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

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

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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, having a deadline of 16 February 2005.

Ref.	Draft type	Description
ED0071	Standard practice statement	Disputes resolution process commenced by the Commissioner
ED0072	Standard practice statement	Disputes resolution process commenced by a taxpayer

(Please note that the above exposure drafts of the Standard Practice Statements refer to the proposed legislative provisions in the Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Bill and are subject to the final enactment of the Bill.)

ED0066	Question we've been asked	Deductions from GST output tax for subsequent changes

The following draft item is available for review/comment this month, having a deadline of 25 February 2005.

Ref.	Draft type	Description
PU0125	Public ruling	Taxability of payments under the Human Rights Act 1993 for humiliation, loss of dignity, and injury to feelings

Please see page 22 for details on how to obtain copies.

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 04/14

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 The Royal New Zealand College of General Practitioners ("the College").

Taxation Law

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

This Ruling applies in respect of section CB 9(d) of the Act.

The Arrangement to which this Ruling applies

The Arrangement is the provision of the Payments by the College to the Trainees, for the Trainees' participation in the Course, on terms and conditions that are materially the same as those contained in the following three documents (provided to the Rulings Unit as part of the application for this Ruling):

- Postgraduate Rural General Practice Education Programme Terms and Conditions: Revised October 2003. This contains the terms and conditions to be agreed between the College and all Trainees enrolled in the General Practice Educational Programme.
- Letter of Appointment of Trainee. This is the letter supplied to the Trainee, by the College, as an agreement of the respective obligations of each party.
- Postgraduate Rural General Practice Education Programme Handbook: Revised October 2003. This is the detailed handbook of the terms, conditions, obligations and syllabus of the Course.

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

1. The College was formed in 1974, and obtained a Royal Charter in 1979. The mission of the College is to improve the health of all New Zealanders through the provision of high-quality general practice care.
2. The main purpose of the College is to provide postgraduate general practice education to qualified doctors.
3. The objects and powers of the College (as set out in clause 5.1 of the 28 September 2002 document entitled "The Royal New Zealand College of General Practitioners: Rules") are:
   - (a) To promote in all ways the highest standards in general practice in New Zealand;
   - (b) To sustain and improve the professional competence of members of the medical profession who are engaged in general practice in New Zealand;
   - (c) To encourage, strengthen, and engage in vocational training for general practice;
   - (d) To conduct, direct, encourage, support or provide for continuing education of general practitioners;
   - (e) To encourage and assist in the provision of a high standard of teaching and training for all undergraduate medical students in the field of general practice in New Zealand;
   - (f) To promote activities that encourage the care of members and their families;
   - (g) To encourage and provide for the training of future teachers of general practice;
   - (h) To inform the public in New Zealand about general practice and primary health care issues;

(i) To conduct, direct, encourage, support or provide for research in matters relating to general practice;

(j) To publish and encourage publication of journals, reports and treatises on matters relating to general practice and allied subjects;

(k) To grant diplomas and other certification of proficiency in general practice or any related subject, whether upon examination, thesis, outstanding work or upon other grounds which may be considered sufficient;

(l) To establish a register of members of the College and to publish and revise the same from time to time;

(m) To acquire, establish, provide and maintain such land and buildings as are deemed necessary and to deal with or dispose of the same with a view to promoting the objects of the College;

(n) To acquire and receive property of any kind whether by way of gift, devise, bequest or otherwise howsoever to be applied solely towards the objects of the College provided that no portion thereof shall be paid or transferred directly or indirectly by way of profit to members of the College, but this shall not prevent a member being reimbursed for professional services;

(o) To apply annual dues received from members to defray the expenses of the College, and for such other objects as may be deemed proper by the Council; and

(p) To undertake all such other lawful acts and things as are incidental or conducive to the attainment of the foregoing objects.

4. The College runs a Postgraduate Rural General Practice Education Programme ("the PRGPEP") created from the objectives of the College and based on the College's commitment to maintaining and supporting standards of excellence among general practitioners. It is viewed as a significant part of a comprehensive cycle of vocational and professional education provided by the College and results in a Fellow of the Royal New Zealand College of General Practitioners qualification.

5. The Course is a 12-week practice-based training course established by the College. The Course is one part of the house surgeon's training programme, and is the first part of the rural general practice education pathway.

6. It is stated by the College (at page 7 of the PRGPEP Handbook: Revised October 2003) that the general aims of the Course are to enable Trainees to:

- Experience and participate in rural general practice in a supportive rural general practice environment.
- Acquire medical knowledge and expertise in a rural general practice context.
- Enhance their interpersonal and communication skills, particularly in relation to patient consultations.
- Develop an understanding of the general practitioner/hospital interface and the interface between health professionals in the rural sector.
- Gain an understanding of the relevant cultural context including Mäori and rural culture.
- Develop collegial and peer associations and linkages.
- Develop an understanding of the pathway to a career in general practice.

7. The Course involves various aspects of training that a Trainee is to complete. Essentially, a Trainee is assigned to an accredited "teaching practice" for 12 weeks. Each teaching practice, which must rank 35 or more on the Ministry of Health's "rural ranking scale", is a general practice medical centre for which the College has contracted with a general practitioner to be the Trainee's teacher. The general practitioner teacher ("the Teacher") holds vocational registration and is paid by the College under a separate contract.

8. The Course involves Trainees entering a planned and managed learning environment achieved through the interactions between the Trainee, the Teacher and patients, as well as interactions with other health professionals in the local area, and it includes support and guidance to ensure that learning occurs, and that a representative experience is obtained.

9. Trainees are formatively assessed during the Course, and they receive a final assessment from the Teacher. This assessment is available to the resident medical officer coordinator as part of the Trainee's house surgeon training. Trainees completing the programme receive a letter of completion of this part of their overall training.

10. The standard week for a Trainee undertaking the Course consists almost entirely of patient contact within the teaching practice to which they are assigned. Trainees can also expect to have, on average, two hours each week of "protected teaching time" with the Teacher, sitting in on consultations, and group seminars. In addition to this, Trainees are required to complete a minimum of three "out of hours" supervised sessions. Given that Trainees are geographically distributed throughout New Zealand they attend teleconference (rather than face-to-face) seminars.

11. A Trainee does not receive any payment from the Teacher, but receives the Payments from the College allocated from the funding the College receives from the Clinical Training Agency ("CTA").

12. The CTA has the mandate to purchase educational programmes that will ensure an adequate and stable future workforce. The CTA funds activities based on identified training requirements in respect of the future workforce, and it is expressly prohibited from funding based on current service needs. The CTA undergoes extensive health sector consultation to ensure that all the programmes it funds (including the Course) meet identified training needs.

13. The dollar value of the Payments is $12,000, being paid monthly during the period of the Course (and representing an annualised payment of $52,000). This amount is set at a level to provide for the maintenance of the Trainees' standard of living while undertaking the Course. The Payments are at a level lower than that which a doctor with similar experience in appropriate employment would earn during the period of the Course.

14. A doctor who wishes to attend the Course as a Trainee applies to the College at the appropriate time. From the total number of applicants, the College undertakes a selection process to accept only the number of Trainees for which it has funding.

15. The criteria by which Trainees are selected are merit-based, the College taking the perspective of selecting Trainees who will benefit the community in the long term. These criteria include whether:

    - the applicant has a firm intention to enter general practice and continue general practice vocational education; and
    - the applicant has completed hospital runs relevant to general practice.

16. The College initiates an agreement with each individual doctor that is to be agreed before the doctor becomes a Trainee in the Course. The obligations of Trainees are contained in the PRGPEP Terms and Conditions: Revised October 2003.

17. In exchange for undertaking the above, the Trainees receive from the College the monthly Payments which are intended to maintain the Trainees while attending the Course.

18. The College Council is responsible for setting the educational philosophy and mission statement for its PRGPEP.

19. With regard to the Course content, the College has developed a curriculum for general practice training in consultation with College Members and Fellows and with the CTA to ensure that Government health priority areas are reflected in the educational programmes.

20. The College determines, in consultation with its Trainees, the methods of delivery for its programme. The College also determines the structure of the programme. Materials for the programme are provided by the College and are purchased with funding provided by the CTA.

21. Each Trainee's activities while undertaking the Course reflect the agreement reached between the Trainee and their Teacher as to how the Course syllabus will, in their view, be best achieved for that Trainee. Each Trainee's activities are therefore designed to enable them to implement their agreed learning programme. A Trainee's performance of these activities may assist the operation of their Teacher's practice, but the activities are not designed to achieve this. As Trainees are unable to work independently without the presence of a supervisor, they are not in the position of providing services.

22. The College selects Teachers who meet a number of specific criteria. These include holding general registration with the Medical Council, being a Fellow of the College, and being assessed by the Regional Director as being competent and able to provide excellent education to a Trainee. The Teachers are employed by the College to provide teaching within the calendar year of the programme. All Teachers must undertake ongoing professional development activities while they remain a Teacher.

23. A director (employed by the College) is responsible for maintaining contact with the Teachers during the programme and resolving any difficulties that may arise. They do so primarily through meetings and practice visits with Teachers. The Regional Directors are kept informed by Teachers on the progress of Trainees.

Condition stipulated by the Commissioner

This Ruling is made subject to the following condition:

a) The Payments made to the Trainees under the Arrangement are not grants made under regulations made under section 193 of the Education Act 1964, section 303 of the Education Act 1989, or any enactment in substitution for those sections.

How the Taxation Law applies to the Arrangement

Subject in all respects to the condition stated above, the Taxation Law applies to the Arrangement as follows:

- The Payments made to the Trainees under the Arrangement are exempt income under section CB 9(d).

The period or income year for which this Ruling applies

This Ruling will apply for the period 1 January 2004 until 31 December 2006.

This Ruling is signed by me on the 30th day of November 2004.

Howard Davis
Senior Tax Counsel

NEW LEGISLATION

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

The prescribed rate of interest used to calculate fringe benefit tax for low-interest, employment-related loans has increased from 8.02% to 8.52% for the quarter beginning 1 January 2005.

The rate is regularly reviewed to ensure it is in line with the Reserve Bank's survey of first mortgage interest rates. It was last changed with effect from the quarter beginning 1 October 2004. The new rate was approved by Order in Council on 24 November 2004.

Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations (No. 4)) 2004 2004/406.

LEGAL DECISIONS – CASE NOTES

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

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

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.

TAX AVOIDANCE

Case: TRA decision no 30/2004

Decision date: 16 November 2004

Act: Income Tax Act 1994

Keywords: Tax avoidance, shortfall penalties

Summary

The TRA found that the transactions entered into did not amount to tax avoidance.

Facts

This matter concerns the affairs of a company, ZHL, and Mr Q, who is involved as director and principal shareholder. Another company, MMHL, is also involved in the arrangements in question.

MMHL was set up in 1974 as a management and investment company. Mr Q was a founding director. Until early 1990, MMHL traded successfully, however the stock market collapse in 1987 left it holding a number of guarantees and with an exposure to foreign exchange losses. MMHL ceased trading in 1989, with accumulated losses in the region of $1m. MMHL also owed money to Mr Q, who, at the relevant time, owned 99% of its shares.

ZHL was set up by Mr Q and a business associate, Mr C; both were shareholders and made monetary contributions to the company. The money was held on capital account. Mr Q made further advances on his current account—his contributions significantly outweighed those made by Mr C.

In 1997, Mr Q approached Mr C, requesting that the current accounts bear interest. Mr C, essentially, refused, and the situation developed into a stand-off, becoming quite acrimonious. Eventually it was agreed that part of Mr Q's current account ($1.2m) would be replaced with an interest-bearing loan from Mr Q to ZHL.

Mr Q assigned his loan to ZHL to MMHL. ZHL agreed to pay interest to MMHL at the rate of 25%. MMHL paid $1.2m to Mr Q as consideration, which Mr Q immediately re-advanced to MMHL. This was done on terms whereby, although interest was to be paid to Mr Q, it was not required unless it was requested. There was no record that interest was ever requested.

MMHL set off the interest received from ZHL against its accumulated losses, and made repayments of capital to Mr Q.

Decision

In summary, the Authority found:

> "1. That the impugned transaction was wholly genuine and driven by necessary commercial imperatives.
>
> 2. The disputants have the right to exercise a choice to structure the transaction to take advantage of tax losses lawfully available to them."

The matter of the appropriateness of the 25% interest rate was of key importance. The CIR argued that it was in excess of what was a suitable rate, as, although the parties were dealing at arm's length, the element of risk was negligible as Mr Q was the controlling party behind both entities. The taxpayer argued that the rate was in line with what would have been charged by any other lender.

The Authority determined that finance would not have been available from a bank, and that finance would have to had to come from a "second-tier lender". MMHL falls into this category. The Authority found that given ZHL's lack of assets to secure the loan against, 25% was a commercial rate of interest.

Having found this, the Authority then went on to consider the question of whether the transaction was caught by the tax avoidance provisions. In response to the CIR's submission that the flow of funds between the parties was circular, the Authority noted:

> "The following consequences fundamentally changed … the financial landscape between the parties:

- ZHL no longer owed money to Mr Q on the current account the subject of the transaction.
- ZHL was required to pay interest of $1.2m borrowings which previously had been interest-free. It thereby reduced its income.
- MMHL received income (or allowed it to accumulate in the books of ZHL) and utilised valuable losses in receiving it.
- MR Q shifted the debt owed to him by ZHL, a company with a recalcitrant minority shareholder, into a company he completely controlled.
- MR Q received no interest but reduced the amount that MMHL owed him. The fact that this came back to him as untaxable capital was an incident of his financial relationship with MMHL and nothing to do with the transaction between ZHL and MMHL."

The Authority goes on to comment that counsel for the disputant "says, … correctly, that but for "*the anti-avoidance rule the deductions claimed by ZHL would be unassailable*." "

In conclusion, the Authority held that the interest payable to MMHL had the necessary nexus with the production of assessable income, and that the agreements were entered into for a proven commercial purpose, with a merely incidental consequence of a favourable tax outcome.

Given this, the Authority did not make any finding on the question of shortfall penalties, as to do so was unnecessary.

UNCLAIMED MONEY – UNPRESENTED FX DRAFTS ARE UNCLAIMED MONEY DUE TO CROWN

Case:	Thomas Cook (New Zealand) Limited v CIR (PC)
Decision date:	11 November 2004
Act:	Unclaimed Money Act 1971
Keywords:	unclaimed money, drafts, foreign currency

Summary

A draft for foreign currency purchased with New Zealand currency which is unpresented by the payee six years after issue is unclaimed money within s 4(1)(e) of the Unclaimed Money Act 1971.

Facts

This case concerns drafts for foreign currency issued by Thomas Cook, which remain unpresented by the payee within six years of purchase by Thomas Cook's customers. The issue was whether funds represented by certain unpresented drafts for a period of at least six years and still held by Thomas Cook (NZ$500,000 up to December 1992) are unclaimed monies which Thomas Cook is required under S 4(1)(e) of the Unclaimed Money Act 1971 to pay over to the Commissioner.

New Zealand has legislation under which, holders of unclaimed monies are required in certain circumstances, to pay those sums over to the Commissioner for use by the Crown (Unclaimed Money Act 1971).

The Act applies to five categories of unclaimed money (specified in section 4) situated in New Zealand, held or owing by certain holders. Each holder is required to keep a register which includes particulars of money unclaimed within the course of the preceding year. The holder of the register must send a notice to the owner at the last known address of any money entered in the register no later than 30 June of the year it is entered. The Commissioner must also be notified. If money is unclaimed by the 30 September it must be paid to the Commissioner by 30 October, when it becomes a recoverable debt due to the Crown.

The heart of the appeal is section 4 (1) (e) of the 1971 Act:

> "[Unclaimed money shall consist of] (e) Any other money, of any kind whatsoever, which has been owing by an holder for the period of six years immediately following the date on which the money has become payable by the holder"

Each draft records the payee and the code number of the relevant bank account which Thomas Cook maintains with the applicable foreign bank, being the account where funds are drawn to meet payment upon presentation of the draft. Thomas Cook regard cheques that have not been presented within 12 months of issue, as stale. If a cheque is presented outside of the 12 months, it may not be honoured by the foreign bank, the payee would then need to go to Thomas Cook to issue a new Cheque for payment or request a telegraphic transfer for the same amount. The Court of Appeal held that the drafts became stale after six months at which point the foreign banks were under no obligation to honour them. The Commissioner's argument was that the presentments of the drafts for payment were not a necessary precondition of Thomas Cook's legal liability to the payee, so the six-year period began from the date of issue. This argument failed, but the alternative argument was that the cause of action on stale drafts arose at the time they became stale (six months after issue).

Decision

The Judicial Committee held that the arguments in the courts below did not properly address the issue. The issue, in the end came down to the unravelling of a non sequiteur. The Court of Appeal had held that in order to be "payable" under the 1971 statute, hence "unclaimed" money, there had to be a demand made for payment. If there had been a demand, how could the money be unclaimed? At paragraph 16 (referring to an example of the use of the word "payable" elsewhere in the legislation:

> "… the word "payable" is used to mean simply that, as between the company and its shareholders, the money is due to the shareholders. They are entitled to it, whether it has been demanded or not and whether, indeed, the company or mutual association can trace them. Money may, of course, be payable only at some specified future date. That is why section 4(1)(e) speaks not merely of money "owing" but of money owing for six years after it "has become payable". But that is not to say that under this legislation it only becomes payable on demand and thus is not payable until claimed. That surely would be the greatest nonsense of all: to say that money can only become unclaimed money once it has in fact been claimed."

There had been a number of arguments raised by both parties which turned on "abstruse points of law arising under the Bills of Exchange Act 1908" but their Lordships did not consider it necessary to address any of those. The decision turned on contextual arguments (as above) based on the scheme of section 4(1) (e) of the 1971 Act. By that analysis the Judicial Committee found that there was no suggestion in the legislation that a cause of action ought to have already arisen in respect of the relevant money before it could be considered payable. Further, that the issue had nothing to do with the Limitation Act as there were the timeframes in the 1971 Act which were inconsistent with that analysis.

Their Lordships thus held that the drafts issued by Thomas Cook were for the purposes of the 1971 Act owing and payable from the date of issue and it didn't matter whether the drafts ever could have been sued upon without a demand being made. Further, it did not mean that they had to become stale either before falling into the payable category.

INTERLOCUTORY DECISIONS OF THE TAXATION REVIEW AUTHORITY CANNOT BE APPEALED

Case:	M & J Wetherill Company Ltd & Ors v TRA and CIR, CA 226/03
Decision date:	10 November 2004
Act:	Taxation Review Authorities Act 1994
Keywords:	Interlocutory appeals from the TRA

Summary

The Court of Appeal confirmed that interlocutory decisions of the Taxation Review Authority cannot be appealed.

Facts

This case has a very long history. In 1996 the Commissioner received a number of requests for cases stated on the objectors' objections (relating to the JG Russell tax avoidance template). The objectors requested that the cases stated be filed in the Taxation Review Authority ("the TRA"), but the Commissioner filed them in the High Court.

The High Court (Baragwanath J) determined that it would more appropriate for the cases stated to be heard in the TRA and told the Commissioner to file them there. In *Case U35* (2000) 19 NZTC 9,330 the TRA accepted the Commissioner's application to file the cases stated out of time and rejected the objectors' application that their objections be allowed. In *Case U41* (2000) 19 NZTC 9,380 the TRA refused to allow an appeal of *Case U35* and struck a purported appeal out.

In *M & J Wetherill & Co Ltd v TRA & CIR* (2001) 20 NZTC 17,166 the objectors judicially reviewed the TRA's decisions in *Case U35* and *Case U41*. The High Court (O'Regan J) largely found for the objectors and sent the case back to the TRA for re-determination. His Honour held, in relation to *Case U41*, that interlocutory decisions of the TRA could be appealed. However, despite their success in the High Court, the objectors appealed to the Court of Appeal. The Commissioner cross-appealed. The Court of Appeal rejected the objectors' appeal and allowed the Commissioner's cross-appeal: *M & J Wetherill & Co Ltd v TRA* (2002) 20 NZTC 17,624. The Court of Appeal also refused an application by the objectors for leave to appeal to the Privy Council: *M & J Wetherill & Co Ltd v TRA* (2002) 20 NZTC 17,681. The Court of Appeal also doubted whether interlocutory decisions of the TRA could be appealed.

In *Case W7* (2003) 21 NZTC 11,049 the objectors attempted to appeal the TRA's decision in *Case U35*.

The objectors argued that as O'Regan J had held that there was a right of appeal in relation to *Case U35* and that since the Commissioner had not appealed that finding the TRA was bound to follow the ruling of the High Court. They submitted that O'Regan J's decision was res judicata and the TRA was therefore obliged to state a case on appeal.

In *Case W7* the TRA refused to state a case on appeal and the objectors judicially reviewed that decision. The review was again heard by O'Regan J: *M & J Wetherill Co Ltd v TRA & CIR* (2003) 21 NZTC 18,311.

Before O'Regan J the Commissioner argued that there was no right of appeal of interlocutory decisions of the TRA, based on the comments of the Court of Appeal in the previous decisions. O'Regan J however held that based on his first judgment there was a right of appeal, but refused to exercise his discretion to grant the relief requested by the appellants. This was based on a number of factors included the doubt expressed by the Court of Appeal as to whether appeal rights existed.

Before the Court of Appeal the appellants argued that O'Regan J was wrong and that their appeal should be allowed. The Commissioner supported the judge's exercise of his discretion but also argued that there is no right to appeal interlocutory decision from the TRA.

Decision

The Court of Appeal noted that the first point to be decided was whether there was a right of appeal of interlocutory decisions under section 26 of the Taxation Review Authorities Act 1994, noting that if that point was resolved against the appellants "it is the end of the whole saga" (at paragraph [53]).

The Court of Appeal held that the Commissioner was correct in his submission that there is no right of appeal of interlocutory matters under section 26(1). Firstly, section 26(1) referred to "[t]he determination of the authority on any objection". This suggested that only the determination of the objection itself could be appealed, and not other findings. Secondly, looking at the subsection as a whole, the factors in subsection (1)(a) and (c) could not be sensibly said to be qualifiers of an interlocutory appeal. Thirdly, the rest of section 26 did not sit easily with a right of appeal on interlocutory matters. It would be unlikely that Parliament would have allowed an appellant nine months to prepare a case on appeal for interlocutory matters. Fourthly, the wider scheme of the Taxation Review Authorities Act supported the construction urged by the Commissioner.

The Court of Appeal therefore held that at paragraph [41] of his judgment (where he had held that the appellants had a right of appeal) O'Regan J proceeded on an incorrect legal premise.

Because of the Court's finding on this issue it was not necessary to consider the other matters raised by counsel. The appeal was dismissed.

AMENDMENT OF A TAXPAYER'S GST DE-REGISTRATION DATE

Case:	CIR v Jeffrey George Lopas and Lorraine Elizabeth McHerron
Decision date:	3 November 2004
Act:	Goods and Services Tax Act 1985 ("the Act")
Keywords:	cancellation of GST registration, termination supply, cessation supply, amendment of a de-registration date

Summary

The CIR is entitled to amend a taxpayer's GST de-registration date to a date after the taxpayer's applied for cancellation date if the taxpayer has made a termination supply after that applied for date.

Facts

This was an appeal by the CIR from a decision of the TRA on 14 May 2004.

Jeffrey Lopas and Lorraine McHerron ("the taxpayers") were in a partnership that registered for GST from 1 October 1992. Its taxable activity was stated as "forestry". In the partnership's first GST return it claimed a GST input tax refund in relation to the purchase of land ("the property").

By deeds of trust dated 20 September 1999 the Jeffrey Lopas Family Trust and the Lorraine McHerron Family Trust were established. These two trusts formed a Family Trusts Partnership ("the Family Trusts Partnership"). The Family Trusts partnership was registered for GST purposes from 1 October 1999.

On 4 October 1999 the taxpayers applied to cancel their partnership's GST registration effective from 30 September 1999 on the basis that their taxable supplies were going to be less than $30,000 in the 12 months following 30 September 1999.

The application form stated that the taxpayers would be retaining the property at a cost price of $115,000 (including GST) and returned GST accordingly. The taxpayers de-registered from 30 September 1999.

Four days after applying to cancel their GST registration (8 October 1999), the taxpayers sold the property to the Family Trusts Partnership for $375,000 (inclusive of GST, if any).

On 13 October 1999 subdivision and land use consent for the property was granted by the Banks Peninsular District Council. The CIR also obtained further information that the Council had been advised that the property had been transferred from the taxpayers to the Family Trusts Partnership in July or August of 1999.

In light of this information the CIR amended the taxpayer's GST cancellation date from 30 September 1999 to 30 November 1999 and thus sought GST to be paid not on the cost price of $115,000 but on the sale price of $375,000.

Decision

The TRA decision had focused on the application section 51(1) of the Act. However the High Court focused on section 52, section 5(3) and section 6(2) of the Act in its decision.

Section 52(1) which the Judge considered to be of key relevance provides:

(1) Subject to this Act, every registered person who carries on any taxable activity shall cease to be liable to be registered where at any time ... the Commissioner is satisfied that the value of that person's taxable supplies in the period of 12 months then beginning will be not more than the amount specified for the purposes of section 51(1) of this Act.

The amount specified in section51(1) at the relevant tine was $30,000.

The Judge focussed on whether the supply of the property was a termination supply in terms of section 6(2) or a cessation supply in terms of section 5(3). The Judge found that;

> "… there was an undoubted connection between the sale and termination of the taxable activity".

For that reason the Judge found that there was no scope for section 5(3) to apply and that as section 6(2) applied, the sale was connected to the termination of the taxpayers forestry activity and it was deemed to be carried out in the furtherance of that taxable activity. For that reason the Judge did not accept that the taxpayers were entitled to cease their GST registration under section 52 of the Act and that they were obliged to pay GST output tax to the CIR by reference to the sale price of $375,000.

Based on the above decision the Judge also found that the CIR was correct to amend the deregistration date to 30 November 1999 and said;

"He had no option but to do so in light of the additional information".

LIQUIDATORS ENTITLED TO PRE-LIQUIDATION INPUT TAX CREDITS

Case: TRA Decision No. 029/2004

Decision date: 2 November 2004

Act: Goods and Services Tax Act 1985

Keywords: specified agent, incapacitated person, liquidator, unclaimed pre-liquidation input tax credits, offset of any output tax owing

Summary

A liquidator is entitled to claim previously unclaimed pre-liquidation input tax credits with no liability to account for any pre-liquidation output tax owing.

Note: From application on and after 10 October 2000 the relevant legislation has been changed with the result that the GST offset rules now apply to input tax credit claims by a liquidator.

Facts

The Company disputant was incorporated on 4 December 1996. Between 1 July 1998 and 31 May 1999 the disputant made and received taxable supplies for GST purposes of respectively $195,847.38 and $192,378.24. The disputant did not register for GST nor did it file any GST returns. On 3 June 1999 the disputant was placed into liquidation, with a liquidator appointed.

By virtue of section 58 of the Goods and Services Act 1985 ("the GST Act") the liquidator became the "specified agent" of the disputant, and the disputant became an "incapacitated person".

On 14 July 1999 the liquidator registered the disputant for GST with effect from 1 July 1998, on the invoice basis. The liquidator on 10 August 1999 filed his first GST return, this return included a claim for a GST input tax refund of $21,375.36 (from a total of $22,234.49) for the period from 1 July 1998 to 31 may 1999, which was for a period before the disputant's liquidation.

The CIR calculated that the disputant should have paid GST output tax of $21,760.82 for the period of 1 July 1998 to 31 May 1999. The CIR disallowed the total claimed GST input tax refund of $22,234.49, but was prepared to allow a refund of $38.45 which took into account some other GST-related matters.

Decision

The key sections of the GST Act 1985 that the Judge had to deal with were sections 20, 58 and 58(1A).

Section 58 and 58(1A) primarily deal with the mechanics of a liquidator becoming a "specified agent"

of a Company that is placed into liquidation. The focus of the decision in respect of section 20 was subsection 20(3) which allows a person registered for GST to claim GST input tax refunds in respect of earlier periods where that person had previously not claimed those refunds.

The CIR argued that:

1. The liquidator is a different person from the underlying registered disputant Company and therefore the liquidator cannot use section 20(3) to obtain GST input tax refunds.
2. That the GST Act was amended from 10 October 2000 to clarify this situation and the CIR's position is the same as that clarifying amendment.
3. That it would be unfair for the liquidator to able to claim the pre-liquidation GST input tax refunds but not be liable for the pre-liquidation GST output tax liabilities.
4. That even if the liquidator is entitled to claim GST input tax refunds the CIR is allowed to offset any GST output tax owing against that claim, either under section 46 of the GST Act or section 310 of the Companies Act 1993.

The disputant's arguments were:

1. That Inland Revenue had, in *Tax Information Bulletin* Vol 7, No 6 advised that a "specified agent" could claim GST input tax refunds related to taxable activity in the pre-liquidation period. The *TIB* specifically referred to section 20(3) of the GST Act in this regard.
2. That the same *TIB* referring to section 58(1A) of the GST Act advised that the liquidator as "specified agent" is not liable for any GST liabilities incurred by the disputant Company in the pre-liquidation period.
3. That a Government discussion document and a commentary by Dr Michael Cullen supported the argument that the liquidator is entitled to claim the GST input tax refunds.
4. That section 20(3) of the GST Act specifically allows a GST registered person to claim any GST input tax refunds in a later period.
5. That there is no statutory obligation on the liquidator to account for any GST output tax and that section 20(4) does not provide for a GST registered person to return GST output tax in a later period.

The Judge found that the question that needed to be decided was:

> ".. the short point for decision in this case is whether or not a liquidator is carrying on the taxable activities of the company in liquidation, or is a registered person separate from the company he is appointed to liquidate. If the former, then he can claim the unused inputs in a later period as he has done, but by virtue of s.58(1A) he is not personally liable for any outputs which relate to the pre-liquidation period."

The Judge found:

1. He did not accept that it was unfair that the liquidator had claimed GST input tax refunds but was arguing that he did not have to accept liability for the GST output tax liabilities. He said "…the GST legislation should not be interpreted against a quest for symmetry".
2. That section 58(1A) created an exception to the general agency provisions of section 60, and that section 58(1A) was intended to ensure that liquidators are treated as a special class of agent and they become the "registered person".
3. That section 20(3) is clear and allows a liquidator as the registered person to claim previously unclaimed GST input refunds.
4. That the effect of section 58(1A) is that the liquidator is not liable for the disputant Company's GST liabilities.
5. That section 58(1A) is a specific provision to deal with a specific situation and as such it prevails over section 46. For that reason the CIR is not entitled to set off any GST output tax owing by the disputant Company against the claimed GST input tax refunds.
6. That section 310 of the Companies Act 1993 just does not apply in this case.

The Judge decided that the disputant is entitled to the GST input tax refund as claimed. In respect of the GST output tax liability the CIR would rank as a preferential creditor in the liquidation.

MEMBERSHIP SHARES GST-EXEMPT

Case:	CIR v Gulf Harbour Development Limited (CA)
Decision date:	5 November 2004
Act:	Goods and Services Tax Act 1985
Keywords:	GST, exempt supply, financial services, shares, club membership

Summary

The Court of Appeal held the supply of membership shares in a golf and country club was an exempt supply for GST purposes because it was the supply of a financial service (equity security).

Facts

This was an appeal from the 27 June 2003 High Court decision.

Gulf Harbour Development Ltd ("GHD Ltd") is the representative member of a group of companies, which includes Gulf Harbour Holdings Ltd, Gulf Harbour Country Club Holdings Ltd ("Holdings") and Gulf Harbour Country Club Ltd ("Country Club Ltd").

In March 1996, Country Club Ltd sold membership shares to Holdings in consideration for Holdings agreeing to pay all of the costs associated with the development of a golf and country club (Gulf Harbour Country Club: "the Club"). The shareholding in Country Club Ltd comprises fully paid up $1 ordinary shares and fully paid redeemable preference shares. It is these redeemable preference shares that are the membership shares in issue.

Holdings issued prospectus' for sale to the public of membership shares in Country Club Ltd. Each membership share was issued for a fixed term of just over 75 years with the term of all memberships expiring on 31 March 2073. On that date, each membership share is to be redeemed for $1 and all rights attaching to that share will cease.

There are three types of membership shares (individual, restricted and corporate) with obligations and restrictions attaching to each type. All holders of membership shares are required to pay annual subscriptions; and have no entitlement to participate in dividends or distributions of any type (except on liquidation), or to vote or attend any company meetings (except where members' interests are directly affected), or to participate in the company's management and operations (except as described in the prospectus in relation to the establishment and operation of the Club Committee).

The Club board may impose a penalty, fine or suspend rights to use the Club facilities or any other rights attaching to the relevant membership share if holders fail to comply with the obligations and restrictions of that membership share. The Club board may also cause Country Club Ltd to forfeit a holder's membership shares in the case of insolvency, criminal conviction, ceasing to be of good character or failing to comply with the obligations or restrictions of the membership share or with the Club rules.

Country Club Ltd did not charge GST in respect of the sale of membership shares to Holdings, and Holdings did not receive an input tax credit in respect of that sale. Holdings did not charge GST on the sale of the membership share to the public because Holdings believed that the on-sale of the membership shares was an exempt supply for GST purposes.

The matter proceeded through the disputes process, and proceedings were filed in the High Court.

The Commissioner contended that the supply was a composite supply of club membership. Alternatively, the Commissioner contended that if the supply was not a composite supply, there were multiple supplies consisting of an equity share (exempt supply) and a club membership (taxable supply).

GHD Ltd contended that there was a single supply of the membership shares and the consideration paid was for shares and not the membership gifts.

Baragwanath J in the High Court found the supply of membership shares was the supply of an equity security, and therefore exempt for GST purposes. The Commissioner appealed this decision to the Court of Appeal.

Decision

The appeal was dismissed.

The Court of Appeal considered the Commissioner's argument to be, in essence, one of substance over form, and as such, contrary to the well-established authorities. *Marac Life Assurance Ltd v CIR* [1986] 1 NZLR 694 has been applied by the Court of Appeal in the GST context, and was again applied to support the High Court's decision and the taxpayer's argument. The Court of Appeal found that preference shares were sold and that they are equity securities for the purposes of the GST Act, and the rights to membership arose exclusively from those equity securities.

With regard to the English cases, the Court of Appeal reiterated the need to approach them with care, given that VAT is levied under a different legislative framework from GST.

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out answers to some enquiries we've received. We publish these as they may be of general interest to readers. A general similarity to items published here will not necessarily lead to the same tax result. Each case should be considered on its own facts.

PAYE WHERE INCOME RECEIVED FRAUDULENTLY OR IN ERROR

Introduction

1. Inland Revenue has been asked to clarify the tax effects of amounts received fraudulently or in error, in the context of source deduction payments.

2. This item considers PAYE consequences where any amount has been received fraudulently or in error and PAYE has been deducted. The income may be employment income, an income-tested benefit, or self-employment income under the Income Tax (Withholding Payments) Regulations 1979.

Legislation

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

4. Where a person receives amounts without "claim of right" they are included as gross income pursuant to section CD 6. Section OB 1 defines "claim of right" as follows:

> "**Claim of right"**, in relation to any act, means a belief that the act is lawful, although that belief may be based on ignorance or mistake of fact or of any matter of law other than the enactment against which the offence is alleged to have been committed.

5. The essence of "claim of right" is that the person must have a genuine belief that the act is lawful. The above definition was inserted with effect from 1 October 2003.

6. Previously, section CD 6 referred to the term "colour of right". Section 2 of the Crimes Act 1961 used to define "colour of right" as follows:

> **"Colour of right"**, in relation to any act, means an honest belief that the act is justifiable, although that belief may be based on ignorance or mistake of fact or of any matter of law other than the enactment against which the offence is alleged to have been committed.

7. If the person repays that income they are entitled to a deduction for the amount repaid in the year it is repaid, pursuant to section DJ 18.

8. Whether a recipient of an incorrect payment has received it without "claim of right" essentially requires some evidence of fraud or criminal dishonesty, rather than merely passively receiving a payment in error. If the taxpayer knows an error has occurred, they may not be able to establish a claim of right, but Inland Revenue is often unable to establish whether or not the taxpayer genuinely believed (rightly or wrongly) that he or she was entitled to the payment.

9. Inland Revenue will generally be unable to apply section CD 6 without material evidence of wrongdoing, and as a matter of practice will usually apply section CD 6 only where a prosecution has been commenced (usually by the police, but also in civil recovery action) against the taxpayer. Section EN 5(2) explains that income under section CD 6 is deemed to be derived in the income year that possession or control of the property is obtained.

10. The PAYE rules apply to source deduction payments. Section OB 2 defines "source deduction payment" as:

> (1) In this Act, except as provided in subsection (2), "source deduction payment" means a payment by way of salary or wages, an extra emolument, or a withholding payment, but does not include an amount attributed in accordance with section GC 14D.

11. Generally, in determining the nature of the obligation, PAYE will not be deductible against income that has been received by a recipient either fraudulently or in error.

Practice

Employment or benefit income received fraudulently by a person

12. Where a person receives income fraudulently it is gross income for the purpose of tax, under section CD 6. However, as the recipient is not entitled to the income it is not a payment subject to PAYE. If PAYE has been deducted, the Commissioner will repay that amount to the person who made the payment on request in writing.

13. The amount assessed to the recipient is the net amount of the fraudulent payment; that is, the amount actually received by them. The recipient is

then responsible for meeting their tax liability on that income. Usually this will require completion of an *Individual tax return (IR 3)*.

14. If the recipient repays any of the income, they can claim a deduction in the year of repayment under section DJ 18.

Example

15. An employee responsible for salary and wages at a small company makes fraudulent payments to himself on a fortnightly basis of $200. The employer discovers this as part of an audit after 24 weeks. In total the company paid an additional $2,400.

16. The employee received $1,944 net in this way and $456 was paid as PAYE in the employee's name.

17. The employee should be assessed income of $1,944. The $456 paid as PAYE should be returned to the employer.

Income received in error from an employer

18. Where an employer has paid an employee in error an amount to which the employee is not entitled (and where section CD 6 does not apply), it is not income the employee is entitled to. Therefore, it is not a payment subject to PAYE and Inland Revenue will return the PAYE to the employer on request in writing. Income that is received in error and repaid will not be assessable to the employee, and employees cannot claim a deduction in the year of repayment. An agreement to repay amounts between employers and employees is a private arrangement.

19. If an employer supplies a letter with amended salary or wages for a prior year (where section CD 6 does not apply), the employee's personal tax summary or return of income will be amended to show the new figures.

20. Sometimes, overpayments of salary and wages occur through simple oversight and are immediately identified, and repaid perhaps in the next pay period. Assuming that sections CD 6 and DJ 18 do not usually apply, if the situation is corrected within the same period, Inland Revenue will permit the employer to correct the matter in the employer monthly schedule filed.

21. However, for various reasons the employer and employee may come to a different arrangement regarding the amount paid in error. For example, they may decide to treat it as income in advance or a bonus. In these situations the income may be accepted as having the characteristics of a source deduction payment and be subject to PAYE. The employer or company would not seek a refund of the PAYE, and Inland Revenue would retain the PAYE as a credit against the employee's tax liability.

22. The character of a payment made in error is a question of fact. This will need to be considered in each case.

Example

23. A bonus payment of $500 is mistakenly paid to the wrong employee. The employee receives $405 and $95 is paid to Inland Revenue as PAYE. The employee, believing it to be an undeclared bonus, spends it. When the error is identified the employee is told of the mistake, but at that time is unable to repay the money.

24. The employer as a matter of goodwill agrees to treat the payment as a bonus. The employee will be taxed on the gross amount, $500. Inland Revenue will retain the PAYE as a credit against the employee's tax liability.

Income received in error by way of a benefit

25. Where income is received in error by way of a benefit (in circumstances where section CD 6 does not apply), the person is not entitled to the receipt of it. The rules are the same as for salary and wages. The overpayment is not a source deduction payment and PAYE does not apply. The recipient has an obligation to repay the amount received.

26. If deducted, the PAYE would be returned by Inland Revenue to the payer, usually Work and Income, on request in writing.

27. If the recipient repays the benefit received in error they get no deduction for the repayments.

28. If Work and Income supply written confirmation of the amended benefit for a prior year (where section CD 6 does not apply), the beneficiary's Personal Tax Summary or Return of Income will be amended to show the new figures.

Requests

29. In any of the above situations, the employer must provide a written request, with the full factual situation, before Inland Revenue will investigate the refund of any PAYE received.

REGULAR FEATURES

DUE DATES REMINDER

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

February 2005

7 End of year income tax

- 7 February 2005
  2004–end-of-year income tax due for people and organisations
  with a March balance date and who do not have an agent

21 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

28 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.

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

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

By post: Tick the drafts you want below, fill in your name and address, and return this page to the address below. We'll send you the drafts by return post. Please send any comments in writing, to the address below. We don't have facilities to deal with your comments by phone or at our other offices.

By internet: Visit **www.ird.govt.nz**
On the homepage, click on "The Rulings Unit welcomes your comment on drafts of public rulings/interpretation statements before they are finalised ." Below the heading "Think about the issues", click on the drafts that interest you. You can return your comments by internet.

Name _____

Address _____

_____

	Draft standard practice statement	***Comment deadline***
☐	ED0071: Disputes resolution process commenced by the Commissioner	16 February 2005
	Draft standard practice statement	
☐	ED0072: Disputes resolution process commenced by a taxpayer	16 February 2005

(Please note that the above exposure drafts of the Standard Practice Statements refer to the proposed legislative provisions in the Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Bill and are subject to the final enactment of the Bill.)

	Draft question we've been asked	
☐	ED0066: Deductions from GST output tax for subsequent changes to taxable use	16 February 2005
	Draft public ruling	
☐	PU0125: Taxability of payments under the Human Rights Act 1993 for humiliation, loss of dignity, and injury to feelings	25 February 2005

Items are not generally available once the comment deadline has passed

No envelope needed—simply fold, tape shut, stamp and post.

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