

# TAX INFORMATION BULLETIN

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## **GET YOUR TIB SOONER ON THE INTERNET**

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This *Tax Information Bulletin* is also available on the internet in PDF. Our website is at **[www.ird.govt.nz](http://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.

If you prefer to get the *TIB* from our website and no longer need a paper copy, please let us know so we can take you off our mailing list. You can do this by completing the form at the back of this *TIB*, or by emailing us at **[tibdatabase@ird.govt.nz](mailto:tibdatabase@ird.govt.nz)** with your name, details and the number recorded at the bottom of the mailing label.



## THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft items are available for review/comment this month, having a deadline of 27 October 2006.

<b>Ref.</b>	<b>Draft type</b>	<b>Description</b>
XPB00012a	Public ruling	Rates apportionment on settlement of a property sale where the vendor has prepaid local authority rates – GST treatment
XPB00012b	Public ruling	Insurance assignment on settlement of a property sale where the vendor has prepaid insurance – GST treatment
XPB00012c	Public ruling	Rental apportionment on settlement of a property sale where the vendor receives a share of rental proceeds from the purchaser after settlement – GST treatment
XPB00012d	Public ruling	Settlement of a property sale where the vendor has not paid local authority rates up to the time of settlement – GST treatment
XPB00012e	Public ruling	Rental apportionment on settlement of a property sale where the vendor has received rental payments from a tenant prior to settlement – GST treatment
XPB00012commentary		Commentary on XPB00012a-e

Please see page 9 for details on how to obtain a copy.

## LEGAL DECISIONS – CASE NOTES

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

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

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

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### TRUST DEBTS PROVABLE IN BANKRUPTCY OF TRUSTEE

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<b>Case:</b>	Commissioner of Inland Revenue v Philip John Duncan
<b>Decision date:</b>	7 July 2006
<b>Act:</b>	Insolvency Act 1967 and Goods and Services Tax Act 1985
<b>Keywords:</b>	“obligation” and “liability”

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#### Summary

A trustee who incurs an obligation to a finance house to develop and sell a property prior to being bankrupted is not liable for GST that he incurs on behalf of the trust as a result of the sales after the date of bankruptcy. The debt is provable in his bankrupt estate in terms of section 87(1) of the Insolvency Act 1987 (the Act).

#### Facts

This was an appeal against a decision made in favour of Mr Duncan in the District Court.

The Commissioner had claimed that Mr Duncan, as trustee, was personally liable pursuant to section 57(3) of the Goods and Services Act 1985 for the GST debt of a trust. Mr Duncan denied personal liability on the ground that he had been bankrupted and the debt should have been proved in his bankruptcy.

Prior to Mr Duncan trustee being bankrupted he had purchased a property for development and claimed a GST input. Mr Duncan had entered into an agreement with a finance house to develop and sell the properties. After Mr Duncan was bankrupted, but before he was discharged from bankruptcy, the trust sold the developed properties but failed to pay the GST output tax. Mr Duncan was the trustee at all times.

#### The District Court decision

The issue was whether in terms of section 87(1) of the Act the GST output tax was provable in Mr Duncan's bankrupt estate. If it was, Mr Duncan is therefore released from liability in terms of section 114 of the Act.

In terms of section 87(1) all debts and liabilities, present or future, certain or contingent, to which the bankrupt is subject at the time of his adjudication, or to which he becomes subject before his discharge by reason of any obligation incurred before the time of his adjudication, shall be debts provable in bankruptcy.

Mr Duncan argued that once the trust had claimed input tax it was always going to have to account for output tax on the sale of taxable supplies. Therefore, at the time of the input claims the trust had a contingent liability for output tax, and, pursuant to section 57(3) of the GST Act, so did the Defendant. This contingent liability was provable in the Defendant's bankrupt estate in terms of section 87 of the Act. As it was not proved, the Defendant was released from liability in terms of section 114 of the Act.

The Commissioner argued that the purchase of the land and the associated GST input claims did not trigger an obligation, contingent or otherwise, for Mr Duncan to account for output tax. That obligation only arose at the time of supply which was after Mr Duncan was declared bankrupt.

The District Court accepted Mr Duncan's argument finding that the future output tax was a contingent liability of Mr Duncan at the time he was bankrupted. It then considered section 98 of the Act. In terms thereof, the Official Assignee can estimate the value of a contingent debt, but if he finds that he cannot fairly estimate it he shall reject the proof of debt. In those circumstances the debt would not be provable in the bankruptcy. The District Court went on to hold that the onus fell on the Commissioner to show that the GST debt would not have been provable and the Commissioner had not discharged that onus.

## **Decision on appeal**

The main thrust of the Commissioner's argument was that the District Court erred because it incorrectly defined the term "contingent liability". The Commissioner claimed that, in line with various decided cases, the judge failed to recognise that before there can be a contingent liability under section 87(1) there must be some form of commitment by the debtor from which he cannot unilaterally withdraw. At the time of Mr Duncan's adjudication output tax was not a contingent liability of the trust because the trust was not committed to the taxable supply of the units and there was, accordingly, no certainty that output tax would become payable. Alternatively, that even if the output tax was a contingent liability of the trust it was not a contingent liability of Mr Duncan at the time of his adjudication. To avoid liability he could have resigned as trustee before the GST was payable.

Mr Duncan supported the District Court's reasoning and finding.

The High Court dismissed the appeal and confirmed the District Court judgment but on different grounds.

In accordance with the Commissioner's argument Chisholm J found that the GST that was incurred after bankruptcy was not a contingent liability of Mr Duncan at the time of his bankruptcy.

Even though the sales and the time of supply that gave rise to the GST debt occurred after the date of bankruptcy he found that the liability arose by virtue of an obligation that was incurred prior to bankruptcy. That obligation was the obligation of the trustee to the trust's financier to develop and sell the properties at the time the financial package was agreed. Chisholm J held that the sales of the developed units that gave rise to GST, which occurred after bankruptcy, occurred because Mr Duncan had a pre-bankruptcy obligation to a finance house to develop and sell the units.

In coming to this conclusion he held that, because both the words "liability" and "obligation" are used in section 87(1), parliament must have intended that they carry different meanings and that "obligation" in the section means something less than legally binding.

Chisholm J went on to hold that it would have been possible to estimate the value of the units in terms of section 98 and dismissed the appeal.

This decision is under appeal.

## REGULAR FEATURES

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### DUE DATES REMINDER

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#### September 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*

##### 29 GST return and payment due

#### October 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*

##### 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](http://www.ird.govt.nz)

On the homepage, click on "Public consultation" in the right-hand navigation bar. Here you will find links to drafts presently available for comment. You can post comments here.

**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 public rulings**

**Comment deadline**

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|--|-----------------|
| <input type="checkbox"/> XPB00012a: Rates apportionment on settlement of a property sale where the vendor has prepaid local authority rates – GST treatment  | 27 October 2006 |
| <input type="checkbox"/> XPB00012b: Insurance assignment on settlement of a property sale where the vendor has prepaid insurance – GST treatment   | 27 October 2006 |
| <input type="checkbox"/> XPB00012c: Rental apportionment on settlement of a property sale where the vendor receives a share of rental proceeds from the purchaser after settlement – GST treatment | 27 October 2006 |
| <input type="checkbox"/> XPB00012d: Settlement of a property sale where the vendor has not paid local authority rates up to the time of settlement – GST treatment                                 | 27 October 2006 |
| <input type="checkbox"/> XPB00012e: Rental apportionment on settlement of a property sale where the vendor has received rental payments from a tenant prior to settlement – GST treatment          | 27 October 2006 |
| <input type="checkbox"/> XPB00012commentary:<br>Commentary on XPB00012a-e  | 27 October 2006 |

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Public Consultation  
National Office  
Inland Revenue Department  
PO Box 2198  
Wellington





