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This TIB has no appendix

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This *Tax Information Bulletin (TIB)* 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 item is available for review/comment this month, having a deadline of 28 May 2004.

Ref	Draft type	Description
IS2783	Interpretation statement	Deductibility of feasibility expenditure

Please see page 58 for details on how to obtain a copy.

The following draft items are available for review/comment this month, having a deadline of 31 May 2004.

Ref	Draft type	Description
ED0051	Question we've been asked	GST group registration of trusts
ED0054	Question we've been asked	PAYE where income received fraudulently or in error
ED0058	Exposure draft	Income Tax Act rewrite—process for resolving potential unintended legislative changes

Please see page 58 for details on how to obtain a copy.

The following draft item is available for review/comment this month, having a deadline of 31 May 2004.

Ref	Draft type	Description
DDG0062	General depreciation determination	Digital photographic minilabs

Please see page 28 for the text of this draft.

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**

LICENSED PREMISES' OPERATORS – DEDUCTIBILITY OF ENTERTAINMENT EXPENDITURE

PUBLIC RULING – BR PUB 04/02

Note (not part of the ruling):

This ruling is essentially the same as public ruling BR Pub 99/3 previously published in *Tax Information Bulletin* Vol 11, No 5 (May/June 1999), and BR Pub 96/5 which was published in *Tax Information Bulletin* Vol 7, No 12 (April 1996). BR Pub 04/02 applies from 1 April 2004 for an indefinite period. Some minor wording and formatting changes have been made. BR Pub 99/3 applied until 31 March 2004.

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

Taxation Laws

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

This Ruling applies in respect of section DG 1 and Schedule 6A of the Act.

The Arrangement to which this Ruling applies

The Arrangement is the incurring of expenditure by any person who carries on business as a licensed premises' operator under the Sale of Liquor Act 1989 ("licensee") and who, in the ordinary course of that business:

- Incurs that expenditure on food or beverages and makes special offers of that food or beverage in arm's length transactions with members of the general public. The special offers of food or beverages to which this Ruling applies include:
  - Happy hours where a licensee offers drinks to customers at reduced prices during a particular time period
  - Offers of free drinks, or food or both on certain days or at certain times to customers or categories of customers selected from the general public
  - Two meals offered to customers for the price of one
  - "Toss the boss" competitions where for every drink purchased, the customer can toss a coin and has the chance to win a free drink, or
- Pays an allowance to an employee (such as a bar manager) to cover the costs of the employee providing in the ordinary course of business, free drinks or food or both to customers on the licensee's business premises but not at a party or similar social function or in a reserved area, or where there is other than an arm's length relationship with the customer.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The deduction available for expenditure on the special offers of food or beverages is not limited to 50% under section DG 1.

- The deduction available for expenditure on the allowance paid to an employee is not limited to 50% under section DG 1.

The period or income year for which this Ruling applies

This Ruling will apply from 1 April 2004 for an indefinite period.

This Ruling is signed by me on the 5th day of April 2004.

Martin Smith
General Manager (Adjudication & Rulings)

COMMENTARY ON PUBLIC RULING BR PUB 04/02

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in public ruling BR Pub 04/02 ("the Ruling").

All references to a "licensee" are to any person who carries on business as a licensed premises' operator under the Sale of Liquor Act 1989.

Background

Under section DG 1, the deduction allowed for expenditure or loss on "specified types of entertainment" set out in Part A of Schedule 6A is limited to 50% of that expenditure, unless the entertainment or benefit is "excluded entertainment" under Part B of the Schedule. If the entertainment or benefit is not of the specified types in Part A, or is excluded entertainment under Part B, the expenditure or loss is fully deductible, provided it is incurred in deriving the taxpayer's gross income or it is necessarily incurred in carrying on a business for the purpose of deriving the taxpayer's gross income, pursuant to section BD 2(1)(b).

Section DG 1 also treats an allowance paid to reimburse expenditure by an employee on specified types of entertainment that fall within Part A, as being expenditure by the taxpayer on the particular specified type of entertainment.

Legislation

Section DG 1 states:

(1) This section and Schedule 6A are intended to limit the amount of the deduction allowed for expenditure or loss incurred on certain types of entertainment, being entertainment that generally involves a significant element of private benefit, to 50% of that expenditure or loss (but subject always to the express provisions of this section and Schedule 6A).

(2) If a taxpayer incurs expenditure or loss on a type of entertainment or benefit (whether consumed or enjoyed by the taxpayer or anyone else) specified in Part A of Schedule 6A then, unless and to the extent that the entertainment or benefit is specified as excluded entertainment in Part B of that Schedule, the deduction allowed for that expenditure or loss will be limited to 50% of the amount that would be allowed as a deduction but for this section.

(3) For the purposes of this section—

(a) A taxpayer will be treated as incurring expenditure on a specified type of entertainment to the extent that the taxpayer pays an allowance for, or reimburses an employee's expenditure on, the specified type of entertainment and the allowance or reimbursement is exempt income under section CB 12:

….

Part A of Schedule 6A lists four "specified types of entertainment":

- Corporate boxes
- Holiday accommodation
- Pleasure craft
- Food or beverages.

Effectively, a description of "food or beverages" for the purposes of Part A of Schedule 6A is contained in clause 4 of Part A, which states:

Food or beverages—

(a) Provided or consumed as an incidence of any of the types of entertainment specified in clauses 1 to 3; or

(b) Provided or consumed off the business premises of the taxpayer; or

(c) Provided or consumed on the business premises of the taxpayer –

  (i) At a party, reception, celebration meal, or other similar social function; or

  (ii) In an area of the premises, such as a boardroom or an executive or client dining room, reserved for use at the time only by those at a certain level of seniority and their guests and not open to all employees of the taxpayer working in the premises.

The Schedule defines "Business premises" as:

(a) The normal business premises; or

(b) A temporary workplace,—

of the taxpayer or of an associated person (not being premises or a workplace established principally for the purposes of enjoying entertainment).

Part B of the Schedule lists *excluded entertainment* (ie entertainment which, being one of the *specified types of entertainment* under Part A of the Schedule, would otherwise be subject to the 50% deduction limit). Clause 9 of Part B states:

Entertainment that is provided by the taxpayer for market value (or otherwise in an arm's length transaction) in the ordinary course of the taxpayer's business which consists of providing one or more specified types of entertainment.

Application of the Legislation

The 50% deduction limit in section DG 1 applies to expenditure that is otherwise fully deductible but which is a "specified type of entertainment" under Part A and not "excluded entertainment" under Part B of Schedule 6A.

Special offers of food or beverages to the public

A. *As a "specified type of entertainment"*

When a licensee makes a special offer of food or beverages or both to the public, the expenditure on that food or beverages is, in most cases, not a *specified type of entertainment* under Part A of the Schedule (and thus not subject to the 50% deduction limit). This is despite the food or beverages being provided or consumed on the "business premises" of the licensee, in terms of clause 4(c) of Part A.

Clause 4(c) has two sets of criteria, both of which must be met before such expenditure falls within a *specified type of entertainment*:

- The first requires that the food or beverages are provided or consumed on the "business premises" of the taxpayer, and
- The second contains two alternatives, which require that the food or beverages be provided or consumed, either at a party (clause 4(c)(i)), or in an area of the premises reserved for a restricted class of employees and their guests (clause 4(c)(ii)).

The special offers of food or beverages made to the public by licensees, although meeting the first set of criteria in clause 4(c), do not ordinarily come within either of the alternatives in the second set.

In relation to the first set of criteria in clause 4(c), the licensed premises where the offer occurs are the licensee's "business premises" as they are the normal business premises of the licensee. The definition of "business premises" in the Schedule excludes "premises or a workplace established principally for the purposes of enjoying entertainment". It could be argued that licensed premises are established principally for the purposes of enjoying entertainment and so would not be the licensee's "business premises". However, it is considered that from the licensee's perspective, the licensed premises are established principally for the purpose of running a business and not for the purposes of enjoying entertainment, and so are the licensee's "business premises" in terms of the Schedule.

Note that, for the purposes of the definition of "business premises", licensed premises are not a temporary workplace of a person who merely conducts a business meeting at the licensed premises because, from that person's perspective, the licensed premises are a workplace established principally for the purposes of enjoying entertainment.

As already indicated in relation to the second set of criteria in clause 4(c), food or beverages provided or consumed on "business premises" (apart from food or beverages consumed in a corporate box, holiday accommodation, or a pleasure craft) are only included as a *specified type of entertainment* if the food or beverages are consumed either at a party or similar social function, or in a reserved area of the premises. In some situations, food and beverages consumed on licensed premises may be consumed at a party or similar social function or in an area reserved at the time for use by certain employees and guests. However, special offers of food and beverages of the type to which the Ruling applies that are made to the public by the licensee during ordinary opening hours of the licensed premises, would not ordinarily be consumed at a party or similar social function, or in an exclusive area as contemplated in clause 4(c) of the Schedule.

B. *As "excluded entertainment"*

However, if the special offers of food or beverages of the type referred to do come within Part A of Schedule 6A, they would be *excluded entertainment* under Part B of the Schedule (and thus not be subject to the 50% deduction limit).

This is because those special offers of food or beverages would usually come within clause 9 of Part B. Clause 9 applies to expenditure on entertainment that is provided at market value, or otherwise in an arm's length transaction, in the ordinary course of a taxpayer's business where that business consists of providing one or more of the specified types of entertainment. Expenditure on such *excluded entertainment* is therefore fully deductible if the entertainment is provided by a business at market value or in an arm's length transaction.

It follows that clause 9 applies to special offers of food or beverages made by a licensee to members of the general public if the food or beverages are provided either at market value, or are otherwise provided in an arm's length transaction in the ordinary course of the licensee's business. Such special offers of food or beverages are made by way of promoting the taxpayer's business and in the interests of future custom. In particular:

- The cost to the licensee of "happy hours", where reduced price drinks are provided to customers during a particular time period in an arm's length transaction in the ordinary course of the licensee's business, will be fully deductible.
- The cost to the licensee of free drinks or food or both, provided on certain days or at certain times to customers or categories of customers selected from members of the general public, is fully deductible if the provision of such free drinks or food occurs in an arm's length transaction in the ordinary course of the licensee's business.
- The cost of providing meals, offered in a "two meals for the price of one" deal, is fully deductible if the meals are provided in an arm's length transaction with customers in the ordinary course of the licensee's business.
- The cost to the licensee of drinks provided to customers in "toss the boss" competitions is also fully deductible if the competitor and the licensee have an arm's length relationship. Where this occurs, the free drink prizes are provided in an arm's length transaction in the ordinary course of business.

Allowances to an employee providing free food or drinks for customers

A licensee may pay a hospitality allowance to an employee, such as a bar manager, to cover the costs of providing free drinks or food or both to customers in the ordinary course of business. The expenditure on such an allowance is not subject to the 50% deduction limit. This is because the drinks or food or both are being provided or consumed on the licensee's business premises but not at a party or similar social function or in an area of the premises reserved for select staff and their guests as contemplated under clause 4(c) of Part A to Schedule 6A. Further, the allowances are excluded from the 50% deduction limit by clause 9 of Part B to Schedule 6A as the free food or drinks or both are not being provided where there is other than an arm's length relationship with the consumer.

The allowance is fully deductible if it is incurred by the licensee in deriving the licensee's gross income or if it is necessarily incurred by the licensee in carrying on a business for the purpose of deriving gross income, pursuant to section BD 2(1)(b).

Examples

Example 1

A licensee offers half-price drinks on St Patrick's Day to all patrons who wear a green hat. All other drinks are provided at full price.

As the half-price drinks are provided to the green hat wearers in arm's length transactions in the ordinary course of the licensee's business, the expenditure on the drinks is excluded from Part A of Schedule 6A, by clause 9 of Part B to the Schedule, and is fully deductible to the licensee.

Example 2

A licensee offers the next round of drinks free for a period of one hour on a Friday night to any customer who, following the purchase of a round, is able to score more than 10 by throwing a single dart at a dartboard.

As the free rounds of drinks are available to all customers in arm's length transactions in the ordinary course of the licensee's business, the expenditure on the drinks is excluded from Part A of Schedule 6A, by clause 9 of Part B to the Schedule, and is fully deductible to the licensee.

FRINGE BENEFIT TAX AND MOTOR VEHICLE MULTI-LEASES

PUBLIC RULING – BR PUB 04/03

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

Taxation Laws

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

This Ruling applies in respect of clause 1(c) of Schedule 2 Part A, and sections CI 2, GC 15, GC 17 and BG 1.

The Arrangement to which this Ruling applies

The Arrangement is the leasing of a motor vehicle under a multi-lease product, to a lessee who in turn provides the motor vehicle to an employee of the lessee, for their private use or enjoyment, or makes the motor vehicle available for such private use or enjoyment.

A "multi-lease product", for the purposes of this Ruling, is a lease product that exhibits the following characteristics:

- it is a lease of a motor vehicle for a specified period, with the option or possibility of the lessee entering into a further or multiple further leases of that vehicle for specified periods, or periods to be specified prior to their commencement
- separate and comprehensive written contracts are required to be executed in respect of each period under the multi-lease product
- any rental rate for a lease period under the multi-lease product is calculated on the same basis as it would be for any other customer who was entering into the lease of the vehicle otherwise than under a multi-lease product
- the lease period to which any entitlement relates is able to be clearly identified in the relevant lease documentation
- there is no contract, agreement, arrangement, plan, undertaking or understanding (whether enforceable or unenforceable) at the time of entering into any lease under the multi-lease product, or prior to that time, or thereafter, which directly or indirectly concerns, relates to, or otherwise affects the Arrangement and is:
  - in any way inconsistent with the characterisation of the leases under the multi-lease product as separate and distinct, or
  - in any way indicative of the specific terms and conditions of any potential further leases being agreed or determined at a time earlier than the time of entering into such further lease or leases
- it does not constitute a finance lease, as defined in section OB 1 of the Act, and
- it does not involve a lease between parties who are associated persons pursuant to section OD 7 of the Act.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The market value of motor vehicles leased under the Arrangement, for the purposes of calculating the value of any fringe benefit arising in respect of those vehicles, in accordance with section CI 3(1) and clause 1(c) of Schedule 2 Part A, is determined on the date on which each lease under the multi-lease product commences.
- Section GC 15 does not apply in respect of the Arrangement.
- Section CI 2 does not apply in respect of the Arrangement.
- Section GC 17 does not apply in respect of the Arrangement.
- Section BG 1 does not apply in respect of the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period 29 March 2004 to 28 March 2009.

This Ruling is signed by me on the 29th day of March 2004.

Martin Smith
General Manager (Adjudication & Rulings)

COMMENTARY ON PUBLIC RULING BR PUB 04/03

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 04/03 ("the Ruling").

Background

A number of motor vehicle lessors offer products whereby a lessee enters into a lease for a specified period (for example, 12-months), with the option or possibility of entering into further leases for pre-specified periods (for example, two further possible leases of 12-months each). There are similar "multi-lease" products available whereby the lease periods are flexible, usually varying in period from 6 months to 75% of the vehicle's depreciable estimated useful life. The lease periods under these "flexible term" multi-lease products are specified prior to their commencement, and are only flexible in the sense that the lessee may assess their requirements toward the end of any given stipulated period, and select an appropriate term for the next period, if one is desired.

Where a lessee under a multi-lease product in turn provides the motor vehicle to one of their employees, for their private use or enjoyment, or makes the motor vehicle available for such private use or enjoyment, a "fringe benefit" arises for the purposes of the FBT rules, by virtue of section CI 1(a) or (b) of the Act.

Section CI 3(1) of the Act provides formulae for calculating the value of any fringe benefit, being a benefit that consists of the private use or enjoyment, or the availability for private use or enjoyment, of a motor vehicle.

The variable "z" in the formulae in section CI 3(1) is the amount that is the value of the benefit that would be able to be enjoyed by the employee if they had unlimited private use or enjoyment of the motor vehicle during the relevant period. This amount is to be calculated in accordance with Schedule 2 Part A, which relevantly provides that the value of such a benefit, where the motor vehicle is leased or rented and the lessor and lessee are not associated persons, is a stipulated percentage of the market value of the motor vehicle on the date on which the period of that leasing or renting commenced.

The relevant issue for the purpose of this Public Ruling is whether the period of leasing of a vehicle under a multi-lease product commences at the beginning of the initial period under the product, and concludes at the end of however many further periods under the product are taken up by the lessee, or alternatively, each period under the relevant product constitutes a separate lease, the period of leasing of a vehicle therefore commencing at the beginning of the relevant period (ie whether the successive periods under multi-lease products constitute separate leases, or together form one lease).

The Ruling also deals with the application of sections GC 15, CI 2, GC 17 and BG 1 to the Arrangement.

The Commissioner has issued a number of product rulings on variations of these types of lease products and accordingly considers that a general public ruling is warranted.

Legislation

Section CI 1 provides (relevantly) as follows:

> In the FBT rules, "fringe benefit", in relation to an employee and to any quarter or (where fringe benefit tax is payable on an income year basis under section ND 14) income year, means 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; but does not include** …
>
> [Emphases added]

Section CI 3 provides (relevantly) as follows:

> (1) For the purposes of the FBT rules, the value of any fringe benefit, being a benefit that consists of the private use or enjoyment, or the availability for private use or enjoyment, of a motor vehicle, shall, in relation to each motor vehicle the private use or enjoyment of which or the availability for private use or enjoyment of which constitutes that benefit, be—
>
> (a) Where the benefit is subject to fringe benefit tax on a quarterly basis, an amount calculated in accordance with the following formula:

where—

$$\frac{y \text{ X } z}{90}$$

…

z is the amount, calculated in accordance with Schedule 2, Part A, that in relation to the quarter and to the motor vehicle is the value of the benefit that would be able to be enjoyed by the employee if the employee had unlimited private use or enjoyment of the motor vehicle in that quarter:

…

(c) Where the benefit is subject to fringe benefit tax on an income year basis under section ND 14, an amount calculated in accordance with the following formula:

where—

$$\frac{y \text{ X } z}{365}$$

…

z is the amount, calculated in accordance with Schedule 2, that in relation to the income year and to the motor vehicle is the value of the benefit that would be able to be enjoyed by the employee if the employee had unlimited private use or enjoyment or availability for private use or enjoyment of the motor vehicle in that income year.

[Emphases added]

Schedule 2, Part A provides (relevantly) as follows:

1. Subject to clause 3, in relation to any quarter or (where fringe benefit tax is payable in respect of the vehicle on an income year basis under section ND 14) to any income year, and to any motor vehicle that in the quarter or income year is provided by any person for the private use or enjoyment of an employee or is available for such private use or enjoyment, the value of the benefit that would be able to be enjoyed by the employee, if the employee had unlimited private use or enjoyment or availability for private use or enjoyment of the motor vehicle in that quarter or income year, shall be,—

…

(c) Where the motor vehicle is leased or rented by that person from any other person, where that person and that other person are not associated persons, 6% or (where fringe benefit tax is payable in respect of the vehicle on an income year basis under section ND 14) 24% of the **market value of the motor vehicle on the date on which the period of that leasing or renting commenced**:

[Emphasis added]

Section GC 15 provides (relevantly) as follows:

(1) For the purposes of the FBT rules, where any benefit which, if it were provided for or granted to an employee would be a fringe benefit, is provided or granted by the employer of the employee, or is provided or granted by another person with whom the employer of the employee has entered into an arrangement for the providing or granting of that benefit, for or to a person other than the employee of the employer, the employee of the employer and the other person being associated persons, that benefit shall be deemed to be a benefit provided for or granted to the employee by the employer of the employee.

Section CI 2 provides (relevantly) as follows:

(1) For the purposes of the FBT rules, where a benefit is provided for or granted to an employee by a person with whom the employer of the employee has entered into an arrangement for that benefit to be so provided or granted, that benefit shall be deemed to be a benefit provided for or granted to the employee by the employer of the employee.

Section GC 17 provides as follows:

Where the Commissioner is satisfied that an arrangement has been entered into between persons and a purpose or effect of the arrangement (not being a merely incidental purpose or effect) is to defeat the intent and application of the FBT rules, or of any provision of the FBT rules, the Commissioner may, notwithstanding the arrangement, deem—

(a) A person who is a party to that arrangement (that person being referred to in this section as the "participant") to be the employer in relation to such other person or such other persons as the Commissioner specifies by notice in writing to the participant; and

(b) Any person so specified to be, in relation to the participant, an employee (that person being referred to in this section as the "deemed employee"); and

(c) Any benefit that—

(i) Is obtained by the deemed employee and is provided or granted by the participant; or

(ii) The deemed employee would have, or might be expected to have, or would in all likelihood have, obtained if that arrangement had not been made or entered into,—

to be a benefit provided or granted by the participant to the deemed employee by virtue of the employment of the deemed employee,—

for the purposes of the FBT rules; and the FBT rules shall apply accordingly throughout such period or periods (each being a period during which that arrangement is in force) as the Commissioner determines.

Section BG 1 provides as follows:

(1) A tax avoidance arrangement is void as against the Commissioner for income tax purposes.

(2) The Commissioner, in accordance with Part G (Avoidance and Non-Market Transactions), may counteract a tax advantage obtained by a person from or under a tax avoidance arrangement.

Section OB 1 provides (relevantly) as follows:

In this Act, unless the context otherwise requires,—

…

"FBT rules" is defined in section OZ 1(1) for the purposes of this Act:

…

"Finance lease" means a lease of a lease asset that is entered into on or after the date that the Taxation (Accrual Rules and Other Remedial Matters) Act 1999 receives the Royal assent under which—

(a) The ownership of the lease asset is transferred to the lessee or an associate of the lessee at the end of the lease term; or

(b) The lessee or an associate of the lessee has the option of acquiring the lease asset for an amount that is likely to be substantially lower than the lease asset's market value on the date of acquisition; or

(c) The lease term is more than 75% of the lease asset's estimated useful life as that term is used in the formula applied by the Commissioner under section EG 4(3)

…

"Lease"—

…

(f) In paragraph (b) of the definition of "cost price", paragraph (b) of the definition of "lessee", and paragraph (a) of the definition of "lessor", and in the definitions of **"finance lease"**, "guaranteed residual value", "initial period", "instalment", "lease asset", "lease payment", "lease term", "outstanding balance", and "specified lease", and in sections CG 11(23), CG 11(23A), EO 2, EO 2A, FC 6 to FC 8, and FC 8A to FC 8G—

(i) Means an agreement under which a lessor transfers to a lessee for a lease term a lease asset or the right to possess a lease asset in consideration for a lease payment; and

(ii) Includes a hire or bailment, and a sublease; and

(iii) Does not include a hire purchase agreement as defined in section 2 of the Hire Purchase Act 1971, or an assignment of a hire purchase agreement; and

(iv) If the same lease asset is leased to the same lessee or an associated person of the lessee under 2 or more consecutive or successive leases, and the Commissioner, having regard to the tenor of this paragraph, regards the consecutive or successive leases as one lease, that lease:

…

"Operating lease" means a lease, other than a finance lease, that is entered into on or after the date that the Taxation (Accrual Rules and Other Remedial Matters) Act 1999 receives the Royal assent:

…

"Tax avoidance arrangement" means an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly—

(a) Has tax avoidance as its purpose or effect; or

(b) Has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the purpose or effect is not merely incidental:

…

"Tax avoidance", in sections BG 1, EH 1, EH 42, GB 1, and GC 12, includes—

(a) Directly or indirectly altering the incidence of any income tax:

(b) Directly or indirectly relieving any person from liability to pay income tax:

(c) Directly or indirectly avoiding, reducing, or postponing any liability to income tax:

[Emphases added]

Section CI 8 provides as follows:

Subject to the FBT rules, the other provisions of this Act and of the Tax Administration Act 1994, so far as they are applicable and with any necessary modifications, shall apply with respect to fringe benefit tax as if it were income tax imposed under section BB 1, and as if every reference to an income year were a reference to a quarter or (where fringe benefit tax is payable on an income year basis under section ND 14) an income year; **but nothing in the FBT rules shall be so construed as to include fringe benefit tax in the expressions "income tax" or "tax" for the purposes of,—**

(a) The provisions listed in section OZ 1(3)(a) to (o); or

(b) Sections 121 and 122 of the Tax Administration Act 1994.

[Emphasis added]

Section OZ 1 provides (relevantly) as follows:

(1) In this Act—

…

"FBT rules" means Part ND and sections CI 1 to CI 6, CI 8 to CI 10, and GC 15 to GC 17 of this Act and sections 93, and 139B, and Part VII of the Tax Administration Act 1994; and includes section CI 11 (being a provision inserted after the original enactment of this Act):

…

(3) In the following provisions (which correspond to provisions in Parts IV and IVA of the Income Tax Act 1976 in which the terms "income tax" and "tax" were used)—

(a) Part B, except for sections BB 3(2) and BH 1; and

…

the terms "income tax" and "tax" do not include—

…

(q) Fringe benefit tax; or

...

[Emphases added]

Section OB 6 (which defines the term "income tax" for the purposes of the Act) provides (relevantly) as follows:

> (2) Notwithstanding anything in subsection (1), the term "income tax" does not include the taxes specified in section OZ 1(3)(p) to (u) when the term is used in the provisions listed in section OZ 1(3)(a) to (o).

Section ND 1 provides (relevantly) as follows:

> (1) 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.

Application of the Legislation

Date of market value determination

In determining whether the successive periods under multi-lease products constitute separate leases, or together form one lease, authorities in relation to the distinction between variation and rescission of contract are of some assistance. It is, however, noted that the question in this case is not one of rescission versus variation of contract, but rather of whether a new contract is entered into upon the natural conclusion of another, versus variation of the original contract.

The House of Lords considered the distinction between variation and rescission of contract in *Morris v Baron and Company* [1918] AC 1 ("*Morris v Baron*"), which was applied in *New Zealand Needle Manufacturers Ltd v Taylor and Another* [1975] 2 NZLR 3. Lord Dunedin in *Morris v Baron* stated the test for making this distinction as follows (at pp 25-26):

> The difference between variation and rescission is a real one, and is tested, to my thinking, by this: In the first case there are no such executory clauses in the second arrangement as would enable you to sue upon that alone if the first did not exist; in the second you could sue on the second arrangement alone, and the first contract is got rid of either by express words to that effect, or because, the second dealing with the same subject-matter as the first but in a different way, it is impossible that the two should be both performed.

Viscount Haldane, in the same case, noted (at p 19) that for a contract to rescind an earlier contract:

> … there should have been made manifest the intention in any event of a complete extinction of the first and formal contract, and not merely the desire of an alteration, however sweeping, in terms which still leave it subsisting.

Lord Atkinson also noted in *Morris v Baron* (at p. 31) that rescission of a contract will be implied

> … where the parties have entered into a new contract entirely, or to an extent going to the very root of the first inconsistent with it.

It is the Commissioner's view that the same sorts of considerations as these are relevant to determining whether a new contract is entered into upon the natural conclusion of another, or the original contract is varied. However, in relation to this particular question, it is the Commissioner's view that in considering whether a party can be sued on a subsequent agreement alone, as if the earlier agreement did not exist, it is not necessary to inquire as to whether both that and an earlier agreement purport to deal with the same subject matter but in different ways.

Further, in the Commissioner's opinion, changes going to the very root of a contract for the lease of a motor vehicle would not necessarily be suggestive of a new contract being entered into upon the natural conclusion of another, as opposed to the original contract being varied. For instance, it could well be that toward the conclusion of the contract for the first, say, 12-month period under a multi-lease product, the parties decide to vary that contract by extending its term for an additional, say, 9-month period, for which the rental rate per month will be decreased. In this situation, the change of period and rental rate would arguably go to the very root of such a contract. However, this does not mean that a new lease contract is entered into as opposed to the original lease contract being varied. It is clear in such a situation that the parties' intention is to vary the contract by extending the lease period and setting an appropriate rental rate to take the extended period into account. As an agreement to vary a lease contract for personal property by extending its term will not alter the legal interest that the lessee has (as the lessee's legal interest arises by virtue of possession, not the lease agreement), but rather will simply alter the lessee's possessory entitlement, the variation would not give rise to a surrender and regrant by operation of law.

Accordingly, it is the Commissioner's view that the rationale behind the considerations relating to inconsistency between different agreements concerning the same subject matter, and whether there are changes going to the very root of a contract, in determining if a contract has been varied or rescinded, is only relevant to the extent that both agreements purport to deal with the same subject matter **at the same time**.

The Commissioner is satisfied that the characteristics set out in the description of a multi-lease product in the Arrangement (discussed further below) ensure that each lease entered into for a further successive period constitutes a distinct lease. Therefore, the market value of motor vehicles leased under the Arrangement, for the purposes of calculating the value of any fringe benefit arising in respect of those vehicles, in accordance with section CI 3(1) and clause 1(c) of Schedule 2 Part A of the Act, is determined on the date on which each lease under the multi-lease product commences.

***Option* or *possibility* of further lease periods**

The description of a "multi-lease product" in the Arrangement requires there to be a lease of a motor vehicle for a specified period, with the **option** or **possibility** of the lessee entering into a further or

multiple further leases of that vehicle for specified periods, or periods to be specified prior to their commencement. The Arrangement would cover lease products with pre-specified potential lease periods (for example a 12-month lease with two further possible leases of 12-months each), and also products with flexible potential lease periods (where if the lessee decides to enter into a further lease they may select the period of that lease, usually within some parameters, prior to its commencement).

Any lease documentation which refers to further potential leases under a multi-lease product should clearly identify that the further leases are ***options*** or ***possibilities*** only.

Separate and comprehensive written contracts

The description of the "multi-lease product" in the Arrangement requires that separate and comprehensive written contracts are required to be executed in respect of each period under the multi-lease product.

Consecutive or successive leases under multi-lease products are generally (but not necessarily) entered into by execution of a schedule or supplement to a master hire/lease agreement. The schedule or supplement is generally required to be read and construed by reference to a master hire/lease agreement, as if each provision of the master hire/lease agreement were set out in the particular schedule or supplement. The schedule or supplement will contain all particulars of the vehicle being leased, including any options, allowances and accessories etc, and will specify the lease term and rate, and any excess kilometre or other charges. The terms and conditions imported by the master hire/lease agreement are the standard generic terms and conditions for motor vehicle leases that the lessor wishes to have in all of its leases, including, for example, provisions with respect to term and payment (usually with reference to the specifications in the relevant schedule or supplement), lessor and lessee obligations and warranties, liabilities and indemnities, termination, and rights arising upon default.

Provided that the schedule or supplement, read and construed by reference to a master hire/lease agreement constitutes a comprehensive contract which is separate from contracts for any other period or periods under the product, the Commissioner will be satisfied with respect to this requirement in the description of a "multi-lease product".

Calculation of rental rate

The description of the "multi-lease product" in the Arrangement requires that any rental rate for a lease period under the multi-lease product is calculated on the same basis as it would be for any other customer who was entering into the lease of the vehicle otherwise than under a multi-lease product.

This requirement is to be considered taking account of all factors which may impact upon the lease rate offered for the particular vehicle, apart from whether the vehicle is leased under a multi-lease product or otherwise. For instance, it is appropriate to have regard to things such as the lease period, customer credit rating, customer fleet size, kilometre allowances, replacement tyre allowances, options, accessories, and general service requirements of the lease, including vehicle maintenance.

The fact that the vehicle may have been previously leased under the multi-lease product or may potentially be leased again under the product, should not be taken into account in formulating the applicable rental rates.

Entitlements

The description of a "multi-lease product" in the Arrangement requires that the lease period to which any entitlement relates is able to be clearly identified in the relevant lease documentation.

Such entitlements may include kilometre allowances, replacement tyre allowances, options, accessories, general service components of the lease, including vehicle maintenance; or any other entitlement or extra.

For example, a quotation may be given for a 12-month lease of a vehicle under a multi-lease product, with projected lease rates for two further possible 12-month leases of the vehicle. If the quotation stipulated, for example, four replacement tyres, two services and a 60,000 kilometre allowance, the period to which these entitlements relates must be apparent. If the entitlements relate to a period longer than the immediate lease term (ie if the anticipated needs over the life of the lease and any further leases of the vehicle which may be taken up were identified in order accurately to project lease rates for further potential periods), the documentation should identify what portion of the entitlements is available for each period or potential period. The lessee is to be entitled to the full amount or value of the entitlements which relate to each lease period entered into, irrespective of whether any further potential lease or leases of the vehicle is or are taken up.

Inconsistent agreements etc

The description of a "multi-lease product" in the Arrangement requires that:

there is no contract, agreement, arrangement, plan, undertaking or understanding (whether enforceable or unenforceable) at the time of entering into any lease under the multi-lease product, or prior to that time, or thereafter, which directly or indirectly concerns, relates to, or otherwise affects the Arrangement and is:

- in any way inconsistent with the characterisation of the leases under the multi-lease product as separate and distinct, or
- in any way indicative of the specific terms and conditions of any potential further leases being agreed or determined at a time earlier than the time of entering into such further lease or leases."

In particular, such an inconsistent agreement, understanding, etc under the first limb may include the following:

- that any party will, or will if requested, renew, extend or vary the lease term
- that the parties will enter into a further lease in respect of the vehicle, or
- that there will be penalties for choosing not to enter into a further lease in respect of the vehicle.

The second limb may include, for example, anything which suggests that rental rates for any potential further lease have been agreed in advance of that lease being taken up, as opposed to simply being estimated or projected. The specific terms and conditions of any potential further lease should be determined at the time such lease is taken up, and take account of all relevant factors in existence at that time (see above, for example, in relation to calculation of rental rate).

Section GC 15

Section GC 15(1) of the Act applies where a relevant benefit is provided for or granted to a person **other than an employee** of the employer (that person and the employee being associated persons), by either the employer, or a third party with whom the employer has entered into an arrangement for the providing or granting of that benefit. Section GC 15(1) then operates to deem that benefit to be provided for or granted to the employee by the employer of the employee.

The description of the Arrangement is limited to the leasing of a motor vehicle under a multi-lease product, to a lessee who in turn provides the motor vehicle to an **employee of the lessee** for their private use or enjoyment, or makes the motor vehicle available for such private use or enjoyment. As the benefits are provided directly to the lessee's employees, rather than any person associated therewith, section GC 15 does not apply in respect of the Arrangement.

Section CI 2

Section CI 2 of the Act applies where a benefit is provided for or granted to an employee **by a person with whom the employer of the employee has entered into an arrangement** for that benefit to be so provided or granted. Section CI 2 then operates to deem that benefit to be provided for or granted to the employee by the employer of the employee.

The description of the Arrangement is limited to the leasing of a motor vehicle under a multi-lease product, **to a lessee who in turn provides the motor vehicle to an employee of the lessee** for their private use or enjoyment, or makes the motor vehicle available for such private use or enjoyment. As the benefits are provided to the lessee's employees **by the lessee**, rather than any person with whom the lessee has entered into an arrangement for the provision of the benefit, section CI 2 does not apply in respect of the Arrangement.

Section GC 17

Section GC 17 of the Act allows the Commissioner to deem certain persons to be in an employment relationship, and to deem benefits to be provided or granted, for the purposes of the FBT rules, by virtue of the deemed employment, where the Commissioner is satisfied that an arrangement with a purpose or effect of defeating the intent and application of the FBT rules, or any provision thereof, has been entered into.

The relevant question for the purpose of this public ruling is whether the Arrangement has the effect of defeating the intent and application of the FBT rules. The intention of the relevant FBT rules is found by ascertaining what was Parliament's intention in this regard. As stated by the Privy Council in *Commissioner of Inland Revenue v Auckland Harbour Board* (2001) 20 NZTC 17,008 at 17,011 per Lord Hoffmann

> … for this purpose, the only available material is the language in which Parliament has expressed itself, properly construed according to currently accepted notions of how a taxing act should be interpreted and with due regard to section 5(j) of the Acts Interpretation Act 1924 as amended.

The Commissioner is satisfied that an Arrangement as described in the Ruling cannot be said to defeat the intent and application of the FBT rules, or any provision thereof. The Act provides that the market value of motor vehicles for FBT purposes, in accordance with section CI 3(1) and clause 1(c) of Schedule 2 Part A, is determined at the commencement of a lease. The general scheme of these provisions is to set out how to calculate the value of the benefit enjoyed by the employee where the motor vehicle is leased or rented. The statutory language makes it clear that the relevant calculations are based on stipulated percentages of the motor vehicle's market value on the date the period of leasing or renting commenced. The Arrangement as described in the Ruling involves separate leases of the motor vehicle, and as such, the market value of the vehicle is correctly determined as at the commencement of each lease. A taxpayer is free to choose, based on valid and reasonable commercial reasons, whether to enter into an extended period lease, or enter into a shorter lease with the possibility of further leases, which may be decided upon as and when required. Further, on the basis of the description of "multi-lease products" in the Ruling, there is nothing which would be indicative of the lease documents constituting a sham.

The Commissioner is therefore of the view that section GC 17 does not apply in relation to the Arrangement.

Section BG 1

Section BG 1 of the Act provides that a tax avoidance arrangement is void as against the Commissioner for income tax purposes, and that the Commissioner may counteract a tax advantage obtained by a person from or under a tax avoidance arrangement.

Section CI 8 relevantly provides that

… nothing in the FBT rules shall be so construed as to include fringe benefit tax in the expressions 'income tax' or 'tax' for the purposes of … the provisions listed in section OZ 1(3)(a) to (o) … .

Of paragraphs (a) to (o) of section OZ 1(3), the only relevant paragraph for present purposes is paragraph (a), the provisions listed therein being

Part B, except for sections BB 3(2) and BH 1.

Accordingly, section CI 8 operates to preclude FBT from inclusion in the expressions "income tax" or "tax" for the purposes of section BG 1 (contained in Part B of the Act).

Further, section OB 6(2) states that the term "income tax", when used in the provisions listed in section OZ 1(3)(a) to (o), does not include the taxes specified in section OZ 1(3)(p) to (u) (paragraph (q), being the relevant paragraph for present purposes, lists "Fringe benefit tax".

Fringe benefit tax is specified in section OZ 1(3)(q) and, as noted above, the provisions listed in section OZ 1(3)(a) are "Part B, except for sections BB 3(2) and BH 1", which includes section BG 1.

The Commissioner is therefore satisfied that section BG 1 does not apply in relation to the Arrangement.

PRODUCT RULING – BR PRD 04/02

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Fletcher Challenge Forests Limited ("FCFL").

Taxation Law

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

This Ruling applies in respect of section CF 3(1)(b).

The Arrangement to which this Ruling applies

The Arrangement involves the payment by FCFL of a first return of approximately $349 million of capital to shareholders ("the Return of Capital") out of the proceeds of the sale by the FCFL group of its forest estate and related assets, and upon the cancellation of FCFL shares. The forest estate sale involves the sale of such assets held by FCFL wholly owned subsidiaries, with the proceeds being repatriated to FCFL.

Further details of the Arrangement, and the background thereto, are as follows.

Sale of entire forest estate

1. On 16 June 2003 FCFL announced that it was seeking buyers for its entire forest estate. FCFL has now reached agreement to sell the forestry assets (excluding the interest held by the FCFL group in Tarawera Forests Limited, "the Tarawera interest") for $560 million to a group of three purchasers, namely, Kiwi Forests Group Limited, Viking Global New Zealand Limited and OTPP New Zealand Forests Limited ("the Purchasers"). The Purchasers will each purchase separate parts of the forestry assets.

2. Neither FCFL, nor any of its wholly owned subsidiaries, are an "associated person" (as defined in section OB 1) with any of the Purchasers. At the time this Ruling was issued FCFL directors understood that the ownership of the Purchasers was as follows:

    - Kiwi Forests Group Limited was owned by four New Zealand resident investors, Messrs Trevor Farmer, Ross Green, Mark Wyborn and Adrian Burr

- Viking Global New Zealand Limited was wholly owned by a fund of institutional investors managed by Prudential Timber Investments Inc of the United States of America
- OTPP New Zealand Forest Investments Limited was wholly owned by The Ontario Teachers' Pension Plan of Canada.

3. On an initial settlement of the sale, FCFL will receive $351 million. The balance of $209 million will be received as and when third party consents are granted to the transfer (to the Purchasers) of the interest of FCFL under various leases, forestry rights and joint venture arrangements that are part of the forestry assets. The consent process is expected to take seven months to complete.

4. Receipt of proceeds from the sale of the Tarawera interest will depend upon when a buyer is located for that asset.

5. The forest estate comprises approximately 80% of the total assets of FCFL. Following completion of the sale of the forest estate (including the Tarawera interest), the business of FCFL will comprise timber processing, marketing and distribution activities.

Return of sale proceeds

6. The Return of Capital is the first of two returns of capital planned for the sale proceeds. The Return of Capital is scheduled to occur in March 2004 and is expected to total approximately $349 million. The second return of up to $311 million (subject to determination of the sale price for the Tarawera interest) is planned to occur once all necessary third party consents have been granted and the outstanding purchase price payable by the Purchasers has been received together with receipt of the sale price of the Tarawera interest. Approximately $65 million will be applied to meet transaction costs, working capital adjustments, repaying debt and forestry staff redundancies.

7. FCFL intends that the Return of Capital will be upon a pro rata cancellation of one out of every two current shares pursuant to an arrangement subject to the supervision of the High Court under Part XV of the Companies Act 1993. A payment of $1.25 per share cancelled will be made and shares will be cancelled wholly and not in part.

8. FCFL will seek shareholder approval for the sale of the forestry assets and the first return of sale proceeds at a meeting of shareholders scheduled to be held on 20 February 2004. If shareholders approve and, if the High Court also approves, the first return of sale proceeds should be made some time in March 2004, with shares consequentially cancelled pursuant to the order of the High Court.

9. The funding for the Return of Capital will be derived from Fletcher Challenge Forests Industries Limited ("FCFIL") selling its shares in East Woodlands Ltd, Northwest Woodland Ltd and South Woodlands Ltd, as well as from FCFIL selling some related forest plant and equipment. Each of these four companies are wholly owned subsidiaries of FCFL. The funding will not reflect trading profits derived prior to the time of the Return of Capital.

10. The sale proceeds received by FCFIL will be used to repay debt owed to Fletcher Challenge Forests (Manufacturing) Limited ("FCFML") of approximately $351 million, which is another wholly owned subsidiary of FCFL. These funds will then be used by other wholly owned companies of the FCFL group to repay debt for the same amount owed within the FCFL group. Ultimately, the sale proceeds will be used by Fletcher Challenge Industries Limited ("FCIL") to pay a dividend of approximately $294 million to FCFL and to repay a debt to FCFL of approximately $57 million.

Payment of dividends

11. FCFL has not paid a dividend since April 1998, as the financial position of the company has not allowed it. However, FCFL is now in a position where it could re-contemplate paying dividends. In this regard, FCFL management estimates that FCFL will be able to pay a dividend for the year ended 30 June 2005.

Level of reserves

12. FCFL's reserves since 1998 were as follows:

Year	Total reserves ($m)
1998	211
1999	222
2000	481
2001	(44)
2002	(299)
2003	(579)

13. Any surplus cash accumulated before dividends are paid to FCFL shareholders will be applied as part of the capital expenditures on upgrading plant, repaying debt, and making investments to establish a suitable platform for FCFL's processing and distribution activities.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) None of the shares cancelled upon the Return of Capital are a "non-participating redeemable share" as defined in section CF 3(14).

b) The share cancellation upon the Return of Capital constitutes a "pro rata cancellation", as defined in section CF 3(14).

c) The Return of Capital constitutes a "fifteen percent capital reduction", as defined in section CF 3(14).

d) At the time the Return of Capital is undertaken, it is not anticipated by the directors of FCFL that the associated returns to shareholders will affect the future dividend policy of FCFL.

e) At the time the Return of Capital is undertaken it is not anticipated by the directors of FCFL that there will be a subsequent issue of shares.

How the Taxation Law applies to the Arrangement

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

- To the extent that it does not exceed the "available subscribed capital per share cancelled" (as defined in section OB 1), the Return of Capital will be excluded from the definition of "dividends" pursuant to section CF 3(1)(b).

The period or income year for which this Ruling applies

This Ruling will apply for the period from 13 February 2004 until 31 March 2006.

This Ruling is signed by me on the 13th day of February 2004.

Martin Smith
General Manager (Adjudication & Rulings)

PRODUCT RULING – BR PRD 04/03

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 Infrastructure Auckland.

Taxation Law

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

This Ruling applies in respect of:

- Section 2
- Section 3A
- Section 5(1)
- Section 5(6D)
- Section 8(1)
- Section 10(2)
- Section 20(3)

The Arrangement to which this Ruling applies

The Arrangement is the making of grants by Infrastructure Auckland ("IA") on the basis of applications from potential recipients to carry out specific transport or stormwater infrastructure projects within the Auckland region. Further details of the Arrangement are set out in the paragraphs below.

Background

1. IA is a body corporate which was established pursuant to the Local Government Amendment Act 1998, and the Infrastructure Auckland Deed.

2. Section 707ZZK(1) of the Local Government Act 1974 ("LGA") provides that the principal function of IA is to contribute funds, by way of grants, in respect of projects, or parts of projects, undertaken in the Auckland Region for the purpose of providing:

    (a) Land transport, or

    (b) Any passenger service, or

    (c) Any passenger transport operation, or

    (d) Stormwater infrastructure

where the projects or parts of projects generate benefits to the community generally in addition to any benefits that accrue to any identifiable persons or groups of persons. (Despite the repeal of the Local Government Act 1974) by the Local Government Act 2002, the provisions relating to IA in Part 44C (sections 707ZZH to 707ZZZZG) continue to have effect as if those provisions were still in force: section 313, Local Government Act 2002.)

3. IA's asset base was originally derived from the Auckland Regional Council (the "ARC"). In 1992, certain assets and liabilities of the ARC relating to its non-core activities were transferred to the Auckland Regional Services Trust ("ARST") under Part XLIVB of the Local Government Act (LGA). However, ARST did not inherit all the functions of the ARC and its primary role was to manage its assets, reduce the liabilities and dispose of specified assets as required under the provisions of the LGA.

4. In 1998, the Government decided that the assets held by ARST should be applied for developing the infrastructure of the Auckland region and it was decided to create IA to facilitate this decision. Pursuant to section 707ZZZL of the LGA, on 1 October 1998 the assets and liabilities of ARST were transferred to IA, with the following exceptions:

   - $10 million was paid to the ARC for the purposes of regional parks
   - $10 million was paid to the territorial authorities of the Auckland region to be applied to significant projects in the Auckland region in the area of arts and culture
   - the assets and liabilities of ARST in relation to the Pikes Point walkway were transferred to the Auckland City Council, and
   - the shares in Watercare Services Limited were divided between the territorial authorities of the Auckland region.

5. Regional Treasury Management Limited, a subsidiary of the ARST, was also dissolved at that time and its assets and liabilities vested in IA.

The making of grants

6. Section 707ZZL(1) of the LGA provides that any local authority which, or other person who, intends to undertake within the Auckland Region a project in respect of which IA may make a grant in the exercise of its functions under section 707ZZK(1) may apply to IA for such a grant.

7. IA, in deciding whether or not to contribute funds to projects or parts of projects or components of projects in the exercise of its principal function under section 707ZZK, must be guided by the criteria specified in clause 5.2 of the Infrastructure Auckland Deed, which provides:

> 5.2 Criteria: The criteria, in relation to each such project, are as follows:
>
> (a) The extent to which the project generates benefits to the community generally in addition to those that accrue to any identifiable persons or groups of persons, and
>
> (b) The extent to which the benefits generated to the community generally by the project exceed the costs (including the external costs) of the project by a margin greater than the assessed risk that the project will not deliver its intended net benefits, and
>
> (c) Whether the project satisfies the requirements of clause 4.1, and
>
> (d) The extent to which the project contributes and gives effect to any Auckland Regional Land Transport Strategy or the Auckland regional growth strategy or any regional policy statement or proposed regional policy statement adopted under the Resource Management Act 1991 or any regional stormwater strategy as adopted by the Regional Growth Forum, and
>
> (e) The principle that the costs of the project, including the external costs, should be:
>
> (i) Allocated in a manner that is consistent with economic efficiency, and
>
> (ii) Where practicable, recovered from those persons or groups of persons who—
>
> – benefit from the project; or
>
> – contributed to such costs; and
>
> in a manner that matches the extent to which those persons or groups of persons benefit from the project or contributed to such costs, and
>
> (f) The extent to which the project will be in the best interests of the inhabitants of the Auckland Region, and
>
> (g) The extent to which the project provides the greatest benefit to the greatest number of people in the Auckland Region, and

(h) The extent to which the project provides for a geographical spread of public benefits across the Auckland Region, and

(i) The degree to which the project may improve economic performance in the Auckland Region, and

(j) The degree to which the project may contribute to regional environmental outcomes, and

(k) The degree of urgency for the project.

8. Clause 4.1 of the Infrastructure Auckland Deed sets out further matters which IA must have regard to in making grants. It states:

> Infrastructure Auckland must ensure that grants it makes under section 707ZZK(1)—
>
> (a) Are made primarily for the purpose of funding the capital components of projects; and
>
> (b) Are not inconsistent with any Auckland Regional Land Transport Strategy or the Auckland regional growth strategy or any regional policy statement or proposed regional policy statement under the Resource Management Act 1991; and
>
> (c) Are made having regard to Transfund New Zealand's funding policies; and
>
> (d) Are not for services for which funding has already been identified (as required by section 707ZZZA(1)(c)).

9. The vast majority of the grants made by IA have been made (and will continue to be made) to local authorities and commercial transport operators who carry on taxable activities and must account for GST in respect of supplies they make.

Terms and conditions attaching to grants

10. The grants IA makes are usually subject to terms and conditions.

11. IA has a broad discretion, pursuant to section 707ZZL of the LGA, to make grants subject to such terms and conditions as IA sees fit.

12. However, in practice, there are three broad categories under which IA will impose conditions in relation to a grant. These are:

(a) Conditions which do no more than ensure the efficient and proper application of the grant funds, consistent with section 707ZZK(1) and 707ZZL(2) of the LGA, as well as other relevant statutory requirements, including one or more of the following conditions:

(i) The grant recipient warranting that it has disclosed all information material to the grant, and that all information supplied is correct

(ii) The grant recipient completing any due diligence or further enquiry (if appropriate) for the purpose of ensuring the feasibility of the project

(iii) The grant recipient obtaining all relevant statutory and other consents and approvals (such as resource consents, building consents, local body and regulatory authority approvals) on terms and conditions that enable it to complete the grant project in accordance with the plans, specifications and project description submitted with the grant application

(iv) The grant recipient obtaining all relevant board and shareholder approvals

(v) The grant recipient having the legal capacity to carry out the project and enter into the requisite contractual arrangements

(vi) The grant recipient entering into the principal contracts required to complete the relevant project

(vii) The grant recipient establishing an appropriate entity to hold assets and/or carry out the project

(viii) The grant recipient obtaining all property and other legal rights that are necessary for the project

(ix) The grant recipient obtaining any additional funding required to carry out the grant project (to the extent that the grant made by IA does not provide sufficient funding)

(x) That any contract for work to be done in relation to the project must, as far as is practicable:

- Be awarded following a competitive process approved by the grant recipient's governing body and which involves the receipt and consideration of at least two competing bids from independent parties

- Provide certainty on pricing and completion, and
- Be on an industry standard form published by Standards New Zealand or similar.

(xi) That the project will be carried out in accordance with all legal requirements (in particular the Resource Management Act 1991 and the Health and Safety in Employment Act 1992)

(xii) Where the grant recipient is not a local authority, IA will designate a local authority to be responsible for ensuring the grant is applied to its approved purpose

(xiii) The project will be completed to specified standards

(xiv) The grant recipient carrying out the project as stated in the grant application. The grant recipient must obtain IA's approval if it cannot complete the project in accordance with the plans, specifications and project description provided in the grant application, or if variations or modifications are required

(xv) The grant recipient obtaining certificates from the project engineer or other qualified, impartial, independent contract administrator approved by IA (who acknowledges that he or she owes a duty of care to IA):

- That a project milestone (as agreed with IA) has been completed as outlined in the grant application
- That the project has been completed in accordance with the plans, specifications, and project description included in the grant application, and a completion certificate issued, and
- Showing the amount of capital expenditure on the project from the date IA approved the grant to the date the project was completed, and copies of the final accounts issued under the construction contract, for consultants and other project costs.

(xvi) The grant recipient providing regular reports to IA at specified intervals, including information on the progress of the project and costs, adverse events that have arisen, and the outcome of the project following its completion, and

(xvii) The grant recipient acknowledging that the assistance provided by IA in respect of the project is limited to the amount of the grant, and IA will have no residual liabilities in respect of the project.

(b) Conditions that ensure that the benefit of the grant is obtained by the Auckland people and region provided that, in any such case, any benefit connected with any specified person or group of persons is incidental to and/or a necessary and unavoidable result of generating benefits to the community generally in the Auckland Region, including one or more of the following conditions:

(i) The grant recipient allowing competitors to use assets that are funded by grants

(ii) The grant recipient allowing general public access to certain assets

(iii) The grant recipient informing the public of the existence of the services, assets or improvements (as the case may be) arising from the grant project, and

(iv) The grant recipient acknowledging the contribution of IA to the funding of the grant project.

(c) Conditions that are contingent on the occurrence of some future event that would alter the assumptions inherent in making the grant, including one or more of the following conditions:

(i) The grant recipient agreeing not to sell or dispose of its interest in assets acquired or approved as part of a project in respect of which a grant has been made unless authorised by IA

(ii) A condition providing that, if assets are disposed of, those assets must continue to be used in a manner that will deliver benefits to the Auckland Region generally, whether by reason of being transferred to a local authority, a subsidiary of a local authority, a competitor or otherwise

(iii) Rights to grants provided by IA may not be assigned

(iv) The grant applicant maintaining the project for the life of the asset in accordance with sound business practice

(v) A right for IA to cancel a grant and require repayment of amounts paid in respect of the grant if:

- the grant recipient cannot complete the project by the specified date, or
- the specified purpose for which the grant was made cannot be achieved, or
- the grant was made in reliance on information that was incorrect or misleading, or
- there are variations to the project to which the grant funds were applied that are not authorised by IA and will have a material adverse impact on the amount of benefit to the community that the project will generate, or
- a condition upon which a grant is made is not satisfied.

(vi) The grant recipient ensuring that any assets created as a result of the grant project remain available to be used for the benefit of the Auckland Region where the grant recipient disposes of its ownership of the assets or ceases to use them for the purposes for which the grant was made, and

(vii) The grant recipient obtaining IA's consent prior to moving certain assets to another physical location or changing the ownership of such assets.

Membership of IA

13. IA is required to be operated by up to seven "members" who are appointed in accordance with the Infrastructure Auckland Deed. The members are responsible for the appointment of the Chief Executive Officer.

14. The members are appointed by a body known as the Electoral College. The Electoral College is established pursuant to the LGA and its function is set out in section 707ZZT, which provides:

> (1) The functions of the Electoral College are—
>
> (a) To appoint, in accordance with this Act and the Infrastructure Auckland deed, members of Infrastructure Auckland
>
> (b) To appoint, in accordance with this Act and the Infrastructure Auckland deed, the chairperson of Infrastructure Auckland
>
> (c) To discharge, in accordance with this Act and the Infrastructure Auckland deed, its duties in relation to Infrastructure Auckland's statement of corporate intent
>
> (d) To monitor the performance of Infrastructure Auckland
>
> (e) To consult with the Minister from time to time about amendments to the Infrastructure Auckland deed
>
> (f) To carry out such other functions as are conferred on it by this Act or any other Act.

15. The Electoral College has eight members with each of the Manukau City Council, the Auckland City Council, the Waitakere City Council, the North Shore City Council, the Papakura District Council, the Rodney District Council, the Franklin District Council and the Auckland Regional Council being entitled to appoint one member.

Central government involvement with IA

16. The Minister of Local Government ("the Minister") has a minor degree of involvement with IA.

17. The Minister has been required to prepare and sign the Infrastructure Auckland Deed. In addition the Infrastructure Auckland Deed may be amended from time to time by Order in Council made on the recommendation of the Minister after consultation with the Electoral College.

18. Pursuant to clause 46.1 of the Infrastructure Auckland Deed, the Minister, in consultation with the Electoral College, must, in the period of 12 months ending with the close of 30 September 2008, conduct a review of the activities and future of IA for the purpose of determining whether there is a continuing need for IA to make grants under section 707ZZK(1).

19. In all other material respects, IA is totally divorced from central government involvement.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) No direct benefit to IA will arise in respect of grants made by IA except for a market rate return to compensate IA for temporary loss of use of funds where circumstances arise which necessitate repayment of a grant previously made.

b) Any benefit resulting from any project in respect of which a grant is made which arises to specified or identified persons or groups of persons is incidental to IA's overall purpose of providing a benefit to the Auckland Region generally.

c) No direct benefit will arise to any member or employee of IA from any project in respect of which a grant is made except in that member or employee's capacity as a member of the community generally living in the Auckland Region.

d) This ruling only applies in respect of grants made subject to no conditions, or subject to one or more of the conditions listed in paragraphs 12(a), 12(b), or 12(c) of the Arrangement, and will not apply in respect of any grant which contains conditions which are not listed in paragraphs 12(a), 12(b), or 12(c) if such conditions are inconsistent with the conditions listed in such paragraphs.

e) The criteria specified in clause 5.2 of the Infrastructure Auckland Deed are the sole criteria that IA will use in determining whether to offer a grant.

How the Taxation Law applies to the Arrangement

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

- The grant payments that the grant recipients receive from IA will not be deemed to be consideration for a supply of goods or services pursuant to section 5(6D).
- The grant recipients will not be required to account for GST pursuant to section 8(1) in respect of the grant payments they receive from IA.

The period or income year for which this Ruling applies

This Ruling will apply for the period from 5 May 2004 to 4 May 2009.

This Ruling is signed by me on the 12th day of March 2004.

M L Spelman
Manager (Corporates)

NEW LEGISLATION

DETERMINATION E11: PERSONS NOT REQUIRED TO COMPLY WITH SECTION EF 1 OF THE INCOME TAX ACT 1994

Summary

This determination sets out the circumstances under which persons do not have to make accrual adjustments to deductible expenditure, as required by section EF 1.

Background

Expenditure that is deductible under section EF 1 must be adjusted for accruals that exist at the end of the income year. This determination specifies the type of expenditure, amount and the maximum period from balance date when accrual adjustments are not required.

The following paragraphs explain the differences between Determination E11 and Determination E10.

Application

The revised determination applies to the income year starting on 1 April 2004 and to every subsequent income year, until the Commissioner cancels the determination.

Explanation

The determination now includes an explanation which was not present in the earlier determinations. It simply states that the determination cancels and replaces Determination E10.

Updating of the Determination

The references to the sections in Determination E10 were outdated. Determination E11 therefore refers to the Income Tax Act 1994 and the Tax Administration Act 1994 where required. The determination has also been updated into the new Parliamentary Counsel Office format.

Paragraph p

Paragraph p has been updated as the Rating Powers Act 1988 has been repealed and Local Government (Rating) Act 2002 is now the relevant enactment.

New paragraph w

A type of expenditure has been added to those that are not required to make accrual adjustments to deductible expenditure under section EF 1. New paragraph w ensures that direct claim settlement costs incurred by a general insurer and included in the outstanding claims reserve of a general insurer in relation to a contract of insurance, do not have to be added back, provided that the total gross claim cost (excluding GST) included in the outstanding claims reserve in relation to any one claim does not exceed $65,000 (excluding GST).

Direct claim settlement costs of a general insurer are costs associated with achieving settlements with the insured, for example assessors and legal costs. The total gross claim cost refers to the size of the individual claim as a whole.

New paragraph w was added for compliance cost reasons. The compliance costs for general insurers of having to identify claims separately and add back at the balance date the unexpired portion of direct claim settlement costs for claims attributable to legal and assessors' costs of less than $65,000 (excluding GST) are significant, relative to the amount of accrual expenditure incurred for each claim. Isolating and subtracting such costs would be both a time-consuming and expensive exercise.

Change to the partnership proviso

The wording of the partnership proviso has also been updated to reflect changes to relevant wording of the Income Tax Act 1994 Act and the Tax Administration Act 1994.

Amounts

There has been no alteration to the amounts in the schedule.

The determination was made under section EF 1(3) of the Income Tax Act 1994. It was signed by Robin Oliver, the General Manager of the Policy Advice Division, on 31 March 2004. The full determination follows.

Determination E11

PERSONS NOT REQUIRED TO COMPLY WITH SECTION EF 1 OF THE INCOME TAX ACT 1994

1. Explanation (which does not form part of this determination).
This determination cancels and replaces Determination E10: Persons Not Required To Comply With Section EF 1 of The Income Tax Act 1994.

2. Reference
This determination is made under section EF 1(3) of the Income Tax Act 1994. It determines the extent to which

persons are not required to comply with section EF 1 of the Income Tax Act 1994, in respect of the income year that commences on 1 April 2004 and every subsequent income year until this determination is cancelled by the Commissioner.

3. Interpretation

In this determination, unless the context otherwise requires—

Expressions have the meanings given by sections OB 1 and EF 1 of the Income Tax Act 1994.

For a person who furnishes a return of income under section 38 of the Tax Administration Act 1994 for an accounting year ending with a day other than the 31st day of March, a reference to an **income year** is treated as being a reference to the accounting year that, under that section, corresponds with the income year.

The following terms have defined meanings:

- **audit fees**, for a person and an income year, means fees incurred by the person in relation to the preparation by a qualified person of a report, for financial reporting purposes, that relates to a financial statement relating to the person and the income year
- **balance date**, in relation to a person and an income year, means the last day of the person's income year
- **expiry date**, in relation to expenditure incurred in an income year, means—

  (a) if the expenditure relates to payment for services, the date by which it is reasonably expected that performance of the service will be completed:

  (b) if the expenditure relates to payment for, or in relation to, a chose in action—

  (i) for a definite period, the last day of the period
  (ii) for an indefinite period, the day on which it is reasonably expected that the period will end.

- **financial statement**, in relation to a person—

  (a) means, subject to paragraph (b)—

  (i) a balance sheet
  (ii) a profit and loss account
  (iii) group accounts
  (iv) a financial statement within the meaning of that term in section 8 of the Financial Reporting Act 1993
  (v) a group financial statement within the meaning of that term in section 9 of the Financial Reporting Act 1993
  (vi) a supporting note or statement that accompanies the financial statement.

  (b) does not include—

  (i) a statement of production quality or production volume
  (ii) a statement prepared in relation to the exercise of any rights in respect of which royalties are payable.

- **mandatory accounting costs**, in relation to a person and an income year (called the **reported year**), means accrual expenditure incurred by the person for the purpose of meeting any requirement imposed on the person by operation of law to provide accounting, statistical, operational, sociological or other information in respect of—

  (a) events occurring in the reported year

  (b) a state of affairs in the reported year

  (c) events occurring in, or a state of affairs in, the income year that immediately follows the reported year, if the events or state of affairs are required to be reported in the financial statements for the reported year.

- **periodic charges** means expenditure regularly incurred on a rated annual or more frequent basis, and includes local authority levies (other than rates), licences and registrations
- **qualified person** means—

  (a) a person qualified for appointment as an auditor of a company in terms of section 165 of the Companies Act 1955 or section 199 of the Companies Act 1993

  (b) a person similarly qualified, according to the law in any other jurisdiction, for appointment as an auditor of a body corporate.

4. Determination

A person who incurs expenditure that is deductible in the income year commencing on 1 April 2004, or that is deductible in any subsequent income year until this determination is cancelled by the Commissioner, shall not be required to comply with section EF 1 of the Income Tax Act 1994 in respect of the expenditure and the income year if—

(a) the expenditure is of a kind described in column (1) of the schedule, and

(b) the sum of all of the amounts of the unexpired portion of the kind of expenditure does not exceed the amount, if any, specified in relation to that expenditure in column (2) of the schedule, and

(c) the length of time between the balance date for the income year and the subsequent expiry date of the expenditure does not exceed the number of months, if any, specified in relation to the expenditure in column (3) of the schedule, and

(d) in relation to expenditure on goods of any of the kinds specified in categories (d) and (k) of the schedule, the goods are in the possession of the person at balance date, and

(e) the deduction of the expenditure has not been deferred to a subsequent income year for financial reporting purposes.

5. Expenditure incurred by partnership

For the purpose of this determination, any expenditure taken into account in making a joint return of income of a partnership for the purpose of the Income Tax Act 1994 and the Tax Administration Act 1994 is treated as if the expenditure were incurred by the partnership and not by any other person.

This determination is signed by me on 31 March 2004.

Robin Oliver
General Manager, Policy

SCHEDULE

Description of expenditure Column (1)	Total amounts of unexpired portion Column (2)	Number of months Column (3)
(a) rental for the lease of land or buildings relating to a period ending more than one month after balance date	$23,000	Six
(b) rental for the lease of land or buildings other than such rental dealt with elsewhere in this determination		One
(c) rental for the lease or bailment of livestock or bloodstock	$23,000	Six
(d) payment for purchase of consumable aids	$58,000	
(e) insurance premiums under an insurance contract if the total amount of such expenditure incurred in the income year in respect of the contract does not exceed $12,000		Twelve
(f) payment in respect of equipment service contracts or warranties if the consideration for the contract or warranty forms an inseparable and indeterminate part of the consideration for the asset or assets to which it relates		
(g) payment in respect of a contract for the service or maintenance of plant, equipment, or machinery if the total amount of such expenditure incurred in the income year in respect of the contract does not exceed $23,000		Three
(h) payment for the use or maintenance of telephone and other communication equipment		Two
(i) costs for services, other than those dealt with elsewhere in this determination	$12,000	Six
(j) periodic charges, other than those dealt with elsewhere in this determination	$12,000	Twelve
(k) purchase of stationery		
(l) subscriptions for a newspaper, journal, or other periodical including the maintenance or annotation of a documentary information service		
(m) motor vehicle registration and drivers' licence fees		
(n) subscriptions, or other fees (but excluding any payment in respect of a franchise agreement) entitling membership of any trade, professional, or other association if the amount of such expenditure incurred in the income year in respect of the association does not exceed $6,000		Twelve
(o) costs on postal and courier services, including such expenditure for franking, private postboxes and private postbags, business reply post and freepost, and expenditure evidenced by the possession of postal stamps		

Schedule continued on next page

Description of expenditure **Column (1)**	**Total amounts of unexpired portion** **Column (2)**	**Number of months** **Column (3)**
(p) rates made and levied under Part 3 of the Local Government (Rating) Act 2002 to the extent of the amount invoiced on or before balance date		
(q) advance bookings for travel and hotel or motel accommodation	$12,000	Six
(r) costs of advertising	$12,000	Six
(s) road-user charges		
(t) audit fees		
(u) mandatory accounting costs		
(v) accrual expenditure incurred in respect of the income year (or any prior income year) that is deductible under section DJ 5 of the Income Tax Act 1994		
(w) direct claim settlement costs included in the outstanding claims reserve of a general insurer in relation to a contract of insurance if the total gross claim cost (excluding GST) included in the outstanding claims reserve in relation to any one claim does not exceed $65,000 (excluding GST)		

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.

Please quote reference: DDG0062

DIGITAL PHOTOGRAPHIC MINILABS

DRAFT GENERAL DEPRECIATION DETERMINATION

We have been asked to review the basic economic depreciation rate applying to "Minilabs" under the "Printing and Photographic" industry category as it applies to digital photographic minilabs. This review was prompted by a submission that the newer digital photographic minilabs were subject to increased technological obsolescence and therefore had a shorter useful life than older technology minilabs.

The Commissioner proposes to issue a general depreciation determination which will insert a new asset class "Digital minilab machines" into the "Printing and Photographic" industry category. It is also proposed to amend the description of the existing "Minilabs" asset class to "Minilab machines (other than digital minilab machines)" in the same industry category. The "Digital minilab machines" will have a depreciation rate of 33% DV (24% SL), based on an estimated useful life of 5 years while the depreciation rate for "Minilab machines (other than digital minilab machines)" of 22% DV (15.5% SL) based on an estimated useful life of eight years, remains unchanged.

The draft determination is reproduced below. The proposed new depreciation rate is based on the estimated useful life set out in the draft determination and a residual value of 13.5%.

GENERAL DEPRECIATION DETERMINATION DEP[X]

This determination may be cited as "Determination DEP[X]: Tax Depreciation Rates General Determination Number [X]".

1. Application

This determination applies to taxpayers who own the asset classes—see page 29.

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 below:

General asset class	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Digital minilab machines which are: • 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.

If you wish to make a submission on the proposed changes, please write to:

Manager, Field Liaison and Communication
Adjudication & Rulings
Inland Revenue Department
National Office
PO Box 2198
WELLINGTON

We are particularly interested in receiving comments regarding the accuracy of the description of the digital minilab asset class as included in the draft.

We need to receive your submission by 31 May 2004 if we are to take it into account in finalising the determination.

2004 INTERNATIONAL TAX DISCLOSURE EXEMPTION ITR15

Introduction

Section 61 of the Tax Administration Act 1994 (TAA) requires people to disclose interests they hold in foreign entities.

Under section 61(1) of the TAA, a person who has a control or income interest in a foreign company or an interest in a foreign investment fund (FIF) at any time during the income year must disclose the interest held. However, section 61(2) allows the Commissioner of Inland Revenue to exempt any person or class of persons from this requirement if disclosure is not necessary for the administration of the international tax rules (as defined by section OZ 1) contained in the Income Tax Act 1994 (ITA).

Under section 61(2), the Commissioner has issued an international tax disclosure exemption which applies for the income year ended 31 March 2004. This exemption may be cited as "International Tax Disclosure Exemption ITR15", and the full text appears at the end of this item.

Scope of exemption

The scope of the 2004 disclosure exemption is the same as the 2003 exemption.

Interests held by residents

Disclosure is required by residents for these interests:

- an interest held in an FIF
- an "income interest of 10% or greater" held in a foreign company. The disclosure obligation applies in respect of all foreign companies regardless of the country of residence.

An "income interest of 10% or greater" is defined in section OB 1 of the ITA. For the purposes of determining exemption from disclosure it includes these interests:

1. An income interest held directly in a foreign company
2. An income interest held indirectly through any interposed foreign company
3. An income interest held by an associated person (which is not a controlled foreign company) as defined by section OD 8 (3) of the ITA.

Example

If a husband and wife each hold an income interest of 5% in a Cayman Islands company, the interests would not be exempt from disclosure because the husband and wife are associated persons under section OD 8(3)(d) Under the associated persons test they are each deemed to hold the other's interests, so they each hold an "income interest of 10% or greater" which must be disclosed.

They are not required to account for attributed foreign income or loss under the controlled foreign company rules. However, they would have to account for FIF income or loss under the FIF rules.

In this example the husband and wife must disclose their interests as interests in a foreign company and as interests in an FIF. However, only the FIF interests should be disclosed on an IR 439, IR 440, IR 441, IR 442 or IR 443 forms (see "Overlap of interests" on page 31).

Foreign company interests

A resident who holds a control or income interest in a foreign company must disclose that interest, regardless of the company's country of residence. The 2004 international tax disclosure exemption also makes no distinction about residence, and any interest in a foreign company which is an "income interest of 10% or greater" must be disclosed. Disclosure is to be made on an IR 477 or IR 479 "Interest in a foreign company disclosure schedule" form.

The disclosure exemption makes no distinction on the residence of a foreign company for these reasons:

- attributed (non-dividend) repatriation rules apply to an "income interest of 10% or greater" in a controlled foreign company (CFC) regardless of the CFC's country of residence.
- to identify tax preferences applied by the taxpayer (whether or not specified in Schedule 3, Part B of the ITA) in respect of an interest held in a foreign company which is resident in a Schedule 3, Part A of the ITA jurisdiction (ie Australia, Canada, Federal Republic of Germany, Japan, Norway, United Kingdom and the United States of America).
- the requirement for a CFC which is resident in a country not listed in Schedule 3, Part A of the ITA to attribute foreign income or loss from 1 April 1993.

Foreign investment fund interests

An interest in a foreign entity must be disclosed if it constitutes an "interest in a foreign investment fund" specified within section CG 15(1) of the ITA. These types of interest must be disclosed:

- rights in a foreign company or anything deemed to be a company for the purposes of the ITA (eg a unit trust)
- an entitlement to benefit from a foreign superannuation scheme
- an entitlement to benefit from a foreign life insurance policy
- an interest in an entity specified in Schedule 4, Part A of the ITA (no entities were listed when this TIB went to press).

However, any interest that does not fall within the above types or which is specifically excluded as an interest in an FIF under section CG 15(2) does not have to be disclosed. The following are listed in section CG 15(2) as exclusions from what constitutes an interest in an FIF:

- an "income interest of 10% or greater" in a CFC (separate disclosure is required of this as an interest in a foreign company)
- an interest in a foreign company that is resident and liable to income tax in a country or territory specified in Schedule 3, Part A of the ITA (ie Australia, Canada, Federal Republic of Germany, Japan, Norway, United Kingdom and the United States of America).
- an interest in an employment-related foreign superannuation scheme
- a qualifying foreign private annuity, unless an election has been made to remain within the FIF regime, by the due date for filing the person's 2004 tax return. See Inland Revenue's booklet *Overseas private pensions (IR 257)* for more information.
- interests in foreign entities held by a natural person other than in that person's capacity as a trustee, if the aggregate cost or expenditure incurred in acquiring the interests remains under $50,000 at all times during the income year
- an interest held by a natural person in a foreign entity located in a country where exchange controls prevent the person deriving any profit or gain or disposing of the interest for New Zealand currency or consideration readily convertible to New Zealand currency
- an interest in a foreign life insurance policy or foreign superannuation scheme acquired by a natural person before he or she became a New Zealand resident for the first time, for a period of up to four years.

A resident who holds an interest in an FIF at any time during the 2004 income year must disclose the interest and calculate FIF income or loss on the form *Interest in foreign investment fund disclosure schedule and worksheet* (IR 439, IR 440, IR 441, IR 442, IR 443). The FIF rules allow a person four options to calculate FIF income or loss (accounting profits method, branch equivalent method, comparative value method and deemed rate of return method), so the Commissioner has prescribed four forms to disclose and calculate FIF income or loss from an interest in an FIF using one of the methods. The respective forms to use for whichever FIF income calculation method you choose to apply is as follows;

- IR 439 form for the accounting profits method
- IR 440 form for the branch equivalent method
- IR 441 form for the comparative value method
- IR 442 form for the comparative value method and multiple interests
- IR 443 form for the deemed rate of return method.

Overlap of interests

A situation may arise where a person is required to furnish a disclosure for an interest in a foreign company which is also an interest in an FIF. For example, a person with an "income interest of 10% or greater" in a foreign company which is not a CFC is strictly required to disclose both an interest held in a foreign company and an interest held in an FIF.

However, to meet the disclosure obligations only one disclosure return (either the IR 477 or IR 479 forms or the IR 439, IR 440, IR 441 or IR 443 forms) is required for each interest a person holds in a foreign entity.

Here are the general rules for determining which disclosure return to file:

1. Use the appropriate IR 439, IR 440, IR 441, IR 442 or IR 443 form to disclose all FIF interests, and in particular:
    - an interest in a foreign company which is not resident in a Schedule 3, Part A country and is not a CFC (regardless of the level of interest held)
    - an income interest of less than 10% in a CFC which is not resident in a Schedule 3, Part A country
    - an interest in a foreign life insurance policy or foreign superannuation scheme, regardless of the country or territory in which the entity was resident.
2. Use the IR 477 or IR 479 forms to disclose:
    - an "income interest of 10% or greater" in a foreign company (regardless of the country of residence) that is not being disclosed on the IR 439, IR 440, IR 441, IR 442 or IR 443 forms.

Disclosure is not required on any of the forms for an income interest of less than 10% in a foreign company (whether a CFC or not) which is also not an FIF interest. An example is an interest which is covered by the Schedule 3, Part A exclusion from the FIF rules.

Interests held by non-residents

The 2004 disclosure exemption removes the need for interests held by non-residents in foreign companies and FIFs to be disclosed.

This would apply for example to an overseas company operating in New Zealand (through a branch) in respect of its interests in foreign companies and FIFs.

The purpose of the international tax rules is to make sure that New Zealand residents are taxed on their share of the income of any overseas interests they hold. However, under the international tax rules non-residents are not required to calculate or attribute income under the CFC regime (section CG 6(1) of the ITA 1994). In addition, under section CG 16(4) of the ITA 1994 a non-resident is not to be treated as deriving or incurring any FIF income or loss. The disclosure of non-residents' holdings in foreign companies or FIFs is not necessary for the administration of the international tax rules.

Summary

The 2004 international tax disclosure exemption removes the requirement of a resident to disclose an interest held in a foreign company (if the interest is not also an interest in an FIF) that does not constitute an "income interest of 10% or greater" (ie it is less than 10%). The disclosure exemption is not affected by the foreign company's country of residence. Further, an interest in an FIF must be disclosed.

The 2004 disclosure exemption also removes the requirement for a non-resident to disclose interests held in foreign companies and FIFs.

Persons not required to comply with section 61 of the Tax Administration Act 1994

This exemption may be cited as "International Tax Disclosure Exemption ITR15"

1. Reference

This exemption is made under section 61(2) of the Tax Administration Act 1994. It details interests in foreign companies in relation to which any person is not required to comply with the requirement in section 61 of the Tax Administration Act 1994 to make disclosure of their interests, for the income year ending 31 March 2004. This exemption does not apply to interests in foreign companies which are interests in foreign investment funds, unless that interest is held by a non-resident of New Zealand.

2. Interpretation

In this exemption, unless the context otherwise requires, expressions used have the same meaning as in section OB 1 of the Income Tax Act 1994 or the international tax rules (as defined by section OZ 1 of the Income Tax Act 1994).

3. Exemption

(i) Any person who has an income interest or a control interest in a foreign company (not being an interest in a foreign investment fund), in the income year ending 31 March 2004, is not required to comply with section 61(1) of the Tax Administration Act 1994 in respect of that interest and that income year, unless the interest held by that person during any accounting period of the foreign company (the last day of which falls within that income year of the person), would constitute an "income interest of 10% or greater", as defined by section OB 1 of the Income Tax Act 1994, as if the foreign company was a controlled foreign company.

(ii) Any non-resident person who has an income interest or a control interest in a foreign company or an interest in a foreign investment fund in the income year ending 31 March 2004, is not required to comply with section 61(1) of the Tax Administration Act 1994 in respect of that interest and that income year if either or both of the following apply:

- No attributed foreign income or loss arises in respect of that interest in that foreign company by virtue of section CG 6(1) of the Income Tax Act 1994, and/or
- No foreign investment fund income or loss arises in respect of that interest in that foreign investment fund by virtue of section CG 16(4) of the Income Tax Act 1994.

This exemption is made by me acting under delegated authority from the Commissioner of Inland Revenue pursuant to section 7 of the Tax Administration Act 1994.

This exemption is signed on the 7th day of April 2004.

Spyros Papageorgiou
Group Manager, Corporates

FOREIGN CURRENCY AMOUNTS – CONVERSION TO NEW ZEALAND CURRENCY

The tables in this item list exchange rates acceptable to Inland Revenue for converting foreign currency amounts to New Zealand currency under the controlled foreign company (CFC) and foreign investment fund (FIF) rules for the 12-months ending 31 March 2004.

The conversion rates for the first six months of each income year are published in the *Tax Information Bulletin* following the end of the September quarter, and the rates for the full 12-months at the end of each income year.

To convert foreign currency amounts to New Zealand dollars for any country listed, divide the foreign currency amount by the exchange rate shown.

Note
If you need an exchange rate for a country or a day not listed in the following Tables A and B, please contact one of New Zealand's major trading banks.

Table A

Use this table to convert foreign currency amounts to New Zealand dollars for:

- branch equivalent income or loss under the CFC rules pursuant to section CG 11(3)(a) of the Income Tax Act 1994
- FIF income or loss calculated under the branch equivalent method pursuant to sections CG 11(3)(a), CG 16(1)(b) and CG 21 of the Income Tax Act 1994
- foreign tax credits calculated under the branch equivalent method for a CFC under section LC 4(1)(b) of the Income Tax Act 1994
- foreign tax credits calculated under the branch equivalent method for an FIF under sections CG 21(3) and LC 4(1)(b) of the Income Tax Act 1994
- FIF income or loss calculated under the accounting profits, comparative value (except if Table B applies, ie where the market value of the FIF interest as at the end of the income year or/and at the end of the preceding income year is not zero) or deemed rate of return methods under section CG 16(11) of the Income Tax Act 1994.

Key

$$\frac{X}{Y}$$

"x" is the exchange rate on the 15th day of the month, or if no exchange rates were quoted on that day, on the next working day on which they were quoted.

"y" is the average of the mid-month exchange rates for that month and the previous 11 months.

Example 1

A CFC resident in Hong Kong has an accounting period ending on 30 September 2003. Branch equivalent income for the period 1 October 2002 to 30 September 2003 is 200,000 Hong Kong dollars (HKD).

HKD 200,000 ÷ 4.2968 = NZ$46,546.27

A similar calculation would be needed for an FIF using the branch equivalent or accounting profits methods.

Example 2

A taxpayer with a 31 March balance date purchases shares in a Philippines company (which is an FIF) for 350,000 pesos (PHP) on 7 September 2003. Using the comparative value or deemed rate of return methods, the cost is converted as follows:

PHP 350,000 ÷ 31.7922 = NZ$11,008.99

Alternatively, the exchange rate can be calculated by averaging the exchange rates "x" that apply to each complete month in the foreign company's accounting period.

Example 3

A CFC resident in Singapore was formed on 21 April 2003 and has a balance date of 31 March 2004. During the period from 1 May 2003 to 30 September 2003, branch equivalent income of 500,000 Singapore dollars was derived.

(i) Calculating the average monthly exchange rate for the complete months May–September 2003.

(0.9906 + 1.0024 + 1.0313 + 1.0239 + 1.0207) ÷ 5 = 1.01378

(ii) Conversion to New Zealand currency:

SGD 500,000 ÷ 1.01378 = NZ$493,203.65

Table B

Table B lists the end-of-month exchange rates acceptable to Inland Revenue for the six-month period ending 31 March 2004. Use this table for converting foreign currency amounts to New Zealand dollars for:

- Items "a" (market value of the FIF interest on the last day of the income year) and "c" (market value of the FIF interest on the last day of the preceding income year) of the comparative value formula under section CG 18 of the Income Tax Act 1994.
- Foreign tax credits paid on the last day of any month calculated under the branch equivalent method for a CFC or FIF under section LC 4 (1)(a) of the Income Tax Act 1994.

Example 4

A New Zealand resident with a balance date of 30 September 2003 held an interest in an FIF resident in Thailand. The market value of the FIF interest at 30 September 2003 (item "a" of the comparative value formula) was 500,000 Thailand baht (THB).

THB 500,000 ÷ 23.6422 = NZ$21,148.62

Note
An overseas currency converter is available on our website
www.ird.govt.nz/cgi-bin/form.cgi?form=currency

Table A: Mid-month and 12-month cumulative exchange rates

Country to NZ $	Currency	Code	15-Apr-03	15-May-03	15-Jun-03	15-Jul-03	15-Aug-03	15-Sep-03	15-Oct-03	15-Nov-03	15-Dec-03	15-Jan-04	15-Feb-04	15-Mar-04
			12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate
Australia	Dollar	AUD	0.9051	0.8882	0.8679	0.8930	0.8935	0.8791	0.8640	0.8764	0.8731	0.8784	0.8872	0.8785
			0.8859	0.8906	0.8911	0.8933	0.8962	0.8978	0.8969	0.8961	0.8930	0.8893	0.8856	0.8820
Bahrain	Dollar	BHD	0.2064	0.2168	0.2188	0.2219	0.2213	0.2196	0.2250	0.2373	0.2424	0.2571	0.2636	0.2441
			0.1896	0.1934	0.1964	0.1997	0.2036	0.2071	0.2108	0.2149	0.2190	0.2235	0.2281	0.2312
Canada	Dollar	CAD	0.7962	0.7902	0.7752	0.8098	0.8176	0.7955	0.7903	0.8211	0.8528	0.8781	0.9215	0.8631
			0.7742	0.7810	0.7870	0.8000	0.7969	0.8011	0.8037	0.8066	0.8107	0.8148	0.8216	0.8259
China	Yuan	CNY	4.5357	4.7593	4.8102	4.8758	4.8550	4.8320	4.9426	5.2151	5.3327	5.6495	5.7945	5.3683
			4.1531	4.2354	4.3030	4.4253	4.4611	4.5528	4.6342	4.7238	4.8131	4.9121	5.0139	5.0809
Denmark	Krone	DKK	3.7698	3.7108	3.6295	3.8793	3.8750	3.8352	3.7777	3.9800	3.9164	4.0001	4.0916	3.9350
			3.7243	3.7210	3.7072	3.7492	3.7596	3.7788	3.7729	3.7971	3.8129	3.8311	3.8556	3.8667
European Community	Euro	EUR	0.5081	0.5001	0.4888	0.5221	0.5211	0.5167	0.5091	0.5357	0.5296	0.5378	0.5494	0.5288
			0.4989	0.4985	0.4967	0.4994	0.5036	0.5061	0.5081	0.5113	0.5136	0.5160	0.5192	0.5206
Fiji	Dollar	FJD	1.0860	1.0854	1.0806	1.1028	1.1000	1.0929	1.0848	1.1176	1.1189	1.1434	1.1576	1.1243
			1.0473	1.0542	1.0588	1.0653	1.0738	1.0808	1.0858	1.0916	1.0958	1.1005	1.1055	1.1079
French Polynesia	Franc	XPF	60.4224	59.4337	58.1450	62.0607	62.0310	61.3801	60.5020	63.6860	62.9506	63.8938	65.3097	62.8274
			59.3489	59.2894	59.0584	59.3888	59.8905	60.1884	60.4298	60.7989	61.0672	61.3440	61.7196	61.8869
Hong Kong	Dollar	HKD	4.2706	4.6093	4.5271	4.5931	4.5758	4.5484	4.6218	4.8926	4.9982	5.2995	5.4381	5.0409
			3.9239	4.0121	4.0753	4.1432	4.2246	4.2968	4.3710	4.4539	4.5363	4.6280	4.7226	4.7846
India	Rupee	INR	25.8133	26.9394	26.9722	27.0914	26.7638	26.4476	26.9456	28.3139	29.0231	30.7228	31.3740	29.0115
			24.1000	24.5068	24.8033	25.1092	25.4833	25.7929	26.1217	26.4845	26.8533	27.2756	27.7076	27.9516
Indonesia	Rupiah	IDR	4,852.0550	4,859.0000	4,774.4300	4,845.2250	5,015.2850	4,934.4100	5,040.2400	5,352.6000	5,460.3550	5,694.8900	5,882.5400	5,600.5700
			4,512.7225	4,565.7150	4,614.6046	4,651.6908	4,732.0275	4,789.7867	4,836.6354	4,906.6179	4,980.8558	5,057.0013	5,135.8075	5,192.6333
Japan	Yen	JPY	65.8575	66.7933	68.1000	69.2529	69.8238	68.4027	64.9460	68.2609	69.6103	72.4200	73.7841	71.6286
			60.7455	61.4361	62.1129	63.1647	64.4735	65.3837	65.8427	66.5196	67.1597	67.9029	68.5209	69.0733
Korea	Won	KOR	670.1300	687.1100	692.6600	692.7100	690.9450	682.9750	701.0400	737.9050	763.4300	805.5350	809.2500	765.2800
			609.5588	618.6338	627.1517	637.6950	650.0221	659.1713	667.7217	679.1296	691.0938	705.6854	718.1883	724.9142
Kuwait	Dollar	KWD	0.1643	0.1717	0.1734	0.1767	0.1757	0.1734	0.1752	0.1852	0.1892	0.2009	0.2061	0.1907
			0.1515	0.1542	0.1564	0.1590	0.1620	0.1646	0.1672	0.1701	0.1730	0.1763	0.1797	0.1819
Malaysia	Ringgit	MYR	2.0822	2.1850	2.2083	2.2384	2.2289	2.2182	2.2691	2.3942	2.4481	2.5937	2.6602	2.4645
			1.9249	1.9627	1.9936	2.0266	2.0662	2.1014	2.1388	2.1799	2.2209	2.2550	2.3018	2.3325
Norway	Krone	NOK	3.9914	4.3054	4.0088	4.3518	4.3288	4.2756	4.1995	4.3926	4.3130	4.5876	4.8502	4.4876
			3.7203	3.7619	3.7795	3.8436	3.9121	3.9712	4.0272	4.0903	4.1430	4.2146	4.2986	4.3410
Pakistan	Rupee	PKR	31.4134	32.9370	33.2799	33.7490	33.6705	33.4503	33.9622	35.8868	32.3166	38.7678	39.8430	36.9110
			29.3751	29.8629	30.2392	30.6607	31.1974	31.6649	32.1528	32.7291	32.9323	33.5727	34.2438	34.6823
Papua New Guinea	Kina	PGK	2.0200	2.0447	2.0272	2.0204	1.9740	1.9465	1.9338	2.0201	2.0954	2.1678	2.2148	2.0381
			1.9357	1.9661	1.9874	1.9983	2.0103	2.0177	2.0166	2.0021	2.0131	2.0199	2.0320	2.0419
Philippines	Peso	PHP	28.5629	29.6790	30.7454	31.2145	31.9235	31.7922	32.4536	34.6882	35.3982	37.5725	38.9259	36.3105
			26.1713	26.7758	27.3290	27.9146	28.6031	29.2189	29.8299	30.5190	31.1984	31.9497	32.7353	33.2722
Singapore	Dollar	SGD	0.9730	0.9906	1.0024	1.0313	1.0239	1.0207	1.0344	1.0820	1.0999	1.1540	1.1701	1.1046
			0.8865	0.9006	0.9122	0.9278	0.9461	0.9616	0.9761	0.9931	1.0101	1.0288	1.0458	1.0572
Solomon Islands	Dollar	SBD	4.0520	4.3147	4.4109	4.4731	4.4621	4.4336	4.5345	4.7890	4.8838	5.1783	5.2944	4.8927
			3.6601	3.7763	3.8770	3.9640	4.0525	4.1373	4.2173	4.3036	4.3882	4.4867	4.5816	4.6433
South Africa	Rand	ZAR	4.2744	4.3853	4.5142	4.4708	4.2950	4.2830	4.1395	4.2161	4.0965	4.8252	4.6222	4.3668
			4.7307	4.7107	4.6656	4.6367	4.5896	4.5330	4.4621	4.4096	4.3770	4.3835	4.3859	4.3741
Sri Lanka	Rupee	LKR	52.8808	55.5504	56.1727	56.9583	56.5899	55.4649	56.1449	60.1671	61.6251	66.0843	68.5888	62.4979
			48.3234	49.3234	50.1457	51.0304	52.0733	52.9378	53.7982	54.8237	55.8454	57.0371	58.2817	59.0604
Sweden	Krona	SEK	4.6357	4.5821	4.4366	4.7694	4.8053	4.7092	4.5570	4.7930	4.7442	4.9314	5.0141	4.8929
			4.5713	4.5646	4.5455	4.5666	4.6052	4.6225	4.6345	4.6578	4.6710	4.6934	4.7237	4.7393
Switzerland	Franc	CHF	0.7605	0.7565	0.7523	0.8094	0.8060	0.8051	0.7860	0.8366	0.8214	0.8390	0.8667	0.8286
			0.7330	0.7348	0.7347	0.7423	0.7520	0.7597	0.7662	0.7751	0.7818	0.7896	0.7992	0.8057
Taiwan	Dollar	TAI	19.0400	19.8950	20.1350	20.2550	20.1350	19.8800	20.2150	21.3950	21.9000	22.9550	23.1750	21.6750
			17.3075	17.6563	17.9679	18.3192	18.7088	19.0142	19.2988	19.6400	19.9767	20.3458	20.6746	20.8879

Country to NZ $	Currency	Code	15-Apr-03	15-May-03	15-Jun-03	15-Jul-03	15-Aug-03	15-Sep-03	15-Oct-03	15-Nov-03	15-Dec-03	15-Jan-04	15-Feb-04	15-Mar-04
			12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate	12-month rate
Thailand	Baht	THB	23.2875	23.9947	23.9153	24.2814	24.2567	23.5705	23.6315	24.9157	25.3301	26.3662	26.9922	25.3500
			21.3147	21.6977	21.9987	22.3742	22.8004	23.1012	23.3349	23.6236	23.9003	24.1981	24.4873	24.6576
Tonga	Pa'anga	TOP	1.1897	1.2251	1.2388	1.2583	1.2561	1.2508	1.2577	1.3034	1.3139	1.3348	1.3375	1.2818
			1.0980	1.1177	1.1348	1.1544	1.1745	1.1917	1.2089	1.2248	1.2394	1.2522	1.2641	1.2706
United Kingdom	Pound	GBP	0.3479	0.3554	0.3469	0.3648	0.3665	0.3639	0.3569	0.3738	0.3700	0.3714	0.3715	0.3589
			0.3230	0.3265	0.3281	0.3325	0.3381	0.3430	0.3472	0.3520	0.3559	0.3589	0.3614	0.3623
United States	Dollar	USD	0.5476	0.5751	0.5806	0.5890	0.5868	0.5837	0.5972	0.6310	0.6442	0.6830	0.7003	0.6473
			0.5032	0.5132	0.5213	0.5300	0.5404	0.5497	0.5596	0.5705	0.5814	0.5934	0.6058	0.6138
Vanuatu	Vatu	VUV	69.4407	70.7492	69.3944	70.4214	70.5837	70.2127	69.6686	71.7978	71.8661	73.5068	74.5469	71.4171
			66.7244	67.3569	67.7148	68.1560	68.7441	69.2526	69.6389	70.0639	70.3709	70.6947	71.0453	71.1338
Western Samoa	Tala	WST	1.7095	1.7162	1.7418	1.7565	1.7553	1.7539	1.7551	1.7874	1.8207	1.8561	1.8928	1.8101
			1.6380	1.6514	1.6638	1.6768	1.6930	1.7074	1.7207	1.7327	1.7454	1.7578	1.7723	1.7796

Table B: End-of-month exchange rates

Country	Currencies	Code	30-Apr-03	30-May-03	30-Jun-03	31-Jul-03	31-Aug-03	30-Sep-03	31-Oct-03	30-Nov-03	31-Dec-03	31-Jan-04	29-Feb-04	31-Mar-04
Australia	Dollar	AUD	0.8972	0.8859	0.8734	0.8933	0.8952	0.8775	0.8674	0.8857	0.8716	0.8784	0.8922	0.8725
Bahrain	Dollar	BHD	0.2104	0.2175	0.2194	0.2192	0.2162	0.2237	0.2301	0.2409	0.2416	0.2520	0.2592	0.2477
Canada	Dollar	CAD	0.8054	0.7915	0.7852	0.8154	0.8005	0.8034	0.8012	0.8370	0.8476	0.8918	0.9228	0.8591
China	Yuan	CNY	4.6183	4.7780	4.8238	4.8295	4.7524	4.9220	5.0597	5.3001	5.3085	5.5412	5.6935	5.4403
Denmark	Krone	DKK	3.7413	3.6053	3.7801	3.8089	3.9178	3.8024	3.9040	3.9954	3.8473	4.0218	4.1164	4.0119
European Community	Euro	EUR	0.5041	0.4857	0.5095	0.5130	0.5275	0.5127	0.5257	0.5380	0.5176	0.5406	0.5531	0.5397
Fiji	Dollar	FJD	1.0888	1.0860	1.0896	1.0892	1.0961	1.0941	1.1004	1.1271	1.1160	1.1312	1.1597	1.1304
French Polynesia	Franc	XPF	59.9236	57.7410	60.5818	61.0034	62.7131	60.9033	62.4650	63.9324	61.4995	64.2539	65.7093	64.1103
Hong Kong	Dollar	HKD	4.3522	4.5010	4.5429	4.5426	4.5758	4.6053	4.7427	4.9702	4.9802	5.2031	5.3557	5.1233
India	Rupee	INR	26.2481	26.9678	26.9142	26.6696	26.7638	26.9476	27.4344	29.0119	28.8868	30.0584	30.8461	28.6681
Indonesia	Rupiah	IDR	4,858.6100	4,820.3300	4,821.3700	4,965.4200	4,889.1500	5,005.4600	5,184.1100	5,454.0700	5,450.8300	5,644.1300	5,826.4600	5,655.9750
Japan	Yen	JPY	66.8441	68.2485	69.6671	70.0351	67.2862	65.8315	66.4471	69.8494	68.8697	70.9714	75.3756	69.4202
Korea	Won	KOR	677.3350	696.7250	695.2100	688.3400	676.3300	683.2400	720.0950	770.2650	766.4000	784.5850	809.5950	757.8000
Kuwait	Dollar	KWD	0.1671	0.1721	0.1746	0.1741	0.1721	0.1744	0.1795	0.1882	0.1889	0.1970	0.2026	0.1936
Malaysia	Ringgit	MYR	2.1201	2.1935	2.2144	2.2171	2.1817	2.2596	2.3229	2.4331	2.4371	2.5439	2.6138	2.4975
Norway	Krone	NOK	3.9287	3.8308	4.2194	4.1932	4.3790	4.1680	4.3083	4.3865	4.3305	4.7324	4.8470	4.5358
Pakistan	Rupee	PKR	32.0023	32.9758	33.4158	33.3365	32.8305	33.9707	34.8877	36.3183	36.4474	38.2266	39.1029	37.3666
Papua New Guinea	Kina	PGK	2.0389	2.0523	2.0168	1.9805	1.9219	1.9427	1.9958	2.0660	2.0923	2.1301	2.1476	2.0386
Philippines	Peso	PHP	29.2430	30.3174	30.8992	31.5203	31.1673	32.3798	33.4721	35.3401	35.3567	37.1544	38.3679	36.7410
Singapore	Dollar	SGD	0.9889	0.9943	1.0212	1.0211	1.0036	1.0265	1.0581	1.1028	1.0938	1.1389	1.1696	1.1040
Solomon Islands	Dollar	SBD	4.1623	4.3839	4.4266	4.4259	4.3702	4.5136	4.6404	4.8584	4.8682	5.0636	5.2127	4.9707
South Africa	Rand	ZAR	3.9589	4.6510	4.3575	4.2796	4.2259	4.2352	4.2238	4.1056	4.4259	4.7089	4.5655	4.1562
Sri Lanka	Rupee	LKR	53.9274	55.8484	56.3134	56.3170	55.2732	55.8549	57.6299	61.1871	61.2104	64.6064	67.6648	63.6804
Sweden	Krona	SEK	4.5940	4.3199	4.6726	4.7043	4.8543	4.5646	4.7429	4.8397	4.6909	4.9483	5.0980	4.9903
Switzerland	Franc	CHF	0.7601	0.7422	0.7862	0.7947	0.8109	0.7873	0.8143	0.8317	0.8069	0.8440	0.8714	0.8413
Taiwan	Dollar	TAI	19.4400	20.0300	20.1400	20.0400	19.5950	20.0600	20.7450	21.9050	21.8100	22.3050	22.9000	21.7250
Thailand	Baht	THB	23.6979	23.8439	24.1632	24.1826	23.4372	23.6422	24.1416	25.2881	25.1505	25.9964	26.7873	25.7556
Tonga	Pa'anga	TOP	1.2126	1.2350	1.2427	1.2347	1.2436	1.2576	1.2727	1.3155	1.3030	1.3024	1.3331	1.2922
United Kingdom	Pound	GBP	0.3499	0.3493	0.3531	0.3602	0.3639	0.3566	0.3605	0.3738	0.3637	0.3692	0.3696	0.3600
United States	Dollar	USD	0.5581	0.5773	0.5827	0.5826	0.5737	0.5944	0.6116	0.6404	0.6419	0.6698	0.6885	0.6578
Vanuatu	Vatu	VUV	70.6455	69.2356	69.8186	69.9264	70.0156	70.1941	70.7382	72.4289	71.6991	72.5500	73.9335	72.6176
Western Samoa	Tala	WST	1.7275	1.7375	1.7237	1.7239	1.7293	1.7546	1.7790	1.8258	1.8113	1.8395	1.8658	1.8206

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

REDUCTION OF SHORTFALL PENALTIES FOR PREVIOUS BEHAVIOUR – IR-SPS INV 295

Introduction

1. This Standard Practice Statement sets out the Commissioner's practice for reducing shortfall penalties for previous behaviour.

Application

2. This Standard Practice Statement applies from 1 April 2004 in respect of tax positions taken on or after 1 April 2000 except for cases where a taxpayer is liable to pay a shortfall penalty before the date of Royal assent of the Act (26th March 2003), in which case the shortfall penalty is not reduced in relation to previous behaviour.

3. This Standard Practice Statement must be read in conjunction with the Standard Practice Statements setting out the Commissioner's practice on imposing and reducing shortfall penalties.

4. Please note that at the time of publication of this SPS, the Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Bill 2004 has been introduced and proposes to rewrite section 141FB of the Tax Administration Act 1994 to improve its comprehensibility. It also proposes to broaden the application of section 141FB to take into account offences under sections 143 to 145 when determining a taxpayer's previous behaviour.

Background

5. The Finance and Expenditure Committee recommended that:

> "…a past record of "good behaviour" be taken into account when deciding whether to impose a penalty"[1]

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

> "…the government should specifically require the review team to report on: whether the government's performance expectations of taxpayers are reasonable;
>
> whether, and to what extent, a past record of 'good behaviour' should be taken into account in deciding to impose penalties or to escalate enforcement;…"[2]

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

> "The policy of imposing tax collection obligations on employers/small businesses, and then punishing them with penalties for getting it wrong builds strong resentment from those that have good 'track records'."[3]

8. The government canvassed these issues in its discussion document *Taxpayer compliance, standards and penalties: a review*, released in August 2001. The discussion document noted that applying a test for good behaviour and determining whether taxpayers had met that test would incur considerable compliance and administrative costs. The government wanted to ensure that any tests could be applied consistently to all taxpayers.

9. Any probation period needs to be sufficiently long to indicate that the taxpayer's behaviour has changed, yet short enough to not excessively burden the taxpayer. Following consultation on the bill, the government considered that in the case of GST, FBT, PAYE and resident withholding tax a two-year period is sufficiently long for a regular taxpayer to demonstrate improved compliance behaviour and a four-year period was appropriate for other revenues.

10. The government considered that applying the previous behaviour reduction provision to all shortfall penalties would have the following benefits:

- Taxpayers see that those taxpayers who repeatedly offend are more harshly penalised, reflecting their failure to begin complying voluntarily.

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

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

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

- A concern that the shortfall penalty rates are excessive is addressed. (Especially in relation to voluntary disclosures where the rules are seen as penalising taxpayers who are attempting to comply.)
- The shortfall penalty rate for first time evasion is aligned with the rate for evasion in Australia and Canada.

11. Section 141FB of the Tax Administration Act 1994 was enacted to give effect to the recommendations outlined in the discussion document *Taxpayer compliance, standards and penalties: a review* including that a taxpayer's past compliance should be taken into account when imposing shortfall penalties.

Legislation

Tax Administration Act 1994

141FB REDUCTION OF PENALTIES FOR PREVIOUS BEHAVIOUR

141FB(1) A shortfall penalty, payable by a taxpayer, under section 141E, for evasion or a similar act is reduced to 50% of the penalty that would otherwise be payable under that section if the taxpayer has not previously been liable to a shortfall penalty that—

(a) Related to the same type of tax as does the current penalty; and

(b) Was for evasion or a similar act; and

(c) Was not reduced for voluntary disclosure by the taxpayer; and

(d) Was eligible for a reduction under this subsection.

141FB(2) A shortfall penalty payable by a taxpayer under any of sections 141A to 141D (called in this section the **current penalty**) is reduced to 50% of the penalty that would otherwise be payable under those sections if, after the date specified in subsection (3) and before the date on which the taxpayer becomes liable for the current penalty, the taxpayer has not been liable to pay a shortfall penalty that—

(a) Related to the same type of tax as does the current penalty; and

(b) If the current penalty is for—

(i) *(repealed)*

(ii) Gross carelessness or taking an abusive tax position, was for evasion or a similar act or for gross carelessness or for taking an abusive tax position:

(iii) Not taking reasonable care or taking an unacceptable tax position, was a shortfall penalty; and

(c) Was not reduced for voluntary disclosure by the taxpayer; and

(d) Was eligible for a reduction under this subsection.

141FB(3) The date referred to in subsection (2) precedes the date on which the taxpayer becomes liable for the current penalty by—

(a) 2 years, if the current penalty relates to the taxpayer's application of the PAYE rules, to fringe benefit tax, to goods and services tax, to resident withholding tax; or

(b) 4 years, if the current penalty relates to any other type of tax.

141FB(4) For the purpose of subsection (2), if a taxpayer is liable for shortfall penalties that relate to tax shortfalls of which the Commissioner becomes aware as a consequence of a single investigation or voluntary disclosure, all the shortfall penalties are treated as a single combined penalty.

In this Standard Practice Statement, all legislative references are to the Tax Administration Act 1994 unless otherwise specified.

Please note that at the time of publication of this SPS, the Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Bill 2004 has been introduced and proposes to rewrite section 141FB of the Tax Administration Act 1994 to improve its comprehensibility. It also proposes to broaden the application of section 141FB to take into account offences under sections 143 to 145 when determining a taxpayer's previous behaviour.

Discussion

12. The Taxation (Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Act 2003 was enacted on 26 March 2003 and it amended, among other things, the shortfall penalty provisions in the Tax Administration Act 1994.

13. The amendments included a reduction of shortfall penalties if, within certain specified probation periods, the taxpayer has not been liable to pay a shortfall penalty on a tax shortfall identified during an Inland Revenue audit.

14. The probation periods are the previous two years in the case of GST, FBT, PAYE and resident withholding tax, or four years in the case of all other tax types.

15. There is no probation period in the case of a shortfall penalty imposed under section 141E (evasion or a similar act)—all subsequent breaches by the taxpayer will be penalised at the higher rate.

16. If a taxpayer voluntarily discloses a tax shortfall, disclosure of that shortfall does not lead to higher rates of shortfall penalties applying to subsequent breaches, whether those subsequent tax shortfalls are voluntarily disclosed or not. It is only when the taxpayer has been audited and a shortfall penalty is imposed that the probation period begins.

Application date

17. The shortfall penalty reduction provision applies to tax positions taken on or after 1 April 2000, except for those cases where a taxpayer is liable to pay a shortfall penalty before the date of Royal assent of the Act (26 March 2003), in which case the shortfall penalty would not qualify for the previous behaviour reduction. This date was chosen to ensure that tax shortfalls identified after the date of enactment but relating to tax periods after 1 April 2000 benefit from the previous behaviour provision.

Clean slate

18. All taxpayers start with a "clean slate". If a taxpayer has had a shortfall penalty imposed before 26 March 2003, when section 141FB was enacted, that penalty is not taken into account in determining whether a subsequent shortfall penalty will qualify for the previous behaviour reduction.

Standard practice

19. This standard practice details the following:

    - the reduction
    - application date
    - tax types
    - exception
    - grouping of shortfall penalties
    - shortfall penalties and the disputes process.

The reduction

20. Shortfall penalties are reduced by 50% if, within the preceding specified probation periods, the taxpayer has not been liable to pay a shortfall penalty on a tax shortfall for the same tax type identified during an Inland Revenue audit.

21. If, a taxpayer had been liable to pay a shortfall penalty in respect of an earlier tax shortfall which was not reduced for voluntary disclosure and was eligible for a previous behaviour reduction, then any subsequent shortfall penalties for the same or a lesser shortfall penalty imposed within the probation period, in respect of the same revenue type, will not qualify for the previous behaviour reduction.

22. For the purposes of this SPS, "audits" include income tax audits, investigations, payroll audits, GST refund checks, payroll and GST registration checks and any other type of review.

23. For the purposes of this SPS, the date a taxpayer is liable to pay a shortfall penalty is deemed to be the due date for payment of the shortfall penalty.

Application date

24. The previous behaviour reduction provision applies to tax positions taken on or after 1 April 2000, except for those cases where a taxpayer is liable to pay a shortfall penalty before the date of Royal assent of the Act (26 March 2003) in which case the shortfall penalty would not qualify for the previous behaviour penalty reduction.

The probation period

25. The probation periods are the previous:

    - two years – in the case of GST, FBT, PAYE and resident withholding tax, or
    - four years – in the case of all other tax types.

26. The probation period runs from the due date for payment of the reduced shortfall penalty.

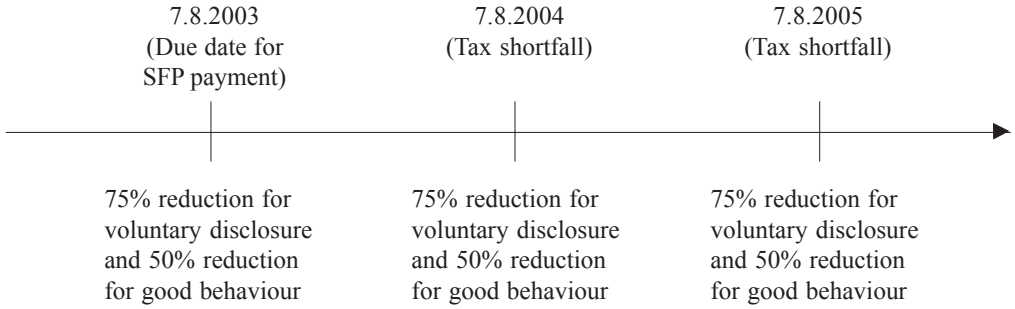
27. The date that the taxpayer takes a tax position that gives rise to the subsequent penalty determines whether or not the subsequent tax shortfall is within the probation period or not.

28. There is no probation period in the case of an evasion shortfall penalty – any subsequent evasion shortfall penalties will not qualify for the previous behaviour reduction.

29. Voluntary disclosures by taxpayers do not count against previous behaviour. It is only when the taxpayer has been audited by Inland Revenue and a shortfall penalty (excluding an evasion shortfall penalty) is imposed that the probation period begins.

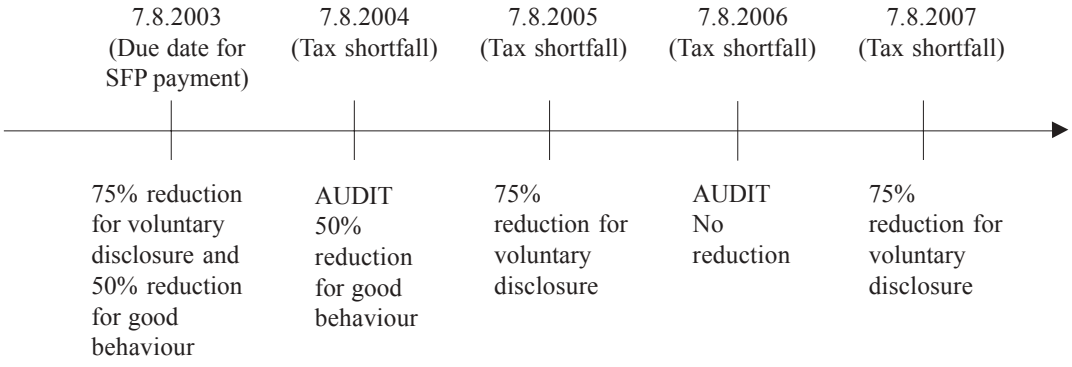
Example 1[4]

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



Example 2

Similar to *Example 1* however, Inland Revenue decides to audit the period following the first voluntary disclosure and a shortfall penalty for evasion is imposed. This shortfall penalty is reduced by 50% for previous behaviour. In the subsequent period the taxpayer makes a voluntary disclosure and the shortfall penalty is reduced by 75% because of the disclosure. Again, Inland Revenue audits the period following the disclosure and a shortfall penalty for evasion is imposed. This shortfall penalty is not reduced. In a subsequent period the taxpayer voluntarily discloses omitted income and the shortfall penalty is reduced by 75% because of the disclosure.



The shortfall penalty on the subsequent tax shortfall does not have to be imposed within the probation period; it is the tax shortfall that must occur within the period for the higher penalty rate to apply.

Note: There is no probation period in respect of evasion shortfall penalties—any subsequent evasion penalty will not be eligible for a previous behaviour reduction.

[4] Please note, the examples in this Standard Practice Statement are intended to illustrate how the Commissioner may apply the practice set out in this Standard Practice Statement—they do not set practice in themselves.

Tax types

30. The previous behaviour reduction provision applies separately to each type of tax, such as PAYE, income tax and GST. Therefore, a penalty imposed in relation to one tax type does not mean that the taxpayer automatically faces a higher penalty rate for another tax type.

Example 3

Inland Revenue audits a taxpayer and identifies a GST shortfall which qualifies for the previous behaviour reduction. This breach (for GST) will not preclude the taxpayer from receiving a previous behaviour reduction for a subsequent income tax shortfall identified during an Inland Revenue audit.

Exception

31. Breaches of the lack of reasonable care and unacceptable tax position standards do not start the probation period for subsequent shortfall penalties for gross carelessness, abusive tax position or evasion. But these higher penalties do start the probation period in relation to subsequent lesser penalties.

Grouping of shortfall penalties

32. Where there is more than one tax shortfall arising as a result of a single investigation or voluntary disclosure, they are grouped and effectively treated as one shortfall penalty.

Example 4

Inland Revenue audits several GST periods and finds a number of discrepancies. The shortfall penalties are treated as a single combined penalty for the purpose of determining whether the taxpayer qualifies for a previous behaviour reduction. The probation period runs from the date the reduced penalty is imposed.

Shortfall penalties and the disputes process

33. Where the Commissioner has issued a notice of proposed adjustment (NOPA) incorporating shortfall penalties with a 50% reduction and the case is proceeding through the disputes process, any shortfall penalties arising in respect of the same tax type but for a different period should not be imposed until after the dispute is resolved. This will ensure that when the result of the dispute is known, the 50% previous behaviour reduction is appropriately imposed.

This Standard Practice Statement was signed by me on 14th April 2004

Margaret Cotton
National Manager
Technical Standards

OPERATIONAL STATEMENT

GST AND THE COSTS OF SALE ASSOCIATED WITH MORTGAGEE SALES

Introduction

1. This Operational Statement sets out the Commissioner's position on GST input tax claims in relation to the costs of sale associated with mortgagee sales namely:

   (i) Whether the mortgagee's costs of sale can be deducted prior to the calculation of GST due, and

   (ii) Whether a mortgagee can claim input tax on a mortgagee sale for the costs associated with the mortgagee sale.

Application

2. This Operational Statement sets out the Commissioner's existing position in relation to the Goods and Services Tax Act 1985.

Background

3. This Operational Statement has been produced due to growing evidence of cases where mortgagees in mortgagee sales are deducting the costs of sale before calculating the GST that is due pursuant to the Goods and Services Tax Act 1985, and related issues.

4. This statement therefore clarifies the GST treatment in relation to the issues that have arisen out of the above situations.

Summary

5. A mortgagee making a mortgagee sale cannot deduct the costs of sale before calculating the GST due under section 17 of the Goods and Services Tax Act 1985.

6. A mortgagee cannot claim input tax for the costs associated with a mortgagee sale.

Legislation

Goods and Services Tax Act 1985

SECTION 3 MEANING OF TERM FINANCIAL SERVICES
3(1) [Financial services defined] For the purposes of this Act, the term **financial services** means any one or more of the following activities:

...

(ka) The payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security, equity security, participatory security, credit contract, contract of life insurance, superannuation scheme, or futures contract:

…

SECTION 3A MEANING OF INPUT TAX
3A(1) [Input tax defined] Input tax, in relation to a registered person, means-
(a) Tax charged under section 8(1) on the supply of goods and services made to that person, being goods and services acquired for the principal purpose of making taxable supplies:

…

SECTION 5 MEANING OF TERM SUPPLY

…

5(2) [Sale in satisfaction of debt] For the purposes of this Act, where any goods acquired (whether in terms of a hire purchase agreement, as defined in the Hire Purchase Act 1971, or otherwise) or produced by a person (that person being referred to hereafter in this subsection as the first person) are sold, under a power exercisable by another person (that person being referred to hereafter in this subsection as the second person), in or towards the satisfaction of a debt owed by the first person, those goods shall be deemed to be supplied in the course or furtherance of a taxable activity carried on by the first person (being deemed a registered person), unless-
(a) The first person has furnished, to the second person, a statement in writing that the supply of those goods would not be a taxable supply if those goods were sold by the first person (notwithstanding that the first person may not be the owner of those goods), and stating fully the reasons why that supply would not be a taxable supply; or
(b) Where the second person has been unable to obtain the written statement referred to in paragraph (1) of this subsection, that person may determine, in relation to any reasonable information held, that the supply of those goods would not have been a taxable supply if those goods had been sold by the first person (notwithstanding that the first person may not be the owner of those goods).

…

SECTION 6 MEANING OF TERM "TAXABLE ACTIVITY"

…

6(3) [Exclusions] Notwithstanding anything in subsections (1) and (1) of this section, for the purposes of this Act the term "taxable activity" shall not include, in relation to any person,-

...

(d) Any activity to the extent to which the activity involves the making of exempt supplies.

SECTION 14 EXEMPT SUPPLIES

14(1) [Exempt supplies] The following supplies of goods and services shall be exempt from tax:

(a) The supply of any financial services (together with the supply of any other goods and services, supplied by the supplier of those financial services, which are reasonably incidental and necessary to that supply of financial services), not being-

(i) A supply of financial services which, but for this paragraph, would be charged with tax at the rate of zero percent pursuant to section 11A; or

(ii) A supply of goods and services which (although being part of a supply of goods and services which, but for this subparagraph, would be an exempt supply under this paragraph) is not in itself, as between the supplier of that first-mentioned supply and the recipient, a supply of financial services in respect of which this paragraph applies:

…

SECTION 17 SPECIAL RETURNS

17(1) [Sale in satisfaction of debt] Where goods are deemed to be supplied by a person pursuant to section 5(2) of this Act, the person selling the goods, whether or not that person is a registered person, shall, on or before the last working day of the month following the month within which the sale was made, -

(a) Furnish to the Commissioner in the prescribed form a return showing-

(i) That person's name and address and, if registered, registration number, and

(ii) The name, address, and, if registered, registration number of the person whose goods were sold; and

(iii) The date of the sale; and

(iv) The description and quantity of the goods sold; and

(v) The amount for which they were sold and the amount of tax charged on that supply; and

(vi) Such other particulars as may be prescribed; and

(b) Pay to the Commissioner the amount of tax charged on that supply; and

(c) Furnish to the person whose goods were sold, details of the information shown on the return referred to in paragraph (a) of this subsection,-

and the person selling the goods and the person whose goods were sold shall exclude from any return, other than a return required pursuant to this subsection, which either or both may be required to furnish under this Act, the tax charged on that supply of goods.

17(2) [Debt due to the Crown] Any amount of tax charged on any supply of goods to which this section applies shall be deemed, for the purposes of this Act, to be tax payable and shall be recoverable as a debt due to the Crown.

SECTION 24 TAX INVOICES

…

24(6) [Modified records] Where the Commissioner is satisfied that there are or will be sufficient records available to establish the particulars of any supply or class of supplies, and that it would be impractical to require that a tax invoice be issued pursuant to this section, the Commissioner may determine that, subject to any conditions that the Commissioner may consider necessary,-

(a) Any one or more of the particulars specified in subsection (3) or subsection (4) of this section shall not be contained on a tax invoice; or

(b) A tax invoice is not required to be issued.

...

SECTION 60 AGENTS AND AUCTIONEERS

60(1) [Supply by an agent] Subject to this section, for the purposes of this Act, where an agent makes a supply of goods and services for and on behalf of any other person who is the principal of that agent, that supply shall be deemed to be made by that principal and not by that agent:

Provided that, where that supply is a taxable supply, that agent, being a registered person, may, notwithstanding anything in this Act, issue a tax invoice or credit note or a debit note in relation to that supply as if that agent had made a taxable supply, and to the extent that that tax invoice or credit note or debit note relates to that supply, that principal shall not also issue, as the case may be, a tax invoice or a credit note or a debit note.

...

Land Transfer Act 1952

SECTION 104 APPLICATION OF PURCHASE MONEY

104(1) The purchase money to arise from the sale by the mortgagee of any mortgaged land, estate, or interest shall be applied –

(a) Firstly, in payment of the expenses occasioned by the sale:

(b) Secondly, in payment of the money then due or owing to the mortgagee:

(c) Thirdly, in payment of subsequent registered mortgages or encumbrances (if any) in the order of their priority:

(d) Fourthly, the surplus s (if any) shall be paid to the mortgagor.

104(2) Where the surplus cannot be paid to the mortgagor by reason of his not being found after reasonable inquiry by the mortgagee as to his whereabouts, the surplus may be paid to the Secretary to the Treasury in accordance with section 102A of the Property Law Act 1952, and the provisions of that section shall apply accordingly.

Discussion

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

Whether the mortgagee's costs of sale can be deducted prior to the calculation of GST due?

8. The term "costs of sale" in this statement refers to expenses that are occasioned by the mortgagee sale. Examples of such expenses are legal fees, valuation fees and real estate advertising and commission. The term "costs of sale" does not include money that is owed under the mortgage such as the interest or principal of the mortgage.

9. Section 5 deems a supply to take place in specific situations. Section 5(2) which deals with a sale in satisfaction of debt situation, provides for there to be a supply by the defaulting person (the mortgagor) where the goods (the mortgaged property) are sold under a power exercisable by another person (the mortgagee sale under the terms of the mortgage agreement). As there is a supply under a mortgagee sale, GST is to be charged pursuant to section 8.

10. It should be noted that sections 5(2) (a) and (b) provide for exceptions where a sale in satisfaction of debt would not be deemed a supply.

11. Section 5(2) alone does not aid in determining whether or not GST is to be calculated on the sale price inclusive of the costs of sale. It has to be read in conjunction with section 17.

12. Section 17 requires persons selling goods in a sale in satisfaction of debt to perform certain duties.

13. Section 17(1)(a) states that the person selling the goods (whether or not GST-registered) must, on or before the last working day of the month following the month within which the sale was made, furnish to the Commissioner a prescribed form. The prescribed form (also known as the special GST 121 return, referred to as the "special return" in this statement) must show the following particulars:

- The person's name and address and, if registered, GST registration number, and
- The name, address, and if registered, the GST registration number of the person whose goods were sold, and
- The date of the sale, and
- The description and quantity of the goods sold, and
- The amount for which the goods were sold and the amount of tax charged on that supply, and
- Any other particulars as may be prescribed.

14. The person selling the goods must at the same time, pay to the Commissioner the amount of tax that was charged on the supply and furnish to the person whose goods were sold, details of the information in the special return pursuant to sections 17(1)(b) and (c).

15. Section 17(2) deems the amount of tax charged on the supply to be tax payable and recoverable as a debt that is due to the Crown.

16. The important phrases in section 17 are the phrases "the amount of tax charged on that supply" in section 17(1) and "tax payable" in section 17(2).

"Amount of tax charged on that supply"

17. The phrase "amount of tax charged" refers to section 8, which is the provision that charges GST on the supply of goods and services. Section 8 provides that GST at the rate of 12.5% is to be charged on the supply of goods and services. The "amount of tax charged" therefore is the amount of the supply multiplied by the GST rate of 12.5%.

18. Section 8 states that GST is to be imposed on the supply "by reference to the value of that supply".

19. Section 10 determines the value of any supply of goods and services. Section 10(2) defines the value of supply to be:

> Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of, -
> (a) To the extent that the consideration for the supply is consideration in money, the amount of the money:
> (b) To the extent that the consideration for the supply is not consideration in money, the open market value of that consideration.

20. Panckhurst J in *Wilke v Commissioner of Inland Revenue* (1998) 18 NZTC 13,923 stated the following regarding section 10:

> "… section 10 is concerned with the "value" of the supply of goods and services. The purpose of the section is to ensure that the true value of the supply is captured for the purposes of the calculation of the goods and services tax component. Importantly, in my view, section 10(2) introduces the statutory options with the words that the value shall be "equal to the aggregate of" the consideration in money or the open market value. The subsection is expansive, rather than limiting, in the sense that the value of a supply is the monetary consideration paid, or where the transaction is not a commonplace arms length monetary one, the open market value of the supply".

21. In the majority of cases, the value of the supply is the consideration paid for the supply (exclusive of GST). Consideration is usually in monetary terms but pursuant to section 10, to the extent that it is not, the market value of the consideration provided to the supplier is used. The value of the supply in a mortgagee sale is therefore usually the monetary

consideration received from the sale of the property but to the extent that it is not, then the open market value of the property is taken. Whichever value is taken, it ignores the costs of sale which means that GST is to be calculated on the total sale price of the mortgaged property (ie is not discounted by the expenses incurred).

22. "The amount of tax charged on that supply" is the GST rate of 12.5% imposed on the consideration received from the sale of the mortgaged property.

"Tax payable"

23. The term "tax payable" is defined in section 2(1) as:

> An amount of tax calculated in accordance with section 19C and section 20 of this Act; and includes –
> a. Any amount referred to in section 17(2) or section 27(6) of this Act:
> b. Any late payment penalty or shortfall penalty:
> c. Any amount of tax refundable by the Commissioner pursuant to section 19C or section 20 of this Act; and, for the purposes of section 57, includes interest payable under Part VII of the Tax Administration Act 1994:

24. The definition refers back to section 17(2) which means that the term "tax payable" is the amount of tax charged on any supply of goods to which section 17 applies. "Tax payable" is therefore the amount of tax charged on a supply, ie the GST rate of 12.5% imposed on the entire sale price of the mortgaged property.

Section 104 Land Transfer Act 1952 and section 17 Goods and Services Tax Act 1985

25. Section 104 of the Land Transfer Act 1952 (Land Transfer Act) determines the order in which money received from a mortgagee sale should be applied. It provides for the money to be applied firstly, to costs occasioned by the sale then to the mortgagee.

26. In the Court of Appeal case of *Commissioner of Inland Revenue v Edgewater Motel Ltd* (2002) 20 NZTC 17,984, in relation to the relationship between section 17 and section 104 Land Transfer Act, Blanchard J held that:

> There is no settled policy apparent in s 104 that a mortgage debt is to have priority over a tax payable as a result of the sale of the mortgaged land. Section 104 does not address taxes, but that does not mean that when they arise under another statute they cannot qualify as expenses. Priority of a tax will depend upon what is dictated by the taxing statute. Section 104 is a general provision which gives priority to expenses occasioned by the sale. In this case the GST Act, by imposing a tax on the sale transaction, creates an expense of sale which ranks under s 104 ahead of the mortgage debt. That it might not do so where the tax is imposed under a different section of the GST Act is beside the point when s 17 is so clearly worded.

27. GST imposed on a mortgagee sale is therefore deemed a cost of sale. The relationship between section 104 of the Land Transfer Act and section 17 is that the latter provision gives rise to GST that is imposed on the sale transaction as a cost of sale thereby ranking ahead of the mortgage debt (ie the mortgage principal and interest).

28. Pursuant to section 104 of the Land Transfer Act, the costs of sale are deducted from the full price of the property as they are ranked ahead of any other deductions. Therefore, if GST is deemed to be a cost of sale, it should also be deducted from the full price of the mortgaged property.

29. Blanchard J went on to state that the selling mortgagee is obliged to pay the GST charged on the supply of the land in priority to any payment in respect of secured debts and that such payment is an expense occasioned by the sale and must ultimately be borne by the mortgagor by way of deduction from the purchase price under paragraph (a) of section 104 of the Land Transfer Act.

30. Statements such as "by imposing a tax on the sale transaction" and "by way of deduction from the purchase price" used by the judge clearly require GST to be imposed on the sale price gross of the costs of sale. The term "purchase price" is the amount of consideration that is given in payment for buying something. That term indicates that it should include all the consideration that is paid for an item.

Conclusion

31. The costs of sale from a mortgagee sale cannot be deducted prior to the calculation of GST due under section 17.

***Whether a mortgagee can claim input tax in a mortgagee sale for the costs associated with the mortgagee sale*?**

32. Section 5(2) does not allow a mortgagee to claim input tax incurred on costs associated with the mortgagee sale as the mortgagee does not supply the property in the course or furtherance of their taxable activity. Instead, the provision provides for the mortgagor (who is deemed to be registered) to have supplied the property in the course or furtherance of a taxable activity.

33. One argument to the contrary is that the mortgagee acts as the mortgagor's agent in a mortgagee sale therefore the mortgagee is entitled to claim input tax on the sold property. The relationship between a mortgagee and a mortgagor is one of creditor and debtor. The mortgagee acts on its own behalf when exercising a power of sale. It is unlikely that there is authority given from the mortgagor to the mortgagee to act on their behalf in selling the mortgaged property.

34. Usually, the mortgagee sale occurs through a power exercised by the mortgagee as agreed upon in the mortgage agreement because of the mortgagor's default in the mortgage payments. The mortgagee cannot purport to claim input tax on the costs of sale as agent for the mortgagor.

35. For the mortgagee to be permitted to claim input tax from the mortgagee sale would require that the sold mortgaged property is supplied in the course or furtherance of their taxable activity (putting aside the fact that section 5(2) deems the mortgaged property to be supplied in the course or furtherance of the mortgagor's taxable activity). In some cases the mortgagee may be able to demonstrate some such connection indirectly. Consideration has to be given as to whether a mortgagee's activity of providing mortgage finance is the provision of financial services, in which case the provision of that service is deemed to be an exempt supply (section 14) and is not part of a taxable activity (section 6).

36. "Financial services" is defined in section 3 for the relevant purpose of this statement to mean "the payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security, equity security, participatory security, credit contract, contract of life insurance superannuation scheme, or futures contract".

37. "Debt security", defined in section 3(2) means any interest in or right to be paid money that is, or is to be, owing by any person, but does not include a cheque. Therefore, the collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security is the provision of a financial service which is an exempt supply.

38. A mortgage is simply security for the repayment of a debt. It satisfies the definition of "debt security" as the mortgagee has the right to be paid money owed by the mortgagor under the mortgage.

39. Therefore, a mortgagee whose activity is as a lender would be considered to be carrying on an exempt activity. As such the mortgagee would be unable to claim input tax from the mortgagee sale. This is subject to the newly enacted section 11A(1)(q) (enacted by the Taxation [Annual Rates, GST, Trans-Tasman Imputation and Miscellaneous Provisions] Act 2003).

Conclusion

40. A mortgagee in a mortgagee sale cannot deduct the costs of sale before calculating the GST due under section 17 of the Goods and Services Tax Act 1985.

41. A mortgagee cannot claim input tax for the costs associated with a mortgagee sale.

This Operational Statement was signed by me on 1 April 2004.

Margaret Cotton
National Manager
Technical Standards

LEGAL DECISIONS – CASE NOTES

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

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

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

DEDUCTIBILITY OF LEGAL EXPENSES

Case: TRA decision 009/2004

Decision date: 27 February 2004

Act: Income Tax Act 1994

Keywords: Deductibility of legal expenses, capital, revenue

Summary

The taxpayers sought to deduct legal expenses incurred from litigation entered into in an attempt to have a service contract reinstated to them on the basis that they had been unfairly treated in relation to the contract process. The CIR considered the legal fees were not deductible as they were incurred in enforcing a contract that was of a capital nature. The TRA allowed the deduction for the legal fees.

Facts

The taxpayer was in the business of land and sea-based commuter and tourist transport services. It wanted to extend its business into another geographical area and the opportunity to secure a contract with the regional council of that area arose. The taxpayer considered it would be an excellent opportunity to break into that particular geographical market.

A rival company to the taxpayer currently held the contract. The taxpayer put in a tender when the contract was put up for renewal. The taxpayer was unsuccessful and the rival company retained the contract.

The taxpayer proceeded with litigation on the basis that they believed that the rival company should not have been awarded the contract as the taxpayer was the favoured bidder.

The taxpayer claimed a deduction from assessable income being costs associated with the litigation in relation to this matter. In previous years the taxpayer incurred legal expenses relating to the litigation, which they did not claim a deduction for.

Decision

The Authority analysed the pleadings and judgment relating to the litigation against the council in detail and concluded that they had limited relevance to this case.

The Authority considered that the relevant issue for it to consider was whether the plaintiff was seeking to enforce the process contract or obtain specific performance of the final contract. The Authority found that there was only one instance where the pleadings reflected that their object was to get the Court to award specific performance of the contract.

Although the Authority acknowledges that the taxpayer's directors themselves provided evidence that the intended result of the litigation was specific performance, it states:

> "It is difficult to know what to make of this evidence and that if the directors did make this known to the lawyers, they certainly did not give it expression in the pleadings other than the claim for judicial review or the final summation to court…
>
> …I interpret what the witnesses said in this case as no more than an expression of the obvious commercial reality that they wanted the outcome of the Court case to put the disputant in a position where it could obtain a final contract…"

The Authority concluded that when applying the "process argument" no further consideration of the authorities relating to the capital or revenue categorisation of "business expenses" was necessary and the legal expenses were clearly on revenue account and therefore deductible.

The Authority's alternative approach

The Authority then goes on to consider the scenario that

> "if he is wrong in holding that the litigation was not intended to acquire the final contract, or if the process contract is something more substantial than he as characterised it to be, it is necessary

to consider whether the rights or property sought to be acquired are on capital or revenue account".

The CIR's arguments are summarised:

"The Commissioner contends that for a variety of reasons this would have added to the capital structure of the business. In summary, the reasons are:

[i] The contact would have significantly expanded the disputant's profit-making structure.

[ii] The initial costs of breaking into that market are capital in nature.

[iii] The service was to be run as a separate profit centre; on one view as a separate entity.

[iv] The contract was a monopoly and came with an existing customer base.

[v] The contract was not itself revenue producing. Only the income earned from that contract would be taxable as profits.

[vi] The contract would have formed the basis of further expansion.

[vii] The contract was only viable if a monopoly.

[viii] The nature of the contract was for once and for all, and brought into being an enduring asset.

[ix] There was a substantial goodwill element about the contract. Goodwill is capital in nature.

[x] The contract was for a signified period of five years.

[xi] The payment of legal fees were not circulating capital and the contract is not stock in trade. It is more akin to a licence or trade work.

[xii] Neither the accounting treatment of the costs nor the way in which the damages claim was quantified as one of loss of opportunity to make profits is determinative for tax purposes.

In summary, the Commissioner submits that the costs were expended in seeking to acquire a capital asset of an enduring nature which would form part of the structure of the taxpayer's business, and from which it would earn a substantial portion of its profits."

The Authority went on to address the CIR's arguments and held that there was no difference between this contract and other similar contracts operated by the disputant and that there was no distinction between the contract itself and the revenue to be derived from it.

In relation to the accounting treatment of the expenditure which was addressed by expert witnesses for both sides, the Authority dismissed the CIR's expert opinion which illustrated that the accounting treatment of expenses is not determinative of the tax treatment of those expenses, and preferred the expert accounting evidence of the taxpayer.

In relation to fixed and circulating capital, the Authority held:

> "In my view to analyse the transaction in this case against the concept of fixed and circulating capital is illuminating and provides a ready answer. On this alternative possibility the legal expenses were incurred in securing the final contract. It would have become part of the circulating capital of the business operated by the disputant along with its other contracts. That is another indicia that the expenses are a deductible revenue item."

Finally, the Authority held that the expenses related to "stock in trade" or "circulating capital" of the company and are properly deductible in the year in which they were incurred. It also held that the contract was a process contract and could not be a capital asset.

MATTERS RAISED IN STATEMENT OF POSITION: NOT EXCLUDED

Case: CIR v Delphi Fishing Company Limited

Decision date: 1 March 2004

Act: Tax Administration Act 1994

Keywords: Statement of Position (SOP), Evidence Exclusion Rule

Summary

Inclusion of a proposition in either party's statement of position means that it is able to be raised in subsequent litigation.

Facts

The tax challenge in the TRA from which this appeal arose was a challenge to the correctness of an assessment, viz a 20% civil penalty pursuant to section 141B Tax Administration Act 1994 ("TAA") for an "unacceptable interpretation".

The ground on which the Commissioner's Adjudication Unit made that assessment was that section 9 Goods and Services Tax Act 1985 ("GST Act") mandated a different consequence from that which was reflected in the taxpayer's GST return, and that the taxpayer's interpretation of section 9 GST Act was not "as likely as not to be correct" (reflecting the statutory test).

The Commissioner's investigator had proposed a civil penalty in the "Statement of Position" issued by the CIR, but on a different basis. The taxpayer had raised section 9 GST Act in its Statement of Position (SOP) in reply, and in the CIR's addendum to his Statement of Position the CIR said that there is one further issue to be considered, namely section 9.

The Adjudication Unit rejected the grounds for imposing penalties set out in the CIR's SOP, but did consider that section 9 justified a penalty being imposed.

The Taxation Review Authority (Authority Willy) held (Case W18 (2003) 21 NZTC 11,175) that as section 9 GST Act was not raised in the Commissioner's first SOP, the Commissioner could not rely on it in the litigation even though section 9 was raised in both the respondent's SOP and the Commissioner's reply, and section 9 was one of the grounds of assessment. As a consequence, the Commissioner was simply unable to defend this challenge. The Commissioner appealed to the High Court

Decision

The purpose of the dispute resolution process includes the Commissioner giving information as to the basis of the disputed decision (here, the assessment) "to be made" by the Commissioner (section 89A(1)(b)(ii)). Further, it is the case that the Commissioner has control over the process. If the Commissioner does not want to invoke a statement of position or is not ready to do so then the Commissioner can wait.

On the other hand, it is clear also that the dispute resolution process is about an exchange of views. It can be described as "iterative" and "almost dialectic". Some changes must be envisaged. A comparison can be made with the previous process under which an assessment was raised and then there was dialogue. Here, the assessment occurs after the dialogue.

It was sufficient that section 9 was disclosed as an issue in the respondent's statement of position. Section 138G does not restrict the parties to matters raised in their own statements of position: the opposite view, which was the Taxation Review Authority's view, would be unfair to the taxpayer because in that case neither party would adequately be able to respond to the other party's statement of position as neither could rely on legal propositions raised by the other party.

The Taxation Review Authority judgment under appeal was incorrect to hold that the reference in section 89M (which enables the CIR to reply to a taxpayes' SOP) to "information" was restricted to facts. France J held that the limiting or constraining feature is that the information must be in response to the other party's material. The additional information then can be anything in one of the four categories in section 89M(4) which informs the recipient of that information. The section is not open-ended but the constraint is not as great as the TRA has concluded.

GST CONSEQUENCES OF SALE AND PURCHASE OF PROPERTY

Case: Commissioner of Inland Revenue v Campbell Investments and the Trustees in the JC Montgomery Family Trust CIV 2003 485 916

Decision date: 19 March 2004

Act: Taxation Review Authorities Act 1994 section 26A

Keywords: Family trust, unincorporated body, input tax credit, supply, GST symmetry, mortgage, shortfall penalty, abusive tax position

Summary

Two members of an unincorporated body purported to sell their shares to another member of the body, the trustees of the Family Trust, for consideration of a peppercorn. No output tax was returned. A second transfer occurred where two members of the body sold their shares to the trustees for $1,025,000 via the execution of a mortgage. The trustees claimed an input tax credit on this amount. The Court found no supply had occurred in the first transaction and that the arrangement had been set up with the dominant purpose of tax avoidance. An abusive tax position penalty was applicable.

Facts

1. A family trust ("the Trust") was established by a taxpayer (T) in May 1965. In February 1986 T executed an acknowledgment of ownership of property which showed him as the registered proprietor of a property, as agent for a syndicate ("the Syndicate"). The shares of the Syndicate were held by T (50%), his wife (33.3%) and the Trust (16.66%). The Syndicate was registered for GST from October 1986.

2. The Syndicate later sold the property and purchased two further properties in 1992 and 1993. These two properties were leased and GST returned on the rents.

3. On 5 October 1997 the first of two transactions involving the parties occurred. On this date T, as agent for the Syndicate, transferred his wife's 33.3% share to her and the Trust's 16.66% to the trustees. The consideration was one peppercorn. No output tax was accounted by the Syndicate for this transaction.

4. On 22 May 1998 the second transfer occurred whereby T and his wife both sold their 50% and 33.3% shares in the properties to the Trust for

$615,000 and $410,000 respectively, to be satisfied by execution of a mortgage over the shares. The agreed settlement date was stated as being 30 January 1998, four months prior to the agreement being entered.

5. The Trust applied for GST registration in June 1998 and requested it be backdated to 5 October 1997. The Trust claimed an input tax credit on the $1,025,000 purchase of the shares.

6. The Commissioner ("the CIR") assessed the Syndicate with output tax on the value of the shares and applied a shortfall penalty of 100% for taking an abusive tax position. He also considered the input tax credit was only available to the Trust in the period ended July 1998 as no payment was made until then.

Decision

7. Wild J found the TRA made a number of factual errors in arriving at its decision against the CIR. These included finding there was a transfer to T of his 50% property share on 5 October 1997 and that this transfer occurred on a Sunday.

First transaction

8. Wild J found there had been no supply from the Syndicate to its members. The Syndicate's taxable activity was renting commercial property and this activity continued after 5 October 1997. The tenants and leases remained the same, the rent continued to be paid into its account and it continued to file GST returns for the rentals. The position claimed to have been taken by the taxpayers had never been implemented.

9. All that happened on 5 October 1997 was a transfer of legal title to the beneficial owners. The peppercorn as negligible consideration was appropriate as the members already owned the properties.

Second transaction

10. In relation to the second transaction, Wild J considered settlement did not occur until 30 July 1998 at the earliest. The Trust was registered on a payment basis but no "payment" was made in January 1998. Payment only occurred at the end of July 1998 when the mortgage was executed. The evidence of the Syndicate continuing to collect the rents after 30 January 1998 only served to reinforce Wild J's decision.

11. Wild J considered the combined effect of section 57(2) and 6(2) meant the supply to the Trust by the members of the Syndicate (an unincorporated body) in the course of carrying out its taxable activity is deemed to be a supply by the Syndicate.

Shortfall penalty

12. As there was a supply by the Syndicate to the Trust in the period ended 31 July 1998 it should have returned output tax on that supply. The tax position it took in that period had shortfall penalty consequences. Wild J considered the Syndicate had taken an abusive tax position in terms of section 141D(1) of the Tax Administration Act 1994 ("the TAA") as it had entered into an arrangement with the dominant purpose of taking a tax position which avoided tax.

13. That position was as follows: the Syndicate continued its taxable activity of renting properties after 31 January 1998. After that date the taxpayer's solicitor devised an arrangement with the dominant purpose of providing the Syndicate with a tax position that removed its tax liability.

14. The essential steps giving effect to the tax avoidance arrangement included: T and his wife entering into the sale and purchase agreements in May 1998; the Trust applying for GST registration in June 1998 but backdating it to October 1997; mortgage execution on 30 July 1998 with settlement occurring six months earlier on 30 January 1998; preparation of GST returns by the accountant; requesting correction of 31 January 1998 return which was filed "in error"; addenda added to sale and purchase agreements stating the supply was to be a going concern if both parties were held to be GST-registered.

15. Justice Wild considered the Syndicate's tax position abusive as it tried to give GST significance to the 5 October 1997 transaction it was not intended to have at the time. The tax position sought to attach the value of a peppercorn to the properties when it only attached the delivery of the properties to the members who already had legal title. The properties themselves were worth far more.

16. In summary Wild J found:

    a. The 5 October 1997 transaction was not a supply for GST purposes

    b. The 22 May 1998 transaction did not involve a supply for GST purposes in January 1998

    c. The Syndicate's tax position for the period ended 31 January 1998 was an abusive one in relation to the supply of rent from the properties

    d. The Syndicate's tax position for the period ended 31 July 1998 was an abusive one in relation to the supply of the properties to the Trust.

EVIDENCE ON RECALL OF JUDGMENT FAILS TO ASSIST TAXPAYERS

Case: TRA decision 012/2004 and 013/2004

Decision date: 10 March 2004

Act: Income Tax Act 1976

Keywords: Recall, bare trust, share dealing

Summary

The taxpayers obtained a recall of a decision pending further evidence from an overseas witness (given by video link). The evidence was given but failed to alter the initial determination.

Facts

This was a recall of part of the judgment in *Case W20* (2003) 21 NZTC 11,197. The taxpayers successfully sought the recall of part of the decision in which the TRA determined that a company holding shares transferred to it by the taxpayers held those shares as bare trustee for the taxpayers. The details upon which this decision was made are reported at *Case W20* but essentially there was an agreement between the company and the taxpayers that gave control of the shares legally held by the company to the taxpayers.

The recall decision is reported as *Case W29*

At the recall hearing evidence was given by an accountant based in Jersey (in the English Channel) regarding the share transfer and the agreement between the taxpayers and the shareholding company.

Decision

After hearing the witness and considering the submissions of the parties, the TRA determined there was no reason to depart from its decision in *Case W20* regarding the bare trustee. Therefore it confirmed the view that the shareholding company held the shares as bare trustee for the taxpayers.

APPLICATION TO RECALL OR ALTER RULINGS REFUSED

Case: TRA decision 014/2004

Decision date: 19 March 2004

Act: Taxation Review Authorities Act 1994

Keywords: Recall, inconsistency between interim rulings

Summary

The objectors argued that certain interim decisions of the Taxation Review Authority were inconsistent but Judge Barber refused to recall or alter them.

Facts

This interlocutory decision relates to certain participants of the JG Russell tax avoidance template. The template operated by grouping profitable companies with companies with tax losses so as to relieve the profitable companies of their income tax obligations. The scheme has been described by the Court of Appeal as a "blatant tax avoidance scheme" (*Miller v CIR; Managed Fashions Limited v CIR* (1998) 18 NZTC 13,961).

This decision follows on from a decision of Judge Barber on 13 August 2003 (now reported as *Case W24* (2003) 21 NZTC 11,246), a decision on 8 January 2004, five decisions on 16 January 2004 and a decision on 17 February 2004.

The objectors argued that Judge Barber's findings in his seven 2004 decisions were inconsistent with what he had held in paragraph [15] of *Case W24*. In that paragraph His Honour stated (in reference to discovery):

> That stance [a narrow approach to discovery] would be time consuming and, frankly, somewhat unnecessary because it seems to me that if Mr Russell wants to view all documents related to the JG Russell template (other than those which are not discoverable due to secrecy and legal privilege) he should be able to do so. … While a strict discovery process should limit Mr Russell to access documents related only to the remaining justiciable issues, it seems to me that Mr Russell's strategies of resistance to template assessments are so wide, and matters are so interwoven, that he should be able to view all documents of relevance, including peripheral relevance but, strictly, subject to secrecy and legal privilege.

However, in the later decisions Judge Barber had refused a number of requests by the objectors for discovery of certain classes of documents.

The objectors submitted that Judge Barber should recall the 2004 rulings to the extent that they deprived the objectors of the right of inspection conferred by the ruling contained in paragraph [15] of *Case W24*. The

objectors also queried some of the Commissioner's claims for legal professional privilege that had been made in respect of a number of legal opinions. They requested that Judge Barber order the authors of the opinions to provide affidavit evidence that they were acting as lawyers, as opposed to employees possessing specialist skills.

The Commissioner simply argued that the decisions were not inconsistent, and that it was not necessary to open the issue of privilege of legal opinions. The Commissioner also emphasised the fact that the Authority had had the benefit of full legal submissions focused on various topics, and that the seven 2004 decisions were issued as a result of them.

Decision

Judge Barber stated:

> [17] I take the view that in all the rulings to which the parties now refer I have provided full reasons for such rulings. I consider that each ruling stands on its own, speaks for itself, and reflects my reasoning at the time I respectively issued the ruling in terms of the submissions made to me in respect of each such ruling and in terms of developing law.
>
> [18] I am not prepared to recall any such ruling nor alter any of them in any way. I have always been very conscious that the Taxation Review Authority is deemed (now, by s.15 of the Taxation Review Authorities Act 1994) to be a Commission of Inquiry under the Commissions of Inquiry Act 1908, and from time to time I have used powers under that Act. I realise that I may well find that s.4C of the Commissions of Inquiry Act 1908, in particular, needs to be applied in order to bring about a fair hearing in these template cases.

NO PERSON EXEMPTED FROM TAXATION

Case: Phillip William Rupe v CIR

Decision date: 1 March 2004

Act: District Courts Act 1947

Keywords: Obligation to pay tax, exemption, Treaty of Waitangi, Māori sovereignty, matters of conscience, validity of legislation, constitution Act 1986.

Summary

The taxpayer challenged his obligation to pay taxes on several grounds—that Māori were exempted by virtue of the Treaty of Waitangi and Māori sovereignty arguments generally. These were dismissed by the High Court as were other arguments relating to the validity of certain legislation and matters of faith and conscience.

Facts

The Commissioner commenced proceedings in the Tauranga District Court for the recovery of GST and ACC amounts owing by the defendant Mr Rupe. The assessments in question were based on GST returns submitted by Mr Rupe. The original sum for which judgment was sought was $17,986. Since proceedings were commenced in February 2000, the addition of penalties and interest has increased the claim to $33,007.83. ACC have since remitted the levies owing and the Commissioner has amended his claim accordingly before the High Court.

Mr Rupe originally filed a statement of defence and counterclaim. The counterclaim was dismissed by the District Court. Mr Rupe also sought to strike out the CIR's claim and that was also dismissed. The basis of both applications and the defendant's defence in this matter and the court below was that of jurisdiction. Mr Rupe claimed not to be subject to New Zealand's taxing statutes by virtue of the Treaty of Waitangi, Māori sovereignty, the Bill of Rights 1688 (UK), and his status as a Christian.

Decision

Justice Venning upheld and incorporated into his decision, the findings of Judge Thomas in the Court below, reported as: *CIR v Rupe* (2003) 21 NZTC 18,129. In addition to those findings, his Honour clearly stated that there is no exemption from the payment of tax on the basis of Maori sovereignty. He cited Hillyer J in *Kaihau v Inland Revenue Department* [1990] 3 NZLR 344:

> "…it is abundantly clear that the New Zealand Parliament has the right to enact legislation applying to all persons in New Zealand, whether they had ancestors who lived here in 1840 or whether they have only recently arrived in New Zealand. The sovereignty of the New Zealand Parliament is clearly stated by Somers J in New Zealand Maori Council and Latimer v Attorney-General & Ors [1987] 5 NZLR 353, 398 . There are exceptions exempting Maori authorities and Maoris from liability for income tax in certain circumstances which do not apply in this case, but apart from that there is in my view, no doubt that section 416 applies to the appellant as it does to everyone else in the country."

On the conscience issue, his Honour preferred the Commissioner's view of Luke 20:22 notwithstanding the appellant's submission that it be read down to its historical context only. He read the "… render unto Caesar …" text as supporting the interpretation that Jesus recognised that even his followers may have to account to a secular state.

He expanded upon the issue with reference to a European Commission of Human Rights appeal (brought by British Quakers who withheld from tax payments an amount equivalent to the percentage appropriated by the government for military spending). Referring to the UN

Convention for the Protection of Human Rights and Fundamental Freedoms, Article 9, the Commission stated:

> "… the Convention does not always guarantee the right to behave in the public sphere in a way which is dictated by [religious] belief: for instance by refusing to pay certain taxes because part of the revenue so raised may be applied for military expenditure … The obligation to pay taxes is a general one which has no specific conscientious implications in itself."

Regarding the Constitution Act 1986, the Judge presiding at the preliminary conference for this hearing invited counsel for the Commissioner to make enquiries regarding the assent copies for the Constitution Act 1986 and the relevant tax Acts. The latter had been located in the High Court in Wellington but pre-1991 statutes were archived elsewhere. The appellant submitted that this was proof of his submission that no assent had been granted. Counsel for the Commissioner referred the Court to section 29(1) Evidence Act 1908 and the Judge agreed:

> "… the copy of the Constitution Act published under the authority of the New Zealand Government is deemed, unless the contrary is shown, to be a correct copy of that Act of Parliament and as the Act records the Assent date it implicitly meant the Act has been assented to in the absence of proof otherwise. … while the appellant has challenged the validity of the Constitution Act he has not provided any evidence to show that the Constitution Act has not been assented to."

Other arguments of the appellant relating to the District Court Judge's reduction of judgment sum, compliance by the Commissioner with policy statements alleged to have been breached and the New Zealand Boundaries Act 1863 were dismissed briefly by the Court.

Venning J gave judgment for the Commissioner in the sum of $27,916.83 pursuant to section 76 of the District Courts Act.

REGULAR FEATURES

DUE DATES REMINDER

May 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

31 GST return and payment due

June 2004

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

30 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

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	Draft interpretation statement	*Comment deadline*
☐	IS2783: Deductibility of feasibility expenditure	28 May 2004
	Draft question we've been asked	
☐	ED0051: GST group registration of trusts	31 May 2004
	Draft question we've been asked	
☐	ED0054: PAYE where income received fraudulently or in error	31 May 2004
	Exposure draft	
☐	ED0058: Income Tax Act rewrite—process for resolving potential unintended legislative changes	31 May 2004

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The Manager (Field Liaison)
Adjudication and Rulings
National Office
Inland Revenue Department
PO Box 2198
Wellington

INLAND REVENUE NATIONAL OFFICE PO BOX 2198 WELLINGTON TELEPHONE (04) 498 5800