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BINDING RULINGS

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

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

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

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

PUBLIC RULINGS – BR PUB 05/02–05/10

Note (not part of ruling): These nine rulings are essentially the same as the previous public rulings BR Pub 02/02-02/10, published in *Tax Information Bulletin* Vol 14, No 12 (December 2002). However, these rulings apply for an indefinite period from 1 April 2005 (the previous rulings expired on 31 March 2005) and apply the Income Tax Act 2004 provisions rather than the Income Tax Act 1994 provisions. The Income Tax Act 2004 came into force on 1 April 2005. The changes between the 1994 and 2004 provisions affecting these rulings are minor wording changes. These changes do not affect the conclusions previously reached.

As before, nine separate binding rulings have been issued covering both the income tax and gift duty implications of similar but separate arrangements. This provides greater certainty to taxpayers over a range of possible arrangements. However, a single commentary applies to all nine rulings.

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING A GRANT OF A LIFE ESTATE, THE BALANCE IS TRANSFERRED TO ANOTHER PERSON—GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING – BR PUB 05/02

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

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 2004 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CC 1(1) and (2) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor grants a life estate (including a lease for life) to him or herself, and then subsequently transfers the balance of the property to another person.

For the purposes of this Ruling:

- A "person" includes a person or persons acting in their capacity as trustees of a trust.
- An interest in land referred to as a "lease for life" is an estate in land giving exclusive possession and enduring for the life of a particular person. It excludes a periodic tenancy.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The life estate (including a lease for life) granted by the transferor is a retention and not a reservation for the purposes of section 70(2) of the EGDA.
- The retention of the life estate (including a lease for life) does not give rise to income to the transferor or the transferee under section CC 1(1) of the ITA.

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING A GRANT OF A LEASE, THE BALANCE IS TRANSFERRED TO ANOTHER PERSON—GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING – BR PUB 05/03

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

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 2004 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CC 1(1) and (2) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor grants a lease for a term to him or herself, and then subsequently transfers the balance of the property to another person.

For the purposes of this Ruling, a "person" includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The lease granted by the transferor is a retention and not a reservation for the purposes of section 70(2) of the EGDA.
- The retention of the lease does not give rise to income to the transferor or the transferee under section CC 1(1) of the ITA.

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING THE TRANSFER TO ANOTHER PERSON, A LIFE ESTATE IS GRANTED BACK—GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING – BR PUB 05/04

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

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 2004 (ITA).

This Ruling applies in respect of section 70 of the EGDA and sections CC 1(1) and (2) and OB 1 (definitions of "lease" and "leasehold estate") of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor transfers property to another person, and under the arrangement the other person subsequently grants a life estate (including a lease for life) back to the transferor out of the property transferred.

For the purposes of this Ruling:

- In determining whether the transfer is for inadequate or no consideration, the value of the life estate granted back is included as consideration.
- A "person" includes a person or persons acting in their capacity as trustees of a trust.
- An interest in land referred to as a "lease for life" is an estate in land giving exclusive possession and enduring for the life of a particular person. It excludes a periodic tenancy.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The life estate (including a lease for life) granted back to the transferor is a reservation for the purposes of section 70(2) of the EGDA.
- The life estate (including a lease for life) granted back to the transferor is not a lease for the purposes of section CC 1(1)(a), and the grant back of the life

estate (including a lease for life) does not give rise to income to the transferor or the transferee under section CC 1(1) of the ITA.

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING THE TRANSFER TO ANOTHER PERSON, A LEASE IS GRANTED BACK—GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING – BR PUB 05/05

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

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 2004 (ITA).

This Ruling applies in respect of section 70 of the EGDA; and sections BD 3(4), CC 1 (1) and (2), EI 6, and OB 1 (definitions of "lease" and "leasehold estate") of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor transfers property to another person and under the arrangement the other person subsequently grants a lease for a term back to the transferor out of the property transferred:

- where:
  - the transferor reduces the price of the property first transferred; or
  - the transferor reduces a debt owed by the transferee to the transferor; or
  - the transferor otherwise pays the transferee; and
- the amount of the reduction in price, reduction in the debt or the payment is attributable to the lease granted back to the transferor.

For the purposes of this Ruling:

- In determining whether the transfer is for inadequate or no consideration, the value of the life estate granted back is included as consideration.
- A "person" includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The lease granted back to the transferor is a reservation for the purposes of section 70(2) of the EGDA.
- The amount of the reduction in price, reduction in the debt or the payment is income to the transferee under section CC 1(1) of the ITA.
- The grant of the lease does not give rise to income to the transferor under section CC 1(1).

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE FOLLOWING THE TRANSFER TO ANOTHER PERSON, A LICENCE IS GRANTED BACK—GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING – BR PUB 05/06

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

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 2004 (ITA).

This Ruling applies in respect of section 70 of the EGDA; and sections BD 3(4), CC 1(1) and (2), EI 6, and OB 1 (definitions of "lease" and "leasehold estate") of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor transfers property to another person and under the arrangement the other person subsequently grants a licence back to the transferor out of the property transferred:

- where:
  - the transferor reduces the price of the property first transferred; or
  - the transferor reduces a debt owed by the transferee to the transferor; or
  - the transferor otherwise pays the transferee; and
- the amount of the reduction in price, reduction in the debt or the payment is attributable to the licence granted back to the transferor.

For the purposes of this Ruling:

- In determining whether the transfer is for inadequate or no consideration, the value of the life estate granted back is included as consideration.
- A "person" includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The licence granted back to the transferor is a reservation for the purposes of section 70(2) of the EGDA.
- The amount of the reduction in price, reduction in the debt or the payment is income to the transferee under section CC 1(1) of the ITA.
- The grant of the licence does not give rise to income to the transferor under section CC 1(1).

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE THE TRANSFEROR PURPORTS TO GRANT HIM OR HERSELF A LICENCE TO OCCUPY AND TRANSFER THE BALANCE—GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING – BR PUB 05/07

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

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 2004 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CC 1(1) and (2) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where:

- the transferor purports to grant to him or herself a licence to occupy; and
- the transferor then purports to transfer the balance of the property to another person; and
- the transferee then grants a licence back to the transferor.

For the purposes of this Ruling, a "person" includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- As a transferor cannot legally grant him or herself a licence to occupy, the full property interest will be transferred to the transferee.
- The licence granted back to the transferor is not a reservation for the purposes of section 70(2) of the EGDA.
- The grant of the licence does not give rise to income to the transferor or the transferee under section CC 1(1) of the ITA.

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE THERE IS A "SIMULTANEOUS" GRANT OF A LIFE ESTATE AND TRANSFER OF THE BALANCE TO ANOTHER PERSON—GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING – BR PUB 05/08

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

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 2004 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CC 1(1) and (2) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor grants him or herself a life estate (including a lease for life) and simultaneously transfers the balance of the property to another person.

A simultaneous transfer includes the situation where it is the intention of the transferor that only the balance or interest in reversion in the property is transferred, even though in conveyancing law terms the whole property initially transfers; and

- there is an immediate equitable obligation on the transferee to grant back the life estate (including a lease for life); and
- the transferor does not obtain any benefit out of the balance or interest in reversion that was transferred; and
- the transferor's intention to retain the life estate (including a lease for life) is evidenced in the documents and in the surrounding circumstances.

For the purposes of this Ruling:

- A "person" includes a person or persons acting in their capacity as trustees of a trust.
- An interest in land referred to as a "lease for life" is an estate in land giving exclusive possession and enduring for the life of a particular person. It excludes a periodic tenancy.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The life estate (including a lease for life) granted by the transferor is a retention and not a reservation for the purposes of section 70(2) of the EGDA.
- The retention of the life estate (including a lease for life) does not give rise to income to the transferor or the transferee under section CC 1(1) of the ITA.

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE THERE IS A "SIMULTANEOUS" GRANT OF A LEASE AND TRANSFER OF THE BALANCE TO ANOTHER PESON—GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING – BR PUB 05/09

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

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 2004 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CC 1(1) and (2) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where a transferor grants him or herself a lease for a term and simultaneously transfers the balance of the property to another person.

A simultaneous transfer includes the situation where it is the intention of the transferor that only the balance or interest in reversion in the property is transferred, even though in conveyancing law terms the whole property initially transfers; and

- there is an immediate equitable obligation on the transferee to grant the lease back; and
- the transferor does not obtain any benefit out of the balance or interest in reversion that was transferred; and
- the transferor's intention to retain the lease is evidenced in the documents and in the surrounding circumstances.

For the purposes of this Ruling, a "person" includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The lease granted by the transferor is a retention and not a reservation for the purposes of section 70(2) of the EGDA.
- The retention of the lease does not give rise to income to the transferor or the transferee under section CC 1(1) of the ITA.

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

DISPOSITION OF REAL PROPERTY FOR INADEQUATE CONSIDERATION WHERE THE TRANSFEROR PURPORTS TO "SIMULTANEOUSLY" GRANT A LICENCE AND TRANSFER THE BALANCE TO ANOTHER PERSON—GIFT DUTY AND INCOME TAX IMPLICATIONS

PUBLIC RULING – BR PUB 05/10

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

Taxation Laws

All legislative references are to either the Estate and Gift Duties Act 1968 (EGDA) or the Income Tax Act 2004 (ITA).

This Ruling applies in respect of section 70 of the EGDA and section CC 1(1) and (2) of the ITA.

The Arrangement to which this Ruling applies

The Arrangement is the disposition of real property for inadequate consideration, where:

- the transferor purports to grant to him or herself a licence to occupy; and
- the transferor simultaneously purports to transfer the balance of the property to another person; and
- the transferee grants a licence back to the transferor.

A simultaneous transfer includes the situation where it is the intention of the transferor that only the balance or interest in reversion in the property is transferred, even though in conveyancing law terms the whole property initially transfers; and

- there is an immediate equitable obligation on the transferee to grant the licence back; and
- the transferor does not obtain any benefit out of the balance or interest in reversion that was transferred; and
- the transferor's intention to retain the licence is evidenced in the documents and in the surrounding circumstances.

For the purposes of this Ruling, a "person" includes a person or persons acting in their capacity as trustees of a trust.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- As a transferor cannot legally grant him or herself a licence to occupy, the full property interest will be transferred to the transferee.
- The licence granted back to the transferor is not a reservation for the purposes of section 70(2) of the EGDA.
- The grant of the licence does not give rise to income to the transferor or the transferee under section CC 1(1) of the ITA.

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

COMMENTARY ON PUBLIC RULINGS BR PUB – 05/02 TO 05/10

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in public rulings BR Pub 05/02-05/10 ("the Rulings").

The commentary deals first with the gift duty implications under the Estate and Gift Duties Act 1968 of each of the arrangements in the public rulings, and secondly with the income tax implications under the Income Tax Act 2004. These rulings are all variations on a theme, where a transferor wishes to transfer real property but wishes still to have some interest in the property. An example is a person who transfers a house to a family trust, keeping the right to occupy the property. These rulings cover different ways in which this can be achieved, and specify situations in which the transactions will give rise to a liability for gift duty and income tax and the situations in which they will not.

All legislative references are to the Estate and Gift Duties Act 1968 (EGDA), the Income Tax Act 2004 (ITA), or the Property Law Act 1952 (PLA).

PART ONE: GIFT DUTY

Background

The rulings are concerned with the situation where someone gives away some property that is subject to gift duty, and takes something back from the gift. Section 70(2) of the EGDA prevents the value of any benefit or advantage reserved from a gift, being deducted from the value of the dutiable gift. If the transferor reserves an interest in the property, the transferor is assessed for gift duty on the value of all of the property transferred, including the interest reserved.

The aim of section 70(2) is to prevent the transferor arguing that the liability for gift duty is reduced. Without section 70(2), the transferor might argue that when an interest in property gifted has been reserved, the transferee has given value to the transferor for the gift in the form of an interest in the property gifted.

If the transferor *reserves* part of the property transferred, that part of the property is included in determining whether or not there is a dutiable gift, and whether or not section 70(2) applies. Property is reserved if, under the arrangement, some of the property gifted is to be given back. If the transferor *retains* part of some property and transfers the rest of the property, the part of the property retained is *not* included in determining whether or not there is a dutiable gift, and whether or not section 70(2) applies.

It is important, therefore, to distinguish between reservations and retentions, as apparently similar transactions are treated quite differently. The analysis in this commentary particularly focuses on the distinction between reservation and retention.

The new rulings and commentary apply on 1 April 2005 for an indefinite period. The previous nine rulings on this matter applied to dispositions of real property made between 1 April 1999 and 31 March 2005. The rulings and commentary were published in *Tax Information Bulletin* Vol 14, No 12 (December 2002).

The main change in these nine rulings is the applicability of the Income Tax Act 2004 which came into force on 1 April 2005. The previous nine rulings were under the Income Tax Act 1994. The changes between the 1994 and 2004 Acts provisions affecting these rulings are minor in nature.

The arrangements

In order to provide for a comprehensive range of situations, the Commissioner has developed nine separate arrangements, BR Pub 05/02-05/10. These arrangements are dispositions of property for inadequate consideration where:

1. A transferor grants a life estate to him or herself, and then subsequently transfers the balance of the property to another person.
2. A transferor grants a lease to him or herself, and then subsequently transfers the balance of the property to another person.
3. A transferor transfers the property to another person, and under the arrangement that other person later grants a life estate back to the transferor out of the property transferred.
4. A transferor transfers the property to another person, and under the arrangement that other person later grants a lease back to the transferor out of the property transferred.
5. A transferor transfers the property to another person, and under the arrangement that other person later grants a licence to occupy back to the transferor out of the property transferred.
6. A transferor purports to grant him or herself a licence to occupy, and transfers the balance of the property to another person.
7. A transferor grants him or herself a life estate and simultaneously transfers the balance of the property to another person.
8. A transferor grants him or herself a lease, and simultaneously transfers the balance of the property to another person.
9. A transferor purports to grant him or herself a licence to occupy, and simultaneously transfers the balance of the property to another person.

It is important to recognise that with section 70(2) of the EGDA such seemingly minor differences in arrangements may significantly change the parties' respective rights and obligations, and the revenue law implications.

The words "grant" and "transfer" are often used interchangeably. For the purposes of this commentary, "grant" refers to the conveyance of the carved-out estate (such as the life interest or lease) and "transfer" refers to the conveyance of the balance of, or reversionary interest in, the property. Some of these arrangements may apply to taxpayers other than individuals. The arrangements specifically include trustees. Because of the nature of the arrangements, the focus is on individuals and trusts, although the same reasoning may apply in some instances to other entities.

Other references

Note that generally speaking, gift duty is payable only when the value of the total amount of gifts made in a year exceeds $27,000. The Commissioner has published two booklets, *Gift duty* (*IR 194)* (April 2002), explaining the general features of gift duty, and *Gift duty – A guide for practitioners* (*IR 195)* (November 2003) which covers some issues in more detail. These are available from Inland Revenue offices or through the website at www ird.govt.nz The Commissioner has also published items on various aspects of gift duty in the *Tax Information Bulletins*.

Summary of conclusions

The following bullet points summarise the different ways of transferring interests in property, the Commissioner's view of whether there is a reservation or retention, and therefore whether section 70(2) of the EGDA applies. In each of these situations, the property must be disposed of for inadequate consideration.

- Where a transferor grants an interest in property to him or herself, and later transfers the balance or reversionary interest in the property to another person, there is no reservation for the purposes of section 70(2) of the EGDA and the section does not apply. The most obvious example is a person who grants him or herself a life estate or a lease, and then subsequently disposes of the balance of his or her interest to another person. The life estate or lease is, in law, a distinct interest in the property separate from the balance of or reversionary interest in the property that is transferred and is not part of the gift. Gift duty is concerned with what is gifted. The focus is on the balance transferred, not the life estate or lease that the transferor kept throughout (BR Pub 05/02 and BR Pub 05/03).
- Where a transferor transfers property to another person, and the parties intend that all the property rights in the property be transferred and then later an interest be granted back, there is a reservation by the transferor of the interest granted back to him or her. If the transfer of the property is a dutiable gift, the transferor would not be able to deduct the value of the reserved interest from the value of the gift, because of the operation of section 70(2) of the EGDA (BR Pub 05/04-05/06).
- Where a transferor grants a property right to him or herself, and simultaneously transfers the balance or reversionary interest of the property to a transferee, it is considered that there is no reservation of a benefit for the purposes of section 70(2) of the EGDA.

  A simultaneous transfer will include the situation where it was the intention of the parties that only the net property interest was to be given away, but because of conveyancing rules, the transfer had to be effected by a transfer of all the property, and then the net property interest being transferred back. In this situation, nothing has been reserved out of the subject matter of the gift. This point was stated in the 1999 House of Lords decision in *Ingram v IRC* [1999] 1 All ER 297, and the Commissioner

has incorporated the point in the rulings and in this commentary. It is, however, consistent with the New Zealand case *Commissioner of Stamps v Finch* (1912) 32 NZLR 514 (CA) (BR Pub 05/07-05/10).

Legislation

Gift duty is imposed under the EGDA by part IV of that Act. The key definitions and provisions relating to gift duty follow.

Section 2(2) defines "gift" as:

"Gift" means any disposition of property, wherever and howsoever made, otherwise than by will, without fully adequate consideration in money or money's worth passing to the person making the disposition:

Provided that where the consideration in money or money's worth is inadequate, the disposition shall be deemed to be a gift to the extent of that inadequacy only.

"Disposition of property" is also defined in section 2(2):

"Disposition of property'' means any conveyance, transfer, assignment, settlement, delivery, payment, or other alienation of property, whether at law or in equity; and, without limiting the generality of the foregoing provisions of this definition, includes—
...

Therefore, for a gift to exist, there must be a disposition of property without fully adequate consideration. A gift exists only to the extent of the inadequate consideration.

Section 61 of the EGDA imposes gift duty on dutiable gifts, at rates set out in section 62. Section 63 provides a definition of dutiable gift. A gift is a dutiable gift if the donor is domiciled in New Zealand or is a body corporate incorporated in New Zealand, or the property which is the subject of the gift is situated in New Zealand.

Under section 66 of the EGDA, a gift is valued at the date it is made. Section 67 allows the Commissioner to value property in such manner as he thinks fit, subject to restrictions in sections 68A-G, 69 and 70.

Section 70 of the EGDA states:

(1) For the purposes of this section–

"Ascertainable" means ascertainable as at the date of the disposition to the satisfaction of the Commissioner:

"Benefit or advantage" means any benefit or advantage whether charged upon or otherwise affecting the property comprised in the disposition or not, and whether—

(a) By way of any estate or interest in the same or any other property; or

(b) By way of mortgage or charge; or

(c) By way of any annuity or other payment, whether periodical or not; or

(d) By way of any contract for the benefit of the person making the disposition; or

(e) By way of any condition or power of revocation or other disposition; or

(f) In any other manner whatever;—

but does not include any annuity or other payment, whether periodical or not, if and so far as the annuity or payment—

(g) Is of a fixed or ascertainable amount in money payable over a fixed or ascertainable period, or for life, or at a fixed or ascertainable date or dates, or on demand; and

(h) Is secured to the person making the disposition—

(i) By a mortgage or charge over the property comprised in the disposition; or

(ii) By an agreement for the sale and purchase of land comprised in the disposition; or

(iii) By an agreement in writing to lease land comprised in the disposition; or

(iv) By deed,—

in each case executed by the person acquiring the beneficial interest under the disposition.

(2) Where any disposition of property is, in whole or in part, a dutiable gift, and is made in consideration of, or with the reservation of, any benefit or advantage to or in favour of the person making the disposition, no deduction or allowance shall be made in respect of that benefit or advantage in calculating the value of the dutiable gift.

(3) Notwithstanding anything in section 78 of this Act, the Commissioner may permit the cancellation or alteration of any instrument creating or evidencing a disposition of property to which this section applies, if application in writing is made by the parties to the instrument within 6 months after the date of the instrument, or within such extended time as the Commissioner thinks fit to allow in the special circumstances of the case. On evidence to his satisfaction being produced of any such cancellation or alteration, the disposition shall not constitute a dutiable gift except to the extent to which the transaction as altered constitutes a dutiable gift.

Therefore, after imposing gift duty the Act provides a valuation regime, including certain prohibitions for deductions when valuing property.

Section 76 allows relief for gift duty for the subsequent gift of a reserved benefit where section 70(2) has applied. The section states:

When the donor of a dutiable gift to which section 70 of this Act applies (in this section referred to as the original gift) subsequently makes a dutiable gift of the whole or any part of the benefit or advantage (as defined in that section) created or reserved on the making of the original gift, there shall be deducted from the gift duty otherwise payable in respect of that subsequent gift (so far as that gift duty extends) an amount calculated in accordance with the following formula:

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

where—

a is the value of that benefit or advantage comprised in that subsequent gift, either at the date of the gift, or at the date of the original gift, whichever is the less; and

b is the value of the original gift; and

c is the amount of gift duty paid on the original gift.

Application of the legislation

The object of section 70(2)

Section 2(2) of the EGDA states that a gift is only a gift to the extent of the amount of the inadequacy of consideration. Section 70(2) requires that any amount "reserved" to the donor of a gift is not to be taken into account as being consideration. This means that in determining the inadequacy of consideration, any reservation is not included as consideration.

The intention behind section 70(2) was discussed by Chapman J of the Court of Appeal in *Finch*:

> If a donor could give a farm or a house to his son, and take back some kind of estate or interest in or charge representing part of the value of some other kind of property of the son, such as a life estate or mortgage, it would be easy to annihilate the taxable value of the gift: therefore that device is barred.

This view is also taken in Adams and Richardson's *Law of Estate and Gift Duty* (5th ed., 1978, Wellington, Butterworths), in which the authors say (p 205):

> Section 70 is aimed at certain types of benefit or advantage which, if they were taken into account as a consideration in calculating the value of a gift, might be used to make a gift appear to be a grant for valuable consideration, thus avoiding or at least postponing the gift duty.

These statements indicate that the policy behind section 70(2) is to prevent donors from arguing that the amount of a gift should be reduced by the value of anything reserved from a disposition of property, with a consequent reduction in the amount of gift duty payable. Instead, a gift with a reservation is valued without taking into account the value of the reservation.

Section 70 only applies to gifts

Section 70 does not operate to create a gift. Section 70 only applies to a gift. If the consideration, including any benefit or advantage reserved is not inadequate, section 70 does not apply. If the total consideration is inadequate, section 70 applies, and the reserved amount is not deducted in determining the amount of the gift. So if property worth $100 with a reservation of $40 is transferred, and the transferee gives consideration of $100, there is no gift and section 70 does not apply. If, instead, property worth $100 with a reservation is transferred and the transferee gives consideration of $90, there is a gift and section 70 applies. The amount of the gift is $10. As section 70 applies, the value of the gift is not reduced to reflect the reservation.

This view was taken by the Court of Appeal in *Commissioner of Stamps v Finch*. At p 318, Stout CJ said:

> In interpreting this section 9 [of the Death Duties Amendment Act 1911, now section 70(2)] it has to be noted that the section begins by stating "when any gift". The transaction has to be a gift. If it was an out and out sale it could not be construed as a gift. In a previous statute, namely section 6 of the Stamp Acts Amendment Act, 1895, the provision was very different. That section began thus: "In order to prevent the avoidance or evasion of duties by family arrangements or otherwise, the definition of 'deed of gift' in section 7 of the Stamp Acts Amendment Act, 1891 is hereby extended to include every deed or instrument whereby any person directly or indirectly conveys, transfers or otherwise disposes of property to or for the benefit of any person connected with him by blood or marriage," etc.
>
> There is in this section 9, no definition of what a gift means. In such a case the Court must ascertain if the word "gift" is interpreted in the Act itself.
> …
>
> If for example it had declared that what was not a "gift" was to be deemed a gift, as was the case in section 6 of the Act of 1895, then the Court would have been bound to interpret section 9 as charging duty on a disposition of property that was not in effect a gift. But there is no such provision in section 9.

In this passage, Stout CJ notes that section 9 (now section 70) only applies if there is a gift without its operation. He then contrasts the section with the previous "very different" wording of the provision which did not require that there is first a gift before the section applied.

This earlier form of the section was applied in *In re Deans* (1910) 29 NZLR 1089. In that case a widow transferred various lands to her four children. In consideration, they paid her some annuities. The actuarial value of the annuities was equivalent to the capital value of the land. The section was held to apply and the value of the annuities was ignored. Gift duty was charged on the capital value of the land. Chapman J said at page 1,098:

> It is argued that this is still limited to transactions which are gifts in some sense. The contrary is, however, plainly declared when the clause refers to transfers made "in consideration or with the reservation" of any benefit or any advantage to or in favour of the transferor or his nominee in that or any other property in the shape of an annuity or benefit of the like class.

Adams and Richardson say in *Law of Death and Gift Duties in New Zealand* at p 205:

> Before s 70(2) can apply there must first be a disposition of property which is "in whole or in part a dutiable gift". If the consideration for a disposition is fully adequate there is no dutiable gift and consequently the section does not apply. But if the consideration is inadequate, even to the smallest degree, there is a dutiable gift involved and s 70(2) can be applied.

How section 70(2) works

The purpose of section 70(2) is to prevent the value of a gift subject to gift duty being reduced if the transferee gives a part of the gifted property back to the person making the gift. For example, a person might gift her house but agree with the recipient that the recipient will later give the transferor the right to continue to live in the house until she dies. If not for section 70(2), the transferor might then claim that the amount of gift duty payable should be reduced. The transferor might argue that the value of the gift is not the value of the house, but the value of the house reduced by the value of the life interest the transferee has agreed to. In these circumstances, section 70(2) will apply so that the value of the life interest is not treated as consideration from the transferee to the transferor.

Therefore, in determining whether or not the transferee has given adequate consideration, and whether section 70(2) applies, the following three-step analysis is required:

- Identify the property that the transferor transfers to the transferee. Does the transferor transfer all the property to the transferee with the transferee granting some property back to the transferor (a reservation of the part given back), or does the transferor transfer only part of his or her property to the transferee, and retain part of the property (a retention of the part not given)?
- Identify the value of the property transferred to the transferee.
- Identify the consideration given by the transferee for that property (the value of any benefit reserved by the transferor is included as consideration in determining whether the consideration given by the transferee for the property transferred is inadequate).

If the transferee's consideration for the property is less than the value of the property, the definition of "gift" in section 2(2) is triggered, and assuming the general requirements in section 63 are met, there is a dutiable gift. The dutiable value of the gift is the difference between the value of the property gifted, less any consideration given. However, at this step, section 70 provides that the value of any interest reserved is not treated as consideration in determining the amount of the dutiable gift.

The first of the three steps in the bullet points is very important, because section 70(2) will apply when there is a reservation of a benefit or advantage from property, and not when there is a retention.

Difference between retaining an interest and reservation of a benefit or advantage

The focus of the arrangements in the public rulings is on the distinction between a reservation of property, and a retention of property. Case law has established that section 70(2) applies if there is a "reservation" of a benefit or advantage to the transferor, but not where there has been a retention of some property.

"Reservation" is not defined in the EGDA. The *Concise Oxford Dictionary* (10th ed. 1999) defines "reservation". The most appropriate definition is:

> 3 a right or interest retained in an estate being conveyed.

The definition implies that a reservation is something kept or retained while an estate is conveyed. The fact that the right or interest must be kept in the estate "being conveyed" may suggest that the reservation of the interest should occur at the same time as the conveyance.

While this dictionary definition may convey the ordinary usage of the word "reservation", the cases dealing with gift duty legislation (including overseas equivalent legislation) have held (as discussed below) that "reservation" has a very narrow, technical meaning. Whether or not there is a reservation will depend on the particular transaction entered into.

In the Court of Appeal case *Lees v CIR* (1989) 11 NZTC 6,079, Richardson J stated the test for whether there is a reservation (in the context of section 12, a provision related to estate duty), at p 6,081:

> The test in that regard is whether the disponor disposed of the whole interest reserving an interest out of that which was disposed of, or whether the disponor disposed of a particular interest and merely retained the remaining interest in the property.

In *Finch*, the only New Zealand case on section 70(2) or its predecessors, Chapman J in the Court of Appeal drew the same distinction:

> ... I do not find that any of the language is apt to describe something which is not and never was reserved out of the gift or the value of the gift, but is an independent item of property retained by the donor.

These statements emphasise the importance of the distinction between a reserved interest and one that is merely retained. While it may be quite proper in ordinary usage to say that they are both reserved and retained, it is clear from the case law that, legally, the difference is an important one, particularly in terms of section 70(2).

In *Finch*, the Commissioner of Stamps assessed gift duty on the transfer of an undivided moiety (ie half share) of land to the transferor's two sons as tenants in common in equal shares. The transferor retained the remaining moiety. The value of the whole land was about £2,200, each moiety being worth just less than £1,100. The sons paid the father £100 in cash to ensure the value of the gift was less than £1,000, which at that time was the exemption level for gift duty. The Commissioner assessed gift duty on the whole value of the land, arguing that the moiety the transferor retained was a reservation of a benefit or advantage in the land. Alternatively, the

Commissioner argued that if the gift was only the moiety transferred, the £100 was a reservation of a benefit or advantage. The transferor argued that the moiety retained was not a reservation of a benefit, nor was the £100 payment.

The five judges in the Court of Appeal all found for the transferor on both counts. All agreed that the transferor had not "reserved" a benefit or advantage in the land by retaining his moiety. The Court held that there is a reservation when a benefit or advantage is reserved from the interest actually given, not the entire estate from which the interest came.

A number of Australian and United Kingdom cases discuss whether there is a reservation of a benefit or advantage from the disposition of property. Two (originating from Australia) concern estate duty rather than gift duty, but they do discuss the meaning of "reservation".

In *Oakes v New South Wales Commissioner of Stamp Duties* [1953] 2 All ER 1563 (PC), the Privy Council considered a case where the transferor declared by deed of trust that he held farmland on trust for his children. He used the profits for the children's maintenance and education. He also claimed remuneration for his work as trustee, which he was entitled to do under the trust deed.

The Privy Council held that the remuneration to the transferor was a "benefit or advantage", even though it was provided for in the trust deed and that, therefore, there was a reservation of a benefit within the meaning of the section. Lord Reid stated at p 1567:

> In their Lordships' judgment, it is now clear that it is not sufficient to bring a case within the scope of these sections, to take the situation as a whole and find that the settlor has continued to enjoy substantial advantages which have some relation to the settled property: it is necessary to consider the nature and source of each of these advantages and determine whether or not it is a benefit of such a kind as to come within the scope of the section.

Lord Reid also confirmed the distinction between "reservation" and "retention" at p 1571 where he said:

> The contrast is between reserving a beneficial interest and only giving such interests as remain, on one hand, and, on the other hand, reserving power to take benefit out of, or at the expense of, interests which are given…

Lord Reid is saying that when a transferor has retained a pre-existing interest, this is not the same as a reservation of a benefit. The Court's opinion was consistent with previous authority including *Earl Grey v Attorney-General* [1900] AC 124; [1900-3] All ER Rep 268 (HL).

Applying these same principles, a number of Australian and United Kingdom cases have found, on the facts, that there was not a reservation from the disposition of property. One of these is *Munro v Commissioner of Stamp Duties (NSW)* [1934] AC 61; [1933] All ER Rep 185 (PC). In that case the transferor entered into a partnership with his six children, and the partnership farmed the transferor's land. Four years later he gifted a portion of the land to each of the children. On the transferor's death the Commissioner attempted to assess death duty on the gifted land. The Privy Council held that the gifted property could not be brought back into the deceased's estate. In the speech of the Privy Council, Lord Tomlin said (p 188 of the All ER Rep report):

> It is unnecessary to determine the precise nature of the right of the partnership at the time of the transfers. It was either a tenancy during the term of the partnership or a licence coupled with an interest. In either view what was comprised in the gift was, in the case of each of the gifts to the children and the trustees, the property shorn of the right which belonged to the partnership, and ... the benefit which the donor had as a member of the partnership in the right to which the gift was subject was not ... a benefit referable in any way to the gift.

This finding is consistent with *Commissioner of Stamp Duties (NSW) v Perpetual Trustee Co Ltd* [1943] AC 425; [1943] 1 All ER 525 (PC) and *Re Cochrane* [1906] 2 IR 200 (CA).

Simultaneous transfers

The case law discussed so far has distinguished between a reservation, where some property is gifted and then an interest in that property is gifted back; and a retention, where a transferor creates an interest out of some property which he or she owns, and gifts the balance or reversionary interest in that property. Recent case law has raised the issue of whether there is a reservation or a retention when an interest is created in property (for example, a life estate in the property) and the balance or reversionary interest is transferred at the same time, or in terms of the legal theory in relation to conveyancing transaction, shortly afterwards. These cases, which will be discussed below, are the House of Lords decision in *Ingram*, and the United Kingdom High Court and Court of Appeal decisions in *Nichols*.

New Zealand courts have held that what is in effect a simultaneous transaction, is not a reservation. In *Finch*, as discussed above, a father transferred an undivided half share in land. The Court of Appeal did not explicitly conclude that the transfers were simultaneous. However, the facts do not disclose any action on the part of the father to grant his half to himself before transferring the other half to his sons. He did not retain something he always had. He had owned the fee simple in the land, and after the transfer, he owned a different estate in the land which was a half share as a tenant in common. The father's moiety appears to have been created at the same time as the other moiety was transferred to the sons. Therefore, the transfers can be viewed as simultaneous transfers.

The Court concluded that there was no reservation of a benefit or advantage, because no interest was granted back to the donor. The father had not reserved an interest out of property that was given, but had retained an independent item of property which was not given to his sons.

The only New Zealand case where the transfers have explicitly been held to be simultaneous is *Lees*. In that case, the transferor created a life interest and transferred the reversionary interest in the property by documents executed on the same day. The Court held that there was a reservation of a benefit to the transferor.

However, the case was concerned with a different provision from section 70(2). Section 12(1)(b) (now repealed) of the EGDA concerned estate duty, and allowed the reservation of a benefit to accompany the disposition of property. It has been noted in some cases that the meaning of this phrase is unclear (*Overton's Trustees v CIR* [1968] NZLR 872), and may be inconsistent with the meaning of the word "reservation" in the context of gift duty. In that statutory context, the Court held that a simultaneous transfer is a reservation. The case is relevant to section 70, however, not for that finding, but because it was held that transfers may sometimes be simultaneous.

The Ingram *case – when is a transfer simultaneous?*

The English courts have more recently considered the issue of simultaneous transfers, in the trilogy of cases involving Lady Ingram. The High Court decision ([1995] 4 All ER 334) was appealed to the Court of Appeal ([1997] 4 All ER 395), which resulted in a further appeal to the House of Lords ([1999] 1 All ER 297). The judgments in the case focused on the meaning of "reservation" in section 102 of the Finance Act 1986 (UK). That provision states that a gift that comes within it will be a "gift with reservation" and may be subject to inheritance tax. The test is whether or not the property gifted continues to be enjoyed by the donor in any way.

In the original (High Court) decision, it was concluded that the transfers were simultaneous and, therefore, there was no reservation of a benefit to the transferor. However, a majority of the Court of Appeal held that there was a grant back and a reservation. The House of Lords held that the transfers were simultaneous, and that there was no reservation.

The facts

In the Ingram case the transaction was structured as follows:

29 March –	Lady Ingram transfers property absolutely to her solicitor.
29 March –	solicitor declares he holds the property on trust for Lady Ingram and is acting on her direction.
30 March –	solicitor grants Lady Ingram two 20-year rent-free leases.
31 March –	solicitor transfers property (subject to the leases) to the two sons and grandson of Lady Ingram (the trustees).
31 March –	the trustees declared themselves to be the trustees of a settlement of the property for the benefit of certain beneficiaries. Lady Ingram is not a beneficiary.

The House of Lords observed that the series of transactions was structured, in part, to make the benefit to Lady Ingram a retention rather than a reservation so that inheritance tax would not be payable. However, in practice, this was more difficult in the United Kingdom than it would be in New Zealand. The United Kingdom has no equivalent provision to section 49 of the New Zealand Property Law Act 1952, allowing a lease to be granted to oneself. As Lady Ingram was unable to grant a lease to herself, it was necessary for her to transfer the property to someone else—her solicitor—so he could grant the lease to her.

The reasoning of the House of Lords

The House of Lords held that there was no reservation. The Law Lords held that section 102 of the Finance Act 1986 (UK) only applied where the benefit was derived from the interest given away. They held that, in this case, the trustees and beneficiaries had never had anything more than the freehold of the property subject to the lease. This property (the freehold less the leasehold interests) was not enjoyed by Lady Ingram in any way. She enjoyed only the leasehold interests. There was no reservation because the interest retained by Lady Ingram had been defined with the necessary precision, whether the leases were technically valid or not. Her intention was evidenced by the documents that gave effect to the transaction.

The Court of Appeal had held that the leases were not valid, and so the whole property must have transferred to the transferees and then a reservation was made back to Lady Ingram. The Court of Appeal also said that even if the leases were valid, that it is not conceptually possible for a lease to come into existence until the lessor has acquired the freehold interest. Therefore, the gift must have comprised the freehold interest and the lessor must have then given a lease back.

The House of Lords concluded that the leases granted by the solicitor to Lady Ingram were valid. However, the Law Lords also stated that they did not need to decide the validity of the leases in order to decide the case. They stated that, even if the leases were not valid, it was clear that the intention of the parties was for Lady Ingram to keep the leasehold rights and only give the other rights in the property away. This intention was evidenced by the documents. Lord Hoffman recognised that under conveyancing law, the whole property must pass before a lease can be granted. However, his Lordship considered that conveyancing form could not apply to make the transfer a reservation when it would otherwise not be. Lord Hoffman stated that (p 303):

It is true that as a matter of conveyancing, no lease can come into existence until the freehold has been vested in the intended lessor. But s. 102 is concerned not with conveyancing but with beneficial interests. It uses words like 'enjoyment' and 'benefit'. In *A-G v Worrall* 1 [1895] QB 99 at p. 104, a case on a predecessor of s. 102, Lord Esher MR began his judgment with the words:

> 'It has been held that in cases of this kind the Court has to determine what the real nature of the transaction was, apart from legal phraseology and the forms of conveyancing.'

If one looks at the real nature of the transaction, there seems to me no doubt that Ferris J [in the High Court] was right in saying that the trustees and beneficiaries never at any time acquired the land free of Lady Ingram's leasehold interest. The need for a conveyance to be followed by a lease back is a mere matter of conveyancing form. As I have said, she could have reserved a life interest by a unilateral disposition. Why should it make a difference that the reservation of a term of years happens to require the participation of another party if the substance of the matter is that the property will pass only subject to the lease?

Lord Hoffman considered it important to look at the real nature of the transaction and not just the conveyancing form. The rights and obligations of each party should be examined to determine whether or not the transactions are within the section.

The Law Lords decided that it was the intention of the parties that only the net property interests be given away. They considered that the way the section was written focused on benefits. They held that Lady Ingram did not receive any benefits from the net property interest, but only from the leases, which were not part of the subject matter of the gift. At no time did the donees hold the property free from Lady Ingram's leasehold interest. Therefore, she was not within the provision as she had not reserved a benefit out of the property the subject of the gift.

The Law Lords identified three aspects of the transaction which persuaded them that this was a situation where the transferor only ever intended that the net property interest be transferred, and not the whole property with a subsequent grant back. First, the House of Lords noted that Lady Ingram had defined very precisely the rights she intended to give away. She had never intended to grant the lease to the trustees, only the freehold shorn of the leasehold interests.

Secondly, the creation and existence of the leases was not dependent on the concurrence of the trustees and beneficiaries. It was never intended that the trustees would receive the whole property and then grant a lease back. This finding was supported by the fact that Lady Ingram had gone to such lengths to grant the lease before transferring the balance of the property.

Thirdly, because of the first two reasons, the House of Lords looked at the equitable rights and obligations of the parties, assuming that the leases were not valid. The Law Lords stated that equity would give Lady Ingram a right to the leases. Where the intention of the parties is clear that it was intended that the transfers be simultaneous, or it was intended that some rights never be given away, then this would give rise to equitable rights and obligations as between the parties. Therefore, in equity, the trustees were regarded as never having received the leasehold interests. From the moment they received the property they were subject to an equitable obligation to grant the leases. The only part of the property they ever received was the freehold less the leasehold interests. Therefore, the subject matter of the gift was the property shorn of the leasehold interests.

These equitable rights would arise from the time of transfer. They would have the effect of making the transfers simultaneous, notwithstanding that in legal theory or under conveyancing rules, the whole property would need to be transferred prior to there being a grant back. This means that the transfers may sometimes be simultaneous where there is (at least under legal theory) a grant back of a right.

The effect of *Ingram*

Following Ingram (HL), in a situation where the parties to the transactions never intend that the leasehold interests should be part of the subject matter of the gift, and they structure the arrangement with the necessary precision so that equitable rights arise simultaneously, the law will give effect to the parties' intention. The transaction should not be viewed as involving an instant of time for property to be transferred and then an interest granted back, in order that conveyance formality be met. The House of Lords in *Ingram* stated that the need for an instant of time was only necessary for conveyancing theory, whereas the particular provision under consideration was more concerned with the rights, benefits and obligations that resulted from the transactions, and with determining enjoyments and benefits of the property interests. The Commissioner's view is that section 70(2) should be interpreted the same way. Discounting the notion of an instant of time between the transfer and the grant back has the result that some transfers, previously considered to be a post transfer grant back, would now be considered to be simultaneous transfers.

It could be argued that the reasoning of the House of Lords judgments in *Ingram* is more sensible than the law as it was before the decision, because the law now will not require such fine distinctions to be made. Before *Ingram* (HL), if a transferor attempted to retain an interest at the same time property was transferred, there was a potential gift duty liability, whereas if the transferor's interest in the land was created a moment before the transfer, there was no potential liability. The House of Lords held that all of these types of transactions (where the transferor wishes to give away property rights while retaining some right of occupation), in circumstances where the transferor defines precisely the rights he or she wishes to give away, have the same end result and that, therefore, there should be no reservation.

The *Nichols* case

In coming to its conclusion, the House of Lords endorsed the approach of Walton J in the High Court decision of *Nichols v IRC* ([1973] STC 278). That case concerned a father who wished to gift the family home and surrounding land to his son. However, the parents wished to continue living on the property. Therefore, they arranged for the property to be transferred to the son, and for the son to execute a lease in their favour.

Walton J in the High Court held that in principle, where property passes which has an immediate equitable obligation on the transferee to grant a lease back, the transaction can amount to a retention of the leasehold interest. Walton J considered that there is no legal impediment to regarding simultaneous transactions as only giving the transferee the property shorn of the leasehold interest. The House of Lords agreed with this approach, and not the Court of Appeal decision in *Nichols* which had reversed Walton J's judgment. The House of Lords in *Ingram* considered it was conceptually possible for a lease to come into existence before the lessor acquires the leasehold interest.

A simultaneous transfer is not always a retention

However, a simultaneous transfer and grant back will not always be outside the scope of section 70(2). Lord Hoffman in the House of Lords indicated that if the leasehold interest held by Lady Ingram had contained benefits that she did not have before the property was transferred, then it may not be possible for the transfer to be a retention of the leasehold.

Lord Hoffman took this point from the Court of Appeal judgment in *Nichols*. Although the House of Lords disapproved of the Court of Appeal judgment in *Nichols*, the disagreement was on the central issue of whether a simultaneous transfer and a lease back could be a retention.

In *Nichols,* a father had given his son his land, and as part of that transaction, the son was required to give a lease back. Under the lease, the son gave a covenant to undertake any repairs. The Court of Appeal held that existence of the covenants made the transaction a reservation, and it could not be a retention. The right to have the buildings repaired under the covenant did not exist before the transfer, and therefore could not be something not given (p 285).

A retention must be a retention of property that the transferor had prior to the transfer of the balance of the property. If, for example, the transferor has a leasehold interest as a result of a transfer of property, and the leasehold interest gives the transferor rights that he or she did not already have, then that leasehold interest could not have been something retained. It can only be something given by someone else. Therefore, if the transferor has a property interest as a result of a transfer that he or she could not have had before the transfer, then the transaction will be a transfer with a grant back, and will be a reservation.

Other points to come from the House of Lords judgment in *Ingram*

The House of Lords judgment held that it is possible in England to create a property interest prior to transferring the balance of the property, by the use of a nominee. Prior to this decision, it had been the view that it was not possible to retain an interest to oneself in England because of the common law rule that one can not grant a property interest to oneself (*Rye v Rye* [1962] 1 All ER 146). That rule has been overridden (at least partly) in New Zealand by section 49 of the Property Law Act 1952. The judgments of both Lord Hutton and Lord Hoffman concluded that, at least in English law, it was possible for a nominee to grant a lease to his or her principal. The implication is that a transferor can now retain a property interest prior to transfer, through the use of a nominee.

Following the House of Lords decision in *Ingram*, the British Parliament enacted anti-avoidance legislation. Section 104 of the Finance Act 1999 inserted sections 102A-102C into the Finance Act 1986 in order to counteract the "lease carve out" scheme which had been held by the House of Lords to be successful in *Ingram*.

This legislation treats gifts of land (or interests in land) on or after 9 March 1999 as property subject to a reservation, where the donor enjoys a "significant right, interest, or is a party to a significant arrangement in relation to the land …" which entitles or enables the donor to occupy or otherwise enjoy the land. These provisions will not apply where:

- The gift is within the spouse exemption;
- The right retained is so negligible that the donor is excluded, or virtually excluded from enjoyment of the land;
- The donor pays full consideration for use of the land;

In addition, where the donor has acquired their interest in the land more than seven years before making the gift, the new provisions will not apply.

However, the New Zealand Parliament has not enacted similar legislation to sections 102A–102C of the UK Finance Act 1986. Therefore, the House of Lords reasoning in interpreting section 102 is still an important aide in interpreting our section 70(2) of the EGDA. It is considered that the fact that the British Parliament made a legislative change following the House of Lords' interpretation of section 102 does not diminish the reasoning of the House of Lords. In New Zealand, where there has been no legislative amendment to section 70(2) of the EGDA, it is considered that the House of Lords reasoning in *Ingram* is valuable in interpreting section 70(2).

Meaning of "reservation" in section 70(2) after Ingram

The law established by the cases

The cases discussed above establish that:

- Property is retained when the transferor retains an interest in property and disposes of the balance or reversionary interest in the property (*Lees*).
- Property is reserved when the transferor disposes of the whole interest and reserves an interest out of that which was disposed of (*Lees*).
- The case of *Finch* distinguishes between a reservation and a retention of a benefit or advantage. There is a reservation when a benefit or advantage is reserved from the interest actually given. There is merely a retention of the benefit or interest if the benefit or interest is held before the transfer of the balance of the property, or if the grant and transfer occur at the same time. See also *Munro, Oakes*, and *Ingram*.
- The House of Lords decision in *Ingram* recognises that the transfers may sometimes be simultaneous. The House of Lords concluded that when the transfers are simultaneous, in circumstances where it was never the intention of the parties that the whole property be disposed of, there will be no reservation. This is because the transferor will have received no benefit arising from the subject matter of the gift.
- The House of Lords judgment in *Ingram* stated that the courts should look at the intention of the parties to the transaction. The House of Lords held that section 102 of the United Kingdom Finance Act, a comparable provision to New Zealand's section 70(2), is concerned with the transfer of benefits and advantages, not the transfers of property which must take place for legal reasons. Sometimes equitable rights will come into effect which will make transfers simultaneous, notwithstanding the requirements of the rules of conveyancing that there be a certain sequencing of transactions. The parties' intentions will be evidenced by the documents of the transaction.
- Simultaneous transfers will include the situation where the transferring of the legal rights does not happen precisely at the same time, where the transfers are part of the one transaction, provided that it was never the intention of the parties that the whole property is transferred, and provided also that equitable rights arise simultaneously (*Nichols* (HC) and *Ingram* (HL)).
- If an apparently simultaneous transfer results in the donor having an interest in property that includes rights that he or she did not have before the transfer, the transfer will be a reservation, and not a retention of property the transferor already had (*Nichols* (CA) and *Ingram* (HL)).

Which types of real property do the rulings apply to?

The rulings apply to real property. Real property includes dwelling houses, farms and commercial buildings. After the initial rulings were issued, the Commissioner was asked whether the arrangements only apply to dwelling houses. In a "Question we've been asked" item, published in *Tax Information Bulletin* Vol 9, No 8 (August 1997), the Commissioner gave the view that real property includes all forms of real property. The Commissioner's view on this issue has not changed.

Application of section 70(2) to the specific arrangements

Pre-transfer grant of a life interest, a lease or a licence to occupy

A pre-transfer grant occurs where the transferor creates an interest in the property and grants that interest to him or herself before transferring the rest of the property interest to a third party (for example, a family trust). If the separation of the interest occurs before the transfer to the other person, the subsequent transfer is treated as the transfer of one interest while retaining another.

If an arrangement is a pre-transfer grant, it does not involve a reservation of interest by the transferor. Section 70(2) does not apply, and accordingly any duty payable will be based on the value of the balance or reversionary interest in the property transferred less the amount of any consideration paid.

This analysis applies to BR Pub 05/02 and BR Pub 05/03.

Life interests granted to oneself

The Property Law Act 1952 (PLA) gives the transferor authority to grant a life estate to him or herself. Under section 49 of the PLA, the transferor may transfer an estate or interest in land to him or herself individually or jointly with others. Section 66A of the PLA provides that covenants in a transfer by the transferor to him or herself (under section 49 of the PLA) are enforceable.

Example 1

A creates a life estate in a property, and then transfers the balance of the property to the trustees of his family trust. A's property is worth $175,000. The value of the life estate is $60,000. The price for the reversionary interest is $100,000. This is outstanding as an unsecured debt owed by the trust to A.

Section 70(2) does not apply. There is a gift because the consideration paid by the trust ($100,000 for property worth $115,000) for the interest in reversion is inadequate. The Commissioner will assess A for gift duty on the $15,000 gifted under section 61, the section which imposes gift duty, assuming other gift duty thresholds and requirements are met. However, section 70(2)

does not apply to include the $60,000 life interest in the dutiable amount, because that interest was retained by the transferor and not gifted to the transferor.

Leasehold interests granted to oneself

A transferor can grant a lease to him or herself in New Zealand. At common law a person could not grant a lease to him or herself, (*In re Nichol* [1931] NZLR 718, 727, Rye v Rye [1962] AC 496; 1 All ER 146). However, because a lease is an estate or interest in land, this rule has been abrogated in New Zealand by sections 49 and 66A of the PLA (*Harding v CIR* [1977] 1 NZLR 337; 2 NZTC 61, 145).

At common law, when the same person owned the freehold and the leasehold interest in a property, a merger of the interests occurred and the lesser interest (the lease) ceased to exist. In equity, merger depended on the intention of the parties. Section 30 of the PLA adopts the equitable rule, so there will only be merger where the parties intend it to occur. Usually, when a person creates a lease and grants it to him or herself, the intention is for the estates to remain separate.

Example 2

B creates a lease for fifty years in her own favour over her property, and then transfers the balance of the property to her only child, C. B's property is worth $250,000. The value of the lease is $100,000. The value of the balance of the property is $150,000. The price to be paid for the balance is $90,000. This price is outstanding, as an unsecured debt owed by C to B.

There is a gift under section 61, the section which imposes gift duty, assuming other gift duty thresholds and requirements are met. The gift is the amount of $60,000, being the inadequacy of consideration for the property transferred worth $150,000, less the $90,000 paid. Accordingly, there is potentially gift duty payable on the $60,000.

Section 70(2) has no application because there is no reservation from the disposition of property to C. Therefore, the Commissioner will not include the $100,000 value of the lease in the dutiable value of the gift.

Licences to occupy purported to be granted to oneself

However, the provisions of the PLA do not extend to a licence to occupy. A licence, unlike a lease, is not an estate or interest in land. A licence is a personal permission to enter land and use it for a particular purpose. As Gresson P said in *Baikie v Fullerton-Smith* [1961] NZLR 901, 906 in a land law context, a licence is basically an authority that prevents the individual to whom it is granted from being regarded as a trespasser on someone else's property. Therefore, a licence must be granted from a licensor to a licensee. In the absence of comparable provisions to sections 49 and 66A of the PLA applying to licences, a landowner cannot license him or herself to be a licensee.

The arrangement in BR Pub 05/07 is the situation where a transferor purports to grant him or herself a licence to occupy before transferring the remaining property interest. The purported grant of the licence will be invalid for conveyancing purposes, and all the rights in the property will be transferred to the transferee. One of two results will occur.

Firstly, the transferee could keep ownership of all the rights to the property. If all property rights are kept, there will be no grant back to the transferor (at any time) and no reservation. However, gift duty will be payable to the extent of the inadequacy of the consideration.

Secondly, the transferee could transfer the licence back to the transferor once the third party has been granted the rights in the property. This is acceptable in land law. Under land law, the grant back would take place after the transfer. This is the situation covered in BR Pub 05/07.

Following *Ingram* (HL), the Commissioner considers that this second situation should not be analysed as a post-transfer grant. *Ingram* established that the focus of section 102 of the Finance Act 1986 (UK) is on the transfer of benefits as a result of the transaction. In the Commissioner's view, section 70(2) should be interpreted the same way. So although a transfer is invalid under legal conveyancing theory, it still may create equitable rights and obligations as between the parties. In this situation, if the intention of the parties was that the licence be taken out of the property before the transfer, then following the equitable maxim "equity, regarding as done what ought to be done", effect will be given to such an agreement for the transfer of land, and equitable rights and obligations will accrue to each party with effect from the moment of transfer. In this situation, the transferee never acquires the property free from the obligation to transfer back the licence the transferor intended to retain. The result will be that from the moment of the transfer, the transferor will have an equitable right to the licence and the transferee will have an equitable obligation to grant it. This has the effect of making the transfers simultaneous.

If the transaction is simultaneous, it will not be a reservation subject to section 70(2). (The other arrangements which are simultaneous transfers are discussed below.) The documents to the transaction will be evidence of the intention of the parties (as in *Ingram* (HL)). They should be used to ascertain what the parties intended was to be the subject matter of the gift.

The first situation mentioned above, where the transferee does not grant a licence back, is not similar in nature to the other arrangements ruled on. Therefore, the Commissioner has not ruled on that arrangement.

Summary of the consequences of pre-transfer grants

Where a pre-transfer grant of a life estate or a lease occurs, there is no reservation of a benefit under section 70(2) (BR Pub 05/02 and BR Pub 05/03). Therefore, the amount of the life estate or lease is not included in the amount of the gift.

A licence to occupy cannot be structured as a pre-transfer grant. The result will either result in no licence, or a simultaneous transfer. Neither of these will be a reservation. Simultaneous transfers are discussed more under a following heading.

Post-transfer grant back of a life estate, a lease, or a licence to occupy

A post-transfer grant back occurs where the transferor transfers property to a transferee subject to the transferee granting an interest (any of a life interest, a lease or a licence to occupy) back to the transferor.

If an arrangement is a gift involving a post-transfer grant, it will be a reservation of an interest by the transferor. Section 70(2) will apply, and accordingly the duty payable will be calculated on the value of the whole of the property transferred, without deducting the value of the reservation, less the amount of any consideration paid.

This analysis applies to BR Pub 05/04-05/06.

Example 3

A transfers property worth $200,000 to B, as she is going overseas for three years and no longer wants to have property in New Zealand. B pays A $100,000 for the property. However, A and B agree that B will grant A a lease for the property when she returns, in three years time. The lease has a value of $50,000. A and B have documents drawn up to this effect. In this case, it is clearly the intention of the parties that the whole property interest is transferred, and at a later time a lease be granted back. The gift is the difference between the value of the property ($200,000) and the consideration paid ($100,000). The value of the lease is a reservation, and so is not deducted from the value of the gift.

Example 4

D has decided to transfer ownership of her family home to a family trust. She wishes to ensure that she has a right to occupy the property for the rest of her life. She intends to transfer the full property interest to the trustees of the trust, and at a later stage, for the trustees to grant her a licence to occupy. In accordance with this arrangement, the trustees later grant D a licence to occupy. The documents are consistent with the parties' intentions.

The property has a market value of $200,000. The licence to occupy is valued in accordance with the provisions of the EGDA at $50,000. The transfer price of the property is $100,000, which D leaves owing as a debt, repayable on demand.

The property is disposed of without fully adequate consideration ($150,000 compared with the market value of $200,000), so the Commissioner will assess D for gift duty under section 61 assuming other gift duty thresholds and requirements are met. The licence is a reservation, because under the arrangement, it is transferred back out of the property gifted. Section 70(2) applies, so the value of the licence is not deducted from the value of the gift. The amount on which gift duty is calculated is $100,000 (being the licence reserved and the extent of the inadequate consideration).

Simultaneous transfers of a life estate, a lease, or a licence to occupy

Life estates and leases

A simultaneous transfer of property occurs where the transferor transfers property to a transferee and simultaneously the transferee grants back an interest in that property (whether a life estate or a lease).

As discussed earlier, the House of Lords in *Ingram* considered that the focus of section 102 of the Finance Act 1986, the comparable section to New Zealand's section 70(2), was on the benefits actually reserved, and not the legal form of the transactions. Where it is clearly the intention of the parties that the net property interest only be transferred, but conveyancing rules would say that the whole property must be transferred before the other interest can be transferred back, the transferor has equitable rights in the interest transferred back from the moment the first transfer is made. It is not necessary to regard there being an instant of time between the transfers, even though it may be required in conveyancing theory. Therefore, the transfers will be simultaneous, and there will be no reservation.

If an arrangement is a simultaneous transfer and grant, no reservation of interest by the transferor is involved. Section 70(2) does not apply, and accordingly any duty payable will be based on the value of the balance or reversionary interest in the estate transferred less the amount of any consideration paid.

This analysis applies to BR Pub 05/08 and BR Pub 05/09.

Licences to occupy and other transactions intended to be pre-transfer grants

As mentioned above under pre-transfer grants, it is not possible for land owners to grant themselves a licence to occupy their land. Therefore, if a person purports to grant him or herself a licence to occupy and then transfers the balance of the land to someone else, that transaction will not, in terms of conveyancing law, be a pre-transfer grant. However, following the House of Lords decision in *Ingram*, where it is the intention of the parties that only the net property interest is to be given away, conveyancing rules should not mean that the transaction is carried out in some other way. Where rights cannot be validly self-granted, but it was clearly the intention of the parties that those rights should not be part of the transfer, equity will give effect to those rights as though they were valid from the time of transfer. If the original transfer is invalid for some other reason, this reasoning may also apply.

The effect of this is that grants of rights that cannot be validly self-granted will often now be simultaneous transfers rather than post-transfer grants back. Therefore, in the case of the arrangement in BR Pub 05/07, it is not possible to grant a licence to oneself. However, the parties' intention to transfer only the net property is evidenced by the documents in which the transferor attempts to grant the licence to him or herself. If that was the parties' intention, equity will demand that the transferee grant the licence back. These equitable rights will arise from the moment of transfer. Therefore, in the Commissioner's view, the arrangement in BR Pub 05/07 will now be treated as a simultaneous transfer rather than a post-transfer grant back, if it is the parties' intention, evidenced by the documents and the circumstances of the transfer, that only the net property interest transfers. Consequently, it will be a retention of the licence and not a reservation.

The arrangement in BR Pub 05/10 is similar to the arrangement in BR Pub 05/07. The arrangement in BR Pub 05/10 is the situation where the parties intend that the transferor will grant a licence to him or herself simultaneously as the balance of the property is granted to someone else. Even though the parties attempt to make the transaction simultaneous, it still amounts to an attempt to grant oneself a licence, and legally the transaction will consist of property passing and a licence being granted back. The documents relevant to the attempt to grant a licence to him or herself will be evidence that only the net property interest was intended to pass. In the Commissioner's view, *Ingram* applies, and this arrangement will be treated as a simultaneous transfer of the licence and the net property, and it will be a retention and not a reservation.

On the other hand, if it is clear from the documents that the whole property interest was intended to be the subject-matter of the gift followed by a grant back, and there is no intention for an interest to be retained, then equity will not intervene to create rights and obligations as between the parties, and there will be a post-transfer grant back. In this situation, there is a reservation of a benefit to the donor.

Transactions that may appear to be post-transfer grants may be simultaneous transfers

It may in some situations be difficult to distinguish between a simultaneous transfer and a post-transfer grant. Both may involve the same legal steps of property transferring and a lesser interest transferring back.

The essential difference between the two is that in a simultaneous transfer, the parties only ever intend the net property interest to pass. In a post-transfer grant, the parties intend the whole property to pass, and the lesser interest subsequently to pass back. The documents relevant to the transaction will be important in establishing the legal nature of the transaction and the parties' intention.

Requirements of a simultaneous transfer needed to satisfy the Commissioner

The Commissioner will be satisfied that a simultaneous transfer amounts to a retention (ie pre-transfer grant) and not a reservation (ie a post-transfer grant), if there is sufficient evidence that the parties never intended that the whole property in question pass to the transferee. This evidence would usually include the following elements, taken from *Ingram* (HL).

- The transferor defines very precisely the rights he or she intends to give away.
- The documents relevant to the transaction support the claim that the parties intend that only part of the property, as defined, is to be given away.
- There is never a time, in equity, when the transferee holds the whole property free of the interest that the transferor seeks to retain.
- The retention is not dependent on the concurrence of the transferee[s], including beneficiaries where the property is transferred to a trust.
- The transferor does not receive an interest in the property that includes something more than he or she previously had, eg covenants by the transferor/lessor to repair the property.

Summary of simultaneous grants

Where there is a simultaneous grant and transfer (BR Pub 05/07-05/10) there is no reservation.

Example 5

H wishes to provide for her children by making sure that they will own her house when she dies. She draws up a document, which gifts the house to the children while at the same time creating a life estate for herself. It was always intended, as evidenced by the documents, that the life estate be created and kept by H. She does not gain any extra rights that she did not have before the gift.

The house is worth $250,000 and the amount of the life estate is estimated to be $45,000.

The amount of the life interest will not be a reservation within the meaning of section 70(2), meaning that H will only be liable for gift duty under section 63 on the amount that is given away, being $205,000.

Other sections of the EGDA affecting reservations

Sliding value clauses

Commonly, documents evidencing the disposition of property provide that the consideration shall be a fixed amount or such higher amount as the Commissioner accepts will not give rise to a gift for gift duty purposes.

If:

- the consideration is bona fide; and
- the obligation to pay it is fulfilled; and
- the consideration is a genuine attempt to approximate the market value of the property;

the Commissioner accepts that where section 70(2) might otherwise apply, and the parties use the sliding value clause to increase the consideration so there is no gift, gift duty will not be payable.

Amendment of documents

Under section 70(3), the Commissioner may permit the cancellation or amendment of any instrument creating or evidencing a disposition of property to which section 70 applies. Application in writing must be within six months of the date of the instrument, or within such extended time as the Commissioner thinks fit to allow in the special circumstances of the case. Documents that are amended or redrawn will be reconsidered to see whether section 70(2) applies to them.

Valuation of retained interests

Section 66 of the EGDA requires every dutiable gift to be valued as at the date of the making of the gift. Section 67 gives the Commissioner a general discretion as to how property is valued, subject to sections 68A to 68G, 69 and 70, which include methods for valuing particular property.

Particularly relevant to this commentary are sections 68A and section 68F. Section 68A prescribes how land is valued. Section 68F provides that the tables of life expectancies in the Second Schedule to the Act are used to value life interests, except in one instance. The Commissioner has some discretion in determining the life expectation of a person suffering from a terminal illness. In practice, in determining the life expectancy of a person suffering from a terminal illness, the Commissioner will generally use Table D. Table D gives the present value of an annuity or other interest for a period other than life, or expectant on an event other than death. The Commissioner will generally apply it for the period which the Commissioner accepts as the actual or expected life expectancy of the person.

When there is more than one transferor, and all are entitled to a life estate or a lease for life, the value of the right should take account of the longest remaining life expectancy of the transferors. The value of the right relates to the time the transferees are out of possession of the property. If all transferors have a right of occupation until their respective deaths, the discount of the property's value to the transferees relates to the longest expected occupation of any of the transferors.

Subsequent gift of reserved benefit

Where gift duty has been paid on a gift valued under section 70, any gift duty on a subsequent gift of the benefit or advantage reserved, or any part of it, may be reduced, under section 76. A deduction from the gift duty on the subsequent gift is calculated as follows:

$$\frac{a}{b} \; x \; c$$

Where:

a is the value of the benefit or advantage comprised in the subsequent gift, either at the date of the gift, or at the date of the original gift, whichever is less; and

b is the value of the original gift; and

c is the amount of gift duty paid on the original gift.

Example 6

Assume A transfers property worth $42,000 to B and reserves a life interest in it.	$ 42,000.00	$
A is a male aged 48 years at date of transfer. The present value of income on capital of $1 for life for a male aged 48, from Table A is 0.71201. The present value of the life interest is therefore 0.71201 x $42,000 = $29,904.42		
The value of the reservation is therefore	29,904.42	
And the value of the balance of the gift is	12,095.58	
A has to pay gift duty on both under Section 70		
– value of the balance of the gift	12,095.58	
– value of the reservation	29,904.42	
Total value of gift 42,000.00		
Duty on $42,000		
on $36,000 at set rate	450.00	
on $6,000 at 10%	600.00	
	1,050.00	

Assume 10 years later A surrenders the life interest. The property previously worth $42,000 is now worth $48,000. A is now aged 58 years at the date of surrender. The present value of income on capital of $1 for the life of a male age 58 from Table A is 0.57617. The present value of the life interest is therefore 0.57617 x $48,000 = $27,656.16

A makes another gift of $30,000 at the same time.		
The aggregate gift is therefore:	30,000.00	
	57,656.16	
Duty on $57,656 is calculated as follows:		
on $54,000 at the set rate	2,250.00	
on $3,656 at 20%	731.20	
Gross gift duty	2,981.20	

Section 76 applies to give relief for the gift duty already paid. The gross gift duty is reduced by the relief given under section 76 where:

(a)	is original gift of reservation	$29,904.40	
	subsequent gift value of reservation whichever is less	$27,656.16	
(b)	value of the original gift	$42,000	
(c)	gift duty on the original gift	$1,050	

$\frac{27,656.16}{42,000.00}$ x 1,050.00 = $691.40

Maximum relief under section 76 = $691.40

Apportionment of the gift duty between the two gifts

Gift $30000 = $\frac{30,000}{\$57,656}$ x 2,981.20 =		1,551.20
Gift $27656 = $\frac{27,656}{57,656}$ x 2,981.20 = $1,430.00		
Less relief under section 76		
1,430.00		
691.40		
$738.60		738.60
Gift duty collectable on subsequent gift		2,289.80

PART TWO: INCOME TAX

Background

Section CC 1 of the ITA includes within a person's income all rent, a fine, a premium, or other revenues derived by a land owner from:

- any lease, licence, or easement affecting the land; or
- the grant of a right to take profits of the land.

This section considers the application of section CC 1 to the arrangements.

The new rulings and commentary apply on 1 April 2005 for an indefinite period. The previous nine rulings on this matter, applied to dispositions of real property made between 1 April 1999 and 31 March 2005. They were published in *Tax Information Bulletin* Vol 14, No 12 (December 2002).

The main change in these nine rulings is the applicability of the Income Tax Act 2004 which came into force on 1 April 2005. The previous nine rulings were under the Income Tax Act 1994. The changes between the 1994 and 2004 Acts provisions affecting these rulings are minor in nature and the Commissioner's view of the income tax aspects of the arrangements has not changed from the expired rulings under the Income Tax Act 1994.

Summary of conclusions

Pre-grant transfer

If a transferor grants an interest in property to him or herself, and later grants the balance or reversionary interest in the property to another person, the interest kept by the transferor does not constitute income of the transferee or the transferor under section CC 1(1).

Post-grant transfer

If a transferor transfers property to another person, reserving an interest in the property which the transferee later grants back to the transferor, the transferee may derive income under section CC 1(1).

The transferee will derive income if the transferee grants a lease or a licence back to the transferor, and an amount is derived by the transferee which is attributable to the lease or licence.

Simultaneous transfer

If a transferor grants him or herself a property interest, and simultaneously transfers the balance or reversionary interest to another person, the interest granted to the transferor does not constitute income to the transferee or the transferor under section CC 1(1).

Legislation

Under sections CC 1(1) and (2) of the Income Tax Act 2004, income can be derived as follows:

CC 1(1)

An amount described in subsection (2) is income of the owner of land if they derive the amount from—

(a) a lease, licence, or easement affecting the land; or

(b) the grant of a right to take the profits of the land.

CC 1(2)

The amounts are—

(a) rent; or

(b) a fine; or

(c) a premium; or

(d) a payment for the goodwill of a business; or

(e) a payment for the benefit of a statutory licence; or

(f) a payment for the benefit of a statutory privilege; or

(g) other revenues.

Section OB 1 contains definitions for the purposes of the Act. Section OB 1 begins:

For the purposes of this Act, unless the context otherwise requires,—

"Lease", "leasehold estate" and "estate" are defined in section OB 1:

lease —

(a) means a disposition that creates a leasehold estate:

…

leasehold estate includes any estate, however created, other than a freehold estate

…

estate, for land,—

(a) means an estate in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and

(b) includes a right, whether direct or through a trustee or otherwise, to—

(i) the possession of the land; or

(ii) the receipt of the rents or profits from the land; or

(iii) the proceeds of the disposal of the land; and

(c) does not include a mortgage

interest,—

…

(f) for land, has the same meaning as estate

Application of the legislation

Section CC 1 deems a person's income to include all rent, a fine, a premium, payment for the goodwill of a business, payments for the benefit of a statutory licence or privilege or other revenues derived by a land owner from any lease or licence affecting the land. Amounts derived from certain transfers of land, where an interest in land is transferred back to the transferor, may be included as income. However, in the arrangements in these rulings only the amounts "rent, a fine, a premium or other revenues" are potentially applicable, and therefore considered.

Pre-transfer grant of an interest in land

Where a lease or a licence is created before land is transferred, an income tax liability will not arise under section CC 1.

Pre-transfer grants – implications for the transferee

If a transferor obtains an interest in land transferred before the balance or reversionary interest in the land is transferred, the transferee does not derive income as a result of the transaction. He or she never owns the interest that the transferor keeps, so does not derive income from that land. Therefore, he or she cannot derive rent, a fine, a premium, or other revenues from that lease or licence as a result of the transfer.

Pre-transfer grants – implications for the transferor

The transferor also does not derive income from the transaction. The transferor does not derive rent, a fine, a premium, or other revenues from a lease, licence, easement, or profits from his or her land. Instead, the owner has simply kept an interest in the land.

This analysis applies to BR Pub 05/02 and BR Pub 05/03.

Example 7

Taxpayer A creates a lease in a property, and then transfers the reversionary interest to the trustees of his family trust. A's house is worth $175,000. The value of the lease is $60,000. The price to be paid for the reversionary interest is $175,000 less the $60,000. This price of $115,000 is outstanding as an unsecured debt owed by the trust to A.

The Commissioner will not assess A or the trustees for income tax under section CC 1(1) on the $60,000 value of the lease. Section CC 1(1) does not apply because neither A nor the trustees derive any rents, a fine or a premium from the lease.

Licences to occupy

A transferor can grant him or herself a life interest or lease over land, before disposing of the balance or reversionary interest in the property to another person. However, it is not legally possible for a transferor to grant a licence to occupy to him or herself. A licence is not an estate or interest in land. A licence is a personal permission to enter land and to use it for a particular purpose. A licence must be granted from a licensor to a licensee.

Consistent with the conclusions relating to gift duty, the Commissioner will treat a purported grant to oneself of a licence as a simultaneous transfer. This point is discussed further below.

Post-transfer grant back of an interest in land

Where land is transferred subject to a lease or a licence later being transferred back, an income tax liability may arise under section CC 1(1).

Post-transfer grants— implications for the transferee

If the transferor transfers land, and reserves an interest in the land by receiving a grant of an interest from the transferee, section CC 1(1) may apply to any gross amount derived by the transferee in relation to that transaction.

There are three parts to section CC 1(1) and (2) that are relevant to the arrangements, to be considered in the following order:

- There must be rent, a fine, a premium, or other revenues.
- The income must be derived by a land owner.
- The income must be derived from a lease or a licence.

Requirement 1 – amounts that are "rents, fines, premiums, or other revenues"

Section CC 1(1) will apply if, by granting an interest back to the transferor, the transferee derives an amount that is within section CC 1(2); that is:

(a) rent; or

(b) a fine; or

(c) a premium; or

(d) a payment for the goodwill of a business; or

(e) a payment for the benefit of a statutory licence; or

(f) a payment for the benefit of a statutory privilege; or

(g) other revenues.

The arrangements potentially subject to section CC 1 (the arrangements in BR Pub 05/05 and BR Pub 05/06) are concerned with situations where property is gifted for inadequate consideration, subject to an interest being granted back to the transferor by the transferee. If the transferee derives an amount that is attributable

to the interest granted by the transferee back to the transferor, the transferee may derive income if the other two requirements of section CC 1 are met (which are discussed below).

An amount is derived even if there is no direct payment

Income is derived by the transferee, even though there may be no payment made to the transferee. Under section BD 3(4) of the ITA, a person derives income when an amount has been, for example, credited in their account or, in some other way, dealt with in their interest or on their behalf. A netting off of obligations is an example of this, and so the transferee "derives" the income. So the amount in the following situations may be income to the transferee:

- the transferor reduces the price (if any) payable by the transferee for the initial transfer of property; or
- the transferor reduces a debt owed by the transferee to the transferor; or
- the transferor otherwise pays the transferee; and

the amount of the reduction in price, reduction in the debt or the payment is attributable to the lease or licence granted back to the transferor.

Whether the amounts derived under the lease or licence arrangements are rents, fines, premiums, or other revenues

The amounts derived under the arrangements in BR Pub 05/05 and BR Pub 05/06 will be subject to section CC 1(1) if they are within section CC 1(2) ie:

(a) rent; or

(b) a fine; or

(c) a premium; or

(d) a payment for the goodwill of a business; or

(e) a payment for the benefit of a statutory licence; or

(f) a payment for the benefit of a statutory privilege; or

(g) other revenues.

However, in the arrangements in these rulings only the amounts "rent, a fine, a premium or other revenues" are potentially applicable. These words in the section are now examined to see when amounts derived under the arrangements are within these words. The lease arrangement in BR Pub 05/05 is discussed first.

"Rent" has been characterised as the contractual sum payable for the use of the leased premises: *United Scientific Holdings Ltd v Burnley BC* [1978] AC 904. A similar definition was used in *Samuel v Salmon* [1945] 2 All ER 520. Rent does not only relate to leases. For instance, the term "rent" or "rent-charge" may be used when a purchaser of land pays periodic sums rather than a lump sum for the land. A "fine" is technically a sum of money payable by the tenant on the renewal of a lease (Hinde, McMorland & Sim, *Land Law* in New Zealand, LexisNexis, Wellington, 2004, para. 11.087), but is sometimes loosely used to refer to a premium (*B G Utting & Co Ltd v Hughes* [1939] 2 All ER 126). A "premium" is a lump sum paid for the acquisition of a lease by a lessee: *Regent Oil Co Ltd v Strick* [1965] 3 All ER 174 at p 197. In *King v Earl Cadogan* [1915] 3 KB 485, at p 492, Warrington J said that

> … a premium is a payment representing the capital value of the difference between the actual rent and the best that otherwise might be obtained… It is in fact the purchase money which the tenant pays for the benefit which he gets under the lease.

The amount derived under the lease arrangement, which is potentially subject to section CC 1(1), arises when one person transfers property to another, and the transferee grants a lease back, and there is either:

- a reduction by the transferor of the price of the property first transferred;
- a reduction of a debt owed by the transferee to the transferor; or
- any other payment by the transferor to the transferee;

where the amount is attributable to the lease granted back to the transferor. This payment arises where the transferor transfers property to another person and the other person later grants a lease back to the transferor.

Under this arrangement, it is not specified whether the consideration is a premium, ie a payment for the acquisition of the lease, or rent, ie a payment made for the use of the property, or a fine, ie a payment for the renewal of a lease.

A premium is a payment for the granting of a lease. In the arrangement, it is specifically stated that the amount is attributable to the lease granted back. In the Commissioner's view, the payment under the arrangement is best characterised as consideration for the granting of the lease and is therefore a premium.

The amount may also be rent, especially if it is quantified on the basis of the current value of rental payments appropriate to the value of the use of the land under the lease. It is least likely to be a fine, because the arrangement involves the granting of a new lease, and not the renewal of a lease. However, if "fine" also means premium, it may be a fine.

In the Commissioner's opinion, the amount derived under the arrangement is either a premium or rent, or a payment for both. Premiums and rents cover between them any payment for the granting of a lease and any payment made during the lease for the use of the property. The amount must be either one of these two types of amounts. Therefore, an analysis of the words of the section supports the conclusion that a one-off payment for a lease is a premium and/or rent.

Section CC 1(2) also applies to amounts of goodwill. The Commissioner considers that the amounts derived under the arrangements are clearly not payments of goodwill. Goodwill is the benefit and advantage of the good name, reputation and connection of a business: I*nland Revenue Commissioners v Muller & Co's Margarine Ltd* [1901] AC 217. There is no business element in the arrangements.

- **Other revenues**

If the amount derived is not a rent, fine, or a premium, the Commissioner's view is that the amount derived under the arrangement comes within "other revenues" in section CC 1(2). The issue in interpreting these words is whether "other revenues" means amounts that are revenue in nature. The amounts derived under the arrangements are lump sums received in relation to the transfer of ownership of interests in land. If "revenues" in the context of section CC 1(2) means revenue in nature, then it could be argued that the amounts derived under the arrangement are capital in nature and not subject to the section.

The ordinary meaning of "revenues" and dictionary definitions suggest that "revenues" means revenue in nature (see the *Concise Oxford Dictionary*, 10th ed, 1999).

The issue, which is discussed next and under the following headings, is not the meaning of "revenues" in isolation, but its meaning in the context of section CC 1(2).

- **Miller v IRC**

The meaning of "revenues" as used in section 88(1)(d) of the Land and Income Tax Act 1954 (which was the same as section CE 1(1)(e) ITA 1994, now sections CC 1(1) and (2) ITA 2004) was considered in *Miller v IRC* 10 AITR 122 (SC). The Court was concerned with a payment received by a land owner for two purposes. It was paid for the right to remove coal from the land owner's land. It was also accepted by the owner as payment in full satisfaction of compensation for damage to the land, which would otherwise be payable under a previous agreement. Henry J made the following comment:

> The word "revenue" in its ordinary import in relation to the owner of land connotes the incomings which arise therefrom: *London, Midland and Scottish Rail Co v Anglo-Scottish Railways Assessment Authority, London and North-Eastern Rail Co v Anglo-Scottish Railways Assessment Authority* (1933) 150 LT 361 (HL) per Lord Tomlin at p 367.

His Honour held that the monthly payments payable to the objector came within the words "other revenues" because they were paid for the use of land. This finding suggests that the purpose of the section is to capture payments made for the use of land.

In finding that the payment was not compensation, and so the section could apply, it could be argued that the case also supports the view that section 88(d) (and section CE 1(1)(e)) only applies to payments that are revenue in nature. The Commissioner's view is that the case does not go that far. The key finding was that the payments were made for the use of land, and so were within the section. Henry J did not make any finding about whether or not capital payments may be within section CC 1(2).

In considering the meaning of "revenue" in *Miller*, Henry J referred to the House of Lords decision in *London, Midland and Scottish Rail Co*. The House of Lords said that the word "revenue" in relation to a business means those incomings of the business which are the products of or are incidental to the normal working of the business. It is arguable that *London, Midland & Scottish Railway Co* is authority for the proposition that "revenues" means amounts received in the course of a business. However, in the Commissioner's view, *London, Midland and Scottish Rail Co* is not direct authority for the meaning of "revenues" in the context of section 88(1)(d), ie CC 1(2), as the statutory contexts are quite different. In *London Midland*, Lord Tomlin was defining "revenue" in relation to a business. Section CC 1 is concerned with amounts derived for the use of land. Even the form of the word is different – "revenues" in section CC 1(2) and "revenue" in the Railways Act.

In summary, although there are arguably indications in *Miller* and *London, Midland and Scottish Rail Co* that "revenues" in section CC 1(2) may mean revenue in nature, in the Commissioner's opinion *Miller* establishes only that payments for the use of land are within the section. Henry J in *Miller* did not hold that capital payments could never come within the section.

- **The context of the section**

The context of the word "revenues" within section CC 1(2) supports the conclusion that the intention is to capture a wide range of payments related to the use of land, and that the section is not limited to payments that are revenue in nature. "Revenues" is preceded by a list, including the words "rent", "a fine" and "a premium". In the Commissioner's opinion, the common theme of the specific words listed is that they are payments made in relation to land. This approach is supported also by considering the other words in the section. The section clearly deals with payments for rights relating to land. Types of interests in land or rights relating to land are listed, and further, these interests or rights are only included if they affect the land. In discussing goodwill in *Romanos Motel Limited v CIR* [1973] 1 NZLR 435, the Court of Appeal said that the aim of the section is to include in income receipts from land (p 438).

The first three amounts, "rent", "a fine" and "a premium" are not linked because they are revenue in nature. Clearly premiums are generally capital in nature. Goodwill, which forms part of this list of amounts before "other revenues", is also usually capital in nature. Given that, it can be concluded that Parliament intended to include at least some capital payments in the section.

The Australian High Court in *Clarke v FC of T* (1932) 6 ALJ 241 interpreted the comparable Australian section as having the broad intention to capture all payments derived from a lease.

- **Case T8**

Case T8 (1997) 18 NZTC 8,044 arguably supports the view that "revenues" in section CC 1(2) means revenue in nature. Barber DJ held on the facts that a payment paid by a lessee was not an option payment but a payment to obtain a lease. Given this finding, in his opinion it was a premium or other revenue derived by the owner of land from a lease affecting the land, and within section 65(2)(g) of the Income Tax Act 1976 (now section CC 1). His Honour made the following comment about section 65(2)(e)

> Also, if the $22,000 was genuinely part of a sale of realty transaction, then s 65(2)(e) would not apply because it assesses revenue from land and not capital derived or relating to land.

Barber DJ could be interpreted as taking the view that the section is aimed at amounts that are revenue in nature. The Commissioner considers in making this comment, his Honour was not asserting that section 65(2)(e) (section CC 1) only assesses revenue and not capital. Clearly some capital items are assessed under section CC 1(2) – premiums are generally capital in nature, as the Privy Council said in *Commissioner of Inland Revenue v Wattie* (1998) 18 NZTC 13,991, at p 13,999, and goodwill is generally capital in nature.

The Commissioner considers that this comment is best interpreted as meaning that the section does not apply to income from the sale of land. If the amount received by the taxpayer had been for an option to purchase the motel, then it would have been for the sale of an interest in land, and such a fee would probably not be within section CC 1. Therefore, in the Commissioner's view, Barber DJ's comment is not authority that no capital payments are caught within section CC 1(2).

- **Commentators' views**

The Report of the Taxation Review Committee 1967 (usually known as the "Ross Report") said that the section treats goodwill as being equivalent to additional rent calculated over the term of the lease but payable at the commencement of the lease. Similarly the Valabh Committee in its December 1989 report *Consultative Document on the Taxation of Income from Capital* said:

> Section 65(2)(g) [now section CC 1] is an attempt to avoid allowing taxpayers to transform lease payments (which would generally be taxable payments received on revenue account) into a non-taxable receipt received on capital account. For that reason, section 65(2)(g) includes in assessable income premiums as well as goodwill received by a lessor.
> …
>
> These provisions demonstrate how it has been found necessary to move the traditional capital/revenue boundary to hinder the ability of taxpayers to transform otherwise assessable income into income on capital account which would not be subject to tax.

These commentators consider that the policy intention is to include in section CC 1(2) payments that are revenue in nature but disguised as capital. Note that that intention does not mean that the section is restricted to capturing disguised rent. The Court of Appeal in *Romanos* rejected the submission by counsel that only disguised rents for the lease of land, as opposed to a payment for what is really a lease of the goodwill of a business, are taxable under the section. As the Valabh Committee says, a decision has been made to include capital payments in section CC 1(2). Thus the Ross and Valabh Committees considered that genuine premiums and goodwill payments, as well as attempts to disguise rent as premiums or goodwill, are within section CC 1(2).

- **Conclusion as to the issue of whether only receipts that are revenue in nature are income under section CC 1(2)**

The Commissioner's opinion is that section CC 1(2) is intended to capture amounts that are paid in relation to use of land, and that payments that have capital attributes may be included in section CC 1(2). The words of the section and the decision in *Miller*, in particular, support this view. *Romanos* and *Clarke* also support the view that the intention of the section is to include in income payments for the use of land. The arguments that would support the contrary view are that *Miller* is not conclusive authority that "revenues" means incomings and not income in nature. The authority relied on by Henry J (*London Midland and Scottish Rail Co)* appeared to find that "revenue" means revenue in nature.

In the Commissioner's view, the contrary arguments are less persuasive than the arguments supporting the view that "revenues" means incomings from land and includes receipts of a one-off nature. Therefore, the Commissioner's view is that the amounts derived under the lease arrangement are not excluded from the words "other revenues" on the basis that payments that are capital in nature are not included in those words.

- **Reliance on *Capel v CIR* (1987) 9 NZTC 6,195**

In the commentary to BR Pub 96/2A, the following was stated:

> A payment for buying a licence to occupy, or a lease, would also normally be considered a capital sum. However, *Romanos* and *Capel* are authority for the proposition that such a payment is included within the term "premiums, or other revenues".

The main issue in *Capel* was whether any of a number of goodwill payments received by a taxpayer setting up burger bar businesses, was for goodwill attached to a site, or for personal goodwill. *Romanos Motel* had established that only goodwill attached to a site is included within section CC 1(2) (then section 88 1(d) of the Land and Income Tax Act 1954). Similarly in *Capel*, the court decided that one goodwill payment attached to the site, and that goodwill payment was within section CC 1(2).

The Commissioner now relies primarily on the arguments already discussed, which support the conclusion that capital payments that are not specifically included within section CC 1(2), are in fact intended to be included in the section.

- **Conclusion as to whether amounts derived under the arrangement involving a lease are subject to section CC 1**

In summary, the conclusions are that the amounts derived in relation to a lease (the fourth arrangement) are subject to section CC 1, because

- The amount is rent or a premium; or
- The amount is included within "other revenues" because it is an incoming from land, and
- The statutory intention is to capture a wide range of amounts derived from a lease, and
- The words "other revenues" do not mean other things that are revenue in nature; instead, they mean incomings from land.

- **Is the licence arrangement subject to section CC 1(1)?**

The discussion so far has related to the application of section CC 1(1) to the arrangement involving a lease. The other arrangement to which section CC 1(1) applies involves a licence: the arrangement in BR Pub 05/06. The words listed in section CC 1(2) – "rent", "fine" and "premium" apply most commonly to leases and not licences. That raises the issue of whether the amount derived under the licence arrangement is subject to the section.

The first point to note is that section CC 1(1) applies to certain receipts derived by the owner of land from "a lease, licence, or easement affecting the land". Clearly, the section applies to licences.

The arrangement involving a licence is described in the ruling as follows:

The Arrangement is the disposition of real property for inadequate consideration, where a transferor transfers property to another person and under the arrangement the other person later grants a licence back to the transferor out of the property transferred:

- where:
  - the transferor reduces the price of the property first transferred; or
  - the transferor reduces a debt owed by the transferee to the transferor; or
  - the transferor otherwise pays the transferee; and
- the amount of the reduction in price, reduction in the debt or the payment is attributable to the licence granted back to the transferor.

In summary, an amount is paid under the arrangement as consideration for the licence granted back to the transferor.

- **Are the payments derived under the arrangement included in the words "other revenues" in section CC 1(2)?**

The Commissioner considers that an amount derived in respect of a licence is included in the words "other revenues" in section CC 1(2). For the reasons discussed above in relation to the lease agreement, the Commissioner does not consider that the words "other revenues" means "revenue in nature". Instead, the Commissioner considers that these words are intended to mean amounts derived in relation to the use of land.

Requirement 2 – the income must be derived by a landowner

The discussion has been about the first requirement of section CC 1, that is, whether there are amounts of "rent", "a fine", "a premium", or "other revenues" under the arrangements.

The second requirement is that income must be derived by an owner or land. In the arrangements in BR Pub 05/05 and BR Pub 05/06, a transferee granting either a lease or a licence back to the transferor is the owner of the land out of which that interest is granted.

Requirement 3 – income derived from a lease or a licence

If the transferee grants the transferor a lease or a licence, and the transferee derives an amount that is attributable to the lease or licence, then the requirement that the income is derived from any lease or licence is satisfied. Accordingly, the transferee is subject to income tax on an amount equal to the value of the amount attributable to the grant of the lease or licence.

This analysis applies to BR Pub 05/05 and BR Pub 05/06.

Example 8

Taxpayer B has decided to transfer her family home to a family trust. She wishes to ensure that she has a right to occupy the house for the rest of her life. She transfers the house to the trustees of the trust. A condition of the transfer is that the trustees subsequently grant B a licence to occupy. The trustees comply with this condition.

The house has a market value of $200,000. A valuer and actuary value the licence to occupy at $50,000. The house is transferred for $175,000, reduced by $50,000 to $125,000 to take into account the value of the licence to occupy. The $125,000 is left owing by the trustees as a debt repayable on demand.

The trust has derived income under section CC 1(1) of $50,000, being the value of the licence to occupy.

- **Life estate**

If the transferee grants the transferor a life estate, the transferee is not subject to section CC 1. The reason is that section CC 1(1) only applies to leases, licences, easements affecting land, and the grant of a right to take the profits of the land.

This analysis applies to BR Pub 05/04.

- **Lease for life**

Generally, an arrangement referred to as a "lease for life" is not a lease, but a life estate. An essential characteristic of a lease is that it has a certain term: *Prudential Assurance Co Ltd v London Residuary Body* [1992] 3 All ER 504. A lease that is based on the duration of a person's life does not have a duration that is certain. It is a freehold estate in the nature of a life estate: see *Amalgamated Brick & Pipe Co Ltd v O'Shea* (1966) 1 NZCPR 580.

In some instances, what is referred to as a lease for life may have a certain duration, and therefore will be a lease. For example, a lease expressed to be for say 200 years or for the life of A, is a valid lease. Although it is not known when A will die, and that A will die before 200 years have passed and the lease will terminate at A's death, the lease has in law a certain duration.

A tenancy with the power of each party to determine the tenancy at the end of any period by giving the appropriate notice, called a periodic tenancy, is a lease because any particular term can be made certain, even though it is impossible at the outset of the tenancy to say for what period the terms will last: *Amalgamated Brick*.

Example 9

C and D decide to transfer their home to a family trust. They wish to ensure that they have a right to occupy the house for the rest of their lives. They transfer the house to the trustees of the trust. A condition of the transfer is that the trustees later grant C and D life estates in the property. The trustees comply with this condition.

The house has a market value of $250,000. The life estates are worth $75,000. The price of the house is $250,000, which C and D leave owing as a debt, repayable on demand. The debt is reduced by $75,000 upon the grant of the life estates.

The trust will not have derived income under section CC 1(1), because the grant of a life estate is not income derived from a lease, licence, easement, or the right to take the profits of the land.

Post-transfer grants—income tax implications for the transferor

There are no income tax implications for the transferor under section CC 1. Section CC 1 applies to rents, a fine, a premium, or other revenues derived from land. When a transferor transfers land, the person no longer owns the land, so cannot receive any rents, a fine or so on from it. Any amount paid by the transferee for the transfer, in the arrangements covered by the rulings, will be consideration for a sale of land.

Simultaneous transfer of a lease or a licence

Where the grant and the transfer of a lease or a licence occur simultaneously, no income tax liability under section CC 1(1) will arise as a result of the transaction.

Purported grant of a licence to oneself

The Commissioner's view is that if a person purports to grant him or herself a licence, whether before or at the same time as the property is transferred to the transferee, that action should be interpreted as an intention to retain rights over the property before the transfer of the balance of the property. Following the House of Lords decision in *Ingram*, discussed above in relation to gift duty, the Commissioner considers that this situation should be treated as a simultaneous transfer.

Simultaneous transfers—implications for the transferee

The transferee is the owner of the property interest transferred from the transferor. Where the transfers are simultaneous, the transferee does not grant anything out of the interest he or she receives, as he or she receives the property interest at the same time as it becomes subject to the obligation to grant an interest in the land back to the transferor. Accordingly, the transferee does not receive any rent, a fine, a premium, or other revenues as a result of receiving the property interest.

As this commentary has explained, a simultaneous transfer includes the situation where the requirements of conveyancing mean that the whole property must be transferred before the other interest can be transferred back. Such a situation will be treated as simultaneous, when the intention of the parties, as evidenced by the documents and surrounding circumstances, is for the transferor to retain an interest in the property transferred, and for the transferee never to obtain the property free of the transferor's interest.

Simultaneous transfers—implications for the transferor

The transferor does not have an income tax liability, because the transferor does not derive any rent, a fine, a premium, or other revenues from a lease or a licence in respect of the property kept or the property transferred.

This analysis applies to BR Pub 05/07-05/10.

Spreading income

When a taxpayer derives income under section CC 1(1), section EI 6 of the ITA allows the person to apportion that income between the income year in which it is derived and any five later income years.

TERTIARY STUDENT ASSOCIATION FEES

PUBLIC RULING – BR PUB 05/11

Note (not part of ruling): This ruling is essentially the same as public ruling BR Pub 03/02 which was published in T*ax Information Bulletin* Vol 15, No 5 (May 2003), and BR Pub 99/1 which was published in *Tax Information Bulletin* Vol 11, No 1 (January 1999). BR Pub 03/02 applied up until 31 March 2005. The Income Tax Act 2004 came into force on 1 April 2005, and legislation references are now to that Act. BR Pub 05/11 applies on 1 April 2005 for an indefinite period.

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

Taxation Laws

All legislative references are to the Income Tax Act 2004 unless otherwise stated.

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

The Arrangement to which this Ruling applies

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

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

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

The period for which this Ruling applies

This Ruling will apply on 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 8th day of June 2005.

Susan Price
Senior Tax Counsel

COMMENTARY ON PUBLIC RULING – BR PUB 05/11

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in public ruling BR Pub 05/11 ("the Ruling").

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

Background

Section KC 5 of the Income Tax Act 2004 ("the Act") provides a rebate to a donor of a gift of money in certain circumstances, where the recipient of the gift is a non-profit body whose funds are applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purpose(s) within New Zealand.

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

The subject matter was previously dealt with in public ruling BR Pub 03/02, which expired on 31 March 2005. This public ruling replaces BR Pub 03/02, effective 1 April 2005. The previous ruling concluded that if a student pays a single fee to the student association to become a member of the student association, and the fee as a whole confers some rights on members, the payment is not a gift for the purposes of section KC 5(4). As the payment of the fee is not a gift, the student is not entitled to a rebate under section KC 5.

Legislation

Section KC 5 provides:

> (1) A taxpayer, other than an absentee, or a company, or a public authority, or a Māori authority, or an unincorporated body, or a trustee liable for income tax under sections HH 3 to HH 6 and HZ 2, is allowed as a rebate of income tax the amount of any gift (not being a testamentary gift) of money of $5 or more made by the taxpayer in the tax year to any of the following societies, institutions, associations, organisations, trusts, or funds (being in each case a society, an institution, an association, an organisation, a trust, or a fund in New Zealand), namely:
>
> (aa) a society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual and the funds of which are, in the opinion of the Commissioner, applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purposes within New Zealand:
>
> (ab) a public institution maintained exclusively for any 1 or more of the purposes within New Zealand specified in paragraph (aa):

(ac) a fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand specified in paragraph (aa), by a society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual:

(ad) a public fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand specified in paragraph (aa):

(ae) - (cl) [provide a list of organisations.]

(2) The rebates provided for in this section must not, in the case of any taxpayer, in any tax year exceed in the aggregate the smaller of—

(a) 331/3% of the aggregate of all gifts described in subsection (1):

(b) $630.

(3) No rebate is allowed under this section in respect of any gift unless the taxpayer furnishes to the Commissioner in support of the taxpayer's claim for the rebate a receipt evidencing to the satisfaction of the Commissioner the making of the gift by the taxpayer.

(3AA) Despite subsection (3), a rebate is allowed under this section if a tax agent makes an application for a refund under section 41A of the Tax Administration Act 1994 on behalf of a person and—

(a) the tax agent sights the receipt evidencing the making of the gift for which a claim is being made; and

(b) the person retains the receipt for 4 tax years after the tax year to which the claim relates.

(3A) A refund may be made under this section only if section 41A of the Tax Administration Act 1994 is complied with.

(4) In this section, **gift** includes a subscription paid to a society, institution, association, organisation, trust, or fund, only if the Commissioner is satisfied that the subscription does not confer any rights arising from membership in that or any other society, institution, association, organisation, trust, or fund.

Application of the Legislation

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

- that person makes a gift (not being a testamentary gift) of money of $5 or more;
- the gift is made to any of the associations listed in section KC 5(1);
- the recipient, in the opinion of the Commissioner of Inland Revenue ("the Commissioner"), applies its funds wholly or principally for charitable, benevolent, philanthropic, or cultural purposes, or is maintained (subparagraphs (ab) and (ac)) or established and maintained exclusively for one or more of those purposes (subparagraph (ad));
- the taxpayer furnishes to the Commissioner a receipt evidencing the making of the gift by the taxpayer to the recipient, or a tax agent makes the refund application on behalf of the taxpayer and the requirements of section KC 5(3AA) are satisfied; and
- section 41A of the Tax Administration Act 1994 is complied with.

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

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

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

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

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

Tertiary student association fees will only be a "gift" for the purposes of section KC 5(4), and will only qualify for a rebate, if the Commissioner is satisfied that the payment does not confer **any** rights arising from membership. Such rights may include things such as rights to do anything, receive anything, or have access to anything in return for the payment. If no rights are received, the payment of a subscription is considered to be in the nature of a donation, because the payer does not get any direct rights in return for the payment. The requirement that a subscription confer no rights does not contain

words of apportionment (ie "to the extent to which"), but is absolute in its terms. Accordingly, if any rights are conferred by any part of the subscription, section KC 5 does not apply, and no rebate is available. It should be noted that section KC 5(4) refers only to rights being conferred: the rights do not have to be exercised or enjoyed by the taxpayer.

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

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

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

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

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

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

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

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

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

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

Example 1

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

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

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

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

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

Example 2

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

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

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.

NATIONAL AVERAGE MARKET VALUES OF SPECIFIED LIVESTOCK DETERMINATION 2005

This determination may be cited as "The National Average Market Values of Specified Livestock Determination, 2005".

This determination is made in terms of section EL 8(1) of the Income Tax Act 1994 and shall apply to specified livestock on hand at the end of the 2004-2005 income year.

For the purposes of section EL 8(1) of the Income Tax Act 1994 the national average market values of specified livestock, for the 2004–2005 income year, are as set out in the following table.

National average market values of specified livestock determination 2005

Type of livestock	Classes of livestock	Average market value per head
		$
Sheep		
	Ewe hoggets	72.00
	Ram and wether hoggets	66.00
	Two-tooth ewes	113.00
	Mixed-age ewes (rising three-year and four-year old ewes)	98.00
	Rising five-year and older ewes	79.00
	Mixed-age wethers	50.00
	Breeding rams	176.00
Beef cattle		
	Beef breeds and beef crosses	
	Rising one-year heifers	399.00
	Rising two-year heifers	587.00
	Mixed-age cows	708.00
	Rising one-year steers and bulls	494.00
	Rising two-year steers and bulls	697.00
	Rising three-year and older steers and bulls	846.00
	Breeding bulls	1,705.00
Dairy cattle		
	Friesian and related breeds	
	Rising one-year heifers	505.00
	Rising two-year heifers	906.00
	Mixed-age cows	1,071.00
	Rising one-year steers and bulls	398.00
	Rising two-year steers and bulls	615.00
	Rising three-year and older steers and bulls	784.00
	Breeding bulls	1,239.00

Type of livestock	**Classes of livestock**	**Average market value per head**
		$
	Jersey and other dairy cattle	
	Rising one-year heifers	434.00
	Rising two-year heifers	826.00
	Mixed-age cows	1,016.00
	Rising one-year steers and bulls	294.00
	Rising two-year and older steers and bulls	498.00
	Breeding bulls	1,011.00
Deer		
	Red deer	
	Rising one-year hinds	75.00
	Rising two-year hinds	160.00
	Mixed-age hinds	181.00
	Rising one-year stags	97.00
	Rising two-year and older stags (non-breeding)	190.00
	Breeding stags	842.00
	Wapiti, elk, and related crossbreeds	
	Rising one-year hinds	92.00
	Rising two-year hinds	178.00
	Mixed-age hinds	205.00
	Rising one-year stags	122.00
	Rising two-year and older stags (non-breeding)	214.00
	Breeding stags	823.00
	Other breeds	
	Rising one-year hinds	46.00
	Rising two-year hinds	70.00
	Mixed-age hinds	94.00
	Rising one-year stags	54.00
	Rising two-year and older stags (non-breeding)	91.00
	Breeding stags	230.00
Goats		
	Angora and angora crosses (mohair-producing)	
	Rising one-year does	35.00
	Mixed-age does	52.00
	Rising one-year bucks (non-breeding)/wethers	24.00
	Bucks (non-breeding)/wethers over one year	27.00
	Breeding bucks	144.00

Type of livestock	Classes of livestock	Average market value per head
		$
	Other fibre and meat producing goats (Cashmere or Cashgora producing)	
	Rising one-year does	23.00
	Mixed-age does	34.00
	Rising one-year bucks (non-breeding)/wethers	22.00
	Bucks (non-breeding)/wethers over one year	26.00
	Breeding bucks	105.00
	Milking (dairy) goats	
	Rising one-year does	250.00
	Does over one year	300.00
	Breeding bucks	300.00
	Other dairy goats	25.00
Pigs		
	Breeding sows less than one year of age	173.00
	Breeding sows over one year of age	220.00
	Breeding boars	266.00
	Weaners less than 10 weeks of age (excluding sucklings)	58.00
	Growing pigs 10 to 17 weeks of age (porkers and baconers)	104.00
	Growing pigs over 17 weeks of age (baconers)	150.00

This detemination is signed by me on the 23rd day of May 2005

Susan Price
Senior Tax Counsel

NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK DETERMINATION 2005 – REISSUED

This determination replaces the National Standard Costs for Specified Livestock Determination 2005 signed on 31 January 2005 (*New Zealand Gazette*, No 32, 3 February 2005). The earlier determination was invalid, and of no effect, because it was issued in error under the Income Tax Act 2004, whereas it should have been issued under the Income Tax Act 1994, which remains in effect for the 2004–2005 and earlier income years. The national standard costs values listed in the table below have not been changed and apply for the 2004–2005 income year.

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 EL 3A(1) of the Income Tax Act 1994. It shall apply to any specified livestock on hand at the end of the 2004–2005 income year where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EL 3A(1) of the Income Tax Act 1994 the national standard costs for specified livestock for the 2004–2005 income year are as set out in the following table.

National standard costs for specified livestock determination 2005

Kind of livestock	Category of livestock	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 26th day of May 2005.

Martin Smith
Chief Tax Counsel

NEW LEGISLATION

DEEMED RATE OF RETURN FOR FOREIGN INVESTMENT FUND INTERESTS

The deemed rate of return used for taxing foreign investment fund interests has increased from 9.45% to 10.17% for the 2004-05 income year. The deemed rate of return, which is set annually, applies to all types of investments, including interests in superannuation schemes and life insurance policies. The new rate was set by Order in Council on 23 May 2005.

Income Tax (Deemed Rate of Return, 2004–05 Income Year) Regulations 2005, 2005/131

FBT RATE FOR LOW-INTEREST, EMPLOYMENT-RELATED LOANS

The prescribed rate of interest used to calculate fringe benefit tax on low-interest, employment-related loans has increased from 8.76% to 9.01% for the quarter beginning 1 July 2005. The rate is reviewed regularly to ensure it is aligned with the Reserve Bank's survey of first mortgage interest rates. The new rate was set by Order in Council on 23 May 2005.

Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations (No 2) 2005, 2005/132

PATRIOTIC AND CANTEEN FUNDS AMENDMENT ACT 2005 – RESULTING TAX AMENDMENT

The recently enacted Patriotic and Canteen Funds Amendment Act 2005 has amended section 79(1)(f) of the Stamp and Cheque Duties Act 1971 to remove the reference to the "Patriotic and Canteen Fund Board".

The legislation relating to the Board has been repealed and the Board has ceased to exist. The amendment comes into force on 17 May 2005, the day after enactment.

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.

INCOME TAX ACT 2004 – PENALTIES AND INTEREST ARISING FROM UNINTENDED LEGISLATIVE CHANGES – SPS 05/02

Introduction

1. This Standard Practice Statement (SPS) sets out the treatment of shortfall penalties and use of money interest when a tax position is taken under the Income Tax Act 2004 (ITA 2004) and a confirmed unintentional legislative change gives rise to a tax shortfall.

Application

2. This SPS applies from the 2005/2006 and subsequent income years.

Background

3. The ITA 2004 was enacted on 7 May 2004 and represents the third stage of a programme to progressively rewrite New Zealand's income tax legislation to make it clear and easy to understand. The ITA 2004 applies from the 2005/2006 income year.

4. The ITA 2004 is the Income Tax Act 1994 (ITA 1994) in rewritten form and no change is intended from the pre-existing law except as specifically listed in Schedule 22A of the ITA 2004 as an identified policy change.

5. When reporting back on the Bill that would become the ITA 2004, the Finance and Expenditure Committee (FEC) noted that unintended legislative changes may still arise due to the difference in language from the ITA 1994. The FEC recommended the appointment of an independent committee to review submissions regarding any differences between the Acts and recommend appropriate action to the government. The Rewrite Advisory Panel (the Panel), which advised on the rewrite of the ITA 1994, has taken on this role. Details of the Panel and the unintended legislative change process are contained in the Panel statement RAP 001 *"Process for resolving potential unintended legislative changes in the Income Tax Act 2004"*. This statement is able to be viewed on the Panel's website at **www rewriteadvisorygovt.nz**

6. The FEC received submissions expressing concern about shortfall penalties and use of money interest (interest) arising from unintended legislative changes made during the rewrite process. Transitional provisions enacted in the 2004 Act carry over the interpretation of the 1994 Act when the meaning arising under the 2004 Act is unclear or gives rise to an absurdity. Inland Revenue's advice to the FEC was that taxpayers who incur tax shortfalls as a result of an unintended legislative change will still be required to meet their tax obligations but should not be subject to penalties and any interest where reasonable care has been taken.

7. Accordingly this SPS sets out Inland Revenue's practice regarding the imposition of penalties and interest when an unintended legislative change results in a tax shortfall for a taxpayer. Unintended legislative changes will generally be reversed by amending legislation. Although the Government will take account of the advice of the Panel, ultimately the final decision is that of the Government. The Government may decide that the unintended legislative change should be retained. The outcome of all unintended legislative change submissions can be followed on the log on the rewrite advisory panel website, in previous column.

Legislation

Income Tax Act 2004

YA 3 Transitional provisions—

Reference to this Act can include earlier Act

(1) A reference in an enactment or document to this Act, or to a provision of it, is to be interpreted as a reference to the Income Tax Act 1994 (or to the Income Tax Act 1976), or to the corresponding provision of the earlier Act, to the extent necessary to reflect sensibly the intent of the enactment or document.

Reference to earlier Act can include this Act

(2) A reference in an enactment or document to the Income Tax Act 1994 (or to the Income Tax Act 1976), or to a provision of that earlier Act, is to be interpreted as a reference to this Act, or to the corresponding provision in this Act, to the extent necessary to reflect sensibly the intent of the enactment or document.

Intention of new law

(3) Except when subsection (5) applies, the provisions of this Act are the provisions of the Income Tax Act 1994 in rewritten form, and are intended to have the same effect as the corresponding provisions of the Income Tax Act 1994.

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 bysection 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.

Tax Administration Act 1994

141A. Not taking reasonable care—

(1) A taxpayer is liable to pay a shortfall penalty if the taxpayer does not take reasonable care in taking a taxpayer's tax position (referred to as "not taking reasonable care") and the taking of that tax position by that taxpayer results in a tax shortfall.

(2) The penalty payable for not taking reasonable care is 20% of the resulting tax shortfall.

(3) A taxpayer who [takes an acceptable tax position] is also a taxpayer who has taken reasonable care in taking the taxpayer's tax position.

(4) Subsection (3) and section 141B(1B) do not exclude a taxpayer who makes a mistake in the calculation or recording of numbers in a return from being liable for a penalty for not taking reasonable care.

141B. Unacceptable tax position—

(1) A taxpayer takes an unacceptable tax position if, viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct.

(1B) A taxpayer does not take an unacceptable tax position merely by making a mistake in the calculation or recording of numbers in a return.

(2) A taxpayer is liable to pay a shortfall penalty if the taxpayer takes an unacceptable tax position and the tax shortfall arising from the taxpayer's tax position is more than both—

(a) $20,000; and

(b) the lesser of $250,000 and 1% of the taxpayer's total tax figure for the relevant return period.

183D. Remission consistent with collection of highest net revenue over time—

(1) The Commissioner may remit—

(a) A late filing penalty; and

(aa) A non-electronic filing penalty; and

(b) A late payment penalty; and

(bb) A shortfall penalty imposed by section 141AA; and

(c) Interest under Part 7—

payable by a taxpayer if the Commissioner is satisfied that the remission is consistent with the Commissioner's duty to collect over time the highest net revenue that is practicable within the law.

(2) In the application of this section, the Commissioner must have regard to the importance of the late payment penalty, the late filing penalty, and interest under Part 7 in promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts.

(3) The Commissioner must not consider a taxpayer's financial position when applying this section.

Discussion

Transitional Provisions

8. The transitional provisions are contained in Part Y of the ITA 2004. The basic premise as reinforced in section YA 3(3) is that the ITA 2004 is the ITA 1994 in rewritten form. Apart from the identified policy changes and subsequent amendments, the provisions in the ITA 2004 are intended to have the same effect as the corresponding provisions in the ITA 1994. The intent is to preserve case law and Inland Revenue practice and policy statements made under the ITA 1994 so they can be applied to interpret the ITA 2004.

9. The ITA 2004 has full effect from the 2005/2006 income year and from this time must be used instead of the ITA 1994. In general taxpayers must consider and apply the ITA 2004 on its own terms.

10. However, in situations where the meaning of a provision of the ITA 2004 is unclear or gives rise to an absurdity, the wording of the former provision under the ITA 1994 is to be used to determine the correct meaning of the new law (section YA 3(4)). In general terms the Commissioner's statements in respect of the ITA 1994 may be relied upon. However this will not always be the case, for example, where the legislation has changed or there is a change in case law.

11. If it is considered that the wording in the ITA 2004 gives rise to a change in meaning from the ITA 1994, a submission can be made to the Panel identifying the potential unintended legislative change (refer Panel statement RAP 001).

12. Section YA 3(5) excludes from the transitional provisions intended changes as listed in Schedule 22A (Identified policy changes) and it also excludes any amendments made to the ITA 2004 after the commencement of the new Act from the application date of the amendment. Therefore if an amendment is retrospective back to the commencement date of the ITA 2004 then the transitional provisions will not apply from that commencement date. In these situations the normal rules of statutory interpretation will apply.

13. If the meaning of the words in the ITA 2004 are clear, then the tax position that a taxpayer takes in their return should be based on the meaning of the words in that Act. This is the case even if the tax liability is greater than was thought to be the case under the ITA 1994. If, on the other hand, it is reasonably believed that the words are unclear or lead to an absurd result, reference should be made to the ITA 1994 to ascertain the meaning of the ITA 2004.

14. In taking a tax position under the ITA 2004, if there is any material doubt about the meaning of the law, a taxpayer is entitled to assume that a provision that has not been amended since the introduction of the Act and not included in Schedule 22A has the same effect as the corresponding provision in the ITA 1994.

Shortfall penalties

15. If a tax shortfall subsequently arises due to an unintended legislative change from the corresponding provision in the ITA 1994 then it is reasonable that the taxpayer will not have to pay interest on the tax shortfall or be liable to a shortfall penalty.

16. To avoid a shortfall penalty, a taxpayer will still have to take reasonable care in taking a tax position whether or not they are applying a Commissioner's published statement. In addition, the taxpayer will need to have taken an acceptable tax position. An acceptable tax position is a tax position that meets the standard of being about as likely as not to be correct. This means that the position taken by the taxpayer should have around or close to a 50% chance or more of being upheld in court.

Interest

17. Interest is automatically calculated when the taxpayer's account is assessed with the correct amount of tax. A taxpayer who incurs a tax shortfall as a result of an unintended legislative change will receive a statement showing interest charged. This cannot be prevented.

18. However section 183D of the Tax Administration Act 1994 (TAA) allows the Commissioner to remit interest if the Commissioner is satisfied that remission is consistent with the Commissioner's duty to collect the highest net revenue that is practicable within the law. In applying section 183D the Commissioner must have regard to the importance of interest in promoting compliance, especially voluntary compliance, by all taxpayers.

19. The Commissioner considers that enforcing the payment of interest in situations where taxpayers incur a tax shortfall as a result of an unintended legislative change would be to the detriment of encouraging voluntary compliance among taxpayers.

20. A taxpayer seeking a remission of interest under section 183D of the TAA is required by section 183H of the TAA to make an application in writing requesting the remission.

Standard practice

Tax shortfall due to an unintended legislative change

21. If a taxpayer incurs a tax shortfall as a result of an unintended legislative change in the ITA 2004, no shortfall penalty will be charged and the taxpayer will be entitled to apply in writing to the Commissioner for a remission of interest.

22. The taxpayer will still need to have taken reasonable care and an acceptable tax position.

23. To obtain a remission of the interest charged, a taxpayer will need to write to the Commissioner requesting remission as this is a legislative requirement.

24. The taxpayer will still be required to pay the shortfall of tax by the due date that is set for it.

25. The Commissioner has identified two scenarios when a shortfall incurred by a taxpayer is a result of an unintended legislative change to the ITA 2004:

Scenario 1

In taking a tax position in their tax return, a taxpayer applies the ITA 2004 as the law is clear. An unintended legislative change from the ITA 1994 is later identified and confirmed by the Panel. On advice by the Panel, the Government amends the ITA 2004 retrospectively to be consistent with the ITA 1994. As a result of the amendment, a tax shortfall arises. It is established that the taxpayer has taken reasonable care and an acceptable tax position.

Comment

In this situation, the taxpayer had taken an interpretation based on the words in the ITA 2004. The tax shortfall that subsequently arose is solely due to the unintended legislative change and the Government's decision to amend the ITA 2004 retrospectively. In this instance no shortfall penalty will be imposed and the taxpayer will be entitled to a remission of interest upon written application to the Commissioner.

Scenario 2

In taking a tax position in their tax return a taxpayer is required to have regard to the wording of the corresponding provisions of the ITA 1994 as the law in the ITA 2004 is unclear or leads to an absurd result. An unintended legislative change in the ITA 2004 is later identified and confirmed by the Panel. The Government decides not to amend the ITA 2004. As a result, a tax shortfall arises. It is established that the taxpayer has taken reasonable care and an acceptable tax position.

Comment

In this scenario the law in the ITA 2004 is not clear or leads to an absurdity. As required under section YA 3(4), the taxpayer has used the law in the ITA 1994 to interpret the meaning of the law in the ITA 2004. However, it is later established by the Panel that the meaning of the law in the ITA 2004 is different from that of the corresponding provision in the ITA 1994. The Government decides to retain the new meaning. Thus the tax shortfall that the taxpayer consequently incurs does not arise due to any fault of the taxpayer. No shortfall penalty will be imposed and the taxpayer will be entitled to a remission of interest upon written application to the Commissioner.

Tax shortfall not due to an unintended legislative change

26. Outside the 2 scenarios above and this SPS, a taxpayer's liability to shortfall penalties and interest will be considered on a case by case basis according to normal principles. This will include the situations where an unintended legislative change is confirmed by the Panel but the tax shortfall incurred by the taxpayer did not arise due to the unintended legislative change. Rather, the tax shortfall arose as a result of an incorrect interpretation by the taxpayer.

27. There will also be instances where an unintended legislative change is not confirmed by the Panel. In this case, it will be clear that a tax shortfall incurred by the taxpayer did not arise due to an unintended legislative change but is the result of an incorrect interpretation by the taxpayer.

28. These cases are no different to any other case when a tax shortfall arises. Whether a taxpayer incurs a shortfall penalty will be decided on the facts of each case, and whether the taxpayer took reasonable care and an acceptable tax position.

29. Interest charged on the shortfall will be payable along with the outstanding tax. Generally, no remission of interest will be allowed. However the taxpayer will still have the right to apply in writing to the Commissioner for a remission of interest and each case will be considered on its on merits in accordance with the relevant Standard Practice Statement (currently RDC 600 *"Remission of penalties and interest"*).

30. By way of contrast to the two scenarios covered earlier, following are four scenarios that are outside the SPS. The first two are when there is a confirmed unintended legislative change but the tax shortfall that arises is not a result of the unintended legislative change. The following two are when a potential unintended legislative change is not confirmed.

Unintended legislative change confirmed by the Panel

Scenario 3

A taxpayer takes a tax position under the ITA 2004 as the law is clear. The tax position taken by the taxpayer is not correct and a tax shortfall arises. An unintended legislative change is later identified and confirmed by the Panel. However, the Government decides not to amend the ITA 2004. It is established that the taxpayer has taken reasonable care and has an acceptable tax position.

Comment

The taxpayer has interpreted the ITA 2004 in taking their tax position. An unintended legislative change has been confirmed but the law in the ITA 2004 is not changed. The tax position that the taxpayer has taken is an incorrect interpretation of the ITA 2004 and the tax shortfall is not due to the unintended legislative change. There will be no shortfall penalty charged but interest will be payable. This scenario highlights the need to have particular regard to the wording of the ITA 2004. An acceptable tax position based on the ITA 1994 will not necessarily give rise to an acceptable tax position under the ITA 2004.

Scenario 4

A taxpayer interprets the law in the ITA 1994 in taking a tax position in their return as the corresponding provision in the ITA 2004 is unclear or leads to an absurd result. An unintended legislative change in the ITA 2004 is later identified and confirmed by the Panel. The Government decides to amend the ITA 2004 retrospectively to be consistent with the ITA 1994. Nevertheless, a tax shortfall arises as a result of an incorrect interpretation of the ITA 1994. It is established that the taxpayer has taken reasonable care and has an acceptable tax position.

Comment

As directed by section YA 3(4) the taxpayer has used the ITA 1994 to ascertain the meaning of the corresponding provision in the ITA 2004 as it is unclear or leads to an absurd result. The ITA 2004 is amended to have the same effect as the ITA 1994 but the taxpayer still has a tax shortfall that is the result of an incorrect interpretation of the provision in the ITA 1994, not the unintended legislative change. There will be no shortfall penalty but interest will be payable.

Potential unintended legislative change not confirmed by the Panel

Scenario 5

A taxpayer applies the law in the ITA 2004 in taking a tax position in their return as the law is clear. A potential unintended legislative change is identified but is not confirmed by the Panel. The tax position taken by the taxpayer is not correct and a tax shortfall arises. It is established that the taxpayer has taken reasonable care and has an acceptable tax position.

Comment

This case is similar to scenario 3 but the Panel has decided that there is no unintended legislative change in the ITA 2004. The taxpayer has a tax shortfall from taking an incorrect interpretation of the ITA 2004. There will be no shortfall penalty but interest will be payable. As with scenario 3, this scenario highlights the need to have regard to the wording of the ITA 2004 when taking a tax position, even when it is thought that there has been an unintended legislative change.

Scenario 6

A taxpayer interprets the law in the ITA 1994 in taking a tax position in their return as the corresponding provision in the ITA 2004 is unclear or leads to an absurd result. A potential unintended legislative change is later identified but not confirmed by the Panel. A tax shortfall arises as a result of an incorrect interpretation of the unchanged ITA 1994. It is established that the taxpayer has taken reasonable care and an acceptable tax position.

Comment

This case is similar to scenario 4 but the Panel has decided that there is no unintended legislative change in the ITA 2004. The taxpayer has incurred a tax shortfall from taking an incorrect interpretation of the law. There will be no shortfall penalty but interest will be payable.

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31. Please note that all six scenarios have been based on the assumption that the taxpayer has taken reasonable care and has an acceptable tax position when taking their tax position. In cases where a taxpayer has not taken reasonable care or has an unacceptable tax position, a shortfall penalty will be imposed.

32. The following matrix summarises the Commissioner's practice when a tax shortfall arises. This matrix assumes reasonable care and an acceptable tax position.

Savings – existing documents and publications

34. All references to the ITA 1994 in existing documents and publications such as standard practice statements and booklets should be read as reference to the ITA 2004 and all policies and practices contained within these documents should be applied to the corresponding provisions in the ITA 2004.

Scenario	Unintended change confirmed?	Unintended change reversed retrospectively?	Shortfall penalties?	Remission of interest?
1 Relies on new law	Yes	Yes	No	Yes
2 New law unclear and relies on old law	Yes	No	No	Yes
3 Relies on new law	Yes	No	No	No
4 New law unclear and relies on old law	Yes	Yes	No	No
5 Relies on new law	No	N/A	No	No
6 New law unclear and relies on old law	No	N/A	No	No

Overpayments by a taxpayer

33. If a taxpayer has an overpayment due to any of the scenarios outlined in the table above the normal rules, as they pertain to the Commissioner paying the taxpayer interest, will apply.

This Standard Practice Statement is signed on10 June 2005.

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.

APPLICATION FOR CONDITIONAL LEAVE TO APPEAL TO THE PRIVY COUNCIL DISMISSED WITH COSTS

Case: CIR v Motorcorp Holdings Ltd & Ors

Decision date: 19 May 2005

Act: Supreme Court Act 2003

Keywords: Right of appeal to Privy Council, Supreme Court Act 2003, transitional provisions, sections 42, 50

Summary

The Court of Appeal has dismissed an application for conditional leave to appeal to the Privy Council against a judgment of the Court of Appeal dated 7 March 2005. The Court found the transitional provisions in the Supreme Court Act 2003 do not operate in favour of a prospective appellant, merely because the High Court delivered a judgment in the matter before 31 December 2003. The appeal to the Court of Appeal must have also been heard before 1 January 2004, even if judgment was delivered later, for a further right of appeal to the Privy Council to exist.

Facts

On 29 January 2004, the CIR filed an appeal in the Court of Appeal against a decision of the High Court delivered by Venning J on 11 December 2003. The appeal was heard on 15 February 2005, and a judgment allowing the appeal was delivered on 7 March 2005. The respondent filed an application for conditional leave to appeal to the Privy Council.

Appeals to the Privy Council were abolished by the Supreme Court Act 2003, section 42 of which provides:

> **42 Ending of appeals to Her Majesty in Council**
>
> (1) No appeal to her Majesty in Council lies or may be brought from or in respect of any civil or criminal decision of a New Zealand court made after 31 December 2003 –
>
> (a) whether by leave or special leave of any court or of her Majesty in Council, or otherwise; and
>
> (b) whether by virtue of any Act of Parliament of the United Kingdom or of New Zealand, or the Royal prerogative, or otherwise.
>
> (2) Subsection (1) is subject to section 50.

The Supreme Court Act contains a transitional provision in respect of decisions of the Court of Appeal made before 1 January 2004 or made after 31 December 2003 in a proceeding whose hearing was completed before 1 January 2004. The saving provision is section 50 of the Supreme Court Act. Of particular relevance is subsection 1(a) which provides as follows:

> **50. Privy Council may still determine appeals in certain existing proceedings**
>
> (1) The Privy Council may hear and determine, or continue to hear and determine,–
>
> (a) an appeal against a final judgment of the Court of Appeal made before 1 January 2004, or made after 31 December 2003 in a proceeding whose hearing was completed before 1 January 2004, where
>
> (i) the matter in dispute on the appeal amounts to or is of the value of $5,000 or upwards; or
>
> (ii) the appeal involves, directly or indirectly, some claim or question to or respecting property or some civil right amounting to or of the value of $5,000 or upwards;

The respondent contended that its case came within the dispensing scope of section 50(1)(a) submitting that on a proper construction of the provision, the reference to the "proceeding whose hearing was completed" is a reference to the High Court proceeding and the High Court hearing. On this approach a right of appeal would lie to the Privy Council because the High Court proceeding was heard and determined before 1 January 2004.

Decision

The Court held that it was inconceivable that Parliament, in repatriating appeals by way of the Supreme Court Act,

could have intended to continue a right of appeal against a decision of the Court of Appeal, not by reference to the timing of that decision but by reference to a lower Court's decision in respect of which an appeal right had been exercised and dealt with.

If there was an ambiguity, it would have to be in terms of the possibility that the words "whose hearing" in section 50(1)(a) could mean "whose hearing in the High Court," but the Court considered that was not tenable, because all exemptions from the section 42 barrier, described in section 50(1), relate to final judgments or decisions of the Court of Appeal. There was no exemption for decisions of the High Court, notwithstanding that the New Zealand (Appeals to the Privy Council) Order 1910, Rule 2(c) provided for a right of appeal directly from the High Court. The Supreme Court Act has only preserved appeals from the Court of Appeal in limited circumstances, and abolished appeals from the High Court, so it cannot be the case that Parliament intended the disposal of the proceedings in the High Court to have significance.

The Court dismissed the application for conditional leave and ordered costs of $1,500 in favour of the Commissioner.

DECLARATORY JUDGMENT ON DEEMED VALUE PAYMENTS BY FISHERS

Case:	Pacific Trawling Ltd & Forty South Ltd v the Chief Executive of the Ministry of Fisheries & the CIR
Decision date:	13 May 2005
Act:	Fisheries Act 1983, Fisheries Act 1996, Goods and Services Tax Act 1985
Keywords:	GST, fisheries, deemed value payment

Summary

Pacific Trawling Ltd and Forty South Ltd successfully sought a declaratory judgment that deemed value payments made by fishers are subject to GST

Facts

The Crown regulates the commercial exploitation of fish species in New Zealand waters under what is known as the quota management system, which the Ministry of Fisheries ("the Ministry") administers. Under the quota management system, a commercial fisher may take and sell quota species only if it holds a valid fishing permit and a quota for a share of the total allowable commercial catch for the relevant species.

When fishing, a fisher frequently catches other quota species for which it does not hold quota. These fish are called by-catch. Both the Fisheries Act 1996 ("the 1996 Act") and its predecessor, the Fisheries Act 1983 ("the 1983 Act"), recognise that by-catch is inevitable, and seek to create incentives to minimise it and avoid wastage. A fisher is required to land by-catch, and may then process and sell it, but must also buy/lease quota to cover the by-catch, or make a "deemed value" payment to the Ministry. Deemed values for each quota species are set at a level that makes by-catch unprofitable, but creates an incentive to land the fish (dumping by-catch at sea is prohibited under both Acts).

The plaintiffs are commercial fishers who have held fishing permits and fish lawfully against quota owned by other firms. They called on the Chief Executive of the Ministry of Fisheries in November 2000 to issue tax invoices in respect of their deemed value payments. The Chief Executive assesses the deemed value of by-catch and administers the quota management system. The Commissioner of Inland Revenue was included in the proceedings because the plaintiffs sought a binding ruling from him under section 91E of the Tax Administration Act 1994. They abandoned it when it became clear that the ruling, if issued, would have been unfavourable.

Decision

For the plaintiffs, Mr Cullen argued that a taxable supply is made when something is supplied in consideration for payment. He characterised that which the Ministry supplies in return for deemed value payments in various ways: as the right to keep and sell the fish, as 'authorisation' of the fisher's ownership of the fish, and as an entitlement to continue fishing without attracting prosecution (under the 1983 Act) or automatic suspension of a fishing permit (under the 1996 Act).

For the defendants, Mr Coleman responded that deemed value payments do not confer property rights since the fisher retains ownership of the fish throughout. They are not fees for services since no services are supplied, nor payments for statutory privileges. If anything, they are statutory demands analogous to levies. Lastly, imposition of GST would give rise to practical difficulties.

After covering the background to the GST Act 1985 and the deemed value regime, His Honour turned to consider what goods or services, if any, the Ministry supplies in return for the deemed value payments.

He concurred with the defendants' contention that ownership of fish, including by-catch, remained with the fisher whether or not deemed value payments were made. The payment did not, therefore, confer a right to keep and sell the fish.

However, Miller J noted that under the 1983 Act, payment of deemed values was part of a defence to what would otherwise be unauthorised possession and sale of

by-catch (it being a strict liability offence to catch fish for which the fisher did not hold quota). That being so:

> "[i]t follows that something was indeed supplied in consideration for the payment, in the form of authority to keep and sell the by-catch covered by the payment where the fisher could also prove that it was genuine bycatch."

He went on to say that although the mechanism used to control by-catch under the 1996 Act is quite different (non-payment of deemed value payments results in suspension of the fishing permit), it too confers a right in return for payment of deemed values–the continued right to use the fishing permit.

As far as the defendants' submissions that the deemed value payments were analogous to a levy or a penalty were concerned, His Honour noted that nothing in the GST Act expressly excludes fines, levies or penalties from GST. Rather, they are excluded because they are not a taxable supply, in which a good or a service is provided in consideration for payment.

Justice Miller was not persuaded that the fact that payments are held on trust until the end of the year in any way altered the situation, and also dismissed the defendant's submissions that there would be practical difficulties in imposing GST on deemed value payments.

COMMISSIONER PROPERLY EXERCISED DISCRETION NOT TO GRANT FINANCIAL RELIEF

Case:	William Murray McLean v CIR (Judicial Review)
Decision date:	25 May 2005
Act:	Tax Administration Act 1994
Keywords:	Judicial review, financial relief, serious hardship

Summary

Mr Mclean had a substantial tax debt arising from his participation in certain tax-driven investments schemes. The scheme deductions were disallowed by the Commissioner and penalties were applied. Mr McLean applied for financial relief but that was declined as the Commissioner was of the view that personal wealth had been quarantined into trusts which were effectively under the control of the taxpayer. Mr Mclean sought judicial review of the Commissioner's decision. The Court upheld the decision agreeing that the trusts were extensions of Mr McLean's financial personality.

Facts

In 1994–95, through LAQCs the plaintiff invested in the Digitech and Salisbury Investment schemes. The Commissioner investigated the schemes and subsequently disallowed the tax losses claimed by the investors in them, including the plaintiff. Some of the investors in the schemes took challenge proceedings but their counsel conceded the challenges during the course of dispute resolution processes on 20 November 2000 (Digitech) and 20 February 2001 (Salisbury). Formal notices of reassessment were then issued to the investors. In the plaintiff's case a reassessment issued in December 2000 in relation to the Digitech tax lossesclaimed by the plaintiff and in March/April 2001 for the tax losses claimed in respect of the Salisbury scheme.

In the mid-1990s the plaintiff was a successful real estate agent. He traded using the company Samuel Vaile and Sons Limited. On 28 February 1996 the plaintiff established two trusts, the St Albans Trust (SAT) and the 1843 Trust (1843 Trust). The plaintiff is the primary beneficiary of both trusts. He is not married and does not have children. The initial trustees were the plaintiff and one of the accountants who promoted the Digitech and Salisbury schemes. On establishing the trusts the plaintiff immediately sold 8,000 of the 10,000 shares in Samuel Vaile and Sons Limited to the 1843 trust for $160,000. At the same time he advanced $160,000 to the 1843 Trust to complete the purchase. The purchase price was left outstanding with no demand to be made for 12 years.

The plaintiff transferred his residential property to SAT subject to the existing mortgage and a life interest in his favour and in 1997 the plaintiff's mother rewrote her will naming SAT as a beneficiary for one-third of the residue, effectively in place of the plaintiff.

During September 1999 the plaintiff came under pressure from financiers to sell down some of the properties owned by SAT. In March 2000 he surrendered his life interest in the St Albans' Avenue property to SAT in exchange for $227,697 to enable SAT to sell the St Albans Avenue property. The $227,697 was payable upon demand, but the plaintiff agreed to postpone making demand for a period of 20 years. There was no provision for interest.

On 31 March 2001 the plaintiff gifted $27,000 to SAT. This continued gifting which had been made in 1998 and 1999. Between April 1997 and March 2000 the 1843 Trust borrowed money from Samuel Vaile and Sons Limited. In turn monies were drawn from the trust by the plaintiff for living expenses and for the purposes of SAT.

On 22 July 2001 the plaintiff's mother died. On 2 May 2002 the plaintiff entered a deed with the trustees of SAT and the trustees of his mother's estate recording that a mortgage registered over one of the properties owned by his mother's estate secured advances made for the benefit of both Samuel Vaile and Sons Limited and the plaintiff. The deed recorded that the mother's estate would discharge the debt and the repayment would constitute a partial distribution of SATs entitlement to a third of the residuary estate. It further recorded that the sum was to be applied in reduction of the debt owned by SAT to the plaintiff.

On 21 June 2002 the plaintiff entered a deed with the trustees of the 1843 Trust in which he discharged the liability of the 1843 Trust for the $160,000 owed by the trust to him. He retook the 8,000 shares in settlement of the debt. However, by June 2002 the shares in Samuel Vaile and Son Limited were worthless. On the same day the 1843 Trust retransferred the rights to the use of the name Samuel Vaile and Sons Limited to SAT for $27,000.

During this time, the plaintiff applied to the Commissioner for financial relief, citing "serious hardship". He said he did not personally have any funds, but offered the Commissioner the shares in the LAQC companies he had used for the purposes of the Digitech and Salisbury schemes or alternatively $5,000 in cash which he stated he would have to borrow from his sister. In 2002 he made another settlement offer of $36,000 over three years and finally $72,000 over three years. The Commissioner took the view that the plaintiff's dealings with his trusts and the effective alienation of his assets into those structures, disentitled him from financial relief. The Commissioner sought and obtained judgment for the debt as it then stood but agreed to a stay of execution pending the outcome of these judicial review proceedings.

Decision

His Honour Justice Venning traversed the above facts in some detail and reviewed the caselaw on judicial review of debt matters. Counsel for the plaintiff sought to distinguish the Raynel and Clarke & Money decisions on the bases that they were "take-it-or-leave-it" offers or that the plaintiff had not wound up his LAQCs. His Honour did not consider those points of distinction material. He dismissed the application as being entirely without merit and awarded costs on that basis.

> "Those actions show a willingness by the plaintiff to engage in transactions with the trusts, ultimately designed to reduce his assets, primarily the debts owing by the trusts to him, at a time when he was well aware of the Commissioner's challenge to the Digitech and Salisbury schemes and further even during the period after he had sought relief from the Commissioner."
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> "In the present case while the plaintiff's offer is not on a take it or leave it basis, in the context of the size of the taxation liability the offers and the terms are modest. The initial offer of $5,000 on the basis he had nothing and would have to borrow from his sister was in commercial terms, a try-on. The Commissioner was entitled to treat the offers that followed, for payment over a long time period of a figure substantially below the core debt, with circumspection."
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> "A particularly material factor the Commissioner was entitled to take into account was that while the plaintiff was engaged in the negotiation process with the Commissioner, he was also engaged in transactions that reduced the value of his assets. The plaintiff or for that matter, another taxpayer can not put himself in a financial position in order to force the Commissioner to accept whatever offer he chooses to make."
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> "In the present case the following factors are relevant to the Commissioner's decision:
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> - The plaintiff participated in a tax avoidance arrangement.
> - The plaintiff took steps to alienate his property and transfer it to trusts.
> - The plaintiff engaged in an exercise to forgive or set off the debts the trusts owed him at a time he knew the Commissioner challenged the tax write off.
> - A number of the transactions he entered with the trusts support an inference that he intended to defeat the Commissioner's claims.
> - The plaintiff did not make completely full and frank disclosure. In light of those matters, the Commissioner was entitled to reject the application for relief and settlement offers of the plaintiff."
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> "I endorse the comments of Randerson J in Raynel. The Commissioner in the present case was quite entitled and indeed obliged to have regard to the integrity of the tax system and the importance of promoting compliance with the Inland Revenue Acts. In this case the clear inference is that notwithstanding the plaintiff's knowledge of his obligations to the Revenue the plaintiff ordered his affairs principally through the use of the SAT and 1843 trusts to do as much as he could to reduce his personal assets and to place as many obstacles as possible in the way of the Commissioner recovering funds from him personally. It would do nothing for the integrity of the tax system if the plaintiff were permitted to act in that way to force the Commissioner to accept a settlement."
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> "As I have noted the review was misguided. The plaintiff and his advisers are aware of the decision of Raynel. Despite knowledge of that clear statement of principle the plaintiff pursued these proceedings. He is to pay the costs consequences of that. Costs to the Commissioner on a 2B basis together with disbursements."

TAXPAYER SEEKS NULLIFICATION OF A COMPANY AMALGAMATION

Case:	Selectrix Management Limited v The Registrar of Companies and The Commissioner of Inland Revenue
Decision date:	2 May 2005
Act:	Companies Act 1955
Keywords:	tax losses, amalgamation, loss of shareholder continuity

Summary

The taxpayer was unsuccessful in its application to nullify a company amalgamation and as a result has "lost" substantial tax losses.

Facts

The plaintiff company and Kororia Services Limited (KSL) were companies whose director was Mr Jon Rivers Lamb. In March 1996 the plaintiff had accumulated tax losses available to it in excess of $5.6 million. KSL was not trading and was not otherwise used by Mr Lamb. Mr Lamb was advised by his accountants of an easy way to "get rid of" an unwanted company by amalgamation. Mr Lamb instructed the accountants to go ahead with the intention of dispensing with KSL.

The accountants prepared documentation for the short-form amalgamation of the plaintiff and KSL. Mr Lamb executed the documents as director of both the plaintiff and KSL. These documents were lodged with the Registrar of Companies (first defendant).

On 28 March 1996 the Registrar of Companies issued a Certificate of Amalgamation under section 209F of the Companies Act 1955 (the Act applicable to the companies at the relevant time). As a consequence KSL was deemed to be dissolved and struck off the Companies Registry.

Subsequently, the Commissioner of Inland Revenue investigated the plaintiff's tax affairs. The plaintiff had claimed accrued tax losses based on the accumulated losses. The CIR disallowed the plaintiff's claim for those accrued tax losses on the grounds that the amalgamation of the plaintiff and KSL broke the necessary shareholder continuity.

The plaintiffs sought declarations that:

- The amalgamation was a nullity and of no legal effect;
- The Certificate of Amalgamation be withdrawn;
- KSL be reinstated to the Register of Companies.

Decision

Issue 1

The plaintiff argued that the plaintiff and KSL were not able to use the short form amalgamation as a matter of law and therefore the amalgamation was a nullity or of no effect.

For the plaintiff to use the short-form amalgamation they needed the companies to be directly or indirectly owned by the same, third company. In the present case the shareholders in the plaintiff were Mr Lamb and Fermata Holdings Limited. In the case of KSL the shareholders were the two Lamb family trusts. The amalgamating companies were not owned by the same company, neither was owned by a company at all.

The plaintiff argued that the long form amalgamation process should have been followed. That process required certain conditions to be satisfied and that these conditions were not satisfied, therefore the amalgamation was a nullity.

The Judge found:

The amalgamation was effected by the issue of the certificate of amalgamation and therefore the issue was whether the Registrar's actions rather than the actions of the company were a nullity.

The Judge also found that the necessary conditions to amalgamate had been met and that the actions of the Registrar in accepting the amalgamation documents were correct, therefore the Registrar's actions were not a nullity. Therefore the issue of the certificate of amalgamation was not a nullity.

The Judge concluded that the documents presented to the Registrar did not have defect, such that the Registrar should have been put on enquiry, and that there was no basis for the declaration that the amalgamation was a nullity, void and of no effect as sought by the pleadings.

Issue 2

The plaintiff argued that if the amalgamation was not a nullity, the Registrar's decision to issue the amalgamation certificate is in any event amenable to review.

Section 209 F of the Companies Act 1955 states that the Registrar must, after receipt of documents required under section 209E issue a Certificate of Amalgamation. The issue was whether there were documents presented to the Registrar as required by section 209E. If there were then prima facie the Registrar had no discretion and was bound to issue the certificate which completed the process.

The Judge did not accept that the defects in the documentation presented to the Registrar were such as to prevent registration. The Registrar was not required to be satisfied as to the underlying facts behind the documents presented to him or to form a view in respect of them.

In the absence of a defect in the process adopted by the Registrar, the Certificate of Amalgamation once issued by the Registrar is effective. In this case there was nothing illegal or defective in the action of the Registrar in issuing the certificate. Prima facie the issue of the certificate is not amenable to review

The Judge then considered that in the exercise of the Court's discretion should the decision be set aside on Judicial Review? The Court took many things into consideration including the prejudice to other parties. It was found that the Commissioner would be affected by the decision to set aside the decision, the Judge also pointed out the significant time period of nine years since the effective amalgamation.

The Judge concluded that he did not consider that there was a basis to review the first defendant's decision in the case. The plaintiff's application was dismissed.

The Judge indicated that perhaps the appropriate remedy for the Plaintiff was against its accountants.

REGULAR FEATURES

DUE DATES REMINDER

July 2005

7 Provisional tax instalments due for people and organisations 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

August 2005

22 Employer deductions

Small employers (less than $100,000 PAYE and SSCWT deductions per annum)

- *Employer deductions (IR 345)* or *(IR 346)* form and payment due
- *Employer monthly schedule (IR 348)* due

31 GST return and payment due

These dates are taken from Inland Revenue's *Smart business tax due date 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.

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