may face penalties and interest if they do not meet the obligations set out in those Acts. Information about obligations, penalties and interest can be found in the Inland Revenue publication *Taxpayer obligations, interest and penalties (IR 240)*, which is available on the Inland Revenue website **www.ird.govt.nz.**

Zero-rating

Paragraphs 22 to 52 set out Inland Revenue's approved method for applying the zero-rating rules in relation to supplies of financial services. Financial services providers who have elected to zero-rate supplies using the guidelines must comply with these paragraphs.

General application

22. The zero-rating rules allow providers to:

    - Zero-rate supplies of financial services to customers who are registered for GST if the level of taxable supplies made by the customer[12] in a given 12-month period (including the taxable period in which the supply is made) is equal to or exceeds 75% of their total supplies for the period.
    - Zero-rate supplies of financial services to customers who may not meet the 75% threshold but are part of a group that does meet the threshold in a given 12-month period (including the taxable period in which the supply is made) – for example, the treasury or finance function of a group of companies that receives financial services.

23. Supplies of financial services cannot be zero-rated if:

    - they are supplied to businesses whose activity of making exempt supplies of financial services and other non-financial exempt supplies is more that 25% of their total supplies; or
    - they are supplied to unregistered persons (or final consumers).

24. When making a decision on whether or not a supply of financial services should be zero-rated, all necessary steps must be undertaken to ensure that the decision is correct.

Evidential requirements

25. It is important to keep adequate books and records to substantiate any decisions to zero-rate financial services to customers, undertake regular reviews of any systems and procedures used to categorise customers and generally comply with the tax law. It is also necessary to have a process that enables those decisions to zero-rate services to be reviewed each year. The review process need not be comprehensive but it is expected that a reasonable sample of data of at least 10% in total across all customer, industry and business groups will be selected and tested. If a material level of

[12] Excluding supplies of financial services zero-rated under sections 11A(1)(q) and/or (r).

inconsistency is detected, Inland Revenue expects that the provider will undertake a more rigorous review and corrective programme.

26. If the financial services provider is aware that a customer is no longer eligible to receive zero-rated supplies, zero-rating should cease. For one-off transactions a review will not necessarily be required – see paragraph 38.

27. Records that Inland Revenue expects to be maintained in relation to this part of the guidelines include communications with customers with regard to their registration status and the 75% threshold.

Identifying eligible customers

28. Unlike the usual GST rules, the zero-rating rules impose a requirement that providers obtain information about their customers. This is intended to ensure that the deductions of input tax that result from applying the zero-rating rules relate only to supplies made to qualifying businesses. Supplies to unregistered customers remain treated as exempt supplies. Input tax cannot be recovered in respect of supplies to these customers.

29. It is expected that the determination of the taxable status of a customer will be made by the provider supplying the financial services. The reason for this is that the difference between the supply of zero-rated financial services and exempt financial services is the respective ability or inability to deduct input tax in respect of those supplies. The deduction of input tax is therefore a matter for the provider – not the recipient to determine.

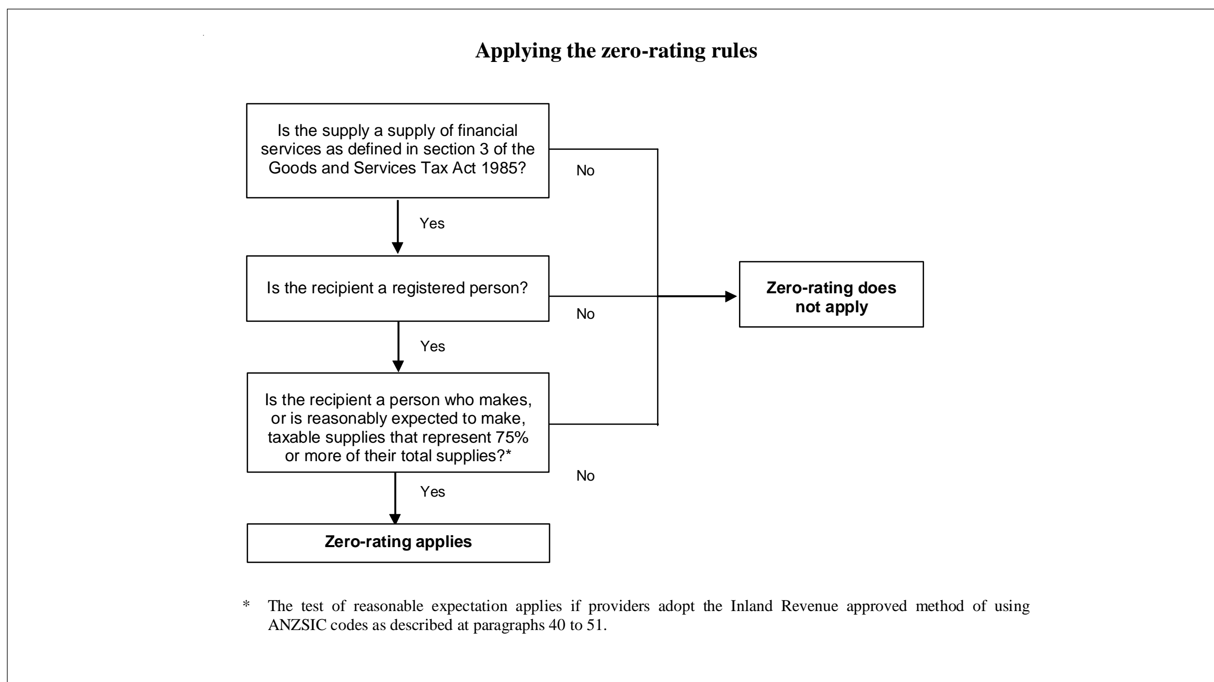
30. The questions that should be considered when determining whether a supply of financial services should be zero-rated are illustrated below.

Zero-rating supplies of financial services

31. The zero-rating rules therefore require that providers consider two questions in relation to their customers' activities:

- ***The registration test***. Is the customer registered for GST?
- ***The 75% test***. Has the customer made, or is likely to make, in the relevant taxable period supplies of goods and services that are taxable supplies that represent 75% or more of total supplies?

Note: When establishing whether or not a customer qualifies under the 75% test, all taxable supplies made by the customer should be considered, except for supplies of financial services that are zero-rated under the new rules. Imported services that are treated as supplies for the purpose of the "reverse charge"[13] should also be excluded for the purposes of this test.



[13] See section 5B and see *GST guidelines for recipients of imported services* and *Tax Information Bulletin* Vol 16, No 1 (February 2004), pp 32 to 45 for a discussion on the reverse charge.

32. Assessing whether the customer qualifies under both limbs must occur in the taxable period in which the supply of financial services is made.

33. If the customer is part of a group, the tests may be applied by reference to the group of which the customer is a member.[14]

General requirements

34. Two options may be adopted in relation to the application of the new zero-rating rules – a transaction-based approach or a customer account approach. The option selected should best suit the customer and the type of financial service supplied.

35. Both options will generally require providers to enquire directly whether or not the customer is registered for GST. Financial services providers may approach Inland Revenue with the view to using an alternative method to determine whether or not a customer is registered for GST.[15] Approval of an alternative method will depend on the level of existing information that the financial services provider holds on its customers and whether the alternative method provides a fair and reasonable result – see paragraph 11.

36. Again, for both options, whether the customer meets the 75% test must be determined either on the basis of information held by the provider on the customer or by using the Australian and New Zealand Standard Industrial Classification codes (ANZSIC codes). A full list of ANZSIC codes may be found on the Statistics New Zealand website.[16]

Determining eligibility per transaction

37. If the supply is in relation to a hire-purchase, finance lease or transaction for which the terms and conditions of the financial service are unlikely to change, the assessment of whether the customer qualifies to receive zero-rated financial services should be established at the time agreement is reached on the contractual terms of the financial service. As GST is a tax on transactions involving the supply of goods and services, any capital or principal arising from the contract should be ignored.[17] Instead, attention should be given to the interest/income margin arising from the transaction because it approximates the value of the intermediation services provided.

38. If the duration of the arrangement is short term – no more than three years – and the terms and conditions of the financial service cannot be altered over that period, providers may exclude these arrangements from any annual review provided that adequate care is taken in determining the eligibility of the customer at the time the arrangement was established. Any arrangement that has an indefinite duration or a duration of more than three years may be required to be periodically reviewed – see paragraph 25.

Example – loan to a bakery

A local bakery approaches a finance company to assist with the acquisition of new equipment. The finance company offers the bakery a two-year table loan and asks the bakery to confirm whether or not it is registered for GST, in case the bakery defaults on the loan and the finance company is required to sell the equipment to recover the debt. As the transaction is largely a one-off arrangement and the cash flows are fixed over the period of the loan (which is short-term), the finance company is not required to include the arrangement in any future internal review. The finance company, having made the assessment that the bakery also meets the 75% taxable supply test, may zero-rate the table loan.

Determining eligibility per customer account

39. If a number of financial services are likely to be supplied to the same customer and/or the cash flows arising under a financial transaction are uncertain – for example, because of a revolving credit facility or regular transactions involving financial instruments/ assets, applying the zero-rating rules on a transaction-by-transaction basis is likely to be difficult. To deal with this, the customer's initial eligibility to receive zero-rated financial services must be established at the time the account is created and may be used going forward, provided that the customer's eligibility is reviewed periodically. Again, rather than considering the capital or principal cash flows to and from the account facility, the provider should take account of the interest/income margin arising from the transaction because it approximates the value of the intermediation services provided.

[14] In section 11A(1)(r) the term "group" is defined by reference to section IG 1 of the Income Tax Act 1994. A group is defined as two or more persons that have an aggregate common voting interest greater than or equal to 66 percent.

[15] For example, Inland Revenue may, depending on the integrity of information held by a provider's internal systems, accept a determination on a customer's registration status on the basis of whether the customer has elected to be covered by the protections and provisions provided for under the Credit Contracts and Consumer Finance Act 2003. A customer that elects to be covered by that Act must be treated as an unregistered person.

[16] See: http://www.stats.govt.nz/domino/external/web/carsweb.nsf/94772cd5918085044c2567e6007eec2c/5b3e1b99a0d86615cc256cec007e6b14?OpenDocument

[17] An exception applies to finance lease contracts. See "GST and finance leases – classification, method of accounting and treatment of residual value clause", *Tax Information Bulletin*, Vol 8, No 1 (July 1996).

Example – overdraft facility provided to a new bridal store

A finance company provides an overdraft facility to a new bridal store that is just starting up. As the owner is still outfitting new premises and has yet to maintain a stable income flow, the business requires a flexible source of financing to meet its day-to-day expenses. On the application form for the overdraft the finance company asks whether or not the bridal shop is registered for GST and the purpose of the overdraft. If, in reviewing the terms and conditions under which the advance is given, the finance company becomes aware that the bridal store's eligibility to receive zero-rated supplies has altered, zero-rating should cease.

Zero-rating using ANZSIC codes

40. Acknowledging the difficulties that may arise when seeking information from customers in relation to their level of taxable supplies, Inland Revenue will accept the use of ANZSIC codes as complying with the second limb (the 75% test) of the zero-rating rules. This means that it is not generally necessary to seek information from customers directly in respect of their level of taxable supplies, but providers are still generally expected to enquire as to whether their customers are registered for GST.

41. For the purposes of the 75% test, customers that can be allocated an ANZSIC code, other than those listed in tables A and B,[18] may be treated as making taxable supplies that exceed the threshold. Providers are not required to enquire directly from their customers as to their ANZSIC code but can make their own judgement as to what ANZSIC code best applies. If, for whatever reason, a customer cannot readily be allocated an ANZSIC code providers can either seek information from the customer directly or treat any supplies of financial services to that customer as an exempt supply.

42. If the customer is part of a group, the ANZSIC code applied should be representative of the predominant activity undertaken by the group of which the customer is a member.

43. Any system or procedure used to allocate an ANZSIC code must provide the necessary accuracy and be subject to yearly internal audit and review – see paragraph 25.

Note: Providers that have reliable information concerning the actual activity of a customer must use this information instead of relying on ANZSIC codes.

ANZSIC codes – an explanation

44. ANZSIC codes are used in New Zealand and Australia for the production and analysis of industry statistics. The objective of the codes is to identify groupings of businesses that carry out similar economic activities. Each code defines an industry and the similar economic activities which characterise the businesses involved in that industry by reference to the primary activity undertaken. In principle, any individual business can be assigned an appropriate industry category on the basis of its predominant activity.

45. When applying the ANZSIC codes for the purposes of the zero-rating rules, the term "business" includes companies, partnerships, trusts, non-profit organisations and government departments.

46. ANZSIC codes are structured according to divisions (the broadest level), subdivisions, groups and classes (the finest level). At the division level there are 17 divisions that are identified by an alphabetical character.

A	Agriculture, forestry and fishing
B	Mining
C	Manufacturing
D	Electricity, gas and water supply
E	Construction
F	Wholesale trade
G	Retail trade
H	Accommodation, cafes and restaurants
I	Transport and storage
J	Communication services
K	Finance and insurance
L	Property and business services
M	Government administration and defence
N	Education
O	Health and community services
P	Cultural and recreational services
Q	Personal and other services

[18] See paragraph 50.

47. The subdivision, group and class levels provide increasingly detailed classification of the broad categories. For example, in the case of fire and general insurance, any business that is primarily involved in this activity would be allocated ANZSIC code K7422, which is derived from the following:

Division	K
Subdivision	74
Group	742
Class	7422

Using ANZSIC codes

48. When using ANZSIC codes to determine whether a customer meets the 75% test, providers should refer to the class level, represented by a four-digit code, that is relevant to the customer's predominant activity. Some class codes may have more than four digits – if this occurs, refer only to the first four. The codes will also sometimes appear with or without the alphabetical character. For the purposes of these guidelines, the class code should be read as including the alphabetical character.

49. If a customer's activity is represented by a code that appears on either tables A or B (subject to paragraph 50) providers will not be able to zero-rate supplies of financial services to that customer. For conciseness, certain activities listed on tables A and B are referred to only by the first two or three digits (representing the subdivision or group classification). Any customer that is allocated a code that starts with those digits cannot receive zero-rated financial services.

50. Customers that are allocated a code that is listed on table A will be treated as not having an activity that complies with the 75% test. Customers that are allocated a code that is listed on table B will be treated as not having an activity that complies with the 75% test unless information is received from the customer that clearly demonstrates otherwise. If the customer provides written evidence of having an activity of making taxable supplies of goods and services exceeding the 75% threshold providers may zero-rate any supplies of financial services to that customer.

51. Codes that are not contained in tables A or B may be treated as complying with the 75% test.

Unregistered persons

52. Supplies of financial services to unregistered persons (final consumers) cannot be zero-rated. In some instances, however, final consumers may be provided with financial products and services as part their association with a registered person – for example, because they are the owner of a business. In these circumstances, care must be taken that supplies of financial services to final consumers are not zero-rated and continue to be treated as exempt supplies.

Example – loan for private purposes

A local builder approaches a finance company to secure a loan to renovate and modify her family home. On the application form the builder gives her business bank account as the account into which the funds should be deposited. As the reasons specified for the loan relate to the private assets of the builder, the finance company cannot zero-rate the interest in respect of the loan.

Table A:

Excluded ANZSIC codes – No zero-rating

Excluded codes		**Reason**
Codes beginning with		
K73 or 73	Finance	Financial services
K7411 or 7411	Life insurance	Financial services
K7412 or 7412	Superannuation	Financial services
K75 or 75	Services to finance and insurance	Financial services
M813 or 813	Foreign government representation	No taxable activity
Q97 or 97	Private households employing staff	No taxable activity
R99 or 99	No response/refusal	No information
0000 or unknown	Miscellaneous	No information

Table B:

Excluded ANZSIC codes – No zero-rating unless activities suggest otherwise

Excluded codes		**Reason**
B1314 or 1314	Gold ore mining	Fine metal
B1317 or 1317	Silver-lead-zinc ore mining	Fine metal
C2723 or 2723	Copper, silver, lead and zinc smelting, refining	Fine metal
C2941 or 2941	Jewellery and silverware manufacturing	Fine metal
E4111 or 4111	House construction	Residential accommodation/5-year rule
E4112 or 4112	Residential building construction	Residential accommodation/5-year rule
F4792 or 4792	Jewellery and watch wholesaling	Fine metal
G5255 or 5255	Jewellery and watch retailing	Fine metal
H5710 or 5710	Accommodation	Residential accommodation
L7711 or 7711	Residential property operators	Residential accommodation
Q961 or 961	Religious organisations	Donated goods and services
Q9629 or 9629	Interest groups	Donated goods and services

Example of zero-rating supplies of financial services using ANZSIC codes

Allocating ANZSIC codes:

A finance company provides financial services to small businesses and households in the company's local community. The company conducts a review of its business clients that are involved in a number of activities and categorizes them as follows:

Client	Registered for GST?	ANZSIC code	Zero-rate?
Bakery	Y	G5124	Y
Builder	Y	E4111	?
Butcher	Y	G5121	Y
Café	Y	H5730	Y
Cash loan business	Y	K7330	N
Cattery	?	Q9529	?
Charity	Y	Q9629	?
Dairy	Y	G5110	Y
Florist	Y	G5254	Y
Fruiterer	Y	G5122	Y
Hairdresser	N	Q9526	N
Health food shop	Y	G5129	Y
Independent bookseller	Y	G5243	Y
Lawyer	Y	L7834	Y
Pharmacist	Y	G5251	Y
Second-hand goods dealer	Y	G5252	Y
Sports club	Y	P9319	Y
Toymaker	Y	C2329	Y
Watchmaker	Y	G5255 or G5269	?

Making further inquiries:

From the review, the finance company decides that it needs to gather more information from the cattery, charity and watchmaker in order to work out whether or not they can receive zero-rated supplies of financial services.

The cattery

The finance company has some doubt about whether or not the cattery is registered for GST. It telephones the cattery owner to establish whether it is registered for GST and the nature of the supplies made. She confirms that the business is registered for GST and has a taxable activity. The finance company makes the assessment that the cattery qualifies to receive zero-rated financial supplies.

The charity

The charity has an activity that largely involves the provision of emergency housing and supplying donated goods. It does not charge for the provision of the emergency housing and receives a small revenue stream from the sale of the donated goods. The charity is very dependent on donations to maintain its operations. As most of the supplies made by the charity are exempt, the finance company decides that the charity cannot receive zero-rated financial services.

The watchmaker

The watchmaker sells and restores watches and clocks, including repairing and servicing personal watches and selling watch accessories. The watchmaker holds some fine gold as stock for restoration purposes but does not sell it separately. He also sells a number of restored pieces on credit and estimates that 15% of his annual income is from interest on those accounts. He makes input tax adjustments in respect of those supplies. The finance company seeks further confirmation of the level of exempt supplies made by the watchmaker and, on the basis of that information, decides that the business is eligible to receive zero-rated financial services as the level of exempt supplies does not exceed 25%.

Deductions from output tax

Paragraphs 62 to 77 set out Inland Revenue's approved method for deducting input tax in relation to any taxable, including zero-rated, supplies made by a financial services provider. Financial services providers that have elected to zero-rate supplies of financial services using the guidelines must comply with those paragraphs.

Paragraphs 78 to 90 provide guidance on the application of section 20C.

Overview

53. The effect of the zero-rating rules is to increase the extent to which providers are able to deduct input tax. This is in contrast to the previous broad exempt treatment of financial services that had applied since 1 October 1986, when GST first applied to goods and services supplied in New Zealand. Exemption means that GST is not charged, and providers are unable to deduct input tax.

54. A further special deduction is allowed in respect of supplies of financial services made to other financial services providers. This deduction is calculated using the formula in paragraph 78.[19]

Evidential requirements

55. When deducting input tax, financial services providers must exercise reasonable diligence to determine the correctness of a GST return. Providers must hold tax invoices and any necessary calculations, samples and ratios that are used to support the deduction of input tax when apportioning input tax between taxable and non-taxable supplies.

Principal purpose test

56. If over 50% of a provider's financial services are to qualifying GST-registered customers, or those supplies together with other taxable supplies exceed the 50% threshold, the provider will be able to deduct input tax on the basis that its principal purpose is that of making taxable supplies. The principal purpose test allows providers to deduct 100% of the GST paid on goods and services acquired in making those taxable supplies.[20] Adjustments to input tax may be required to the extent that there are non-taxable supplies.[21]

57. If the provider's principal purpose remains that of making exempt supplies, it will not be able to deduct 100% of the GST paid but may, instead, recover a proportion of the GST paid using the rules concerning adjustments for change in use – see paragraphs 59 to 61.

Test	**Input tax that can be claimed**	**Adjustment required?**	**Timing of any adjustment**[22]
The goods and services are acquired for the principal purpose of making taxable supplies	100% of the GST paid may be deducted	Yes, if the goods and services are applied for a purpose of making supplies of **non**-taxable goods and services	At any one of the following times: - period-by-period - annually - one-off
The goods and services are **not** acquired for the principal purpose of making taxable supplies	No deduction is available	Yes, if the goods and services are applied for a purpose of making taxable supplies of goods and services	At any one of the following times: - period-by-period - annually - one-off if less than $18,000 or Inland Revenue agrees

[19] See section 20C.

[20] See section 20(3)(a) and (b).

[21] See section 21.

[22] Any further changes to the timing of any change in use adjustments can only be made with Inland Revenue's approval. See sections 21C(4) and 21G(3) depending on the nature of adjustment.

58. These guidelines set out a method for financial services providers to determine the deduction of input tax in respect of both their zero-rated supplies and other taxable supplies, focusing primarily on how to value zero-rated supplies for this purpose.

Adjustments for change in use

59. If a financial services provider cannot deduct input tax using the principal purpose test, an adjustment may be permitted using the change-in-use provisions.[23] These provisions allow a deduction when goods and services acquired for the principal purpose of making non-taxable supplies are applied to making taxable supplies. The deduction allowed under these sections is proportionate to the use to which those goods and services are put. There are a number of adjustment methods by which input tax is allocated between taxable and non-taxable (including exempt) supplies.

60. The methods of allocating input tax are:

- **Actual use**: This method of allocation requires the taxpayer to attribute the use of the goods and services directly to the extent that they are used for a purpose of making taxable supplies. This method should be used in preference to others whenever possible.
- **Turnover method**: This method is used in cases where the actual use method is too difficult to apply – for example, in the case of overhead expenses. The formula expressed in the GST Act is:

$$\frac{\text{Total value of exempt supplies for taxable period}}{\text{Total value of all supplies for taxable period}}$$

- **An alternative (or special) method**: This method is available, provided that Inland Revenue approves it, if it results in allocated amounts that are as fair and reasonable as under the actual use method. If providers are unable to allocate input tax on the basis of actual use they should use the special method described in paragraphs 62 to 77, or another special method agreed in writing by Inland Revenue – see paragraph 12, rather than the turnover method. If a provider has been using a method that is approved by Inland Revenue and it produces a fair and reasonable result, the provider may continue to use that method instead of the one recommended in these guidelines.

61. In all cases the method of allocation used must result in a fair and reasonable allocation of input tax between taxable and other supplies.[24]

Valuing supplies of financial services and adjusting for changes in use

62. Financial services providers who do not allocate input tax according to actual use will have to value their supplies of financial services for the purposes of allocating input tax between taxable and exempt supplies. These supplies will need to be valued, usually every taxable period or annually, every time an adjustment for any change in use is made. The valuations will not always be straightforward because, unlike a normal supply of goods and services, the financial services will often not be calculated by reference to an express consideration.

63. The objective of valuing financial services when adjusting for changes in use is to identify charges for financial intermediation rather than valuing the underlying financial instruments involved in the transaction.[25] This is because it is the value of the services that is being measured for GST purposes, not the value of the financial products.

64. When valuing financial intermediation services, it is important that providers disregard amounts received as a result of non-financial transactions and non-financial asset sales such as land, buildings, vehicles and equipment. A non-financial transaction is a supply of goods and services that is not included within the scope of the definition of "financial services" for GST purposes.

65. Financial services providers price their intermediation services either by setting a specific, explicit fee or by setting a margin. The net margin can be based on a proportion of a set figure, such as an interest rate or commission percentage (for example, 10% of funds managed) or a difference between rates or percentages (for example, a 2% charge, the difference between a lending rate of 6% and a borrowing rate of 4%). The value of any financial intermediation services supplied should be either the explicit fee charged or the net margin received.

66. Inland Revenue expects that in determining the value of financial margins relevant New Zealand generally accepted accounting practice (GAAP) will be applied.

Special adjustment method using net margins and gross fees to value financial intermediation services

67. Inland Revenue will accept calculations using net margins and gross fees to value financial intermediation services when making adjustments for changes in use for GST paid on goods and services that are not directly attributed to taxable or

[23] See sections 21E to 21G and see *Tax Information Bulletin* Vol 12, No 12 (December 2000), pp 31 to 37.

[24] See sections 21A(3).

[25] Also see *Commissioners of Customs and Excise v First National Bank of Chicago* 1998 (Case C-172/96), European Court of Justice, 14 July 1998.

exempt supplies. The valuations determined under this method should be recorded as zero-rated supplies in Box 6 of the provider's GST return.

Example – value of supplies as a net margin

Interest received from advances made	$10,000
Interest paid to account holders	$ 8,000
Net interest margin	$ 2,000

68. This special method of valuation requires providers to value the margin derived by way of interest income, net proceeds from transactions in securities and gross fees. It is not necessary to continually review individual loan balances or periodically review the value of individual holdings in securities.

69. Services that are directly charged by way of transaction fees and commissions should be valued at their invoiced price or the gross amount recognised as income for financial reporting purposes.

Valuing supplies of financial services for specific transaction types

70. For specific transaction types, the following will apply.

Debt

71. Transactions involving debt are to be valued by reference to the interest margins that arise from the principal. The principal itself should be ignored. If the transaction involves the supply of goods and services under a credit contract or the lease of goods and services under a finance lease, financial services providers should refer to "GST and finance leases – classification, method of accounting and treatment of residual value clause", *Tax Information Bulletin* Vol 8, No 1, July 1996.

Equity

72. Intermediation services involving the provision of equity will generally involve a specific fee or commission. If they do not, providers for whom equity is part of a taxable activity should refer to Inland Revenue for specific guidance. Transactions involving the issue or repurchase of a provider's own equity must be ignored.

Transactions involving financial instruments such as derivatives and secondary market debt

73. Intermediation services for other financial instruments that do not involve a fee or commission can also be referred to Inland Revenue. Transactions involving the issue or repurchase of a provider's own financial instruments must be ignored.

Special transactions

74. When valuing supplies of financial services using net margins and gross fees, some transactions may present special difficulties.

Transactions with associated persons

75. As an anti-avoidance measure special valuation rules[26] apply to financial services supplied to an "associated person".[27] When zero-rated financial services are supplied to associated business customers and financial services providers at greater than market value, market value must be used. Otherwise the agreed value can continue to be applied.

Net loss margin

76. Sometimes the net margin from a financial instrument will be a net loss – for example, when a financial instrument is realised at a loss or a movement in foreign exchange gives rise to a loss under a foreign exchange hedging contract. If this occurs, the margin should be treated as zero for the purposes of the valuation formula.

Net treasury income

77. Most financial services providers will engage in transactions using reserves to derive income in addition to that received from any core intermediation activity. This is done as a means of reducing exposures to risk that may arise in respect of transactions with customers that are undertaken as part of that core activity. To the extent that the treasury function is (or is part of) a taxable activity, such transactions should be valued only when financial contracts are closed or financial instruments are realised. The net realised amount is the value that should be included in the valuation formula.

[26] See sections 10(3), 10(3A) and 10(3B).
[27] See section 2A.

Formula for valuing change-in-use adjustments under these guidelines

$$\frac{\text{Total value of taxable supplies}}{\text{Total value of all supplies}} = \text{Input tax recovery ratio}$$

The total value of taxable supplies is calculated based on:

- net interest from transactions to businesses
- net margins from exchange and derivatives transactions to businesses
- other net/margin revenue from businesses
- gross fees and commissions received from transactions to businesses
- all other zero-rated supplies
- all supplies that are subject to GST at the rate of 12.5%

The total value of all supplies is calculated using:

- all net interest
- all net margins from exchange and derivative transactions
- all other net/margin income
- all gross fees and commissions
- all other supplies

When determining the value of taxable supplies to be included in the formula, providers should be mindful of the following:

- ***Exports:*** In the absence of directly attributing input tax to any exported goods and services, amounts relating to exports should be included in the numerator.

- ***Imported services:*** Any imported services that have been subject to the reverse charge **must be excluded** from both the numerator and the denominator.[28]

The information required to apply the formula should be able to be sourced from financial statements. Determining the margins from treasury transactions such as foreign exchange and derivative transactions to businesses may require sampling. Any sampling period will need to include the last day of a financial quarter (such as 31 March, 30 June, 30 September and 31 December), as this day is typically busier than others. Providers can contact Inland Revenue to ascertain whether the sampling they propose is appropriate to their circumstances.

The reference to "business" means those registered persons that qualify to receive zero-rated supplies – meaning the business does not have more than an incidental activity of making exempt supplies (less than 25% of total turnover in a given 12-month period).

[28] See section 5B.

Example of making change-in-use adjustments under these guidelines

Adjusting for changes in use

The finance company makes adjustments for changes in use every year in the taxable period after its end of financial year. The adjustments are based on the accounting reports prepared by the company for the financial year.

Adjustments are required for both revenue and capital expenditure.

Adjustment worksheet for the period 1/1/2006 to 31/12/2006

Income	*% taxable*	*$'000*	*$'000*
Interest received (exempt)		14,500	
Less interest expense (exempt)		8,700	
Net interest (exempt)			5,800
Interest received (taxable)		13,800	
Less interest expense (taxable)		11,600	
Net interest (taxable)	100%		2,200
Treasury income		7,100	
Less treasury expense		5,100	
Net treasury income	80%		2,000
Commissions and fees (exempt)			5,400
Commissions and fees from advisory service	100%		2,820
Total income			**18,220**
Less provision for doubtful debts			220
Income after provisions			**18,000**

Operating expenses	*% taxable use*		
Wages and salaries		7,850	
Insurance		2,600	
Rental		570	
Consultants	100%	1,700	
Phone		30	
Travel	100%	44	
Power		560	
Depreciation		240	
Selling costs	40%	2,580	
Total operating expenses			**16,174**
Operating surplus before taxation			**1,826**

Example – direct attribution

Travel

All travel expenses were incurred in relation to the finance company's business clients and were incurred for the principal purpose of making zero-rated financial services. As the travel expenses can be directly attributed to making taxable supplies, the finance company deducts input tax in the taxable period in which those expenses were incurred.

Consultants

As part of providing an advisory service to its clients, the finance company contracted various consultants. The cost of these consultants can be directly attributed to providing standard-rated advisory services, so the finance company deducts input tax on the consultants' fees in the taxable period in which those expenses were incurred.

Selling costs

The finance company directly attributes 40% of its selling costs to supplies of zero-rated financial services to its business clients.

Example – revenue adjustment

The finance company is adjusting office overheads for the taxable supplies made over the year. Over the year it has not deducted input tax in respect of overhead items because these costs have been acquired for the principal purpose of making non-taxable supplies.

- Exempt supplies for 12 months — $11.6 million ($5.8 + $5.4 + 0.4 million)
- Taxable supplies for 12 months — $6.62 million ($2.2 + $2.82 + 1.6 million)
- Total supplies for 12 months — $18.22 million

Step	Instruction	Example
Step 1	Work out the percentage of taxable use for the year. Total value of taxable supplies for period / Total value of all supplies for period = % of total supplies that are taxable.	$6.62 million / $18.22 million = 36% This is the percentage of taxable supplies.
Step 2	Add up expenses over the year on which GST has been paid. Call this amount E.	The overheads to be adjusted for the year are: Insurance $2.6 million Rental $0.57 million Phone $0.03 million Power $0.56 million Total $3.76 million
Step 3	Multiply E by the taxable percentage from step 1.	$3.76 million x 36% is $1.3536 million.
Step 4	Divide this amount from step 3 by nine. This is the adjustment to show on the IR 372 calculation sheet under "Business use of private or exempt goods and services for annual or period-by-period adjustments". Transfer the totals to Box 13 of the GST return.	The adjustment the finance company shows on the IR 372 calculation sheet is $150,400 ($1.3536 million/9). This represents the input tax that can be deducted in respect of GST incurred overhead expenses.

Example – capital adjustment

In the same year, the finance company purchases a new office building to cater for new business. The cost of the new building is $8 million including GST. The building is reinforced concrete. The finance company also makes a change-in-use adjustment for the new office building. Note that a capital adjustment can be calculated using the amount determined as depreciation.

Step	Instruction	Example
Step 1	Work out the percentage of taxable use for the year. Total value of taxable supplies for period / Total value of all supplies for period = % of total supplies that are taxable	$6.62 million / $18.22 million = 36% This is the percentage of taxable supplies.
Step 2	For the taxable period in question, take the lower of the cost or current market value of the goods to be adjustment for taxable supplies. Call this L.	The lesser of the cost or open market value is $8 million.
Step 3	Find out the straight-line depreciation rate for the asset. Call this S.	The general straight line depreciation rate for reinforced concrete buildings is 3%.
Step 4	$\frac{L \times S}{N}$ x percentage of taxable use from step 1 N is the number of taxable periods each year in which the change in use adjustments will be made.	$\frac{\$8 \text{ million}}{1}$ x 3% x 36% = 86,400
Step 5	Divide the amount from step 4 by nine. This is the adjustment to show on the IR 372 calculation sheet under "Business use of private or exempt goods and services for annual or period-by-period adjustments". Transfer the total to Box 13 of the GST return.	The adjustment the finance company shows on the IR 372 calculation sheet is $9,600 ($86,400/9). This represents the input tax that can be deducted in respect of GST incurred on acquiring the capital asset.

Effect on operating profit

The adjustments for change in use, made in the first taxable period after 31 December 2006, have the following effect on the finance company's operating surplus.

	GST content	*Deductible input tax*	*Revised expenses*	
Income after provisions				**18,000**
Operating expenses				
Wages and salaries	-	-	7,850	
Insurance	288.9	104.0	2,496	
Rental	63.3	22.8	547.2	
Consultants	212.5	212.5	1,700	
Phone	3.3	1.2	28.8	
Travel	5.5	5.5	44	
Power	62.2	22.4	537.6	
Depreciation	26.6	9.6	230.4	
Selling costs	300.0	120.0	2,580	
Total operating expenses				**16,014**
Operating surplus before taxation				**1,986**

Supplies between financial services providers

Application

78. Financial services supplied to another financial services provider generally cannot be zero-rated because most financial service providers will not satisfy the requirement that 75% of their supplies are taxable supplies. Instead, the GST Act provides a further deduction from output tax in relation to supplies of financial services made to another financial services provider (the direct supplier). The deduction relates only to exempt supplies of financial services made to the direct supplier and is limited to the extent that the direct supplier makes taxable supplies, including supplies of zero-rated financial services, to business customers that meet the 75% taxable supplies threshold. The deduction is calculated according to a formula.[29]

Formula for calculating the deduction for supplies of exempt financial services to other financial services providers

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

Where:

a — is the total amount in respect of the taxable period that the registered person –

(i) would not be able to deduct under section 20(3); and

(ii) would be able to deduct under section 20(3),

other than under section 20(3)(h), if all supplies of financial services by the financial services provider were taxable supplies:[30]

b — is the total value of exempt supplies of financial services made to the direct supplier in respect of the taxable period:

c — is the total value of supplies made in respect of the taxable period:

d — is the total value of taxable supplies made by the direct supplier in respect of the taxable period as determined under section 20D:

e — is the total value of supplies made by the direct supplier in respect of the taxable period as determined under section 20D.

[29] See sections 20C.

[30] The definition of item "a" is in the process of being amended by the Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Bill.

79. This proportional deduction from output tax is in addition to that which can be recovered as a deduction from output tax using the principal purpose test or by way of a change-in-use adjustment.

80. The proportion is found by multiplying two fractions. The first fraction is the proportion of the total value of supplies made by the provider that consists of exempt supplies of financial services to a recipient financial services provider (the direct supplier). The second fraction is the proportion of the total value of supplies made by the direct supplier that consists of taxable supplies (including zero-rated supplies of financial services).

81. The formula is limited to the activities of the direct supplier. Further supplies of financial services – for example, by the direct supplier to a third or subsequent financial services provider, are not included in the formula.

Information required from the direct supplier

82. The method used to determine the deduction is based on statistical information that is provided by the direct supplier in relation to its ratio of taxable supplies to total supplies (items "d" and "e" of the formula).[31] The presentation of this statistical information can be in the form of a percentage or fraction.

83. Providers must obtain the ratio from the direct supplier before making the deduction. If a ratio is not provided, the deduction cannot be claimed.

84. The GST Act does not, however, require the direct supplier to provide this information.

85. If the direct supplier agrees to provide the necessary statistical information, the GST Act requires that the ratio must be current to each taxable period in which supplies of financial services are made.[32] This will require communication between the financial services provider and the recipient of the financial services regarding the correct ratio to be applied to that taxable period.

86. If the direct supplier provides statistical information which, in the direct supplier's opinion, represents its activities over the last 12 months, that ratio may be applied by the provider for a further 12 months. Accompanying the ratio must be a written statement from the direct supplier that the ratio is a fair reflection of its activities over the last 12 months, including the taxable period in which the ratio is first sought. A new ratio from the direct supplier must be sought at the end of those 12 months.

87. If the provider receives notice from the direct supplier that its ratio is no longer considered accurate or reliable the provider must immediately cease using that ratio and seek an updated one.

Evidential requirements

88. To claim the deduction, providers are expected to have written notice or other permanent records of the direct supplier's ratio of taxable to total supplies.[33] This written notice can be in the form of an email or letter. If the information is given by telephone, it must be followed up in writing for evidential purposes. The direct supplier must also state the period of time for which the ratio applies.

Disclosing a direct supplier ratio

89. If providers choose to disclose their ratio of taxable to total supplies to other financial services providers, in addition to providing the ratio in writing, they must maintain a regularly updated database of those persons that have received that ratio. The database should also detail the date that ratio was disclosed and the period to which it applies.

90. If providers become aware that the disclosed ratio is materially incorrect they must notify those financial services providers on their database, advising them to cease using the ratio until a new correct ratio is provided.

Other matters

Tax invoices

91. The GST Act requires registered persons to issue a tax invoice in relation to any taxable supplies made to another registered person, if requested. This obligation also applies in relation to zero-rated supplies. In the context of zero-rated financial services (which do not give rise to a deduction of input tax for the recipient), there is no practical purpose in requiring that tax invoices be issued in respect of such supplies. A tax invoice does not, therefore, need to be issued in relation to zero-rated financial services.[34]

Transition

92. From 1 January 2005, financial services providers that have elected to apply the new legislation should begin zero-rating supplies of financial services from the first day of the taxable period in which Inland Revenue receives written notice. Deductions of input tax in respect of such supplies should also begin from the same date.

[31] See sections 20D.
[32] See sections 20C.
[33] See items d/e as set out in section 20C.
[34] See sections 24(6)(b).

93. Input tax deducted for goods and services consumed in the taxable period in which they were acquired will be determined by reference to the time of supply only. This means that no change-in-use adjustments will be available for such goods and services purchased before the application date, to reflect any increase in taxable supplies after that date.

94. Input tax deducted under the change-in-use provisions for goods and services acquired before the application date but used periodically after that date will able to reflect any increase in taxable supplies after the application date in which the change in use adjustment occurs.

95. One-off change-in-use adjustments to take account of any increase in taxable supplies resulting from these reforms are not permitted.[35]

Examples – transition

In July 2003 a finance company acquired a new telephone system and supporting software. The system is treated as a fixed asset and its cost spread over its useful life. As the asset was not acquired for the principal purpose of making taxable supplies, the finance company makes an adjustment to reflect a level of taxable use. Adjustments are made annually. In January 2005 the finance company elects to zero-rate supplies of financial services. It can recognise the higher level of taxable use of the telephone system in its annual adjustment after 1 January 2005.

Part-way through 2004, the finance company renews its subscription to an information service. The service is not acquired for the principal purpose of making taxable supplies and costs less than $18,000. The company does, however, make an one-off adjustment at the time of renewal to reflect that the service is applied for making some taxable supplies. As the subscription is only for a year and the adjustment for taxable use is made before 1 January 2005, the finance company cannot make a further adjustment.

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GST GUIDELINES FOR RECIPIENTS OF IMPORTED SERVICES

The new rules

1. The Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003 amended the Goods and Services Tax Act 1985 (the GST Act) to introduce a "reverse charge" mechanism to tax certain imports of services – for example, management, legal and accounting services, a new software installation (and after-sales service) or products downloaded via the internet.

2. From 1 January 2005 GST-registered recipients of supplies of imported services are required to add GST to the price of the services and include the tax in the normal GST return and pay it to Inland Revenue if:
   - the services would be subject to GST if supplied in New Zealand; and
   - the recipient makes more than a minimal level of exempt or other non-taxable supplies.

3. These guidelines explain how the reverse charge affects these supplies of imported services.

New definitions

4. The following definitions have been included in the GST Act as part of the introduction of the reverse charge:
   - "Goods" means all kinds of personal or real property, but does not include choses in action, money or a product that is transmitted by a non-resident to a resident by means of a wire, cable, radio, optical or other electromagnetic system or by means of a similar technical system.
   - "Non-resident" means a person to the extent that the person is not resident in New Zealand.

Application

5. These guidelines apply to a deemed supplier required to self-assess GST on the value of a supply of imported services. For the purposes of GST, a service is anything which is not goods or money. Any business which receives a supply of imported services, or any other person who receives a substantial supply of imported services, is potentially liable to pay GST on the supply.

[35] See sections 21G(1B) and 21H(2)(b).

Supply of imported services

6. A supply of imported services is subject to GST if:

- the services are supplied by a non-resident supplier to a recipient who is a New Zealand resident;
- the services are acquired by a person who has not in the last 12 months made (and does not expect in the next 12 months to make) supplies of which at least 95% in total are taxable supplies; and
- the supply of the services would be a taxable supply if it were made in New Zealand by a registered person in the course or furtherance of their taxable activity;[1]

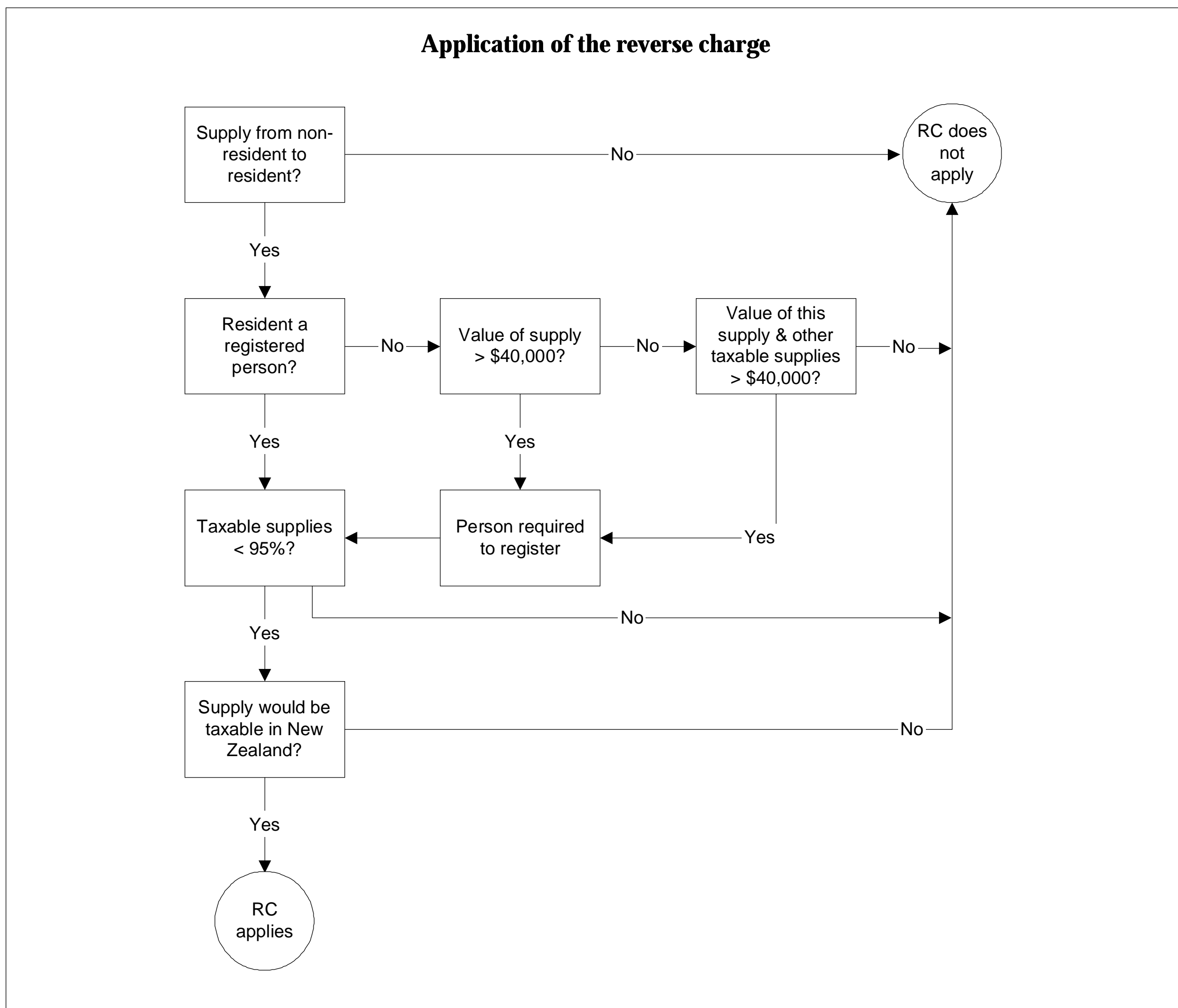
The 95% threshold is consistent with the 5% threshold in the change-in-use adjustment rules. Therefore if a registered person is required to account for the reverse charge, it is likely that the person is already required to make change-in-use adjustments.

7. Supplies of services that would be exempt supplies if made in New Zealand, such as certain financial services, are not subject to the reverse charge. Also, services that would otherwise be subject to GST at 12.5% under the reverse charge can, in most circumstances, be zero-rated under section 11A if they would have been zero-rated had they been supplied in New Zealand.

8. A person required to pay GST under the reverse charge is treated as the supplier of the services for the following purposes:

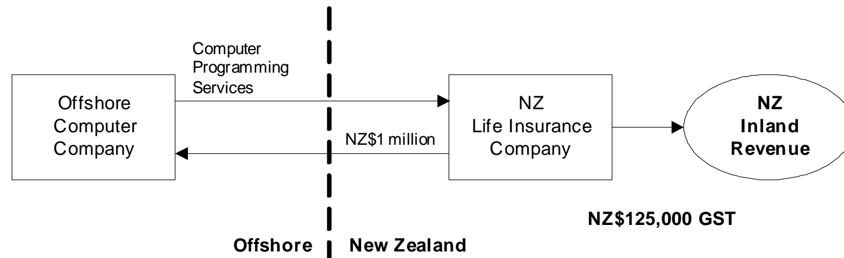
- registration;
- payment of output tax;
- record keeping; and
- avoidance.

9. For all other GST purposes the person is the recipient of services.



[1] See section 8(4B) of the Act.

Example 1: The operation of the reverse charge



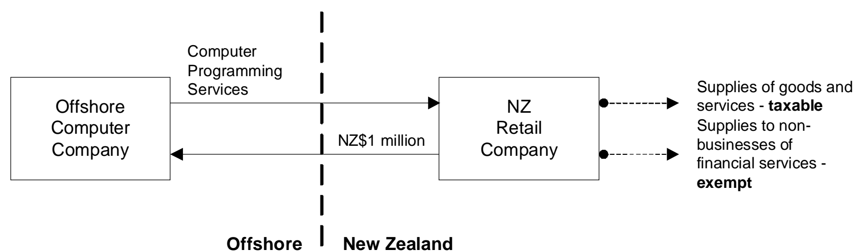
An offshore computer company makes a supply of programming services to a New Zealand life insurance company. The life insurance company makes solely exempt supplies of services. It is charged $1 million for the programming services, which it pays on receipt of the services. An invoice is provided after payment is made. The two companies are not associated persons.

In this situation:

- The services are supplied by a non-resident supplier to a resident recipient.
- The services are acquired by a person who has not in the last 12 months made (and does not expect in the next 12 months to make) supplies of which at least 95% in total are taxable supplies.
- The supply of the services would be a taxable supply if it were made in New Zealand by a registered person in the course or furtherance of their taxable activity.

The New Zealand insurer is required to register for GST if it is not already registered. It is required to account for GST on the value of the supply. The value of the supply is $1 million (the consideration for the supply), so the output tax is $125,000.

Example 2: When the reverse charge does not apply



An offshore computer company makes a supply of programming services to a GST-registered New Zealand retail company. The retail company makes a mix of 98% taxable supplies of goods and services and 2% exempt supplies of financial services, such as hire purchase, to non-registered consumers. It is charged $1 million for the programming services, which it pays on receipt of the services. An invoice is provided after payment is made. The two companies are not associated persons.

In this situation:

- The services are supplied by a non-resident supplier to a resident recipient.
- The services are acquired by a person who **has**, in the last 12 months made (and **does** expect in the next 12 months to make) supplies of which at least 95% in total are taxable supplies.

Therefore the supply is not subject to the reverse charge because the New Zealand retailer makes taxable supplies in excess of the 95% threshold.

Registration requirements

10. Because imported services are treated as having been supplied by the recipient in the course or furtherance of a taxable activity carried on by the recipient, the value of imported services supplied to that person is included in the total value of supplies made by that person for the purposes of determining liability to register for GST under section 51. Although many businesses making supplies in New Zealand are currently registered for GST, the reverse charge may require others to register – in particular, any person importing services as a private consumer.

11. A person must register for GST if:

    - the total value of supplies made in any month and the 11 preceding months exceeds $40,000, or
    - the total value of supplies made in any month and the 11 following months exceeds $40,000.

12. Therefore a person who makes no other taxable supplies in New Zealand may be required to register as a result of importing in excess of $40,000 of services in any 12-month period. Persons who do make other taxable supplies but fall below the $40,000 threshold may be required to register if they import services which, together with other taxable supplies, exceed the threshold.

Example 3: Requirement to register for GST – importing significant amount of services

A wealthy retired businesswoman who is not registered for GST has commissioned the building of a substantial property on the outskirts of Auckland. She contracts Italian architects, designers and landscapers for the project. Plans and drawings are sent to her electronically. She is required to register for GST and pay output tax on the value of those services if, together with any other services she has imported in the same 12-month period, the value exceeds $40,000.

Example 4: Requirement to register for GST – registration threshold exceeded

A business that is not currently required to register for GST makes $39,000 of supplies that would be taxable if the business were GST-registered. It purchases an international franchise licence for $10,000. As the value of the supplies made by the business is now $49,000, the business is required to register for GST.

13. Further details on registration requirements are in the Inland Revenue booklet *GST – do you need to register? (IR 365),* which is available on the Inland Revenue website – **www.ird.govt.nz**

Related-party transactions

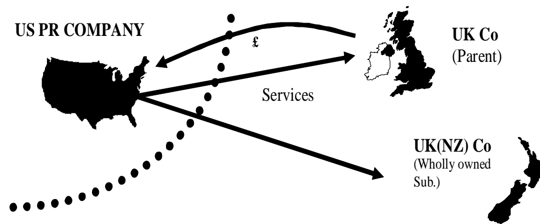
14. Charges for services from an associated overseas business can relate to a specific service or be incorporated into a larger sum. This may be the case, for example, within a group of companies or single multi-national company, when the parent company or head office may allocate a proportion of its costs to the various parts of the enterprise (referred to as a "cost allocation").

15. The reverse charge applies to a cost allocation by treating it, in the first instance, as a supply of services.[2] However, the reverse charge does not apply to any part of a cost allocation that relates to salary or wages, interest[3] and other exempt supplies.[4] For the purposes of the reverse charge, the ordinary meaning of "salary", rather than the meaning used for income tax purposes, applies. In the Concise Oxford Dictionary "salary" means a "fixed regular payment made … by an employer to an employee".

16. For the purposes of the reverse charge, a New Zealand entity or presence must be treated as separate from its offshore presence in relation to the "imported services". This means that a New Zealand branch of a non-resident company must be treated as a separate entity and supplies within a group of companies cannot be disregarded by applying the grouping rules.

Example 5: Separate entities

UK Co, a manufacturer/wholesale company, engages in an international advertising campaign. The campaign is developed and produced in the USA by a third party. The campaign, including advertising time around the world, costs $72 million. UK Co decides to allocate $9 million dollars of the cost to its New Zealand subsidiary UK (NZ) Co.



The subsidiary in New Zealand records the cost allocation as an imported service in its GST return and pays GST of $1.125 million to Inland Revenue.

[2] See section 8(4C).
[3] See section 10(15C).
[4] See section 8(4B)(c).

Example 6: Related-party financial services

Aus Co, an insurance company, charges its New Zealand subsidiary $17 million for reinsurance of life insurance contracts.

The supply of the reinsurance services would be an exempt supply of financial services if it were made in New Zealand. Therefore the supply is not subject to the reverse charge

Example 7: Intra-group supplies

Aus Co, a large retail operation with outlets throughout Australia and New Zealand, maintains a branch in New Zealand Zealand to handle the consumer finance operations of Aus Co in New Zealand. To reflect accurately the costs incurred in Australia for providing backroom support to the New Zealand branch, Aus Co imposes an annual charge of $6 million on the New Zealand branch.

Previously, this charge had been ignored for GST purposes. However, the New Zealand division is now required to record the amount of the annual charge as an imported service in its GST return, excluding any amounts representing salary and interest.

17. The value of related-party services subject to the reverse charge is reduced by the value of any salary or interest charges from any member of a non-resident company's wholly owned group, or separate branches or divisions of the same company, that form part of a cost allocation.

Example 8: Related-party transaction

E is the offshore head office of a multinational company. F is the New Zealand branch of the multinational company. The companies supply financial services. E provides administrative, accounting and management services to F and to other branches in other countries. E recovers the cost of providing these services by making a cost allocation to each branch every year.

F is debited with a cost allocation of $10 million. This covers administrative and management costs but, owing to the minor nature of the accounting services it receives from E, F is not allocated any accounting costs. Within the $10 million of administrative and management costs, there are the following cost components:

Staff salaries:	$5 million
Financing (interest) costs:	$1 million
Administration costs:	$1.5 million
Management costs:	$2.5 million
Total cost allocation	**$10 million**

A cost allocation is treated as a supply of services by a non-resident to a resident that would be taxable if made in New Zealand. F acquired the services other than for the sole purpose of making taxable supplies. E and F are treated as separate entities carrying on activities. Components of a cost allocation that are attributable to salaries and interest incurred by E are excluded from the value of the cost allocation subject to the reverse charge. Therefore only $4 million of the cost allocation is subject to the reverse charge.

The accounting services provided to F at no cost are a taxable supply acquired for non-taxable purposes. However, there is no uplift to market value, as the cost of the accounting services would have been allowed as an income tax deduction for F if it were a separate legal entity for the purposes of that Act. (See discussion of value of supply and Example 13.)

Therefore the amount subject to the reverse charge is:

Staff salaries:	0 excluded
Financing (interest) costs:	0 excluded
Administration costs:	$1.5 million
Management costs:	$2.5 million
Accounting:	0 (no market value uplift required)
Total subject to reverse charge:	$4 million
GST at 12.5%	
Total GST to be returned:	**$500,000**

Mixed-use acquisitions

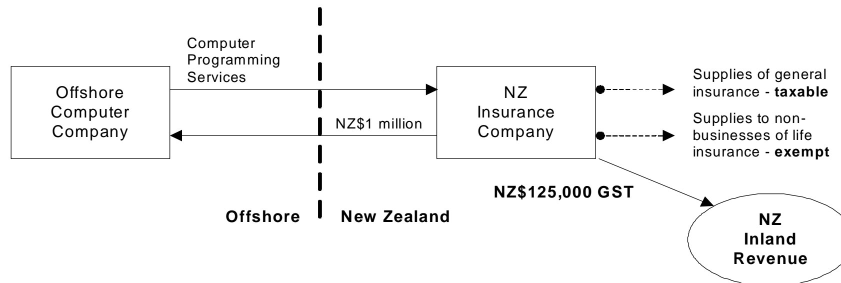
18. Although a person who acquires imported services is treated as having made the supply for the purposes of the reverse charge, that person is the recipient of the services for all other GST purposes, including input tax credit claims and change-in-use adjustments. This means that amounts paid by the recipient of imported services should not be taken into account for the purposes of:
    - the turnover method (see section 21A) in relation to change in use adjustments; or
    - determining whether a customer meets the 75% test (see sections 11A(1)(q) and (r)) in relation to zero-rating supplies of financial services.

19. A recipient of services subject to the reverse charge may be able to claim, under the general change-in-use adjustment rules, either an input tax credit based on their principal purpose or change-in-use adjustments[5] to reflect any taxable use of the imported services.

[5] Either one-off or on-going.

Example 9: Mixed-use acquisition – principally exempt

An offshore computer company provides computer programming services to a GST-registered New Zealand life insurance company for $1 million.



Using a turnover approach, 70% of the services are used for making exempt supplies of life insurance, and 30% for making taxable supplies of general insurance. Under the reverse charge, the life insurance company is required, therefore, to add GST to the $1 million, giving a figure of $1.125 million, and include the GST of $125,000 imposed under the reverse charge in its GST return.

The life insurance company is not entitled to an input tax credit in relation to the supply of the computer programming services because it has not acquired the services for the principal purpose of making taxable supplies.

Because the life insurance company uses 30% of the services for making taxable supplies, it is entitled to a change-in-use adjustment, and is able to make a period-by-period or annual deduction during the term of the asset from its output tax liability.

The life insurance company does not, however, include the $1.125 million as a supply it has made for the purposes of making the adjustment based on turnover.

20. A person who has acquired imported services for the principal purpose of making taxable supplies is entitled to claim an input tax credit for the GST paid under the reverse charge. The person, however, is required to make a change-in-use adjustment and return additional output tax to the extent that the services were not acquired for the purpose of making taxable supplies.

21. A person who has not acquired imported services for the principal purpose of making taxable supplies is not entitled to an input tax credit for the GST paid under the reverse charge. That person may, however, under the change-in-use adjustment provisions, claim back the GST paid to the extent that the services were acquired for the purpose of making taxable supplies.

22. In either instance, when input tax credits are available, a tax invoice is not required if the output tax on the relevant supply has been accounted for.

Example 10: Mixed-use acquisition – principally (but not 95 percent) taxable

A multinational shipping company supplies a software package to its GST-registered New Zealand subsidiary for $1 million. Using a turnover approach, 85% of the services are used for making taxable supplies and 15% for making exempt supplies. The reverse charge applies, as the services are acquired by a company which makes taxable supplies of less than 95% of total supplies.

Under the reverse charge, the subsidiary is required to add GST to the $1 million, giving a figure of $1.125 million, and include the GST of $125,000 in its GST return.

The subsidiary is, however, entitled to an input tax credit of $125,000, as the software was acquired for the principal purpose of making taxable supplies. It has the option to make a one-off, period-by-period or annual adjustment by way of output tax to reflect the extent of the exempt use of the software.

Zero-rating services consumed wholly outside New Zealand

23. The reverse charge applies only to services that cannot be regarded as being wholly consumed outside New Zealand. Services can be zero-rated if they are physically performed outside New Zealand. In most circumstances, services are physically performed at the time and place at which they are physically received. However, services which are intangible in nature and are performed offshore, such as a legal opinion or feasibility study, cannot be regarded as necessarily wholly consumed offshore. These services are not, therefore, treated as zero-rated services for the purposes of the reverse charge.

Example 11: Zero-rating under the reverse charge

A GST-registered New Zealand life insurance company sends an employee to Sydney to obtain a legal opinion from an Australian law firm in relation to a proposed transaction and pays for the employee's accommodation in a Sydney hotel. The life insurance company makes predominantly exempt supplies of services.

The life insurance company is charged $1 million for the legal services, which it pays on receipt of the services. An invoice is provided after payment is made. The life insurance company is charged $500 for the accommodation services, which the employee pays for using a business credit card. The life insurance company is not an associated person of either the law firm or hotel.

In this situation:

- The legal and the hotel services are supplied by a non-resident supplier to a resident recipient.
- The legal and hotel services are acquired by a person who makes predominantly (more than 95%) exempt supplies.
- The supply of the legal and hotel services would be a taxable supply if it were made in New Zealand by a registered person in the course or furtherance of the person's taxable activity.

The supplies are subject to the reverse charge. However, the supply of imported services may be zero-rated if the services are physically performed outside New Zealand and the nature of those services is such that they can be physically received only at the time and place at which the services are physically performed.

Although it is arguable whether the supply of legal services is "physically received" when the employee receives the opinion, the nature of the legal services means that they could be physically received other than at the time and place at which they are physically performed. The New Zealand life insurer can receive the opinion at any time and place (including New Zealand). The supply of legal services cannot, therefore, be zero-rated and is subject to GST at 12.5% under the reverse charge, requiring the New Zealand life insurer to return $125,000. If the life insurer has acquired the legal services for the principal purpose of making taxable supplies of general insurance, the company is entitled to an input tax credit for the GST charged.

The hotel accommodation services, on the other hand, can only ever be physically received where they are performed. Therefore these services can be zero-rated and the New Zealand life insurer is not required to return GST on the supply.

Time of supply rules

24. The normal time of supply rules generally apply for the purposes of the reverse charge. This means that the time of supply for the reverse charge is the earlier of when an invoice is issued or payment is made for the supply. If the supply is between associated persons, which might occur, for example, with head office charges, an invoice may not have been issued, or payment made, until, say, year end. To cater for these circumstances, the time of supply test for supplies between associated persons has been amended to allow application of the test to be deferred until the end of the taxable period that includes the date which is two months after the recipient's balance date for the year in which the services were performed.

25. The time of supply for a supply of services between associated parties subject to the reverse charge is, therefore, the earliest of:
    - when an invoice is issued;
    - when payment is made in respect of the supply; or
    - the end of the taxable period that includes the date which is two months after the recipient's balance date for the year in which the services were performed.

26. In the case of services supplied under an agreement that provides for periodic payments, the services are treated as being successively supplied, with each supply taking place when a payment becomes due or is received, whichever is the earlier.

Example 12: Time of supply

A (offshore parent company) and B (New Zealand subsidiary) are parts of a multinational group. Throughout the year A supplies B with administrative and accounting services. B is registered for GST, accounts for GST on a two-monthly taxable period basis and makes solely exempt supplies. B is not required to pay for these services until after the end of each year, when a lump sum is charged for administrative and accounting services provided by the parent company to all members of the multinational group.

The supply of services is subject to the reverse charge as it is a supply that would be taxable in New Zealand and it is acquired by a business which makes taxable supplies amounting to less than 95% of total supplies. B's balance date is 30 June, and the end of the taxable period that includes the date that is two months after B's balance date is 31 August.

The time of supply for the services is either:

Invoice: If A provides B with invoices/an invoice for the services provided before either payment is made or 31 August, the time of supply for the service/services is when the invoice is issued.

Payment: If B makes payment for the services before either the issue of invoices/an invoice for the supply/supplies or 31 August, the time of supply is when the payment/payments are made.

Taxable period following balance date: If neither an invoice is issued, nor payment made, before 31 August, then the time of supply is 31 August. The supply is therefore required to be included in B's GST return, due on 30 September.

Transitional provisions

27. Special time-of-supply rules[6] apply when a supply of imported services spans the introduction of the reverse charge. The rules are based on the transitional provision which applied on the introduction of GST to address situations when tax would be either chargeable on supplies received before the date of introduction of GST, or would not be chargeable on supplies received after the date of introduction of GST.

28. The new rules provide that a supply of services occurs at the time the services are performed, and they are treated as being performed continuously and uniformly during the whole of the period or periods over which the services are performed.

29. To the extent that services are treated as being supplied before the reverse charge came into effect, the services are not subject to GST. To the extent that services are treated as being supplied on or after the reverse charge came into effect, they are subject to GST, even if they were invoiced or paid for before the reverse charge came into effect.

Value of supply

30. The value of a supply subject to the reverse charge will generally be equal to the consideration for the supply. This ensures that the supply is GST-exclusive in the same way as for imported goods.

31. Applying the normal rules for supplies between associated persons would mean that the value of the supply would be the greater of the actual consideration or the open market value of the supply.

32. To minimise compliance costs, however, the actual consideration will be treated as the correct value for a supply between associated parties in the following circumstances:

- if the payment, or any payment that would be made, for the services is allowed as an income tax deduction to the recipient; or
- if the supply is between separate branches or divisions of the same company and the payment for the services would be allowed as an income tax deduction to the recipient if the branch or division were entitled to income tax deductions, or would be if any payment were made.

Example 13: Value of supply of services

As part of an international advertising campaign for a multinational group, C (an offshore parent company) supplies D (a GST-registered New Zealand subsidiary that makes predominantly exempt supplies) with advertising services. As the advertising services are for a multinational group and most of the costs are absorbed and incurred in other countries in which the company operates, the New Zealand branch is not charged for the services, either explicitly or by way of a cost allocation from the head office.

The supply of services is subject to the reverse charge because it is a supply that would be taxable in New Zealand and it is acquired other than for solely taxable purposes. Under the general time of supply rule, as C and D are associated persons, D would have to calculate the market value of the services it has received. However, an uplift in the value of supply to market value is not required, as the cost of the advertising services would have been an income tax deduction for company D. The value of the supply and the GST payable are, therefore, zero.

[6] See section 84B.

Example 14: Value of supply of intangible property

C electronically supplies a software licence to D for $200,000 but its market value could be considerably more. The licence is treated as a supply of services, and the supply is subject to the reverse charge as it would be taxable in New Zealand and is acquired other than for solely taxable purposes. Prima facie, because C and D are associated persons, D would have to calculate the market value of the services it has received. However, an uplift in the value of supply to market value is not required, as the cost of the software licence would have been allowed as a depreciation deduction for D. The value of the supply is, therefore, $200,000, and GST at 12.5% on this is $25,000.

Documentation requirements

33. A recipient of a supply of imported services subject to the reverse charge is required to maintain sufficient records to establish the correct value on which GST should be charged. The following information is required for this purpose:
    - the name and address of the supplier;
    - the date on which, or the period during which, the supply was received;
    - a description of the services supplied;
    - the consideration for the supply;
    - the time by which payment of the consideration for the supply is due; and
    - the amount of the consideration for a supply that the taxpayer has treated as not affecting the value of the supply under section 10(15C)(a) and (b) (that is, salary and interest).[7]
34. An invoice or other supporting documentation, such as a supply contract or record of payments made, may substantiate the valuations adopted for the purposes of the reverse charge.
35. An invoice is not required in order to claim input tax credits in respect of the imported services if output tax has been paid on the supply.[8]
36. Adequate information from the related head office or related entity is needed to ascertain the correct value of staff salaries and interest to be excluded from internal charges subject to the reverse charge.

Charges between associated persons

37. Charges for services supplied between associated persons are valued at cost if payment is allowed as an income tax deduction. In other circumstances, the value of the supply is its market value. In determining market value, Inland Revenue will accept charges calculated and evaluated in accordance with the income tax transfer pricing guidelines.
38. There is no explicit statutory requirement to prepare and maintain transfer pricing documentation, but it should be adequate to ensure that a person is able to demonstrate readily to Inland Revenue that its prices are consistent with the arm's length principle in section GD 13 of the Income Tax Act. The arm's length charge is one that is consistent with what would have been charged and accepted in a transaction between independent enterprises in comparable circumstances.
39. Even so, taxpayers are not expected to prepare levels of documentation that are disproportionate to the amount of tax revenue at risk in their transactions. The cost of preparing documentation should be weighed against the risk that Inland Revenue will make a pricing adjustment.
40. Inland Revenue would expect to see, at a minimum, the following documentation:
    - an identification of the cross-border transactions for which the taxpayer has a pricing exposure;
    - a broad functional analysis of the taxpayer's operations, to identify the critical functions being performed;
    - an estimation of the business risk of not undertaking and documenting a more detailed pricing analysis;
    - an estimation of the costs of complying with the rules and guidelines.
41. A taxpayer should also, as far as practicable, seek to collect and retain documentation that is:
    - existing at the time the taxpayer was developing or implementing any arrangement that might raise pricing issues, or
    - brought into existence close to the time the transaction occurs.
42. Such documentation might include books, records, studies, analyses, conclusions and any other written or electronic material recording information that may be relevant in the determination of transfer prices.

[7] See section 24B.
[8] See section 20(2)(d).

43. The transfer pricing guidelines are appended to *Tax Information Bulletin* Vol 12, No 10 (October 2000). This document is also available on the internet. Visit Inland Revenue's website at **www.ird.govt.nz** and choose the *Tax Information Bulletin* section.

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PAYMENTS FOR PROTECTING NATIVE FORESTS

Four payments to landowners for permanently protecting native forest on their land are to be exempt from income tax under the Forests (Payment of Money) Order 2004.

The Order in Council, made on 11 October 2004 under the Forests Amendment Act 2004 (see *TIB* Vol 16, No 8), grants income tax exemptions in relation to payments made by the Nature Heritage Fund to the owners of four blocks of forested land in the Rowallan and Hokonui survey districts of Southland. The payments, made between December 2002 and December 2003, were in exchange for the owners entering into conservation covenants over the land. The covenants prevent commercial logging in these blocks.

The Order in Council, which came into effect on 11 November 2004, implements part of the government's SILNA (South Island Landless Natives Act) policy package, announced in 2002.

The blocks were part of land granted under the South Island Landless Natives Act (SILNA) 1906. Timber on this land was exempted from controls on the use of indigenous timber enacted in the Forests Amendment Act 1993.

Forests (Payment of Money) Order 2004/349

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, Court of Appeal, Privy Council and the Supreme Court.

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.

RUSSELL LOSES JUDICIAL REVIEW OF INTERLOCUTORY DECISION IN SUMMARY PROSECUTION

Case:	J G Russell v District Court (Manukau) & CIR
Decision date:	30 September 2004
Act:	Tax Administration Act 1994, Summary Proceedings Act
Keywords:	Sec 17 TAA, summary prosecutions, discovery order, compliance

Summary

Mr Russell unsuccessfully sought to review the District Court's conclusions regarding the Commissioner's compliance with discovery orders made in a summary prosecution at the District Court.

Facts

This is a JG Russell related matter. It originated from summary prosecutions under sec 17 Inland Revenue Department Act 1994 for failure to comply with section 17 requests.

Mr Russell was the tax agent for approximately 36 entities (he was also involved with some of these in differing capacities) for which the Commissioner had made information requests. Mr Russell did not respond and prosecutions were commenced in 1996. There were a large number of these, some 226, and Mr Russell alleged these were an abuse of power by the Commissioner.

At a pre-trial hearing Mr Russell sought discovery of a very wide range of documents to prove his abuse of power defence. The trial judge at the District Court ordered discovery and the Commissioner complied. Mr Russell was unhappy with the extent of this and sought that the trial judge enforce her orders. After examining the Commissioner's discovery documents and making some minor adjustments the trial judge was satisfied of the Commissioner's compliance with her orders.

Some six and a half months after this Mr Russell sought judicial review of the judge's decision and sought the remedy that the Commissioner's prosecutions be stayed indefinitely. At the High Court O'Regan J declined to give any remedy (as such remedies are at the Court's discretion): reported at (2002) 20 NZTC 17,704. Mr Russell appealed to the Court of Appeal.

Decision

The Court of Appeal (in a judgment by Anderson J) dismissed the taxpayer's appeal.

The Court said

> "[13] The short point on this appeal is whether the appellant has demonstrated any proper basis for an appellate court to interfere with the District Court Judge's assessment that her orders had been complied with and the High Court Judge's exercise of an available discretion. The answer is plainly no. And even if it were, this Court would exercise its own discretion not to grant relief on the grounds of inordinate and inexcusable delay between decisions…complained of and the filing of judicial review proceedings. This Court could not countenance disruption to the District Court's summary criminal processes by lethargically instituted applications for judicial review…"

SUPPLY OF A GOING CONCERN

Case: TRA No. 010/03

Decision date: 8 October 2004

Act: GST Act

Keywords: supply of a going concern, agreement in writing

Summary

The TRA found that there was no clear evidence of there being an agreement in writing between the parties that the sale of the realty was as a going concern. There were no written particulars of the lease in either agreement so they have not been included in the agreement for the sale of the realty for the purposes of Clause 3.1. This means that Clause 14 cannot be applied to the realty sale and purchase agreement to create the necessary agreement in writing to comply with section 11 1(c)(ii).

Facts

In July 1998 the disputant vendor entered into an agreement for sale and purchase of real estate in respect of property comprising both a commercial and residential portion, both of which were leased. The commercial portion was leased on 3 April 1995 for a three-year term with 2 three-year rights of renewal. On 1 November 1995 this lease had been assigned to tenants to carry on a restaurant business which had been operated by the disputant. On the residential portion there was a separate cottage rented for $120 per week but no written tenancy agreement.

The agreement was a standard ADLS form. The sale price was $235,000 and on the front page neither "Plus GST (if any)" nor "Inclusive of GST (if any") was deleted. The form also stated "If neither is deleted the purchase price includes GST (if any)".

The transaction was settled on 31 August 1998. The taxpayer was registered for GST.

The contract contained (inter alia) Clause 14 which stated:

> "14. If this agreement relates to the sale of a tenanted property then unless otherwise expressly stated herein the parties agree that the supply made pursuant to this agreement is the supply of a going concern under Section 11(c) of the Goods and Services Tax Act 1985 on which GST is chargeable at zero%..."

The special conditions contained a provision:

> "This contract is conditional on the purchaser buying the business."

Clause 3.1 of the contract provided:

> " 3.1 Unless particulars of a tenancy are included in this agreement the property is sold with vacant possession and the vendor shall so yield the property on the possession date together with such keys to all exterior doors as are in the vendor's possession."

The front page of the contract under the heading "Details of the Tenancy" only had "rent" noted as $120 and "right of renewal" is circled.

On the same date in July 1998 the purchasers of the realty entered into an agreement with the lessees for the sale and purchase of the restaurant business. The purchase price was $100,000 plus GST if any. The special conditions of that contract for the sale of the restaurant provided:

> "This contract is conditional on the purchaser buying the freehold and that fact being confirmed to the vendor within 15 days."

Settlement of both contracts was effected on 31 August 1998.

The tenancy agreement in relation to the cottage was verbal and contained no right of renewal. It was a monthly tenancy at law.

The Commissioner assessed the commercial portion of the property as a taxable supply and adjusted the disputants return for the GST period to include the GST component of the sale price, namely $15,222.22 ($^1/_9$ of $137,000, being the valuation of the commercial portion of the total supply of the property).

Decision

Judge Barber found that the intention of all parties (ie the vendors and purchasers of the realty **and** the vendors and purchasers of the restaurant business) was that the overall transaction comprised a going concern. At settlement the purchasers intended to acquire the property subject to the restaurant lease and simultaneously at settlement transfer it to their company. The property was to be sold/acquired subject to the existing lease and the parties ensured that the lease survived settlement.

Judge Barber stated that in his view where there were two simultaneous contracts entered into involving the same purchasers and the same property, each conditional on the other, it is sensible to read them together. Particulars of the restaurant lease still however needed to be set out somewhere to bring Clause 14 into effect and Judge Barber found that the problem for the taxpayer was that the agreement for sale and purchase of the business did not give any particulars of the lease of the restaurant and the only possible reference to a particular in a lease is the circling of "right of renewal" in the agreement for sale and purchase of the realty; and even that could have meant the monthly tenancy of the cottage (rather than the restaurant complex).

Judge Barber found that there was no clear evidence of there being an agreement in writing between the parties that the sale of the realty was as a going concern, whether recorded in either agreement (ie of the realty or of the business) or anywhere else. He found that the correspondence indicated that the parties do not and never have agreed in writing that the sale was as a going concern to be zero-rated.

Judge Barber held that although the agreement for the sale of the business makes many references to the lease there are no particulars of that lease in any agreement, in writing, so they have not been included in the agreement for the sale of realty for the purposes of Clause 3.1. This means that Clause 14 cannot be applied to the agreement for sale and purchase of the realty to create the necessary agreement, in writing, to comply with section 11 1(c)(ii).

LIABILITY OF DIRECTORS FOR A COMPANY'S TAX DEBT

Case:	Kim Spencer and Susan Spencer v CIR
Decision date:	19 October 2004
Act:	Section 61 Goods and Services Tax Act 1985/section HK11 Income Tax Act 1994
Keywords:	struck-off company, liability of directors, whether the invoking of section HK11 is a disputable decision that is not an assessment or an assessment or both

Summary

The CIR was successfully Judicially Reviewed as to his invocation of section 61 of the Goods and Services Tax Act 1985 ("section 61 of GST Act") and section HK11 of the Income Tax Act 1994 ("section HK11") on two grounds:

1. That as the company taxpayer was struck off the Companies Office Register at the time of making the assessment the assessment was a nullity.

2. That the CIR had denied the directors' rights by not allowing them to challenge the underlying tax liability owed by the company taxpayer but only allowed them to challenge whether there as an arrangement under section HK11.

Facts

On 24 August 2000 a company called Gin Point Park Ltd ("Gin Point") was paid a GST input tax credit of $868,750 in respect of its 31 July 2000 GST return. This refund was paid in relation to an unconditional contract to purchase land by Gin Point, which it was intending to develop. The contract had an extended settlement date of 1 June 2001.

During early 2001 a number of problems arose and the contract was cancelled. On or about 30 April 2001 the vendor issued a credit note in respect of the cancelled contract. Gin Point did not return the value of the credit note for GST output tax purposes in the relevant GST return.

On 10 August 2001 the IRD issued an assessment disallowing the claimed GST input tax credit as claimed in the 31 July 2000 return. This assessment was not preceded by a NOPA as the IRD had taken the view that section 89C of the Tax Administration act 1994 ("TAA") applied.

Gin Point had been removed from the Companies Office Register on 20 June 2001 and was restored to that register on application by the IRD on 19 November 2001. Therefore at the time that the assessment was issued Gin Point was not a registered company.

Gin Point did not challenge that assessment and the assessment was deemed to be accepted by Gin Point. On 10 January 2002 the IRD wrote to both Mr and Ms Spencer, the taxpayers in this case ("the taxpayers"), and advised them that the IRD was invoking section HK11 of the Income Tax Act 1994 ("section HK11") and that they as directors of Gin Point were personally liable for Gin Point's tax liability (section HK11 was invoked via section 61 of the Goods and Services Tax Act 1985).

Section HK11 is the section that allows the IRD in appropriate situations to try to recover any tax owing by a company from either its directors and/or shareholders. Ms Spencer had been a registered director and the IRD had deemed Mr Spencer to be a director as he was not a registered director.

On 7 March 2002 the taxpayers filed a NOPA with the IRD in respect of the arrangement as alleged by the IRD under section HK11, and in respect of the underlying tax liability owed by Gin Point. The IRD wrote back advising that the assessment against Gin Point had proceeded to deemed acceptance and for that reason the taxpayers could not challenge the underlying tax liability. They could only challenge the arrangement as alleged under section HK11.

On 6 May 2002 the IRD issued NORs in respect of the NOPAs. The NORs advised that if the taxpayers wished to reject the NORs then they must do so within 2 months. The taxpayers did not reject the NORs.

The IRD then took the view that there had been deemed acceptance of the NORs and proceeded to institute recovery proceedings in the District Court to recover Gin Point's tax arrears from the taxpayers.

The taxpayers in response instituted these legal proceedings to Judicially Review ("JR") the IRD's decision in respect of the invoking of section HK11. JR proceedings are proceedings where the IRD's process is considered rather than considering whether a person does in fact owe any tax.

Decision

The Judge found for the taxpayers in respect of two issues.

Issue 1

The Judge found that as the IRD had not made a decision about invoking section HK11 at the time of making the assessment against Gin Point the IRD could not have nominated an agent and so section HK11(8) did not apply. The Judge however, then proceeded to consider what the status was of an assessment issued against a "struck-off" company. The Judge found that the assessment had been issued against a "non-existent" company and that prima facie the assessment was a nullity. The Judge was of the view was that the assessment was an invalid assessment.

The IRD had argued that because Gin Point had been restored to the Companies Office Register that the assessment was to be treated as being validly issued. The IRD relied on s330 of the Companies Act 1993 ("section 330") which says:

> A Company that is restored to the New Zealand register shall be deemed to have continued as if it had not been removed from the register.

The Judge considered a number of decisions in this area and concluded that s330 would only apply to validate an action where the rights of third parties have not been adversely affected. In this case he considered that to validate the issuing of the assessment would adversely affect the taxpayers and he therefore declined to validate the assessment.

The Judge found that as there was no valid assessment that this was sufficient ground in itself to find for the taxpayers.

Issue 2

The taxpayers had argued that the invocation of section HK11 was neither a disputable decision nor an assessment and that this matter should have been brought as legal proceedings in either the District or High Court. Not as part of the tax dispute procedures.

The Judge did not accept that. The Judge considered the letter of 11 January 2002 and decided that that letter contained two disputable matters:

1. A decision to invoke section HK11, and
2. An assessment of tax on the taxpayer for the same sum as owed by Gin Point to the IRD.

The Judge took the view that the IRD's advice to the taxpayers that they could not challenge the underlying tax liability was a denial of the taxpayers' rights and that they were entitled to under Part IVA of the TAA.

Because the IRD had denied the taxpayers their dispute rights the Judge decided that the "determination" of 11 January 2002 was also invalid.

LEGAL FEES NOT DEDUCTIBLE

Case:	CIR v Fullers Bay of Islands Limited, *CIV2004-404-1731*
Decision date:	26 October 2004
Act:	Income Tax Act 1994
Keywords:	expenditure of a capital nature, legal fees incurred in order to secure a contract for services

Summary

The High Court found that litigation expenses incurred in order to obtain a contract for services are not deductible as they are expenditure of a capital nature.

Facts

This was an appeal by the CIR from a TRA decision of 27 February 2004.

Fullers Bay of Islands Limited ("Fullers BOI") was in the business as an operator of land and marine-based (ferry services) tourist and commuter services operating in Northland. It wanted to commence business in Auckland and viewed obtaining the contract for the Devonport Ferry Service as an opportunity to break into the Auckland market.

At the time, Fullers Group Ltd ("the Fullers Group") (a rival company to Fullers BOI) held the contract for the Devonport ferry run. Fullers BOI put in a tender for the Devonport ferry run when the Auckland Regional Council ("ARC") put the contract, ("the contract") which had a five-year term, up for renewal.

Fullers BOI was unsuccessful and the Fullers Group retained the contract. Fullers BOI later discovered that there had been some communication from the ARC to the Fullers Group about the Fuller BOI tender. The Fuller Group then lodged a commercial registration application which was accepted.

Fullers BOI proceeded with litigation against the ARC and the Fullers Group on the basis that had this communication not occurred between an ARC staff member and the Fullers Group, Fullers BOI would have been awarded the contract (Fullers BOI was the favoured bidder prior to the Fullers Group lodging an application

for commercial registration). Part of that litigation included a claim for damages of $6.2m, which Fullers BOI claimed was the income that it would have earned if it had been awarded the contract.

In the 1999 income year, Fullers BOI claimed a deduction from assessable income of $612,792 as legal fees associated with the litigation brought against the ARC and the Fullers Group.

In the 1997 and 1998 income years, Fullers BOI incurred legal fees relating to the ARC/Fullers Group litigation, which they did not claim a deduction for.

Decision

The Judge referred to the reasons given in TRA's decision as to why the expenditure was an allowable deduction. Those reasons in essence were:

1. That the expenditure was not incurred to obtain the contract but was incurred in order to obtain the benefits of a process contract.
2. That there was no clear link between the claim for damages and any enduring property that would form part of Fullers BOI capital structure.
3. That the contract related to stock in trade or circulating capital.

The Judge set out six tests that he considered relevant in order to determine whether the expenditure was deductible.

1. Was the expenditure for the purposes of carrying on an existing trade or rather to enable the taxpayer to enter that trade? The Judge said that the critical test in this case was, "what was the practical and business objective?" The Judge found that that objective was not just to win a court case but to secure the contract.
2. Was the expenditure recurring or made once and for all ("in one breath"). The Judge found that the taxpayer was attempting to secure the contract "in one breath" rather than building up a competing business in the marketplace.
3. Was the contract part of the business structure or just part of the "ordinary" process in order to obtain regular returns? The Judge found that the taxpayer's objective had been to secure monopoly rights which are capital in nature.
4. Was the contract an enduring asset? The Judge found that a five-year contract was one that would result in an enduring asset.
5. Was the legal fee expenditure from fixed or circulating capital? The Judge found that the expenditure was from circulating capital.
6. How the payment of the legal fees would be treated on ordinary principles of commercial accounting. The Judge accepted both the CIR's and taxpayer's submissions that the principles of commercial accounting are not of particular assistance.

The Judge found that numbers 1 to 4 of the above tests favoured the CIR's argument that the expenditure was incurred in relation to expenditure of a capital nature. The Judge found that the 5th test favoured Fullers BOI but took the view that what matters is not the source of the expenditure but the purpose. In respect of 6th test the Judge did not find that this factor favoured either the CIR or the taxpayer.

The Judge stated that:

> "Considering the purpose of the expenditure overall I am satisfied that it was to secure what is in terms of tax law a capital asset however it may be characterised for other purposes."

The Judge's decision was that the expenditure is not deductible.

TENANCY DETAILS OMITTED – NOT A GOING CONCERN

Case:	TRA Decision No 026/2004
Decision date:	8 October 2004
Act:	Goods and Services Tax Act 1985
Keywords:	going concern, tenanted premises, written agreement

Summary

An agreement for the sale of retail premises was not a sale of a going concern. The sale and purchase agreement omitted to mention the existing tenancies and therefore the purchaser could expect to take to property in vacant possession. Although the purchaser accepted the tenancies no obligation to do so existed and this did not change the fact no written agreement existed that the sale was for a going concern.

Facts

The disputants sold a central retail site for a figure inclusive of GST if any. Settlement took place but a dispute developed as to how that transaction should be treated for GST purposes. The purchaser claimed that the supply was a taxable supply and pursued an input tax credit. The disputant vendors maintain that the transaction was a supply of a going concern so that it was zero-rated.

At the date of signing the sale and purchase agreement the building was subject to leases or occupancies by

various tenants. One tenant did not exercise her right of renewal of the lease and sold her business. The new owner entered into a new leasing agreement with the purchaser and commenced business prior to settlement date. Another tenant rented the lobby but vacated prior to settlement. A coffee lounge was also operated in the building but it had been taken over by a new owner prior to the agreement and the evidence conflicted as to whether the shop was operating at the time the agreement was signed. The last shop was vacant at the time the agreement was signed but at settlement was tenanted. Those tenants gained entry prior to settlement and paid all rent to the purchaser.

The only issue before the court was whether an agreement existed that this sale was for a going concern.

Decision

Section 11(1)(c) GST Act requires an agreement in writing between the vendor and purchaser that the sale relates to a going concern.

Clause 14.1 of the agreement is designed to record an agreement between the parties that a sale of a tenanted property is supplied as a going concern by agreement. However this only applies if the agreement relates to the sale of a tenanted property.

Under clause 3.1 of the agreement, the property was sold with vacant possession unless there were particulars of a tenancy included somewhere in the agreement. There were no references to tenancies or leases in the agreement. The vendors did not fully disclose the tenancies to the purchaser until the working day before settlement. Although the purchaser took over the tenancies, it had not intended to and was not obliged to.

The purchaser contracted on the basis that there would be no tenancies existing at the time of settlement. The fact is, the agreement as signed did not relate to the sale of a tenanted property and is not an agreement in writing for the supply of a going concern.

ACC LATE PAYMENT INTEREST NOT INCOME

Case:	Decision no 028/2004 (TRA 092/03)
Decision date:	27 October 2004
Act:	Income Tax Act 1994
Keywords:	ACC compensation, earnings, penalty, fine, income

Summary

The taxpayer received interest from ACC in respect of a late payment subsequent to a dispute. The TRA held that such interest is in the nature of a fine imposed on the corporation and is not income in the hands of the recipient.

Facts

This case was heard immediately before TRA 091/03 (TRA Decision 023/2004, 16 September 2004) and the point involved is identical in both cases.

The Disputant received earnings related compensation from ACC. However, payment of that compensation was delayed due to a dispute between the Disputant and the Corporation.

As a result of the delay, the Disputant was awarded interest for late payment of that compensation (under section 72 of the Accident Rehabilitation and Compensation Insurance Act 1992).

The Disputant did not declare the interest for income tax purposes. In the Commissioner's opinion, the interest should have been returned in the 2000 income tax year.

The Commissioner assessed the Disputant for additional income in the income year ended March 2000, resulting in residual income tax to pay of $41,754.57.

The matter proceeded through the Disputes Process to Adjudication which found for the CIR. The Disputant filed a challenge in the TRA.

Decision

The TRA held the amount received by the Disputant was not taxable because it was not income under ordinary concepts.

The primary reason given for this finding was that the payment was a fine imposed on ACC. It was not "true" interest because it was not intended to reimburse a claimant, and because it was a fine imposed on ACC, it could not be recharacterised as income in the hands of the recipient.

In the decision for the related matter, the Authority found in favour of the Commissioner on several subsidiary

arguments raised by the Disputant. To the extent which counsel for the Disputant in this case relied upon matters which went against these previous decisions, the earlier views taken by the Authority hold.

However the Authority wished to comment on one matter relied on by counsel for the Disputant in this case that was not raised in the previous case. Counsel for the Disputant submitted, and the Authority agreed, that the Department participated in an extensive consultation and checking process when the Taxation (Core Provisions) Bill was before the House. The Authority agreed with counsel's submission that there is no unequivocal intent expressed in the amended legislation, and given the extent and length of involvement by the relevant officials, it is highly unlikely that Parliament simply overlooked deciding whether or not to tax the penalty payments in question.

In addition, the Authority thought it unlikely that, given the stringent reviews undertaken by Parliament to the ACC legislation from time to time, attention would not have been given to the tax status of such ACC penalty payments. The TRA decided that there is no clear indication that Parliament intends that such payments should be taxable, given that despite opportunity to do so in any of these review sessions, Parliament has declined to enact any specific legislation.

REGULAR FEATURES

DUE DATES REMINDER

December 2004

20 Employer deductions

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

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

January 2005

17 GST return and payment due

20 Employer deductions

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

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

31 GST return and payment due

These dates are taken from Inland Revenue's *Smart business tax due date calendar 2004–2005*
The calendar reflects the due dates for small employers only—less than $100,000 PAYE and SSWT deduction per annum

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

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	Draft item	Comment deadline
	Draft interpretation statement	
☐	IS0081: Reliance on a binding ruling after company amalgamation	14 January 2005
	Draft question we've been asked	
☐	QB0033: Payments made in addition to financial redress under Treaty of Waitangi settlements—income tax treatment	14 January 2005
	Draft interpretation statement	
☐	IS0053: Shortfall penalty for not taking reasonable care	14 January 2005
	Draft interpretation statement	
☐	IS0055: Shortfall penalty—unacceptable interpretation and unacceptable tax position	14 January 2005
	Draft standard practice statement	
☐	ED0067: Income Tax Act 2004—transitional provisions and penalties and interest arising from unintended legislative changes	31 January 2005

Items are not generally available once the comment deadline has passed

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