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CONTENTS

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

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THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft items are available for review/comment this month, having a deadline of 11 March 2005.

Ref.	Draft type	Description
ED0073	Standard practice statement	Retrospective adjustments to salaries paid to shareholder-employees
ED0074	Standard practice statement	Non-standard balance dates for managed funds and "as agent" returns

The following draft items are available for review/comment this month, having a deadline of 31 March 2005.

Ref.	Draft type	Description
IS0082	Interpretation statement	Interest deductibility—Public Trustee v CIR
IS0057	Interpretation statement	Deductibility of business relocation costs
QB0036	Question we've been asked	GST consequences of a cancelled contract

Please see page 94 for details on how to obtain a copy.

INTERPRETATION STATEMENTS

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

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

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

WORK OF A MINOR NATURE

This item was originally issued as an exposure draft for public consultation in 2000. A revised exposure draft was issued for public consultation in November 2002, and a further revised draft was issued for public consultation in May 2004. Since the publication of the most recent exposure draft, the Income Tax Act 2004 has been enacted. Two amendments have been made:

- One sentence in the discussion of boundary adjustments has been replaced in order to clarify the Commissioner's position; and
- A statement has been added to the effect that no change is required as a result of the enactment of the Income Tax Act 2004.

Summary

This Interpretation Guideline sets out the Commissioner's interpretation of specific work undertaken as part of development or division work, in the context of section CD 1(2)(f), that constitutes "work of a minor nature" and therefore excludes the proceeds of sale from being treated as gross income of the taxpayer.

The guiding principle in deciding whether work done in undertaking a subdivision is of a minor nature, is that it depends on an overall assessment of the facts of each case, having regard to the time, effort and expense involved. This is to be measured both in absolute terms and relative to the nature and value of the land on which the work is done.

The question of whether or not work is of a minor nature requires an overall assessment of what was done in particular circumstances, rather than the application of a checklist. There are four different overlapping factors to be taken into account:

- The importance of the work in relation to the physical nature and character of the land.
- The total cost of the work done in both absolute and relative terms.
- The nature of the professional services required.
- The nature of the physical work required for the subdivision (if any).

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

This Interpretation Guideline was prepared with reference to the Income Tax Act 1994. It has been reviewed following the enactment of the Income Tax Act 2004. In the new Act, section CD 1(2)(f) is recast as sections CB 10, CB 15(1), CB 18, and CB 21. There are no intended policy changes in the relevant legislation. While there are some changes to the words used, these changes are not considered material. It was therefore concluded that the enactment of the Income Tax Act 2004 does not lead to any change in the law dealt with in this Interpretation Guideline.

Background

Section CD 1(2)(f) includes in the gross income of a person any amount derived from the sale or other disposition of land where the following elements exist:

- An undertaking or scheme (whether or not an adventure in the nature of trade or business) involving the development or division into lots of that land.
- The development or division work has been carried on or carried out by or on behalf of the taxpayer, on or in relation to that land.
- The work is not work of a minor nature.
- The undertaking or scheme was commenced within 10 years of the date on which that land was acquired by the taxpayer.

Issues

Section CD 1(2)(f) taxes the gross income from the sale of land where development or division work has been done that is more than of a minor nature. The question considered in this statement is: what factors do the courts take into account in determining whether a development or division of land is "work of a minor nature" in terms of section CD 1(2)(f) so that the proceeds of sale are not deemed to be gross income of the taxpayer. This is determined by considering:

- The background to section CD 1(2)(f) including the policy reasons for its introduction.
- The context and words of section CD 1(2)(f), including interpretative provisions specific to section CD 1.
- The basic principles for approaching section CD 1(2)(f), including consideration of the meaning of certain expressions used in section CD 1(2)(f): "undertaking or scheme", "development or division into lots", "development or division work", and "work of a minor nature".
- The factors that the courts have weighed in deciding whether work is of a minor nature, namely:
    1. The importance of the work in relation to the physical nature and character of the land.
    2. The total cost of the work done, in both absolute and relative terms.
    3. The nature of the professional services required.
    4. The nature of the physical work required for the subdivision (if any).

Legislation

Section CD 1 states:

(1) Any amount derived from the sale or other disposition of any land, being an amount to which this section applies, is gross income.

(2) For the purposes of subsection (1), the gross income of any person includes the following amounts –

….

(f) Any amount derived from the sale or other disposition of land where –

(i) An undertaking or scheme, whether or not an adventure in the nature of trade or business, involving the development or division into lots of that land has been carried on or carried out, and that development or division work, not being work of a minor nature, has been carried on or carried out by or on behalf of the taxpayer, on or in relation to that land; and

(ii) That undertaking or scheme was commenced within 10 years of the date on which that land was acquired by the taxpayer:

Provided that this paragraph shall not apply in any case where the development or division work involved in any undertaking or scheme (being development or division work in relation to which, apart from this proviso, this paragraph would apply if it were development or division work of other than a minor nature) is for the purposes of the creating or effecting of a development or division or any other improvement that is for use in and for the purposes of –

(iii) The carrying on by the taxpayer of any business on or from the land, not being a business that consists of that undertaking or scheme; or

(iv) The residing, on the land, of the taxpayer and any member of the taxpayer's family living with the taxpayer; or

(v) The deriving by the taxpayer, from or in relation to the land, of gross income of any of the kinds referred to in section CE 1(1)(e):

The element requiring that the work not be of a minor nature is an exclusion in relation to the section. If the work that has been and will be undertaken by the taxpayer is "work of a minor nature", any gains on sale will not be gross income under section CD 1(2)(f).

Analysis

Background to section CD 1(2)(f)

The provisions of section CD 1 were originally enacted as section 88AA of the Land and Income Tax Act 1954. The provisions of section 88AA were inserted by section 9(1) of the Land and Income Tax Amendment Act 1973.

In the Court of Appeal decision of *Lowe v C of IR* (1981) 5 NZTC 61,006, Cooke J said (at p 61,010) that the purpose behind the addition of section 88AA was to remove the need for a profit-making intention before an amount could be seen as income arising from a scheme or undertaking. He went on to note that in the same year as the Land and Income Tax Act 1954 had been amended by the inclusion of section 88AA, the Property Speculation Tax Act 1973 (imposing tax on profits derived from the buying and selling of land for speculative purposes) had also been passed. He noted that under that Act an assessable profit derived from speculative land transactions could not escape tax on the ground that it was a capital gain. He went on to say:

> The exception of certain dispositions of farm land for farming purposes [in section CD 1] throws some light on the policy of the legislature. It suggests that, by contrast, Parliament had in mind, for example, vendors who were able to make profits by schemes of development or subdivision which took advantage of the growing community's need for urban expansion into rural land. In defined circumstances they were to contribute some share of their profits to the community. And both exceptions are

consistent with an intention that a profit should not automatically escape [section CD 1(2)(f)] or [section CD 1(2)(g)] merely because it was a capital profit; for cases within the exceptions would normally be instances also of capital profits.

But I do not base any conclusion on the exceptions. The crucial point is that the phrase "whether or not an adventure in the nature of trade or business" reflects the very language used in McClelland's case to describe undertakings or schemes giving rise to income according to ordinary usages and concepts. The only reasonable inference is that for the future Parliament was ruling out that criterion in cases falling within [section CD 1(2)(f)] or [section CD 1(2)(g)].

The purpose of section CD 1(2)(f) was referred to in Parliament by the then Member for Kapiti, Mr O'Flynn, at the third reading of the Land and Income Tax Amendment Act 1973. He said:

It is quite wrong to claim that a man who owns a section of half or three-quarters of an acre for, say, not quite 10 years, and who cuts it up into three lots and sells two of them, would be lumbered with what the Opposition emotionally called a capital gains tax. The paragraph uses the words "not being work of a minor nature", and it is well known that if one merely cuts up a big section the only work involved for the subdivider is having a surveyor draw up a simple plan, and often not even a plan which requires the formal depositing arrangements under the Land Transfer Act. (NZPD, Vol 387, 1973: 4,805)

Richardson J in *Costello v CIR* (1994) 16 NZTC 11,253 said (at p 11,256):

The focus [of the inquiry under section CD 1(2)(f)] is on the nature of the work involved, as is apparent from the parallel provisions of [section CD 1(2)(g)] and the description of work within the parentheses in [g]. The focus is on what was actually done not on the economic benefits from doing the work.

It appears that such an interpretation (focusing on the activity undertaken rather than the taxpayer's intention to profit) gives the best effect to the intention of Parliament. The general aim of section CD 1 is that profits from trading in property or arising from schemes of development or subdivision or from improvements to land should be taxable. However, section CD 1(2)(f) is worded so as to exclude very basic subdivisions (such as the most basic and simple domestic ones) from its operation.

Context and wording of section CD 1(2)(f)

A brief summary of the scope of section CD 1 is provided to place section CD 1(2)(f) in its legislative context. The wording of section CD 1(2)(f) will then be looked at more closely to give an understanding as to how the "work of a minor nature" exemption fits into the section as a whole.

Scope of section CD 1

Section CD 1 commences by providing in subsection (1) that certain amounts derived from the sale or other disposition of land are gross income. Subsection (2) then identifies the amounts that are deemed to be gross income. It sets out seven different tests, and satisfying any one of those tests suffices. Subsections (3) to (7) provide exceptions for certain amounts that would otherwise be gross income under one or more of the paragraphs in subsection (2). A proviso to section CD 1(2)(f) extends the exceptions in subsection (3) in terms specific to section CD 1(2)(f) and adds a further exception for section CD 1(2)(f) relating to the derivation of income from real property assessable under section CE 1(1)(e). Subsections (10) to (14) are interpretative and deeming provisions, further explaining the "land" to which section CD 1 applies, and providing for associated persons transactions, mortgagee sales, and compulsory acquisition by the Crown or any local or public authority. Subsections (5), (8) and (9) are repealed.

Section CD 1(1) states:

Any amount derived from the sale or other disposition of any land, being an amount to which this section applies, is gross income.

Section CD 1(2) provides that amounts derived from the sale or disposition of land will be gross income if –

- The land was acquired with the purpose or intention of selling or otherwise disposing of it: section CD 1(2)(a).
- When the land was acquired, the taxpayer was in the business of dealing in land and either the land was acquired for the purpose of the business of dealing in land, or the land was sold or disposed of within 10 years of acquisition: section CD 1(2)(b).
- When the land was acquired, the taxpayer was in the business of developing or subdividing land (not being development or division work of a minor nature), and either the land was acquired for the purposes of the business, or the land was sold or disposed of within 10 years of acquisition: section CD 1(2)(c).
- When the land was acquired, the taxpayer was in business as a builder, and the taxpayer carried out improvements of more than a minor nature to the land, and either the land was acquired for the purposes of the business, or the improved land was sold or disposed of within 10 years of completing the improvements: section CD 1(2)(d).
- Within 10 years of acquisition the taxpayer disposes of the land for more than it cost, and 20 % of that excess is due to any one or more of: the rules of an operative district plan or any change in those rules after the taxpayer acquired the land; or any resource consent or Planning Tribunal decision after the taxpayer acquired the land; or the removal of any limitation on the use of the land under the Resource Management Act 1991 after the taxpayer acquired the land; or the likelihood of any of these; or any similar change or occurrence. (This provision (section CD 1(2)(e)) does not apply if any other paragraph of section CD 1(2) applies.)

- An undertaking or scheme commencing within 10 years of acquisition and involving the development or subdivision of the land has been carried on or carried out and the work undertaken is not work of a minor nature: section CD 1(2)(f), discussed in more detail below.
- Where none of the above applies, the amount was derived from a development or subdivision undertaking or scheme involving significant expenditure on certain specified types of work: section CD 1(2)(g).

Section CD 1(2)(b)–(d) include an associated persons test. This means that if, when the taxpayer acquired the land, an associated person was in the business dealt with in the relevant paragraph, the amount will be included in the gross income of the taxpayer if the land was acquired for the business, even if the taxpayer was not in the business. An associated persons test is included in these provisions because they relate to sales and dispositions that are taxable on the basis of the characteristics of the taxpayer selling or disposing of the land, rather than on the nature of the transaction itself. Because the characteristics of the taxpayer are central to the taxability of the transaction, the association of the taxpayer with a person with characteristics that section CD 1(2)(b)–(d) relates to will also make the transaction taxable. The test of whether a taxpayer and another person are associated persons is applied only at the time of the acquisition of the land. The test of association is not applied at the time of the sale or other disposition of the land (see BR Pub 03/05, *TIB* Vol 15, No 9, September 2003).

Section CD 1(2)(b), (c), and (e) are limited in scope because they apply only if the land is sold or disposed of within 10 years of acquisition, if the land was not acquired for the purpose of the taxpayer's business. Section CD 1(2)(d) will only apply if the land is sold or disposed of within 10 years of the date on which any improvements to the land were completed, if the land was not acquired for the purpose of the taxpayer's business of erecting buildings. In section CD 1(2)(f), the requirement is that the undertaking or scheme of subdivision must be commenced within 10 years of the date on which the land was acquired. Section CD 1(2)(a) and section CD 1(2)(g) apply without a time limit.

Exemptions

A transaction that may otherwise be included in gross income under section CD 1(2)(a) to (g) will be exempt if it also comes within one of the exemptions provided for in section CD 1(3), (4), (6) and (7). These exemptions relate to land used for business premises or for residential or farming purposes. The proviso to section CD 1(2)(f) excludes from section CD 1(2)(f) development, division or other improvements for the taxpayer's use in and for certain purposes. These purposes are: carrying on any business on or from the land; residing on the land; or deriving income of a kind referred to in section CE 1(1)(e) (that is, rents, fines, premiums, or other revenues from any lease, licence, or easement affecting the land, or from the grant of any right of taking the profits of the land).

Interpretative provisions

Section CD 1(10) makes it clear that section CD 1 will apply where the whole or part of any land is sold.

Section CD 1(11)-(13) contain deeming provisions relating to associated persons' transactions and the definitions of "sale" and "disposition".

The elements of section CD 1(2)(f)

In discussing the elements of section CD 1(2)(f) in general terms, McMullin J said in *Lowe v CIR* (1981) 5 NZTC 61,006 at p.61,034:

> In enacting sec. [CD 1(2)(f)] in the form in which it did, the legislature has placed some limitations upon the taxability of profits or gains derived from the sale or other disposition of land. Profits or gains are only caught by the provision where the undertaking or scheme:
>
> (a) Involves a development or division into lots that has been carried on or out, and
>
> (b) The work of development or division is not of a minor nature, and
>
> (c) The undertaking or scheme was commenced within 10 years of the date, and
>
> (d) It is outside of the matters mentioned in [section CD 1(6) and (7)].
>
> The time element is particularly important. It distinguishes the class of case caught by sec. [CD 1(2)(f)] from cases of subdivision or development by persons who have held and used their land as farm land for a longer period of time and have found subdivision necessary or worthwhile only because of the impact of the urban sprawl. These factors, namely the time at which the subdivision is carried out and the need for development to be of more than a minor nature, suggest to me that the legislature was creating a new and separate category of taxable gains or profits, whether they be regarded as capital or not, when it introduced sec. [CD 1(2)(f)].
>
> I think that there is no warrant for placing upon the subsection a construction which would limit its application to profits or gains of a traditionally income kind and the activity engaged in by appellants falls squarely within the provision.

However, proceeds from a scheme or undertaking that have the characteristics outlined by McMullin J will only be included in gross income if the exemptions in section CD 1(2)(f)(iii)–(v) do not apply. The exemptions state that section CD 1(2)(f) does not apply to any development, division, or improvement that is used in, and for, the purposes of:

- any business carried on by the taxpayer on or from the land with the exception, of course, of a land subdivision or development business to which section CD 1(2)(c) would apply;

- a private residence for the taxpayer and any member of his or her family living with him;
- the derivation of rents or other similar revenues from the land.

Basic principles for approaching section CD 1(2)(f)

When discussing the question of what constitutes work of a minor nature, the courts consistently refer to the need to assess each case on its own facts.

Costello v CIR (1994) 16 NZTC 11,253 is the leading case on the meaning of the phrase "work of a minor nature" as it is the only Court of Appeal decision on the issue. Richardson J (as he then was), delivering the Court of Appeal's judgment, noted that the phrase focuses on the nature of the work undertaken, not the economic benefits that result from the work. He emphasised the need to carry out a comparative analysis of the work undertaken in determining whether the work was minor in nature. He commented, at p 11,256, that this analysis needed to be performed on a case by case basis rather than by simply applying a pre-determined or mechanical checklist:

> "Minor" like "lesser" is a relative expression. It becomes a question of degree. Whether the work in question is of a minor nature is a matter of fact to be determined on all the circumstances of the particular case. Every subdivision of a larger area into lots will include some survey work, the preparation of appropriate plans, obtaining planning consents and local authority permits and associated legal work including the depositing of subdivisional plans and the issue of any separate titles. [Section CD 1(2)(f)] recognises that the work involved in some subdivisions may be of a minor nature. Whether or not it is so in the particular case calls for an assessment of what was done which in practical terms may require consideration of the time, effort and expense involved. The statutory yardstick is not precise. It does not specify any particular criteria. It calls for an overall judgment not a mechanical application of a checklist.

His Honour's comments are an amplification of the obiter remarks he made in *Lowe v CIR* (1981) 5 NZTC 61,006 in which he said (at p 61,020):

> Whether work is of a minor nature must, it seems, depend on an overall assessment of such matters as the time, effort and expense involved, measured both in absolute terms and relative to the nature and value of the land on which the work is done.

Accordingly, in general terms, whether work done in undertaking a subdivision is of a minor nature depends on an overall assessment of the facts of each case, having regard to what has been done relative to the nature and value of the land involved. A matrix of cases that have considered the work of a minor nature exemption is at the end of this guideline.

Meaning of "undertaking or scheme"

The words "undertaking or scheme" were considered in *Vuleta v CIR* [1962] NZLR 325. Henry J at p 329 defined scheme as:

> a plan, design, or programme of action, hence a plan of action devised in order to attain some end; a project, an enterprise.

This definition has been approved in a number of land subdivision cases, including *Wellington v CIR* (1981) 5 NZTC 61,101 at p 61,103 and *O'Toole v CIR* (1985) 7 NZTC 5,045 at p 5,049.

In *Lowe v CIR* (1981) 5 NZTC 61,006 and *Costello v CIR* (1994) 16 NZTC 11,253, it was accepted by the taxpayers that the subdivision work they had done amounted to an undertaking or scheme. In both cases the Court commented that this was a proper concession to make. Richardson J noted in *Lowe v CIR* (at p.61,020):

> More importantly for present purposes, division as an alternative to development and the limitation of the exception to work of a minor nature suggest that not a great deal is required by way of activity to constitute a plan or programme of action an undertaking or scheme under the paragraph.

The Court in *O'Toole* stated at p 5,050 that an undertaking or scheme existed because the taxpayers:

> entered into a project or enterprise directed towards the subdivision of their land into lots with a view to sale of those lots at a profit. The scheme existed in the plan or purpose to sell off the lots not reserved by the objectors for their own use in order to realise the maximum available profit.

Meaning of "development or division into lots"

In *Dobson v CIR* (1987) 9 NZTC 6,025 at p 6,029 Hardie Boys J stated that the scheme of the statute made it clear that "development" is to be interpreted in a restricted sense. It means development in the sense of the preparation of the land for an intended use. It does not include the development of buildings as this is dealt with in section CD 1(2)(d). In *Dobson v CIR*, "development" was found to be the demolition of existing buildings and the clearing of the sites. This implies that development work entails some form of physical work undertaken in relation to the land, although no actual subdivision has been carried out (*Anzamco Ltd (in liq) v CIR* (1983) 6 NZTC 61,522), whereas division into lots involves some definite action in terms of the division of land into lots. Unlike the term "development", no physical activity involving the land needs to occur. However, there is a degree of overlapping between "development" and "division" work (*Wellington v CIR* (1981) 5 NZTC 61,101 at p 61,104, confirmed by the Court of Appeal in *Smith v CIR* (No 2) (1989) 11 NZTC 6,018 at p 6,024).

The cases also show that the term "division into lots" does not require the land to be physically divided into lots (*O'Toole v CIR* (1985) 7 NZTC 5,045). However, there are certain criteria that need to be fulfilled before it can be said that a division into lots has taken place. These criteria are listed in *Wellington v CIR* as planning and preparation of formal plans, survey work, obtaining town planning consents and local authority permits, and legal work including the deposit of subdivision plans and the issue of separate titles if required. Therefore, the term "division into lots" requires, at a minimum, a level of activity designed to facilitate the division of land.

Boundary adjustments

In respect of a boundary adjustment (relocation, rearrangement, or realignment) it is the Commissioner's view that a voluntary boundary adjustment to surveyed boundaries between contiguous lots of Land Transfer land will amount to "division into lots" for the purposes of section CD 1(2)(f), even where there is no increase in the number of lots. A boundary adjustment requires the existing boundaries to be erased and new boundaries to be created although there is no increase in the number of lots. The work is exactly the same type of work that is carried out in a subdivision where the number of lots is increased. A boundary adjustment therefore divides the land. Whether it was previously differently divided into lots is not a relevant consideration on the straightforward language of section CD 1(2)(f)(i), and in *Lowe v CIR* (1981) 5 NZTC 61,006 (CA, Cooke, Richardson and McMullin JJ), both Cooke J and Richardson J indicated that the natural meaning of the words was to be adopted in construing section CD 1(2)(f). It is therefore the Commissioner's view that, if a lot of land owned by a person is altered by transferring a part of the lot to, and including it in the title for other adjoining land owned by, another person there is a division into lots of the first-mentioned lot.

Furthermore, section CD 1(13) provides that section CD 1 applies where the land sold is the whole or part of any land to which section CD 1 applies or the whole or part any such land together with any other land. Therefore, if the boundaries between adjoining lots of land owned by the same person are altered, there is a division into lots of the land comprised of those adjoining lots; and if any of the resulting lots is sold or otherwise disposed of any amount derived on the sale or other disposition will be gross income under section CD 1(2)(f) if the other requirements of section CD 1(2)(f) are satisfied.

However in many cases a boundary adjustment will involve nothing more than minimal survey and legal work, and no physical work on the land. That is clearly work of a minor nature, so that many straightforward boundary adjustments are not within section CD 1(2)(f).

In *Case S1* (1995) 17 NZTC 7,001, 7,004 Barber DJ said that a boundary adjustment was deemed not to be a subdivision. In the Commissioner's view, the context of this statement, including its place in the decision under the heading "The evidence and the facts" and the surrounding discussion of the taxpayer's property division activities, shows that this statement is not intended as Judge Barber's analysis of the law or as a general proposition of law. The statement merely reflects the evidence given on the reasons for the taxpayer's decision to pursue, and later not to pursue, a boundary adjustment.

It is also considered that an interpretation that such a boundary adjustment or relocation was not a "division into lots" or "division work" could potentially give rise to anomalies in the operation of the section. For example, a landowner who owns a 10 acre block and carries out a subdivision of 5 acres would be subject to the provisions of section CD 1(2)(f) as this activity would be a "division into lots" or "division work", whereas a land owner who owns a 10 acre block with two existing titles (a 1 acre block and a 9 acre block) and amends the existing titles to comprise of two 5 acre blocks would not be subject to the provisions of section CD 1(2)(f). On the proper construction of section CD 1(2)(f), a boundary adjustment or relocation is a division into lots. The primary test in section CD 1(2)(f) turns on the work involved in the development or division scheme. A boundary adjustment involves similar work to other subdivision of land, and produces a similar outcome. It would therefore seem logical in terms of the underlying policy of the provision that section CD 1(2)(f) applies in the same way to a boundary adjustment as it does to other subdivision of land.

A boundary adjustment where any physical work is carried out could also fall within the broad definition of "development work" for the purposes of section CD 1(2)(f) (see *Anzamco (in liq) v CIR* (1983) 6 NZTC 61,522, *Dobson v CIR* (1987) 9 NZTC 6,025 and *Wellington v CIR* (1981) 5 NZTC 61,101).

A subdivision of land will satisfy the requirements of section CD 1(2)(f) as it will be an undertaking or scheme (being a plan of action directed toward some end) and it will also constitute division into lots as required by that section. As Richardson J noted in *Lowe v CIR* (1981) 5 NZTC 61,006, (at p.61,020):

> More importantly for present purposes, division as an alternative to development and the limitation of the exception to work of a minor nature suggest that not a great deal is required by way of activity to constitute a plan or programme of action an undertaking or scheme under the paragraph.

Costs to be specifically included or excluded in the phrase "development or division work"

The meaning of "development or division work" includes any type of work done on or in relation to the land, such as (but not limited to) professional fees (surveyor, solicitor, valuations), fencing, demolishing buildings, clearing the site, the cost of installing power or water onto a site, and creating a driveway or entranceway.

Some costs incurred by subdividers and specifically included or excluded by the courts are outlined below.

Cost of constructing any building

In *Dobson v CIR,* Hardie Boys J held that development work in section CD 1(2)(f) does not include the construction of buildings, as income derived from this activity is assessed under section CD 1(2)(d). Therefore, the cost of constructing any building on the land being subdivided should be excluded in deciding whether or not the work done is of a minor nature.

Sometimes it can be difficult to determine whether the work is preliminary development or division work (and therefore not excluded in deciding whether or not the work done is of a minor nature) or part of the construction process. In *Dobson* Hardie Boys J concluded (at p 6,030):

> … demolition, clearing of the sites, surveys, the deposit of plans, the preparation of cross leases, the obtaining of composite titles, were all part of, and together comprised, the development and division work involved. All else was part of the construction of the new flats.

Accordingly, the demolition and clearing of the sites was regarded as preliminary work that was within the phrase "development and division into lots".

Whether an item of development work is preliminary to construction work or is part of the construction process is a question of fact to be determined in each case. For example, drainage work preparatory to the construction process, and drainage which is part of the building itself.

Dobson was followed in *Case R7* (1994) 16 NZTC 6,035. In that case an old house was purchased, placed on the site of the subdivision, and partly renovated. The Authority held on the basis of the facts before him that the development and subdivision work carried out on the property was work of a minor nature. Barber DJ did not regard the purchase and placement of the house on the site as being development work. He excluded the necessary minor excavation work for the foundations of the house from consideration when he weighed up whether or not there had been work of a minor nature.

Where a building existed on the land before the subdivision was begun, it is suggested that it should be included in the value of the land against which the cost of the subdivision work is measured. This conclusion is inferred from the facts in *Wellington v CIR*, which Hardie Boys J cited with approval in *Dobson* (although not on this point), and with the general principle that once a building is attached to the land it becomes a part of the land. In *Wellington v CIR* Ongley J held that work costing $9,080, in relation to the land and buildings that cost $12,000, could hardly be said to be of a minor nature.

Financial contributions as a condition of a resource consent

A financial contribution of either money or land may be imposed as a condition on a resource consent under the Resource Management Act 1991 (the "RMA"), as a charge against landowners who are subdividing. The financial contribution will be specified in the relevant district plan, and can be a significant proportion of the total subdivision costs. It can often end up being more than half the cost of the subdivision.

The planning consent provisions of the RMA repealed those of the Local Government Act 1974. Under the RMA financial contributions in the form of money relate broadly to environmental management issues such as the management of natural and physical resources.

A financial contribution may also be made in the form of an actual transfer of land to the Council. The cost of dividing off additional lots of land as a financial contribution may increase the cost of a subdivision. However, this will not be an issue in cases dealing with work of a minor nature. Land is only given in large developments, as in a small development the amount of land cut off as a financial contribution would be very small. Therefore, in small subdivisions, where the exemption for work of a minor nature will apply, a financial contribution would be required generally in the form of money only.

i. Financial contributions in the context of section CD 1(2)(f)

Case D24 (1979) 4 NZTC 60,597 is the only case directly considering whether a financial contribution should be taken into account in deciding whether work is "development or division work" in section CD 1(2)(f).

A.J. Lloyd Martin said (at p.60,607):

> The amount payable to a local authority as "Reserve Contribution" cannot in my opinion be considered as amounts payable for "work" done. Such sums become payable as the result of the subdivision of land into lots but the contributions are not part of the costs involved in creating such subdivisions.

He went on to hold that expenditure incurred in the preparation and deposit of the necessary land transfer plan could not be considered as "work" for the purposes of the section.

Wellington v CIR overruled *Case D24* on the question of whether surveying of the land and preparation of the land transfer plan constitute "development or division work" for the purposes of the "work of a minor nature" test. However, Ongley J did not comment on what A.J. Lloyd Martin had said on the question of reserve contributions, although his list of the minimum work required for a subdivision in *Wellington v CIR* included the category "obtaining town planning consents and local authority permits".

ii. Financial contributions in the context of section CD 1(2)(g)

Aubrey v CIR (1984) 6 NZTC 61,765 (applied in *Mee v CIR* (1988) 10 NZTC 5,073), a High Court case dealing with the meaning of "work involving significant expenditure" under section CD 1(2)(g)), supports the argument that Ongley J's category of work involving "obtaining town planning consents and local authority permits" means only the professional work involved in these activities.

In *Aubrey*, Tompkins J had said (at p 61,769):

> The Crown contended that a reserve fund contribution paid in cash would also be in the second category [note: the second category to which Tompkins J was referring was the second category of work listed in the definition of 'division or development work' in section CD 1(2)(g). The work listed in the brackets following the words 'division or development work' could be divided into two categories. The first consisted of "earthworks, contouring, levelling, drainage, roading, curbing or channelling". The second category was described as "any other work, service, or amenity customarily undertaken or provided in major projects"], because the provision of reserves was an amenity customarily provided in major projects. It must be remembered that all the words in brackets are describing the kind of development or division work that has been carried out or carried on or in relation to the land. The division work involves the preparation and obtaining of the requisite approval of the scheme plan of the subdivision, then the lodging in the Land Registry Office of the deposited plan. The legal and survey costs involve expenditure on that work. But although a reserve fund contribution may be required to obtain the approval of the subdivision, I do not consider that it can be regarded as an expenditure on that work. Nor do I consider that it can be regarded as an expenditure on an amenity customarily provided in major projects.

Given that Tompkins J considered that a reserve fund contribution could not be considered as expenditure on "division work", it is the Commissioner's view that A.J. Lloyd Martin's analysis in *Case D24,* stating that the amount paid as a reserve contribution does not count as "work", is still good law. Therefore, financial contributions of money and/or land as a condition of resource consent are excluded from the meaning of "development or division work".

Environmental assessments as part of resource consent

Another requirement of resource consent is that the applicant must also provide "an assessment of any actual or potential effect that the activity may have on the environment, and the ways in which any adverse effects may be mitigated": section 88(4)(b) of the RMA. The Commissioner considers that the meaning of "development or division work" includes any work involved in obtaining an environmental assessment as part of resource consent.

The Commissioner considers that any subdivision will constitute an undertaking or scheme involving development or division into lots for the purposes of section CD 1(2)(f).

Meaning of "work … carried on or carried out by or on behalf of the taxpayer"

The Courts have not addressed the meaning of the words "work … carried on or carried out by or on behalf of the taxpayer" in the context of section CD 1(2)(f)(i) or its predecessor legislation. However *in Mee v CIR* (1988) 10 NZTC 5,073 (HC), Hardie Boys J considered the words:

> … development or division work … has been carried on or carried out by or on behalf of the taxpayer on or in relation to that land.

in section 88AA(1)(e) of the Land and Income Tax Act 1954 (now section CD 1(2)(g)). One matter in dispute was whether a payment (as a condition of the subdivision consent) of an agreed sum to the territorial authority for roading, water and sewage was within this description. Hardie Boys J found that it was not, saying (among other things):

> … Execution of this scheme did not involve the taxpayer in this particular work. All that was required of him was the payment of money to enable the Council to do it at a later date. When the Council did eventually do it, it did not do it on Mr Mee's behalf. It was not acting as his agent, or in any other representative capacity, but independently, in the fulfilment of its own duties. …

It is inferred from this that work performed by a local authority in fulfilment of its own statutory functions is not "work … carried on or carried out by or on behalf of the taxpayer" in terms of section CD 1(2)(g). Because section CD 1(2)(f) was originally enacted at the same time as, and as part of the same legislative scheme as section CD 1(2)(g), and because the two paragraphs deal with development or division work involved in the development or division into lots of land, it is presumed that a court would adopt the same view if the question arose in relation to section CD 1(2)(f).

Resource consent application fees

A taxpayer subdividing land may require consent under the Resource Management Act 1991 to do so (a "resource consent"). The Resource Management Act 1991 provides for territorial authorities to accept and consider applications for resource consents. The territorial authority receives, processes and grants or declines the resource consent application in fulfilment of its function of controlling the actual or potential effects of the use, development, or protection of land, of the subdivision of lanhd, of the emission of noise, and of the actual or potential effects of activities in relation to the surface of rivers and lakes (Resource Management Act 1991, section 31). Territorial authorities charge the applicant for this work. The work may benefit the taxpayer (if the resource consent is granted), but it also benefits neighbours of the land in question by ensuring that the proposed use of the land accords with the local district plan and by providing them with an opportunity to influence the matters for which the resource consent is sought.

Because the territorial authority receives, processes and grants or declines the resource consent application in fulfilment of its own statutory function, that work is not "work … carried on or carried out by or on behalf of the taxpayer" in terms of section CD 1(2)(f)(i).

Consequentially, resource consent application fees should not be included in the costs taken into account when considering whether the development or division work is work of a minor nature.

"Work of a minor nature"

In *Costello v CIR* (1994) 16 NZTC 11,253, Richardson J stated (at 11,256):

> Every subdivision of a larger area into lots will include some survey work, the preparation of appropriate plans, obtaining planning consents and local authority permits and associated legal work including the depositing of subdivisional plans and the issue of any separate titles. **[Section CD 1(2)(f)] recognises that the work involved in some subdivisions may be of a minor nature.** [Emphasis added]

On this basis, therefore, it can be inferred that the elementary level of survey, legal and planning work necessary to complete a basic subdivision would of itself be considered to be work of a minor nature. Any other conclusion would mean that the work of a minor nature exemption to paragraph (f) would not serve any purpose. This is also consistent with what Mr O'Flynn, the then Member for Kapiti, at the third reading of the Land and Income Tax Amendment Act 1973, stated when he said:

> It is quite wrong to claim that a man who owns a section of half or three-quarters of an acre for, say, not quite 10 years, and who cuts it up into three lots and sells two of them, would be lumbered with what the Opposition emotionally called a capital gains tax.

This indicates that the purpose of the work of a minor nature exception to section CD 1(2)(f) is to make sure the basic subdivision requiring only minimal work would not be taxable. It is important to bear this in mind when approaching the work of a minor nature exemption.

Therefore, the Commissioner considers that some subdivision schemes or undertakings must be able to comprise work of a minor nature. Factors the courts have taken into account when deciding whether the development or division work is work of a minor nature are discussed below.

Factors the courts have weighed in deciding whether work is of a minor nature

While the courts have said that whether or not work is of a minor nature is a relative expression requiring assessment of what was done in particular circumstances, rather than the application of a checklist, they have also referred to a number of factors to be taken into account in determining the issue. The remainder of this guideline will focus on how each of these overlapping factors has been interpreted and applied. They are:

- The importance of the work in relation to the physical nature and character of the land.
- The total cost of the work done, in both absolute and relative terms.
- The nature of the professional services required.
- The nature of the physical work required for the subdivision (if any).

1. The importance of the work in relation to the physical nature and character of the land

The importance of the work in relation to the physical nature and character of the land is a relevant factor in deciding whether work is of a minor nature. However, it should be noted that physical change to the land is not necessary for the work to be of more than a minor nature.

This factor was discussed in *Dobson v CIR* (1987) 9 NZTC 6,025. In this case the taxpayer had demolished the dwellings on three properties and replaced the dwellings with a number of new flats. The subdivision work involved demolition, clearing of the sites, surveys, plan deposits, preparation of cross-leases and obtaining composite titles. Considered all together, this work could not be considered "minor". Hardie Boys J found that the most significant feature of the development was the demolition of buildings on the properties, and commented (at p 6,030):

> This was development work, and it was not minor, whatever its cost may have been, for it altered the whole character of each property, allowing for its complete redevelopment, which would not otherwise have been possible.

Hardie Boys J said that the land to be considered, when looking at the importance of the work to the nature and character of the land, was the original land and not the newly created lot.

While it is arguable that the creation of an additional lot is more than a minor adjustment to the land, the courts have not ordinarily found the creation of a new lot per se to be a major change to the nature and character of the land. Generally, something more has been needed. In *Dobson* it was thought that the mere bisection of a lot was of itself work of a minor nature. Hardie Boys J said (at p 6,030):

> I doubt that the subdivision at Lyttleton/Edinburgh Streets, which involved simply the bisection of a virtually rectangular lot, was of itself more than work of a minor nature, and possibly the same might be said of that at MacKenzie Avenue, although there the access strip to the street meant that two boundary lines, connected by an arc, were required.

In *Case E90* (1982) 5 NZTC 59,471 Bathgate DJ said (at p 59,476):

> …I consider that the nature and effect of the work in the way of development or division into lots must be a significant factor in ascertaining whether or not that work is of a minor nature in relation to that land.…In this case one single piece of land in one title has been subdivided, there has been a division of the building into three major units, and two smaller units, with the definition of a further piece of land as common property.… I consider all this is not "work of a minor nature" for that particular piece of land. Nor has O satisfied me on the balance of probabilities that the division work alone is of a minor nature.

It has been suggested by some commentators that this appears to confuse the effect of the subdivision work with the extent of that work. It is the Commissioner's view that:

- Section CD 1(2)(f) requires consideration of whether the work is not work of a minor nature — that is, it addresses the work itself and not the effects of the work; and
- In considering whether physical work is not work of a minor nature, the effect of that physical work is a relevant consideration, though it is only a consideration and it is not determinative.

This may be contrasted with the consideration of legal and professional work. It is explained later in this interpretation guideline that in considering whether legal or professional work is not work of a minor nature, one must consider the amount and complexity of the work (regardless of the costs incurred for it).

2. The total cost of the work done, in both absolute and relative terms

Richardson J in *Lowe v CIR* (1981) 5 NZTC 61,006 stated that whether work is of a minor nature must depend on an overall assessment of the work involved, including the cost, as measured both in absolute (or total) and relative terms.

(i) Total cost of the work to be done in absolute terms

The court can take into account the total cost of the work to be done in absolute terms. The following table lists cases in chronological order (as to when the work was carried out), the total cost of the work with which the court was concerned, and the result in each case.

Wellington v CIR (1972)	$9,000	Not minor
O'Toole v CIR (1974)	$7,000	Not minor
Case E41 (1982)	$4,500	Not minor
Case P61 (1985)	$6,334	Minor in nature
Costello v CIR (1991)	$1,700	Not minor

Not all cases make reference to the absolute amount expended in subdividing. In *Dobson v CIR*, *Case N59* (1991) 13 NZTC 3,457, *K v CIR* (1991) 13 NZTC 8,216, *Case R7* and *Case E90* the Court did not refer to the total amount incurred by the taxpayer in the development or division.

It should be noted that the findings reached in these cases were not solely determined according to the value of the work incurred. Other factors were also considered. For example, in *O'Toole* although the costs were largely limited to the surveying fees, the amount of time involved was reflected in the account for almost $8,000 and this amount could not be considered a minor amount for surveying fees. (The difference between this figure and the figure in the table is explained by the fact that the original account tendered by the surveyor was $8,000, but the taxpayer negotiated a reduction.)

Tompkins J stated in *K v CIR* that cost is one, but not the only, factor to be taken into account in deciding whether or not work is of a minor nature. In that particular case no legal costs were incurred because Mr K, being a solicitor, was able to and did carry out the work without charging himself or his wife a fee.

In analysing cost on an absolute basis there is no figure that will determine the issue definitively. It is a matter of degree. For example, in *Costello* it did not assist the taxpayer that the professional fees for the whole subdivision were a modest $1,700. The Court of Appeal, when reviewing the work required to complete the subdivision, as opposed to cost of the work, was of the view that it was of more than a minor nature. On the other hand, in *Case P61* the subdivisional survey costs were $6,334 in 1984 dollars. Barber DJ did not find that this expenditure jeopardised a decision that the work was minor in nature.

Although the work is to be measured in both absolute and relative terms, the Commissioner considers that there will always be a point where the absolute value of the sum expended is so high this factor alone will indicate that the work is more than minor. Conversely, the amount may be so low that as an absolute figure the amount could in no circumstances be seen to be more than minor. However, this would only occur in extreme circumstances. As discussed below, although the amount of money spent is not enough to make the work of more than a minor nature on an absolute basis, the amount spent may indicate that there is more than work of a minor nature in relative terms.

(ii) Cost of the work done in relative terms

In his judgment in the Court of Appeal in *Lowe v CIR* (1981) 5 NZTC 61,006 (CA, Cooke, Richardson and McMullin JJ), 61,028, Richardson J said:

> Whether the work is of a minor nature must, it seems, depend on an overall assessment of such matters as the time, effort and expense involved, measured both in absolute terms and relative to the nature and value of the land on which the work is done.

Thirteen years later, giving judgment for the Court of Appeal in *Costello v CIR* (1994) 16 NZTC 11,253 (CA, Richardson, Casey and Ellis JJ), Richardson J made reference to the total professional charges being "very small relative to land values", not in relation to the cost of the land.

In *K & Anor v CIR* (1991) 13 NZTC 8,216 (HC, Tompkins J), Tompkins J says "Whether the work is of a minor nature is a matter of fact to be determined depending on all the circumstances of the particular case. Cost is one, but not the only factor." Tompkins J goes on to find that the work involved in that case was not work of a minor nature. He considers the cost of the work, but finds that it is not a relevant consideration because some of the work was performed by one of the taxpayers at no cost.

However in *Case E41* (1982) 5 NZTC 59,255 (TRA, Barber DJ), Barber DJ considers the relative amount of certain development and division costs, including fencing work carried out by the taxpayer, and finds that it was not work of a minor nature. It is unexceptionable that the cost of the work performed by the taxpayer himself is ignored in such a case, for recognition of further costs could only have increased the relative significance of the development and division work.

In the High Court and the Taxation Review Authority, the cost of the work has been compared with, or it has been suggested that the cost should be compared with –

- The cost of the land (*Wellington v CIR* (1981) 5 NZTC 61,101 (HC, Ongley J)); or
- The "ultimate value achieved" (*Dobson v CIR* (1987) 9 NZTC 6,025 (HC, Hardie Boys J)); or
- The sale price of the land or some of it (*Case E41* (1982) 5 NZTC 59,255 (TRA, Barber DJ); *Case P61* (1992) 14 NZTC 4,416 (TRA, Barber DJ)).

There are no other High Court judgments or TRA decisions dealing with the question (in *O'Toole v CIR* (1985) 7 NZTC 5,045 (HC, Davison CJ) the comparison was made by a witness, not by Davison CJ).

In the Commissioner's view, whether the development and division work is work of a minor nature is a matter of fact to be determined depending on all the circumstances of the particular case, and relative cost is one, but not the only, factor to be considered. When considering relative cost, the cost of the work should be compared with the land in its state and value at the commencement of the work. That is because the cost of the work is to be compared with "the value of the land on which the work is done" (see the reference to *Lowe*, above), and drawing the comparison with the value of the land at any other time risks distortion due to alterations to the land and movement in land values. If the value of the land at that time is not available, it may be appropriate to compare the cost of the development or division work with the cost or the sale price of the land if the purchase or sale was relatively close in time to the commencement of the work. However, even if the purchase or sale was relatively close in time to the commencement of the work, intervening events might give reason to expect significant price movements so that the comparison might be misleading, and in such circumstances the alternative comparisons would not be appropriate. And if the work is performed at no cost, the work itself remains the important consideration.

It is necessary to keep in mind the statutory test. The cases considered above were not decided on the cost of the development or division work alone. The statutory test is whether the work is work of a minor nature. The comparison of the cost of the work with the value of the land uses monetary value as a basis for comparison between subjects (the work and the thing on or in relation to which it is done) that might otherwise be incommensurable. In any particular case a cost comparison may not be determinative. And if a cost comparison is significant, other bases of comparison may be also be appropriate or more appropriate.

As noted earlier, the findings reached in these cases were not solely determined according to the cost of the work done. The other factors that go towards determining whether the subdivision work is work of a minor nature are now considered.

3. The nature of the professional services required

The cases establish that the more the professional services utilised in undertaking a subdivision, the less the likelihood that it will be work of a minor nature. For example, there may be the need to employ an engineer or a valuer in order to undertake the subdivision. Alternatively, it may only be necessary to employ a solicitor and a surveyor in order to undertake the subdivision, but the work undertaken might be of a high degree of complexity and/or require a large number of hours to complete.

In *Wellington v CIR* (1981) 5 NZTC 61,101 at p 61,103, Ongley J referred to the minimum work needed to complete a subdivision where no physical work is carried out:

> Where no physical work of division is undertaken the work involved in division of a larger area into lots nevertheless must include at least the following:
>
> (i) planning and preparation of formal plans,
>
> (ii) survey work,
>
> (iii) obtaining town planning consents and local authority permits, and
>
> (iv) legal work including deposit of subdivisional plans and issue of separate titles if required.

The fulfilment of these requirements will require the services of a surveyor and a solicitor. The need for professional services may go beyond these minimum requirements. For example, in *Costello v CIR* (1993) 15 NZTC 10,285 (HC); (1994) 16 NZTC 11,253 (CA) the taxpayers needed the services of three different professional disciplines in order to complete their subdivision.

How complex is the professional work?

The courts have been willing to accept that the work is minor in nature only when the actual work involved is simple in nature: *Case P61*, *Case R7*. When additional work, beyond minimal surveying and conveyancing, is required for completion of the scheme, and that work is a fundamental and integral component of the subdivision, it seems that such work would be considered work of more than a minor nature. If any conclusion can be drawn, it is that a basic subdivision necessitating only the barest professional services will be work of a minor nature. The introduction of an additional activity that is an integral part of the undertaking may be enough to make the work more than of a minor nature: *K v CIR, Costello v CIR, O'Toole v CIR*, *Case N59*.

In *Costello* Speight J noted in the High Court that substantive work was required from the surveyor but those fees only amounted to a modest $1,104. His services were required for:

- the receipt of instructions
- searching the title and ascertaining survey information
- measuring the flats and calculating the areas
- dividing the appropriate plans into individual holdings and delineating common areas
- obtaining consents from the chief surveyor in accordance with the Unit Titles Act 1972
- depositing the plan in the Land Transfer Office.

The surveyor's evidence was that it was a very straightforward job as the building was single-storeyed, thus no cross-section of overlapping entitlements was required, and the angles in the building were all right-angles and parallel with land boundaries. However, inspection of the plan produced showed that there were more than 30 separate areas delineated, with their respective entitlements. Work was also done by a valuer in accordance with the requirements of the Unit Titles Act 1972, so that an appropriate valuation could be made for each unit. Speight J held that while the fees charged by the professionals were modest, a complicated series of steps was undertaken by the three separate disciplines of law, surveying, and valuation. The scheme could not have been finalised and unit titles made available for issue unless each of the steps was accurately completed. The number of the lots and the complicated nature of the plan as presented, and the fact that the unit title procedure was more complicated than the earlier crossleasing procedure, led Speight J to the conclusion that it was not work of a minor nature.

The taxpayers appealed to the Court of Appeal: (1994) 16 NZTC 11,253. The taxpayers argued, among other things, that Speight J:

- appeared to be influenced by his conclusion that the unit title procedure involved was a complicated one requiring a considerable variety of professional services and in doing so placed undue weight on those factors. Counsel for the taxpayers submitted that there was no evidence before the High Court supporting the view that subdivision by way of a unit title was inherently more complicated than cross-leasing;
- had placed undue weight on the number of lots resulting from the unit title procedure and the plan of division;
- had placed unjustified weight on the distinction between historical cross-leasing procedures and the procedures contained in the Unit Titles Act.

Counsel for the taxpayers emphasised that non-physical subdivisional work will always involve some survey work, the preparation of formal plans, obtaining town planning consent and local authority permits, and some legal work. This would always include depositing subdivision plans and the issuing of separate titles.

The Court of Appeal held that although the surveyor's fee was modest and the total professional charges were very small relative to the land values, the job took the surveyor 36 hours in order to achieve the object of the subdivision into 9 lots. (The fees charged by the solicitor and surveyor were only $560 plus $13 disbursements and $1,012 plus $92 respectively. The valuer whose job it was to allocate percentages of the total value to each of the respective 9 units did not charge a fee and received a small gift.)

The Court held that Speight J neither erred in his overall approach to the question nor in his conclusion. Therefore, it was not work of a minor nature.

K v CIR (1991) 13 NZTC 8,216 involved complex legal work in the subdivision of two properties. Tompkins J said (at 8,221):

> There would also have been considerable legal work in the deposit of each of the subdivisional plans and the issue of the separate titles that were going to be required in order to carry out the scheme involving, as it did, the sale of the home units. In this particular case no legal costs were incurred because Mr K, being a solicitor, was able and did carry out the work without charging himself or his wife a fee.

Similarly in *Case N59* the subdivision work was held not to be work of a minor nature due to the considerable legal work involved.

In *Case P61* two lots of land were amalgamated and then subdivided. The taxpayer's subdivision expenditure comprised only survey and legal work. It was submitted by the taxpayer that the only cost that was incurred in the subdivisional work was $6,334 relating to the survey work.

The subdivision involved the creation of a number of easements to give access and to convey power and water. Barber DJ ascertained that these easements were effected by way of the standard Memorandum of Easements procedure in reliance on the Land Transfer Act and were quite straightforward from a legal point of view, needing little time, and was not more than work of a minor nature. The amount of the legal costs was not known because the costs had been incorporated into the taxpayer's legal fees for each sale. Barber DJ stated that he understood that the legal fees relating to the subdivisional work were modest.

The Judge noted that the subdivision work in this case comprised much of the type of work listed by Ongley J in *Wellington*. However, he said that the degree of such work that had been needed was relatively much less in relation to this particular subdivision, and therefore the work was of a minor nature.

Case R7 also concerned an amalgamation. The Judge referred to the comments of Speight J in *Costello v CIR* (1993) 15 NZTC 10,285 that whether work is of a minor nature is a matter of fact to be determined on all the circumstances of the particular case. In *Case R7* the Judge held that the development and subdivision work was of a minor nature because it involved uncomplicated and quite minor survey work and legal work.

In other cases more complex professional work, coupled with additional physical work, has lead the courts to conclude that the work was not of a minor nature. This will be dealt with in the next section.

4. The nature of the physical work required for the subdivision (if any)

If physical work (in addition to professional work) is required to carry out the subdivision, the work required to complete the subdivision will be more than that of the most basic subdivision. However, the mere presence of physical work in a subdivisional scheme will not necessarily mean that it is more than work of a minor nature. The physical work undertaken should simply be weighed along with the other factors to be taken into account in deciding whether or not the work is of a minor nature, bearing in mind the fact that physical work will indicate that something more than the most basic subdivision is being undertaken.

In *Wellington v CIR* (1981) 5 NZTC 61,101, Ongley J indicated that division work in relation to land includes:

- Physical work such as fencing, planting, and other work directly related to land; and
- Non-physical types of work, eg survey and legal work.

Other physical work involved in a subdivision could include the connection of water, sewerage, telephone, and electricity. Access in the form of roading or driveways may also need to be created.

In *Case E41* the taxpayer carried on a farming business on a 279-acre property, and in 1972 decided to create a subdivision of six lots out of a block of 177 acres. To carry out the subdivision he organised a survey and the issue of titles, and did some fencing work, which was the only physical work required. The survey and legal costs to the taxpayer were $1,160 and $39 respectively. In relation to the fencing, the taxpayer cleared and burnt off gorse and put in 190 chains of fencing at a cost of $3,303. Three of the lots were sold after the predecessor to section CD 1(2)(f) came into effect.

The taxpayer submitted that the subdivision involved development or division work of a minor nature. He contended the fencing work should not be taken into consideration, because it related to the renewal of existing boundaries and was not part of the subdivision work.

On the facts of this case, although the division work was not that extensive by comparison with other subdivisions, the combination of the survey, legal and fencing work was something more than of a minor nature. It was held that the fencing work was a necessary part of the subdivision and was not effected as part of the consideration for the sale price.

Of the 190 chains of fencing erected, about 62 chains were for the replacement of existing fences, as many of these were not stock-proof and over 50 years old. Only 120 chains were new fencing. Of these, 63 chains of the new fencing bounded the farm retained. The fencing work cost $3,303, of which $2,408 was for materials and $895 for a fencing contractor. The taxpayer had done much of the work himself, including removing the gorse on the boundaries with a tractor and rear-mounted blade. This took about two or three days of non-continuous work. The gorse was then burnt.

Barber DJ said that the fencing work done was more than of a minor nature even after allowing for the renewal in common boundary aspects. The physical work involved in the division was the fencing work, the cost of which has already been referred to, and the survey work the fees of which were approximately 1% of the sale of the three lots. It was not correct to say that the fencing work was part of the sale rather than the subdivision, because the sale would not have been completed unless the fencing condition had been fulfilled.

However, a lack of physical work does not necessarily mean that the work will be of a minor nature. For example, in *O'Toole v CIR* no physical work was done and yet the work was held to be of more than a minor nature.

Any physical work done on the property to be subdivided must be division or development work before it can be taken into account in deciding whether or not the work is of a minor nature. In *Case P61* some previous orchard development work had been done involving felling trees, drainage, and irrigation. These costs had been written off in the orchard accounts some years before the subdivision. Water pipes and power were laid for a house erected by the taxpayer after acquiring the property for use mainly as an orchard enterprise.

Barber DJ said that the previous work done did not form part of the undertaking or scheme of the subdivision. It was done for a different purpose and the subdivision was entitled to the benefit of it.

Conclusions

The meaning of "development or division work" includes any type of work done on or in relation to the land, such as (but not limited to) professional fees (surveyor, solicitor, valuations), fencing, demolishing buildings, clearing the site, the cost of installing power or water onto a site, and creating a driveway or entranceway.

Work performed by a local authority in fulfilment of its own statutory functions and for the benefit of others as well as the taxpayer is not "work … carried on or carried out by or on behalf of the taxpayer" in terms of section CD 1(2)(f)(i).

Costs to be specifically included or excluded in the development or division work:

- Where a building exists on the land before the subdivision commences, it should be included in the value of the original land against which the cost of the subdivision is measured: *Wellington.*
- The cost of constructing any building on the land being subdivided should be excluded from the total cost of the development or division work: *Dobson.*
- Financial contributions of money and/or land as a condition of resource consent are excluded from the total cost of the development or division work.
- The meaning of "development or division work" includes any work involved in obtaining an environmental assessment (section 88(4)(b) of the RMA) as part of resource consent.
- The work undertaken by a local authority in considering a resource consent application is not "work … carried on or carried out by or on behalf of the taxpayer". Resource consent application fees payable to a territorial authority for the development or division into lots of land are therefore excluded from the total cost of the work.

The general guiding principle in deciding whether work done in undertaking a subdivision is of a minor nature is that it depends on an overall assessment of the facts of each case, having regard to the time, effort and expense involved, measured in both absolute and relative terms: *Lowe v CIR, Costello v CIR*.

The courts have said that the question of whether or not work is of a minor nature is a relative expression requiring assessment of what was done in particular circumstances, rather than the application of a checklist. However, the courts have referred to four different overlapping factors to be taken into account in determining this question:

1. The importance of the work in relation to the physical nature and character of the land.
    - Physical change to the land is not necessary for the work to be of more than a minor nature.
    - Where the actual work carried out on the property is substantial this will indicate that the work is more than minor in nature.
    - While substantial change to the physical character of the land will probably indicate that the work is more than minor in nature, the lack of any change to the physical character of the land may also be a factor that the courts take into account in deciding whether work is of a minor nature: *Case P61*.
    - The land to be considered is the original land and not the newly created lot: *Dobson.*
    - It is not necessary to look at the effect of the work on the legal status of the property, only the impact or effect of such work on the physical nature and character of the property.
2. The total cost of the work done, in both absolute and relative terms.
    - Where a comparison of the cost of the work and the value of the land is relevant to the question whether work is work of a minor nature, the comparison should be between development or division costs incurred and arms' length prices and values for the land about the same time, or over a period of time when price movements (whether generally, locally, or specific to the site) are not material to the comparison. However there may be circumstances where a court would find a comparison between the cost of the work and the cost or the sale price of the land to be relevant (for example where the comparison is quite clear and the time between the purchase or sale and incurring the expenditure on the work is not so long as to suggest that the two are not comparable).
    - Cost is only one factor to be taken into account in deciding whether or not work is of a minor nature: *K v CIR*.
    - In analysing cost on an absolute basis, there is no figure that will determine the issue definitively. It is a matter of degree.
    - In exceptional circumstances, the absolute value of the sum expended may be so high that this factor alone will indicate that the work is more than minor. Conversely, the amount may be so low that as an absolute figure the amount could in no circumstances be seen to be more than minor.
    - The amount of money spent in undertaking a subdivision may be enough to indicate that there is work of more than a minor nature in relative terms, even if it is not enough to indicate that it is work of more than a minor nature on an absolute basis.

3. The nature of the professional services required.
    - The cases establish that the more professional services are utilised in undertaking a subdivision, the less likely that it will be work of a minor nature.
    - The minimum work involved to complete a subdivision where no physical work is needed will require the services of a surveyor and a solicitor: *Wellington*. However, the need for professional services may go beyond these minimum requirements: *Costello*.
    - Work that is simple in nature is more likely to be minor in nature: *Case P61, Case R7*.
    - When additional work, beyond minimal surveying and conveyancing, is required for completion of the scheme, and that work is a fundamental and integral component of the subdivision, it seems that such work would be considered work of more than a minor nature.
    - The introduction of an additional activity that is an integral part of the undertaking, may be enough to make the work more than of a minor nature: *K v CIR, Costello v CIR, O'Toole v CIR, Case N59*.
4. The nature of the physical work required for the subdivision (if any).
    - If physical work (in addition to professional work) is required to carry out the subdivision, the work required to complete the subdivision will be more than that of the most basic subdivision. However, the mere presence of physical work in a subdivisional scheme will not necessarily mean that it is more than work of a minor nature. The physical work undertaken should simply be weighed along with the other factors to be taken into account in deciding whether or not the work is of a minor nature, bearing in mind the fact that physical work will indicate that something more than the most basic subdivision is being undertaken: *Case E41, O'Toole v CIR*.
    - Any physical work done on the property to be subdivided must be division or development work before it can be taken into account in deciding whether or not the work was of a minor nature: *Case P61*.
    - Previous physical work done for a different purpose will not form part of the undertaking or scheme of the subdivision, and therefore the subdivision will be entitled to the benefit of it without it counting as development or division work: *Case P61*.

Examples

Note: While each fact situation must be considered individually, the following examples may be of assistance by way of illustration.

These examples consider only the work of a minor nature requirement and do not consider other requirements of section CD 1(2)(f) or any other matter that may determine the taxpayer's liability.

Example 1

A taxpayer owns a 75-acre farm. In addition to the house she lives in, there is an old farmhouse situated at one end of the property. She wishes to subdivide off the old farmhouse and three acres of surrounding land. The expected sale price of the house and surrounding land is estimated to be $130,000. The cost of the subdivision has been estimated at $3,300. The survey costs are estimated to be $2,700 and the legal costs $600, including GST. The subdivision expenses are approximately 2.5% of the projected sale price. No fencing work is required as the house and surrounding land have existing creek and hedge boundaries. The property already has water, and a septic tank for sewage. No easements are required.

All the work involved is minimal and straightforward. The professional services required are minimal and simple, and no physical work is required. The cost of the work is small compared to the estimated value of the land. Therefore, the proposed subdivision work that the taxpayer intends to carry out is work of a minor nature.

Example 2

A taxpayer purchased 10 acres, containing a house, garage, and barn for $220,000. The land value portion was $120,000.

Council approval was obtained for a subdivision of seven acres which was carried out, and the land subsequently sold for $200,000. Costs involved in the subdivision amounted to $33,000. The professional services of a surveyor, solicitor, and valuer were used. The taxpayer also organised fencing, felling and planting work, and the excavation of a driveway. Work involved in the subdivision included the removal of pine trees, a bush regeneration programme, stock-proof fencing, a site survey, the excavation of a driveway, and the planting of trees. The buildings and one acre of the remaining three acres are used for the taxpayer's car restoration business and residence.

It is considered that this subdivision involves work of more than a minor nature. While the survey and legal services could be classed as straightforward, additional services, ie fencing, planting and felling of trees, the excavation of a driveway and a valuation, were required to effect the scheme. This additional work means that the work is more than minor in nature. Furthermore, the costs involved could not be seen as minor either on an absolute basis or when compared with the value of the land and the sale price of the subdivision. Therefore, the work is of more than a minor nature, and the $200,000 received from the sale of the land will be included as gross income if the other requirements of section CD 1(2)(f) are met and the exceptions elsewhere in section CD 1(2) do not apply.

Example 3

Purchaser acquired a 50-hectare farm property at a cost of $400,000. Two months later, she was offered $50,000 for a 0.5 hectare parcel of the land, and accepted.

The condition imposed by the Council for subdivision consent is:

- Construction of an entranceway to the subdivided lot ($550).

Satisfactory arrangements for telephone service to the subdivided lot already existed. Constructing an entrance way to the lot cost $550 and was very straightforward. In addition, a power supply to the subdivided lot already existed. Within one month of Purchaser's acquisition of the property, the power was connected for farm development purposes at a cost of $2,800 paid to the power company.

The creation of the entranceway is development work.

The farm had three existing titles, so it was a relatively simple exercise to adjust the boundaries to provide a small residential block for sale. The boundary adjustment is division work. The costs involved in the subdivision were:

Surveying (including:)	$
Scheme plan preparation and submissions	1,500
Field Work and LT plan preparation	2,000
Entrance way	550
Legal fees	1,000
Total	5,050

The professional services of a surveyor and a lawyer were required to subdivide the land. The legal work involved was minimal in both cost and complexity. The survey work was standard as it entailed only a simple boundary adjustment.

The work undertaken by the Purchaser is the type of work typical of a basic subdivision, and the professional services were relatively simple. The legal and surveying work required appears to be quite straightforward. One additional item of physical work is to be carried out: the construction of the entranceway. However, it is considered that this is sufficiently minor still to be work of a minor nature.

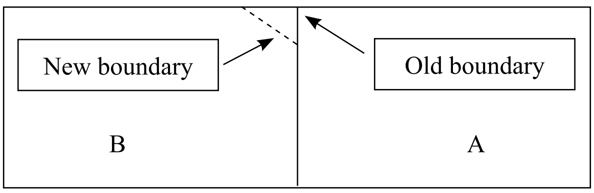
The power was connected within one month of Purchaser's acquisition of the property at a cost of $2,800. The erection of the transformer structure was an expensive procedure, was work of a physical nature and, in conjunction with the construction of the entranceway, might be considered to be too complex to be "work of a minor nature". However, it did not form part of the undertaking or scheme of subdivision. It was done for a different purpose, of farm development. On this basis the additional costs associated with the supply of electricity to the section would not form part of the subdivision.

It should be noted that although the Commissioner considers that this example does not involve work of more than a minor nature, it is considered to be borderline.

If the Purchaser had, in addition to the above fact scenario incurred significant expenditure in dividing the 0.5 hectare parcel of the land into three portions, as well as fencing the relevant sections off (including the removal of gorse bushes, creating new fences and replacing old ones), the Commissioner considers that this example would most likely not be work of a minor nature. In that circumstance, the proceeds of the sale of the land would be included as gross income if the other requirements of section CD 1(2)(f) were met and the exceptions elsewhere in section CD 1(2) did not apply.

Example 4

In the course of preparing to sell his quarter-acre residential property, A discovers that he and his neighbour B have been mistaken for some time as to the location of the boundary between them. As a result, A's spa pool and surround extends a little over the boundary near the rear corners of their properties. He raises the question with B, and it is agreed that they will remedy the matter by a boundary adjustment to add a small corner from the rear of her property to his (see diagram). The only work involved is straightforward survey and legal work and is completed without any difficulty.



The work involved is work of a minor nature and is therefore not within section CD 1(2)(f)(i).

Matrix of cases considering the work of a minor nature exemption

Note: The approximate date of expenditure or receipt is indicated for each case. For example, "(1974–75$)" indicates that the expenditure or receipt occurred in the 1974 and 1975 years.

Cases where it has been decided that the work is of a minor nature

Case	Land division/development & total value	Work: professional & physical	*Reasons for decision*
Case D24 (1979) 4 NZTC 60,597	• Division of 2.429 ha. into 6 lots • Total sale value of lots $32,900 (1975–76$) • Cost of land $22,000 (1971$)	• Cost of subdivision, professional services, surveyor's fees, disbursements and legal fees: $1,939 (1975–76$) • Reserve contribution $1,170 (1974$)	• Reserve contribution not work so costs of subdivision relative to value of land were minimal • Land Transfer Office deposit not considered to be "work" in circumstances of case (disapproved in *Wellington*)
Case P61 (1992) 14 NZTC 4,416	• Amalgamation of 2 lots of land and then subdivision into 3 sections, land swap, and further subdivision to create 3 smaller lots • 20 acres • Two sections sold for $46,137 (1984$) and $40,000 (1986$) each	• Surveying and legal work simple and straightforward • Cost of survey work $6,336 (1986$) • Water, sewage and clearing work undertaking 5 or 6 years earlier for orchard purposes	• While type of work similar to that in *Wellington*, the degree of work was relatively much less in this case • Costs of earlier work done for orchard purposes excluded
Case R7 (1994) 16 NZTC 6,035	• Amalgamation of 9-acre block of land with two ¼ acre sections • Total cost of land (9 acre block with two ¼ acre sections): $34,250 (1973$) • House built on corner of section, a small adjoining section was added to it and this part then subdivided and sold in a swap deal • House site sold for $30,000 (1974$)	• House site not part of development work • Uncomplicated and quite minor survey and legal work	• Uncomplicated and quite minor survey and legal work

Cases where it has been decided that the work is not of a minor nature

Case	Land division/development & total value	Work: professional & physical	*Reasons for decision*
Wellington v CIR (1981) 5 NZTC 61,101	• Division of land into 8 blocks • Three blocks amalgamated into 1 block • Block of land later subdivided back into 3 original blocks and 2 blocks were subsequently sold • Land and buildings cost $12,000 (1970$)	• Subdivision work cost over $9,000 (1971–72$)	• Cost of subdivision in relation to cost of land meant was more than work of a minor nature)
Case E41 (1982) 5 NZTC 59,225	• Subdivision of part of farm (177 acres) into 6 lots • Sale of 3 lots after section 88(1)(d) came into force	• Cost of work approximately 1% of amount of sale value of 3 lots • Total costs of work (fencing, legal and surveying work): $4,502 (1972 –73$) • Fencing included removal of gorse bushes, creating new fences and replacing some old fences. Work carried out mainly by farmer.	• Combination of survey, legal and fencing work was more than of a minor nature
Case E90 (1982) 5 NZTC 59,471	• Block of land divided into 5 lots • Unit sold	• Unit title plan prepared at cost of $482 (1977–78$) • Division into three major units and two smaller units, with further piece as common property	• Subdivision of land into 3 major units, 2 smaller units and the definition of a further piece as common property meant was not of a minor nature for the particular piece of land
O'Toole v CIR (1985) 7 NZTC 5,045)	• Subdivision of farm in 1974 into 18 lots • 12 lots sold, 3 kept and remainder were up for sale • Cost of land $22,600 (1970$)	• No physical work involved • Subdivision work considered quite difficult by surveyor. Approximate cost $7,000 (1973$)	• Difficulty of survey, for reasons of topography, extent of cover on land and age and unavailability of previous survey marks meant was not work of minor nature
Dobson v CIR (1987) 9 NZTC 6,026	• Development of 3 rental properties	• Demolished buildings, cleared site, surveyed land, prepared and deposited cross leases and subdivision plans and obtained composite titles	• Totality of work involved was more than of a minor nature

Cases where it has been decided that the work is not of a minor nature (continued)

Case	Land division/development & total value	Work: professional & physical	*Reasons for decision*
Case N59 (1991) 13 NZTC 3,457	• Purchase of section to build 2 home units • Original intention to sell 1, later decided to sell both units	• Surveying, preparing, lodging and depositing plans with LTO, drafting and executing cross leases and obtaining separate composite titles • No evidence of cost	• Objectors failed to discharge onus of proof to show work was of a minor nature • Doubtful that work involved would be regarded as work of a minor nature
K v CIR (1991) 13 NZTC 8,216	• 2 cross-lease developments • Cost of land and buildings for first development $101,641 (1973$) • Cost of land and buildings for second development $95,247 (1973$)	• Demolished existing buildings, replaced with home units • Subdivision of land and cross-leasing home units • Taxpayer solicitor performed own legal work so no legal costs, but large amount of time involved • Total cost of cross-lease plans: $476.66 (1973-74$)	• Cost only one factor • Division work significant as was essential for completion of scheme
Costello v CIR (1993) 15 NZTC 10,285	• Block of flats subdivided into nine lots and sold	• No physical work involved • Total costs of work (surveyor, solicitor and a valuation) approximately $1,700 (1981$) • Work was straightforward but 30 separate areas had been delineated	• Significant amount of time involved • Unit title procedure more complex than cross-lease • Complicated nature of plan

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.

PROVISIONAL DEPRECIATION DETERMINATION PROV12

This determination may be cited as "Determination PROV12: Tax Depreciation Rates Provisional Determination Number 12".

1. Application

This determination applies to tax payers in the "Hotels, motels, restaurants, cafés, taverns and takeaway bars", "Residential rental property chattels" and "Shops" industry categories and to tax payers who own assets in the "Office equipment and furniture" asset category.

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 10 (1)(b) of the Income Tax Act 1994 I hereby amend Determination DEP1: Tax Depreciation Rates General Determination Number 1 (as previously amended) by:

- Inserting into the industry categories "Hotels, motels, restaurants, cafés, taverns and takeaway bars", "Residential rental property chattels" and "Shops", and the asset category "Office equipment and furniture", in the appropriate alphabetical order, the provisional asset class, estimated useful life, and diminishing value and straight line depreciation rates listed below:

Office equipment and furniture	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Integrated silk flower arrangements	2	63.5	63.5

3. Interpretation

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

This determination is signed by me on the 15th day of December 2004

Martin Smith
Chief Tax Counsel

LIVESTOCK VALUES – 2005 NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK

The Commissioner of Inland Revenue has released a determination, reproduced below, setting the national standard costs for specified livestock for the 2004–2005 income year.

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

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

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

For bobby calves, information from spring 2004 is used while other dairy NSCs are based on survey data for the year ended 30 June 2004. For sheep, beef cattle, deer and goats, NSCs are based on survey data for the year ended 30 June 2003 which is the most recent available for those livestock types at the time the NSCs are calculated.

The NSCs calculated for the year ended 31 March 2005 have remained relatively static. The major change was the drop in the NSC for rising one-year old dairy cattle due to an increase in homebred calf numbers.

Total expenditure on most farm types increased in the survey year on which the NSCs are based. However, these increases were off-set by better calving and lambing percentages.

The new NSCs struck each year only apply to that year's immature and maturing livestock. Mature livestock valued under this scheme effectively retain their historic NSCs until they are sold or otherwise disposed of, albeit through a FIFO or inventory averaging system as opposed to individual livestock tracing. It should be noted that the NSCs reflect the average costs of breeding and raising immature livestock and will not necessarily bear any relationship to the market values (at balance date) of these livestock classes. In particular, some livestock types, such as dairy cattle, may not obtain a market value in excess of the NSC until they reach the mature age grouping.

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

The NSC scheme is only one option under the current livestock valuation regime. The other options are market value, the herd scheme and the self-assessed cost (SAC) option. SAC is calculated on the same basis as the NSC but uses a farmer's own costs rather than the national average costs. There are restrictions in changing from one scheme to another and before considering such a change livestock owners may wish to discuss the issue with their accountant or other adviser.

National Standard Costs for Specified Livestock Determination 2005

This determination may be cited as "The National Standard Costs for Specified Livestock Determination, 2005"

This determination is made in terms of section EC 23 of the Income Tax Act 2004. It shall apply to any specified livestock on hand at the end of the 2004–2005 income year where the tax payer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EC 23 of the Income Tax Act 2004 the national standard costs for specified livestock for the 2004–2005 income year are as set out in the following table.

Kind of livestock	Category of livestock	National standard cost
		$
Sheep	Rising 1 year	22.40
	Rising 2 year	15.10
Dairy cattle	Purchased bobby calves	130.90
	Rising 1 year	668.00
	Rising 2 year	92.90
Beef cattle	Rising 1 year	217.50
	Rising 2 year	127.20
	Rising 3 year male non-breeding cattle (all breeds)	127.20
Deer	Rising 1 year	74.10
	Rising 2 year	37.20
Goats (meat and fibre)	Rising 1 year	17.70
	Rising 2 year	12.10
Goats (dairy)	Rising 1 year	106.40
	Rising 2 year	17.20
Pigs	Weaners to 10 weeks of age	79.20
	Growing pigs 10 to 17 weeks of age	61.70

This determination is signed by me on the 31st day of January, 2005.

Martin Smith
Chief Tax Counsel

STANDARD PRACTICE STATEMENTS

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

New referencing system

Please note that with effect from the 2005 calendar year, a new referencing system has been adopted for all new standard practice statements. Existing standard practice statements issued prior to 2005 will retain their original references until such time as they are replaced or re-issued.

All new standard practice statements issued by Inland Revenue will be prefixed with a 2-digit year to help identify the age of the publication and each new standard practice statement issued in the same calendar year will be sequentially numbered.

LATE FILING PENALTY
SPS 05/01

Introduction

1. This standard practice statement (SPS) sets out the Commissioner's practice for imposing late filing penalties under section 139A of the Tax Administration Act 1994 (TAA).

Application

2. This SPS applies from 4 February 2005 and replaces Standard Practice Statement RDC 5, Late filing penalty originally published in *Tax Information Bulletin* Vol 11, No 6 (July 1999).

Background

3. The New Zealand tax system is based on voluntary compliance. It relies on tax payers voluntarily meeting their obligations under the tax laws, for example, filing tax returns by the due date. Section 139A of the TAA imposes a penalty on a tax payer for failure to furnish certain returns by the due date. For example, an annual tax return, employer monthly schedule or annual imputation return required to be furnished by an Australian imputation credit account company that is not required to furnish a return of income for an income year. The purpose of the penalty is to promote voluntary compliance and ensure penalties for breaches are imposed impartially and consistently.

Legislation

Tax Administration Act 1994

139A Late filing penalties

(1) This section applies to tax returns required to be furnished under sections 33, 41 to 44, and 79 (in this Part, "annual tax returns"), the annual imputation return required to be furnished under section 69(1) and (1B)(a) by an Australian imputation credit account company that is not required to furnish a return of income for an income year, the reconciliation statement required to be provided under regulation 3 of the Accident Rehabilitation and Compensation Insurance (Earnings Definitions) Regulations 1992 or regulation 15 of the Accident Insurance (Premium Payment Procedures) Regulations 1999 or any successor to that regulation made under the Injury Prevention, Rehabilitation, and Compensation Act 2001, and the employer monthly schedule required to be provided under section NC 15(1)(a) or (b) or (c) or (d) of the Income Tax Act 1994.

(2) A tax payer is liable to pay a late filing penalty if–
- (a) The tax payer does not complete and provide on time–
  - (i) An annual tax return:
  - (ii) An annual imputation return required to be furnished under section 69(1) and (1B)(a):
  - (iii) A reconciliation statement:
  - (iv) An employer monthly schedule; and
- (b) The Commissioner notifies the tax payer that the penalty is payable.

(3) The late filing penalty for an annual tax return for a tax payer with net income–
- (a) Below $100,000, is $50;
- (b) Between $100,000 and $1,000,000 (both figures inclusive), is $250;
- (c) Above $1,000,000, is $500.

(4) The late filing penalty for an annual imputation return or reconciliation statement or employer monthly schedule is $250.

(5) Except in the case of a late filing penalty resulting from an employer monthly schedule, the Commissioner must, not less than 30 days before imposing a late filing penalty–
   (a) Send written notice to a tax payer that a late filing penalty may be imposed if a return specified in the notice is not filed; or
   (b) Publicly notify that a late filing penalty may be imposed on tax payers who omit to file the required return.

In this standard practice statement all legislative references are to the Tax Administration Act 1994 unless otherwise stated.

Discussion

4. Under section 139A, a late filing penalty applies to:
   - Annual tax returns;
   - ACC reconciliation statements;
   - Employer Monthly Schedules;
   - Annual imputation returns required to be furnished under section 69(1) and (1B)(a) by an Australian imputation credit account company that is not required to furnish a return of income – from 1 April 2003.
5. Although section 139A provides for late filing penalties to be imposed in respect of outstanding ACC reconciliation statements, Inland Revenue no longer collects these statements on behalf of the Accident Compensation Corporation. Therefore, Inland Revenue will not impose late filing penalties in respect of these statements.
6. The Commissioner must give at least 30 days notice to the tax payer of the intention to impose a late filing penalty for an annual tax return or annual imputation return required to be filed by an Australian imputation credit account company. The Commissioner must provide such a notice either in writing or by public notification to a tax payer or group of tax payers. If the outstanding return is filed within the 30-day period, or an extension of time is granted to file the outstanding return, the penalty will not be imposed.
7. For employer monthly schedules, the Commissioner must notify the tax payer that the late filing penalty is payable but no prior notification of intention to impose a penalty is required.
8. The amount of the late filing penalty for annual tax returns is based on the amount of net income as follows:
   - Less than $100,000 $50
   - From $100,000 to $1,000,000 $250
   - Greater than $1,000,000 $500
9. The amount of the late filing penalty for an employer monthly schedule and an annual imputation return required to be filed by an Australian imputation credit account company is $250.

Standard Practice

Imposing the late filing penalty

10. The Commissioner's practice is that a late filing penalty is imposed on the following:
    - Income tax returns for individuals (IR 3)
    - Income tax returns for companies (IR 4)
    - Employer monthly schedules (IR 348 and IR 349)
    - Annual imputation returns required to be furnished under section 69(1) and 69(1B)(a) by an Australian imputation credit account company that is not required to furnish a return of income for an income year that corresponds to an imputation year (IR 4J).
11. A late filing penalty will be imposed in the following circumstances.

Income tax returns

12. A late filing penalty will be imposed in respect of an outstanding income tax return in the following situations:
    (a) the return is not filed by the due date, and is not subject to an extension of time arrangement; or
    (b) the return is subject to an extension of time arrangement, and is not filed by the date agreed to in the arrangement; or
    (c) an extension of time arrangement is withdrawn from a client/all clients of a tax agent, and the return(s) are not filed by the date specified when the extension of time was withdrawn; or
    (d) the return is for a client of a tax agent with an extension of time arrangement and is not filed by the 31st of March in the year immediately following the income year to which the return applies.
13. The Commissioner will provide written notification of at least 30 days prior to the intention to impose the late filing penalty, either by public notification or directly to the tax payer.
14. The amount of the penalty for outstanding income tax returns is determined from the tax payer's previous year's net income based on the return filed. Once the return is received the amount of the penalty is checked and amended if necessary, for example, where the net income is in a different income bracket to the previous year's return.

15. If Inland Revenue has no information on which to base the late filing penalty, or the previous year's return has not been filed, the minimum penalty of $50 is imposed. When the return is received the amount of penalty is checked and increased where appropriate. If the amount of the late filing penalty is increased, time will be given to pay any additional penalty. The minimum penalty remains payable if the return is subsequently filed and shows a loss.

16. The due date for payment of a late filing penalty is the later of a date specified by the Commissioner, not being less than 30 days after the date of the notice informing of the imposition of the penalty, or the terminal tax due date for the income year to which the return relates.

Employer monthly schedule

17. Although the Commissioner is only required to notify the employer that the penalty is payable and is not required to provide prior notification of the intention to impose the penalty, Inland Revenue will take a liberal approach in regard to imposing a late filing penalty in respect of an employer monthly schedule.

18. The first time an employer fails to file an employer monthly schedule by the due date, the Commissioner will issue a warning notice to the employer advising a late filing penalty will not be imposed providing the schedule is filed immediately.

19. If, within 12 months of the warning notice being issued, a further default in filing a schedule occurs (second default), a late filing penalty will be imposed in respect of that schedule (second default) and a notice will be issued to the employer advising the penalty is payable.

20. If the tax payer defaults again after 12 months of a warning notice being issued, a further warning notice will be issued. If a further default occurs within 12 months of the second warning notice being issued, a late filing penalty will be imposed in respect of that schedule.

21. The due date for payment of a late filing penalty is the 5th or 20th of the month following the month in which the schedule was due to be filed depending on whether the employer remits PAYE deductions monthly or twice monthly.

Annual imputation return

22. A late filing penalty will be imposed when the return has not been filed by the due date and at least 30 days written notification of the intention to impose the penalty has been given, either directly to the tax payer or by public notification.

23. The due date for payment of a late filing penalty is the later of a date specified by the Commissioner, not being less than 30 days after the date of the notice informing of the imposition of the penalty, or the date by which the company is required to furnish the annual imputation return.

Reversal or remission of late filing penalty

24. The Commissioner's practice is that the late filing penalty may be reversed if:

    - the return was filed before the date the late filing penalty was imposed, but had not been "lodged" by Inland Revenue; or
    - the return or employer monthly schedule was not required to be filed; or
    - in respect of an employer monthly schedule, the tax payer did not pay any salary or wages even though a registered employer.

25. The Commissioner's practice is that the late filing penalty may be remitted if the legislative criteria contained in sections 183A and 183D of the TAA are met. Remission of penalties is discussed in a separate standard practice statement.

26. The Commissioner's practice is that the late filing penalty will not be remitted if:

    - the tax payer has an extension of time arrangement as a client of a tax agent, but the agent had not notified the Commissioner that the tax payer was their client before the late filing penalty was imposed.
    - the tax payer was granted an extension of time arrangement (either as a client of a tax agent or individually), after the late filing penalty was imposed.

This standard practice statement is signed on 4 February 2005.

Signed

Graham Tubb
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, Court of Appeal, Privy Council and the Supreme Court.

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

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

DEPRECIATION OF RIGHT TO USE TRADEMARKS

Case:	The Trustees in the CB Simkin Trust and the Trustees in the NC Simkin Trust v CIR of New Zealand
Decision date:	15 December 2004
Act:	Income Tax Act 1994
Keywords:	Depreciation, depreciable intangible property, trademarks, Schedule 17, right to use, ownership

Summary

The tax payers are not entitled to a depreciation deduction in relation to trademarks because they did not own the right to use the trademarks.

Facts

This was an appeal by the tax payers from a decision of the Court of Appeal (reported at (2003) 21 NZTC 18,117) upholding the High Court decision (reported at (2002) 20 NZTC 17,611).

The issues are the same for both Trusts. Each purchased trademark(s) from companies engaged in businesses which used the trademark(s). Simultaneously, the Trusts licensed the trademark(s) back to the respective vendor companies, granting exclusive rights to use the trademarks for seven years.

The Trusts then sold their residual rights in the trademarks (and names) to third parties, with the trademark to remain the property of the Trusts for seven years (ie the period of the licence).

The licensees paid annual royalties for the right to use the trademarks.

The Trusts claimed depreciation in the 1996 and 1997 years, in relation to the trademarks, on the basis they were the owners of the trademarks.

The Commissioner disallowed the claims, on the basis the Trusts were not entitled to claim depreciation.

Decision

The Privy Council upheld the earlier decisions, dismissing the appeal and ordering the appellant to pay the costs of the appeal.

The depreciation regime states only the owner of the right to use a trademark can depreciate the right to use the trademark. The Trusts did not own the rights to use the trademarks because that right had been licensed exclusively to the licensees.

Lord Scott expressed the view that it is unclear whether the words after "Schedule 17" in the section OB 1 definition of "depreciable intangible property" are intended as explanatory of the reasons for the particular types of intangible property listed, or whether they are criteria that an item of intangible property must possess in order to qualify for depreciation (paragraph 6 of the judgment).

However, his Lordship considered this does not need to be resolved if the item does not fall within the listed types, and their Lordships found the relevant item to be "the right to use a trademark", which is listed.

Their Lordships rejected the tax payers' arguments that the Trusts retained the "proprietary" right to use and the licensees had only a "contractual" right to use as offending common sense.

The tax payers' also argued that if the Trusts were not the owners of the right to use the trademarks, then the licensees must be, because someone must be able to claim the depreciation. Their Lordships dispatched this argument, stating that the licensees had no capital asset to depreciate (they were entitled to, and did, deduct the annual royalty), and furthermore the fact that the licensees could not claim the depreciation did not assist the trustees with their claim to a depreciation allowance.

STRUCK-OFF COMPANY HAS NO STATUS; OBJECTION RIGHTS CAN NOT BE ASSIGNED

Case:	TRA 046/01, TRA Dec 001/2005
Decision date:	18 January 2005
Act:	Companies Act 1993; Tax Administration Act 1994
Keywords:	Struck-off, assigning objection rights

Summary

A struck-off company has no status to continue its objection. The company could not assign its objection rights (even prior to the strike-off) as these were personal to the tax payer objecting

Facts

This is a Russell template-related matter.

The tax payer company entered into the Russell template. After investigation the tax payer was re-assessed on what is called "Track A" in 1990 and consequently the former shareholders were assessed on "Track B" in 1994. The tax payer objected and eventually a case was stated to the TRA.

However between the objections and the case stated the tax payer company was struck off the Companies Register and ceased to exist. Six weeks prior to this occurring, the tax payer company purported to assign its objection rights to Mr Russell.

Decision

The Authority followed its earlier decisions in the following cases: Case W5, Case W6 and Case W13 to conclude that once the company was struck off it was incapable of pursuing its objection.

As to the effectiveness of assigning the objection rights, the Authority noted that unlike Case W13 (where a similar assignment purported to occur) in this case the assignment was prior to the striking off of the company. However the Authority considered that the deed was ineffective to assign the rights for the same reasons in Case W13 (The only person who has the right to object to an assessment and to require that the objection be heard and determined by the TRA is the person who has been assessed for income tax. The objection procedure is personal to the tax payer. The tax payer's rights or obligations cannot be assigned under the revenue legislation).

NO APPEAL FROM INTERLOCUTORY RULINGS

Case:	TRA 33/00, TRA 002/2005
Decision date:	18 January 2005
Act:	Taxation Review Authority 1994
Keywords:	Interlocutory ruling, appeal

Summary

There is no right of appeal from an interlocutory ruling of the TRA.

Facts

The tax payer had been subject to a number of reassessments in its 1989 tax year which were objected to by the tax payer. The CIR did not file a case stated on the matter, having effectively allowed the objection by the last re-assessment made.

Mr Russell, for the tax payer, sought an order from the TRA to allow his objection on the basis the Commissioner had failed to allow it. The Commissioner did not oppose this but pointed out the last assessment made had allowed all the items subject to the objection, making any order sought redundant. The TRA, in a ruling, concluded it did not need to make any orders as the objection had effectively been allowed: Case V15 (2002) 20 NZTC 10,174.

The tax payer sought to appeal this Ruling.

Decision

The Authority opened the reasons for its decision saying:

> "In Case V15 I declined to grant an order allowing the relevant objection because there were no remaining issues between the parties as all the issues raised by the tax payer had been conceded by the Commissioner … it seems to me to be common sense that an objector cannot appeal a case where it has totally succeeded to such an extent that it is not even necessary to make orders in favour of the objector." [par 31]

The Authority was guided by the M & J Wetherill Co. Ltd v TRA (2004) 21 NZTC 18,924 decision of the Court of Appeal to conclude there was no right of appeal to interlocutory determinations of the Authority as these did not constitute a determination on any objection within sec 26 of the Taxation Review Authorities Act 1994. The Authority relied upon the statutory requirements of the TRA Act and did not place any weight on the fact the ruling effectively ended the litigation (although this effect was acknowledged).

As the Commissioner had conceded all the issues, there was no money at stake (therefore no right of appeal on that basis) and the Authority considered there were no questions of law capable of serious and bona fide argument.

There were no grounds to justify filing and continuing the purported appeal and it was struck out.

CHURCH SUPERANNUATION SCHEME NOT CHARITABLE

Case:	Jarod Peter Hester & Ors v CIR, CA 6/04
Decision date:	14 December 2004
Act:	Income Tax Act 1994
Keywords:	Superannuation scheme, charity

Summary

The tax payers' appeal was unsuccessful. The superannuation scheme was not exempt from tax pursuant to section CB 4(1)(c) of the Income Tax Act 1994. The correctness of the *Presbyterian Church Fund* case was doubted.

Facts

Introduction

This case was an appeal of a decision of O'Regan J reported as *Hester & Ors v CIR* (2004) 21 NZTC 18,421. In that decision the High Court held that a superannuation scheme was not exempt from income tax pursuant to s CB 4(1)(c) of the Income Tax Act 1994 (which exempts income derived by trustees for charitable purposes).

Background

The appellants are the trustees of the Church of Jesus Christ of Latter-day Saints ("the Church") Deseret Benefit Plan ("the Plan"). The Plan is a defined benefit and contributory superannuation scheme providing retirement income to employees of the Church. The appellants claimed the Plan was a "trust for charitable purposes" and therefore exempt from income tax.

The Plan is for employees of the Church. The Church does not have paid ministers, but has a system of "callings" whereby Church members perform ecclesiastical functions. The Church itself has charitable status. The salaries received by the members of the Plan related to their temporal job, not their calling.

The Church's employees were employed at the Church's Administration Centre in Takapuna, the Church Temple in Hamilton and the Church College also in Hamilton. There was also provision for admission to the Plan of an "associated employer" though none in fact had been admitted.

The Administration Centre was, during the relevant time, the centre of the overall operation of the Church's operations in New Zealand. Members of the Plan at the Administration Centre included managers, human resources staff, IT staff, secretarial and clerical staff, and accounting staff. Church College is a private secondary school which is run and financed by the Church. It teaches the national curriculum as well as providing religious education to students. All staff members (apart from one) belonged to the Church. Members of the Plan at the College include teachers, secretarial and administrative staff, and catering and security staff. The Temple is the most sacred place the Church has in New Zealand. Members of the Plan at the Temple include managers, gardeners, security guards, clerical workers, and clothing and cafeteria workers.

The High Court decision

In the High Court the appellants argued that their situation was indistinguishable from the existing case law, particularly the *Presbyterian Church Fund* case (discussed further below). The Commissioner argued that their situation was distinguishable, and the High Court agreed and found for the Commissioner. The High Court also dismissed an argument that the Commissioner was acting in a discriminatory way in relation to the Plan.

Decision

The main judgment was given by William Young J. His Honour set out the factual background to the dispute and summarised the legislation. Section CB 4(1)(c) of the Income Tax 1994 was discussed and it was concluded that the words "established exclusively for charitable purposes" did not apply to "trusts for charitable purposes".

The Judge then discussed in detail the two leading authorities: *Presbyterian Church of New Zealand Beneficiary Fund v CIR* [1994] 3 NZLR 363 and *Baptist Union of Ireland (Northern) Corporation Ltd v Commissioners of Inland Revenue* (1945) 26 TC 335 ("*Presbyterian Church Fund*" and "*Baptist Union*").

The *Baptist Union* case concerned the Baptist Union of Ireland Annuity Fund, the object of which was to provide annuities for its members and their widows and orphans. The *Presbyterian Church Fund* case dealt with a superannuation fund that was primarily for the benefit of retired ministers of the Presbyterian Church and their dependents.

William Young J noted that the arguments originally presented before the Court of Appeal were relatively narrow. The appellants sought to apply the *Presbyterian Church Fund* case while the Commissioner supported O'Regan J's decision in the High Court and did not seek to challenge the correctness of the *Presbyterian Church Fund* case. However, during the course of argument the members of the Court of Appeal became concerned whether the *Presbyterian Church Fund* case was correctly decided and invited further submissions on that point. The Commissioner then asserted that that case had been incorrectly decided while the appellants supported it.

In considering the Commissioner's submissions that the *Presbyterian Church Fund* case was wrongly decided William Young J noted that there was some strength in the Commissioner's submission that the cases where gifts for the benefit of clergy were held to be charitable involved outside bounty (including in the *Baptist Union* case). However, in the *Presbyterian Church Fund* case a very significant proportion of the funds of that superannuation scheme came from members.

William Young J concluded (at paragraphs [85] and [86]):

> It is hard to see the *Presbyterian Church Fund* as having the "altruistic" features which in the end moved MacDermott J to hold that the Baptist Union Fund was a trust for charitable purposes.
>
> On that basis, it is well open to question whether the decision of Heron J in the *Presbyterian Church Fund* was correctly decided.

The Judge then set out some history relating to the taxation of superannuation schemes and noted the long-standing view that superannuation schemes for the benefit of ministers of religion were charitable. Because of these factors the Court of Appeal declined to overrule the *Presbyterian Church Fund* case (at paragraph [93]):

> Given the history to which we have referred, the fact that the Commissioner did not appeal the *Presbyterian Church Fund* case and the extent to which it has been acted on in ways which would now be hard to unpick, we think it would be wrong to overrule the decision …

William Young J then considered whether O'Regan J was right to distinguish the *Presbyterian Church Fund* case. The appellants argued that the benefits provided to the employees under the Plan were as closely associated as the advancement of religion as in the *Presbyterian Church Fund* case. The Commissioner argued that there were many grounds of factual difference. The Judge considered some sections in the New Zealand Bill of Rights Act and the Human Rights Act noting that the appellants' submissions on discrimination had some force. It was accepted that the tax system should not operate in a way that provides preference for "mainstream churches" (a term used in the *Presbyterian Church Fund* case) and it was noted that the Court of Appeal had "given anxious consideration to whether it is possible to maintain the distinction drawn by O'Regan J between the circumstances affecting the Plan and those which applied in the *Presbyterian Church Fund* case." (at paragraph [102])

The Court of Appeal concluded that the *Presbyterian Church Fund* case should not be extended to the situation of appellants. At paragraph [106] William Young J stated:

> If the Plan is accorded charitable status, the implications are likely to be serious. Amongst the employees covered by the Plan are teachers employed by Church College. If the provision of superannuation benefits for them by means of a contributory scheme is charitable because they are working for the Church, similar plans for school teachers employed by other church schools would also be charitable. Indeed, given that the advancement of education is a charitable purpose, presumably plans for the benefit of anyone working in the education field would likewise be entitled to charitable status. Arguably the same would apply to plans for doctors and nurses and ancillary staff (whose work is addressed to relief for the "impotent") and for social workers (who work with "the poor"). Similar status would be likely to be claimed for plans associated with the many other occupations associated with public service. In that context, allowing the appeal is likely to start a ball rolling which, unchecked, would have the potential to dent the income tax system severely.

The Court of Appeal therefore found for the Commissioner on the main issue.

In relation to a secondary issue the Commissioner's argument also was considered favourably by the Court of Appeal, though it did not make a definitive finding on it. The Plan's deed allowed employees of "associated employers" to join the Plan. The Commissioner submitted that a trust that permits the application of income for purposes that are not charitable cannot, itself, be charitable. It was irrelevant that there were no associated employers in the year in question. The Court of Appeal stated at paragraph [115]:

> It is not entirely unknown for trusts to be set up for what ostensibly are charitable purposes, but for other purposes (or beneficiaries) to be able to be introduced at the will of a person associated with the trust. It would be unsatisfactory if such a trust was able to operate with the benefit of charitable status associated with the charitable purposes ostensibly provided for but then for the purposes and beneficiaries to be changed to permit distribution to or for a non-charitable purpose or beneficiary.

Hammond J also gave a short concurring judgment. His Honour noted that the *Presbyterian Church Fund* case as being "very much at the outermost limits of the existing doctrine" but noted that he "would not be minded to overrule that decision, even if it were procedurally appropriate to do so, by a side wind as it were." Hammond J concluded by stating (at paragraph [14]):

> It follows that, in my view, the scheme under consideration is well beyond the existing doctrine for an allowable religious charitable trust—it is too broadly conceived as to the persons who can come within it —and on that basis alone the present appeal should be dismissed.

TIME LIMIT FOR TAX PAYER TO ISSUE NOPA BEGINS ON FILING RETURN

Case	TRA Decision No. 31/2004
Decision date	23 December 2004
Act	Tax Administration Act 1994, sections 138H, 89K, 92, 138B, 138C, 138E(1)(e)(iv); Taxation Review Authorities Act 1994, section 13A, Taxation Review Authorities Regulations 1998, regulation 12.
Keywords	Strike out

Summary

The Tax payer filed a return intending to follow it up with a NOPA requiring that an item returned as income be deleted. It acted in the mistaken belief that the response period commenced on receipt of the notice of assessment, which is no longer issued as a matter of course under the self-assessment regime.

Due to an error, the return acknowledgment was issued to the wrong address and the NOPA was not filed with Inland Revenue until after the response period had expired. The proceedings sought to challenge the Commissioner's decision under section 89K that no exceptional circumstances existed to excuse the filing of a NOPA out of time. The Authority found it had no jurisdiction to hear the challenge.

Facts

The department applied for an order striking out the notice of claim. In essence the grounds for the application were that the notice of claim disclosed no right of challenge under Part VIIIA of the Tax Administration Act 1994. The background to the application was as follows:

The tax payer filed its 2003 return on 2 July 2003 which disclosed the receipt of the sum of $167,000 paid to the disputant by a former lessee as consideration for cancellation of a lease. The accountant who filed the return considered the receipt to be a capital sum, and made arrangements for a tax consultant to attend to the filing of a NOPA upon receipt of a notice of assessment. The department was sent a letter advising that the address of the tax payer had changed from its accountant to the tax consultant engaged to prepare the NOPA.

On 29 July 2003 the department issued a return acknowledgment form to the wrong address. This resembled a notice of assessment form, but was merely advice of the self assessment figures. The tax consultant expected this communication would be sent to him so he could prepare the NOPA, but he did not learn of it until the former accountant returned from his overseas trip.

That led to the disputant filing a NOPA on 31 October 2003, which the TRA accepted was as soon as reasonably possible after discovery by its advisers that the return acknowledgment form had been sent to the wrong address. However, that NOPA was out of time, in that it needed to have been filed by 1 September 2003, unless the department allowed an extension of that period on the basis of there being exceptional circumstances.

Decision

The TRA found that with the introduction of self-assessment, section 92 of the TAA now provides for each tax payer, not the Commissioner to make an assessment of their taxable income and income tax liability. This meant that the time for filing a NOPA commenced on the date the income tax return was filed, and not on the date the return acknowledgment form was issued by the department.

The TRA accepted that the decision under section 89K that there were no exceptional circumstances to excuse the late filing of the NOPA was not a disputable decision pursuant to section 138E(1)(e)(iv). All other decisions which the disputant alleged the Commissioner had made were merely ancillary to the decision that there were no exceptional circumstances. Alternatively, even if all other decisions were independent decisions which satisfied the decision of "disputable decision" the disputant still had no right of challenge because its NOPA did not satisfy the statutory time limits.

The TRA also found there was no right of challenge under section 138B of the TAA. It was not necessary for the department to issue a response notice as the NOPA was out of time.

Judge Barber also noted the circumstances of the disputant's failure to file the NOPA in time could arguably (but with difficulty) amount to an exceptional circumstance. He earlier observed that the question is not as clear cut against the Tax payer as the department thinks it is. However he accepted that this was a matter for the Commissioner and the Authority had no jurisdiction to hear the matter and there was no option but to grant the application.

CIR WINS NEW ZEALAND'S LARGEST TAX AVOIDANCE CASE IN HIGH COURT

Case	Accent Management Ltd, Ben Nevis Forestry Ventures Ltd, Bristol Forestry Ventures Ltd, Clive Bradbury, Greenmass Ltd, Gregory Peebles, Kenneth Laird Estate, Lexington Resources Ltd, and Redcliffe Forestry Ventures Ltd v CIR
Decision date	20 December 2004
Act	Income Tax Act 1994
Keywords	tax avoidance, commerciality of investment, depreciable intangible property, Trinity Scheme, forestry

Summary

The Trinity Scheme involves investment in a Douglas fir forest growing in Southland, entered into between March 1997 and July 2000. Under the scheme each investor (through a series of companies and a joint venture vehicle) acquired a licence to use land for forestry purposes. The duration of the licence is 50 years, which approximates one Douglas fir growing cycle.

The licence agreement gives no title to the land or the trees but gives a right to proceeds of sale of the trees after deduction of various charges, as well as various ancillary rights, eg rights to production thinnings and biomass/ pollution credits.

The investors agreed by promissory note to pay a fixed price for the licence in 50 years' time. The calculations used to fix this price were highly contentious, but were purportedly projected off an initial stumpage figure for 1997, a figure for log price growth over 50 years, and an average annual rate of inflation over 50 years. The calculations produced exponential adjustments on a year-by-year basis, and the consequent licence fee is a huge sum, being $2,050,518 per hectare. The licensee is also liable to pay the planting and maintenance expenses. The up-front fees paid (largely by promissory note) to the landowner exceeded the cost of the land.

A further aspect of the scheme for the 1997 year for Tranche 1 investors was an insurance element. The investors took out a loss of surplus insurance policy under which the insurer assumed risk for a stipulated value of the forest in the year 2048. The value (approximately $2.05 million per hectare) is sufficient to enable the investor to break even, being the amount the investors have to pay for the licence in 2047. Premiums are payable by both the investors and the landowner, with the investors paying both a cash amount in 1997 ($1,307 per hectare) and a further amount by promissory note for payment in 2047 ($32,971 per hectare). The landowner's premium is to be paid in 2047 ($410,104 to $1,230,311 per hectare, depending on the value reached).

Thus payment for the investment overall was largely on a deferred basis. Over 99% of the total expenditure claimed over the life of the investment, and 87% of the expenditure claimed for the first (1997) year is deferred until the year 2047. The two promissory notes (one to the landowner and one to the insurer) for this expenditure are limited recourse to the proceeds of forest harvest.

The investors claimed deductions for the insurance premium and forestry agency fees in full in the first year, being the year in which they were incurred. They also contended that the licence fee is deductible as depreciable intangible property under Schedule 17 of the Income Tax Act 1994. The licence fee cost is the combination of the initial payment and the amount due in year 50, which is amortised over the 50 year duration of the licence.

The Commissioner issued assessments for the 1997 and 1998 years adding back the deductions claimed in relation to the insurance premium for the 1997 year and the amortised licence premium for the 1997 and 1998 years. The Commissioner also fixed penalties in relation to the 1998 year.

Decision

The Judge held as follows on each of the issues:

Commerciality - The prospect of a positive return from the forest at maturity is unlikely but it cannot be ruled out.

Depreciation - The payment described as a licence premium is not of itself deductible pursuant to section EG(1) of the ITA.

Insurance - The insurance premiums meet the requirements of deductibility under sections BB7 and DL1(3) of the ITA and are not required to be spread under the accruals regime.

Sham - While CSI (the captive insurance company) was not in a sound financial position and Dr Muir (in particular) and Mr Bradbury had their own reasons for incorporating it and for fixing and controlling the insurance premiums to be paid to it, those factors do not of themselves support a finding of sham tax avoidance.

Tax avoidance - The dominant purpose of the arrangement was tax avoidance.

Penalties - Penalties were properly imposed under section 141D of the TAA on the basis the plaintiffs took an abusive tax position.

REGULAR FEATURES

DUE DATES REMINDER

March 2005

7 Provisional tax instalments due for people and organisations with a March balance date

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

31 GST return and payment due

April 2005

7 End of the year income tax

- **7 April 2005**

  2004 end-of-year income tax due for clients of agents with a March balance date

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

29 GST return and payment due

These dates are taken from Inland Revenue's *Smart business tax due date calendars 2004–2005 and 2005–2006*. These calendars reflect the due dates for small employers only—less than $100,0000 PAYE and SSCWT deductions per annum.

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

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

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

By internet: Visit **www.ird.govt.nz**
On the homepage, click on "Public consultation" in the right-hand navigation bar. Here you will find links to drafts presently available for comment. You can send in your comments by the internet.

Name ________________________________

Address ________________________________

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Draft standard practice statement	***Comment deadline***
☐ ED0073: Retrospective adjustments to salaries paid to shareholder-employees	11 March 2005

Draft standard practice statement	***Comment deadline***
☐ ED0074: Non-standard balance dates for managed funds and "as agent" returns	11 March 2005

Draft interpretation statement	***Comment deadline***
☐ IS0082: Interest deductibility—*Public Trustee v CIR*	31 March 2005

Draft interpretation statement	***Comment deadline***
☐ IS0057: Deductibility of business relocation costs	31 March 2005

Draft question we've been asked	***Comment deadline***
☐ QB0036: GST consequences of a cancelled contract	31 March 2005

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NEW LEGISLATION

TAXATION (VENTURE CAPITAL AND MISCELLANEOUS PROVISIONS) ACT 2004.

TAXATION (ANNUAL RATES OF INCOME TAX ACT 2004–05) ACT 2004

The Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Bill was introduced in March 2004. It received its first reading in Parliament on 7 April, its second reading on 21 October and its third reading on 14 December 2004. The two resulting Acts received Royal assent on 21 December 2004, the date of enactment.

The Taxation (Venture Capital and Miscellaneous Provisions) Act 2004 amends the following:

- Income Tax Act 2004
- Income Tax Act 1994
- Income Tax Act 1976
- Tax Administration Act 1994
- Goods and Services Tax Act 1985
- Taxation Review Authorities Act 1994
- Taxation Review Authorities Regulations 1998.

The Taxation (Annual Rates of Income Tax 2004–05) Act 2004 confirms the income tax rates for the 2004–05 income year.

Some amendments make corresponding changes to the Income Tax Act 1994 and the Income Tax Act 2004, which comes into force on 1 April 2005. When this occurs we have cited the corresponding section numbers of both Acts, to assist readers of this commentary on the new legislation.

As part of the progressive rewrite of income tax law, the Income Tax Act 2004 introduced rewritten Parts A to E of the 1994 Act and re-enacted the remaining Parts of that Act. This means the section numbers in the two Acts differ in the first five Parts, but are the same from Part F on if merely re-enacted in the 2004 Act. If, however, provisions were moved to later Parts in the course of rewriting Parts A to E, they were given new section numbers in the 2004 Act.

POLICY ISSUES

NEW RULES FOR INTERNATIONAL VENTURE CAPITAL

Section CB 2(1) and CB 2(4) of the Income Tax Act 1994 and section CW 11B of the Income Tax Act 2004

Introduction

Amendments to the Income Tax Act remove a tax barrier to unlisted New Zealand companies gaining access to offshore private equity and venture capital. The changes target non-resident institutional investors such as foreign pension funds that are tax-exempt in their own jurisdictions and are established or resident in a number of approved countries. Tax-exempt institutional investors, such as foreign pension funds, account for a substantial proportion of international venture capital. These changes are similar to those enacted in Australia in 2001.

Background

The term "venture capital" is used typically to describe a variety of private equity investments, from funding of new companies and early stage expansion capital to management buy-in and buy-out transactions for established companies. As a rule, venture capital investment concerns investments into unlisted companies.

Before the amendments, there were no special tax rules for venture capital investment. Therefore a venture capital investor that purchased shares in an unlisted New Zealand company would be taxed on any gains according to ordinary tax concepts.

Under these principles, dividends are taxed as gross income when they are derived, and profits derived on the sale of shares are taxed if the shares are held on revenue account. Broadly, shares are held on revenue account if they are purchased with the dominant purpose of resale, or if the profits from sale form part of the investor's business income.

The application of these rules to non-resident investors is subject to the provisions of a double tax agreement (DTA) if the non-resident is resident in a country with which New Zealand has a DTA. In the context of venture capital investment, our DTAs will not generally remove New Zealand's ability to tax revenue account share profits. In other words, before these amendments, non-resident venture capital investors investing in New Zealand would be taxed on realised share profits if they held the shares on revenue account.

The nature of venture capital investing, combined with the capital/revenue distinction, resulted in complexity and uncertainty for non-residents contemplating venture capital investment in New Zealand.

The new rules target non-resident venture capital investors established or resident in an approved country that are sensitive to the imposition of New Zealand tax. Non-resident investors will generally be sensitive to such tax if they are tax-exempt in their own jurisdiction, since their tax-exempt status will mean that they will not be able to claim, or make use of, a credit for New Zealand tax paid. In the venture capital context this is an important issue because a number of institutional investors that invest in venture capital internationally, such as United States pension funds, are tax-exempt in their home jurisdiction.

The new rules use the availability of a tax credit (or other similar compensation) for New Zealand tax paid as a proxy for whether an entity is sensitive to the imposition of New Zealand tax. This should ensure that foreign tax-exempt institutional investors can qualify for the exemption.

It is very common for tax-exempt institutional investors to invest in venture capital opportunities via a foreign fund. In a venture capital context, foreign funds pool capital from a number of different investors and invest the capital in a number of different local fund managers. Therefore, to be effective, the new rules also accommodate such foreign funds.

In addition, the tax rule that limited the ability of special partners in a special partnership to offset special partnership tax losses against their other income has been repealed. This is designed to facilitate New Zealand resident investors investing alongside non-resident investors in venture capital through a special partnership.

Key features

The main provisions giving effect to the new venture capital tax rules are contained in section CB 2(1)(g) and section CB 2(4) of the Income Tax Act 1994 and section CW 11B of the 2004 Act. The main features of the new provisions are as follows:

- Profits derived by a qualifying foreign equity investor (QFEI) on the sale of shares in unlisted New Zealand resident companies that do not engage in certain prohibited activities are exempt from income tax.
- A QFEI can either be a direct non-resident investor, an investor in a foreign "flow-through" limited partnership or a foreign "flow-through" entity.
- To qualify as a direct QFEI the non-resident must satisfy the following main criteria:
  - The person must be resident in a country with which New Zealand has a DTA (excluding Switzerland).
  - The person must be unable to benefit from a tax credit in its own jurisdiction for any tax that New Zealand would have imposed if it were not for the exemption.
- For a person to qualify as a QFEI in a foreign limited liability partnership the partnership must satisfy the following main criteria:
  - The partnership must be established under the laws of a country with which New Zealand has a DTA (excluding Switzerland).
  - The partnership must have at least one limited partner.
  - The general partner of the partnership must be resident in a country with which New Zealand has a DTA (excluding Switzerland).
  - All partners with a greater than ten percent interest in the partnership must be:
    - resident in country with which New Zealand has a DTA (excluding Switzerland); and
    - unable to benefit from a tax credit in their own jurisdiction for any tax that New Zealand would have imposed if it were not for the exemption.
- For a foreign flow-through entity to qualify as a QFEI it must meet the following main criteria:
  - The entity must be established under the laws of a country with which New Zealand has a DTA (excluding Switzerland).
  - All members with a greater than ten percent interest in the entity must be:
    - resident in country with which New Zealand has a DTA (excluding Switzerland); and
    - unable to benefit from a tax credit in their own jurisdiction for any tax that New Zealand would have imposed if it were not for the exemption.
- Section HC 1 has been repealed. This provision prohibited the partners of special partnerships from offsetting special partnership tax losses against their other income.

Detailed analysis

The venture capital exemption is provided by the addition of new paragraphs (g) and (h) to section CB 2(1) of the Income Tax Act 1994 and the addition of CW 11B(1) to the 2004 Act. These provisions provide that the proceeds from the sale of shares by an eligible investor in certain unlisted New Zealand companies will be exempt from income tax if a number of criteria are met. The rules for determining which non-resident investors qualify are contained in the definition of "qualifying foreign equity investor" (QFEI) in section CB 2(4) of the 1994 Act and section CW 11B(4) of the 2004 Act. The new provisions do not change the current treatment of dividends that non-residents derive from the underlying companies.

Concept of eligible investment

New paragraphs (g) and (h) of section CB 2(1) and section CW 11B(1) list the criteria under which an amount may qualify as "non-residents' exempt income". Broadly, to be exempt, an amount must be derived by a QFEI from the sale of shares in an unlisted New Zealand resident company that does not have as a main activity one of the listed prohibited activities.

Venture capital investment can be made directly into a particular unlisted company (by purchasing shares directly in that company) or indirectly (by purchasing shares in a holding company that on-invests into the particular unlisted company). The new venture capital rules contemplate both scenarios. Section CB 2(1)(g) and section CW 11B(1)-(2) concern direct investment, while section CB 2(1)(h) and section CW 11B(1) and (3) concern indirect investment via a holding company.

Under both paragraphs, a number of criteria must be met in order for the investment to qualify for the exemption. Several of the criteria under each paragraph are very similar or the same — the main, common criteria will be discussed first. The criteria that are specific to investment directly and via a holding company will then be discussed.

Common criteria

Applies to shares and options to purchase shares

The exemptions in section CB 2(1)(g) and section CB 2(1)(h) of the 1994 Act and sections CW 11B(1) of the 2004 Act are limited to the sale of a share or an option to buy a share. The exemption is limited to shares and options to buy shares because a key characteristic of venture capital investment is that the venture capital investor's return is connected directly with the performance of the company into which the investment is made. This is why a debt investment is not included in the exemption.

The current definition of "share" in section OB 1(a) encompasses investments that have both debt and equity characteristics. That is, in subparagraph (ii) of section OB 1(a) a debenture to which section FC 1 applies is included in the definition of "share". A debenture of this type is one where the interest payable is determined by reference to the dividends payable or the company's profits. As the return from such a debenture is linked directly to the performance of the company, it is appropriate that such an investment is included in the new venture capital rules.

This definition would not encompass a share option because a share option is not a direct "interest in the capital of a company". However, the economic substance of a share option (the option to purchase shares in a company at a given price at some time in the future) is clearly akin to an equity interest in that company. Therefore the sale and purchase of an option to buy a share is included in the new rules (section CB 2(1)(g); section CB 2(1)(g)(i); section CB 2(1)(h); section CB 2(1)(h)(i) of the 1994 Act and section CW 11B(1)(b) of the 2004 Act).

The purchase of a note that is convertible into shares is also encompassed by the exemption, provided that the conversion occurs before the sale is made (section CB 2(1)(g)(i); section CB 2(1)(h)(i) of the 1994 Act and section CW 11B(1)(b) of the 2004 Act). This is consistent with the Australian approach and provides further flexibility when investing in venture capital.

Investments held for at least 12 months

To qualify for the exemption, a QFEI must have purchased the share, share option or convertible note at least 12 months before the share or share option is sold (section CB 2(1)(g)(i); section CB 2(1)(h)(i) of the 1994 Act and section CW 11B(1)(b) of the 2004 Act). This requirement is designed to ensure that the investment is genuinely venture capital in nature. That is, one of the key factors that distinguish venture capital from other types of investment is that the stock is generally held for the medium to long term. (For this reason venture capital is often referred to as "patient equity".)

Direct investment

Listing requirements

To qualify for the exemption, the shares purchased by the QFEI must either be unlisted on a "recognised exchange" at the time of purchase or, if they are listed at the time of purchase, they are de-listed at some stage within a year following the purchase (section CB 2(1)(g)(iii)(A), (B) of the 1994 Act and section CW 11B(1)(d) of the 2004 Act). A recognised exchange is defined in section OB 1. Broadly, it can be described as an exchange market established in New Zealand or anywhere else in the world that exhibits certain criteria that are likely to produce genuine market values for the stock that is traded.

Main activity cannot be a prohibited activity

To qualify for the exemption, the company into which the investment is made cannot, for the entire period of the investment, carry on as its main activity any of the activities listed in section CB 2(1)(g)(iv)(A)-(H) of the 1994 Act and section CW 11B(2)(a)-(h) of the 2004 Act). The prohibited activities include land development and ownership and the provision of financial services.

Investment into holding companies

Section CB 2(1)(h) of the 1994 Act and section CW 11B(3) of the 2004 Act ensure that a venture capital investment made via a company that on-invests (the holding company) into the ultimate investee company can still qualify for the exemption. The provisions are designed to ensure a level of commercial flexibility when making venture capital investment.

In a private equity context, holding companies typically engage as their main activity in the provision of funding to the ultimate investee companies. Given this main function, it is likely that an investment into such a holding company would not qualify under section CB 2(1)(g). This is because the holding company would probably be considered to have as a main activity the provision of financial services or investing passively. (Both are prohibited activities under section CB 2(1)(g)(iv)(D) and (H) and section CW 11B(2)(a) to (h).) Section CB 2(1)(h) and section CW 11B(3) overcome this problem by providing that an investment into a holding company can qualify, provided a number of criteria are met. (These criteria are additional to the criteria that are common to direct investment and investment into a holding company that are discussed above.)

Listing requirements

To qualify for the exemption, there must be some time during the 12 months following purchase of the investment when the shares of the holding company that is invested into are not listed on the official list of a recognised exchange (section CB 2(1)(h)(iii) of the 1994 Act and section CW 11B(1)(d) of the 2004 Act). This is the same criterion as for direct investment.

In addition, there is a requirement that the companies that the holding company invests into (both New Zealand resident and non-resident companies) not be listed on a recognised exchange at some time during the period of the investment in the holding company. There is also a requirement that there be at least one point in time during the period of the investment when each of the ultimate investee companies and the holding company is not listed on a recognised exchange (section CB 2(h)(vii) and section CW 11B(3)(c)).

Activity of holding company

The holding company must have as its main activity the provision of capital, either as debt or equity, to other companies (section CB 2(1)(h)(iv) and section CW 11B(3)).

Activities of New Zealand resident companies invested into

The New Zealand resident companies that the holding company invests into do not have as their main activity any of the prohibited activities that apply to direct investments, unless the activity is the provision of financial services or passive investment (section CB 2(1)(h)(v)(A) and section CW 11B(3)(a)(i)). This is to ensure that if the holding company investment route is taken, the companies that ultimately receive the benefit of the investment are in the same category as those that are targeted by the direct investment exemption.

The exception that is provided for New Zealand resident companies invested into that provide financial services or engage in passive activities is designed to accommodate an investment by a holding company into another holding company (second-tier holding company). This explains why there is a requirement that the second-tier holding company cannot have as a main activity the provision of financial services or passive investment activity unless the activity is the provision of capital to other companies (section CB 2(1)(h)(v)(B) and section CW 11B(3)(a)(ii)).

The rules have also been designed to accommodate chains of New Zealand resident holding companies. This is achieved by allowing the second-tier holding company to provide capital to companies that are similar in nature to the second-tier holding company (third-tier holding companies) or are the target investee companies (section CB 2(1)(h)(v)(C) and (D) and section CW 11B(3)(a)(iii) and (iv)). The inclusion of the words "directly or indirectly" in these provisions is designed to ensure that multiple tiers of holding companies are accommodated by the rules.

Activities of non-New Zealand resident companies invested into

A non-New Zealand resident company cannot provide capital to a New Zealand resident company, either directly or indirectly, that has as a main activity any of the prohibited activities listed in section CB 2(1)(g)(iv)(A) to (H), section CB 2(1)(h)(vi), section CW 11B(2)(a)-(h) and section CW 11B(3)(b)). This rule is designed to ensure that the new rules cannot be used to direct investment into ineligible activities via an offshore holding company.

Concept of eligible investor

The automatic venture capital exemption in paragraphs (g) and (h) of section CB 2(1) and section CW 11B(1) is available only to certain non-resident investors. A qualifying investor is defined as a "qualifying foreign equity investor" (QFEI), of which there are three categories (section CB 2(4) and section CW 11B(4)). The first category targets non-residents that invest directly into New Zealand venture capital opportunities, while the other two categories target indirect investment via foreign limited liability partnerships and foreign flow-through entities.

Investment directly into New Zealand

This category is aimed at non-resident venture capital investors that provide the capital to the ultimate investee company directly. The rules that determine whether a person qualifies as a QFEI under this category are contained in section CB 2(4)(a) and the definition of "foreign exempt person" in section CW 11B(4). The main criteria that must be satisfied in order to qualify under this category are discussed below.

Resident in an approved country

To qualify as a QFEI under this category, the person must be non-New Zealand resident and resident in a country that is approved for the purpose of the definition of QFEI (section CB 2(4)(a)(i) and section CW 11B(4), paragraph (a) of the definition of "foreign exempt person"). With the exception of Switzerland, this list contains all countries with which New Zealand currently has a DTA in force. These countries are:

- Australia
- Belgium
- Canada
- China
- Denmark
- Fiji
- Finland
- France
- Germany
- India
- Indonesia
- Ireland
- Italy
- Japan
- Korea
- Malaysia
- Netherlands
- Norway
- Philippines
- Russia
- Singapore
- South Africa
- Sweden
- Taiwan[1]
- Thailand
- United Arab Emirates
- United Kingdom
- United States of America

The new rules in section CB 2(7) and section CW 11B(6) contain the provisions for including and withdrawing countries. This list is amendable by Order in Council.

The presence of a DTA will allow Inland Revenue to invoke the exchange-of-information Article of the DTA in order to receive information on particular investors and transactions. This will assist in the administration of the new rules.

To be included on the list it is necessary for the DTA country to engage in effective exchange-of-information. For this reason Switzerland is not included on the list. It is recognised that effective information exchange agreements may be negotiated in the future outside the context of a full DTA. If this occurs there may be some scope to extend the list of eligible countries beyond those with which there is a DTA.

Inability to make use of a credit for New Zealand tax paid

To qualify for the exemption, the non-resident investor must be unable to claim a tax credit or other compensation for any income tax that New Zealand tax laws may, but for the exemption in the new section CB 2(1)(g) and (h) and section CW 11B(1), have levied on the income (section CB 2(4)(a)(v) and section CW 11B(4), paragraph (e) of the definition of "foreign exempt person"). This inability must result from the investor's special status under the tax laws of its home jurisdiction. The formulation targets investors that are tax-exempt in their own jurisdiction owing to their special status under the tax laws there, rather than their particular circumstances at any point in time. For example, a non-resident that is unable to utilise a credit because it is in a tax loss position for the year would not qualify as a QFEI.

The inability to make use of a credit cannot arise from flow-through status

The non-resident must also be treated by the tax laws of the country in which it is resident as the person who derives the proceeds from the sale of the shares (section CB 2(4)(iv) and section CW 11B(4), paragraph (d) of the definition of "foreign exempt person"). This is designed to exclude from this category of QFEI foreign vehicles that are treated by the tax laws of their countries as flow-through for tax purpose. Broadly, a flow-through vehicle is not taxed as an entity. Instead the income flows through to the vehicle's investors and is taxed according to those investors' individual tax status.

If foreign flow-through vehicles were not excluded from this category of QFEI it would be possible that such vehicles that New Zealand may treat as being resident in an approved country would qualify under this

[1] Under our "One China" policy, Taiwan is not recognised as a sovereign state. Therefore this DTA was entered into as an agreement between the New Zealand Commerce and Industry Office and the Taipei Economic and Cultural Office in New Zealand

category. This is because such vehicles could maintain successfully that the fact that they are not taxed as an entity automatically means that they are unable to benefit from a credit for New Zealand tax that would otherwise be imposed. This would not necessarily be the correct result because the determination of whether a foreign flow-through vehicle should benefit from the exemption should depend on whether the main investors in the vehicle can benefit from a tax credit for any New Zealand tax imposed. The rules concerning the other two categories of QFEI (paragraphs (b) and (c) of section CB 2(4) and paragraphs and section CW 11B(4) ("foreign exempt partnership" and "foreign exempt entity") have been designed to ensure that this determination is made appropriately.

Foreign limited liability partnerships

This category of QFEI is designed to accommodate non-resident venture capital investors in foreign limited liability partnerships (FLLPs) that New Zealand treats as transparent for tax purposes. In this context "transparent" means that, instead of taxing the foreign vehicle as an entity, New Zealand tax rules would tax the investors in the vehicle directly, based on their interest in the vehicle. The rules are designed to provide the exemption to the non-resident person investing in the vehicle, provided that the vehicle meets a number of criteria. The rules are contained in section CB 2(4)(b) and the definition of "foreign exempt partnership" in section CW 11B(4), and the main criteria are discussed below.

Established under the laws of an approved country

To qualify as a QFEI under this category, the non-resident person must be an investor in an unincorporated body that is established under the laws of an approved country (section CB 2(4)(b)(i) and section CW 11B(4), paragraph (a) of the definition of "foreign exempt partnership"). It is also necessary to accommodate FLLPs that are established under these State laws of an approved country. This is because in a number of countries that have federal systems, it is a particular state law rather than the federal law that establish these vehicles. Therefore the subparagraphs also provide for bodies that are "established under the laws of part of such a territory".

Must have the main characteristics of a limited partnership

The unincorporated body must exhibit the main characteristics of a limited partnership (section CB 2(4)(b)(ii)-(v) and section CW 11B(4), paragraphs (b)-(e) of the definition of "foreign exempt partnership"). Therefore the body must be one that:

- consists of persons (section CB 2(4)(b)(ii) and section CW 11B(4), paragraph (b) of the definition of "foreign exempt partnership");
- is treated by the tax rules of the other country as flow-through body (section CB 2(4)(b)(iii) and section CW 11B(4), paragraph (c) of the definition of "foreign exempt partnership");
- has at least one general partner who is involved in the running of the body, has a controlling interest in the body and is liable for all the debts of the body (section CB 2(4)(b)(iv) and section CW 11B(4), paragraph (d) of the definition of "foreign exempt partnership"); and
- has at least one limited partner who has a limited involvement in the running of the body, does not control the body and has limited liability for the debts of the body (section CB 2(4)(b)(v) and section CW 11B(4), paragraph (e) of the definition of "foreign exempt partnership").

General partners resident in approved territory

The unincorporated body's general partners must all be resident in an approved territory (section CB 2(4)(b)(vi) and section CW 11B(4), paragraph (f) of the definition of "foreign exempt partnership"). The general partners are the people in the body that are responsible for the business activities of the body. Therefore it is likely that they will have access to the necessary information concerning investors and investments. Requiring general partners to be resident in an approved country (that is also a country with which New Zealand has a DTA with an effective exchange-of-information Article) should ensure that Inland Revenue is able to administer the rules effectively.

Substantial investors are resident in an approved territory

To qualify as a QFEI under this category, the non-resident person must be an investor in an unincorporated body where all the investors that own ten percent or more of the capital of the body are resident in an approved territory (section CB 2(4)(b)(vii) and section CW 11B(4), paragraph (g) of the definition of "foreign exempt partnership"). This provision will ensure that the significant investors in the body are resident in a country with which New Zealand has a DTA with an effective exchange-of-information Article. This should ensure that Inland Revenue is able to administer the rules effectively.

Substantial investors in the body are not able to benefit from a tax credit

To qualify as a QFEI under this category, the non-resident person must be an investor in an unincorporated body where all the investors that own ten percent or more of the capital of the body are unable to benefit from a tax credit for New Zealand tax that would, in the absence of the exemption, be payable (section CB 2(4)(b)(viii) and section CW 11B(4), paragraph (h) of the definition of "foreign exempt partnership"). This criterion is designed to ensure that the main ultimate investors are sensitive to the imposition of New Zealand tax.

Foreign flow-through entities

This category of QFEI is designed to accommodate non-resident venture capital investors that invest through a foreign flow-through entity that is established as a separate legal entity in the country in which it has been established. The criteria that will determine whether the foreign flow-through entity will qualify as a QFEI under this category are very similar to those that apply to the FLLP category. The following explains the main qualification criteria for foreign flow-through entities where they are different from the FLLP QFEI category. (The rules are contained in section CB 2(4)(c) and the definition of "foreign exempt entity" in section CW 11B(4).)

Established as a legal entity under the laws of an approved country

To qualify under this category, the foreign hybrid must be established as a legal entity under the federal or state laws of the country in which it is established and must be established under the laws of an approved country (section CB 2(4)(c)(i) and section CW 11B(4), paragraph (a) of the definition of "foreign exempt entity").

Membership

The foreign flow-through entity must have members that hold interests in the capital of the entity and are entitled to shares of the entity's income (section CB 2(4)(c)(ii) and section CW 11B(4), paragraph (b) of the definition of "foreign exempt entity"). In order to ensure commercial flexibility and accommodate current structures, it is not necessary that the members' entitlement to income is in direct proportion to their interest in the capital of the entity.

Not resident in a country that taxes the foreign hybrid as an entity

To qualify under this category, the foreign flow-through entity cannot be resident in a country that has laws that tax the foreign flow-through entity as an entity on its income (section CB 2(4)(c)(iii) and section CW 11B(4), paragraph (d) of the definition of "foreign exempt entity"). This provision ensures that a foreign flow-through entity that is taxed as an entity in the country in which it may be resident for tax purposes does not qualify for the exemption. Such entities should not qualify because their taxable status in their country of residence will make it unlikely that they are sensitive to the imposition of New Zealand tax.

Tax treatment of venture capital not covered by the exemption

The new tax rules for venture capital are not intended to affect the current tax treatment of venture capital investment that is not covered by the new exemptions. Under the current tax rules, profits from the sale of shares will be taxable only if, broadly, the shares were purchased with the dominant purpose of resale or the profits form part of the investor's business income. The new exemption is designed to remove a risk that certain foreign investors could be caught by these rules. In this sense the new rules should be viewed as a "safe harbour" for the investments of a certain category of non-resident investors.

Application date

The new venture capital rules apply from 1 April 2004.

Special partnerships

The preferred method of venture capital investment internationally is through the use of limited liability vehicles that are "flow-through" for tax purposes. This means that any income of the entity is borne by the partners and not taxed at the entity level.

To properly facilitate the flow of international venture capital into New Zealand it is necessary to ensure that the special partnership rules that provide limited liability and flow-through treatment properly reflect the way international venture capital is carried out. Section HC 1 has been repealed to remove a tax barrier to the operation of the special partnership rules. Section HC 1 is the provision that prevented special partners of a special partnership from offsetting their special partnership tax losses against their other income.

The rule was introduced to counter a number of aggressive tax schemes that occurred in the 1980s. It has been repealed because the deferred deduction rules (contained in sections ES 1 to ES 3 and sections GC 29 to GS 31) should provide the necessary protection against abusive tax schemes. The removal of section HC 1 will be helpful for venture capital investment into New Zealand because it will remove a barrier to local entities investing alongside international venture capital investors.

Application date

The repeal of section HC 1 applies to special partnership gross income and allowable deductions for the 2004–05 and subsequent income years.

AUSTRALIAN UNIT TRUSTS

Sections CF 2(1)(i), CF 2(6)(a), CF 3(2)(c)(ii), CF 8(a), DJ 11B and OB 1 of the Income Tax Act 1994 and sections CD 7B, CD 7C, CD 21B, DB 44 and OB 1 of the Income Tax Act 2004

Introduction

An issue of units in an offshore unit trust when there is an arrangement to issue the units instead of vesting money or property absolutely in the unit holder will be treated as a taxable bonus issue. Amendments also clarify that an amount that vests absolutely in a unit holder of an offshore unit trust is treated as a taxable dividend. The changes close a loophole that allowed certain New Zealand investments in Australian unit trusts to be tax-free.

Background

An opportunity existed for New Zealand resident investors to use Australian unit trust (AUT) structures to reduce or eliminate tax on certain investment income. This problem gave rise to a significant tax base maintenance concern and provided an incentive for New Zealand residents to use AUT structures rather than New Zealand vehicles when making certain investments.

Income earned by non-Australian residents through an AUT that is not sourced in Australia is not subject to Australian tax if it is distributed in the same year that it is earned. Previously, this income could also escape New Zealand tax if it was distributed by way of a non-taxable bonus issue of new units in the AUT. The amendment was introduced by Supplementary Order Paper number 210 on 11 May 2004.

Key features

- The amendments treat as a taxable bonus issue an issue of units in an offshore unit trust where there is an arrangement to issue the units instead of vesting money or property absolutely in the unit holder (sections OB 1 of the 1994 Act and CD 7C of the 2004 Act).
- An amendment also clarifies that an amount vesting absolutely in a unit holder of an offshore unit trust is treated as a taxable dividend (section OB 1 of both Acts and sections CF 2(1) (i) of the 1994 Act and CD 7B of the 2004 Act).
- The application of the change is limited to offshore unit trusts (various sections).
- An amendment also ensures that companies deriving exempt offshore dividends can claim an appropriate deduction for expenses incurred (sections DJ 11B of the 1994 Act and DB 44 of the 2004 Act).

Application date

The amendments apply to amounts vested and units issued on or after the date the Act came into force, 21 December 2004.

Detailed analysis

The problem dealt with by the amendments

When applicable, New Zealand's international tax rules tax offshore equity investments comprehensively. An exemption exists, however, for investments in countries that have a similar tax system to New Zealand's. These countries are known as "grey list" countries, and Australia is included on this list. For many investors this means that they are taxed only on a distribution of dividends derived from these offshore entities.

Under New Zealand tax law investments in unit trusts, including offshore unit trusts, are treated as investments in a company. Trust law still applies to these investments such that if the trustee of a trust vests funds absolutely in a beneficiary, the beneficiary has an absolute beneficial interest in those funds. The dividend tax rules applicable to companies treat amounts that are distributed from a company to a shareholder as a taxable dividend. Therefore, given that a unit trust is treated as a company, and the beneficiary of the unit trust gains an absolute beneficial interest in an amount, the absolute vesting of that amount in a beneficiary was, before the amendment was made, probably already treated as a dividend for tax purposes.

Previously, however, an amount that would otherwise be treated as a dividend could, in certain circumstances, be non-taxable if it was distributed by way of a "bonus issue" of new units rather than cash. Section OB 1 defines a "bonus issue" as, essentially, the issue by a company to a shareholder of new shares in a situation where the company does not receive consideration for the issue. If the shareholder pays for the new units this is not a "bonus issue".

The problem with the rules as they were was that a unit holder could, when units of a particular class were purchased, agree that future amounts that the trustee or the trust deed vested absolutely in them were to be reinvested in new units rather than distributed in cash. If such an agreement was made it would appear that, before the amendment, the reinvestment of the amount was not consideration provided by the unit holder to the unit trust. This means that the unit trust could issue new units that were treated as "bonus issues". These could then be treated as non-taxable bonus issues.

This is clearly the wrong result from a policy perspective. The amounts which vest absolutely in the beneficiary are economically equivalent to a dividend and should, therefore, be treated equivalently. The fact that the shareholder has chosen to have the amount reinvested in a new unit should not alter the dividend character of the amount that vests absolutely.

Examples of structures that caused particular concern are those that invested back into New Zealand government stock. This is problematic because, if the New Zealand resident had invested in the government stock directly rather than through the AUT, full New Zealand tax would have been paid on the interest income.

The solution

Amendments to definition of taxable bonus issue (section OB 1 and section CD 7C of the 2004 Act)

The main amendment is to the definition of "taxable bonus issue" in section OB 1 and the definition of dividend in section CD 7C of the 2004 Act. The amendment provides that an issue of units in an offshore unit trust that are made as part of an arrangement when units are issued instead of the unit trust vesting money or property absolutely in the unit holder is a taxable bonus issue. This ensures that unit holders in offshore unit trusts cannot, essentially, agree to have distributions reinvested in new units in order to escape dividend taxation.

Amendments to dividend definition (sections CF 2(1)(i) of the 1994 Act and CD 7B of the 2004 Act))

Section CF 2(1)(i) has been amended and new section CD 7B inserted, to put beyond doubt that amounts distributed by an offshore unit trust that vest absolutely in the unit holder are treated as taxable dividends.

While it is almost certain that an amount that vests absolutely in a beneficiary is already treated as a dividend under sections CF 2(1)(a) of the 1994 Act and CD 3(1) and CD 4(1) of the 2004 Act, this amendment puts the issue beyond doubt. For the amendments to deal effectively with AUT structures it is vital that a vesting from a unit trust is treated as a dividend. If it could be argued that such a vesting was not treated as a dividend, the AUT structures could still provide an opportunity for New Zealand resident investors to minimise or eliminate tax on their investments.

This could be achieved by the AUT vesting an amount of income absolutely in the New Zealand resident beneficiary. This would result in the income not being taxed in Australia and, if the amount that was vested was not a dividend for New Zealand tax purposes, the amount would not be taxed in New Zealand. It would not be necessary for the vesting to be accompanied by the issue of a new unit. The vested amount would simply be reflected in a higher value for existing units. If the New Zealand resident beneficiary held such units on capital account, this additional value could be realised as a tax-free capital gain when the unit was eventually sold.

Expenditure derived by a company in deriving exempt dividends

The problem that arose in the AUT investment context is that, as a result of the amendments, the treatment of certain bonus issues of units from unit trusts have changed from non-taxable in nature to taxable dividends. For a company that holds units in such a unit trust, this will result in the issue of those units being treated as exempt dividends under section CB 10(1) of the 1994 Act and section CW 9(1) of the 2004 Act and, therefore, subject to a dividend withholding payment (DWP) deduction of 33%. Expenditure incurred by the New Zealand resident company in deriving the exempt dividends is not likely to be tax-deductible, in the absence of the current amendment, as the expenditure would have been incurred to derive exempt income (section BD 2(2)(b) of the 1994 Act and section DA 2(3) of the 2004 Act). The problem has existed for some time and was on the government's tax policy work programme.

From a policy perspective a full deduction should be allowed when the income is fully subject to either New Zealand income tax or DWP. However, if a New Zealand resident company derives a dividend from a non-resident company, situations can arise where the dividend is not subject to full New Zealand tax or full DWP. Allowing a full deduction in these situations would give rise to an inappropriate result.

The amendment solves this problem by, essentially, providing that a deduction be allowed for expenditure incurred by a company deriving dividends that are exempt under section CB 10(1) of the 1994 Act and section CW 9(1) of the 2004 Act to the extent that DWP on the dividends is not relieved by the conduit tax rules (new section DJ 11B of the 1994 Act and section DB 44 of the 2004 Act).

HORTICULTURAL PLANTS – REPLACEMENT PLANTS AND ECONOMIC AMORTISATION RATES

Sections CG 11(7), DO 4, DO 4B, DO 4C, DO 4D, DO 8(c), FD 10(3)(b), OB 1 and Schedule 7, Part A, item 12 of the Income Tax Act 1994

Sections DO 4, DO 4B, DO 4C, DO 4D, DO 4E, DO 5, DV 13, OB 1 and Schedule 7, Part A, item 8 of the Income Tax Act 2004

Sections 44C and 91AAB of the Tax Administration Act 1994

Introduction

Under amendments to the Income Tax Acts 1994 and 2004 and the Tax Administration Act 1994, the Commissioner of Inland Revenue will be able make determinations to list various types of plants and provide specific amortisation rates that reflect the estimated useful life of each type listed.

When the Commissioner sets a particular rate for a type of plant, that rate will apply instead of a default rate for plants that are not of a type listed. The amortisation rate set by the Commissioner for a plant will be based on the estimated useful life of the plant.

The plants listed by the Commissioner also qualify under rules that allow immediate deductions for a limited proportion of replacement planting. The rules for replacement plants are designed to give certainty in law but flexibility for managing plantations.

The amendments apply from the 2003–04 income year but, in practice, come into effect in accordance with the Commissioner's determinations.

Background

An immediate deduction for plants was previously allowed by the Commissioner only for the replacement of a small number of dead or destroyed plants of the same species and variety. As such, the scope of what was considered a repair to or maintenance of a plant extended to include a limited amount of replacement planting in addition to other repair and maintenance activities such as pruning — though a significant limitation was that, to be deductible, replacements had to be made on a like-for-like plant basis.

If a plant is replaced to repair or maintain its productive contribution to a business, the most commercially appropriate plant should be used. Ideally, the replacement plant should not be limited to the same type of plant as that replaced but should be of a type that represents the best choice for the business — this might be an improved or different type of plant. Other considerations include the number of plants that would be economic to replace at a time. In some cases it is desirable to replace whole rows of plants or an area of plants for reasons including the control of disease, to provide consistent growing conditions or simply to make use of the same type of plants being planted elsewhere on the same orchard or in the same horticultural business.

These concerns were raised by the New Zealand Fruitgrowers Federation, who sought a more certain legal position to provide more flexibility to manage replanting activities, particularly so that using the most commercially desirable varieties would not produce different tax effects when that meant a different plant would be used.

Key features

Who do the rules apply to?

In most cases the rules will apply to commercial horticultural growers like orchardists, though the rules are cast in broader terms to apply to a person who carries on a horticultural business on land developed for that purpose.

What do the rules relate to?

The rules relate to expenditure on the development of land by planting horticultural plants — typically this will be an orchard.

Expenditure incurred from planting the kinds of plants listed by the Commissioner must be amortised at the rates determined by the Commissioner, based on the estimated useful life of those plants. An exception is provided so that some expenditure incurred in planting may be deducted in the year it is incurred if the plants are replacement plants. In either case this is the treatment for "listed horticultural plants".

Expenditure incurred from planting plants that are not listed by the Commissioner is deducted under a rule provided for "non-listed horticultural plants". It retains the same treatment that was previously provided for vines and trees and operates as a kind of default rule for horticultural plants not listed by the Commissioner.

Amortising planting expenditure

Under section DO 4C of the Income Tax Act 1994 and section DO 4B of the Income Tax Act 2004, expenditure on planting listed horticultural plants must be amortised at the rates determined by the Commissioner under section 91AAB of the Tax Administration Act 1994, unless it is deducted in relation to planting replacement plants under section DO 4D of the 1994 Act or section DO 4C of the 2004 Act.

Non-listed horticultural plant expenditure must be amortised at the 12 percent rate provided under section DO 4 and item 12 in Part A of Schedule 7 of the 1994 Act or section DO 4 and item 8 in Part A of Schedule 7 of the 2004 Act.

Deducting replacement planting expenditure

Section DO 4D of the 1994 Act and section DO 4C of the 2004 Act allow a limited amount of replacement planting expenditure to be fully deducted in the year it is incurred. These deductions are limited to a maximum of 15% of an orchard being replaced over a three-year period. Allowing some replacement planting expenditure to be deducted is comparable to the treatment of repair and maintenance expenditure such as for pruning plants. Within a three-year period, replacements in any one year may be deducted in that year in relation to up to 7.5% of an orchard. Thus if 7.5% of an orchard is replaced and immediately deducted in each of the first two years of a three-year period, no replacement planting can be deducted in the third year of that period.

These rules are based on allowing up to 5% of an orchard on average to be replaced and deducted in a year. Any other replacements must be capitalised and amortised using the rates set by the Commissioner.

For example, 4% of an orchard could be replaced and deducted under this rule for the current year when in the preceding year 7.5% and the year prior to that 3.5% of the orchard was replaced and deducted. Replacement planting of more than 4% of the orchard in the current year would have to be amortised.

The proportion of the orchard replaced is measured by reference to the land affected by replacement planting activities. Changing the density at which plants are planted should not affect the extent to which a deduction is allowed for replacement plantings.

Writing off planting expenditure

A plant that is not replaced with a plant for which an immediate deduction is taken can be written off by deducting its book value when it ceases to exist or to be used as part of a business to derive income (section DO 4C(5) and section DO 4B(6)).

However, if a plant is replaced with a replacement plant for which an immediate deduction is taken, the plant cannot be written off because it is, in effect, treated as repairing and maintaining an existing plant. For tax purposes, the new plant is treated as a continuation of the old plant. Thus the book value of the old plant can be allocated to the new plants or any other plants, such as those in the same block. The rules leave it open for growers to choose the method of allocating these book values in a way that best suits their business (section DO 4C(6) and section DO 4B(7)).

Definitions

Key definitions in both the 1994 and 2004 Income Tax Acts are "diminished value", "estimated useful life", "listed horticultural plant", "non-listed horticultural plant", "planting", "plot", "replacement area fraction" and "replacement plant".

Application date

The amendments to the Income Tax Act 1994 came in to force on 21 December 2004, the date of Royal assent, and apply from the 2003–04 income years. The amendments relating to listed horticultural plants will not have effect until an administrative determination is made by the Commissioner under new section 91AAB in the amendments to the Tax Administration Act 1994. Amendments to the Income Tax Act 2004 come into force from 1 April 2005. A related consequential amendment is made to section 44C of the Tax Administration Act 1994, also with force from 1 April 2005.

DEDUCTIBILITY FOR COSTS ASSOCIATED WITH PATENT AND RESOURCE MANAGEMENT ACT CONSENT APPLICATIONS THAT ARE NOT GRANTED OR ARE WITHDRAWN

Sections DG 61(A) and DJ 14B of the Income Tax Act 1994 and sections DB 13B and DB 28B of the Income Tax Act 2004

Introduction

Costs associated with patent and resource management consent applications that are not granted or are withdrawn have been made deductible. These costs were previously not deductible under either the general deductibility rules or the depreciation rules.

Background

Patents and certain consents issued under the Resource Management Act 1991 are depreciable intangible property. To the extent expenditure incurred in applying for a patent or resource management consent results in an application being granted, the costs must be capitalised and depreciated. However, if an application is unsuccessful or is withdrawn, any costs incurred up to that point are not depreciable as there is no depreciable asset.

Key features

A new section DG 6(1A) has been added to the Income Tax Act 1994 and new section DB 28B to the 2004 Act to allow deductibility for costs associated with patent applications that are not granted or are withdrawn. The costs that are deductible are those that would have been part of the cost of a patent (for depreciation purposes) if the application had been granted.

A new section DJ 14B has also been added to the Income Tax Act 1994 and new section DB 13B to the 2004 Act to allow deductibility for costs associated with resource management consent applications that are not granted or are withdrawn. Again, the costs that are deductible are those that would have been part of the cost of a resource consent (for depreciation purposes) if the application had been granted. On the recommendation of the Finance and Expenditure Committee, the change applies to both resource consent applications that, if successful, would have resulted in consents with a fixed legal life (fixed life intangible property) as well as non-fixed life consents that would nevertheless have been depreciable by other means (for example, included in the cost of a building or other structures).

Application date

The amendments will apply to applications that are not granted or are withdrawn in the 2004–05 or a subsequent income year.

FEBRUARY 2004 AND JULY 2004 FLOODS

Sections EF 1(5), EG 19(3), EZ 9, EZ 9B, GD 1 and OB 1 of the Income Tax Act 1994

Sections CX 41B, DO 5B, DP 3B, EA 3, EE 41, EW 47B, GD 1 and OB 1 of the Income Tax Act 2004

Section 177D of the Tax Administration Act 1994

Section 48A of the GST Act 1985

Introduction

Several amendments deal with technical matters identified in a review of the circumstances faced by businesses as a consequence of the storms that occurred around New Zealand in February 2004 and in the Bay of Plenty area in July 2004. The amendments:

- create a deduction for the tax loss on commercial buildings destroyed in the storms;

- create a deduction for the tax loss on farming land improvements destroyed in the storms;
- exclude gifts of trading stock and consumables, made as a result of the storms, from the anti-avoidance provision that treats them as sales and purchases at market value;
- provide relief for consumables that are destroyed;
- deal with tax issues related to new start grants; and
- correct an oversight in the definition of "qualifying event".

Background

The amendments were introduced by means of Supplementary Order Paper 218 and as a result of submissions made to the Finance and Expenditure Committee.

Other than the amendment in relation to destroyed consumables, all these measures apply only to those affected by the storms throughout New Zealand in February 2004 and in the Bay of Plenty in July 2004. Long-term solutions are being developed separately.

Key features

Destroyed buildings

If buildings are disposed of for less than their adjusted tax value, the loss is generally not deductible. Section EG 19(3) of the Income Tax Act 1994 has been replaced and part of section EE 41(2) of the 2004 Act has been replaced so that the general rule does not apply to buildings that were destroyed or rendered useless for the purpose of deriving income as a result of the storms around New Zealand in February 2004 or in the Bay of Plenty area in July 2004.

Destroyed land improvements

Certain improvements to land used for farming, aquaculture or forestry businesses are deductible over time if they continue to be used in a farming business. The types of improvements and their rates of deduction are set out in Schedule 7. While deductions are permitted for the cost of any repairs or maintenance, deductions were not permitted for losses on disposal of farming land improvements. Section EZ 9B has been inserted into the 1994 Act and sections DO 5B and DP 3B have been inserted into the 2004 Act to permit a deduction for the diminished value of improvements destroyed or made useless for the purpose of driving income as a result of storms around New Zealand in February 2004 or in the Bay of Plenty area in July 2004.

Gifts of trading stock and consumables

Under the previous rules, if a business disposed of trading stock for less than market value, it was deemed to have sold it at market value. The law treated donated trading stock (such as a cow) or consumables (such as hay) as being sold at market value by the donor, and purchased at market value by the donee. Donors were effectively taxed on the profit, and donees received a deduction for the market value as though they had purchased the stock.

Therefore sections GD 1(4) in both the 1994 and 2004 Acts have been replaced. The anti-avoidance provision no longer applies to trading stock that is donated as a result of the storms around New Zealand in February 2004 or in the Bay of Plenty area in July 2004. Trading stock in these provisions is taken to include both stock and consumables.

Destroyed consumables

The tax law provides a deduction for the cost of consumables such as hay that is purchased or produced by a taxpayer for use in a business. However, there was a technical problem: the law required that, at some point, the consumables had to be used in the course of deriving income. Arguably, if they were destroyed by a flood or fire they could not be used in the course of deriving income. Section EF 1(5)(a) of the 1994 Act and section EA 3(4) of the 2004 Act have been replaced so that goods destroyed or rendered useless for the purpose of deriving income are not required to be added back as unexpired expenditure.

New start grants

New start grants are being provided to farmers forced to leave their properties as a result of the floods to ensure that those with less than $65,000 in equity will receive a grant of up to $65,000 (GST-inclusive) per family.

"New start grant" has been defined in section OB 1. Section EZ 9 of the 1994 Act has been replaced so that amounts forgiven as a prerequisite for the payment of the new start grants are not income under the accrual rules or section CE 4. This applies only to the extent that the amounts forgiven cannot be set off against losses of the taxpayer, the taxpayer's business or, in certain cases, the losses of an associated taxpayer. New sections CX 41B and EW 47B have been inserted into the 2004 Act for the same effect.

Consequential amendments have been made to:

- move the definition of "business of farming" from section OB 1 into section EZ 9 of the 1994 Act because it does not apply to any other provisions;
- section 177D of the Tax Administration Act 1994; and
- section 48A of the Goods and Services Tax Act 1985.

Definition of "qualifying event"

The definition of "qualifying event" in section OB 1 has been expanded to include:

- the storm that occurred during the month of July 2004 in the Bay of Plenty area; and
- any naturally-occurring event that occurs after the month of July 2004 in respect of which a state of emergency is declared under the Civil Defence Act 1983 and the Governor-General by Order in Council declares to be a qualifying event. This corrects an oversight in the original legislation.

Application date

The definition of "qualifying event" is effective from 1 February 2004, and the other amendments apply for the 2003-04 and subsequent income years.

SALE AND LEASEBACK OF INTANGIBLES

Sections FC 8B and OB 1 of the Income Tax Act 1994 and Income Tax Act 2004

Introduction

Amendments have been made to ensure that taxpayers entering into transactions involving the sale and leaseback of intangibles such as trademarks do not get deductions for what are, in substance, repayments of loan principal. The amendments are designed to protect the tax base.

The tax rules for finance leases, which prevent deductions being taken for the principal amount of a deemed loan, have been amended to ensure that the transactions involving the sale and leaseback of intangibles that cause concern are caught by these rules.

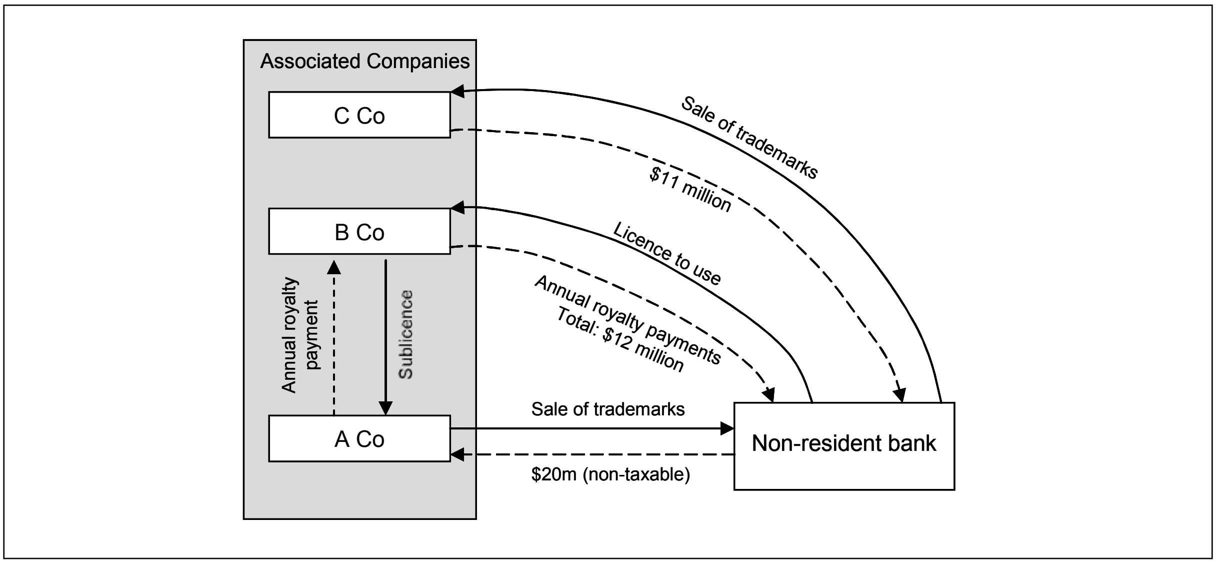
Background

The government announced in May 2003 that it was concerned about a scheme involving the sale and leaseback of intangibles under which tax deductions were claimed for what were, in substance, repayments of principal under a loan. The government said that it would propose remedial legislation to ensure that such deductions could not be taken.

Schemes that may allow deductions for repayment of loan principal

Described below are the simplified features of a transaction under which, before these amendments, deductions may have been allowed for what are, in substance, loan principal repayments.

A Co, B Co and C Co are associated. A Co sells its trademarks or brand names to a non-resident bank for, say, $20 million (which is non-taxable as any profit is a capital gain). The bank immediately grants to B Co an exclusive licence to use the trademarks for a fixed term in return for annual royalty payments totalling, say, $12 million that are deductible to B Co. B Co grants a sublicence to A Co on the same terms. The bank grants to C Co an option to purchase the trade marks, subject to the bank retaining the right to receive the licence payments from B Co. The exercise price under the option is, say, $11 million, the reduction in value of the trademarks from $20 million reflecting the bank's right to continue to receive the royalty income from B Co during the licence period. The option is exercised on the date that the bank buys the trademarks and the licence begins, so that the bank pays A Co $20 million for the trademarks and immediately sells them to C Co for $11 million. The bank's net outgoing is $9 million, which it pays in return for future payments of $12 million.



In substance, the transaction is a loan of $9 million from the bank to the group, and the bank treats the transaction for tax, regulatory and accounting purposes accordingly. By structuring the loan as a licence, a deduction may have been available to B Co for what are, in substance, repayments of the $9 million principal, instead of only the $3 million interest that would be allowed if the transaction were in the form of a loan. This outcome is contrary to the policy intent underlying the tax treatment of debt transactions (and it may be that the tax avoidance provisions in the Income Tax Act 1994 apply to it).

Finance lease rules

The Income Tax Act contains provisions called finance lease rules that, in certain circumstances, recharacterise lease transactions as the purchase of the leased asset by the lessee, with the purchase funded by a loan from the lessor to the lessee. The lessee can depreciate the leased asset (if it is depreciable property) and, instead of obtaining a deduction for lease payments, obtains a deduction under the accrual rules for the interest component of the deemed loan. The treatment of the lessor mirrors that of the lessee — the lessor cannot depreciate the leased asset, and returns as income the interest component of the deemed loan.

The finance lease rules were introduced in 1982 and revised in 1999. They recognise that certain lease transactions are, in substance, financing arrangements, under which the lessor finances the purchase of the leased asset by the lessee. Broadly, they are triggered when the lease arrangement provides for the transfer of the asset to the lessee or an associate of the lessee, or when the asset is leased for most of its effective life.

Application of finance lease rules

The amended finance lease rules apply in the following way to the transaction in the example. The trademarks are treated as sold from the bank to B Co on the day the lease starts. The bank is treated as giving B Co a loan of $9 million, and B Co is treated as using the loan to purchase the trademark. The interest component of the deemed loan is $3 million (being $9 million consideration payable to B Co less $12 million consideration payable by B Co). This amount is deductible to B Co and spread under the accrual rules. B Co is treated as owning the lease asset (the trademarks) but as trademarks are not depreciable property, there is no depreciation deduction. This treatment accords with the correct policy outcome.

Key features

The following amendments to the finance lease rules in the Income Tax Act 1994 have been made to ensure that taxpayers entering into transactions involving the sale and leaseback of intangibles do not get deductions for what are, in effect, repayments of loan principal.

Licence to use intangible property

It ha been clarified that the finance lease rules in sections FC 8A to FC 8I apply to the granting of a licence to use intangible property. This has been achieved by amending paragraph (f) of the definition of "lease" in section OB 1, which applies for the purposes of the finance lease rules.

The result of this amendment flows through to the other definitions that use the term "lease", such as "finance lease", "lease asset", "lease term", "lessee" and "lessor". In the definition of "lease asset", the personal property that is subject to the licence to use intangible property is the intangible property itself such as a trademark.

Application of definition of "finance lease" to arrangements

It has been clarified that the finance lease rules apply if a feature referred to in the definition of "finance lease" — such as a transfer of ownership to the lessee or an associate or an option granted to a lessee or an associate — is contemporaneously part of the lease arrangement but is not specified in the lease agreement itself. This has been achieved by changing the opening wording of the definition of "finance lease" in section OB 1 to refer to a lease that "involves or is part of an arrangement that involves" a feature of the definition.

Previously, the definition of "finance lease" referred to a lease "under which" there was a feature referred to in the definition. It was not clear whether this wording was adequate to catch an arrangement involving a feature of the definition, such as a transfer of ownership to a lessee or associate, which was documented separately from the lease.

The addition of "at the time of entry" wording in this amendment confirms that only any arrangement existing at the time a lease is entered into should be taken into account in determining whether or not the lease is a finance lease. Therefore events that occur subsequently and independently to entering into the lease are not treated as part of the arrangement (other than an effective extension of the lease term through a consecutive or successive lease for which an adjustment is made under section FC 8I).

Transfer of ownership of lease asset during lease term

The application of paragraph (a) of the definition of "finance lease" in section OB 1 has been widened to include a lease under which ownership of the lease asset is transferred to the lessee or an associate of the lessee during or at the end of the lease term rather than only at the end of the lease term. Consequential amendments have also been made to section FC 8B(2) and (3) to refer to ownership of the lease asset being acquired on or by the date that the lease term ends.

New owner not entitled to lease payments

The definition of "finance lease" in section OB 1 has been expanded — new paragraph (d) — to include an arrangement that involves a right of an associate of the lessee to acquire the lease asset (or a right of the lessor to require an associate of the lessee to acquire the lease asset) during the lease term if the associate is not entitled to all of the lease payments that may fall due after the acquisition.

The new test targets a feature of the transactions causing concern: that the sale of the lease asset back to the associate of the lessee does not involve the associate as the new owner receiving all of the lease payments accruing from the date of sale, as would normally be the case. Instead, lease payments continue to flow to the previous owner (the financier). It is this feature of the transactions that indicates their financing nature and, accordingly, it is appropriate to treat arrangements with this feature as finance leases.

Other technical amendments

A technical error in paragraph (c) of the definition of "finance lease" in section OB 1 — which compares the lease term with the lease asset's estimated useful life — has been corrected by removing the reference to the formula in section EG 4(3). The purpose of this formula is to set the diminishing value economic rate of depreciation for an asset. However, intangible property that is fixed life intangible property must be depreciated using the straight line depreciation basis and cannot be depreciated on a diminishing value basis. Therefore the formula in section EG 4(3) can have no application to this type of depreciable property.

The new wording of paragraph (c) of the definition of "finance lease" now refers to "a lease term that is more than 75% of the lease asset's estimated useful life". The definition of "estimated useful life" in section OB 1 applies to all depreciable property, including fixed life intangible property.

The definition of "lessee" has been amended by omitting the reference to "hires, or bails". This reference and a reference to licensing intangible property are unnecessary because reliance can be placed on the reference to "leases". Section 32 of the Interpretation Act 1999 means that this latter reference has a corresponding meaning to the paragraph (f) definition of "lease", which includes a hire, bailment or a licence to use intangible property.

This amendment also makes the definitions of "lessee" and "lessor" consistent because the latter does not use hire or bailment terminology.

The foregoing amendments to the definition of "finance lease" in section OB 1 have been achieved by replacing that definition.

The main purpose of the amendments is to protect the tax base. The amendments are not intended to affect normal commercial leasing transactions that do not raise tax base maintenance concerns.

Application date

The amendments apply for arrangements entered into on or after 29 March 2004.

ORGANISATIONS APPROVED FOR CHARITABLE DONEE STATUS

Section KC 5(1) of the Income Tax Act 1994 and Income Tax Act 2004

The following organisations have been granted charitable donee status from the 2004–05 income year:

- Medicine Mondiale
- New Zealand Jesuits in India Trust
- Operation Vanuatu Charitable Trust

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

EARLY PAYMENT INCOME TAX DISCOUNT

Subpart MBC of the Income Tax Act 1994 and subpart MBB of the Income Tax Act 2004

Introduction

A 6.7% discount of tax has been introduced to encourage individuals who begin receiving self-employed or partnership income to pay tax voluntarily in the year before they begin paying provisional tax. This will relieve the financial strain they face when they begin paying provisional tax and have two years' worth of tax payments to make, namely, income tax for the prior year and provisional tax for the current year.

Background

As part of the government's growth and innovation strategy, proposals were considered to reduce the costs faced by small businesses in complying with the tax system. One such proposal involved providing a discount of tax to individuals who voluntarily pay tax in the year before that in which they are required to pay provisional tax, thereby aligning the payment of tax with when income is earned. The proposal aims to reduce the number of taxpayers who get into debt with tax payments and thereby reduce the compliance costs incurred.

This proposal was included in the government's 2003 discussion document "Making tax easier for small businesses". Significant support was received for the proposal, from submissions to the discussion document and market research undertaken with small and medium-sized businesses.

Key features

New subpart MBC has been added to the Income Tax Act 1994 and new subpart MBC has been added to the 2004 Act. They provide a discount of tax to individuals who begin receiving self-employed or partnership income, to encourage them to pay tax voluntarily in the year before they become liable for provisional tax.

Who qualifies for the discount?

To qualify, individuals have to:

- be either self-employed or a partner in a partnership;
- derive assessable (gross) income predominantly from a business (not being interest, dividends, royalties, rents or beneficiary income);
- not be required to pay provisional tax in the income year;
- make a voluntary payment of income tax before the end of the income year (31 March for a March balance date taxpayer);
- elect to receive the discount within the timeframe for filing a return of income for that income year;
- have not been liable to pay provisional tax in the prior four years; and
- have never received an early payment discount unless they come within the four-year rule outlined below.

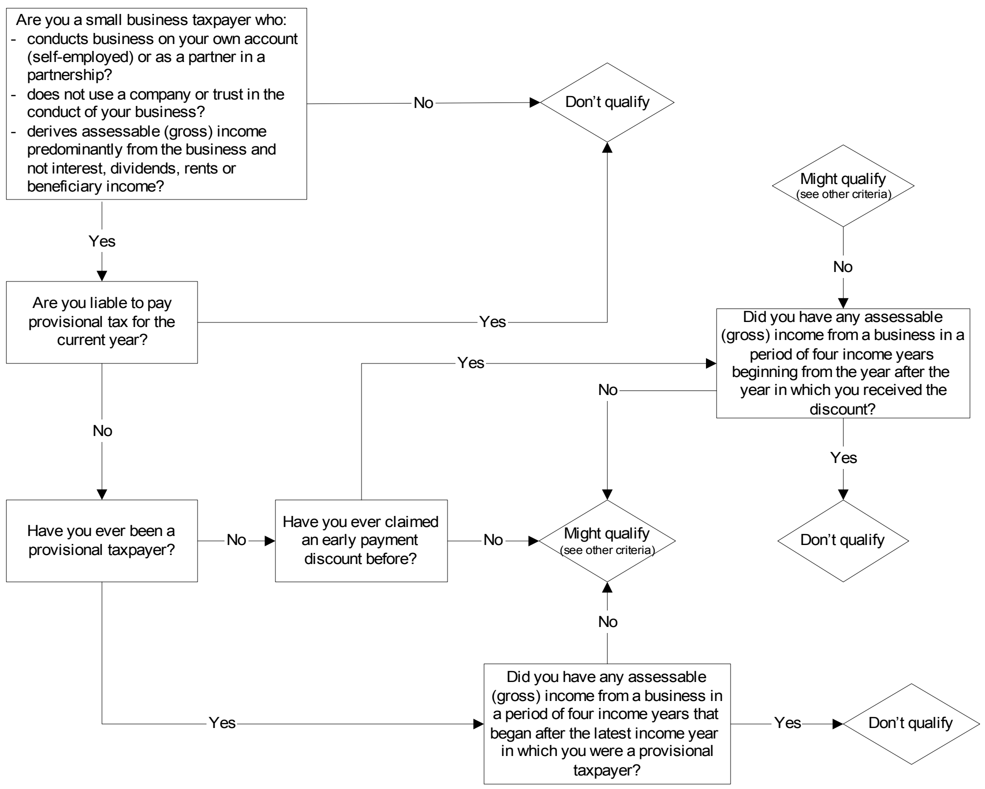
Once they have made a voluntary payment they must keep the lesser of the following in their income tax account until terminal tax date for the income year:

- the amount of voluntary payments made before the end of their income year; or
- the amount of terminal tax for the income year.

Those who are provisional taxpayers before they begin receiving self-employed or partnership income will not be entitled to the discount as they do not face two years' tax payments in their second year in business and are already aware of the need to make provisional tax payments.

The discount is not available when a taxpayer merely ceases paying provisional tax. For example, a business that derives assessable (gross) income but is in a tax loss situation would not qualify for the discount.

Do you qualify for the discount?



Four-year rule

A concession in the new legislation enables taxpayers to claim the discount again if they have ceased deriving partnership and self-employed income for a period of four years and then begin a new business. This is because taxpayers who have been out of business for some time, (four years) may be less aware of the problem that two years' worth of tax will become due in their second year in business.

Election

Individuals will be able to choose whether to receive the discount in their first year of business or in a subsequent year, but they must claim the discount before the year in which they begin paying provisional tax, when qualification ceases.

Taxpayers who omit to claim the early payment discount in their tax return will be able to apply to the Commissioner of Inland Revenue to amend their return and claim the discount but must do so before the last date for furnishing the return for the income year in which the early payment discount is claimed.

Calculation

The discount will be calculated at the rate of 6.7% of the amount paid during the year or 105%of the individual's end-of-year residual income tax liability, whichever is the lesser. Any overpaid tax plus the discount will be refunded to the taxpayer or can be offset against other tax owing.

When a taxpayer claims the early payment discount in a tax year and the return is reassessed for that year, the amount of the discount may also be reassessed.

Examples of who will qualify for the discount

Example 1

Angela derives solely business income for a four-year period. The business grows, and in the third year her residual income tax liability (tax not deducted at source) exceeds $2,500, so she becomes a provisional tax payer. She is required to pay provisional tax in her fourth year in business.

	Year 1	Year 2	Year 3	Year 4
Income	$3,000	$12,000	$25,000	$30,000
Residual income tax liability	$450	$1,950	$4,680	$5,730
Become a provisional tax payer	No	No	Yes	Yes
Liable to pay provisional tax	No	No	No	Yes
Entitled to discount	Yes	Yes	Yes	No

Angela can claim the discount once in either of the first three years, as she is not required to pay provisional tax. However, she would maximise the benefit of the discount by claiming it in the third year in business. If the discount has not been claimed before the fourth year entitlement ceases.

Example 2

Denis derives income from two sources, business income of $50,000 and interest income of $30,000. He would meet the test of deriving gross income predominantly from business as his business income is the predominant income. However, if he had salary and wages of $50,000 and business income of $20,000 his assessable (gross) income would be predominantly from salary or wages and he would not qualify for the discount.

Example 3

Sean started business last year and had a residual income tax liability of over $2,500. He qualifies as a provisional tax payer and is required to pay provisional tax in the current year. If at the end of the current income year his residual income tax is less than $2,500 he cannot claim the discount as he was a provisional tax payer last year and is required to make provisional tax payments this year. However, he could have claimed the early payment discount last year because, although he qualified as a provisional tax payer, he did not have to make provisional tax payments last year.

Example 4

John starts up a business and in his second year the business grows. He decides to pay income tax voluntarily during the second year. When he prepares his year 2 tax return his residual income tax is $1,800, and he decides to claim the early payment discount while he still can. In year 3 the business grows again and John becomes a provisional tax payer. However, in year 4 the business loses market share and ceases.

John does not operate a business in years 5 to 8 and begins business again in year 9. He can claim the early payment discount because he has begun business after a four-year gap since he was last in business and last paid provisional tax.

If, however, he had continued to be liable for provisional tax in years 5 to 8 he would not be able to claim the early payment discount.

Example 5

Mary begins as a self-employed consultant and, although she is not liable for provisional tax, makes voluntary payments of income tax in her first year and claims the discount in her end of year return. However, in year 2 her business ceases. Mary is then employed and stays in that job for 5 years. In year 8 she takes up self-employment again and can claim the discount again in year 8 because she has not derived income from self-employment for four years or been liable for provisional tax for four years.

Example 6

Tom enters a partnership and in the second year he is required to pay provisional tax. In year 3 he leaves the partnership and is no longer required to pay provisional tax in the following years. He takes a five-year break travelling overseas. On returning to New Zealand he decides to become self-employed. He makes voluntary payments of tax in his first year of self-employment and therefore qualifies for the early payment discount.

Application date

This amendment applies from the income year beginning 1 April 2005.

DISPUTES RESOLUTION PROCESS

Sections MD1(1), MD1(2), MD(2B) of the Income Tax Act 1994 and Income Tax Act 2004; definition of "response period" and "disputable decision" in section 3(1), sections 89C(db) and 89C(eb), 89DA(2), 89E(1), 89F, 89G(2), 89K(1)(a)(ii), 89K(1)(a)(iii), 89K(1)(b)(ii)(A), 89K(1)(b)(ii)(B), 89K(1)(d), 89K(3)(a) and (b), 89M(1), 89M(6B), 89M(7), new sections 89N and 89O, 108B(1), 108B(1B), 113(1), 138B(3) and 138F of the Tax Administration Act 1994; the proviso to section 20(3) and section 45 of the Goods and Services Tax Act 1985; section 13B(1)(a) of the Taxation Review Authorities Act 1994 and regulation 18(5) of the Taxation Review Authorities Regulations

Introduction

Amendments give effect to proposals outlined in the government discussion document "Resolving tax disputes: a legislative review", which was released in July 2003.

The framework within which tax disputes are resolved has been amended to ensure that the process is meeting its intended objectives.

To provide greater certainty and consistency for both Inland Revenue and taxpayers in relation to their returns, amendments have also been made to the refund periods for income tax and goods and services tax.

Background

Over the last decade a broad package of tax administration reforms has been introduced in response to developments such as increased technology and self-assessment. The areas of reform include:

- tax simplification, including removal of the requirement for most wage and salary earners to file returns;
- compliance and penalties legislation;
- binding rulings;
- a progressive rewrite of the income tax legislation; and
- the introduction of legislation supporting taxpayer self-assessment.

It was within this environment of tax administration reform that the disputes resolution process was introduced, in 1996, in response to the recommendations of the Organisational Review of the Inland Revenue Department, which was chaired by Sir Ivor Richardson.

The disputes procedures at that time were perceived as deficient in that they did not adequately support the early identification and prompt resolution of issues leading to tax disputes. A new disputes resolution process was subsequently introduced to deal with these concerns.

The resolution of a dispute is achieved through a series of steps prescribed in legislation, the main elements of which are:

- A notice of proposed adjustment (NOPA). This is a notice by either the Commissioner or a taxpayer to the other that an adjustment is sought in relation to the taxpayer's self-assessment.
- A notice of response (NOR). The NOR is a notice of response issued by the party receiving the NOPA if they disagree with the NOPA.
- A disclosure notice and statement of position (SOP). A disclosure notice triggers the issue of a SOP. A SOP contains the detailed facts and legal arguments to support the position taken and, again, is issued by both parties. It is an important document because it limits the parties to their respective facts and arguments if the case goes to court — this limitation is referred to as the "evidence exclusion rule".

The prescribed documents are intended to encourage an all "cards on the table" approach to dispute resolution that ensures that all the relevant evidence, facts, and legal arguments are canvassed before a case goes to court. There are also two administrative phases in the process — the conference and adjudication phases. The conference is a relatively formal meeting between Inland Revenue and the taxpayer which aims to clarify and, if possible, resolve the issues. Adjudication involves the independent consideration of the dispute by Inland Revenue and is the final phase in the process before the taxpayer's assessment is amended.

The process is set out in Figures 1 and 2 over the page.

Figure 1: Disputes resolution process commenced by the Commissioner

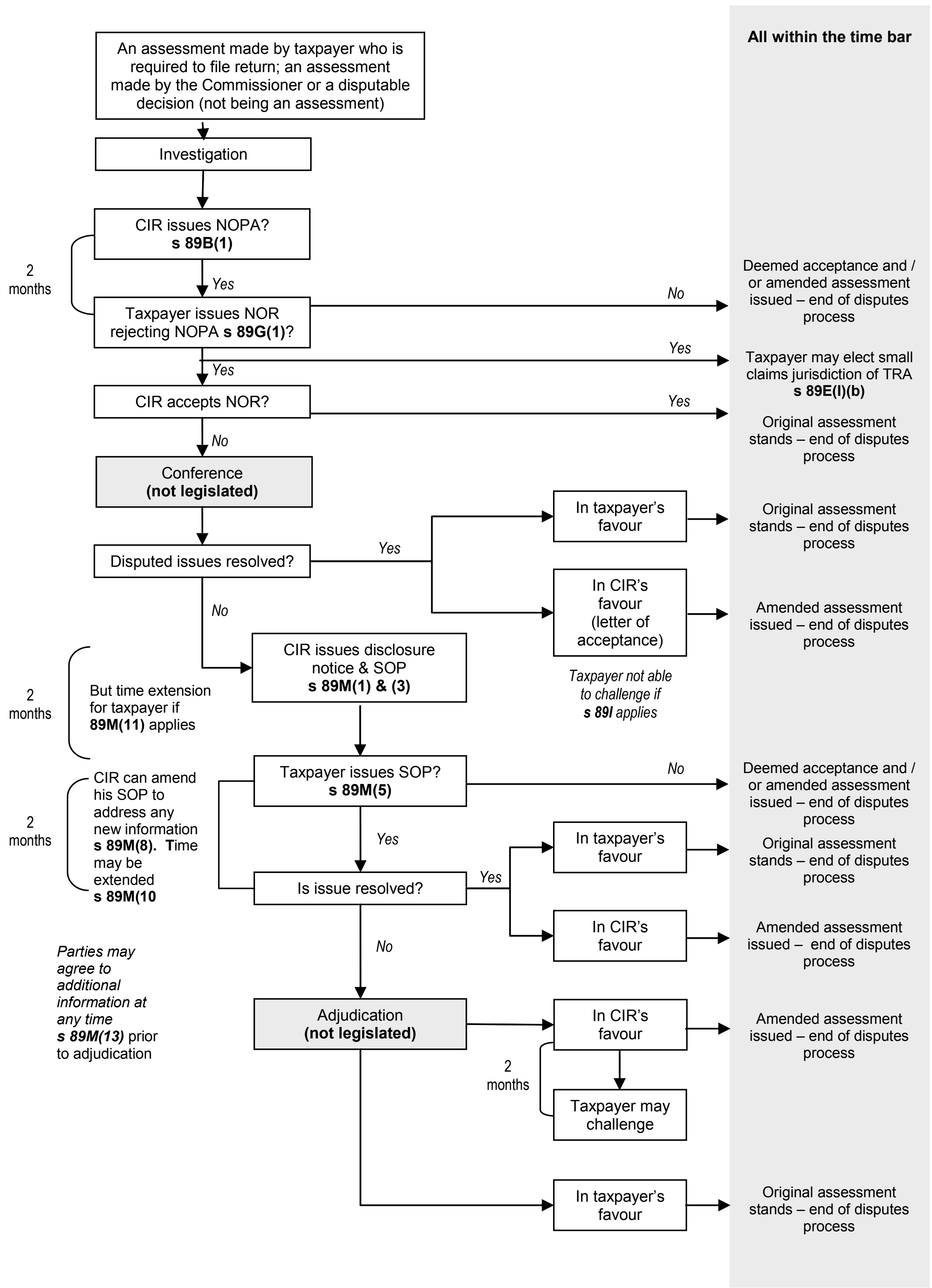
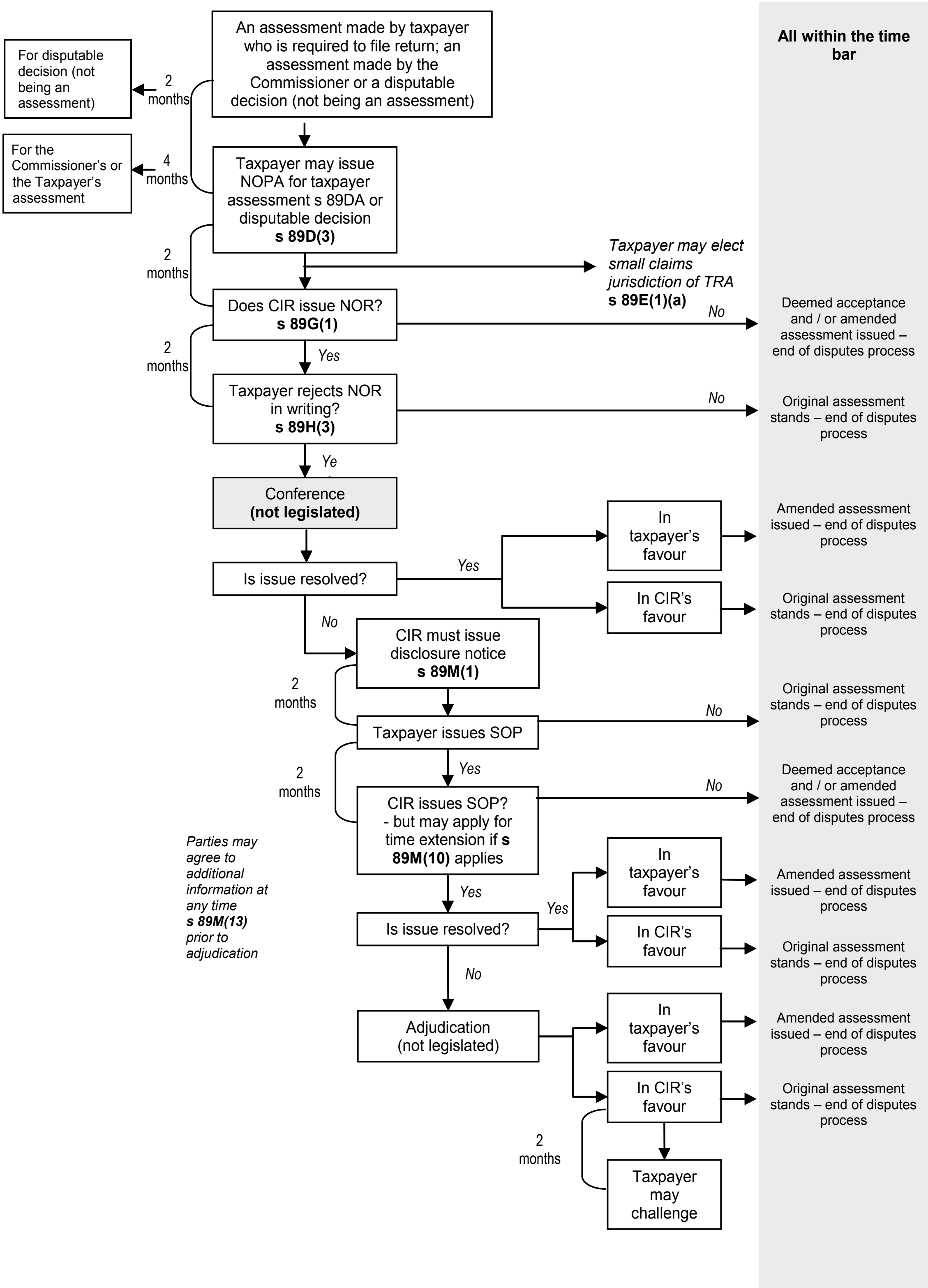


Figure 2: Disputes resolution process commenced by a taxpayer



The 2003 discussion document

The government discussion document "Resolving tax disputes: a legislative review" was released on 2 July 2003 for public comment. The purpose of the discussion document was to ensure that the government's objective of making the dispute resolution procedure fairer, faster and generally more efficient was being supported by the legislation. The review therefore focused on particular ways in which the legislative process could be improved for both taxpayers and Inland Revenue. It recognised, however, that the process for resolving disputes is dependent on efficient administrative practices and noted that Inland Revenue is undertaking a separate review of these practices.

The document covered five broad subject areas:

- the need for the Commissioner to follow the full process set out in the legislation;
- the content and the level of detail of the various documents required by the Commissioner and the taxpayer during the dispute;
- the increasing incidence of taxpayers seeking to adjust their own returns in relation to issues that are likely to be disputed;
- providing certainty regarding timeframes, including timeframes for GST; and
- miscellaneous issues.

The document outlined the objective of the review as being to ensure that the administration is operating efficiently at the lowest possible cost and to promote voluntary compliance as a result of disputes being handled fairly and resolved promptly.

Changes recommended at select committee

A significant change at the Finance and Expenditure Select Committee stage, when the bill introducing the amendments was being considered, was made to the proposal to require the issue of a NOPA to claim an input tax credit within two years if a credit had not been claimed in the correct period. This provision was changed instead to allow a two-year period to claim an input tax credit in a current period return. Outside of the two-year period, an unlimited time to claim an input tax credit in a current period return will be allowed in limited prescribed circumstances.

Another significant change was to remove from the proposals a provision which would clarify and extend the circumstances in which the Commissioner could override the four-year statute bar in making an assessment.

Key features

Completing the process

Amendments to ensure that the various steps required to facilitate the resolution of a dispute are completed include:

- New section 89N clarifies that the Commissioner of Inland Revenue must, other than in prescribed circumstances, apply all the legislated steps of a dispute
- Section 108B replaces the current six-month period within which the parties may agree to extend the time available for a dispute with a 12-month period with the ability for the taxpayer to extend that period for a further six months; and
- Section 89K expands the circumstances in which a document that is provided late by the taxpayer will be accepted by the Commissioner.

Improving efficiency and cost-effectiveness

A number of amendments aim to ensure that the disputes resolution process is more accessible to taxpayers and that the costs incurred in preparing the various documents are no greater than is necessary for each particular case. Amendments aimed at achieving this include:

- simplifying the documentation required by both parties to progress a dispute (amended sections 89F and 89G);
- requiring a more detailed document when a NOPA is issued by a taxpayer (section 89F);
- extending the time for taxpayers to initiate a dispute to their self-assessment from two months to four months (amendment to the definition of "response period" in the TAA);
- introducing a more accessible small claims process which includes raising the threshold for such cases from $15,000 to $30,000 and clarifying that a "precedent" case is one that has wider implications for other taxpayers (sections 13B of the Taxation Review Authorities Act 1994, 89E of the TAA and regulation 18 of the Taxation Review Authorities Regulations 1998); and
- allowing the disputes process to be stayed pending the outcome of a test case if both parties agree (new section 89O).

Timeframes for refunds

The revised timeframes for refunds are based on the need to manage government revenue risk and the need to ensure that tax is correctly paid. To achieve this, the timeframes within which tax refunds are allowed (sections MD1(1)and MD1(2) and MD 1(2B) of the Income Tax Act 1994 and Income Tax Act 2004 and section 45 of the GST Act) have been amended to provide for a four-year period to claim a refund. An eight-year refund period will remain when the overpayment of tax is due to clear mistake or simple oversight.

GST input tax deductions

The proviso to section 20(3) of the GST Act has been amended to give taxpayers two years, from the earlier of the date of the invoice or payment, to claim an input tax credit in a current period return rather than the unlimited time previously available to taxpayers.

Outside of that two-year period, taxpayers will be able to claim an input tax credit in a current period return only if the failure to claim the credit arose from the following circumstances:

- a clear mistake or simple oversight by the taxpayers;
- the inability by the taxpayer to obtain a tax invoice;
- there has been a dispute over the quantum of the invoice that was not resolved within the two-year period; and
- it is found only later that a supply is taxable and the taxpayer had not claimed the related input tax credits.

Application dates

The amendments to the disputes procedures will apply to disputes commenced under Part IVA of the Tax Administration Act 1994 on or after 1 April 2005, the time of commencement usually being the issue of a notice of proposed adjustment by either Inland Revenue or the taxpayer, with the following exceptions:

- Amendments to timeframes within the process (the response periods) will apply to notices issued on or after 1 April 2005. If the response period relates to a GST return, the amendments apply to notices issued in relation to GST return periods starting on or after 1 April 2005.
- Amendments relating to income tax refunds will apply from the 2004–05 income tax year. Amendments relating to GST refunds and current period input tax deductions will apply for GST taxable periods starting on or after 1 April 2005.
- Amendments relating to situations where an assessment can be issued without starting the disputes process apply to assessments for which notices are issued on or after 1 April 2005.
- Amendments to the challenge procedures apply from the date of enactment, 21 December 2004.

Detailed analysis

Starting the disputes process

Timeframe for taxpayer-initiated notice of proposed adjustment – definition of "response period"

In recognition of the requirement on taxpayers to provide detailed information to the Commissioner when they initiate a dispute, the definition of "response period" in section 3(1) of the TAA has been amended to give taxpayers four months — instead of two months — to initiate a dispute to their self-assessment, or to dispute a notice of assessment issued by the Commissioner. The period will apply from the date a taxpayer's notice of assessment is received at an office of Inland Revenue. If a taxpayer is issuing a NOPA to their self-assessment, the date of their notice of assessment will be provided to the taxpayer through the issue of a return acknowledgement letter.

In the definition of "response period", the provision of a two-month period starting on the date of issue of a notice from the disputant rejecting an adjustment proposed by the Commissioner is being removed because it is redundant.

Efficency and cost effectiveness measures

The documentation required as part of the disputes process – sections 89F and 89G

The content of the notice of proposed adjustment is prescribed in section 89F. The amended section 89F requires that both documents issued by the taxpayer or the Commissioner must contain sufficient detail to identify the issues arising between the parties and be in the prescribed form. The section then details further requirements, depending on whether the document is issued by the Commissioner or the taxpayer.

Section 89F(2) requires the Commissioner to identify the adjustments and provide a concise statement of the key facts and law in sufficient detail to ensure the taxpayer is informed of the grounds of the Commissioner's NOPA. The reference to "concise statement of the key facts and law" means that the document should be relatively brief, but at the same time cover all the issues relevant to the dispute. The Commissioner must also state how the law applies to the facts to ensure the proposed adjustment, and the arguments used to support it, are consistent with the proposed facts.

Section 89F(3) requires the taxpayer NOPA to identify the adjustment made to the assessment. The NOPA must also provide a statement of the facts and the law in sufficient detail to inform the Commissioner of the grounds for the NOPA, a statement of how the law applies to the facts and copies of all material documentary evidence that the taxpayer is aware of at the time the notice is issued in support of the claim.

The need for the taxpayer to provide more detail than the Commissioner in a NOPA was highlighted in chapter 5 of the July 2003 discussion document. The amendment recognises that, because of the greater level of detail that will be required, potential disputes may be resolved at an earlier stage — ideally, without the need for further investigation.

Section 89G(2) requires a notice of response to state concisely the facts, law and arguments the issuer considers to be wrong in the NOPA and the reasons for this. The issuer of the response notice must also include any facts and legal arguments relied on and how the arguments apply to the facts.

Finally, the issuer of the NOR must state concisely an adjustment to any figure referred to in the NOPA that results from the facts and legal arguments relied on in the NOR. This requirement ensures that the NOR responds fully to the NOPA. There is no requirement that the amount referred to be final. As the dispute progresses, the amount in dispute may be altered reflecting the outcome of a conference or other discussions between the parties.

These amendments will ensure that there is a balance between allowing some flexibility for taxpayers and the Commissioner of Inland Revenue in preparing the documents, so that costs are reduced, and ensuring that both parties have all the information required to adequately address the issues raised in the dispute.

The requirement that the legal arguments are applied to the facts will ensure that the proposed adjustment is not a statement which appears out of context in relation to the rest of the document but is, rather, a logical conclusion.

Test cases – new section 89O

New section 89O has been inserted into the TAA to allow for the suspension of a dispute following the outcome of a test case. The section will apply if a dispute between a taxpayer and the Commissioner has been identified and the Commissioner has designated a case involving another taxpayer as a test case.

If the section does apply, the taxpayer and the Commissioner may agree to suspend the dispute from the date of the agreement if there is similarity between the facts and questions of law in the dispute and the case that has been designated as a test case. In such a case, any time bars affecting the dispute are stayed until the earliest of the date of the court's decision, the date on which the test case is otherwise resolved, or the date on which the dispute is otherwise resolved. In agreeing to suspend the dispute, the taxpayer agrees to be assessed (or not as the case may be) on the basis of the test case. In such a case, any time bars affecting the dispute are extended by the period of the suspension.

Enabling the Commissioner to designate a case as a test case earlier in the disputes process will reduce administrative and compliance costs that might otherwise arise if the case involves, say, a taxpayer who is one of a number involved in a single scheme or in a series of similar transactions.

Example

The Commissioner has issued Robert with a NOPA, thereby starting the disputes process. Robert and the Commissioner have agreed in writing to suspend the dispute between them because there is significant similarity between Robert and the Commissioner's dispute and a challenge that has been designated as a test case. The time bar to complete Robert's dispute will fall on 31 March 2006.

Section 89O(3) states that the suspension starts on the date of the agreement and ends on the earliest of:

(a) the date of the court's decision in the test case:

(b) the date on which the test case is otherwise resolved:

(c) the date on which the dispute is otherwise resolved.

Robert and the Commissioner agree to suspend the dispute between them on 9 June 2005. The date of the court's decision on the test case is 9 July 2006. Therefore the suspension is from 9 June 2005 to 9 July 2006.

Section 89O(4) states that the Commissioner may make an assessment (as the case may be) that is consistent with the resolution of the test case.

The court's decision on 9 July is in the Commissioner's favour and the Commissioner may make an assessment for Robert that is consistent with the test case.

Because the test case was decided outside of the time bar as it applied to Robert, section 89O(5) determines the period of time within which the Commissioner must make the assessment. The period of time within which the Commissioner must make the assessment for Robert is the total of:

(a) the four year timebar – the time within which the Commissioner should have made the amended assessment in the absence of the suspension; and

(b) the period of the suspension described in section 89O(3).

Therefore the Commissioner must make the amended assessment for Robert on 9 July 2006.

This new test case procedure for disputes does not affect the taxpayer's ability to challenge the assessment through the court process.

Small claims process

The government considered that cost should not be a deterrent to using the disputes process, especially for smaller taxpayers, for whom the cost of progressing the dispute may far outweigh the amount of tax in dispute.

An amendment to section 89E and consequential amendments to the Taxation Review Authorities Act 1994 and the Taxation Review Authorities Regulations 1998 are intended to make the small claims process more accessible to taxpayers by:

- raising the threshold for the amount of tax in dispute from $15,000 to $30,000 (section 89E(1) of the TAA and section 13B(1)(a) of the Taxation Review Authorities Act 1994); and
- clarifying that "precedent" means the case will be of precedence for taxpayers other than the taxpayer in question (Regulation 18(5) of the Taxation Review Authorities Regulations 1998).

Completing the process

New section 89N

The Commissioner is generally limited to a four-year period within which to amend a taxpayer's assessment following an investigation or in certain other circumstances. In cases involving a dispute the assessment is amended following the completion of the disputes process, which must occur within the four-year period (unless the parties agree to a time bar waiver).

New section 89N requires the Commissioner to follow all the legislated steps of the disputes process, other than in specific circumstances. Completing the process means considering the taxpayer's statement of position whether in a Commissioner-initiated dispute or a taxpayer-initiated dispute, before issuing an amended assessment. This requirement is contained in section 89N(2).

The process does not have to be completed before an assessment is issued, in the following circumstances:

- The Commissioner notifies the disputant that, in the Commissioner's opinion, the disputant, in the course of the dispute committed an offence under an Inland Revenue Act that has effectively delayed the process (89N(1)(c)(i)).

An alleged offence committed by a taxpayer may mean the Commissioner needs to act quickly and issue an amended assessment.

- A taxpayer involved in a dispute, or an associated person of the taxpayer, may take steps as to the location of the taxpayer's assets to avoid or delay the collection of tax (89N(1)(c)(ii) and (iii)).

The exception relating to the location of the taxpayer's (or an associated person of the taxpayer's) assets is designed to address the risk of the taxpayer or associated person of the taxpayer seeking to dispose of assets which may be required to meet an outstanding tax liability, and the issue of an assessment becoming urgent.

- The taxpayer has begun judicial review proceedings in relation to the dispute or an associated person of the taxpayer involved in another dispute involving similar issues has begun judicial review proceedings (89N(1)(c)(iv) and (v)).

The exception for judicial review proceedings reflects that the parties' resources may be directed away from progressing the dispute through the process towards addressing the facts and issues in the judicial review application.

- During the dispute, the taxpayer fails to comply with a request under a statute for information relating to the dispute and fails to comply within the period that is specified in the request (89N(1)(c)(vi).

Failure by a taxpayer to comply with a request for information if it is necessary to resolve the dispute or to comply with another matter relating to the dispute may, similarly, delay the progression of the dispute within the four-year time bar.

- The taxpayer elects to have the dispute heard by the Taxation Review Authority acting in its small claims jurisdiction (89N(1)(c)(vii)).

The small claims process is a simpler separate process when the dispute is intended to be resolved without completion of the full disputes process.

- The taxpayer and the Commissioner agree in writing that the dispute should be resolved by the court or the Taxation Review Authority without the completion of the disputes process (89N(1)(c)(viii)).

In some disputes, particularly those involving less tax in dispute and/or less complex issues, both parties may agree that it is more efficient to have the case resolved in the court or the Taxation Review Authority.

- The taxpayer and the Commissioner agree in writing to suspend the dispute pending a decision in a separate test case that is being challenged (89N(1)(c)(ix)).

If the taxpayer and the Commissioner agree in writing to suspend the disputes process pending the outcome of a test case, the process should not be followed.

Application to the High Court

Section 89N(3) provides for the Commissioner to apply to the High Court for an order to allow more time for completion of the dispute, or to allow the disputes process not to be completed.

An order from the High Court would be sought if the Commissioner considered that there were reasonable grounds, other than those specifically prescribed, for not having followed the full statutory process. Whether or not there were reasonable grounds could depend, for example, on the complexity of the issues, whether the taxpayer had caused prolonged delays and whether there were significant matters that were unforeseen by either party that provided a justification for delay.

New section 89N(4) states that the application to the High Court must be made within the four year timebar.

New section 89N(5) states that if an application is made, the period of time in which an amended assessment must be made is the total of:

- the four-year timebar – the time within which the Commissioner should have made the amended assessment in the absence of the application; and
- the period of time that starts on the date of the application (made within the time bar) and ends on the earliest of:
  - the date of the High Court's decision of the application:
  - the date on which the application is otherwise resolved:
  - the date on which the dispute is otherwise resolved; and
- any further period directed by the court.

Example

The Commissioner issues a NOPA on 3 January, and a NOR is issued by the taxpayer two months later, but there is no time to complete the disputes process as the time bar will fall on 31 March. An application is made under section 89N(3) on 11 March — within the four-year time bar — to the High Court. The Commissioner applies for an order that the Commissioner issue the assessment without completing the disputes process, or in the alternative, that there be more time to complete the process.

The Court decides on 6 April that an assessment may be issued without completion of the disputes process. The court allows a further five days to issue the assessment. The time within which the amended assessment must be issued is the total of:

- the time within which the Commissioner would be required to amend the assessment; and
- the date of the court's decision; and
- the further period allowed by the court as a result of the application, that is, five more days.

The amended assessment must be made by 11 April.

Commissioner may at any time amend assessments – section 113

The new section will not affect the Commissioner's ability to agree to make an adjustment to an assessment in cases, for example, of clear mistake or simple oversight. Therefore the Commissioner will still be able to amend an assessment under section 113 (which contains the general power to amend assessments) within the four-year statute bar but subject to new section 89N.

Disclosure notices – section 89M

A disclosure notice is a simple document which triggers the application of the "evidence exclusion" rule. The rule restricts what the Commissioner and the disputant may raise in a court challenge to matters raised in their respective statements of position.

An amendment to section 89M requires that disclosure notices must be issued, except in situations where the Commissioner does not have to complete the disputes process. To address the consequential issue with regard to the protection of witnesses, new subsection 89M(6B) will clarify that "evidence" when referring to the evidence exclusion rule will refer to the available documentary evidence and does not include a list of witnesses or types of witnesses. Therefore witnesses in sensitive cases will continue to be protected, without undermining the effect of the evidence exclusion rule. The amendment will also provide more flexibility for the presentation of evidence when cases are being prepared before they go to court.

An amendment to section 89M(7) clarifies which document the disputant is deemed to accept — depending on whether the taxpayer or the disputant initiated the dispute — if the taxpayer does not respond within the response period for the statement of position.

Four-year time bar waiver period – section 108B

The Commissioner is generally limited to a four-year period within which to amend a taxpayer's assessment following an investigation of the taxpayer or in certain other circumstances.

Previously, taxpayers could agree to extend this four-year time bar by up to six months if more time was required to complete the disputes process. The extension takes the form of a waiver, which must be in the prescribed form and signed and delivered to the Commissioner by a taxpayer before the expiry of the relevant four-year period.

Section 108B(1) extends this six-month period to 12 months to provide sufficient time to complete the disputes process in cases where this time is needed. Again, the extension will apply only when the parties agree. The taxpayer can extend the 12-month period by a further six-month period. This additional six months would not need to be agreed with Inland Revenue

Section 108B(1B) states that the Commissioner will not be able to raise new issues during the waiver period that are not identified and known to both parties before the start of the period.

Exceptional circumstances – section 89K

The exceptional circumstances provision allows the Commissioner to accept a late document within the response period if exceptional circumstances apply. The current definition of "exceptional circumstance" was thought to be too restrictive and has, therefore, been extended.

Section 89K has been amended to give the Commissioner the discretion to accept a late document, including a statement of position, outside of the applicable response period if the lateness is minimal or the document is late owing to one or more statutory holidays falling within the response period

> **Example**
>
> John is issued with a NOPA on 26 August and must issue a NOR by 25 October. However, Labour Day falls on 25 October. Because a statutory holiday falls within John's response period he has one extra day within which to file his NOR. His NOR is then due on 26 October.
>
> **Example**
>
> Mildred is issued a NOPA on 17 June and but her NOR is not received by 16 August due date. Her NOR is received on 18 August. The Commissioner exercises the discretion in this case to accept the NOR as it is only two days late.

Timeframes

Timeframes for refunds of excess tax

The refund provisions in the Income Tax Act 1994 and Income Tax Act 2004 (sections MD1(1), MD1(2) and MD(2B)) and section 45 Goods and Services Act 1985 have been amended to limit the eight-year refund period to four years.

If the Commissioner is satisfied that the taxpayer has paid excess tax and four years have not passed from the end of the income year or GST return period in which the taxpayer provided the return, the Commissioner must refund the overpayment.

The Commissioner may extend the period to eight years if the overpayment of tax is due to clear mistakes and simple oversights, and for rebate claims. Retaining the eight-year period in cases of clear mistake and simple oversight protects existing taxpayer rights to refunds.

Refunds will still be allowed to be paid by the Commissioner outside of those time limits if application is made to the Commissioner before the expiry of the applicable time limit.

GST input tax deductions

The proviso to section 20(3) of the GST Act has been amended to provide for an unconditional two-year time frame from the date of an invoice or payment (whichever is earlier) to claim an input tax deduction in a current period return.

Outside of that two-year period, taxpayers will be able to claim an input tax credit in a current period return in certain limited situations only. There will be an unlimited time to claim an input tax credit in a current period return for the following circumstances:

- The failure to claim the credit was due to the taxpayer's inability to obtain a tax invoice.

Failure to claim a credit due because the taxpayer was unable to obtain a tax invoice is self-explanatory. Taxpayers should also note that section 24(1) of the GST Act requires that a supplier must, at the request of the registered recipient, provide the recipient with a tax invoice within 28 days of the making of the request.

- The failure to claim the credit has arisen because there is a dispute over the amount of the invoice that is not resolved within the two-year period.

> **Example**
>
> Mary owns and operates a florist shop and files a GST return on a payments basis. She has arranged for a new supplier to deliver her roses for the busy month of February. Mary discusses over the phone the cost of the first supply of roses. When she receives the invoice, the amount of the invoice far exceeds the estimated price she discussed with the supplier. She does not pay the invoice, which in turn means that she does not claim the associated input tax credit. Mary and the supplier enter into a dispute over the amount of the invoice and the case goes to court. The case is resolved three years after the issue of the invoice in favour of the supplier. Mary pays the supplier and claims the input tax deduction accordingly.

- The failure to claim the credit arises when only later it is found that a supply is taxable and the taxpayer had not claimed the related input tax credits.

> **Example**
>
> A church group is registered for GST. The church group carries out repairs and maintenance on the church and the associated hall, which has been rented out on a regular basis for a number of years. The church group has claimed input tax credits in relation to the repairs and maintenance on the church hall, but not the church itself as the church group did not think it was part of its taxable activity and therefore it could not claim the input tax credits. The Commissioner informs the church that the repairs and maintenance are part of its taxable activity and as such is a taxable supply. The church therefore claims the related input tax credits.

- The failure to claim the credit was due to clear mistake or simple oversight.

Example

Dominic owns a hairdressing salon and is registered for GST. He files on a two-monthly, invoice basis. Dominic has a very particular filing system, where every invoice he receives is filed alphabetically, so he knows exactly where each invoice is in order to claim GST input tax credits in the correct period. Dominic goes on holiday and leaves his senior stylist, Toni, in charge of the salon in his absence. Toni receives an invoice from one of the salon's suppliers and instead of filing the invoice alphabetically, as Dominic does, she puts the invoice on top of the cabinet and it is subsequently lost. Two and a half years later, Dominic discovers the invoice. He is outside of the two-year period. The misplaced invoice is an oversight, so Dominic is able to claim the invoice in a current period because the failure to claim the credit was due to clear mistake or simple oversight.

If the taxpayer has not claimed the input tax credit within two years and none of the circumstances as outlined above apply, the taxpayer may apply to the Commissioner for an agreed adjustment. The Commissioner can adjust a return, subject to the general four-year timebar, within the period in which the input tax credit should have been claimed.

Minor amendments

Disputable decision

A clarification to the definition of "disputable decision" in the interpretation section of the TAA excludes from the definition particular sections of the disputes process that are left to the discretion of the Commissioner.

The decisions left to the Commissioner's discretion that will not be disputable decisions include:

- section 89K, relating to late actions occurring within the response period;
- section 89L, which allows the Commissioner to apply for a High Court order to issue a notice rejecting an adjustment proposed by a taxpayer that the Commissioner has accepted or is deemed to have accepted;
- section 89M(8), which allows the Commissioner to provide additional information to the Commissioner's statement of position in response to the disputant's statement of position;
- section 89M(10), which allows the Commissioner to apply for a time extension to reply to a disputant's statement of position; and
- section 89N(3), which allows the Commissioner to apply to the High Court for an order allowing more time to complete the process, or that completion is not required.

The amendments ensure that only substantive issues are disputed and that issues about the process cannot be disputed under the process.

When assessments can be issued without a NOPA – section 89C

Section 89C lists the circumstances when the Commissioner may make an assessment without issuing a NOPA. They include when the assessment reflects an agreement between the Commissioner and the taxpayer or when the Commissioner believes a notice may cause the taxpayer to leave New Zealand.

Two new subsections have been added to the list of circumstances when the Commissioner may issue an assessment without first issuing a NOPA. New section 89C(db) enables the Commissioner to issue an assessment made in relation to a matter that is identical to an assessment of the taxpayer for another income year that is at the time subject to court proceedings. In this situation the disputes process would have been completed in relation to the earlier assessment, and the purpose of the amendment is to reduce the compliance and administrative costs of going through the process again.

New section 89C(eb) provides that an assessment can be issued if the taxpayer has left New Zealand and may have been involved in fraudulent activity. The new subsection extends the current exception for situations where a notice may cause the taxpayer to leave New Zealand.

Minor amendments to the challenge procedures – sections 138B(3)(b) and 138F(1)

Section 138B(3) allows taxpayers to challenge an assessment when the Commissioner has rejected (by issuing a notice of response) a notice of proposed adjustment issued by the taxpayer and the Commissioner does not subsequently issue an amended assessment. The taxpayer must file proceedings within the response period of the written disputable decision from the Commissioner, which may include another form of written correspondence by the Commissioner.

Some confusion has arisen for taxpayers in respect of the response period of the written disputable decision from the Commissioner provided for in section 138B(3)(b). Taxpayers can challenge an assessment if they file proceedings within that response period. This written disputable decision was not intended to be restricted to the notice of response referred to in section 138B(3)(a).

Therefore the amendment clarifies this point by providing that the reference to "within the response period of the written disputable decision from the Commissioner" is not restricted to the notice of response issued by the Commissioner.

The effect of the amendment is that the full disputes process will more clearly be provided for in the case of a taxpayer-initiated dispute as the time for challenging the Commissioner's decision will not be limited to the two months after the Commissioner's notice of response.

Section 138F(1) gives taxpayers the right to challenge an assessment made by the Commissioner that takes account of a disputable decision. This section does not then provide for a response period within which the challenge must be commenced because there is no cross-reference to section 138B, which does provide a response period.

The amendment clarifies that for a challenge made under the section to be effective, the taxpayer must commence the challenge within the response period from the date of the Commissioner's notice of assessment.

IMPUTATION CREDITS AND TRANSFERS

Section MD 4 of the Income Tax Act 1994

Introduction

Taxpayers can elect that a credit arises to the imputation credit account (ICA) or dividend withholding payment account (DWPA) in certain circumstances when overpaid tax was transferred before the comprehensive transfer rules in the Income Tax Act came into effect.

Background

The company imputation system ensures that company shareholders are not taxed twice on company income – once in the hands of the company, and again when profits are distributed as dividends.

Briefly, companies keep an ICA which records the tax payments made by the company as credits and amounts allocated to dividends as debits. If a company's ICA has a debit balance at 31 March in any year, the company is liable to pay further income tax. This ensures that imputation credits attached to dividends do not exceed the net amounts of tax paid by the company.

To ensure that imputation credits are associated with whoever owns the company when the tax is paid, there is a "continuity debit" to the ICA whenever there is a significant change in ownership (direct or indirect) of the company. If a company that has suffered a breach in continuity is also due a tax refund for a tax overpayment that arose before the continuity breach, this refund (to the extent of the debit) can still be paid without further affecting the ICA balance.

Similar rules apply to withholding payments.

Section MD 4 (which was repealed in 2003) ensured that a taxpayer could not take undue advantage of the imputation or dividend withholding payment rules when transferring overpaid income tax or dividend withholding payment to another year or to another tax type (such as PAYE or GST) or to another taxpayer. However, where there had been a prior breach in shareholder continuity, section MD 4 did not work appropriately.

Example

Company A makes an income tax payment of $100, taking the ICA balance to $100. Subsequently, there is a breach of shareholder continuity, leading to a debit in the ICA. Later it is determined that the $100 is an overpayment and a refund is sought. After the overpaid tax is refunded, the company pays the amount back to Inland Revenue (say, in satisfaction of the next provisional tax payment due).

For the purposes of determining whether a refund can be made, the balance in the ICA can be increased by the breach of continuity debit of $100 under section MD 2(4). Therefore the refund can be made in this case.

A second debit relating to the refund is recorded only if the refund is greater than the breach in continuity debit (section ME 5(1)(e)(iii)). Therefore no further debit will arise to the ICA when the refund is made.

When the refund has been subsequently paid back to Inland Revenue for offset against the next provisional tax liability, a credit will arise in the ICA for the payment.

Imputation credit account

Transaction	***Debit***	***Credit***	***Balance***
Payment		$100	$100 Cr
Breach in shareholder continuity	$100		Nil
Refund	Nil		Nil
Payment of provisional tax		$100	$100 Cr

Before this amendment, section MD 4 denied the second imputation credit if a transfer was made instead of a refund and payment.

Generic transfer rules introduced in 2002 provide a better result than section MD 4 did, so section MD 4 was repealed by the Taxation, (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003. The issue described above, however, continued to exist for transfers made before the section was repealed.

Key features

The now repealed section MD 4 provided that a credit did not arise to the ICA or DWPA if overpaid tax was transferred. New subsections (2) and (3) have been added to section MD 4 to provide for a credit (a permitted credit) to arise in some circumstances.

Section MD 4(2) provides that section MD 4(1) does not prevent a permitted credit if:

- the transferred tax could have been refunded instead of transferred; and
- between the time when the tax which gave rise to the overpayment was paid and the date of the request for the transfer, the company suffered a breach in shareholder continuity and a debit arose accordingly to the ICA or DWPA; and
- the taxpayer elects that the permitted credit arises.

The permitted credit arises under section ME 4(1)(a) or section MG 4(1)(a) as tax or dividend withholding payment "paid". For the purposes of those sections "paid" includes "distributed, credited, or dealt with in the interest of" and, therefore, includes an amount transferred.

New subsection (3) provides that the amount of the permitted credit is the amount transferred less the amount of the debit that would have arisen under section ME 5(1)(e) if the overpayment had been refunded.

Application date

The amendment has effect from the start of the 1997-98 year (when section MD 4 was introduced) to the date when section MD 4 was repealed (1 April 2003).

Detailed analysis

A permitted credit can arise to an ICA if section MD 4(2) is satisfied. Section MD 4(2) is satisfied if:

- a company was entitled to a refund of overpaid income tax (section MD 2(4)); and
- the overpaid tax was transferred, either at the taxpayer's request or on Inland Revenue's initiative; and
- a breach of shareholder continuity occurred between the time when the tax that led to the overpayment was paid and the time the transfer was made; and
- a credit would have arisen to the ICA if the:
  - overpayment had been refunded;
  - and the refunded amount had been repaid in satisfaction of a tax liability; and
- the company requests that section MD 4(2) and (3) apply to the transfer.

New subsection (3) provides that the amount of the permitted credit is the amount transferred less the amount of the debit that would have arisen under section ME 5(1)(e) if the overpayment had been refunded.

Example

Company B's ICA balance at 31 March 2000 is $100. A breach in shareholder continuity occurs on 30 June 2000. As a result, a debit arises to the ICA of $100 and the ICA balance is now nil.

Company B pays tax of $50 on 7 July 2000, bringing the ICA balance to $50.

On 30 April 2001 an income tax overpayment of $150, which arose before the breach in shareholder continuity, is identified. Company B applied to have $150 transferred to 2002 provisional tax. This was done, but under section MD 4, as it applied in 2001, no credit arose to the ICA for the transfer. At that stage there was no provision that allowed a debit to arise relating to a transfer of overpaid tax.

In 2004, Company B requests that subsections MD 4(2) and (3) be applied.

Under section MD 4(3) the permitted credit will be the amount transferred less the debit that would have arisen if the amount transferred had been refunded instead of transferred. Section ME 5(1)(e)(iii) provides that a debit arises to the ICA when a refund is made, except to the extent of a debit that arose upon a previous breach in continuity.

In the example, a previous debit of $100 arose upon a breach of continuity. Therefore, had $150 been refunded, the debit that would have arisen to the ICA would have been $50. Accordingly, the permitted credit will be the amount transferred ($150) less the debit that would have arisen under section ME 5(1)(e)(iii) if the transferred tax had been refunded ($50). The permitted credit is, therefore, $100. Entries in the ICA would be:

Imputation credit account

Transaction	*Debit*	*Credit*	*Balance*
Balance 31 March 2000			$100 Cr
Breach in shareholder continuity	$100		Nil
Payment 7 July 2000		$50	$50 Cr
Transfer	Nil		$50 Cr
Permitted credit		$100	$150 Cr

This is the result that would have occurred had the overpaid tax been refunded and repaid.

THE "PAYE BY INTERMEDIARIES" RULES

Sections NBB 2(1)(c), 2(4)(b), 4(1), 4(1B), 4(2), 4(3), 4(4)(c), 4(4)(d), 5(1), 5(1B), 5(2B), 6(2) and OB 1 of the Income Tax Act 1994 and the Income Tax Act 2004

Sections 120OB(1), 141JB(1), 167(2B), 168(4), 169(1B) of the Tax Administration Act 1994

Introduction

A number of amendments have been made to the "PAYE by intermediaries" rules to further improve their operability. The rules allow accredited intermediaries to largely assume an employer's obligations under the PAYE rules — to calculate PAYE, pay it to Inland Revenue and file PAYE returns. The amendments to the rules:

- allow PAYE intermediaries to make payments of net salary and wages directly to employees (from an employer's account) provided the associated PAYE is simultaneously transferred, or is transferred before the payment to employees is made, into an intermediary's trust account;
- clarify the accreditation requirements for PAYE intermediaries; and
- require PAYE intermediaries to represent at least ten employers.

Background

From 1 April 2004, the new "PAYE by intermediaries" rules allow accredited intermediaries to largely assume an employer's obligations under the PAYE rules (calculating PAYE, paying it and filing returns). Under the rules, employers' obligations are limited to paying their employees' gross salary and wages to the PAYE intermediary and providing basic payroll information.

An amendment has been made to the rules to provide greater flexibility to PAYE intermediaries in how they make payments to employees. Before this change, the "PAYE by intermediaries" rules required employers to deposit the gross salary or wages of employees into a trust account operated by the intermediary. The intermediary was then responsible for disbursing the deposited funds — net pay to employees and PAYE to Inland Revenue. Concerns were raised that this model could result in a number of unnecessary risks and transactions costs being incurred by prospective intermediaries.

To deal with those concerns, the rules have been changed to allow PAYE intermediaries to make payments of net salary and wages directly into employees' bank accounts (from an employer's account) provided the associated PAYE is simultaneously transferred, or is transferred before the payment to employees is made, into an intermediary's trust account. Employers and PAYE intermediaries will, however, still have the option of using the trust account for gross salary and wages, if so desired.

Amendments also clarify the application of certain accreditation requirements for PAYE intermediaries — namely, the requirement for applicants to give notice to the Commissioner that they are of suitable character to be a PAYE intermediary (such as not having been convicted of offences involving fraud). If the applicant is not a "natural person" (such as a company), the intent is for this requirement to apply to the directors and other statutory officers of the company rather than to all employees of the company, many of whom will have no direct role in the PAYE intermediary function. This distinction has been clarified in respect of an applicant for accreditation that is a body corporate. On recommendation of the Finance and Expenditure Committee, the rules have further been clarified so that for an applicant that is an unincorporated body (such as a partnership), each member of the unincorporated body will be subject to the accreditation requirements discussed above.

Finally, amendments reduce the risk of the "PAYE by intermediaries" rules being abused by entities registering as intermediaries who do not intend to represent any employers, by requiring PAYE intermediaries to act on behalf of a minimum of ten employers.

Key features

Sections NBB 2(1)(c) and 2(4)(b) of the Income Tax Act 1994 and 2004 have been amended to clarify that the accreditation requirements in those sections apply to a "director, secretary or statutory officer" when the applicant is a body corporate and, in the case of an unincorporated body, to the members of the unincorporated body.

Section NBB 4(1) of the 1994 and 2004 Acts has been replaced and new section NBB 5(1B) added to give greater flexibility to PAYE intermediaries in how they can make payments to employees. If the gross pay of employees is not transacted through a PAYE intermediary's trust account, replacement section NBB 4(1)(a) requires employers to make available sufficient funds to a PAYE intermediary to cover both employees' net salary and wages and the PAYE. New section NBB 5(1B) then requires a PAYE intermediary, when making payments of net salary and wages directly to employees, to transfer the associated PAYE into the trust account simultaneously (or transfer the PAYE before the payment to employees is made).

As a result of the changes to section NBB 4(1), a number of consequential amendments have been made, including the addition of a new section NBB 4(1B), changes to sections NBB 4(2), NBB 4(3), NBB 4(4)(c) and (d), NBB 5(1), NBB 5(2B) and NBB 6(2) and changes to sections 120OB(1), 141JB(1), 167(2B), 168(4) and 169(1B) of the Tax Administration Act 1994.

The definition of "PAYE intermediary" in section OB 1 has been amended to require PAYE intermediaries to represent at least ten employers.

Application date

The amendments are effective from the application date of the "PAYE by intermediaries rules" — pay periods beginning on and after 1 April 2004.

REDUCTION OF NON-DECLARATION RATE FOR NON-RESIDENT CONTRACTORS WHO ARE COMPANIES

Section NC 7(2) of the Income Tax Act 1994 and the Income Tax Act 2004

Introduction

Employers who make withholding payments to non-resident contractors are required to withhold tax from the payments, this amount is increased if the contractor makes no declaration. An amendment reduces this non-declaration rate for companies from 15% to 5%.

Background

Withholding payments made to non-resident contractors are subject to the non-resident contractors' withholding tax. Non-resident contractors are required to make a withholding declaration under the Income Tax Act. If no declaration is made an extra withholding payment is imposed. The amendment reduces the amount that has to be withheld if the non-resident contractor is a company and it does not make a declaration.

The reason for lowering the rate is that companies will have overheads while carrying out contract activities in New Zealand. Consequently, the net amount earned by non-resident companies in most cases will be significantly lower than their gross earnings, to which non-resident contractors' withholding tax applies. A lower total withholding tax rate of 20%, if no tax code declaration is made, is more appropriate for non-resident contractors that are companies, to reflect the typical difference between net and gross earnings.

Key features

The Income Tax (Withholding Payments) Regulations 1979 makes certain payments to non-resident contractors subject to withholding tax. The regulations require that tax be withheld at 15% of the contract payment.

Section NC 7(2) of the Income Tax Act 1994 applies in addition when an employer who is making a withholding payment has not received a withholding declaration from a contractor. Before the amendment was enacted that section required that the employer had to increase the amount withheld by 15%.

Section NC 7(2) has been amended specifically with regard to payments to non-resident contractors who are companies. It reduces the extra amount that needs to be withheld in the absence of a withholding declaration to 5%.

A specific anti-avoidance rule has also been added to the provision. It is intended to prevent abuse of the reduction in the rate applicable to non-resident contractor companies by individuals recharacterising themselves as companies.

Application date

The amendment applies from 21 December 2004.

RWT ON USE-OF-MONEY INTEREST

Sections NF 1(2)(a), 1(2)(a)(x), 1(3) and 1(3A) of the Income Tax Act 1994 and the Income Tax Act 2004

Introduction

The Commissioner of Inland Revenue is no longer required to deduct resident withholding tax ("RWT") from use-of-money interest ("UOMI") paid to a taxpayer in respect of overpaid tax.

Background

The amendment is intended to reduce both compliance costs for taxpayers and administrative costs to Inland Revenue.

When UOMI paid by the Commissioner was introduced, it was intended that it be assessable and subject to the RWT rules. This ensured that, from the taxpayer's perspective, UOMI paid by the Commissioner was treated, as much as possible, like interest received from a bank.

In practice, however, it resulted in an overly complex system with significant compliance costs for taxpayers, especially in relation to RWT credits. Inland Revenue was also faced with increased administrative costs.

Key features

Section NF 1(2)(a) has been amended to exclude UOMI paid by the Commissioner from being subject to the RWT rules. Sections NF 1(2)(a)(x), 1(3) and 1(3A) have been repealed, as they become unnecessary as a result of the amendment.

UOMI paid by the Commissioner is no longer subject to withholding at source, although it is still gross income for tax purposes. It will now become part of a taxpayer's residual income tax calculation, and will either be added to the taxpayer's provisional tax payments or paid at the terminal tax date.

Application date

The amendment applies to interest payable as of 1 April 2005.

INCORPORATED SOCIETIES – CARRYING FORWARD AND GROUPING TAX LOSSES

Section OB 1 of the Income Tax Act 1994 and 2004, new sections OD 3(4) and OD 3(5) of the Income Tax Act 1994, and section 8B of the Income Tax Act 1976

Introduction

The definition of "special corporate entity" has been amended to include incorporated societies that have no shares on issue to members of the society. The effect of this amendment is to allow such incorporated societies to carry forward tax losses and offset income and losses against the income and losses of companies in the same group.

The amendments also allow commonly owned incorporated societies to offset income and losses for the 1997–98 to 2002–03 income years.

Background

The amendments ensure that incorporated societies which are treated as companies for tax purposes, can access the same provisions that allow other corporate entities to carry forward losses and offset them against those of companies in the same group.

Before 1992, incorporated societies were able to carry forward and offset their tax losses. In 1992, the loss carrying forward rules were substantially overhauled. An unintended consequence of this overhaul was that incorporated societies were now required to satisfy the shareholder continuity test in order to access the loss provisions.

Incorporated societies may not satisfy the shareholder continuity test on the grounds that they do not issue shares and previously could not be exempted from this requirement as they did not fall within the definition of "special corporate entity". Since 1992, some incorporated societies have applied the loss provisions as if they applied to them, while others have followed the letter of the law.

Key features

The definition of "special corporate entity" in section OB 1 of the 1994 and 2004 Acts has been amended to include any body incorporated under the Incorporated Societies Act 1908 that has no shares on issue to members of the society. A similar amendment has been made to section 8G of the Income Tax Act 1976. This allows incorporated societies to carry forward tax losses and offset income and losses against those of companies in the same group.

New section OD 3(4) of the Income Tax Act 1994 allows commonly owned incorporated societies that do not issue shares to offset income and losses within the same group of companies for the 1997–98 to 2002–03 income years. This provision treats a member of an incorporated society that does not issue shares as holding a share, and these shares carry all the shareholder decision making rights. The result is that a voting interest is created that can be used for the purposes of subpart IG of the Act.

New section OD 3(5) of the Income Tax Act 1994 ensures that incorporated societies that applied new section OD 3(4), do not breach continuity upon being treated as a "special corporate entity" in the 2003–04 income year.

Application date

The amendment allowing incorporated societies to carry forward losses and offset income and losses against those of companies in the same group has two application dates:

- In relation to the carry forward of tax losses, the amendment applies from the 1992–93 income year.
- In relation to the offsetting of income and losses by incorporated societies and companies that are in the same group, the amendment applies from the 1992–93 income year if the society has, before 29 March 2004 (date of introduction of the bill), filed a tax return and the society has adopted a tax position in that return that is consistent with the proposed amendments.

The amendment that allows commonly owned incorporated societies to offset income and losses, applies from the 1997–98 income year to the 2002–03 income year if the incorporated societies have taken this tax position in relation to tax returns filed for those years.

CONFIRMATION OF ANNUAL INCOME TAX RATES FOR 2004–05

Schedule 1, Income Tax Act 1994

The income tax rates for the 2004–05 income year have been confirmed as follows:

Policyholder income	33 cents for every $1 of schedular taxable income
Mäori authorities	19.5 cents for every $1 of taxable income
Companies, public authorities and local authorities	33 cents for every $1 of taxable income
Trustee income (including that of trustees of superannuation funds)	33 cents for every $1 of taxable income
Trustees of group investment funds in respect of category A	33 cents for every $1 of schedular taxable income
Taxable distributions from non-qualifying trusts	45 cents for every $1 of taxable income
Other taxpayers (including individuals)	
– Income not exceeding $38,000	19.5 cents for every $1 of taxable income
– Income exceeding $38,000 but not exceeding $60,000	33 cents for every $1 of taxable income
– Income exceeding $60,000	39 cents for every $1 of taxable income
Specified superannuation contribution	
Where the employee has made an election under section NE 2AA contribution	39 cents for every $1 of the withholding tax
Where the employer has made an election under section NE 2AB and the amount of salary or wages given by section NE 2AB is:	
– not more than $9,500	15 cents for every dollar of contribution
– more than $9,500 and not more than $38,000	21 cents for every dollar of contribution
-– more than $38,000	33 cents for every dollar of contribution
Where no such election is made	33 cents for every $1 of contribution

The income tax rates confirmed are those that applied for 2003–04, with the following exceptions:

- a new rate for the income of Mäori authorities;
- there is no longer a rate for undistributed rents, royalties and interest of the Mäori Trustee; and
- new rates for specified superannuation contributions where the employer has made an election under section NE 2AB of the Income Tax Act 1994.

The rates apply for the 2004–05 income year.

INFORMATION-MATCHING

Sections 3, 81, 82 and 85 of the Tax Administration Act 1994

Introduction

Student allowance recipients (or partners of students receiving the married student allowance rate) have been included in data exchanges between Inland Revenue and the Ministry of Social Development. The purpose of information-matching is to identify any overpayments of student allowances.

In addition, the information which Inland Revenue may supply to the Ministry regarding beneficiaries or student allowance recipients in employment has been increased.

Background

Data exchanges currently take place between Inland Revenue and the Ministry of Social Development to identify those in employment and/or to locate those who have an amount payable to the Ministry.

Key features

The secrecy provisions in sections 81, 82 and 85 of the Tax Administration Act have been amended to include student allowance recipients (or partners of students receiving the married student allowance rate) in data matches between Inland Revenue and the Ministry of Social Development, to establish whether they have been working while in receipt of an allowance. That information will be used by the Ministry to establish whether entitlement to the allowance had ceased owing to the level of a recipient's (or partner's) income.

A further change to section 82 the Tax Administration Act has increased the information which Inland Revenue may supply to the Ministry regarding beneficiaries or student allowance recipients in employment to include their:

- employer's telephone number and/or email address;
- tax code; and
- name and date of birth.

This additional information will enhance the accuracy of the match and thus reduce unnecessary contact with beneficiaries, students and their employers.

Application date

The amendments apply from 21 December 2004.

GST AND SELF-ASSESSMENT

Sections 89D(2C), 89DA(1), 92B, 106(1D), 106(1E), 108A(1), 108A(3), 108B(3)(f) of the Tax Administration Act 1994 and sections 2(1), 16(3), 17(3), 19B(2B), 20A(1)(b), Part IV (repealed) and section 51B of the Goods and Services Tax Act 1985

Introduction

Amendments have been made to the Goods and Services Tax Act 1985 and the Tax Administration Act 1994 (TAA) to provide that GST is a self-assessed tax. GST, like income tax, relies on taxpayers making the initial assessment of their own tax liability. The amendments aligning the GST legislation with the practice of self-assessment follow the legislative approach used for income tax.

Background

Modern tax administration practices recognise that taxpayers have the best information about their own activities. As such, taxpayers are better placed than the Commissioner to assess their tax liabilities by making the appropriate calculations and furnishing their returns. Therefore both the GST and income tax systems rely on taxpayers making the initial assessment of their tax liability.

Self-assessment for GST was previously not fully provided for in the legislation. Legislating explicitly for self-assessment for GST now aligns the legislation with practice, thus allowing taxpayers' obligations to be provided for more clearly and directly.

Self-assessment for income tax was enacted in 2001 to apply from the 2002–03 income year, and the self-assessment amendments for GST follow the approach for income tax.

Although not involving significant policy change, the introduction of self-assessment into the GST legislation will add to and enhance other improvements being made to simplify tax administration. The GST self-assessment provisions also achieve a better interface between the GST Act and the TAA.

Application date

The amendments apply to GST taxable periods starting on or after 1 April 2005.

Key features

Part IV of the GST Act, relating to the assessment of GST, has been repealed. The main effect of former section 27 of the GST Act is achieved by new section 92B of the TAA. A taxpayer who is required to provide a return under the GST Act for a taxable period must make an assessment of the tax payable for the period.

The Commissioner will retain specific powers to amend a taxpayer's assessment under section 113 of the TAA or make an assessment under section 106 if a taxpayer fails to self-assess.

Consequential amendments have been made to the timebar provisions in section 108A for amending GST assessments and the timebar waiver provisions in section 108B of the TAA, reflecting the move to self-assessment. These changes are based on the model used in the income tax time bar provision in section 108.

A number of provisions in the GST Act have been repealed because their effect is replicated by existing provisions in the TAA. For example, the effect of section 29 of the GST Act (assessments deemed correct except in challenge proceedings) is replicated in section 109 of the TAA, so section 29 has been repealed.

Detailed analysis

Requiring taxpayers to make a GST assessment

Part IV of the GST Act, relating to the assessment of GST, has been repealed with its effect being achieved by existing or new provisions in Part VI (assessments) of the TAA. New section 92B in Part VI of the TAA requires a taxpayer (as defined in section 3 of the TAA) to self-assess for GST. In particular, subsection (1) states that a taxpayer who is required to provide a GST tax return for a GST return period must make an assessment of the amount of GST payable for the return period. The self-assessment provision also applies to any person required to provide a special return under section 17 of the GST Act.

The terms "GST return period" and "GST payable" in the TAA have the same meanings as the terms "taxable period" and "tax payable" in the GST Act.

Date of self-assessment

New section 92B(2) states that the assessment is made on the date on which the taxpayer's GST tax return is received at an office of the department.

In practice, this means that on the date of receipt by Inland Revenue of the taxpayer's return, the return is datestamped — electronically or manually — and it is this date that is entered into Inland Revenue's computer system. Once this date is entered into the system, a return acknowledgement form is generated and sent to the taxpayer. The taxpayer will therefore have a record of the date of receipt, and the date of self-assessment.

Notice of self-assessment

New section 16(3) of the GST Act provides that a return filed for a taxable period must contain a notice of the assessment made under section 92B of the TAA. Similarly, new section 17(3) of the GST Act provides that a special return required to be provided under section 17(1) must contain a notice of the self-assessment.

Commissioner amendment of assessments

The Commissioner retains the power to amend any GST assessments, including those made by the taxpayer. The function of former section 27(2) of the GST Act is achieved by section 113 of the TAA. Section 113 allows the Commissioner to amend an assessment at any time, subject to new section 89N.

Persons treated as registered

The function of former section 27(5A) and (6) is now achieved by new section 51B of the GST Act. This section deems persons to be registered in certain situations.

Commissioner assessments

The Commissioner retains the power to make an initial assessment (default assessment) if the taxpayer fails to self-assess. Section 106 of the TAA has been amended to enable the Commissioner to make an assessment of the GST payable if a person does not provide a GST tax return (including returns required to be filed because the person is treated as being registered under 51B) or provides a return with which the Commissioner is not satisfied.

If the Commissioner, instead of the taxpayer, makes the initial assessment, the requirement for a taxpayer to self-assess does not apply.

Timebar for amending a GST assessment

Amendments have been made to sections 108A and 108B to reflect self-assessment of GST. The time bar provision in section 108A(1) has been simplified to provide that if a taxpayer provides a GST tax return for a GST return period and an assessment has been made, and four years have passed from the end of the GST return period in which the taxpayer provided the tax return, the Commissioner may not amend the assessment.

Disputing an assessment made by the Commissioner

If the Commissioner has made the initial assessment for the taxpayer, the taxpayer can dispute the assessment only after furnishing a GST return. This requirement is contained in new section 89D(2C).

Disputing a GST self-assessment

Section 89DA enables taxpayers to propose adjustments to their own assessments by issuing a notice of proposed adjustment. This provision has been amended to incorporate GST self-assessments.

Consequential amendments

- An amendment to section 2(4) of the TAA ensures that Part VI (Assessments) of the TAA applies to GST assessments.
- The effect of former section 27(3) and (5) is achieved by section 111 of the TAA. In particular, new section 111(8) continues the effect of former section 27(3)(b).
- The effect of former section 28 of the GST Act is achieved by section 114 of the TAA. Section 114 provides that the validity of an assessment made by the Commissioner is not affected by failure to comply with the Inland Revenue Acts.
- The effect of former sections 23(3) and 29 of the GST Act is achieved by section 109 of the TAA. Section 109 provides that except in challenge proceedings every disputable decision (which includes an assessment) and its particulars is taken to be correct.
- The effect of former section 30 of the GST Act relating to evidence of returns and assessments is achieved by section 110 of the TAA.
- In sections 2(1) and 20A(1)(b) of the GST Act, the reference to section 27(6) has been replaced with a reference to its successor provision new section 51B.

PENALTIES APPLICABLE TO NON-RESIDENT CONTRACTOR WHEN EXEMPT FROM TAX IN NEW ZEALAND

Sections 141(2), 141AA, 183A(1) and 183D(1) of the Tax Administration Act 1994

Introduction

A penalty of $250 per employer monthly schedule will be imposed if an employer fails to make a required deduction from the withholding payment to a non-resident contractor. This penalty is capped at $1,000 per employer monthly schedule. The amendment applies only in cases where the non-resident contractor that the withholding payment is made to is totally relieved from paying tax in New Zealand. It replaces the present shortfall penalty because that penalty is not appropriate in these circumstances.

Background

New Zealand employers are required to withhold non-resident contractors' withholding tax from contract payments to non-resident contractors, regardless of whether the non-resident qualifies for total tax relief under a double tax agreement. The Commissioner of Inland Revenue is able to issue an exemption certificate in these situations, but in some situations obtaining the certificate may be overlooked.

If the contractor qualifies for total relief under a double tax agreement the contractor is refunded the tax paid when a tax return is filed at the end of the year. However, if the New Zealand employer does not withhold tax, a shortfall penalty was payable. The shortfall penalty was imposed on the New Zealand employer even if no New Zealand tax was payable by the non-resident contractor.

The new section changes this by providing for a different penalty to apply. A penalty is needed because it ensures that non-resident contractors apply for a certificate of exemption, which in turn provides useful information to the Commissioner.

Key features

New section 141AA of the Tax Administration Act 1994 imposes a penalty on an employer who makes a withholding payment to a non-resident contractor for the purposes of the Income Tax (Withholding Payments) Regulations 1979 if that employer does not withhold the correct amount of tax. The penalty applies only if the non-resident contractor is exempt from all liability to pay tax in New Zealand on their income.

The employer is liable for a shortfall penalty of $250 for each return period for which the employer failed to make a required tax deduction from a withholding payment.

The amendment provides that in these circumstances the employer will not be subject to the normal shortfall penalty provisions. The penalty is capped at $1,000 per employer monthly schedule.

Application date

The amendment applies to withholding payments made on or after 1 April 2005.

TAX SHORTFALLS – LOSS ATTRIBUTING QUALIFYING COMPANIES

Section 141 FD of the Tax Administration Act 1994

Introduction

To the extent an adjustment reduces a net loss of a loss attributing qualifying company (LAQC), shortfall penalties will be charged to the shareholder, not the company. If the shareholder does not claim a deduction for the attributed loss, no penalty is charged. The change provides a better mechanism for reducing the double incidence of penalties if an LAQC and shareholder are both penalised for the same shortfall.

Background

Net losses of an LAQC are attributed to shareholders. Before the enactment of the Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003, the law allowed shortfall penalties to be charged to both the LAQC and the shareholders if a loss claimed by an LAQC was adjusted and caused a shortfall for the shareholder as well.

The Act was retrospectively amended in 2003 to add section 141FC, allowing a shareholder in an LAQC to receive an offset to his or her penalty if the LAQC paid its penalty in full. This approach was adopted because it did not cut across Chapman v Commissioner of Inland Revenue (HC M402-SD02). At the time the Amendment Act was passed, the case was under appeal.

The section 141FC offset mechanism was clumsy from both a taxpayer's and Inland Revenue's perspective. Once the Chapman case was resolved (the appeal was withdrawn) a more conceptual approach to this issue became possible.

Key features

New section 141FD applies automatically when an LAQC has a net loss and that loss is subsequently reduced or reversed. The LAQC will not be charged a shortfall penalty in these circumstances. The shareholder will be charged a shortfall penalty if he or she has claimed a deduction for the attributed loss.

If an adjustment results in net income to the LAQC, however, the company will be charged the shortfall penalty.

Section 141FC, which allows a shareholder in an LAQC to apply for an offset of a shortfall penalty if a penalty is charged to both the shareholder and the company, has been repealed.

Application date

The new rules apply to shortfall penalties imposed for return periods beginning on or after 1 April 2005.

REMEDIAL ISSUES

FUND WITHDRAWAL TAX

Sections CL 4(2) and CL 8 of the Income Tax Act 1994 and sections CS 1 (2),(3),(4) and (4B) and CS 7(2),(3) and (4B) of the Income Tax Act 2004

Introduction

The Fund Withdrawal Tax (FWT) rules have been amended to clarify that they do not apply to those superannuation fund members who have elected that a higher rate (39%) of specified superannuation contribution withholding tax apply, or that the specified superannuation contribution made by their employer be treated as salary or wages.

Amendments also clarify the cessation of employment exemption, which is an exemption for withdrawals made on or after, or shortly before, cessation of employment. They introduce an exclusion from the tax in some situations where specified superannuation contributions have not been made throughout the last two complete income years and during any period subsequent to the last complete income year, "the minimum employment period".

A new annual de minimis of $5,000 applies to withdrawals made upon cessation of employment when the member has completed a minimum employment period.

Background

The rate of specified superannuation contribution withholding tax is generally a flat rate of 33%. When the top personal tax rate was increased to 39% an avoidance opportunity was created.

The FWT rules were introduced to counter this avoidance opportunity. The FWT rules aim to minimise the tax benefit for those earning over $60,000 a year from substituting employer contributions to a superannuation fund for salary and wages and subsequently withdrawing the increased contribution and thus avoiding the 39% rate. The FWT rules provide that, in certain circumstances, withdrawals are subject to tax.

At the recommendation of the select committee considering the bill an annual de minimis of $5,000 was added in relation to withdrawals made on cessation of employment in situations where the member has completed the minimum employment period. The de minimis relates to the amount of the employer contribution to superannuation savings withdrawn and removes the need to assess the consistency in size and frequency of the employer contributions over the minimum employment period.

Key features

The amendments aim to clarify the legislation so that the original policy intent of the legislation is achieved.

The first amendment relates to employees who have elected to have all or part of their employer specified superannuation contribution taxed at either a higher rate of 39% (section NE2AA (1) of the Income Tax Act 1994 and the Income Tax 2004) or treated as salary or wages (section NE 2A(1)). It is not the policy intent that the rules apply to the withdrawal of these amounts from superannuation funds.

FWT is intended to deal with an avoidance concern that is not present when such an election is made. This exclusion was not made clear in the previous rules, and the amendment ensures that employer contributions that are subject to the 39% rate or treated as salary or wages are not subject to FWT.

The remaining amendments concern the exception for withdrawal when a member ceases employment, contained in section CL 8 of the 1994 Act and section CS 7 of the 2004 Act. The FWT does not apply to contributions that are withdrawn on or after, or shortly before, an employee ceases employment, except in limited circumstances. In some circumstances, a literal interpretation of these sections conflicts with its intended application. The practical application is that FWT has applied when it is the policy intent that it should not.

Section CL 8(2) of the 1994 Act and section CS 7(2) and (3) of the 2004 Act have been amended to enable previous employment to be counted for the "two years or more" employment requirement ("minimum employment period") if the employer changes but the member has transferred his or her superannuation entitlement to the new employer's superannuation fund. This scenario may have occurred as part of a business restructuring — for example, a company buy-out where an employee joins the new employer's fund and all of that employee's existing superannuation entitlements are transferred to the new employer's fund.

In some circumstances an employee could meet the "minimum employment period" test but would fail the contribution tests in either of the original sections CL 8(2)(b) or CL 8(2)(c) and sections CS 7(3)(b) or CS 7 (3)(c) because the employee had been in a scheme for less than three complete years before ceasing employment. New section CL 8(2B) of the 1994 Act and new section CS 7(4B) of the 2004 Act provide the discretion for the Commissioner to relax the contribution tests in circumstances where the employment test is met. In practice, if the amount of the employer's contribution paid on the member's behalf is prescribed by the superannuation fund's documentation and applies generally to members in similar circumstances to the member under consideration, and the reason for joining the fund was not to avoid the top personal tax rate, the withdrawal will not be subject to FWT.

New section CL 8(2)(c)(ii) of the 1994 Act and new section CS 7(2)(d)(iii) of the 2004 Act provide for a de minimis of $5,000 for each income year for withdrawals of contributions if the employer contributions to superannuation savings withdrawn do not exceed $5,000 per year. The de minimis applies if the employee meets the "minimum employment period" and the employer or a previous employer made contributions.

Example

The following example explains how the amendments to section CL 8 of the 1994 Act and section CS 7 of the 2004 Act will apply in practice.

Member A and Member B both joined the superannuation scheme offered by their employer, First Co Limited, on 1 April 2001. In January 2003 First Co Limited was acquired by New Co Limited, and employees of First Co Limited became employees of New Co Limited. As part of the deal, New Co Limited agreed to continue to offer superannuation benefits on the same terms as those offered by the First Co Limited. The members' earnings were not altered by the deal.

Member A chose to transfer his entitlement from the First Co Limited superannuation fund to the New Co Limited superannuation fund. Member B joined the New Co Limited superannuation fund but elected to receive his First Co superannuation fund benefit.

Member A and Member B both resign from the employment of New Co Limited in December 2004.

Member A satisfies the "minimum employment period" specified in amended sections CL 8(2)(a) of the 1994 Act and CS 7(2)(a) and CS 7(3)(a) of the 2004 Act and the requirements of CL 8(2)(b) and CS 7(2)(b) and (c) as the member has been employed by either First Co Limited or New Co Limited for all of the period from 1 April 2002 to December 2004.

Whether or not Member A's benefit is subject to FWT will depend on which (if any) of the conditions set out in amended sections CL 8(2)(c) and CS 7(2)(d) apply.

Sections CL 8(2)(c) and CS 7(2)(d) provide an FWT exemption if the specified employer contributions that are part of the withdrawal do not exceed $5,000 for each income year for which contributions have been made. For Member A this amounts to $18,750 for the three years and nine months during which contributions have been made by either of the two employers.

Assuming that Member A is eligible for 60% of his employer account, employer contributions of $31,250 could have been made over the three-year nine-month period and the benefit would be exempt.

If this exemption does not apply, the conditions of amended sections CL 8(2B) (a) or (b) and CS 7(3) and (4) or (4B) will need to be satisfied. Under sections CL 8(2B)(a) and CS 7(3) and (4) the conditions are specific and provide for an exemption if contributions in each of the income years during the minimum employment period have not increased by 50% or more over the previous complete income year (including the annualised contributions for any period since the last 31 March).

In the case of Member A this will necessitate a comparison of the employer contributions in the income year 1 April 2002 to 31 March 2003 with those in the year 1 April 2001 to 31 March 2002, as well as for the subsequent financial and part financial years. As Member A was a member of First Co Limited's fund for all of the 2002 financial year, and as his superannuation terms and pay conditions were not altered by the sale of First Co Limited to New Co Limited, it is expected that Member A's benefit would be exempt from FWT.

Member B satisfies the conditions of sections CL 8(2)(a) and (b) and CS 7(2)(a) and (3)(a) and (b). However, in relation to section CL 8(2)(c) and section CS 7(3)(c), it is necessary to consider only the period and contributions relating to his membership of the New Co Limited fund. Hence the de minimis threshold is $10,000 for the two years during which specified superannuation contributions have been made by New Co Limited. If the amount withdrawn is $10,000 or less the de minimis will treat the withdrawal as not being subject to FWT.

If the de minimis rule does not apply it is necessary to consider the application of section CL 8(2B) and CS 7(3) and (4) or (4B). With only two years of employer contributions, Member B will fail the requirements of sections CL 8(2B)(a) and CS 7(3)(c).

The next step is to consider whether sections CL 8(2B)(b) and CS 7(4B) apply, which is at the discretion of the Commissioner of Inland Revenue.

The factors taken into account in applying this discretion are as follows:

- Consistency of employer contribution: In a situation where employer contributions to superannuation savings on behalf of a member have been maintained at a consistent level (either in absolute dollar terms or as a percentage of earnings) throughout the part of the minimum employment period that the employee was a member (such as is the case for Member B) this factor will be met.
- Short membership period but minimum of three years' employment: If the employer contributions to superannuation savings made on

a member's behalf were made at a rate specified by rules that apply to other employee members of the fund in a comparable position this factor will be met.

Other factors that may be necessary to take into account in determining whether the discretion in sections CL 8(2B) (b) and CS 7(4B) apply:

- In relation to provisions in defined benefit arrangements, the Commissioner will consider the employer contributions have been set so as to provide benefits that are consistent with value of those defined benefits. If so the factors will be met.
- In relation to factors in subparagraphs (i) and (ii) of section CL 8 (2B)(b) and CS 7(4B)(b) and (c) the Commissioner will also consider whether the employee member had a controlling interest in the employer over the period of the contributions. If so, the factors may not be met.

Application date

The amendment clarifying that the FWT rules contained in section CL 4 of the Income Tax Act 1994 do not apply to those fund members who have made an election under section NE 2AA(1) or section NE 2A(1) will apply retrospectively from 14 September 2000, when the FWT rules came into effect.

The amendments clarifying the cessation of employment exemption in section CL 8(2) of the 1994 Act and section CS 7(2) and (3) of the 2004 Act will apply from the date of enactment, 21 December 2004. The amendments to the 2004 Act apply from the 2005–06 income year.

DEFERRED DEDUCTION RULE

Sections ES 1 to 3 of the Income Tax Act 1994 and sections GC 29 to 31 of the Income Tax Act 2004

Introduction

A further restriction has been placed on the operation of the deferred deduction rule, a revenue protection measure. It does not apply if 70% of an arrangement's assets consist of foreign shares held on capital account.

The criteria for defining limited recourse loans have been restated to clarify that loans from associated persons are generally excluded and, separately, arm's-length loans from New Zealand financial institutions are excluded from the definition. Two other changes ensure consistency or make the rule work as it was designed to.

Background

The deferred deduction was introduced in the Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003. The general purpose of the rule is to combat aggressive tax arrangements which provide taxpayers with excessive tax advantages. The tax savings occur regardless of the success of the arrangement.

These changes further target the rule and clarify aspects of it.

Key features

Foreign shares

Section ES 1(1)(e) of the 1994 Act and section GC 29(1)(e) of the 2004 Act have been amended to restrict the deferred deduction rule from applying to companies where 70% or more of the arrangement assets consist of foreign shares, if the proceeds upon any disposition of shares are not gross income, other than under the foreign investment fund rules. Comprehensive tax rules surround such investments, and the deferred deduction rule should not impose further potential tax obligations.

Other changes

Section ES 1(1)(e) of the 1994 Act and section GC 29(1)(e) of the 2004 Act have been further amended to clarify that the rule will not apply where either:

- limited recourse amounts constitute less than 50% of net arrangement assets; or
- 70% or more of the arrangement assets are assets of the kind listed in sections ES 1(1)(e)(ii) and GC 29(1)(e)(ii).

The criteria in sections ES 2(3)(d) and GC 30(3)(d) for a limited recourse loan have been amended to reflect the original intent. Loans are caught if:

- they are from an associated person who in turn has borrowed on a limited recourse basis; or
- they are not provided on an arm's-length basis; and
- they are not provided by a lender who regularly lends money and is resident or situated in New Zealand.

Sections ES 1 and ES 3 of the 1994 Act and section GC 29 to 31 of the 2004 Act have been amended to ensure that references to losses attributed by loss attributing qualifying companies are treated in the same way in both sections and both Acts.

Application date

The amendments apply from the 2004–05 income year, but do not apply to arrangements entered into before the start of the 2004–05 income year, unless:

- at the time of entering into the arrangement, the investor could have reasonably have expected that ten or more people would acquire an interest in the arrangement; and
- 70% or more of the allowable deductions of the investors from the arrangement for the income year arise from an interest in fixed life intangible property or software.

This is the general application date for the deferred deduction rule.

TRANS-TASMAN IMPUTATION

Sections FDB 1, ME 1, ME 1B, ME 1C, ME 10, ME 11, ME 12, ME 18, ME 19, MG 11 and OB1 of the Income Tax Act 1994 and Income Tax Act 2004, section 139A of the Tax Administration Act 1994

Introduction

A number of remedial amendments have been made to the recently enacted trans-Tasman imputation rules to improve their administrability and coherence.

Background

The trans-Tasman imputation rules in the Income Tax Act were enacted in 1995 to bring Australian resident companies within the scope of the imputation rules. This was part of a bilateral agreement with the Australian government which also included New Zealand-resident companies within the Australian imputation rules.

Australian and New Zealand shareholders of trans-Tasman companies that choose to take up these reforms can now be allocated imputation credits representing New Zealand tax paid and franking credits representing Australian tax paid, in proportion to their ownership of the company. However, each country's credits can be claimed only by its residents.

Key features

- Section FDB 1(1)(e) has been repealed and section FDB 1(2)(ab) has been added to clarify that an imputation group must include all members of a consolidated group or no members of a consolidated group.
- Section FDB 1(2)(b) has been amended to clarify that it is only when members of more than one consolidated group form or join an imputation group that the credits in a consolidated group imputation credit account must have the same shareholder continuity profile.
- Section ME 1(2)(a) has been amended to clarify that it is companies resident in countries other than New Zealand that are excluded from maintaining imputation credit accounts, rather than non-resident companies. This is because it is only resident companies under section ME 1(1) that are required to maintain an imputation credit account.
- Section ME 1B(4)(a) has been amended to give the Commissioner of Inland Revenue a discretion to accept late elections. The Commissioner will accept a late election only when the election would have been valid had it been received on time.
- The formula in section ME 1C has been corrected so it is "a x b" – that is, dividend times the exchange rate (rather than the previous a + b).
- Section ME 10(1D)(b) has been clarified to ensure that all entries to the imputation credit account from the New Zealand members of a trans-Tasman imputation group go to the resident imputation group, whether or not they could be considered to be "transactions".
- Section ME 12(1)(b)(i) has been removed and sections ME 18(1)(a), ME 18(3)(b), ME 19(3)(a) and (b) and ME 19(4)(b) have been amended to ensure that, for companies within a consolidated or imputation group, transfers can still be made between an individual company's imputation credit account and policyholder credit account. Section ME 18(4)(b) has been updated to refer to an imputation group's imputation credit account.
- Section ME 11(1)(f), ME 11(2)(d) and MG 11(1) have been amended to ensure that transfers made from a dividend withholding payment account to an imputation credit account can also be made to the imputation credit account of the imputation group of which the dividend withholding payment company is a member.
- The definition of "resident in Australia" in section OB 1, paragraph (a), has been omitted. This ensures that Australian resident companies which are also resident in New Zealand (dual resident companies) are eligible to elect to become imputation credit account companies.
- Section 139A(5) of the Tax Administration Act 1994 has been amended to omit annual imputation returns from this provision. This is to improve the consistency of the late filing penalty rules.

Application dates

The Commissioner's discretion to accept late elections and the amendments to allow transfers from a company's dividend withholding payment account to its imputation group's imputation credit account apply from the date of enactment, 21 December 2004.

The amendment to section ME 1C comes into force on 1 October 2003, the date from which Australian companies could pay imputed dividends.

The other amendments apply from 1 April 2003, the date from which Australian companies could use New Zealand's imputation rules.

MĀORI AUTHORITIES

Sections HI 3(3), HI 5, Table HI 8, new sections MD 2B(1B), MD 2B(4B), MK 8(5) and MK 8(5B) of the Income Tax Act 1994 and Income Tax Act 2004 and new section 181D of the Tax Administration Act 1994

Introduction

The recently enacted Māori authority rules have been amended to align them with the recently amended company imputation rules, resolve minor technical problems and provide greater certainty with respect to the election start date for entities that wish to be taxed as a Māori authority.

Background

The amendments were required because:

- The company imputation rules, on which the Māori authority rules were based, were recently amended by the Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003 and the Taxation (Relief, Refund and Miscellaneous Provisions) Act 2002, but no corresponding amendments were made to the Māori authority rules.
- There were two unintended omissions from the Māori authority rules when these rules were originally drafted.
- There was a need to provide greater certainty with respect to the election start date for entities wishing to be taxed as a Māori authority. Previously, the Commissioner had the ability to determine the start date but this did not give adequate certainty of tax treatment.

Key features

- Section HI 3(3) of the Income Tax Act 1994 and Income Tax Act 2004, which provided for the Commissioner of Inland Revenue to determine the effective start date of an election to become a Māori authority, has been replaced with a provision that sets an explicit start date for an election. The amendment requires that elections start from the beginning of the income year in which the election notice is provided to the Commissioner unless the authority wishes to start the election from the immediately following income year.
- Row 4 of Table HI 8 has been amended to ensure that when a Māori authority elects to be taxed as a trust, the income under the Māori authority rules which is still to be distributed is treated as trustee income and, therefore, can be distributed tax-free.
- Section HI 5 has been amended to include in the definition of "taxable Māori authority distribution" a taxable bonus issue made by a Māori authority that is a company.
- New section MD 2B(1B) clarifies that a Māori authority can be refunded income tax if there is a credit balance in its Māori authority credit account at the end of the relevant imputation year, without the need for multiple returns to be filed by the authority. The amendment is relevant to Māori authorities that have an extension of time for filing returns.
- New section MD 2B(4B) clarifies that any excess tax paid by a Māori authority can be credited as at a date on which there is no liability to pay provisional tax but from which use-of-money interest applies in relation to underpaid provisional tax.
- Section MK 8(5) has been replaced by new subsections, MK 8(5) and (5B). New subsection (5) provides that payments of further income tax may be credited to an income tax liability (including provisional tax) that arises at any time when the Māori authority is required to establish and maintain a Māori authority credit account. New subsection (5B) provides that payments of income tax may be credited against the further income tax liability as long as the payment was made after 31 March in the year when the Māori authority credit account debit caused the further income tax liability.
- New section 181D of the Tax Administration Act 1994 provides for the remission of use-of-money interest and late payment penalties on further income tax liabilities when income tax liabilities are outstanding at the same time. The remission will apply to the extent that the amount of further income tax charged is equal to or less than the amount of the unpaid income tax liability.

Application date

The amendments to the 1994 Act are effective from the 2004–05 income year, the application date of the new Māori authority rules. The amendments to the 2004 Act are effective from the 2005–06 tax year.

ALLOCATION DEFICIT DEBIT RULES FOR LIFE INSURANCE COMPANIES

Sections ME 18, ME 26, MG 5, MG 15, MG 16A, NH 6, OB 1 and new section MG 8B of the Income Tax Act 1994 and the Income Tax Act 2004

Introduction

The allocation deficit debit rules for life insurance companies have been amended to prevent the inappropriate results that could arise under the previous rules.

The new rules in section MG 8B are designed to ensure that the ratio by which dividend withholding payment (DWP) credits are attached to shareholder dividends does not exceed the equivalent ratio for policyholders.

To the extent that the shareholder ratio exceeds the policyholder ratio, an allocation deficit debit will arise in the life insurer's DWP account. This debit, in appropriate circumstances, will result in a corresponding credit to the policyholder credit account (PCA) of the life insurer.

The general policy approach in former section MG 8(5), which is to discourage refundable DWP credits from being streamed to shareholders so they are advantaged relative to policyholders, remains unchanged.

Background

The former section MG 8(5) was intended to operate as an anti-avoidance rule to discourage life insurance companies streaming refundable DWP credits to their shareholders in preference to their policyholders. It operated by recording a debit, called an allocation deficit debit, to a life insurer's DWP account when the fraction of DWP credits transferred to the PCA in an imputation year was less than the fraction of imputation credits transferred to the PCA in the same imputation year.

The provision was enacted as part of the new rules for the taxation of life insurance companies in 1990. It was intended to operate as an anti-avoidance provision to prevent a life insurer streaming refundable DWP credits to its shareholders and non-refundable imputation credits to its policyholders. At the time the rules were enacted, the Commissioner of Inland Revenue stated in *Tax Information Bulletin* Vol 2, No 3, October 1990 (Appendix C) at paragraph 17.4:

> ". . . The life insurer is able to elect to make transfers to its PCA from its WPA [DWP account]. However, as dividend withholding payments are refundable if not fully utilised by the person who ultimately receives them, there are provisions to ensure that a life insurer is unable to stream these credits to its shareholders as opposed to its policyholders . . ."

Some of the larger distortions under the previous rules arose because they focused on credits and debits arising to the memorandum accounts in one imputation year. They did not take into account opening and closing balances and, therefore, did not recognise that some life insurers may not clear out their DWP and imputation credit accounts each year by either transferring credits to the PCA or attaching them to dividends. If, for example, a life insurer had a substantial opening credit balance in its imputation credit account (ICA) and it elected to transfer a large proportion of these credits to the PCA, the imputation credit transfer fraction may well have been significantly higher than the DWP transfer fraction, even if the company had transferred all available DWP credits to the PCA.

The following policy issues were taken into account when developing the new allocation deficit debit rules:

- The application of the legislation should be limited to potential streaming events. Potential streaming events would arise in years when DWP credits are attached to dividend payments to shareholders.
- Once the threshold event has occurred, the penalty calculation should take a cumulative approach rather than focusing on memorandum entries in separate imputation years.
- The calculation should not rely solely on memorandum account entries but should have regard to distributions to both shareholders and policyholders.
- The allocation deficit debit in the DWP account should, when appropriate, result in a corresponding credit to the PCA.

The calculation should not result in inappropriate or disproportionate penalty amounts.

Application date

The new allocation deficit debit rules for life insurance companies apply generally for the 2004–05 and subsequent imputation years.

Life insurance companies are also able to elect to apply the new rules retrospectively for an imputation year that begins after 31 March 1995 and before 1 April 2004. It is expected that only taxpayers that have incurred allocation deficit debits under the previous rules will do so. If a company makes such an election, the new rules apply to the imputation year specified in the election and subsequent imputation years.

An amalgamated company is entitled to make an election for an amalgamating company (which has ceased to exist on amalgamation) to apply the new rules retrospectively up to the date of amalgamation. A nominated company for a consolidated group is also able to elect that the new rules apply retrospectively for the consolidated group.

Key features

The formula used in former section MG 8(5) could give rise to distorted and inappropriate results, including the imposition of excessive allocation deficit debits. For example, it was possible for a life insurance company to incur a large allocation deficit debit even when it had not paid a dividend to its shareholders and, therefore, by definition, could not have streamed any DWP credits to its shareholders.

The amendments implement a new basis for calculating allocation deficit debits, to deal with the previous rules' deficiencies. The new allocation deficit debit rules should prevent the distorted and unintended results produced under the previous rules.

The new allocation deficit debit rules no longer compare the fraction of DWP credits transferred to the PCA to the fraction of imputation credits transferred to the PCA. Instead, the DWP crediting ratio for shareholders (measured by DWP credits attached to dividends/amount of dividends) is compared against the equivalent ratio for policyholders (measured by DWP credit transfers to PCA/policyholder base income).

The new rules apply only to an imputation year in which a dividend payment (with DWP credits attached) is made. However, for the purposes of the allocation deficit debit calculation, the relevant period of time to be considered is from the end of that imputation year back to the start of the imputation year following the imputation year in which a shareholder dividend was last paid — the DWP reference period. The first DWP reference period will start no earlier than 1 April 2004 unless a taxpayer elects to apply the new rules from an earlier date.

The key legislative aspects of the new allocation deficit debit rules for life insurance companies are:

- New section MG 8B replaces former section MG 8(5) to (7). Under this new section an allocation deficit debit arises when the "shareholder DWP ratio" exceeds the "policyholder DWP ratio" in a "DWP reference period".
- "Shareholder DWP ratio" is defined as total DWP credits/total dividends paid.
- "Policyholder DWP ratio" is defined as DWP credits transferred to the policyholder credit account/net policyholder income.
- "DWP reference period" is defined as the current imputation year plus previous years if no dividend was paid with DWP credits attached.

Therefore the new method is based on ensuring that the ratio by which DWP credits are attached to shareholder dividends does not exceed the equivalent ratio for policyholders.

If an allocation deficit debit arises in the DWP account under the new rules, a corresponding credit is recorded in the PCA to the extent the DWP account has a closing credit balance. If the allocation deficit debit exceeds the DWP account closing credit balance, that excess is not creditable to the PCA. In particular, the legislation works as follows:

- New sections ME 18(1)(bb) and ME 26(2)(d) allow a credit to the policyholder credit account of the allocation deficit debit if it is less than or equal to the closing credit balance of the DWP account.
- New sections ME 18(1)(bc) and ME 26(2)(e) allow a credit to the policyholder credit account equal to the closing credit balance of the DWP account if the allocation deficit debit exceeds that balance.

Detailed analysis

The basis for the new allocation deficit debit rules is to regard policyholders and shareholders as equity participants in a life insurance company. Shareholders receive rewards by way of dividends, and policyholders receive rewards by way of deemed distributions measured using the policyholder base.

To the extent that the shareholder DWP ratio is greater than the policyholder DWP ratio, a debit will arise in the DWP account.

These ratios have specific DWP reference period rules for the purpose of calculating the numerator and denominator. The DWP reference period is from the end of the imputation year in which a dividend (with DWP credits attached) was paid, back to the start of the imputation year following the year in which the previous shareholder dividend (with DWP credits attached) was paid. For example, if DWP credits are attached to dividends paid on 15 March 2008, and the previous dividend with DWP credits attached was paid on 15 March 2005, the DWP reference period concerned would be 1 April 2005 to 31 March 2008.

The first DWP reference period starts no earlier than the date the new rules first apply to a taxpayer. This is 1 April 2004 unless the taxpayer elects to apply the new rules from an earlier date, in which case the first DWP reference period starts from that earlier date.

The new rules require each life insurer to make the following calculations in the year that DWP credits are attached to dividends paid to shareholders:

Step 1: Determine DWP reference period

This includes the current imputation year plus any imputation years immediately before the current imputation year in which no dividends with DWP credits attached were paid.

Step 2: Determine whether policyholder income is positive

If the total of the policyholder income and net loss for the DWP reference period is zero or a net loss, the following allocation deficit debit rules do not apply — section MG 8B(2)(a).

Step 3: Determine shareholder DWP ratio

The formula for determining the shareholder DWP ratio is:

$$\frac{f}{g}$$

Where:

f = total DWP credits attached to the dividend(s) in the DWP reference period

g = total amount of dividends paid in the DWP reference period

Step 4: Determine policyholder DWP ratio

The formula for determiningthe policyholder DWP ratio is:

$$\frac{c}{d \times (1 - r)}$$

Where:

c = total net transfers from the DWP account to the PCA in the DWP reference period

d = policyholder base income in the DWP reference period

r = the rate of tax

Policyholder base income in the denominator is the aggregate of policyholder base income in respect of the income years the PCA has been debited to meet the company's policyholder base liability in the DWP reference period. This definition is consistent with the PCA debit timing rules in sections ME 18(3)(a) and ME 18(4)(a). For example, if a life insurer has a 30 September balance date and attached DWP credits to dividends paid on 15 March 2004, the policyholder base income would include the 30 September 2003 income year results, but not the 30 September 2004 income year results. This is because the DWP reference period rule would only include the 31 March 2004 imputation year. The debit to the PCA in that imputation year would be made on 30 September 2003 in respect of the 2003 income year income tax liability.

For the purposes of calculating item "d", if the policyholder base has recorded a loss then this loss can be offset against other policyholder base income in the DWP reference period. Item "d" is, therefore, the net amount of policyholder income in respect of the DWP reference period.

As the policyholder base income is the pre-tax amount in the current section CM 15 formula, the factor (1–r) is needed to make policyholder base income net of tax, in the same way that shareholder dividends are net of tax.

Step 5: Determine whether an allocation deficit debit is required in the DWP account

If the shareholder DWP ratio f/g is greater than the policyholder DWP ratio c/d(1–r), streaming is deemed to have occurred and the DWP account must be debited. This allocation deficit debit may result in a corresponding credit to the PCA, an allocation deficit debit solely in the DWP account, or a combination of both (as calculated in steps 6 and 7, below).

If the shareholder ratio f/g is smaller than the policyholder ratio c/d(1–r), no adjustment is required as section MG 8B(2)(b) would not apply.

Step 6: Allocation deficit debit when the DWP account balance remains in credit

The amount to be debited to the DWP account depends on whether the DWP account will be in debit or credit after the allocation deficit debit is made.

The first step requires calculation of the potential DWP allocation deficit debit or "maximum deficit debit", as set out in new section MG 8B, which is calculated as follows:

Maximum deficit debit = (shareholder DWP ratio – policyholder DWP ratio) × d (1–r)

Then the maximum deficit debit is compared with the balance of the DWP account at year end (before any allocation deficit debit is imposed).

If the DWP account balance is greater than or equal to the maximum deficit debit — that is, if it will remain in credit or be zero after the allocation deficit debit is imposed — the amount of the maximum deficit debit is debited to the DWP account and credited to the PCA — refer sections ME 18(1)(bb) and ME 26(2)(d).

This places the accounts in the same position as if the transfer had been made at the time the dividend was paid and no streaming would be involved.

Step 7: Reduced allocation deficit debit when the DWP account balance goes into debit

If the DWP account credit balance is less than the "maximum deficit debit" (before any allocation deficit debit is imposed), the allocation deficit debit would leave the DWP account in debit. In this case, a reduced allocation deficit debit is calculated.

The purpose of this further formula is to ensure that the credit ratio is the same for both policyholders and shareholders. It is designed to ensure that inappropriate or disproportionate debits do not arise.

While the reduced deficit debit is one formula, in substance, it consists of two parts. The first part takes into account that for both parties (shareholders and policyholders) the maximum DWP credit ratio that can be supported is:

$$\frac{\left(\begin{array}{c}\text{DWP credits attached to dividends +}\\ \text{Total net transfers from DWP account to PCA +}\\ \text{DWP closing balance}\end{array}\right)}{\text{Shareholder dividend + (net) policyholder base income}}$$

Expressed algebraically, this reads:

$$\frac{f + c + \text{DWP closing balance}}{g + d(1 - r)}$$

The DWP closing balance is the DWP closing balance before the initial allocation deficit debit is imposed and is represented by item "e" in the reduced deficit debit formula in new section MG 8B(4).

The maximum credits that can be attached to dividends is, therefore, the maximum DWP ratio, f + c + e multiplied by the dividends paid (item "g") divided by g + d(1 – r).

On this basis, the reduced allocationdeficit debit would be:

The closing DWP credit balance before any allocation deficit debit is made (item "e") plus DWP credits attached to dividends (item "f") minus:

$$g \times \frac{(f + c + e)}{g + (d \text{ x } (1 - r))}$$

which makes the complete formula for the reduced deficit debit as:

$$e + f - g \times \frac{(f + c + e)}{g + (d \text{ x } (1 - r))}$$

After the reduced deficit debit is imposed, the closing debit balance in the DWP account will be subject to a 10% dividend withholding payment penalty tax under section 140C of the Tax Administration Act 1994.

Although the PCA receives a credit equal to the amount of the DWP account closing credit balance before the initial allocation deficit debit is imposed — sections ME 18(1)(bc) and ME 26(2)(e) — it is not credited with any other part of the reduced deficit debit.

The reason for not crediting the PCA with the full amount of the reduced deficit debit is linked to the nature of this debit. The DWP account closing debit balance indicates shareholders have received more DWP credits than were available (if streaming had not occurred). The payment required from the company to clear the balance, therefore, represents DWP credits which have been used by the shareholders inappropriately and so must be repaid. The repayment would leave the tax base in a neutral position. However, if the payment was also creditable to the PCA the tax position would no longer be neutral. Effectively, the shareholders would continue to receive a benefit because fewer imputation credits and DWP credits would need to be transferred to the PCA in the future.

Consequential amendments

New sections ME 18(2)(bb) and ME 26(3)(d) ensure that the credits to the PCA are made on the last day of the imputation year in which an allocation deficit debit arises.

Sections MG 5(1)(f) and MG 15(1)(f) have been clarified to provide that they apply only to allocation deficit debits arising under section MG 8(4).

Sections MG 5(1)(g) and MG 15(1)(g) have been updated to refer to the allocation deficit debits arising under new section MG 8B.

New section MG 16A(1B) deals with the application of new section MG 8B to consolidated groups. In particular, it ensures that any dividends paid within a consolidated group are not taken into account in new section MG 8B.

Section NH 6(3) and (4) have been repealed because they replicated the rules — now contained in section MG 16A(1) and (1B) — concerning the application of sections MG 8 and MG 8B to consolidated groups.

The definition of "allocation deficit debit" in section OB 1 has been updated to include a reference to the debits arising under new section MG 8B.

Examples

The following examples illustrate the calculations:

(a) Suppose one year is involved and, during that year, a (net) dividend of \$10m is paid with \$4m DWP credits attached. The (net) policyholder base income is \$50m and, during the year, net credits of \$15m were transferred from the DWP account to the PCA. At year-end the closing balance in the DWP account was a credit of \$8m (before any allocation deficit debit). The DWP reference period in this case is the imputation year.

The shareholder DWP ratio (f/g) is : 4/10 = 40 %

The policyholder DWP ratio (c/d(1 – r)) is: 15/50 = 30 %

As the ratio for shareholders is greater, under section MG 8B(2)(b) streaming has occurred and an allocation deficit debit must be recorded. The maximum deficit debit is:

(Shareholder DWP ratio – policyholder DWP ratio) × (net) policyholder base income

This $5m maximum deficit debit is less than the $8m DWP account credit balance, so $5m is transferred from the DWP account to the PCA. After the transfer, $3m credit remains in the DWP account.

This places the insurer in the same position as if it had transferred net credits of $20m from the DWP account to the PCA during the imputation year. The crediting ratio would then have been 40% for both shareholders and policyholders.

(b) The facts are the same as in the preceding example but at year-end only $2m remains in the DWP account (before any allocation deficit debit).

Now the maximum deficit debit of $5m exceeds the $2m credit balance in the DWP account. In order to prevent an inappropriate or disproportionate penalty amount, the allocation deficit debit will need to be capped at the level of the reduced deficit debit.

The first step is to calculate the maximum DWP ratio used in this calculation.

$$\frac{\left(\begin{array}{c}\text{DWP credits attached to dividends +}\\ \text{Total net transfers from DWP account to PCA +}\\ \text{DWP closing balance}\end{array}\right)\text{[2]}}{\text{Shareholder dividend + (net) policyholder base income}}$$

Expressed algebraically, this reads:

$$\frac{f + c + e}{g + d(1- r)} = \frac{\$4m + \$15m + \$2m}{\$10m + \$50m} = 35\%$$

The reduced deficit debit is:

$$e + f - (35\% \times g) = \$2m + \$4m - (35\% \times \$10m) = \$2.5m$$

A debit is made to the DWP account of this amount, and a credit of $2m is made to the PCA equal to the DWP closing credit balance (before the allocation deficit debit) — section ME 18(1)(bc).

After this transfer, the DWP account will be $0.5m in debit and must be cleared by a cash payment which will not get credited to the PCA.

[2] These figures are the DWP account transfers to the PCA and the DWP closing balance *before* the initial allocation deficit debit is imposed.

BRANCH EQUIVALENT TAX ACCOUNTS AND LOSSES

Sections MF 4, MF 5, MF8 and MF 10 of the Income Tax Act 1994 and Income Tax Act 2004

Introduction

A number of clarifying or minor corrective amendments have been made to the branch equivalent tax account rules

Background

The Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003 made amendments to the branch equivalent tax account rules to:

- ensure that only New Zealand-sourced losses could create branch equivalent tax account credits;
- provide consistency between the treatment of current and past year domestic losses;
- simplify the branch equivalent tax account rules generally.

Key features

- Sections MF 4(2)(a) and MF 8(3)(a) have been amended to omit their reference to paragraph (b) of sections MF 4(1) and MF 8(2) because this paragraph no longer exists following the simplification of the branch equivalent tax account credit rules enacted in 2003.
- Similarly, sections MF 5(2) and MF 10(2) have been repealed because they are no longer considered necessary following the simplification of the branch equivalent tax account rules in 2003.
- Sections MF 5(6B) and MF 10(5B) have been amended to clarify that the excess is grossed up into a loss, rather than the excess being the amount that becomes a loss.
- Section MF 8(2)(a) has been amended to ensure that item d in the formula also includes the foreign tax credits of consolidated group members in section LC 16. Item e in the formula has also been amended to ensure that it includes all branch equivalent tax account debits used to offset the income tax liability of the consolidated group.

Application date

The amendments apply to the 1997–98 and subsequent income years, unless a taxpayer has filed before 26 June 2003 a return of income for the income year, and the return of income relies on the statutory provisions as they were before the enactment of the Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003.

DATE OF SELF-ASSESSMENT

Section 92 of the Tax Administration Act 1994

Introduction

An amendment ensures that the date of a taxpayer's self-assessment is the date the return is received at an Inland Revenue office.

Background

Following the introduction of self-assessment into tax legislation in 2001, taxpayers are required to assess their taxable income and income tax liability. Self-assessment also includes an assessment of any net loss, terminal tax or refund due. Provision was made for taxpayers to be able to fix a date that would create certainty as to the date of their self-assessment. The date needed to be within a time period prescribed by the Commissioner of Inland Revenue. This period would be determined by reference to the last date on which a taxpayer is required to furnish a return of income.

In practice, however, the date of notice of assessment has been treated as the date of receipt of the return by Inland Revenue, and taxpayers are being advised of the date.

Therefore sections 92(2) and 92(3) of the Tax Administration Act were redundant.

Key features

Section 92(2) has been replaced with a new section that provides that the date of assessment is the date on which the taxpayer's return of income is received at an Inland Revenue office. Section 92(3) has been repealed.

In practice, this means that on the date of receipt of the taxpayer's assessment, the return is datestamped — electronically or manually — and it is this date that is entered into Inland Revenue's computer system. Once this date is entered into the system, a return acknowledgement form is generated and sent to the taxpayer. The taxpayer will therefore have a record of the date of receipt, and the date of self-assessment.

Application date

The amendment applies from the 2004–05 income year.

ASSESSMENTS IN DISPUTED CASES

Section 114 of the Tax Administration Act 1994

Introduction

The validity of assessments made at the direction of an authorised officer, and those that follow practice and current policy approved by the Commissioner of Inland Revenue, has been confirmed.

Background

As part of the disputes resolution process, the documents that comprise each party's arguments are forwarded to Inland Revenue's Adjudication Unit for review. The function of the Unit, as described by Sir Ivor Richardson, is to consider the dispute impartially and independently of the audit function.[3] An amended assessment, if required, is then issued, based on this review.

Depending on the outcome of the adjudication process, a taxpayer's assessment may be amended by Inland Revenue. This involves the adjudication officer directing another officer (usually the investigating officer) to make the assessment on the grounds specified by the adjudication officer.

Administratively, it is more efficient that the investigating officer, rather than the adjudicator, makes and issues the amended notice of assessment (if required) after the adjudication division has considered the issue. All officers of the department should follow current practice directed by the Commissioner when considering the issues relating to the assessment. The amendment confirms that assessments issued by one Inland Revenue officer at the direction of another remain valid. This is necessary following a draft Crown Law opinion which had raised an issue as to whether the assessing officer's function could be fettered in such circumstances.

Key feature

Section 114 of the Tax Administration Act 1994 has been amended to confirm that assessments made at the direction of an authorised officer and assessments made following current policy or practice directed by the Commissioner are valid.

Application date

The amendment will apply from the date of enactment, 21 December 2004.

WRITE-OFF – DATE OF MEASUREMENT OF NET LOSS

Section 177C(6) of the Tax Administration Act 1994

Introduction

Net losses will be allowed to be measured on the basis of the last return filed by a taxpayer rather than according to the taxpayer's return of income for the income year immediately before the income year in which the outstanding tax is written off.

[3] *Organisational review of the Inland Revenue Department; Report to the Minister of Revenue (and on tax policy, also to the Minister of Finance)* from Organisational Review Committee April 1994, page 67.

Background

The Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002 introduced the new taxpayer financial relief rules. Under section 177C(5), if the Commissioner writes off outstanding tax for a taxpayer who has net losses, any net losses of the taxpayer are reduced, in whole or in part, in proportion to the amount written off. Section 177C(6) provided that the net losses were measured "according to the taxpayer's return of income for the income year immediately before the income year in which the outstanding tax is written off".

In applying the legislation, Inland Revenue encountered two practical problems. First, where there were returns outstanding these returns were then requested, which lead to delays in finalising cases. Second, where a case was being considered just after a balance date but before the due date for the return, any decision made in relation to write-off had to be followed up after the return had been filed, to ensure that any losses had been properly extinguished.

Key features

An amendment has been made to section 177C(6) to allow net losses to be measured based on the last return filed by the taxpayer.

Application date

The amendment applies to tax that is written off from the date of enactment.

GST RULES FOR FINANCIAL SERVICE PROVIDERS – DEDUCTIONS FROM OUTPUT TAX

Section 20C of the Goods and Services Tax Act 1985

Introduction

A change has been made to the application of section 20C of the Goods and Services Tax Act 1985 to ensure that the section reflects its policy intent. The change modifies the application of item "a" contained in the formula in section 20C and prevents taxpayers from being able to claim deductions of input tax twice.

Background

Sections 20(3)(h) and 20C were inserted into the GST Act by the Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003 as part of a number of amendments to implement the zero-rating of business-to-business supplies of financial services. Section 20(3)(h) allows taxpayers a deduction of input tax for exempt supplies of financial services made to another financial services provider. The deduction is calculated according to a formula in section 20C.

The formula contained in section 20C has been modified by changing the definition of item "a".

The value of the deduction calculated under section 20C was previously as follows:

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

Where:

a is the total amount that the registered person would be able to deduct under section 20(3), other than under section 20(3)(h), in respect of the taxable period if all supplies of financial services were taxable supplies:

b is the total value of exempt supplies of financial services by the registered person to the direct supplier in respect of the taxable period:

c is the total value of supplies by the registered person in respect of the taxable period:

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

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

The formula provides a proportional deduction of input tax and is in addition to that which can be recovered as a deduction of input tax if the taxpayer's principal purpose is that of making taxable supplies or by way of a change-in-use adjustment.

The proportion is found by multiplying two fractions. The first fraction is the proportion of the total value of supplies made by a taxpayer that consists of exempt supplies of financial services to a recipient financial services provider (the direct supplier). The second fraction is the proportion of the total value of supplies made by the direct supplier that consists of taxable supplies (including zero-rated supplies of financial services). The result of these fractions is multiplied by the amount in respect of which input tax could be claimed if all supplies by the taxpayer were taxable supplies.

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

A problem arose because the formula assumed that when calculating the value of item "a", the taxpayer was unable to deduct input tax at all. This is not always the case. If a taxpayer had been able for any reason to deduct GST paid on the purchase of goods and services the application of "a" in the formula could have allowed taxpayers to deduct input tax twice, once in respect of the initial deduction and again under the formula.

The change was introduced during the Finance and Expenditure Committee's consideration of the bill.

Key features

Item "a" of the formula in section 20C has been modified to ensure that when a taxpayer has deducted input tax under section 20(3) a further deduction is not allowed under the formula.

Item "a" is now defined by:

(i) isolating the total value of input tax that cannot be claimed under section 20(3) of the GST Act; and

(ii) allowing a deduction of the input tax calculated in (i).

The value of the deduction allowed under section 20(3)(h) is found by completing the rest of the formula.

Application date

The amendment applies from 1 January 2005.

Example

Finance Co is completing its monthly GST return. It has recorded expenditure of $54,000 including GST of $6,000. Finance Co attributes the input tax of $6,000 between its taxable and exempt supplies as follows:

Input tax $6,000

Taxable use
$1,250

Exempt use
$4,750

For the purposes of calculating item "a" in the formula Finance Co uses the input tax identified for exempt use ($4,750) rather than the total $6,000.

MISCELLANEOUS TECHNICAL AMENDMENTS

A number of miscellaneous technical amendments have been made to the tax Acts. Unless otherwise indicated, the amendments apply from the date of enactment.

Removal of references to "assessable"

Sections CG 25, GC 14 and HH 3 of the Income Tax Act 1994

The references to "assessable" in the headings of sections CG 25 (cases where assessable income calculation cannot be undertaken), GC 14 (income assessable to beneficiaries) and HH 3 (gross income assessable to beneficiaries) of the Income Tax 1994 have been removed because they are redundant. This is consistent with the removal of references to "assessable" by the self-assessment amendments enacted in 2001.

Expenditure on leases of personal property

Section EO 2 of the Income Tax Act 1994

Section EO 2 of the 1994 Act provides a straight line spreading rule for expenditure on leases of personal property. It is intended that finance leases be excluded from the ambit of this provision because the timing of finance lease expenditure is governed by the accrual rules. A clarifying amendment has been made to achieve this policy intent. This amendment applies from 20 May 1999, when the finance lease rules were implemented.

Definition of "lessee's acquisition cost"

Sections FC 10 and OB 1 of the Income Tax Act 1994 and Income Tax Act 2004

The drafting of the definition of "lessee's acquisition cost" in sections FC 10(8)(a) and OB 1 has been clarified by following the approach used in the definition of "lessor's disposition value" in section OB 1. In particular, it has been made clear in the definition of "lessee's acquisition cost" that the consideration is provided to the lessee under the finance lease or the hire purchase agreement.

Further dividend withholding payment correction

Section MG 9 of the Income Tax Act 1994 and Income Tax Act 2004

Section MG 9(5C), relating to further dividend withholding payment payable by a company, was enacted recently by the Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003, with application from the 1998-1999 imputation year. The reference to "income tax" in this provision was a drafting error and has been replaced by a reference to "dividend withholding payment", with the same application date as new section MG 9(5C).

Amounts of PAYE tax deductions

Sections NC 6 and NC 12 of the Income Tax Act 1994 and the Income Tax Act 2004

Section NC 6, which relates to amounts of PAYE tax deductions, referred to tax deductions fixed by an annual taxing Act. These references were redundant because the annual taxing Act is not used to fix amounts of PAYE deductions. Instead, the amounts of PAYE deductions are generally the amounts of the basic tax deductions specified in Schedule 19 of the Income Tax Act 1994 and the Income tax Act 2004. Accordingly, the annual taxing Act references in section NC 6 have been omitted, which has simplified the wording of the provision and assisted in highlighting the central role played by the basic tax deductions specified in Schedule 19. Section NC 12 has been consequentially amended to remove its reference to amounts of PAYE deductions being changed by annual taxing Act.

Fringe benefit tax rules – insertion of an omitted section reference

Section ND 12 of the Income Tax Act 1994 and the Income Tax Act 2004

An omitted reference to section ND 10(3) of the Income Tax Act 1994 and the Income Tax Act 2004 has been inserted into section ND 12 of those Acts. Employers who use the multi-rate method for calculating their fringe tax liability and cease to employ staff in the first three quarters of the income year must treat the quarter in which employment ceases as the final quarter of the year and undertake the multi-rate calculation in relation to that quarter. Section ND 12 is intended to modify the return filing and payment dates for that quarter. The omitted reference to section ND 10(3) meant that only the provisions relating to the payment of the fringe benefit liability were modified, not the return filing provision. The amendment to the 1994 Act applies to fringe benefits provided or granted by an employer on or after 1 April 2000 (being the application date of the multi-rate FBT rules), unless the employer has filed a return before 29 March 2004 (date of introduction of the bill) and relied on section ND 12, as that section applied before the enactment of this amendment. The amendment to the 2004 Act applies to the 2004–05 and subsequent tax years.

Dividend withholding payments by local authorities

Section NH 1 of the Income Tax Act 1994 and Income Tax Act 2004

From the 1997–98 income year, local authorities have been exempted from the liability, under section NH 1, to pay 33% dividend withholding payments on dividends from foreign companies.

In principle, dividend withholding payments are paid on behalf of shareholders, but local authorities have no shareholders. Local authorities are not liable to tax on any other investment income, although they do pay tax on income derived from their trading enterprises. In 2002, the legislation was amended to exempt charities from a dividend withholding payment obligation.

Timing of expenditure on leases of land and buildings

Section OB 1 of the Income Tax Act 1994 and Income Tax Act 2004

A drafting error at the time the finance lease rules were enacted in 1999 resulted in expenditure on leases of land and buildings being excluded inadvertently from the definition of “accrual expenditure” in section OB 1, which in turn meant that such expenditure was not covered by the timing rule in section EF 1. An unintended consequence was that a taxpayer could have claimed an upfront deduction for the entire amount of a lease prepayment, instead of spreading the prepayment over the term of the lease, as intended. Before the finance lease rules were implemented the timing of expenditure on leases of land and buildings was covered by the timing rule in section EF 1. An amendment has therefore been made to ensure that expenditure on leases of real property continues to be covered by section EF 1 of the 1994 Act (section EA3 of the 2004 Act). This has been achieved by including the term “operating lease” in the list of provisions to which paragraph (f) of the definition of “lease” in section OB 1 applies. This amendment applies from 20 May 1999, the inception of the new finance lease rules, unless a taxpayer filed a return before 29 March 2004 which was based on the previous law.

Definition of “land tax”

Section OB 1 of the Income Tax Act 1994

The definition of “land tax” in section OB 1 was redundant and has been repealed.

Definition of “premium”

Section OB 1 of the Income Tax Act 1994 and section FC 13 of the Income Tax Act 2004

The definition of “premium” in section OB 1 was amended in 1999 as part of amendments to ensure that guarantee fees paid to non-residents are subject to an effective tax rate of 3.3% on the gross amount under section CN 4. However, some of the wording of the 1999 amendment may have inadvertently taken certain insurance premiums outside the ambit of section CN 4. In particular, the addition of a reference to a premium being payable “to an insurer” may have made it more difficult to apply section CN 4 in the situation where a non-resident parent of a New Zealand company enters into a contract of insurance with a non-resident insurer to cover risks faced by the New Zealand company and the New Zealand company reimburses its non-resident parent for premiums paid on the contract of insurance. These reimbursing payments should come within the section OB 1 definition of “premium” and therefore be subject to section CN 4 (sections FC 13 to FC 17 of the 2004

Act). The amendment's removal of the insurer reference in the definition of "premium" facilitates this. The lists of provisions to which the definitions of "premium" and "insurer" apply have also been corrected.

Requisition of information held by offshore entities

Section 17 of the Tax Administration Act 1994

Section 17(1C), which relates to the Commissioner's information-gathering powers, was amended recently by the Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003. The amendment involved replacing "held by" with "in the knowledge, possession or control of". However, because this provision refers essentially to ownership-type interests, it has been amended to revert to references to "held by" as it is not accurate to refer to ownership interests being "in the knowledge of" a person. The use of "held by" is also consistent with the approach used in similar associated persons and nominee provisions in the Income Tax Act 1994.

Secrecy of restricted information

Section 81 of the Tax Administration Act 1994

When section 81(4) of the Tax Administration Act was last amended to authorise Inland Revenue's disclosure of information to the Department of Internal Affairs and the Ministry of Health, a corresponding amendment was not made to section 87 to require the officers of the Department of Internal Affairs and the Ministry of Health to maintain the secrecy of that restricted information.

Section 87 of the Tax Administration Act 1994 has been amended to require the officers of the Department of Internal Affairs and the Ministry of Health to maintain the secrecy of all restricted information communicated to them. This is the same requirement that is imposed on Inland Revenue officials.

Matters that cannot be challenged

Section 138E of the Tax Administration Act 1994

Former section 40(c) of the GST Act listed certain decisions of the Commissioner under the GST Act that could not be disputed under the former objection provisions in that Act. These provisions were replaced in 1996 by the current challenge provisions in the Tax Administration Act. However, the effect of former section 40(c) of the GST Act was not replicated in section 138E of the Tax Administration Act, which lists certain matters that cannot be challenged. A remedial amendment to section 138E has been made to correct this oversight and restore the previous position.

Reduction of penalties for good behaviour

Section 141FB of the Tax Administration Act 1994

Section 141FB, which allows shortfall penalty rates to be halved if a taxpayer has a past record of good behaviour, has been rewritten to improve its comprehensibility. The only significant policy change is that offences under sections 143 to 145 are now taken into account in determining whether a taxpayer has a sufficient track record of good behaviour.

Change-in-use deductions

Section 21E of the Goods and Services Tax Act 1985

Section 21E(4) facilitates the obtaining of a change-in-use deduction in respect of goods and services acquired for the principal purpose other than that of making taxable supplies which are then applied for a purpose of making taxable supplies. This provision is intended to replicate the effect of the first proviso to former section 21(5) and former section 21(6) of the GST Act. Two minor clarifying amendments have been made to section 21E(4) to ensure that the effect of the previous provisions is continued as was intended. In particular, the reference to "if" has been replaced with "to the extent that", and the reference to "sections 21 and 21I" has been replaced with "sections 21 or 21I". The amendments have the same application date as sections 21 and 21I, meaning they apply to goods and services treated as being supplied on and after 10 October 2000.

Improving interface with Tax Administration Act

Former sections 31, 50, 61B, 80 and 81 of the Goods and Services Tax Act 1985 and sections 185, 225 and 226 of the Tax Administration Act 1994

The general approach to tax administration provisions in the Inland Revenue Acts is that if they apply generically to a number of different taxes they should be aggregated and contained in the Tax Administration Act rather than replicated in the various other Inland Revenue Acts. Consistent with this approach, sections 50 (appropriation authority for refunds), 80 (authorising the making of regulations to extend statutory deadlines) and 81 (concerning general regulation-making powers) of the GST ACT have been repealed as their functions can be performed by sections 185, 226 and 225 respectively of the Tax Administration Act. These Tax Administration Act provisions have been consequentially amended to include references to the GST Act. Sections 31 and 61B of the GST Act, concerning the application of the disputes and penalties provisions in the Tax Administration Act 1994, were no longer necessary and have therefore been repealed.

Transitional provision for supplies of imported services

Section 84B of the Goods and Services Tax Act 1985

The transitional provisions in new section 84B for the reverse charge on imported services have been corrected to refer to the time of performance of the services, with the same application date as these provisions (25 November 2003).

Determinations in relation to financial arrangements

Sections 90, 90AC, 90AD, 90AE and 90A of the Tax Administration Act 1994

The determinations rules have been amended to allow the Commissioner to cancel a determination before issuing a replacement determination. It became apparent that, contrary to the intent of the legislation, this was not allowed under the previous rules.

Sections 90(6), 90AC(6) and 90AE of the Tax Administration Act 1994 allow the Commissioner to "vary, rescind, restrict, or extend a determination" made under sections 90(1) and 90AC(1) by replacing the determination or by making a new determination. The determination does not have to be used for a financial arrangement which was entered into before the new determination was published until four years after the date of publication of the new determination.

LEGISLATIVE DRAFTING ISSUES

COMMENCEMENT DATE FOR AMENDMENTS TO THE INCOME TAX ACT 2004

Readers will notice that most provisions amending the Income Tax Act 2004 come into force on 1 October 2005, under section 2(16), and apply for the 2005–06 and later tax years, under section 167(2).

The Income Tax Act 2004 comes into force on 1 April 2005, under section A2(1), and applies for the 2005–06 and later tax years, under section A2(2). Many of the amendments to that Act made by the Taxation (Venture Capital and Miscellaneous Provisions) Act 2004 thus apply for the same tax years as does the amended Act but come into force later than does the amended Act.

There are two reasons for delaying the commencement of provisions that amend the Income Tax Act 2004 until 1 October in the first tax year for which the amendments apply. The first reason is relevant to the Taxation (Venture Capital and Miscellaneous Provisions) Act 2004 because that Act amends provisions of the Income Tax Act 1994 and similarly amends the corresponding provisions of the Income Tax Act 2004. The second reason is relevant to future amendments that apply for periods that are tax years.

Section YA 3 of the Income Tax Act 2004

The first reason relates to the effect of section YA 3 of the Income Tax Act 2004, which governs the relationship between the Income Tax Act 1994 and the Income Tax Act 2004. Section YA 3(4) and (5) provide that:

> *Old law is interpretation guide*
>
> (4) Except when subsection (5) applies, in circumstances where the meaning of a taxation law that comes into force at the commencement of this Act (new law) is unclear or gives rise to absurdity, —
>
> (a) the wording of a taxation law that is repealed by section YA 1 and that corresponds to the new law (old law) must be used to determine the correct meaning of the new law; and
>
> (b) it can be assumed that a corresponding old law provision exists for each new law provision.
>
> *Limits to subsections (3) and (4)*
>
> (5) Subsections (3) and (4) do not apply in the case of —
>
> (a) a new law specified in schedule 22A (Identified policy changes); or
>
> (b) a new law that is amended after the commencement of this Act, with effect from the date on which the amendment comes into force.

Section YA 1 repeals the Income Tax Act 1994. It thus repeals several provisions after they have been amended by the Taxation (Venture Capital and Miscellaneous Provisions) Act 2004. The repealed provisions, called "old law" in section YA 3, correspond to provisions in the Income Tax Act 2004, called "new law" in section YA 3, that are also amended by the Taxation (Venture Capital and Miscellaneous Provisions) Act 2004.

If an amendment to a new law commences on the same date as the Income Tax Act 2004, section YA 3(4) applies to the interpretation of the amended new law. Section YA 3(4) would require the meaning of an amended new law that "is unclear or gives rise to absurdity" to be determined by the corresponding amended old law. Such an approach would not be appropriate because the amended new law is not a rewritten version of the amended old law; the old law was rewritten and then the resulting new law was amended. The interpretation of the amendment to the old law should not determine the interpretation of the amendment to the new law.

Section YA 3(5)(b) prevents such an application of section YA 3(4) if the amendment to the new law has a commencement date later than 1 April 2005. Since the amendments in the Taxation (Venture Capital and Miscellaneous Provisions) Act 2004 come into force after 1 April 2005, their interpretation will not be affected by section YA 3(4).

Amendments applying for tax years

Many amendments to the Income Tax Act 2004 apply for a specified tax year and later tax years. An individual taxpayer is initially affected by the amendment for the taxpayer's income year that corresponds to the first tax year. The taxpayer's corresponding income year may begin at any time from 2 October in the preceding tax year to 1 October in the tax year.

A commencement date of 1 October 2005 is chosen for an amending provision so that the amended provision of the Income Tax Act 2004 is not affected before the end of the latest possible preceding income year. If an earlier date were chosen, some taxpayers would be governed for part of the preceding income year by the provision of the Income Tax Act 2004 as it appeared in the statute book before the amendment, although that form of the provision would no longer be part of the statute book.

In the past, amending provisions that apply for the income years that correspond to a tax year have commonly come into force on the first day of the tax year, such as 1 April 2005. The later commencement date for such an amending provision does not affect the application of the amended provision for all of the income years that correspond to the tax year. Only the date of the change to the text of the Income Tax Act 2004 is affected.

DRAFTING CONVENTION FOR LISTS OF PARAGRAPHS

Inland Revenue drafters have decided to improve the consistency with which they conform to the drafting convention described below.

The convention

If items in a list of paragraphs are linked conjunctively, they are separated by "; and". The use of "; and" is thus equivalent to introducing the list of paragraphs with the words "all of the following: …".

If items in a list of paragraphs are linked disjunctively, they are separated by "; or". The use of "; or" is thus equivalent to introducing the list of paragraphs with the words "one, but not more than one, of the following: …".

A colon is used to separate items in a list of paragraphs if the items in the paragraphs are not linked conjunctively or disjunctively. The use of the colon may thus be equivalent to introducing the list with the words "one or more of the following: …".

Comment

Items separated by a colon under the convention could be separated in colloquial English prose by "and" or "or" (which would be equivalent to each other in the context) with or without a comma or semi-colon. The use of "and" and "or" in such a way detracts from the conjunctive and disjunctive senses of the two terms; for drafting purposes, it would be better not to use either conjunction for such a list.

It is not possible to omit all conjunctions from a list when drafting in prose but it is possible to separate items in a list of paragraphs without using a conjunction. Inland Revenue drafters have decided to do so consistently.

For technical drafting reasons, the Parliamentary Counsel Office chose several decades ago to use a bare colon, rather than a bare comma or semi-colon, to link paragraphs that are not linked conjunctively or disjunctively. Inland Revenue drafters are using the same convention.

DRAFTING CONVENTION FOR THE NUMBERING OF INSERTED PROVISIONS

Inland Revenue drafters have adopted the drafting convention described below.

The convention

Provisions inserted at end of sequence

If a statute is amended by inserting provisions after an existing provision that has the last number in a sequence, and the inserted provisions are numbered by reference to that existing provision, the inserted provisions are numbered so as to continue the sequence.

For example, if subsection (5) is the last subsection in a section, new sections inserted after subsection (5) are inserted as subsections (6), (7), (8) and so on. Similarly, new paragraphs inserted between existing paragraphs (cb) and (d) in a subsection are inserted as paragraphs (cc), (cd), (ce) and so forth.

Provisions inserted within or before sequence

If a statute is amended by inserting provisions between two existing, sequentially numbered provisions, or before the beginning of an existing sequence of provisions —

(a) provisions numbered by reference to the existing provision that they follow are numbered by adding "b", "c", "d", "e" and so on, or "B", "C", "D", "E" and so on, to the number of that existing provision;

(b) provisions numbered by reference to the existing provision that they precede are numbered by adding "a", "ab", "ac", "ad"and so on, or "A", "AB", "AC", "AD" and so on, to the number of that existing provision.

For example, new sections inserted between sections 3 and 4 of an Act are inserted as sections 3B, 3C, 3D and so on. Similarly, new paragraphs inserted between paragraphs (cb) and (cc) in a subsection are inserted as paragraphs (cbb), (cbc), (cbd) and so on. Note that in these examples no section 3A or paragraph (cba) is inserted; a section 3A would precede section 3 and a paragraph (cba) would precede paragraph (cb).

On the other hand, new paragraphs inserted before paragraph (a) of a subsection are inserted as paragraphs (aa), (aab), (aac) and so on. Similarly, new subsections inserted between subsections (3) and (3B) in a section are inserted as subsections (3BA), (3BAB), (3BAC) and so on. Note that in these examples no paragraph (ab) or subsection (3BB) is inserted; under the preceding part of the convention, a paragraph (ab) would follow paragraph (a) and a subsection (3BB) would follow subsection (3B).

Comment

Taxation Acts are regularly amended by the insertion of new provisions. An inserted provision, or sequence of provisions, must be numbered in a way that identifies its position in the principal Act. Provisions that are inserted into New Zealand statutes are numbered by adding a letter to the number of an existing provision that the inserted provision follows or precedes. The convention described above is based on existing New Zealand drafting practice, with two variations of that practice for the purposes of systematic consistency.

Use of "A" or "a" as a suffix

The first, and more significant, variation relates to a restriction on the use of "A" or "a" as a numbering suffix. This suffix has been used by drafters to indicate the first in a sequence of inserted provisions. Thus, new sections inserted between sections 3A and 3B of an Act have been numbered 3AA, 3AB, 3AC and so on. There has, however, been no standard way of indicating whether the new provisions have been inserted before or after a provision. Thus, new sections inserted between sections 3 and 3A of an Act can also be numbered 3AA, 3AB, 3AC and so forth.

As a result, if the provisions of an Act are numbered as sections 1, 2, 3, 3A, 3AA, 3AB, 3AC, 3B, 4 and so on, there is currently no standard way of numbering new provisions that are to be inserted between sections 3 and 3A. The solution to the problem, in the absence of a systematic convention, is to use the numbers 3AAA, 3AAB, 3AAC and so on. Such an approach merely postpones the further problems of numbering provisions that later may be inserted between sections 3A and 3AA and provisions that later may be inserted between sections 3AA and 3AB. In addition, users of the Act cannot infer the order in which provisions appear in the Act from the numbering of those provisions; the relative position of the provisions depends on the order in which they have been inserted.

The variation that has been adopted to avoid such a situation is to use "A" or "a" as a suffix for new provisions that are numbered by reference to the existing provision before which they are inserted. The other letters of the alphabet are used as suffixes for new provisions that are numbered by reference to the existing provision after which they are inserted.

Under the convention, then, provisions numbered "xB", "xC", xD" and so on are provisions that are inserted after provision "x" with numbers that at the time of insertion are equivalent to "x-plus-1", "x-plus-2", "x-plus-3" and so on. A provision numbered "xA" can be thought of as having at the time of insertion a number equivalent to "x-minus-1", subject to the next variation.

Use of "AB", "AC", etc., or "ab", "ac", and so on as suffixes

The second variation is a consequence of the first variation. It relates to the use of "AB", "AC" and so on, or "ab", "ac" and so on as numbering suffixes. These suffixes are used to indicate provisions that are inserted after a provision for which "A" or "a" is used for the suffix. The variation is necessary because the suffixes "B", "C", and so on, and "b", "c" and so on are reserved for provisions inserted elsewhere.

Under the convention, if the provisions of an Act are numbered as sections 1, 2, 3, 3B, 3BB, 3BC, 3BD, 3C, 4 and so on, new provisions that are to be inserted between sections 3 and 3B are numbered 3BA, 3BAB, 3BAC and so on. New provisions that are inserted between sections 3B and 3BB are numbered 3BBA, 3BBAB, 3BBAC and so on. Provisions that are inserted between sections 3BB and 3BC are numbered 3BBB, 3BBC and so on. Provisions that are inserted between sections 3BD and 3C are numbered 3BE, 3BF, 3BG and so on.

The numbering is systematic and does not depend on the order in which insertions are made.

Advantages and disadvantages

The systematic nature of the numbering convention is a major advantage for drafters and, it is suggested, for users of the taxation Acts.

A minor disadvantage is the extra number of letters in some suffixes that result from the second variation. Drafters consider that this result does not outweigh the advantages of the approach.

A possible disadvantage of the convention is that users of taxation Acts may be confused by the first variation because they will not know whether or not there is a provision between, say, paragraphs (a) and (ab). The purpose of this item is to inform users of the convention that produces such a result and of the justification for the convention.

Users who do not read this item are most likely to be using a commercial publisher's annotated version of the taxation Act, as consolidated by the publisher. Such a version will include the history of the provision. A user will be able to determine from the history that no other provision was inserted.

Other users who do not read this item will be using the officially printed version of the amending Act in conjunction with the officially printed version of the principal Act as assented. The text of the amending provision will inform those users of the relationship between the inserted provision and the existing provision.

ORDERS IN COUNCIL

STUDENT LOAN SCHEME – REPAYMENT AND INTEREST WRITE-OFF THRESHOLDS FOR THE 2004–05 TAX YEAR

The student loan scheme repayment threshold, which sets the income level at which compulsory repayments begin, will increase from its current level of $16,172 to $16,588 for the 2005–06 tax year.

The student loan scheme interest write-off threshold, which sets the level of income that part-time or part-year students may have and still be entitled to a full interest write-off, will increase from its current level of $26,140 to $26,799 for the 2005–06 tax year.

These thresholds are reviewed annually in December each year. They have been inflation adjusted by the forecast of the annual movement in the December CPI contained in the December Economic Fiscal Update and, in the case of the repayment threshold, rounded up so that it is divisible into whole dollars on a weekly basis.

Student Loan Scheme (Repayment Threshold) Regulations 2004

Student Loan Scheme (Income Amount for Full Interest Write-off) Regulations 2004

USE-OF-MONEY INTEREST RATES TO RISE

The use-of-money interest rates on underpayments and overpayments of tax and duties are to increase in line with current market interest rates. The new rates are:

- Underpayment rate: 13.08% (up from 11.93%)
- Overpayment rate: 5.71% (up from 4.83%)

The new rates apply from 8 March 2005, the starting date for interest relating to the third instalment of provisional tax for standard balance date taxpayers. The rates are reviewed regularly to ensure that they are in line with market rates. The new rates are consistent with the base lending rate and the 90-day bill rate.

The rates were changed by Order in Council on 31 January 2005.

Taxation (Use of Money Interest Rates) Amendment Regulation 2005 (2005/8).

STUDENT LOAN SCHEME – INTEREST RATES FOR 2005–06

The total student loan scheme interest rate for the 2005–06 tax year will remain at 7.0%.

The total interest rate has two components — the base interest rate and the interest adjustment rate. These are 5.5% and 1.5% respectively for the 2004-05 tax year. From 1 April 2005 the base interest rate will decrease to 4.2% and the interest adjustment rate will increase to 2.8%.

Student Loan Scheme (Interest Rates) Regulations 2005