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

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

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THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

If you wish to make a submission on one of our drafts, please let us know before the comment deadline if you are unable to meet that date.

Email

public.consultation@ird.govt.nz

Post

Public Consultation
Inland Revenue National Office
PO Box 2198
Wellington

The following draft items are available for review/comment this month, having a deadline of 22 December 2006.

Ref.	Draft type	Description
IS0049	Interpretation statement	GST exempt supply: supply of accommodation in a dwelling
QB0033	Question we've been asked	Payments made in addition to financial redress under Treaty of Waitangi settlements—income tax treatment

The following draft items are available for review/comment this month, having a deadline of 16 February 2007.

Ref.	Draft type	Description
ED 0090	Standard practice statement	Requests to amend assessments
ED 0094	Question we've been asked	Zero-rating of supplies of "sail-away boats" – used as security or offered for sale

The following draft items are available for review/comment this month, having a deadline of 23 February 2007.

Ref.	Draft type	Description
QB0056	Question we've been asked	New employee relocation expenses
XPB0034	Public ruling	Maori trust boards: declaration of trust for charitable purposes made under section 24B of the Maori Trust Boards Act 1955—income tax consequences

Please see page 41 for details on how to obtain a copy.

BINDING RULINGS

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

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

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

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

PRODUCT RULING – BR PRD 06/04

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

Name of the person who applied for the Ruling

This Ruling has been applied for by TOWER Consolidated Group.

Taxation Law

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

This Ruling applies in respect of the definition of "dividend" as defined in subpart CD of the Income Tax Act 2004.

The Arrangement to which this Ruling applies

The Arrangement is the demerger of the Australian business of the TOWER group. Further details of the Arrangement are set out in the paragraphs below.

1. Rename Andric Pty Limited

The parent of a significant proportion of the Australian operations of TOWER Limited, Andric Pty Limited, will be renamed TOWER Australia Group Limited ("TAGL"). Andric Pty Limited is wholly owned by TOWER Limited subsidiary TOWER Group Network Ltd ("TGN"). The renamed TAGL is the company that will be transferred to TOWER Limited shareholders and listed on the Australian Stock Exchange. It will leave the TOWER Limited group as part of the demerger.

2. Restructuring to ensure that all Australian entities are held via TAGL

The restructure will require the sale of TOWER Holdings Australia Pty Limited by its New Zealand parent TOWER Insurance Group Limited to TAGL.

Following the restructuring, TAGL will hold the existing Australian operations of TOWER Limited, namely TOWER Retail Life, TOWER Alliances & Group Life and TOWER Australia Investments.

TOWER Limited (to be renamed TOWER New Zealand after the demerger) will continue to own TOWER Limited's New Zealand operations, which include TOWER Health & Life, TOWER General Insurance and TOWER Investments. It will retain its listing on the New Zealand and Australian stock exchanges.

3. Shareholder approval

A shareholders' meeting to approve the proposed demerger will be held on 6 November 2006. The arrangement will take effect only if it is approved by a special resolution of TOWER Limited shareholders (i.e. 75% of shareholders voting, either in person or by proxy).

4. Agreement to acquire shares in TAGL

TOWER Limited will enter into an agreement to acquire the shares in TAGL from its wholly owned subsidiary TGN. The agreement will permit TOWER Limited to direct TGN to distribute the shares in TAGL on a pro rata basis directly to TOWER Limited's shareholders on its behalf.

5. Buy back of TOWER Limited shares, using TAGL shares as consideration and subsequent cancellation of repurchased TOWER Limited shares

A court order will be sought to direct TGN to transfer the shares in TAGL to the shareholders in TOWER Limited pursuant to the above agreement. The current proposal provides that TOWER Limited will transfer all of its 234.3 million shares in TAGL to TOWER Limited shareholders on a pro rata basis of 0.6511 TAGL shares for every TOWER Limited share held, and, in return for that transfer, cancel 0.4760 TOWER Limited shares for every TOWER Limited share held.

TOWER Limited intends to round fractional entitlements (with 0.5 being rounded up). At the conclusion of the exercise, TOWER Limited shareholders will hold TAGL shares and a reduced number of TOWER Limited shares.

6. TAGL issues entitlements to subscribe for TAGL shares

Following the demerger, TAGL will raise A$160 million of new equity. This capital raising will be by way of an Entitlement Offer in which TAGL shareholders will be provided with an Entitlement to buy 0.4269 TAGL shares for every TAGL share held. The Entitlement Offer is to be fully underwritten by Guinness Peat Group plc. The rights are renounceable by the TAGL shareholders and can be traded on the Australian Stock Exchange.

In addition to the special resolution required above, the proposal will not proceed unless there is approval by ordinary resolution (50% or more of the votes cast by shareholders voting at the Special Meeting) to the GPG underwriting agreement.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

(a) All TOWER Limited shares cancelled as part of the Arrangement will be ordinary listed shares of the same class issued by TOWER Limited, and will each be cancelled in whole, not in part.

(b) A market value circumstance will not exist at the time of the cancellation.

(c) The aggregate amount payable by TOWER Limited to its shareholders on account of the cancellation will be equal to or greater than 15 percent of the market value of all ordinary shares issued by TOWER Limited at the time the company first notified shareholders of the proposed cancellation, which was 8 August 2006.

(d) TOWER Limited will not issue shares (as defined in section OB 1 of the Income Tax Act 2004) in connection with, or as a consequence of, the demerger.

(e) The aggregate amount of available subscribed capital of TOWER Limited per share cancelled, at the time of the cancellation, will not be less than the amount distributed on cancellation.

(f) The demerger Arrangement (including the factual and accounting basis on which it is entered into) when completed does not differ materially from the proposal provided to Inland Revenue and set out in the material supplied.

How the Taxation Laws apply to the Arrangement

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

- The pro rata share cancellation by TOWER Limited, where TAGL shares are distributed to shareholders, does not constitute a "dividend" as defined in subpart CD of the Income Tax Act 2004.
- The Commissioner is satisfied that the cancellation is not in lieu of the payment of a dividend under section CD 14(8).

The period for which this Ruling applies

This Ruling will apply for the period from 20/11/2006 to 31/03/2007.

This Ruling is signed by me on the 18th day of September 2006.

D B Kelly
Manager
Financial Sector, Corporates

INTERPRETATION STATEMENTS

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

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

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

SHORTFALL PENALTY—EVASION

1. SUMMARY

1.1 All legislative references in this interpretation statement are to the Tax Administration Act 1994 ("the Act") unless otherwise stated.

1.2 This statement provides a detailed interpretative explanation of the shortfall penalty imposed under section 141E for "evasion or a similar act", with particular emphasis on what constitutes evasion "or a similar act".

1.3 Section 141E(1) imposes a penalty for two types of behaviour that may occur in taking a tax position.

- The first, in paragraph (a), is evasion (of the assessment or payment of tax by a taxpayer for themselves or another).
- The second type, in the remaining paragraphs of section 141E(1), requires knowledge of the breaches set out in those paragraphs (misapplying a deduction or withholding tax, or not making tax deductions, or obtaining or attempting to obtain a refund for the taxpayer themselves or another knowing there is no entitlement to such a refund).

1.4 Evasion occurs when a taxpayer deliberately breaches a tax obligation. The required mental element for evasion will be present if the taxpayer knew or strongly suspected that the taxpayer's course of conduct would breach a tax obligation. In other words, evasion requires intentional behaviour or subjective recklessness; negligence and carelessness are insufficient.

1.5 The other paragraphs of section 141E(1) set out various acts or omissions which constitute a "similar act" to evasion. They all require that the act or omission occurs "knowingly". The following points should be noted in relation to this knowledge requirement:

- These other paragraphs require that the taxpayer has knowledge of doing the act (or the omission); unlike evasion they do not require that the taxpayer has knowledge that the act or omission is in breach of a tax obligation;
- The knowledge requirement can be satisfied by actual knowledge of or subjective recklessness toward the doing of the act (or of the omission). Like evasion, negligence and carelessness are insufficient to satisfy the test.

1.6 The statutory defence (in section 141E(2)) that can apply to section 141E(1)(b) (misapplying a deduction or withholding tax) applies only where the deduction has since been accounted for, and the taxpayer establishes (on the balance of probabilities) that the illness, accident, or other cause beyond their control directly caused the breach.

1.7 Apportionment of a shortfall penalty (provided for in section 141F(2)) between the taxpayer (for example, a company) and the officer of the taxpayer involved is possible where the breach is failing to make or account for a deduction, or misapplying or permitting misapplication of a deduction. The criteria for determining the apportionment are the relative actions or omissions of the company and the officer involved, and the reasonableness of those actions or omissions.

2. BACKGROUND

2.1 In March 1998, a Standard Practice Statement was published which dealt with the evasion or similar act penalty (INV-220). This appeared in *Tax Information Bulletin* Vol 10, No 3 (March 1998). This Standard Practice Statement has now been withdrawn in relation to tax positions taken on or after 1 April 2003. Standard Practice Statements dealing with shortfall penalties were withdrawn at this time due to the enactment of the Taxation (Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Act 2003, which made various changes to the shortfall penalty regime. One of these changes was the introduction of section 141FB, which deals with the reduction of penalties for previous behaviour.

2.2 The focus of this Interpretation Statement is on what constitutes "evasion or a similar offence". As no changes were made to this concept, this Interpretation Statement will cover some of the same ground as the Standard Practice Statement,

but will reflect recent amendments to the legislation and incorporate case law issued since the Standard Practice Statement was issued. The principles outlined in this statement are consistent with the Standard Practice Statement. They are also consistent with the brief examples of evasion contained in *Tax Information Bulletin* Vol 8, No 7 (October 1996) and the example of evasion given in "Shortfall penalties for failure to deduct or account for PAYE", *Tax Information Bulletin* Vol 12, No 5 (May 2000). It should be noted, however, that of the factors set out in bullet points as factors to consider in the latter *Tax Information Bulletin,* only the fifth bullet point is relevant where it is the evasion shortfall penalty that is under consideration.

3. LEGISLATION

3.1 Section 3(1) includes the following definitions:

> **3 Definitions**
>
> (1) In this Act, unless the context otherwise requires,—
>
> …
>
> **"Shortfall penalty"** means a penalty imposed under any of sections 141A to 141K for taking an incorrect tax position or for doing or failing to do anything specified or described in those sections:
>
> …
>
> **"Tax position"** means a position or approach with regard to tax under one or more tax laws, including without limitation a position or approach with regard to—
>
> (a) A liability for an amount of tax, or the payment of an amount of tax:
> (b) An obligation to deduct or withhold an amount of tax, or the deduction or withholding of an amount of tax:
> (c) A right to a tax refund, or to claim or not to claim a tax refund:
> (d) A right to a credit of tax, or to claim or not to claim a credit of tax:
> (e) The provision of a tax return, or the non-provision of a tax return:
> (f) The derivation of an amount of gross income or exempt income or a capital gain, or the inclusion or non-inclusion of an amount in gross income:
> (g) The incurring of an amount of expenditure or loss, or the allowing or disallowing as a deduction of an amount of expenditure or loss:
> (h) The availability of net losses, or the offsetting or use of net losses:
> (i) The attaching of a credit of tax, or the receipt of or lack of entitlement to receive a credit of tax:
> (j) The balance of a tax account of any type or description, or a debit or credit to such a tax account:
> (k) The estimation of the provisional tax payable:
> (l) Whether the taxpayer must request an income statement or respond to an income statement issued by the Commissioner:
> (m) The application of section 33A(1):
> (n) A right to a rebate:
>
> …
>
> **"Tax shortfall",** for a return period, means the difference between the tax effect of—
>
> (a) A taxpayer's tax position for the return period; and
> (b) The correct tax position for that period,— when the taxpayer's tax position results in too little tax paid or payable by the taxpayer or another person or overstates a tax benefit, credit, or advantage of any type or description whatever by or benefiting (as the case may be) the taxpayer or another person:
>
> …
>
> **"Taxpayer's tax position"** means—
>
> (a) A tax position taken by a taxpayer in or in respect of—
> (i) A tax return; or
> (ii) An income statement; or
> (iii) A due date:

3.2 Section 4A sets out how to interpret provisions relating to a taxpayer's tax position and obligations:

> **4A. Construction of certain provisions**—
>
> (1) In this Act—
>
> (a) A provision referring to a tax liability or to a tax obligation, or to something a person must do, refers to a taxpayer's liability or obligation under a tax law:
> (b) A provision referring to a taxpayer taking a tax position or to a taxpayer's tax position, also refers to the taxpayer's—
>
> (i) Claiming or returning or not claiming or returning the tax position; or
> (ii) Paying or deducting or not paying or deducting an amount of tax; or
> (iii) Being placed in the tax position,—
>
> whether knowingly or intentionally or involuntarily:
>
> (c) A provision referring to a tax position taken in a tax return refers to a tax position taken explicitly or implicitly in the tax return:
> (ca) A provision referring to a tax position taken in an income statement refers to a tax position taken explicitly or implicitly in the income statement, whether or not the tax position was included by the Commissioner in the income statement:

(d) A provision referring to a taxpayer's obligation to pay an amount of tax refers to the taxpayer's obligation to pay tax to the Commissioner:

(e) A provision referring to a taxpayer's obligation to provide a tax return refers to the taxpayer's obligation to complete and provide the tax return to the Commissioner:

(f) A provision referring to a taxpayer's obligation to provide a tax form refers to the taxpayer's obligation to complete and provide the tax form to the person entitled to it:

(g) A provision referring to any tax (including, for the avoidance of doubt, a penalty) or interest is to be taken to be a reference to all, or part, or the relevant part, of the tax or interest.

(2) For the purposes of this Act—

(a) A company is deemed to make a dividend withholding payment deduction when payment is made to the company of a foreign withholding payment dividend:

(b) A deduction is deemed to be made when payment is made of the net amount of any source deduction payment:

(c) The amount of a deduction described in paragraph (a) or paragraph (b) is deemed to have been applied for a purpose other than in payment to the Commissioner if the amount is not paid to the Commissioner by the relevant due date:

(d) If the amount of a deduction described in paragraph (a) or paragraph (b) is not paid to the Commissioner by the due date, the amount is deemed to be unpaid tax.

(3) References in this Act to tax liabilities in respect of making, or accounting for, deductions of tax under the PAYE rules, to the extent necessary, are also to be construed as including references to liabilities in respect of making, or accounting for,—

(a) Deductions of premiums payable under the Accident Rehabilitation and Compensation Insurance Act 1992 or regulations made under that Act or the Accident Insurance Act 1998 or a regulation made under that Act; or

(aa) deductions of levies under the Injury Prevention, Rehabilitation, and Compensation Act 2001 or a regulation made under that Act; or

(b) Deductions under the Child Support Act 1991; or

(c) Repayment deductions or other deductions under the Student Loan Scheme Act 1992,—

where the relevant liabilities arise or are to be performed at the same time as the tax liabilities under the PAYE rules.

(4) Where a taxpayer required to provide a return under any of sections NC 15, NF 4, NG 11, and NH 3 of the Income Tax Act 2004—

(a) Furnishes a return that shows a liability to pay tax under that section; and

(b) The tax is required to be paid by a due date for a return period; and

(c) The liability shown in the return is greater than the tax that the taxpayer paid by the due date—

the taxpayer's tax position in respect of the due date is the tax paid and not the amount of tax shown as payable in the tax return.

(5) If a taxpayer does not provide a tax return for a return period, the taxpayer is deemed, in relation to each type of tax, to take, in respect of every due date that would be covered by a tax return for the return period if a return were provided, a tax position that is based on the tax of that type paid by the taxpayer for that return period.

(6) Where—

(a) A provision (in this subsection referred to as ``the relevant provision'') of this Act applies in respect of a taxpayer making an objection to or a challenge in respect of an assessment or other disputable decision, but not to both; and

(b) It is necessary or appropriate for the purposes of another provision of this Act that applies with respect to objections or challenges, but not to both, that the relevant provision apply,—

the relevant provision is to be read as if it referred with respect to both objections and challenges.

3.3 Section 141E imposes a liability for a shortfall penalty in the following terms:

141E Evasion or similar act

(1) A taxpayer is liable to pay a shortfall penalty if, in taking a tax position, the taxpayer—

(a) Evades the assessment or payment of tax by the taxpayer or another person under a tax law; or

(b) Knowingly applies or permits the application of the amount of a deduction or withholding of tax made or deemed to be made under a tax law for any purpose other than in payment to the Commissioner; or

(c) Knowingly does not make a deduction or withholding of tax required to be made by a tax law; or

(d) Obtains a refund or payment of tax, knowing that the taxpayer is not lawfully entitled to the refund or payment under a tax law; or

(da) Attempts to obtain a refund or payment of tax, knowing that the taxpayer is not lawfully entitled to the refund or payment under a tax law; or

(e) Enables another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law; or

(f) Attempts to enable another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law—

(referred to as "evasion or a similar act").

(2) No person shall be chargeable with a shortfall penalty under subsection (1)(b) if that person satisfies the Commissioner that the amount of the deduction has been accounted for, and that the person's failure to account for it within the prescribed time was due to illness, accident, or some other causes beyond the person's control.

(3) If a taxpayer enables or attempts to enable another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law, the taxpayer is liable to pay to the Commissioner an amount equal to the shortfall penalty that would have been imposed if the other person's tax position had been the taxpayer's tax position.

(4) The penalty payable for evasion or a similar act described in subsection (1) is 150% of the resulting tax shortfall.

3.4 Section 141F provides:

141F Commissioner to determine portions in which shortfall penalty payable by taxpayer and officers of taxpayer

(1) If—

(a) A taxpayer is required to make or account for a deduction or withholding of tax under a tax law; and

(b) An officer of the taxpayer fails to make a deduction or withholding of tax under a tax law or applies or permits to be applied the amount of the deduction or withholding of tax other than in payment to the Commissioner,—

one shortfall penalty, calculated in accordance with this Part, may be imposed in respect of each tax position taken by the taxpayer.

(2) If the Commissioner determines that a shortfall penalty is required to be imposed, the Commissioner may determine the portion that each of the taxpayer and the officers is to be liable for that penalty having regard to—

(a) The acts or omissions of the taxpayer and the officers; and

(b) Whether those acts or omissions were reasonable in the circumstances of the case.

4. EVASION OR A SIMILAR ACT

BACKGROUND TO THE SHORTFALL PENALTY FOR EVASION OR A SIMILAR ACT

A tax position

4.1 Section 141E imposes a shortfall penalty for "evasion or a similar act". A shortfall penalty is a penalty imposed as a percentage of a tax shortfall, or deficit or understatement of tax, which results from certain actions on the part of a taxpayer. For a shortfall penalty to apply, a "taxpayer's tax position" must have been taken and have resulted in a "tax shortfall". "Taxpayer's tax position" is defined in section 3(1) to mean a "tax position" taken by a taxpayer in or in respect of a tax return, an income statement or a due date. The term "tax position" is defined in section 3(1) to mean a position or approach with regard to tax under one or more tax laws. The definition includes a non-exhaustive list of tax laws, a position or approach to which would constitute a tax position; e.g. a liability for an amount of tax; a right to a rebate etc. This definition is "without limitation" and, therefore, very broad. This is further indicated by section 4A, which defines the construction of certain provisions, and, in respect of "tax position" provides:

4A. Construction of certain provisions—

(1) In this Act—

(a) A provision referring to a tax liability or to a tax obligation, or to something a person must do, refers to a taxpayer's liability or obligation under a tax law:

(b) A provision referring to a taxpayer taking a tax position or to a taxpayer's tax position, also refers to the taxpayer's—

(i) Claiming or returning or not claiming or returning the tax position; or

(ii) Paying or deducting or not paying or deducting an amount of tax; or

(iii) Being placed in the tax position,—

whether knowingly or intentionally or involuntarily:

(c) A provision referring to a tax position taken in a tax return refers to a tax position taken explicitly or implicitly in the tax return:

(ca) A provision referring to a tax position taken in an income statement refers to a tax position taken explicitly or implicitly in the income statement, whether or not the tax position was included by the Commissioner in the income statement:

4.2 "Tax position" is, thus, a wide term and would appear to encompass all eventualities: it includes acts and omissions (including filing a return or not filing a return) whether involuntary or knowing, and if a return is made it includes implicit as well as explicit tax positions. The term "tax shortfall" is defined in section 3(1) to mean the difference between the taxpayer's tax position for the return period and the correct tax position.

The penalty

4.3 The Act divides actions of taxpayers which would result in a tax shortfall into five categories of fault, or breach, with a specified penalty rate for each category. At the extreme end of the scale is behaviour covered by section 141E and subject to a penalty of 150% of the resulting tax shortfall.

4.4 Section 141E(1) imposes a shortfall penalty on a taxpayer who evades the assessment or payment of tax for themselves or others, or who knowingly misapplies a deduction or withholding tax, or who knowingly does not make tax deductions, or who obtains or attempts to obtain a refund for themselves or another knowing there is no entitlement to such a refund. Thus section 141E(1) essentially contains two types of behaviour: the first, in paragraph (a) is evasion; the second type, in the remaining paragraphs of section 141E(1), requires knowledge of the breaches set out in those paragraphs.

4.5 The shortfall penalty of 150% of the resulting tax shortfall is subject to various reductions potentially available under sections 141FB (previous behaviour: 50%), 141FD (shareholders of loss attributing qualifying companies); 141G (voluntary disclosure: 40% or 75%), 141I (temporary shortfall: 75%) and 141J (limitation of reduction). The penalty is also subject to a 25% increase under section 141K if the taxpayer obstructs the Commissioner in determining the correct tax position. The following related Standard Practice Statements may assist in the interpretation and application of these adjustment provisions:

- INV-231 *Temporary Shortfall - permanent reversal* (published in *Tax Information Bulletin* Vol 11, No 8 (September 1999));
- *INV-251 Voluntary Disclosures* (published in *Tax Information Bulletin* Vol 14, No 4 (April 2002));
- *INV-260 Notification of a Pending Audit or Investigation* (published in *Tax Information Bulletin* Vol 12, No 2 (February 2000));
- *INV-295 Reduction of Shortfall Penalties for Previous Behaviour* (published in *Tax Information Bulletin* Vol 16, No 3 (April 2004)) (NB: this item was under review when this Exposure Draft was published; see Exposure Draft ED-0086);

4.6 It should also be noted that where the shortfall penalty results from the failure to make or account for deductions or withholding taxes or from applying those to a purpose other than payment to the Commissioner, there is an ability (section 141F) for the Commissioner to apportion the shortfall penalty between a company taxpayer and its officers involved.

4.7 Unlike the other shortfall penalties, the burden of proving "evasion or a similar act" to which section 141E applies is specifically placed on the Commissioner (section 149A(2)). However, as with the other shortfall penalties, it is a civil penalty and the standard of proof is therefore the balance of probabilities (section 149A(1)).

The relationship of the shortfall penalty with criminal prosecution

4.8 Another unique feature of "evasion or a similar act" is that, as well as giving rise to liability for a shortfall penalty, there is the prospect of a criminal prosecution. Section 143B(2) provides that it is a criminal offence for a person to evade or attempt to evade the assessment or payment of tax by themselves or another. Section 143B(1) covers acts (such as not making tax deductions or providing false returns) which are done either with the intent of evading the assessment or payment of tax, or in order to obtain a refund or payment of tax for themselves or any other person with the knowledge that there is no entitlement to such a refund or payment. The penalty for an offence under section 143B is imprisonment for a term not exceeding 5 years or a fine not exceeding $50,000, or both.

4.9 Criminal liability for the tax deduction offences (misapplying or not making deductions) is imposed by section 143A. It is headed "knowledge offences" and includes the same tax deduction offences in paragraphs 143A(1)(d) and (e) as set out in paragraphs 141E(1)(b) and (c). The penalty for an offence against section 143A is $25,000 for a first offence and $50,000 for subsequent offences. For misapplying deductions there is provision, in some situations, for imprisonment for a term not exceeding 5 years or a fine not exceeding $50,000, or both (section 143A(8)). For these

criminal prosecutions the onus of proof is on the Commissioner (section 149A(4)). The standard of proof is beyond reasonable doubt (section 149A(3)).

4.10 Section 149(5) states that the Commissioner may not prosecute a taxpayer for taking an incorrect tax position if a shortfall penalty has been imposed for taking that incorrect tax position. However, section 149(4) specifically provides that the Commissioner can impose civil penalties (which includes the evasion shortfall penalty) after a taxpayer has been prosecuted for an offence under the Act, regardless of whether the prosecution was successful or not.

4.11 It is considered that the reference to whether or not the prosecution was successful is an acknowledgement of the different standards of proof on the Commissioner in this area. As noted above, in criminal prosecutions the Commissioner has the onus of proof to the standard of "beyond reasonable doubt" (see sections 149(3) and 149A(4)). For the shortfall penalty of evasion, the Commissioner has the onus of proof to the standard of "balance of probabilities" (see sections 149A(1) and 149A(2)). Because of this difference, it is possible that the Commissioner may fail to satisfy the evidential standard in a criminal prosecution, yet have sufficient evidence to satisfy the lower threshold of the balance of probabilities for the evasion shortfall penalty.

4.12 In determining whether to impose a shortfall penalty for evasion the Commissioner will consider a number of criteria including:

- Whether the taxpayer has been previously prosecuted and/or been subject to shortfall penalties for evasion;
- The reason given by the taxpayer for his/her behaviour;
- The degree of culpability of the taxpayer;
- The likelihood of future compliance;
- The degree of cooperation received from the taxpayer;
- The effect on promoting voluntary compliance; and
- The duty to protect the integrity of the tax system.

4.13 Where the taxpayer has been prosecuted for evasion the following additional factors will be considered:

- Whether the taxpayer was successfully prosecuted under section 143B of the Act; and
- Comments made by the judge in sentencing the offender (in the event of a successful prosecution).

4.14 Although the Act provides for both civil and criminal forms of evasion, in the remainder of this Interpretation Statement the focus will be on the civil shortfall penalty for "evasion or a similar act" provided for by section 141E(1). The concept of "evasion" in paragraph (a) will be considered first, followed by the knowledge offences in the remaining paragraphs of section 141E(1).

The concept of evasion

4.15 Evasion is unique amongst the shortfall penalties in that it requires *mens rea* or the mental element of intention. This distinction was recognised in *Case W4* (2003) 21 NZTC 11,034 where Judge Barber stated:

> 44 …. "gross carelessness" refers to a high level of disregard for the consequences and is characterised by conduct which creates a high risk of a tax shortfall occurring where this risk and its consequences would have been foreseen by a reasonable person in the circumstances [but may not have been foreseen by the taxpayer in question].
>
> 45 **It seems to me that if *mens rea* is involved then there must be tax evasion** rather than gross carelessness.
>
> [Emphasis and bracketed words added]

4.16 The need for a mental element was also recognised in an *obiter* comment in *CIR v Peterson* (2002) 20 NZTC 17,589 where Hammond J stated that evasion occurs when a taxpayer **seeks to** reduce tax through fraudulent misrepresentation:

> 30 It has long been recognised that there are three broad categories by which taxpayers may seek to reduce the burden of tax. The first is outright taxation evasion. This is really a form of fraudulent misrepresentation, and is subject to heavy penalties, and even the criminal law.

Mens rea *or the mental element of evasion*

4.17 There is long-standing case law on the specific mental element required to constitute evasion. The requirement is that the taxpayer has endeavoured or intended to avoid the payment of tax. In Taylor v Attorney-General [1963] NZLR 261, in relation to section 231 of the Land and Income Tax Act 1954, McGregor J considered the meaning of the word "evade". At page 262 he stated:

> The meaning... most consonant with the intention of the Legislature is that adopted in the High Court of *Australia in Wilson v Chambers Proprietary Ltd*. (1926) 38 C.L.R. 131. In dealing with a section of the Customs Act "No person shall evade payment of any duty which is payable". Higgins J (ibid., 148) expresses the view "To say the least 'evade' would seem to **connote the exercise of will in avoiding**; whereas a mere failure to pay may be by accident or mistake". Starke J adverts to the intentional avoidance of payment and says:

> "Clearly, in my opinion, the word 'evade' in the Act **does not necessarily involve any device or underhand dealing for the purpose of escaping duty**; **but on the other hand it involves something more than a mere omission or neglect to pay the duty.** It involves, in my opinion, the intentional avoidance of payment in circumstances indicating to the party that he is or may be under some obligation to pay duty. **The circumstances may consist of knowledge, or neglect of available means of knowledge,** that the omission to pay is or may be in contravention of the Customs law' (ibid., 151).
>
> In my view the word "evade" associated with the expressions "attempts to evade" or "does any act with intent to evade" **includes an element of intent** ....This also seems to be in conformity with the view of Knox CJ in the same case, when he says: "The distinction in meaning between the words 'evade' and 'avoid' is well established, and a charge of evading payment is **not made out by evidence which proves no more than that the person charged failed or omitted to pay an amount payable** by him" (ibid.,136). [emphasis added]

4.18 It can be seen from these comments that the taxpayer's intention is relevant in determining whether the person has evaded the assessment or payment of tax. Simply establishing that a person has failed to return or pay tax on an amount will not be sufficient to prove evasion. The intention or *mens rea* element of evasion will be satisfied if the taxpayer knew that their act or omission was in breach of a tax obligation.

Recklessness is sufficient mens rea

4.19 It is clear that intention or actual knowledge will satisfy the *mens rea* element of evasion. In addition, in a number of cases decided under the previous penal tax regime the courts have also held that in some cases recklessness will also satisfy the *mens rea* element of evasion. This is illustrated by Judge Barber in *Case S100* (1996) 17 NZTC 7,626 at page 7,627:

> The respondent accepts that it must prove an intent on behalf of the objector to evade payment of tax and that evade is more than failing or omitting to pay and is more than mere negligence. **However, recklessness can amount to evasion**. A deliberate disregard of one's obligations may amount to recklessness as may an appreciation of a positive risk and proceeding regardless. [Emphasis added]

4.20 For further examples where recklessness has been held to be sufficient to constitute evasion see *Case N6* (1991) 13 NZTC 3,043, 3,046; *Case N53* (1991) 13 NZTC 3,419, 3,420; *Case Q19* (1993) 15 NZTC 5,104, 5,107; and *Case Q20* (1993) 15 NZTC 5,108.

4.21 In considering the meaning of "recklessness" it is helpful to refer to the meaning given to the term in the criminal law. This was the approach taken by Judge Willy in *Case P29* (1992) 14 NZTC 4,213 discussed at paragraph 4.26 below.

4.22 In the criminal law "recklessness" has in the past been given two inconsistent meanings: objective or inadvertent recklessness and subjective recklessness. The general position in the criminal law in New Zealand is that recklessness is to be tested subjectively, unless the context of the legislation requires an objective interpretation. *Adams on Criminal Law* (Brookers, April 2006) at paragraph CA20.24 states:

> **Two meanings of "recklessness"**
>
> In modern case law "recklessness" has been given two inconsistent meanings; one requires actual awareness of the risk of committing the alleged offence while the other does not require such awareness. While the first of these has been recognised as the basic meaning of the concept in this country and in other common law jurisdictions, (see CA20.25; *Sansregret v R* (1985) 17 DLR (4th) 577; [1985] 1 SCR 570 (SCC); *R v Smith* (1982) A Crim R 437 (HC); *R v G* [2003] UKHL 50; [2003] 4 All ER 765 (HL)), "inadvertent recklessness" may still be relevant in some contexts. …
>
> **(1) Recklessness as the conscious taking of an unreasonable risk**
>
> This is commonly described as "subjective recklessness", to emphasise the need for actual awareness, or "Cunningham recklessness", after the first modern English case which clearly adopted this meaning: *R v Cunningham* [1957] 2 QB 396; [1957] 2 All ER 412 (CA). In 1970 a UK Law Commission Working Paper formulated the test as follows:
>
> "A person is reckless if, (a) knowing that there is a risk that an event may result from his conduct or that a circumstance may exist, he takes that risk; and (b) it is unreasonable for him to take it having regard to the degree and nature of the risk which he knows to be present."
>
> This was adopted in *R v Stephenson* [1979] QB 695 (CA).
>
> **(2) Inadvertent recklessness**
>
> In *Commissioner of Police of the Metropolis v Caldwell* [1982] AC 341, also reported as *R v Caldwell* [1981] 1 All ER 961 (HL), the House of Lords had to interpret s 1 Criminal Damage Act 1971 (UK) which makes it an offence to damage property "being reckless" as to whether property would be damaged. The majority held that "reckless" should be given its ordinary meaning, which it held was not confined to cases where the risk was actually foreseen, and that a person is reckless as to whether property would be damaged if (p 354; p 966):

> (1) He does an act which in fact creates an obvious risk that property will be damaged; and
>
> (2) When he does the act he either has not given any thought to the possibility of there being any such risk or has recognised that there was some risk involved and has nevertheless gone on to do it.

4.23 The extract above from *Adams on Criminal Law* notes that subjective recklessness has been recognised as the basic meaning of the concept in this country and in other common law jurisdictions. However, it also notes that inadvertent or objective recklessness may still be relevant in some contexts. This has been confirmed by the Court of Appeal in *R v Harney* [1987] 2 NZLR 576 at 579:

> Subject to the requirements of particular contexts, however, we incline to the view that "recklessly" has usually been understood in New Zealand to have the meaning given in pre-*Caldwell* textbooks [i.e. a subjective meaning].

4.24 *Harney* can be compared with *R v Howe* [1982] 1 NZLR 618, an earlier Court of Appeal case in which an objective meaning of recklessness was adopted. However, it has been suggested that the objective meaning adopted in *Howe* can be attributed to the particular context in which that case was decided and that it does not support the general application of an objective standard in New Zealand (see *Adams on Criminal Law* at paragraph 20.25).

4.25 For other non-tax cases, which support the subjective interpretation of recklessness see *Bottrill v A* [2001] 3 NZLR 622 (CA) at para 170; *R v H* (1989) 4 CRNZ 461, 464 and *R v Stephens* (unreported, High Court, T 91/83, Auckland, 8 December 1983)

4.26 In Case P29 Judge Willy traversed the taxation case law and the New Zealand criminal law cases on recklessness. Following the case law discussion, he held that recklessness was to be tested subjectively. At page 4,222 he stated:

> Although those expressions of what is the proper test to be applied in New Zealand relate to specific provisions of the Crimes Act I nevertheless think they are of general guidance to this Authority in deciding how to approach questions of recklessness in the context of the objector's obligation to disclose all of his taxable income in any given year. In doing so however it must be borne clearly in mind that there is still an ingredient of moral turpitude in a finding of recklessness. It must never in my view be confused with mere negligence or inattention. Before recklessness can be said to exist some degree of knowledge must be present. As it is put by Mr Simon France in his article "A reckless approach to liability" 1988 18 VUWLR 144 at p 146 the person must:
>
> > Have ignored a risk they knew to be present so as to avoid the unpleasantness of having their suspicions confirmed.
>
> Where negligence is alleged no actual knowledge of the relevant matter of fact need be present. For various policy reasons the law of negligence has substituted for actual knowledge of the facts some presumed knowledge which would have been acquired by the use of reasonable foresight. Where recklessness is alleged the Commissioner must prove beyond reasonable doubt that the facts which were actually known to the taxpayer were such that they must have put him on enquiry that the income returned for tax purpose was understated. Faced with those facts the Commissioner must then show that the taxpayer made the conscious decision to ignore them and to return the understated income without making any further enquiry.
>
> Conclusion
>
> I endeavour to approach the question of whether the objector in this case was reckless having regard to that subjective test.

4.27 Judge Willy's adoption in *Case P29* of the subjective meaning of recklessness is supported by Judge Barber's comment in *Case S100* set out in paragraph 4.19 above, where he states that a deliberate disregard of one's obligations may amount to recklessness. The "deliberate disregard" of an obligation implies that the taxpayer has knowledge of the risk that the obligation exists.

4.28 While *Cases P29* and *S100* support a subjective meaning of recklessness, it is noted that in *Case M117* (1990) 12 NZTC 2,749, a case involving a knowledge offence, Judge Barber made the obiter comment that recklessness should be tested objectively. At page 2,755 Judge Barber stated:

> My analysis of the objector's conduct, as shown by the evidence, does not reveal to me any degree of recklessness. Possibly, she has been rather careless, or even negligent, but she was always concerned about her obligations and failed to meet them through pressures of work and pressures in her personal life and, apparently, due to a certain amount of confusion and muddlement. These aspects are quite inconsistent with recklessness. I was not addressed on the concept of recklessness but it seems helpful to refer to the criminal law. In *R v Caldwell* [1982] AC 341 the House of Lords applied an objective test of whether or not a defendant is shown to have acted recklessly. The New Zealand Court of Appeal applied *Caldwell* in *R v Howe* [1982] 1 NZLR 618, a case involving allegations of riotous damage, and said at p 623: -

> "As to recklessness, there has been a line of cases in England of high authority affirming that this word has no separate legal meaning. And that, although involving more than mere carelessness, it is not limited to deliberate risk-taking but includes failing to give any thought to an obvious and serious risk: *R v Caldwell* [1982] AC 341; [1981] 1 All ER 961, *R v Lawrence*, *R v Pig*g [1982] 2 All ER 591; [1982] 1 WLR 762."
>
> All in all, the approach of the objector may have been casual, but not to the extent of recklessness.

4.29 Judge Barber's comment in *Case M117* that recklessness is to be tested objectively is based on a brief analysis of *Howe* and *Caldwell*. However, as represented by *Harney* (discussed from paragraph 4.23) the general position in the criminal law in New Zealand is that recklessness is to be tested subjectively, unless the context of the legislation requires an objective interpretation. It is noted that *Case M117* was decided three years after *Harney*. It is unclear why Judge Barber did not refer to this case.

4.30 It is considered that when balanced against *Cases P29* and *S100* and the comments of the Court of Appeal in *Harney* on recklessness in the criminal law, the weight of authority indicates that recklessness is to be tested subjectively for the purposes of the evasion penalty.

4.31 It is considered that based on the case law discussed above subjective recklessness is sufficient to satisfy the *mens rea* requirement of evasion. A taxpayer will be subjectively reckless if the taxpayer avoids tax in circumstances where the taxpayer knew or strongly suspected that the taxpayer's conduct would breach a tax obligation.

4.32 The next question is whether recklessness is sufficient *mens rea* for evasion under the current penalties regime. Section 141E sets out the current evasion civil penalty:

> **141E Evasion or similar act—**
>
> (1) A taxpayer is liable to pay a shortfall penalty if, in taking a tax position, the taxpayer—
>
> (a) **Evades** the assessment or payment of tax by the taxpayer or another person under a tax law; or
>
> (b) **Knowingly** applies or permits the application of the amount of a deduction or withholding of tax made or deemed to be made under a tax law for any purpose other than in payment to the Commissioner; or
>
> (c) **Knowingly** does not make a deduction or withholding of tax required to be made by a tax law; or
>
> (d) Obtains a refund or payment of tax, **knowing** that the taxpayer is not lawfully entitled to the refund or payment under a tax law; or
>
> (da) attempts to obtain a refund or payment of tax, **knowing** that the taxpayer is not lawfully entitled to the refund or payment under a tax law; or
>
> (e) Enables another person to obtain a refund or payment of tax, **knowing** that the other person is not lawfully entitled to the refund or payment under a tax law; or
>
> (f) attempts to enable another person to obtain a refund or payment of tax, **knowing** that the other person is not lawfully entitled to the refund or payment under a tax law—
>
> (referred to as "evasion or a similar act").
>
> (2) No person shall be chargeable with a shortfall penalty under subsection (1)(b) if that person satisfies the Commissioner that the amount of the deduction has been accounted for, and that the person's failure to account for it within the prescribed time was due to illness, accident, or some other cause beyond the person's control.
>
> (3) If a taxpayer enables or attempts to enable another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law, the taxpayer is liable to pay to the Commissioner an amount equal to the shortfall penalty that would have been imposed if the other person's tax position had been the taxpayer's tax position.
>
> (4) The penalty payable for evasion or a similar act described in subsection (1) is 150% of the resulting tax shortfall.
>
> [Emphasis added]

4.33 From the words of section 141E(1) it can be seen that the evasion penalty is a knowledge offence. The evasion penalty is imposed upon a taxpayer who evades or knowingly commits an action that affects their liability to pay tax. It is noted that the current penalty regime continues to use the word "evade". This word has not been defined under either regime, although the courts have discussed the meaning of the word in cases decided under the previous regime (see paragraph 4.19 above). It is considered that the word "evade" in section 141E(1)(a) has the same meaning as it did in the previous regime in section 420 of the Income Tax Act 1976 and that the case law on the meaning of "evades" will continue to apply under the current regime.

4.34 In *Cases P29* and *S100* (discussed at paragraphs 4.26 and 4.27), which were decided under the previous penal tax regime, it was held that subjective recklessness is sufficient *mens rea* for evasion. It is considered that the reasoning

underlying these decisions will also apply to evasion under the current penalties regime as the term "evasion" continues to be used in section 141E.

4.35 In addition, the conclusion that the recklessness must be subjective is supported by paragraphs (b) to (f) of section 141E(1), which each deal with an act committed with the knowledge that the act is unlawful. This knowledge requirement is consistent with a subjective approach to recklessness in section 141E(1)(a). That the recklessness must be subjective is also supported by non-tax case law. This non-tax case law has held that the general position is that recklessness is to be tested subjectively unless the context requires otherwise (see discussion from paragraph 4.22). The context of section 141E does not require an objective approach. Rather the context of section 141E, and in particular the knowledge requirement discussed above, supports a subjective approach to recklessness.

4.36 It is considered that subjective recklessness will continue to be sufficient *mens rea* for evasion under the current penalty regime.

Relationship between evasion and gross carelessness

4.37 Having concluded that subjective recklessness is sufficient *mens rea* for evasion under section 141E, the final matter to resolve is the interaction between the evasion and gross carelessness shortfall penalties in respect to recklessness. There is potential for some confusion as to the interaction between these penalties, which is highlighted by Judge Barber's comments in *Case W4* (2003) 21 NZTC 11,034 that "gross carelessness must be something similar to recklessness".

4.38 Section 141C sets out the gross carelessness civil penalty:

> **141C Gross carelessness—**
>
> (1) A taxpayer is liable to pay a shortfall penalty if the taxpayer is grossly careless in taking a taxpayer's tax position (referred to as "gross carelessness").
>
> (2) The penalty payable for gross carelessness is 40% of the resulting tax shortfall.
>
> (3) **For the purposes of this Part, gross carelessness means doing or not doing something in a way that, in all the circumstances, suggests or implies complete or a high level of disregard for the consequences.**
>
> (4) A taxpayer who takes an acceptable tax position is also a taxpayer who has not been grossly careless in taking the taxpayer's tax position.

4.39 It is considered that gross carelessness is similar to objective recklessness. Doing or not doing something in a way that suggests a "high level of disregard for the consequences" could be regarded as reckless. In addition, the words "in all the circumstances" and "suggests or implies", suggest the application of a reasonable person test. Under this wording it appears that the person need not actually have a high level of disregard for the consequences. The definition simply requires that after considering all the circumstances, the taxpayer's conduct "suggests or implies" a high level of disregard for the consequences.

4.40 It is considered that when Judge Barber made the statement in *Case W4* that "gross carelessness must be something similar to recklessness" he was comparing gross carelessness with **objective** recklessness. In interpreting the term "gross carelessness" Judge Barber adopted an objective test. At paragraph 44 he stated:

> The term "gross carelessness" for the purposes of the penalties provisions of the Act is defined in s 141C(3) as "doing or not doing of something in a way that, in all the circumstances, suggests or implies a complete or high level of disregard for the consequences". I agree with Ms Parkash that **the definition of "gross carelessness" refers to a high level of disregard for the consequences and is characterised by conduct which creates a high risk of a tax shortfall occurring where this risk and its consequences would have been foreseen by a reasonable person in the circumstances.** [Emphasis added]

4.41 Given that Judge Barber adopted an objective test in interpreting the term "gross carelessness", his subsequent statement that gross carelessness must be something similar to recklessness is considered to have been referring to **objective** recklessness. This is confirmed by his subsequent comments that if *mens rea* is involved, there is evasion not gross carelessness. Judge Barber stated:

> It seems to me that if mens rea is involved then there must be tax evasion rather than gross carelessness. The defendant seems to accept that, in this case, there was no mens rea or the mental element of intention. While I accept that stance of the defendant, I find it rather generous.

4.42 Judge Barber also found the Commissioner's acceptance that there was no *mens rea* in *Case W4* "rather generous".

4.43 The concept of recklessness can be relevant to both evasion and gross carelessness. Where the taxpayer is subjectively reckless, that is, where the taxpayer strongly suspects that their conduct will result in a breach of a tax obligation and proceeds regardless, this is sufficient *mens rea* for evasion. However, if the taxpayer is objectively reckless; that is, the taxpayer is genuinely unaware that their conduct

has created a high risk of a tax shortfall, but the risk and its consequences would have been foreseen by a reasonable person in the circumstances, then this will give rise to a shortfall penalty for gross carelessness. This is consistent with paragraph 1.2 of the Gross Carelessness Statement published in *Tax Information Bulletin* Vol 16, No 8 (September 2004).

> "Gross carelessness" is defined in section 141C(3) to mean doing or not doing something in a way that, in all the circumstances, suggests or implies complete or a high level of disregard for the consequences.
>
> The test for gross carelessness is objective and is based on what a reasonable person would foresee as being conduct which creates a high risk of a tax shortfall occurring.
>
> Gross carelessness involves recklessness but, unlike evasion, does not require an element of mens rea or intent to breach a tax obligation.

4.44 A person who is subjectively reckless in taking a tax position could in some situations satisfy the criteria for both a shortfall penalty for gross carelessness and a shortfall penalty for evasion. Subjective recklessness is likely to satisfy the gross carelessness standard as well as the mental element required for evasion. In such situations, subsections (2) and (3) of section 149 will apply. Subsection (2) states that the taxpayer can only be liable for one shortfall penalty for each tax shortfall and subsection (3) states that the highest penalty will apply. Therefore, if the taxpayer is potentially liable for both evasion and gross carelessness, only the evasion shortfall penalty will apply.

4.45 Thus, subjective recklessness is sufficient *mens rea* for evasion to exist. Recklessness is the conscious taking of a risk; knowing the facts and choosing to ignore them or the need to be on enquiry to which they give rise. If the taxpayer strongly suspects an obligation may exist but does not investigate further before taking a tax position this could amount to recklessness and evasion if a tax shortfall results. By contrast, if the taxpayer is honestly unaware of (and has no reason to be on enquiry as to) an obligation so has no intention to endeavour to avoid it, the penalty for evasion will not apply (although the gross carelessness or lack of reasonable care penalties may).

Proving intent

4.46 As mentioned earlier, the burden of proof is on the Commissioner and the standard is that of the balance of probabilities. This means the Commissioner must prove that it is more likely than not that the taxpayer had the requisite *mens rea* for evasion. This mens rea requires that the taxpayer knew or strongly suspected that the taxpayer's course of conduct would breach a tax obligation. The test for evasion is a subjective test – it must be proved that the particular taxpayer had certain knowledge, but it can be tested objectively. In other words the requisite knowledge or intention may be inferred through an objective analysis of the surrounding circumstances and conduct.

4.47 In *Lloyds Bank Ltd v Marcan* [1973] 2 All ER 359, the Court stated at page 367-8:

> The word 'intent' denotes a state of mind. A man's intention is a question of fact. Actual intent may unquestionably be proved by direct evidence or may be inferred from surrounding circumstances. Intent may also be imputed on the basis that a man must be presumed to intend the natural consequences of his own act: see the judgments of Lord Hatherley LC and Giffard LJ in *Freeman v Pope*.

4.48 In *Case H90* (1986) 8 NZTC 619 at 624 Barber DJ made a similar statement regarding inferring intent:

> … recklessness may amount to intention and that intent can be inferred by reference to such factors as the taxpayer's background and business experience. Evasion includes an element of intent, and actual knowledge can be established by direct evidence or by inference.

Evasion– summary

4.49 In summary, evasion:

- Occurs when a taxpayer breaches a tax obligation and the taxpayer knew or strongly suspected that the taxpayer's conduct would result in that breach:
- Requires intentional behaviour or subjective recklessness.

Similar acts

4.50 As mentioned earlier, section 141E(1) essentially contains two types of behaviour. The first is evasion, which is set out in paragraph (a). The second type is set out in the remaining paragraphs of section 141E(1) and requires that the breaches set out in those paragraphs occurred "knowingly". It is this knowledge requirement that makes a breach of one of these paragraphs a "similar act" to evasion. Evasion requires knowledge in that the taxpayer must know or strongly suspect that their conduct will result in the breach of a tax obligation.

"Knowingly"

4.51 The concept of "knowingly" has been discussed in a recent case. *Case W3* (2003) 21 NZTC 11,014 concerned PAYE deductions made by the taxpayer but applied for a purpose other than payment to the Commissioner (section 141E(1)(b)). It was held that the taxpayer had done so knowingly, and Judge Barber made the following observations on "knowingly":

> [53] …. It is not seriously in dispute that this was done "knowingly" in terms of s 141E(1)(b) so there is little point in my traversing the case authorities cited on that concept. However, in looking at that concept, it is settled law that the test of knowledge is subjective, refer *Meulen's Hair Stylists Ltd v C of IR* [1963] NZLR 797 (SC); and that negligence or carelessness are insufficient to satisfy the test of "knowingly" , refer *Meulen's case* and *Godfrey Allan Ltd v C of IR* (1980) 4 NZTC 61,548 (HC). Actually, that is consistent with the current shortfall penalty regime which has separate shortfall penalties for "lack of reasonable care" and "carelessness". The test is whether the failure to account for PAYE was something known to the defendant to have occurred. Recklessness as to whether the PAYE has been paid is sufficient to amount to a known failure to pay — refer *Case R31* (1994) 16 NZTC 6,171. Knowledge of the existence of the facts in question without knowledge of the unlawfulness of an act will be sufficient — refer *C of IR v Gordon* (1989) 11 NZTC 6,082 (HC). Knowledge of a responsible officer of a taxpayer company may be attributed to the company — refer *Meulens* case.

4.52 It is worth considering the point regarding the *Gordon* case referred to by Judge Barber. There it was held that as the taxpayer's conduct was only considered to be that of carelessness and failure to interest himself in his obligation to account for tax deductions in that case, it could not be shown that he had "knowingly" done so in terms of section 368(1)(b) of the Income Tax Act 1976. Jeffries J held that there had to be knowledge of the facts relating to the act that was required to be done, but that knowledge that the law made it an offence was not necessary. He stated at page 6,084:

> In my view the word "knowingly", as used in the section, imports only a knowledge of the existence of the facts in question, when those facts are such as bring the act within the provision of the law. The word does not require in its meaning any knowledge of the unlawfulness of such acts. See *CIR v Orme* (1984) 6 NZTC 61,831; (1984) 8 TRNZ 129. A requirement of knowledge does not mean that the act must be done with any specific intent.

4.53 For example, in *Meulens* it was stated at page 799:

> In my opinion if the prosecution proved in each case (not necessarily by direct evidence, which would usually be quite unobtainable but at least by necessary inference from proved facts) that on the 21st day of the relevant month the appellant company, by some responsible officer, had knowledge that a payment was due on the preceding 20th and that it had not then been paid that would clearly be sufficient to establish that the appellant knowingly failed to make the payment.

4.54 Although *Case W3* was on paragraph (b) of section 141E(1), the observations on "knowingly" are applicable to all the paragraphs of section 141E(1) which use that term. It can be seen that many of the points made are consistent with the discussion above on "evasion", however, unlike evasion it does not require any "blameworthy" intent to breach a law that is either known or suspected to exist. "Knowingly":

- requires knowledge of the doing of the act (or of the omission) that amounts to a breach;
- is a subjective test;
- can be satisfied by recklessness, but
- negligence or carelessness is insufficient to satisfy the test.

Paragraph (b) of section 141E(1)

4.55 Paragraph (b) imposes a shortfall penalty on a taxpayer who knowingly applies or permits the application of the amount of a deduction or withholding of tax made or deemed to be made under a tax law for any purpose other than in payment to the Commissioner. As was said in *Case W3* (paragraph 47), three elements must be satisfied before a taxpayer's liability for a shortfall penalty for failure to account for PAYE deductions can be established; namely, he or she must have taken a "tax position", applied or permitted the application of PAYE deductions for a purpose other than in payment to the Commissioner, and done so knowingly. Barber DJ went on to note that the first two elements are easily satisfied:

> [48] The relevant tax law is s NC 15(1)(c) of the Income Tax Act 1994 which states that the disputant is required to make PAYE deduction payments to the defendant. The disputant made the relevant deductions from the wages of employees and was therefore required to pay same to the defendant but failed to do so. Refraining from filing a return or from making payment of an amount of tax constitutes taking a "tax position" for the purposes of s 141E. It is clear from s 4A(1)(b)(ii) of the TAA that non-payment of PAYE to the defendant by the due date is the taking of a tax position. Further, s 4A(2)(d), together with (b), deems a deduction to be unpaid tax if not paid by the due date. By failing to pay the PAYE deductions by the due date, the defendant has taken a tax position and that is so with a failure to pay any amount of tax.
>
> ….
>
> [53] In accordance with s 4A(2)(c) it is deemed that all those failures to pass on PAYE have been applied for a purpose other than in payment to the defendant.

4.56 The tax position element has been discussed earlier in this statement (see paragraphs 4.1 and 4.2) where the breadth of that term and consequent ease of satisfying it is discussed. In terms of tax positions relating to the deduction offences (such as section 141E(1)(b)) it is worth discussing Judge Barber's reference to "s 4A(2)(d), together with (b)". These are construction provisions which state that a deduction is deemed to be made when payment of any net source deduction payment

occurs and, if such a deemed deduction is not paid to the Commissioner by due date it is deemed to be unpaid tax. As mentioned earlier, the section 3(1)(a) definition of "tax position" includes a liability for the payment of an amount of tax, and thus the effect of these construction provisions is that a tax position has been taken.

4.57 Similarly, the second element (that the taxpayer has applied or permitted the application of the amount for any purpose other than in payment to the Commissioner) is satisfied by a deeming provision. Section 4A(2)(c) provides that deemed deduction payments are deemed to have been applied for a purpose other than in payment to the Commissioner. The effect of these construction provisions is that the only element that remains to be proved when section 141E(1)(b) is considered is whether the element of "knowingly" has been met.

4.58 "Knowingly" has been discussed above: it requires knowledge (or subjective recklessness) of the doing of the act (or of the omission) that amounts to a breach. In *Case W3* Judge Barber said (paragraph 53):

> It is settled law that the test of knowledge is subjective, refer *Meulen's Hair Sylists* [sic] *Ltd v CIR* [1963] NZLR 797 (SC); and that negligence or carelessness are insufficient to satisfy the test of "knowingly", refer *Meulen's* case and *Godfrey Allan Ltd v CIR* (1980) 4 NZTC 61,548 (HC)… The test is whether the failure to account for PAYE was something known to the defendant to have occurred. Recklessness as to whether the PAYE has been paid is sufficient to amount to a known failure to pay - refer *Case R31* (1994) 16 NZTC 6,171. Knowledge of the existence of the facts in question without knowledge of the unlawfulness of an act will be sufficient - refer *CIR v Gordon* (1989) 11 NZTC 6,082 (HC). Knowledge of a responsible officer of a taxpayer company may be attributed to the company - refer *Meulens* case.

Statutory defence to section 141E(1)(b)

4.59 Section 141E(2) provides no shortfall penalty is chargeable under section 141E(1)(b) if the taxpayer establishes that the PAYE deduction has been accounted for and the failure was due to illness, accident, or some other cause beyond their control. The section states that the taxpayer must "satisfy" the Commissioner that the failure was due to illness. Therefore, the burden of proving the defence is on the taxpayer. The standard of proof is the balance of probabilities (section 149A(1)).

4.60 This defence was raised in *Case W3* where the taxpayer stated the reason he had not paid over the PAYE deductions was due to the Commissioner not releasing a GST refund. Judge Barber traversed case law establishing that a cause beyond the person's control does not refer to liquidity problems:

> [61] It is settled law that liquidity problems are not a matter coming within the confines of provisions equivalent to s 141E(2): refer *Driscoll v C of IR* (1984) 6 NZTC 61,861(HC), *Hammond v Walesby and Paramount Graphics Limited* (1986) 8 NZTC 5,185(HC), and *C of IR v JF McCormick Ltd* [1964] NZLR 56 in particular. These cases show that liquidity problems in general do not constitute a cause beyond the employer's control. This must be particularly so where a taxpayer makes payments of tax deductions with the knowledge that bank overdraft limits are being exceeded as was the case with the present disputant. ….

4.61 The High Court case *C of IR v Joy Wright Ltd* (1984) 6 NZTC 61,788 dealt with the defence for illness. The taxpayer company in that case was charged with knowingly applying PAYE tax deductions for a purpose other than in payment to the Commissioner (under the then effective provision, section 368(3) of the Income Tax Act 1976). Its defence was that the principal officer of the company was in a depressed state due to family and business worries and so the failure was due to illness or other cause beyond the officer's control. The defence was successful in the District Court and on appeal. In dismissing the Commissioner's appeal from the acquittal, Gallen J stated at page 61,790:

> There is very little authority on the interpretation of the section concerned. In *C of IR v JF McCormick Ltd* [1964] NZLR 56, Macarthur J held that the words "illness, accident or other cause beyond his control" appearing in the equivalent section of the Act then in force were not to be construed ejusdem generis and that therefore the words "beyond his control" were not to be interpreted in some way as pertaining to illness or accident. He did, however, hold that **that particular defence was only available when it was proved that a situation existed where there was some cause beyond the defendant's control which prevented him from paying** to the Commissioner moneys already held by him and impressed with a trust in favour of the Crown. …
>
> In essence, I consider the situation will always be a matter of degree and will depend upon a factual finding that circumstances existed whereby there was a **direct causal connection between the circumstances put forward as a defence and failure to pay.** .....
>
> [I]n this case the learned District Court judge clearly found as a fact that the **depressive illness of the principal officer of the respondent resulted in her being unable to integrate her activities sufficiently to carry out that part of her business responsibility which related to the accounting to the Commissioner of Inland Revenue for PAYE deductions.** This is a finding of fact made after hearing the evidence. Clearly he accepted that

> the degree of disability was sufficient to bring the respondent within the provisions of the proviso to the section. I consider he was entitled so to find.
>
> [Emphasis added]

4.62 The following can be distilled from the words of section 141E(2) and the case law:

- The amount of the deduction must have been accounted for to the Commissioner before the defence can apply;
- There must be a direct causal connection between the circumstances put forward as a defence and the failure to pay; and
- A lack of funds (including due to awaiting payment from the Commissioner on other matters) does not establish the defence.

Apportionment of the penalty

4.63 Section 141F(2) provides that the Commissioner may apportion a shortfall penalty between the taxpayer (for example, a company) and the officer of the taxpayer involved in failing to make or account for a deduction, or in misapplying or permitting misapplication of a deduction. "Officer" is defined (albeit in an inclusive manner) in section 3(1) as:

> for the purposes of sections 89C, 141F, 141G, 142C, and 147 and the definition of "taxpayer" in section 157(10), in relation to a corporate body, includes -
>
> (a) A director or secretary or other statutory officer of the corporate body:
>
> (b) A receiver or a manager of any property of the corporate body, or a person having powers or responsibilities, similar to those of such a receiver or manager, in relation to the corporate body:
>
> (c) A liquidator of the corporate body:

4.64 Section 141F(2) provides that in deciding the apportionment regard is to be had to:

> (a) The acts or omissions of the taxpayer and the officers; and
>
> (b) Whether those acts or omissions were reasonable in the circumstances of the case.

4.65 There is no case law on the section, but it may be relevant to note the following. Despite a submission in relation to section 141F being made by the Institute of Chartered Accountants of New Zealand that:

- the maximum penalty applicable to the officer who commits the offence should be specified, and
- if no such specification is made, guidelines should be provided on how the Commissioner will undertake the apportionment,

the Officials in the *Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill* (1997) (to whom the submission was made) declined to make any such specification or provide such a guideline. The reasoning was given as follows (at page 39 of the report):

> The legislation clearly sets out the criteria to be used to determine how any shortfall penalty should be apportioned. The criteria are the relative actions or omissions of the taxpayer and the officers and whether those acts or omissions were reasonable.
>
> We see no reason to limit the potential penalty imposed on an officer beyond the natural limit of the size of the penalty being imposed. There may be cases where it is appropriate that the officer face a significant penalty, which might be prevented from being imposed if a cap were introduced.

4.66 Thus, while there is not any guidance given by case law (as there is no case law on the section) and not a great deal of specificity in section 141F, it is clear that significant penalties to the officers involved were envisaged, and that in determining the apportionment what is to be considered is the relative actions or omissions of the taxpayer and the officers involved, and the reasonableness of those actions or omissions. Where more than one officer is involved, the reasonableness of the acts or omissions of each officer will be considered with a view to establishing whether an apportionment of the penalty between the various officers to take into account relative culpability is appropriate.

4.67 It might be thought that as it is the taxpayer's (ie. the company's) tax liability, the taxpayer is primarily responsible and if the taxpayer has taken no action to monitor the actions of its officers then it is liable for the entire penalty. However, this is not what the legislation and background material indicates. In each case, the acts or omissions of both the taxpayer **and** the officer are to be considered; it is their relative culpability that will determine the apportionment of the penalty. Therefore, even in a situation where the taxpayer (company) is at fault through not having set up monitoring processes, the nature or character of the actions or omissions of the officer could result in part of the penalty being imposed on him or her.

The remaining paragraphs of section 141E(1) and subsection (3)

4.68 The remaining paragraphs of section 141E(1) describe other acts or omissions that will be subject to a shortfall penalty for evasion. When the application of one of the other paragraphs of section 141E(1) is considered, all that must be decided is whether the specified breach (act or omission) occurred, and whether it has occurred "knowingly", which requires only knowledge of, or recklessness

towards, the doing of the act (or of the omission) that amounts to the breach.

4.69 The remaining paragraphs of section 141E(1) provide that the following acts or omissions are offences. The knowledge requirement of each paragraph is emphasised.

> (c) **Knowingly** does not make a deduction or withholding of tax required to be made by a tax law; or
>
> (d) Obtains a refund or payment of tax, **knowing** that the taxpayer is not lawfully entitled to the refund or payment under a tax law; or
>
> (da) Attempts to obtain a refund or payment of tax, **knowing** that the taxpayer is not lawfully entitled to the refund or payment under a tax law; or
>
> (e) Enables another person to obtain a refund or payment of tax, **knowing** that the other person is not lawfully entitled to the refund or payment under a tax law; or
>
> (f) Attempts to enable another person to obtain a refund or payment of tax, **knowing** that the other person is not lawfully entitled to the refund or payment under a tax law –

4.70 Paragraph (c) will apply if taxpayer knowingly does not make a deduction or withholding of tax that is required to be made under a tax law.

4.71 Paragraphs (d), (da), (e), and (f) relate to the obtaining of a refund or payment of tax, knowing that there is no entitlement to that refund or payment of tax. Paragraphs (d) and (da) provide that the penalty will apply whether or not the taxpayer is successful in obtaining the refund or payment of tax. Paragraphs (e) and (f) provide that the penalty will also apply to a person who enables or attempts to enable another person to obtain a refund or payment of tax.

4.72 Section 141E(3) quantifies the shortfall penalty imposed on a taxpayer who enables, or attempts to enable, another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to that refund or payment of tax. For the purposes of section 141E(3) the tax position of the taxpayer for whom the refund or payment was sought is treated as being the tax position of the enabling taxpayer. This tax position is then used to calculate the shortfall penalty for evasion that is imposed on the enabling taxpayer.

4.73 This means that two penalties could potentially be imposed in these situations. One penalty could be imposed on the person for whom the refund or payment was sought, and a second penalty could be imposed on the enabling taxpayer.

Examples

4.74 The following examples illustrate the application of the "evasion or a similar act" shortfall penalty. The focus of these examples is on whether the facts constitute "evasion or a similar act". Therefore, it can be assumed that the taxpayer has taken a tax position which has resulted in a shortfall, and this point (and any potential application of the variation in penalty provisions) will not be discussed in the examples. There are further examples in *Tax Information Bulletin* Vol 8, No 7 (October 1996).

Example 1

Mrs A, a small-business person, does not include several items of income in her accounts or tax return as she feels she cannot afford to pay tax on this income.

Should a shortfall penalty for evasion be imposed?

Here, the intention or *mens rea* element of evasion is met, as Mrs A is breaching a known tax obligation.

Example 2

Mr B, who had been teaching overseas, returned to New Zealand leaving $300,000 invested in the country in which he had been living. He had been told by the investment company at the time of investing the money that the investment was tax free within that country and New Zealand. For some time after his return to New Zealand he continued to hold that view. He did not mention the investment income when filing his New Zealand tax returns for the next 10 years. During these 10 years, he said he had gradually become unsure as to whether the income was taxable. The uncertainty, he said, had come from discussions with friends, where he had been given two differing viewpoints. He said he thought perhaps he was not liable for tax, but as time went on his doubts grew. He said that after making further enquiries in about year 5 he was almost certain that the investment income was taxable, but by that stage he was too afraid of the financial consequences of contacting the Department.

Should a shortfall penalty for evasion be imposed?

The intention or *mens rea* element of evasion relates to breaching a known tax obligation or a tax obligation which the taxpayer strongly suspects may exist. Initially there is no intent to evade a known or suspected obligation, so the behaviour does not amount to evasion, although the taxpayer may be liable to a gross carelessness penalty. However, the behaviour later crosses the borderline into evasion. Here, from at least year 5, Mr B strongly suspected an obligation may exist but he chose not to investigate further (for example, by making enquiries of the Department or getting advice from an accountant or lawyer) as he did not want to have his suspicions confirmed. He chose

to close his eyes to this issue by deliberately and intentionally refraining from taking any steps to discover the tax status of the income he received. This disregard of a suspected obligation from at least year 5 amounts to subjective recklessness which is sufficient *mens rea* for evasion.

Example 3

Ms C was one of three shareholders and directors of a company which had operated a garden centre from 1993. Ms C had always been the person who prepared and filed the company's PAYE returns. From April this year until October (when it ceased trading) the company's PAYE returns which it filed were not accompanied by payments. Ms C states that full disclosure has been made to Inland Revenue as to the correct PAYE amounts payable on PAYE returns filed, so she was not trying to evade tax. Ms C also states that since her return from Malaysia in March she has been suffering from a rare disease she contracted there which makes her confused at times and generally has put her under significant stress.

Should a shortfall penalty under section 141E(1)(b) be imposed?

Section 141E(1)(b) imposes a shortfall penalty on a taxpayer who knowingly applies or permits the application of the amount of a deduction or withholding of tax made or deemed to be made under a tax law for any purpose other than in payment to the Commissioner. As discussed earlier in this interpretation statement, the elements of this offence, other than "knowingly", are easily established by virtue of deeming provisions that exist in the Act. The key element is therefore "knowingly". This requires only knowledge of the doing of the act (or of the omission) that amounts to a breach, not any specific (such as evasive) intent. It also does not require knowledge that the act (or omission) amounts to a breach of law, merely that the act (or omission) occurred. The question here then, is whether Ms C (and, therefore, the company for which she is a responsible officer) knew she had failed to make a payment of the PAYE due to the Commissioner. As Ms C normally completes the PAYE returns, it can be inferred that she (and therefore the company) knew that payments were due each month. She also had filed returns for the months in question, and so had knowledge that payments were due in respect of those months.

In this respect it is noted that the fact she did continue to file returns and conduct other business suggests that the disease and stress did not affect her ability to function to the extent that it could be said she did not act "knowingly". While a lapse in concentration occasioned by the stress or the confusion brought on by the disease could be a plausible explanation for a single lapse, this was repetitive and, therefore it can be inferred, knowing behaviour. It can be concluded that Ms C knowingly failed to make the payments.

The next issue is whether the section 141E(2) exclusion applies to prevent section 141(1)(b) applying. For this defence to apply the deductions must since have been paid to the Commissioner, which they have not been. However, assuming they had been, it must be shown that the illness caused the failure to pay the PAYE deductions. Here, when the illness is weighed with the other evidence, it has not been shown that it was the illness which was responsible for the failures. Despite the illness Ms C managed to prepare and file the returns and continue other operations of the company, and while a lapse in concentration or confusion could be a plausible explanation for a single lapse, this was repetitive and, therefore it can be inferred, deliberate behaviour occasioned by something other than confusion. The defence is not an ongoing one, and if Ms C felt unable to prepare and file such returns there was ample time for her to arrange for someone else such as an accountant to do it instead. Accordingly, the defence under section 141E(2) is not available to the company.

How should the penalty be apportioned between the company and Ms C?

The starting point under section 141E(1)(b) is that the penalty is imposed on the company. However, section 141F(2) allows the Commissioner to apportion certain penalties imposed on a taxpayer between the taxpayer and an officer of the taxpayer. Section 141F(2) can apply where the taxpayer is required to make or account for a deduction or withholding of tax and an officer of the taxpayer fails to do so. In this example, section 141F(2) would allow the Commissioner to apportion the shortfall penalty that the company is liable for under section 141E(1)(b) between the company and Ms C.

To determine the portions that the company and Ms C are to be liable for, it is necessary to consider the relative actions or omissions of the company and Ms C and whether they were reasonable. The history and experience of both will be relevant. Here, this was ongoing and deliberate behaviour by Ms C not to pay the PAYE deductions to the Commissioner for a period of 7 months, not a one-off misunderstanding. The company too, however, may be considered blameworthy in not having any systems in place to check such behaviour i.e. the lack of realisation by the other two shareholders and directors as to what was going on over such a prolonged period. Taking into account the deliberateness of Ms C's actions and the company's lack of systems to check such behaviour, it could be considered that Ms C and the company were equally to blame for the shortfall. In this situation, the Commissioner could therefore consider it reasonable to apportion the penalty 50:50.

OPERATIONAL STATEMENT

OS 06/02 INTERACTION OF TAX AND CHARITIES RULES, COVERING TAX EXEMPTION AND DONEE STATUS

Introduction

1. This statement outlines how the Charities Commission and the Inland Revenue Department will monitor and advise charitable entities of the requirements for income tax and gift duty exemptions and donee status following the opening of the Charities Commission register on 1 February 2007.

2. The Government has acknowledged the enormous contribution that the charitable sector makes to New Zealand. To aid in the funding of charitable organisations the Government provides a subsidy in the form of an exemption from income tax that allows such entities' spending on charitable purposes to be made out of untaxed income. Other tax benefits are also provided. Many charities and other organisations also receive an indirect subsidy through allowing donors to qualify for a rebate from their income tax.

3. However, it is acknowledged that there is little or no monitoring of the activities of charitable organisations. There is a lack of information about who benefits, and how, from the tax assistance provided. Furthermore, the charitable organisations have to deal with many different Government agencies on a regular basis.

4. The Charities Commission has been established to promote public confidence in the charitable sector, to promote the effective use of charitable resources and educate and assist charities in relation to matters of good governance and management. The Commission's functions include advising charities on matters of good governance, establishing and maintaining a charities register, monitoring registered charitable entities and reporting on matters relating to charities.

5. In accordance with the goals of the Charities Act 2005, Inland Revenue and the Charities Commission will work together to provide information on the tax status of charitable entities. The Commission's website may be accessed at **www.charities.govt.nz** for general information and information on to how to apply for registration.

Application

6. This Operational Statement will apply from 1 February 2007.

Background

7. Income tax exemptions are available to trusts, societies and institutions that meet the requirements of the Income Tax Act 2004 in terms of deriving income for charitable purposes. Exemptions from income tax are provided for under section CW 34 (non-business income) and CW 35 (business income) of the Income Tax Act 2004. Under the self assessment regime an organisation must assess for itself whether these income tax exemptions apply to it.

8. Although taxpayers are required to self assess their tax obligations, the practice has been that charities have sought the opinion of the Commissioner of Inland Revenue on their tax status.

9. In accordance with one of the aims of Government in establishing the Charities Commission there will, as much as possible, be a seamless interface between registration and entitlement to tax exemptions. From 1 July 2008, it will be a pre-requisite for charities wishing to obtain these tax exemptions that they are first registered with the Charities Commission as "charitable entities" under the Charities Act 2005. Once registered, charities will still need to assess for themselves whether they meet the requirements of the tax legislation to obtain a tax exemption or advantage. Inland Revenue can challenge their decision at a later date, generally by audit, but will not be involved in giving advice on charitable status prior to registration.

10. A working protocol has been agreed between Inland Revenue and the Charities Commission through which entities that register as charitable entities under the Charities Act 2005 will also be advised of the requirements for the charities tax exemptions.

11. Where the charities legislation and the Income Tax legislation do not align (business income and donee status) this Operational Statement provides advice to organisations so they can ensure compliance with the requirements for tax exemption. The Charities Commission and Inland Revenue will work together to ensure that charitable entities are aware of relevant tax information.

12. To enable the Charities Commission and Inland Revenue to work together provision is made for the exchange of information between the Charities Commission and Inland Revenue. Section 30 of the Charities Act provides for the supply of Charities

Register information by the Charities Commission to Inland Revenue for the performance of the functions of the Revenue Acts.

Summary

13. The following is a summary only and more detail is provided within this operational statement. In brief, Inland Revenue's operational practice will be:

    a) entities with non-business income that are registered with the Charities Commission will prima facie qualify for the income tax exemption in respect of that income;

    b) for entities that derive business income, registration alone will not be sufficient for the business income tax exemption and they must self assess the extent to which their charitable purposes are carried out in New Zealand;

    c) entities that currently enjoy income tax exemption should register with the Commission by 1 July 2008. Failure to do so will result in the loss of their tax exempt status until they are subsequently registered;

    d) entities currently listed as donee organisations will continue to enjoy donee status even though they may decide not to register with the Charities Commission;

    e) newly registered charities will generally not need to make separate application to Inland Revenue for donee status;

    f) organisations that choose not to become registered charitable entities may still apply to Inland Revenue for approval as donee organisations;

    g) during the transitional period (from 1 February 2007 to 30 June 2008) charities will retain their existing tax exempt status for income tax, gift duty and resident withholding tax;

    h) the exemption from gift duty for gifts to charitable trusts, societies and institutions will cease from 1 July 2008 where the entities have not registered with the Commission;

    i) from 1 July 2008 Inland Revenue will not issue certificates of exemption from resident withholding tax to charitable entities unless they are registered with the Commission;

    j) charitable organisations are still required to have IRD numbers;

    k) after 30 June 2008 Inland Revenue will attempt to contact charitable organisations that our records show have an exemption from income tax, and have not registered with the Charities Commission, to determine their position; and

    l) in the past Inland Revenue has suggested there be restrictions in their rules preventing entities from altering certain clauses without prior approval. Inland Revenue strongly recommends that organisations remove any requirement in their rules for Inland Revenue to consent to rule changes. To enable this to happen, Inland Revenue hereby consents to an amendment removing any such rule. Inland Revenue will not otherwise give specific approval to any rule changes.

Operational Practice

14. On becoming registered with the Charities Commission an entity will receive a letter from the Commission notifying them that their application has been successful and enclosing Inland Revenue information as to the implications for their tax position as a charity.

15. Trusts, societies or institutions with non-business income that are registered under the Charities Act will prima facie be treated by Inland Revenue as qualifying for the income tax exemption. There is one exception to this prima facie treatment by Inland Revenue. This relates to council-controlled organisations (CCOs) discussed at paragraph 46 below. Such entities are not necessarily entitled to the non-business income tax exemption and are encouraged to contact Inland Revenue's Large Enterprises Unit for further advice.

16. Inland Revenue's practice (as set out in the booklet Charitable organisations (IR 255 December 2002) at pages 38 to 45) has been that an organisation would forward a copy of its founding documents and these, which could be in draft form, would then be considered and advice given as to whether or not the organisation met the requirements for the tax exemption(s) sought. Generally we will no longer be doing this. Charities will not require, and should not expect, clearance from Inland Revenue before applying for registration with the Charities Commission. The booklet Charitable organisations is being revised and should be available in February 2007. It is recommended that you refer to this booklet for further information.

Business income

17. Trusts, societies or institutions that derive income from a business (excluding income derived by a council-controlled organisation (CCO) or local authority from a CCO) are exempt from income tax to the extent that the income is applied to charitable purposes within New Zealand, provided that no person with some control over the business is able to direct or divert income derived from the business to their benefit or advantage.

Business income – extent to which charitable purpose carried out in New Zealand and diversion of amounts derived from the business

18. For trusts, societies or institutions that derive business income, registration alone will not (as in the case of non-business income) be sufficient for the business income tax exemption. The trusts, societies or institutions must also self assess the extent to which their charitable purposes are carried out in New Zealand. Furthermore, it is required that no person with some control over the business may able to divert an amount derived from the business to their own benefit, and neither may the trust, etc be carried on for the private pecuniary profit of any individual.

19. Where the charitable purpose is not limited to New Zealand, the income is apportioned between those purposes within New Zealand and those outside New Zealand and taxed accordingly. This self assessment must be undertaken year by year.

20. Whether a person is able to divert an amount by materially influencing decisions is a matter of fact and degree. In any audit the documentation of charitable entities (trust deeds or constitutions, etc) will be examined to determine whether a person with some control over the business is able to exert influence that would enable that person to receive a benefit or advantage. A determination has to be made as to whether a benefit is gained or is able to be gained by a person (who has some control of the business) had it not been for the influence of that person.

21. A person does not have some control over a business merely because they provide professional services to the business and their ability to determine the benefit or advantage arises (i) in the course of a professional public practice, or because they are (ii) a trustee company, (iii) the Public Trust or (iv) the Maori Trustee.

22. If it is clear that the establishment of any benefit or advantage has been undertaken in a manner to ensure that no more than market value was paid, Inland Revenue will accept that there has been no material influence.

23. A payment for the provision of services or goods at market value will not be considered to be a benefit or advantage.

What happens if a charity doesn't register with the Charities Commission by 1 July 2008?

24. The Charities Act provides for amendments to the tax legislation requiring a charity to be registered to qualify for a "charitable" tax exemption. If a charity is registered before the date that the amendments to the tax legislation come into force (1 July 2008), it is likely to be in a position to "seamlessly" continue to assess itself as tax exempt. However, if an organisation registers after the tax amendments are in force, that charity may not qualify for income tax exempt status for the whole year. For an entity with a 31 March balance date that is registered with the Charities Commission as of 1 February 2009 the situation would be:

Period from 1 April 2008 to 30 June 2008	*tax exempt*
Period from 1 July 2008 to 31 January 2009	*liable for tax*
Period from 1 February 2009 to 31 March 2009	*tax exempt*

Accordingly it would have to file a return for the year ending 31 March 2009 to account for the period from 1 July 2008 to 31 January 2009. Inland Revenue will attempt to contact those charitable organisations that it has a record of as currently having an exemption from income tax and do not register with the Charities Commission by 1 July 2008. The purpose of this contact will be to ascertain the current intention of the organisation as to registration.

Donee status

25. The Commissioner of Inland Revenue's approval is required for donee status whether or not the entity is registered as a charity. This is a separate process from applying to the Charities Commission for registration as a charity. In order to determine whether a rebate can properly be claimed by a donor, Inland Revenue needs to consider whether the society to whom the money was donated is of a kind referred to in section KC 5 of the Income Tax Act 2004. If an entity is currently a donee organisation then its donee status will continue even though it decides not to register with the Charities Commission unless Inland Revenue has information to the effect that it no longer qualifies.

26. There are four general categories of donee organisations defined in paragraphs (aa) to (ad) and the Commissioner of Inland Revenue is required to be satisfied that an entity complies with the relevant requirements before giving approval. Where approval is sought under paragraph (aa) for example, there are, in addition to considering whether its purposes are charitable, benevolent, philanthropic or cultural, two further questions to be considered. These are whether the funds are applied wholly or principally within New Zealand and whether the entity is carried on for the private pecuniary profit of any individual.

27. Registration as a charitable entity does not itself confer donee status. The granting of this status will continue to be administered by Inland Revenue but the process will be simpler for many organisations.

28. Once a charitable entity becomes registered then, provided it has ticked the box indicating that donations are a source of income on the form it completed when applying to be registered, Inland Revenue will automatically consider whether to grant donee approval. Where donations are a source of income and the registered charitable entity has indicated that its funds are applied *wholly* within New Zealand then donee status will be granted. Where a charity applies a proportion of its funds overseas then Inland Revenue will need to consider whether overall the entity's funds are applied *principally* to charitable purposes within New Zealand. Entities will receive advice from Inland Revenue as to whether they have qualified for donee status. Registered charities which already have that status will receive a letter of confirmation.

29. Entities that choose not to register with the Charities Commission may continue to enjoy donee status where approval has previously been given. Where an entity would like to have donee status but does not wish to become registered as a charity, or where its purposes are benevolent, philanthropic or cultural rather than charitable, then it will need to apply to Inland Revenue for approval as a donee organisation. The booklet Charitable organisations IR 255 provides assistance.

30. Where an entity has had its application for registration as a charity declined, it is unlikely that it will qualify for donee status on the ground that its purposes are charitable. However approval will be granted where its purposes, although not meeting the standard of being charitable, are nevertheless benevolent, philanthropic or cultural.

31. Inland Revenue may review donee status where an entity which currently has that status finds that its application for registration with the Charities Commission is declined.

32. Although an entity may not itself qualify for donee status, a fund may be established and managed within a non-charitable organisation and such a fund may qualify for donee status. See the IR 255 *Charitable organisations* for information on applying for donee status.

33. However Inland Revenue may reconsider an entity's existing donee status where that entity applies to register as a charitable entity but its application is declined by the Charities Commission. If an entity is not a donee organisation, the donation information provided with the application to register as a charity will be forwarded to Inland Revenue for consideration. Newly registered charities will not need to make a separate application to Inland Revenue for donee status where they have indicated in their application for registration with the Commission that they will be or are in receipt of donations.

34. A council-controlled organisation cannot gain an exemption from income tax but may nevertheless qualify for donee status under section KC 5.

Gift duty exemption

35. Section 73(1) of the Estate and Gift Duties Act 1968 provides an exemption from gift duty in respect of any gift creating a charitable trust, or establishing any society or institution exclusively for charitable purposes, or any gift in aid of any such trust, society, or institution. From 1 July 2008 (the date that the tax amendments made by the Charities Act 2005 come into force) any such society, institution, or trustees of a trust must be registered as a charitable entity under the Charities Act 2005 in order to take advantage of the exemption. Registration may be backdated to the date of a gift to which section 73(1) applies – see section 20 of the Charities Act 2005. Section 73(2) declares that certain classes of gifts (e.g. to the Health Research Council of New Zealand) shall not constitute dutiable gifts. The classes of gifts defined in section 73(2) will continue to be exempt from gift duty even if the organisations covered by section 73(2) are not registered with the Charities Commission. Entities referred to in Section 73(2) may of course choose to register for other reasons.

IRD numbers

36. Charitable organisations are still required to have IRD numbers.

Discussion

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

Income tax exemption

38. Under the Act income tax exemptions are available to charitable entities for income derived for charitable purposes.

39. From 1 July 2008, for the income tax exemptions to apply the entity must be registered as a charitable entity under the Charities Act 2005. An exception is where the charitable entity derives income indirectly from a business. Where the entity is not itself conducting the business enterprise, but the enterprise is being run, for example, by a company that carries on the business for the entity's benefit, that company is not also required to be registered (though if it itself has charitable purposes it may choose to do so). It will still need to contact Inland Revenue to ensure that we have listed it as being exempt from tax. Section 13 of the Charities Act provides for registration as a charitable entity.

> **13. Essential requirements**—
> (1) An entity qualifies for registration as a charitable entity if,—

(a) in the case of the trustees of a trust, the trust is of a kind in relation to which an amount of income is derived by the trustees in trust for charitable purposes; and

(b) in the case of a society or an institution, the society or institution—

(i) is established and maintained exclusively for charitable purposes; and

(ii) is not carried on for the private pecuniary profit of any individual; and

(c) the entity has a name that complies with section 15; and

(d) all of the officers of the entity are qualified to be officers of a charitable entity under section 16.

40. Where trusts and societies or institutions have obtained binding rulings under the Tax Administration Act 1994 for exemptions under sections CW34 (Charities: Non-Business Income) and/or CW35 (Charities: Business Income), they will be considered to meet the "charitable purposes" component of the requirements for registration.

41. Where a trust, society or institution is deregistered from the charities register under section 31 of the Charities Act 2005, income earned by the trust, society or institution will no longer be exempt from the date of deregistration.

Charities: Non-Business Income

42. Section CW 34 of the Act (see the Appendix) provides for income tax exemptions for the non-business income (for example investment income such as interest, dividends and rent) of trusts and societies or institutions. An amount of income derived by a trust for charitable purposes is exempt from tax. Income derived by a society or institution is also exempt from income tax where the society or institution is established and maintained exclusively for charitable purposes and is not carried on for the private pecuniary profit of any individual.

43. The requirements for registration as a charitable entity under the Charities Act and the requirements for the non-business income tax exemption under the Income Tax Act are similar in nature.

44. Trusts, societies or institutions that comply with the registration requirements under the Charities Act will prima facie be treated by Inland Revenue as qualifying for the income tax exemption in section CW 34, except for council-controlled organisations.

45. Charitable entities will, however, still be subject to audit by Inland Revenue.

46. The non-business income exemption for charitable trusts, and societies or institutions established and maintained exclusively for charitable purposes, does not extend to income derived by council-controlled organisations ("CCOs") or income derived by local authorities from CCOs. According to the Income Tax Act definition, a CCO includes an entity (not being a company) that operates a trading undertaking for the purpose of making a profit and in respect of which one or more local authorities have: (i) control of 50% or more of the votes at any meeting of the members, or (ii) the right to appoint 50% or more of the trustees, directors, or managers. It also includes a company in which equity securities carrying 50% or more of the voting rights at a meeting of the shareholders of the company are: (i) held by one or more local authorities, or (ii) are controlled by one or more local authorities.

Charities: Business Income

47. Where a trust or a society or institution carries on a business then the income derived directly or indirectly from the business (excluding income derived by a CCO or local authority from such organisation), by, or for, or for the benefit of the trust, society or institution, is exempt to the extent that it is applied to charitable purposes within New Zealand, provided that no person with some control over the business is able to direct or divert income derived from the business to their benefit or advantage.

48. Where a trust, society or institution derives business income, registration alone will not (as in the case of non-business income) be sufficient for the entity to be exempt from income tax. There is the requirement that at to least to some extent the trust, society or institution carry out its charitable purposes in New Zealand (an apportionment test), and the further requirements that no person with some control over the business is able to divert an amount derived from the business to their own benefit, and that the trust, etc is not carried on for the private pecuniary profit of any individual.

49. Under the self assessment regime taxpayers are obliged to assess their own tax obligations. In the case of trusts, societies or institutions that derive income from a business it is imperative that the entity self assesses its tax status correctly. Inland Revenue may monitor registered charitable entities that are in business for compliance with section CW 35. The following paragraphs are provided for the assistance of charitable entities that derive business income.

50. Section CW 35(1) also applies to companies that carry on a business for the benefit of a trust, society or institution and do not have charitable purposes or objects. Such a company does not have to register with the Charities Commission in order for the business income that is directed to a trust, society or institution to be exempt. The amount of business income so directed will be exempt from income tax provided the recipient trust, society or institution-

- carries out its charitable purposes in New Zealand; and
- the trust, society or institution is itself registered with the Charities Commission.

In New Zealand

51. Income derived directly or indirectly from a business is exempt to the extent that the charitable purpose is performed in New Zealand. Where the charitable purpose is not limited to New Zealand, the income is apportioned between those purposes within New Zealand and those outside New Zealand. (See section CW 35(4) below.)

52. For example, income derived from a business for the benefit of a trust for the education of Pacific Island children, will be exempt to the extent that the income is used for the education of Pacific Island children in New Zealand. Income from the business used for the education of Pacific Island children outside of New Zealand would not be exempt.

53. It is advisable that funds used in New Zealand and outside New Zealand are separately recorded within the accounting records.

Control over business

54. Where a person (by virtue of their capacity as a trustee, settlor, shareholder or director) has some control over the business and is able to divert an amount derived from the business to his/her own benefit or advantage, the income derived by the business will not be tax exempt. Situations in which persons are treated as having some control are defined in subsections (5), (6) and (7) of section CW 35 of the Act (see the Appendix). Private pecuniary profit is a criterion for registration and will be looked at by the Charities Commission when making a decision on registration. Where there is the potential for private pecuniary profit it is likely to mean that the organisation would not be registered. However Inland Revenue has a duty to apply the tax legislation and so may, notwithstanding registration, decide whether or not in any particular case the exemption for business income should apply.

55. The section CW 35 tax exemption will not apply if a person having some control of the business has the *potential* to benefit. It is not necessary for the benefit or advantage to be actually received.

56. In any audit, Inland Revenue will examine the affairs of the entity including any documentation, etc. The documentation of charitable entities (trust deeds or constitutions, etc) will be examined to ensure that no person with some control over the business is able to exert influence that would enable that person to receive a benefit or advantage. A determination has to be made as to whether a benefit is gained or is able to be gained by a person (who has some control of the business) were it not for the influence of that person. The person's legal as well as practical ability to influence will be examined (*CIR v Dick* (2001) 20 NZTC 17,396).

57. There is a wide spectrum of situations in which a person may be able to exercise some control over a business. At one extreme would be situations of duress or oppressive conduct, or where the person controls the decision making in terms of majority voting rights, or with associated persons controls the board or where the trust instrument grants a right of veto over decisions to that person. At the other end of the spectrum are cases where the settlor is consulted but has no power to direct, or the person in question is only one of a number of trustees or directors involved in decision making.

58. Whether a person is able to exert material influence is a matter of fact and degree. It will depend upon the facts, the particular arrangement, the degree of relationship of the parties, the documentation of the charitable entity and the way it makes its decisions.

59. Where there is a sole trustee, it would be implied that the sole trustee would be able to exert the requisite influence.

60. In instances where there are two or more persons that are able to influence a decision, whether a person is able to materially influence may depend on whether the person actually participates in the discussion and decision making. Even if in a minority on the decision making group, material influence could still be exerted. For example, a person whose advice is well regarded by the trustees is able to influence the other trustees to his/her own advantage.

61. The past behaviour of the entity, that is, the pattern of distributions or whether any benefits have been afforded at any time to any person who is able to influence the entity by virtue of his or her status, can be a guide as to whether in practice the person in question is able to materially influence the setting of benefits. For example, in *CIR v Dick* Glazebrook J stated (paragraph 65) that:

> In the situation where benefits and income have never been accorded and where the practice has been to utilise any surplus for the charitable objects of a trust it would not be reasonable for the Commissioner to take the view that any of the persons having the requisite capacities were for those income years able to influence materially the amount of benefits or income.

62. Adequate records (e.g. minutes of meetings) will have to be kept to show how decisions were made.

63. Companies that are in business are in some cases subject to rights granted to shareholders and directors under the Companies Act 1993. Where

such rights enable a person to influence the decisions of a business, so that the person obtains a benefit, or is able to obtain a benefit or advantage, the income derived from that business will not be exempt from tax. Special provisions may be required eliminating such powers that enable a person to influence company decisions.

Benefit or Advantage

64. A benefit or advantage that is received or is able to be received by a person is defined widely in section CW 35(8) of the Act.

65. Where a person in some control of a business receives any one of these benefits, or any other amount covered by subsection (1)(b), the section CW 35 business income exemption does not apply. Something acquired through the provision of services or goods at market value is not considered to be a benefit or advantage.

66. Where a person is able to materially influence a benefit or advantage while providing professional services to the trust or company by which the business is carried on and they provide the services in the course of a professional public practice, or as a trustee company, or the Public Trust or Maori Trustee, that person is deemed not to have control over the trust or the company for their own benefit (subsection CW 35(7)). The term company includes a society or institution.

67. Furthermore, where it is clear that the setting of any benefit or advantage has been undertaken in a scientific manner to ensure that no more than market value is paid Inland Revenue will accept that there was no material influence (*CIR v Dick* (2001) 20 NZTC 17,396).

Donee organisations

68. Section KC 5 provides for a tax rebate in respect of donations of money of $5 or more to a society, institution, association, organisation, trust, or fund, the funds of which are, in the opinion of the Commissioner of Inland Revenue, applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purposes within New Zealand. Entities given approval are known as donee organisations or as having donee status. Note, the rebate does not apply to certain bodies including Public Authorities and Maori Authorities.

69. Section DB 32 provides that a company (not being a close company unless its shares are listed on a recognised exchange) may claim a deduction for gifts of money to these organisations. The deduction for all gifts made in a tax year is limited to 5% of the amount that would otherwise be the company's net income in the tax year. A similar deduction is allowed under section DV 11 to a Maori authority for donations made to any Maori association (as defined in the Maori Community Development Act 1962 for the purposes of that Act) or to donee organisations.

70. In order to determine whether a rebate can properly be claimed, Inland Revenue needs to consider whether the society, etc. is of a kind referred to in section KC 5 of the Act. The information contained in the application for registration of the society as a charitable entity will assist in this process.

71. Approval as a donee organisation does not necessarily carry an implication of charity. This is because section KC 5 also applies to benevolent, philanthropic or cultural purposes. Applications for approval as a donee organisation under these other grounds should continue to be sent directly to Inland Revenue. Approval as a benevolent, philanthropic, or cultural organisation does not imply that the organisation is accepted as a charity. However, in most cases charitable organisations would qualify as donee organisations.

72. Where an approved donee organisation applies funds for purposes both within and outside New Zealand it is advisable that the use of the funds in and outside New Zealand be separately recorded within the accounting records.

73. The entity will also need to show in its constituting documents that its funds will be applied wholly or principally within New Zealand. Should an audit later be conducted then the entity must also be able to show that it has complied with the relevant requirements of section KC 5.

74. An organisation whose funds will be applied mainly overseas would need to approach the Government via Inland Revenue for legislation enabling it to be specifically included in the list of donee organisations. This is because of the express limitation in section KC 5 itself that the funds must be applied principally for charitable purposes within New Zealand.

75. For those organisations applying funds mainly overseas Cabinet will only consider, for inclusion within section KC5, organisations whose funds are principally applied towards:

    (a) the relief of poverty, hunger, sickness or the ravages of war or natural disaster; or

    (b) the economy of developing countries (recognised as such by the United nations); or

    (c) raising the educational standards of a developing country.

    Specifically excluded are charities formed for the principal purpose of fostering or administering any religion, cult or political creed.

    When forwarding your application to Inland Revenue it would be helpful if it is supported with the following:

a) an indication of the amount of donations likely to be received in any year;

b) an indication of the proportion of annual income which is likely to be applied to charitable purposes outside New Zealand; and

c) any other information which you would like used to support your case.

Receipts

76. To qualify for the rebate a person must produce a receipt from the approved donee that meets the following criteria:

- be officially stamped with the name of the approved donee or branch of the organisation,
- clearly indicate that it is a donation and the amount,
- show the date the donation was received, and
- be signed by a person authorised by the approved donee to accept donations.

Resident withholding tax

77. Certificates of exemption from resident withholding tax (RWT) are issued to, among others, persons who derive exempt income under section CW 34 *Charities: non-business income*, section CW 35 *Charities: business income and section* CW 36 *Charitable bequests* of the Act. Where these persons or entities claim to be charities then they will need to register with the Charities Commission. On becoming registered entities may apply to Inland Revenue for certificates of exemption. Inland Revenue will accept registration with the Commission as proof that they are charitable.

78. In the transitional period from 1 February 2007 until 30 June 2008 Inland Revenue will accept applications for exemption without evidence of registration or tax exempt status. However, after 30 June 2008 these entities will be checked and if they have not registered they must return their income in their annual income tax returns. Any exemption certificates will be cancelled.

Record keeping

79. Under section 32 of the Tax Administration Act 1994 all gift-exempt bodies must keep sufficient records in the English language to enable Inland Revenue to determine both the sources of donations and the application, within New Zealand or within a country or territory outside New Zealand, of their funds. The Commissioner of Inland Revenue may, however, authorise a gift-exempt body to keep those records in a language other than English if the gift-exempt body applies in writing to the Commissioner for the authorisation.

80. Section 58 of the Tax Administration Act provides that every gift-exempt body may be required to furnish, if requested, a return of its funds derived or received in any tax year and showing the source and application of those funds.

Alterations to the founding documents

81. In the past Inland Revenue has suggested that organisations have clauses in their founding documents which restrict them from altering certain clauses without prior approval from the Commissioner. The relevant clauses would be those defining the charitable purposes or objects, the clause relating to personal advantage, the rule change clause and the winding up clause. Inland Revenue will no longer give prior approval to clause changes and strongly recommends that organisations remove any such requirement in their rules. To enable this to happen, Inland Revenue hereby consents to an amendment removing any such rule.

82. The Charities Commission will however require any rule changes to be notified to them within 3 months after the changes have been made to ensure that a charity retains its registration. The Commission will not review draft documents including draft amendments to an entity's objects and rules. Where such a change is made the executed documents should be filed with the Commission.

This Operational Statement is signed on 14th of November 2006.

Graham Tubb
Group Tax Counsel
Assurance

APPENDIX – LEGISLATION

Income Tax Act 2004

CW 34 Charities: non-business income

Exempt income

(1) The following are exempt income:
(a) an amount of income derived by a trustee in trust for charitable purposes:
(b) an amount of income derived by a society or institution established and maintained exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual.

[Effective on 1 July 2008]

Exclusion: trustees, society, or institution not registered

(1B) This section does not apply to an amount of income if, at the time that the amount of income is derived, the trustee or trustees of the trust, the society, or the institution is not, or are not, registered as a charitable entity.

Exclusion: business income

(2) This section does not apply to an amount of income derived from a business carried on by, or for, or for the benefit of a trust, society, or institution of a kind referred to in subsection (1).

Exclusion: council-controlled organisation income

(3) This section does not apply to income derived by -
(a) a council-controlled organisation; or
(b) a local authority from a council-controlled organisation.

CW 35 Charities: business income

Exempt income

(1) Income derived directly or indirectly from a business carried on by, or for, or for the benefit of a trust, society, or institution of a kind referred to in section CW 34(1) is exempt income if -
(a) the trust, society, or institution carries out its charitable purposes in New Zealand; and

[Effective on 1 July 2008]

(ab) the trustee or trustees of the trust, the society, or the institution is or are, at the time that the income is derived, registered as a charitable entity; and

(b) no person with some control over the business is able to direct or divert, to their own benefit or advantage, an amount derived from the business.
Subsections (3) to (8) expand on this subsection.

Exclusion

(2) This section does not apply to income derived by -
(a) a council-controlled organisation; or
(b) a local authority from a council-controlled organisation.

Carrying on a business: trustee

(3) For the purposes of subsection (1), a trustee is treated as carrying on a business if -
(a) the trustee derives rents, fines, premiums, or other revenues from an asset of the trust; and
(b) the asset was disposed of to the trust by a person of a kind described in subsection (5)(b); and
(c) either -
  (i) the person retains or reserves an interest in the asset; or
  (ii) the asset will revert to the person.

Charitable purposes in New Zealand and overseas

(4) For the purposes of subsection (1)(a), if the charitable purposes of the trust, society, or institution are not limited to New Zealand, income derived from the business in a tax year is apportioned reasonably between those purposes in New Zealand and those outside New Zealand. Only the part apportioned to the New Zealand purposes is exempt income.

Control over business

(5) For the purposes of subsection (1)(b) for a tax year, a person is treated as having some control over the business, and as being able to direct or divert amounts from the business to their own benefit or advantage if, in the tax year, -

(a) they are, in any way, whether directly or indirectly, able to determine, or materially influence the determination of, -
  (i) the nature or extent of a relevant benefit or advantage; or
  (ii) the circumstances in which a relevant benefit or advantage is, or is to be, given or received; and

(b) their ability to determine or influence the benefit or advantage arises because they are -
  (i) a settlor or trustee of the trust by which the business is carried on; or
  (ii) a shareholder or director of the company by which the business is carried on; or
  (iii) a settlor or trustee of a trust that is a shareholder of the company by which the business is carried on; or
  (iv) a person associated with a settlor, trustee, shareholder, or director referred to in any of subparagraphs (i) to (iii).

Control: settlor asset disposed of to trust

(6) For the purposes of subsection (5), a person is treated as a settlor of a trust, and as gaining a benefit or advantage in the carrying on of a business of the trust, if -

(a) they have disposed of an asset to the trust, and the asset is used by the trust In the carrying on of the business; and

(b) they retain or reserve an interest in the asset, or the asset will revert to them.

No control

(7) For the purposes of subsection (1)(b), a person is not treated as having some control over the business merely because -

(a) they provide professional services to the trust or company by which the business is carried on; and

(b) their ability to determine, or materially influence the determination of, the nature or extent of a relevent benefit or advantage arises because they -
  (i) provide the services in the course of and as part of carrying on, as a business, a professional public practice; or
  (ii) are a trustee company; or
  (iii) are Public Trust; or
  (iv) are the Maori Trustee.

Benefit or advantage

(8) For the purposes of subsection (1)(b), a benefit or advantage to a person -

(a) may or may not be something that is convertible into money:

(b) unless excluded under paragraph (d), includes deriving an amount that would be income of the person under 1 or more of the following provisions:
  (i) section CA 1(2) (Amounts that are income):
  (ii) sections CB 1 to CB 21 (which relate to income from business or trade-like activities):
  (iii) section CB 28 (Property obtained by theft):
  (iv) sections CC 1 (Land), CC 3 to CC 8 (which relate to income from financial instruments), and CC 9 (Royalties):
  (v) section CD 1 (Income):
  (vi) sections CE 1 (Amounts derived in connection with employment) and CE 8 (Attributed income from personal services):
  (vii) section CF 1 (Benefits, pensions, compensation, and government grants):
  (viii) section CG 3 (Bad debt repayment):
  (ix) sections CQ 1 (Attributed controlled foreign company income) and CQ 4 (Foreign investment fund income):

(c) includes retaining or reserving an interest in an asset in the case described in subsection (3), if the person has disposed of the asset to the trust or the asset will revert to them:

(d) does not include earning interest on money lent, if the interest is payable at no more than the current commercial rate, given the nature and term of the loan.

Non-exempt business income

(9) If an amount derived from the carrying on of a business by or for a trust is not exempt income because of a failure to comply with subsection (1)(b), the amount is trustee income.

CW 36 Charitable bequests—

Exempt income

(1) An amount of income derived by a deceased's executor or administrator is exempt income to the extent to which the requirements in subsections (2) and (3) are met, having regard to all relevant matters including—

(a) the terms of the deceased's will, including the rights of annuitants, legatees, and other beneficiaries; and

(b) the nature and extent of the debts and liabilities of, and other charges against, the estate and their likely effect on the income and assets available for distribution to the beneficiaries; and

(c) the shares and prospective shares of the beneficiaries in the income and assets of the estate.

Gift to charity

(2) The first requirement is that the amount arises from or is attributable to assets of the estate that have been left to a trust, society, or institution of a kind referred to in section CW 34(1).

Exempt in hands of charity

(3) The second requirement is that the amount, if derived by the trust, society, or institution or by a business carried on by, or for, or for the benefit of it, would be exempt income under section **CW 34 or CW 35.**

[The following 3 subsections come into force on 1 July 2008]

Registration as charitable entity not required until end of income year that follows income year in which deceased died

(4) An amount of income derived by a deceased's executor or administrator that is derived during the period beginning on the deceased's date of death and ending at the end of the income year that follows the income year in which the deceased died is not prevented from being exempt income under this section merely because the trustee or trustees of the trust, the society, or the institution is not, or are not, registered as a charitable entity.

(5) For the purposes of subsection (4), until the end of the income year that follows the income year in which the deceased died, the requirements in sections **CW 34** and **CW 35** for the trustee or trustees of the trust, the society, or the institution to be registered as a charitable entity must be disregarded when applying those sections for the purposes of this section.

(6) This section does not apply to an amount of income derived after the end of the income year that follows the income year in which the deceased died if, at the time that the amount of income is derived, the trustee or trustees of the trust, the society, or the institution is not, or are not, registered as a charitable entity.

History

Section CW 36 (4), (5) and (6) inserted by the *Charities Act* 2005 (No 39 of 2005), section 67, **effective on 1 July 2008 (SR 2006/300)**.

Defined in this Act:

amount, business, distribution, exempt income, income, New Zealand

DB 32 Gifts of money by company—

Who this section applies to

(1) This section applies to—
(a) a company that is not a close company:]
(b) a close company that has its shares quoted on the official list of a recognised exchange.

Deduction

(2) The company is allowed a deduction for a gift of money that it makes to a society, institution, association, organisation, trust, or fund of any of the kinds described in section KC 5(1) (Rebate in respect of gifts of money).

Amount of deduction

(3) The deduction for the total of all gifts made in a tax year is limited to 5% of the amount that would be the company's net income in the tax year if this section did not exist.

Link with subpart DA

(4) This section supplements the general permission. The general limitations still apply.

Defined in this Act:

amount, close company, company, deduction, general limitation, general permission, net income, recognised exchange, share, supplement, tax year

DV 11 Maori authorities: donations—

Deduction

(1) A Maori authority is allowed a deduction for—

(a) a donation that it makes to a Maori association, as defined in the Maori Community Development Act 1962, for the purposes of the Act:]

(b) a gift of money that it makes to a society, institution, association, organisation, trust, or fund of any of the kinds described in section KC 5(1) (Rebate in respect of gifts of money).

Amount of deduction

(2) The deduction for the total of all donations and gifts made in a tax year is limited to 5% of the amount that would be the Maori authority's net income in the tax year if this section did not exist.

Link with subpart DA

(3) This section supplements the general permission and overrides the capital limitation. The other general limitations still apply.

Defined in this Act:

amount, capital limitation, deduction, general limitation, general permission, Maori authority, net income, supplement, tax year

KC 5 Rebate in respect of gifts of money

(1) A taxpayer, other than an absentee, or a company, or a public authority, or a Maori 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): … .

NF 9 Certificates of exemption—

(1) Any of the following persons may apply to the Commissioner to be issued with a certificate of exemption: …

(i) any person who derives in any tax year amounts that are exempt income under any of sections CW 31(2) (and, for this purpose, the Reserve Bank of New Zealand is not a public authority), CW 32(2), and CW 33 to CW 44 and CW 50 in relation to the activities of that person in the capacity in which that person derived that exempt income:

(j) any person to whom section DV 8 applies and who would, but for that section, have net income, in that person's most recently completed accounting year, of an amount less than the amount for the time being specified in that section.

OB 1 Definitions

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

registered as a charitable entity means registered as a charitable entity under the Charities Act 2005.

Estate and Gift Duties Act 1968

73. Exemption for gifts to charities and certain bodies—

(1) Any gift creating a charitable trust, or establishing any society or institution exclusively for charitable purposes, or any gift in aid of any such trust, society, or institution, shall not constitute a dutiable gift *if, at the time that the gift is made, the society, institution, or trustees of the trust is or are registered as a charitable entity under the Charities Act 2005.*

Editorial Note

The words in italics are an amendment made by section 72 of the Charities Act 2005 and come into force on 1 July 2008.

Charities Act 2005

13. Essential requirements—

(1) An entity qualifies for registration as a charitable entity if,—

(a) in the case of the trustees of a trust, the trust is of a kind in relation to which an amount of income is derived by the trustees in trust for charitable purposes; and

(b) in the case of a society or an institution, the society or institution—

(i) is established and maintained exclusively for charitable purposes; and

(ii) is not carried on for the private pecuniary profit of any individual; and

(c) the entity has a name that complies with section 15; and

(d) all of the officers of the entity are qualified to be officers of a charitable entity under section 16.

(2) The trustees of a trust must be treated as complying with subsection (1)(a) if,—

(a) in accordance with a ruling made under Part 5A of the Tax Administration Act 1994,—

(i) an amount of income derived by the trustees in trust is treated as having been derived by the trustees in trust for charitable purposes for the purposes of section CW 34 of the Income Tax Act 2004; or

(ii) income is treated as having been derived directly or indirectly from a business carried on by, or for, or for the benefit of the trustees in trust for charitable purposes for the purposes of section CW 35 of the Income Tax Act 2004; or

(b) the income derived by the trustees is deemed to be income derived by trustees in trust for charitable purposes under section 24B of the Maori Trust Boards Act 1955.

(3) A society or an institution must be treated as complying with subsection (1)(b) if, in accordance with a ruling made under Part 5A of the Tax Administration Act 1994, that society or institution is treated as being a society or institution that is established and maintained exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual for the purposes of section CW 34 or section CW 35 of the Income Tax Act 2004.

(4) Subsections (2) and (3) cease to apply in relation to an entity if—
(a) the period for which the ruling applies has expired; or
(b) the ruling has ceased to apply because of section 91G of the Tax Administration Act 1994; or
(c) the ruling has otherwise ceased to apply to the entity.

(5) Despite subsections (1) to (3), an entity does not qualify for registration as a charitable entity if—
(a) the entity is designated under section 20 or section 22 of the Terrorism Suppression Act 2002 as a terrorist entity or an associated entity; or
(b) the entity has been convicted of any offence under sections 7 to 13D of the Terrorism Suppression Act 2002.

30. Commissioner may supply register information for purposes of Inland Revenue Acts—

(1) The Commission may supply any register information or documents to a person for the purpose of assisting the person in the exercise of the person's powers under any of the Inland Revenue Acts or in the performance of the person's functions under any of the Inland Revenue Acts if, in the opinion of the Commission, it is in all the circumstances appropriate to do so.

(2) For the purposes of this section, "register information or documents" means—
(a) information or documents that are contained in the register:
(b) information or documents that would have been contained in the register but for the exercise of a power under section 25 to omit or remove that information or those documents from the register.

QUESTIONS WE'VE BEEN ASKED

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

GST TREATMENT OF FUNDING PROVIDED TO TREATY OF WAITANGI CLAIMANTS BY THE CROWN THROUGH THE OFFICE OF TREATY SETTLEMENTS

Sections 5(6D) and 8(1) of the Goods and **Services Tax Act 1985—definitions of** "consideration", "goods" and "services"

Question

In the Interpretation Statement on *Treaty of Waitangi Settlements—GST Treatment* (published in TIB Vol 14, No 9 (September 2002)) it was considered that redress under a Treaty of Waitangi ("Treaty") settlement was not subject to goods and services tax (GST). The Commissioner has now been asked whether GST is chargeable on funding provided by the Crown through the Office of Treaty Settlements ("OTS") to claimants for negotiation costs ("claimant funding"). (This item does not address the GST treatment of supplies received by claimants that are paid for out of claimant funding.)

Answer

Claimant funding is not subject to GST, because:

- Claimant groups do not supply goods or services to the Crown in the course of negotiating a Treaty settlement;
- Claimant funding does not constitute "consideration" within the statutory definition as there is an insufficient relationship between claimant funding and any supply that might be made by a claimant group to the Crown; and
- Claimant funding is not in the nature of a grant or subsidy in terms of section 5(6D) of the Goods and Services Tax Act 1985 ("the Act").

Analysis

Background

The Crown accepts that historical breaches of the Treaty have occurred and has indicated its willingness to enter into negotiations to settle claims in respect of such Treaty breaches. The Crown provides a contribution (through the OTS) towards costs incurred by claimant groups in connection with the negotiation of the settlement of such claims. Funding is provided for negotiation costs such as rent, administration, travel, accommodation and communication costs, fees for legal, financial or other advice, negotiators' fees and hui costs. Claimants may decide to undertake additional research to establish a particular aspect of their claim. However, the Crown does not provide funding for research. The Crown may commission research if additional research is required in order to enable settlement to be reached. Claimant funding is not provided to a claimant group unless the group's representatives establish that they have a mandate to represent the group. The representatives of the claimant group receive claimant funding on behalf of the group.

Claimant funding does not necessarily cover all the negotiation costs incurred by a claimant group. The amount of the funding approved by the Crown depends on the size and complexity of the claim, and whether any features of the claimant group could make negotiation and consultation with its members more difficult and expensive (for example, whether the members of the claimant group are in strong agreement about the proposed negotiations, the size of the claimant group and how scattered its members are, and whether hui are required).

The timing of instalments of claimant funding is linked to milestones in the negotiation progress (that is, Mandate, Terms of Negotiation, Formal Negotiation to Deed of Settlement and Ratification). The Crown advises claimant groups of the funding allocated to each milestone once Cabinet has approved the overall amount of claimant funding to be given to a group. Payments are made by instalments of no more than $50,000 each. Claimants must provide copies of itemised invoices for negotiation costs incurred by the claimants to enable the OTS to establish that the funding has been used for negotiation costs. The claimants must also undertake an annual audit and review to:

- Provide verification that the correct accounting standards have been used and procedures maintained and that the claimants' financial statements represent an accurate view of transactions that have occurred for the period; and
- Ensure claimant funding has been used on valid negotiation-related expenses.

Claimant funding is in addition to any financial redress under the Deed of Settlement between the Crown and the claimant group. It is provided because in the absence of funding by the Crown, it may be difficult to achieve settlement or the settlement reached may not be lasting.

Imposition of GST

Under section 8(1) of the Act, GST is imposed on the supply of goods or services in New Zealand by a registered person in the course or furtherance of a taxable activity carried on by that person by reference to the value of the supply. The value of a supply of goods or services is the "consideration" for the supply: section 10(2) of the Act.

Claimant groups may be registered persons. A supply of goods or services by a claimant group could be a supply made in the course or furtherance of a taxable activity carried on by the claimant group.

Whether claimant groups supply goods or services to the Crown

Claimant groups do not supply any goods in the course of negotiating a Treaty settlement. Claimant groups may transfer property to the Crown under the final Deed of Settlement signed on the completion of the negotiations. However, none of the agreements entered into in the course of settlement negotiations (the Deed of Mandate, Terms of Negotiation or Heads of Agreement) involves the transfer of property by the claimant group.

"Services" means some action that helps or benefits the recipient: *Case S65* (1996) 17 NZTC 7,408; *F B Duvall Ltd v CIR* (1997) 18 NZTC 3,470. Claimants may undertake the following activities in connection with the negotiation of a Treaty settlement:

- The preparation for, and conduct of, negotiations with the Crown (including mandating, agreement on the terms of negotiation, preparation of a negotiation brief and formal negotiations);
- A forbearance not to pursue claims through the courts or the Waitangi Tribunal or by other means while in negotiation;
- Research (additional to research the Waitangi Tribunal or the Crown Forestry Rental Trust or the Crown carries out) to support its claims;
- The provision of invoices relating to negotiation costs and audited financial statements accounting for the use of claimant funding.

The pursuit of a Treaty settlement is an activity carried on for the claimant group's benefit, rather than an activity carried on for the Crown's benefit. Mandating establishes that the claimant group's representatives have the authority to represent that group in negotiations with the Crown, and is undertaken for the purpose of enabling a claimant group to initiate negotiations with the Crown. The agreement that negotiations will continue only if the parties do not pursue claims through the courts, the Waitangi Tribunal or by other means during negotiations is part of the framework for Treaty negotiations and relates to the process for negotiating settlement. If a claimant group carries out additional research, it does so in order to obtain evidence to support its claim against the Crown. The carrying out of additional research is part of a process of seeking compensation from the Crown and is incidental to the pursuit of redress from the Crown. Compliance with accounting requirements is not sought as an end in itself and is incidental to the negotiation of a Treaty settlement that is not itself a service. Viewed as a whole, the claimants' activities are directed at obtaining compensation for the Crown's Treaty breaches. Such activities are undertaken to recover compensation from the Crown rather than for the Crown's benefit and do not constitute a service provided by the claimants to the Crown.

Therefore, the Commissioner does not consider that claimant groups provide either goods or services to the Crown in the course of negotiating a Treaty settlement.

Whether claimant funding is "consideration" within the statutory definition

Also, for claimant funding to be subject to GST, it must be "consideration" for a supply of goods or services. The definition of "consideration" in section 2(1) of the Act reads as follows:

"Consideration", in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body:

A distinction is drawn between a payment in respect of the payee's taxable activity and a payment that is consideration for a supply of goods and services: *Director-General of Social Welfare v De Morgan* (1996) 17 NZTC 12,636; *NZ Refining Co Ltd v CIR* (1997) 18 NZTC 13,187 (CA). For a payment to be "consideration" within the statutory definition a sufficient relationship must exist between the making of the payment and the supply of goods or services. An expectation that the recipient of the payment would carry out a certain activity is not enough. It is not sufficient that the person who receives the payment carries out some activity that has the effect of benefiting either the person making the payment or some other person. It is also not sufficient that the payment enables the recipient to carry on an activity. The transaction must involve reciprocal obligations between the payer and payee: *NZ Refining Co Ltd v CIR; Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075.

Hence, it is not sufficient that the Crown agrees to provide claimant funding in the expectation that the claimants will begin and continue negotiations. It is also not sufficient that the claimants' activity in carrying out the negotiations provides a benefit to the Crown in facilitating Treaty settlements or that the provision of claimant funding enables the claimants to carry out negotiations.

The Commissioner considers that there is an insufficient relationship between claimant funding and any supply of goods or services that might be made by a claimant group to the Crown in negotiating a Treaty settlement with the Crown. The real and substantial relationship is between claimant funding and the Crown's Treaty breaches giving

rise to the claims to which the negotiations relate. Therefore, the Commissioner considers that claimant funding is not "consideration" within the statutory definition.

Whether claimant funding is in the nature of a grant or subsidy

As claimant funding is provided by the Crown through the OTS, section 5(6D) of the Act potentially applies. If section 5(6D) applies, claimant funding would be deemed to be consideration for the supply of goods or services by a claimant group. For section 5(6D) to apply, claimant funding must be a "payment in the nature of a grant or subsidy" and must be paid to a claimant group "in relation to or in respect of" a taxable activity carried on by the claimant group.

The words "in relation to or in respect of" are words of the widest import: *Shell NZ Ltd v CIR* (1994) 16 NZTC 11,303. It is possible that there may be some relationship between claimant funding and a taxable activity carried on by the claimant group.

The definition of "payment in the nature of a grant or subsidy" in section 5(6E) of the Act is not an exhaustive definition. Therefore, case law on the meaning of "grant or subsidy" is relevant to the interpretation of the phrase "payment in the nature of a grant or subsidy". The case law indicates that:

- A "grant or subsidy" is financial assistance the Crown or a public body pays in money to promote some activity for the benefit of the community or a section of the community.
- A "grant or subsidy" is a gift in the sense that it is assistance the Crown provides gratuitously and voluntarily.
- A payment the Crown or a public authority makes merely for the purpose of discharging an obligation is not a payment in the nature of a grant or subsidy.

See *Placer Development Ltd v Commonwealth of Australia* (1969) 121 CLR 353; *First Provincial Building Society v Commonwealth of Australia* 95 ATC 4145; *GTE Sylvania v R* [1974] CTC 751; *Reckitt & Colman Pty Ltd v FCT* 4 ATR 501; *Director-General of Social Welfare v De Morgan*; and *Kena Kena Properties Ltd v A-G* (2002) 20 NZTC 17,433.

The Crown agrees to enter into negotiations to settle Treaty claims because it accepts that it has breached its obligations under the Treaty in respect of the claimants. The need for the claimants to incur costs in negotiating a settlement with the Crown is occasioned by the Crown's Treaty breaches. Claimant funding is provided by the Crown in order to enable the Crown to discharge obligations in respect of historical breaches of the Treaty that the Crown acknowledges did occur. The provision of claimant funding is occasioned by an obligation to provide redress for a loss suffered by the claimants as a consequence of the Crown's Treaty breaches and it is provided to facilitate settlement. Claimant funding compensates the claimants for costs that they incur directly as a result of the Crown's Treaty breaches.

A public benefit (in the form of better race relations and social harmony) may result from the settlement of long standing Treaty grievances generally. However, the claimant funding is provided in order to enable the Crown to discharge its obligations in respect of breaches of the Treaty.

Therefore, the Commissioner considers that for the purposes of section 5(6D) of the Act claimant funding is not a payment in the nature of a grant or subsidy.

Surplus in claimant funding

It is possible that the amount of the claimant funding that the Crown has agreed to provide may exceed the negotiation costs the claimants have incurred. Any amount that the Crown has agreed to provide and that has not been spent when settlement is finalised is paid to the claimant group in addition to the Financial Redress (as defined in the Deed of Settlement). In legal terms, a surplus in claimant funding is not part of the Financial Redress. However, in practice, claimant funding is taken into account in developing the overall financial package offered to the claimants.

Whether or not claimant funding, which the Crown has agreed to provide, has been spent in full on negotiation costs, it is not "consideration" for GST purposes, because an insufficient relationship exists between a payment in respect of claimant funding and any goods or services a claimant group may potentially supply and is not a payment in the nature of a grant or subsidy.

Advance payments of financial redress used for negotiation costs

The amount of claimant funding approved by Cabinet will not normally be increased. However, if the claimants' negotiation costs exceed the amount of the approved funding and good progress has been made in negotiations and settlement is close, the Crown may provide additional funds to the claimants. Additional funds are generally in the form of an advance out of any financial redress that may ultimately be agreed. Any advance payment is deducted from the final settlement amount paid under the Deed of Settlement. Financial and commercial redress under a Treaty settlement is not subject to GST (TIB Vol 14, No 9 (September 2002)). A pre-payment of financial redress is still financial redress and is not subject to GST. It is not relevant that an advance payment is used by a claimant group to meet negotiation costs.

REGULAR FEATURES

DUE DATES REMINDER

December 2006

20 Employer deductions

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

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

January 2007

15 GST return and payment due

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 calendar 2006–2007*. This calendar reflects the due dates for small employers only—less than $100,000 PAYE and SSCWT deductions per annum.

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

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

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

Name _____

Address _____

_____

Draft interpretation statement	***Comment deadline***
☐ IS0049: GST exempt supply: supply of accommodation in a dwelling	22 December 2006
Draft questions we've been asked	***Comment deadline***
☐ QB0033: Payments made in addition to financial redress under Treaty of Waitangi Settlements—income tax treatment	22 December 2006
☐ ED 0094: Zero-rating of supplies of "sail-away boats" – used as security or offered for sale	16 February 2007
☐ QB0056: New employee relocation expenses	23 February 2007
Draft standard practice statement	***Comment deadline***
☐ ED 0090: Requests to amend assessments	16 February 2007
Draft public ruling	***Comment deadline***
☐ XPB0034: Maori trust boards: declaration of trust for charitable purposes made under section 24B of the Maori Trust Boards Act 1955 —income tax consequences	23 February 2007

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