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

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THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft items are available for review/comment this month, having a deadline of 3 November 2006.

Ref.	Draft type	Description
ED0091	Question we've been asked	Meaning of "place of effective management"

The following draft items are available for review/comment this month, having a deadline of 24 November 2006.

Ref.	Draft type	Description
IS0059	Interpretation statement	Sale of long-term residential rental properties—GST implications

The following draft items are available for review/comment this month, having a deadline of 30 November 2006.

Ref.	Draft type	Description
QB0041	Question we've been asked	Ability to rule where an arrangement is being audited
XPB00017	Public ruling	Federal Insurance Contributions Act (FICA)—fringe benefit tax liability

Please see page 14 for details on how to obtain a copy.

BINDING RULINGS

This section of the *Tax Information Bulletin* 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 06/03

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Westpac Banking Corporation ("Westpac"), BT Financial Group (NZ) Limited ("BT") and Westpac New Zealand Limited ("Newco").

Taxation Laws

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

This Ruling applies in respect of sections BD 3, BG 1, CA 1, CE 1, CE 5, GB 1, GC 17 and the definitions of "salary or wages", "extra pay", "withholding payment" (in section OB 1) and "source deduction payment" (in section OB 2).

The Arrangement to which this Ruling applies

The Arrangement is the provision of childcare services (referred to as the "Westpac Child Care Centre Benefit") by Westpac, the parent company of BT and Newco, to employees of the Westpac Group (which for the purposes of this Ruling is defined to mean Westpac, BT, and Newco), on Westpac's premises.

Westpac, BT and Newco will not charge employees for the cost of the childcare services and the services will be provided as a benefit to employees in addition to the salary or wages normally paid to such employees. Employees will enter into a salary reduction agreement with their respective employer, modifying the existing employment contract, pursuant to which an employee's pre-tax salary will be reduced by an amount equivalent to the value of the childcare services provided to that employee by Westpac. BT and Newco will pay Westpac for the cost of the childcare services provided to their respective employees. This agreement will be legally effective so as to operate as a contractually binding and enforceable agreement to reduce the amount of pre-tax salary by the value of the childcare services provided.

Further details of the Arrangement are set out in the paragraphs below.

1. Westpac, BT and Newco satisfy the section IG 1(2) definition of "group of companies".

2. Westpac will enter into a management agreement with ABC Developmental Learning Centres (NZ) Ltd ("ABC"), the draft of which was provided to the Rulings Unit on 11 November 2005. Pursuant to this management agreement, ABC is to provide childcare management services at each childcare centre to Westpac. Westpac will provide a licence of the premises to ABC to enable ABC to carry out its obligations to Westpac.

3. Westpac has been planning for some time to provide childcare centres to be made available to its employees, to enable employees in the Westpac Group to achieve a better work/life balance. Westpac is committed to providing childcare services to employees of the Westpac Group, as this is of obvious benefit to its employees and also because it is consistent with Government policies to achieve greater participation in the workforce for employees with children. It is also expected that the provision of childcare services will have flow-on commercial benefits for Westpac in the form of a higher level of employee satisfaction with Westpac as a employer and a resulting improvement in employee morale and retention.

4. In 2004 Westpac entered into negotiations with ABC Learning Centres Limited ("ABC Learning"), an experienced operator of childcare facilities in Australia. Westpac and ABC Learning entered into a memorandum of understanding to provide the framework for negotiating a more detailed management agreement. This memorandum of understanding was dated 29 November 2004, and was provided to the Rulings Unit on 11 November 2005.

5. It is intended that Westpac will establish a pilot site, to be operational in 2006, in Auckland, Wellington or Christchurch. It is expected that childcare centres will be established in the other two cities shortly after the pilot site becomes operational. It is possible that Westpac may establish childcare centres in other cities. Westpac sent out a request for employees to register their interest for the planned childcare centres. As a result of this request, 196 employees registered their interest in respect of a total of 227 children. Registrations of interest for 91 of these children were for the Auckland childcare centre, 80 for the Wellington childcare centre, and 56 for the Christchurch childcare centre.

6. Westpac and ABC Learning entered into the memorandum of understanding to provide a framework for negotiating the terms of a management agreement between ABC and Westpac, pursuant to which Westpac will contract with ABC for ABC to provide, on Westpac's behalf, quality tailored childcare management services on Westpac's premises, for the benefit of New Zealand employees in the Westpac Group.

7. The memorandum of understanding is no more than a commitment by the parties to negotiate the terms of a more detailed management agreement and, consequently, the memorandum of understanding does not deal in any detail with the nature of the arrangement to be entered into between Westpac and ABC.

8. Since entering into the memorandum of understanding, the parties have negotiated a detailed management agreement, including schedules, dealing with various aspects of the operation of the childcare centres to be established by Westpac. (As noted above, a draft form of this management agreement was provided to the Rulings Unit on 11 November 2005). In addition, Westpac has prepared a salary reduction agreement (also provided on 11 November 2005), which contains the terms on which Westpac will provide childcare services to its employees. Westpac provided an amended version of the salary reduction agreement on 1 May 2006, incorporating the adjustment for accrued leave referred to in paragraph 32 below. The same form of salary reduction agreement (with some modifications) will be used for BT's and Newco's employees.

9. Broadly, the management agreement:

   (i) sets out the agreed services to be provided by ABC, on behalf of Westpac (refer Schedule 1 of the agreement), and the applicable service standards;

   (ii) provides that ABC is responsible for the day-to-day administration of each centre and dealing with parents in relation to children at the centre;

   (iii) requires that each childcare centre be licensed at all times (and that ABC will be required to apply for the licence for each childcare centre), and that ABC will comply at all times with its obligations under the Education (Early Childhood Centres) Regulations 1998;

   (iv) requires that ABC will indemnify Westpac for any breach of the Regulations and other applicable regulatory requirements; and

   (v) provides for termination rights, including termination at Westpac's discretion.

10. The management agreement contemplates that there will be a separate licence agreement for each childcare centre, which will outline the terms of the licence to be provided by Westpac to ABC, to enable ABC to carry out its obligations under the management agreement at a particular site.

11. Westpac and ABC will co-operate to identify and develop suitable sites as childcare centres, pursuant to clause 4 of the management agreement and in accordance with Schedule 7. When a suitable site has been identified and developed as a childcare centre, Westpac will take a lease of the site (if Westpac does not own or already lease the site), Westpac and ABC will enter into a site licence in respect of that site and ABC will then commence providing the childcare services, on behalf of Westpac to Westpac Group's employees, through the childcare centre at that site. ABC will be required to pay a licence fee to Westpac.

12. The Auckland District Law Society model lease (4th Edition) is intended to be the form of lease that Westpac will use for a childcare centre. However, the provisions relating to the "Guarantor" (who would normally guarantee the lessee's obligations) will be deleted from the lease agreement. In addition, the lease agreement will be subject to any amendments negotiated with the owner of the premises. It is possible that the owner of the premises may have its own form of lease agreement, in which case Westpac would negotiate over the terms of that lease agreement. Any such lease agreement entered into will be a standard and conventional lease that is on arm's length and commercial terms.

13. The signage on each childcare centre is likely to incorporate the following information:

> "**[Location] Child Care Centre**
> Managed by ABC Corporate Care Pty Ltd
> A wholly owned subsidiary of ABC Learning Centres"

14. Westpac will incur certain direct costs in relation to each site operated as a childcare centre, which will be principally the costs payable under the lease for the site. Westpac will also incur the cost of any increase in insurance premiums, as a result of the premises being used as a childcare centre, and

other costs which Westpac reasonably considers are necessary for the premises to be used as a childcare centre. Westpac will recoup these costs from ABC, by way of the licence fee. The licence fee is to be paid monthly in advance (clause 3.1 of Schedule 2 of the Licence for Use and Occupation of Premises).

15. ABC will charge a fee to Westpac, referred to as the Westpac Usage Fee, in consideration for the services provided by ABC at each childcare centre (clause 6.1(a) of the management agreement). The Westpac Usage Fee is defined, in respect of each childcare centre, as the aggregate of the Child Care Fees in each fortnight for services provided by ABC to each child of a Westpac Group employee enrolled at that centre. The Child Care Fees are calculated in accordance with Schedule 5 of the management agreement. Schedule 5 is divided into two parts. Part A provides how ABC must set the Child Care Fees at each centre. These Child Care Fees are to reflect, in Westpac's reasonable opinion, market rates. Part B provides how ABC must invoice the Child Care Fees.

16. Although each childcare centre will be a Westpac childcare centre and ABC is to be engaged merely to manage each childcare centre on behalf of Westpac, ABC has negotiated the right to contract directly with members of the public to provide childcare services at the childcare centres. For this purpose members of the public will include Westpac Group employees who are not participating in the Westpac Child Care Centre Benefit (and effectively are non-Westpac Group employees for the purposes of access to each childcare centre). Any such contractual arrangements will be directly between ABC and members of the public and will not involve Westpac Group. The ability to offer places to members of the public was considered important by ABC, to ensure the economic viability of each childcare centre. If there are surplus places at any childcare centre after all participating Westpac Group employees have taken up places, ABC will be able to offer such surplus places to members of the public. As a result it is expected that ABC should be able to operate each childcare centre at full capacity and achieve greater economies of scale. This should assist with minimising the costs to Westpac of providing childcare services to Westpac Group's employees.

17. Westpac's objective in setting up each of the childcare centres is to provide for childcare services for employees of the Westpac Group. Each childcare centre is to have a proposed capacity of 75 children, giving the three childcare centres a total proposed capacity of 225 children (although it is possible that the Auckland childcare centre may have a slightly greater capacity). Based on the 196 employees who registered their interest in respect of a total of 227 children, Westpac's expectation at the outset of the arrangement is that, over time, an average of at least 50% or more of the total number of children at the three childcare centres will be children of employees of Westpac Group who participate in the Westpac Child Care Centre Benefit.

18. Westpac has not adopted a policy that childcare centres will be closed, if the number of children of Westpac Group employees falls below a certain number. However, where the numbers of children of Westpac Group employees using a particular childcare centre falls to a level where Westpac considers that it no longer fulfils the commercial objectives set out in paragraph 4, Westpac will carry out a review of the viability of that childcare centre and make a decision as to whether to continue to keep the centre operating.

19. Clause 9 of the management agreement regulates the availability of places in a centre between Westpac Group employees and non-Westpac Group employees. Clause 9.1(a) provides that the manager shall ensure that priority of enrolment at each centre is provided to the children of parents employed by Westpac Group, in accordance with the priority access guidelines in schedule 2 to the management agreement. Clause 9.2 provides that where there are vacancies at a centre, the manager may make such vacancies available to children whose parents are not employed by Westpac Group, on terms and conditions no less favourable than the terms and conditions applicable to Westpac employees, but subject always to the application of the guidelines in schedule 2.

20. Schedule 2 is in three parts. Part 1 deals with the allocation of places at a centre between children of Westpac Group employees and non-Westpac Group employees, prior to the centre opening. Part 2 of the schedule sets out the procedures for allocating vacant places at a centre from the date the centre becomes operational. Clause 18 of the schedule provides that once a parent of a non-Westpac Group child has accepted a place at the centre, that child shall be guaranteed continuity of that place as long as required, unless:

    (i) the centre is designated as a high use centre under Part 3 of the schedule; and

    (ii) the child was aged 2 years or under when the child commenced care and has not yet taken up a place in the 3 year old age group; and

    (iii) the centre continues to have a high use designation.

21. Clause 19 of the schedule provides that places made available to children (aged 2 or under when care commenced) of non-Westpac Group employees can be reclaimed for the children of Westpac Group employees on 6 months notice, in the case of centres with a high use designation. Part 3 of the schedule sets out the process for applying a high

use designation to a centre. Essentially, Westpac can request that any centre be classified as high use, except if the manager is able to produce evidence that children of Westpac Group employees are taking up less than 75% of the available places at the centre.

22. The management agreement makes it clear that the manager must not collect any childcare fees directly from any Westpac employee (who is participating in the Westpac Child Care Centre Benefit) who has children at a childcare centre (clause 6.3(a)). The manager must also ensure that priority of enrolment at any childcare centre is provided to the children of parents who are employees of Westpac Group. Any disputes regarding priority of enrolments shall be determined by Westpac, in accordance with an enrolment policy to be formulated by Westpac (clause 9.1).

23. Westpac's right to terminate the management agreement or any site licence is provided for in clause 15.2 and clause 15.3. In addition to having the right to terminate the management agreement or any site licence if the manager is in breach, Westpac has an absolute discretion to terminate the agreement or any site licence, on giving 60 days' written notice to ABC.

24. The structure of the arrangement, as reflected in the management agreement, is as follows. Westpac wishes to provide childcare facilities to its employees and wishes to be able to control the quality and the continuance of those services. Westpac will be able to control the quality and the continuation of the services by having control of the premises as lessee, and by setting the operational standards in the management agreement. If the manager breaches the operational standards, Westpac can terminate the manager's site licence and arrange for another provider of childcare services to manage the particular childcare centre. Also, if for any other reason Westpac is unhappy with the level of services provided by the manager, Westpac has a complete discretion to terminate either the management agreement in its entirety or any particular site licence. Westpac's control of the premises and control of the manager is intended to minimise any operational and regulatory risks to which Westpac could be exposed through the provision of childcare services to its employees.

25. If Westpac is not the lessee of the premises, Westpac would be subject to the risk that the provision of childcare services through the particular childcare centre would be discontinued if, for example, ABC were to close that childcare centre or if Westpac, for whatever reason, became dissatisfied with ABC's standard of performance. This would not be an acceptable commercial risk for Westpac, because the discontinuance of the provision of childcare services through the particular childcare centre would have a disproportionately adverse effect on its relationship with its employees, who no doubt would feel considerably let down if the provision of childcare services through a particular childcare centre was discontinued. Westpac is able to remove or at least control that risk, by having control of the premises and having the ability to terminate the manager's performance of services at the particular childcare centre (and arranging for a substitute manager to carry on providing the services at the particular centre).

26. If any of Newco's or BT's employees wish to take up a place at a childcare centre Newco/BT will arrange with Westpac for Westpac to provide the necessary childcare services to those employees. That company will pay Westpac for the cost of the childcare services.

27. The salary reduction agreement serves two purposes. First, the agreement modifies the terms and conditions of an employee's employment contract with Westpac/BT/Newco by providing for a salary reduction. Secondly, the agreement sets out the terms of the childcare benefit available to employees.

28. Under clause 3 of the agreement, an employee's pre-tax salary for future pay periods is reduced by a specified amount, being the amount identified in the application form to be completed by each employee. The amount of the reduction may be adjusted if childcare fees are increased or the employee requires additional childcare services, but such adjustments would apply only for future pay periods. Clause 5 stipulates that the salary reduction does not, under any circumstances, create an entitlement or right to any monetary sum whatsoever.

29. Under clause 4, Westpac/BT/Newco agrees to provide or procure the provision of childcare services to an employee, equivalent in value to the amount of the reduction in salary, on the terms and conditions set out in the schedules to the agreement. This right to receive childcare services is not transferable by the employee.

30. Schedule 1 contains the formula (refer paragraph 10 of section 1) for calculating the amount of the salary reduction, which is calculated from the number of children that the employee wishes to place at the childcare centre, the Child Care Fees set by ABC for each child and the number of fortnightly periods that the particular childcare centre is treated as open each year. For the purposes of the formula, a childcare centre usually will be treated as open for 26.07 fortnightly periods per year, even though there will be times that the centre will be closed, such as during summer holiday periods. If a childcare centre were to be closed temporarily for an unexpected reason (for example, a fire at the centre), the salary reduction would continue to apply. If an unexpected closure were to continue

for an indefinite period, it is likely that Westpac/BT/Newco and the employees would renegotiate the salary reduction pursuant to clause 7 of the agreement.

31. Schedule 1 to the agreement does refer to certain contingencies or consequences of the salary reduction agreement, for example, the position of employees who wish to continue to keep a child or children at a centre during periods of unpaid leave. In such cases, the employee must pay the applicable childcare fees to Westpac/BT/Newco (out of after-tax income).

32. Salary reductions cannot be back-dated and will only apply for future pay periods. As noted in paragraph 18 of schedule 1, an employee cannot elect to reduce a salary, after it has been earned. In particular, employees will not be able to receive the childcare services benefit while taking leave, the entitlement to which accrued before the date of the salary reduction agreement. Employees will be required to pay for the childcare services used while taking leave, the entitlement to which accrued before the date of the salary reduction agreement, by way of an adjustment provided for in the salary reduction agreement.

33. Paragraph 16 in the schedule itemises some of the implications of a salary reduction, including the effect on benefits or insurances, ACC entitlements, liable parent payments and the ability to borrow.

34. An employee shall not be able to reduce his or her salary to a level which would be in breach of any applicable minimum wage laws or other legislative requirements.

35. The maximum percentage of salary that an employee is able to sacrifice is based on the policy of Westpac Australia. This policy sets a maximum salary sacrifice of the lower of 40% of gross salary and $40,000.

36. Employees can only enter into a salary sacrifice agreement in respect of children for whom the employee has legal responsibility (for example, natural or adopted children, or children of whom the employee is the legal guardian).

37. This Ruling only applies to the Arrangement in so far as it relates to the provision of childcare services by Westpac to employees of Westpac, BT and Newco on Westpac's premises.

Condition stipulated by the Commissioner

This Ruling is made subject to the following condition:

a) The maximum level of salary reduction for full time employees is the lower of 40% of gross salary and $40,000.

b) The Arrangement will be consistent in all material respects with the following draft or final documents provided to the Rulings Unit:

- the Management Agreement between Westpac Banking Corporation and A.B.C. Learning Centres Limited (ABC) (and the associated Schedules (1,2,4,5,6, and 7)), provided to the Rulings Unit on 11 November 2005;
- the Licence for Use and Occupation of Premises between Westpac Banking Corporation and A.B.C. Corporate Care Pty Limited (which comprises Schedule 3 to the Management Agreement between Westpac Banking Corporation and A.B.C. as noted above), provided to the Rulings Unit on 11 November 2005; and the amendment made in respect of this document which was provided to the Rulings Unit on 15 June 2006;
- the Memorandum of Understanding between Westpac Banking Corporation and ABC Learning Centres Limited, provided to the Rulings Unit on 11 November 2005;
- the amended Salary Reduction Agreement, provided to the Rulings Unit on 1 May 2006; and
- the Childcare Services Agreement between Westpac Banking Corporation and BT Financial Group provided to the Rulings Unit on 15 March 2006.

How the Taxation Laws apply to the Arrangement

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

- The amount of the reduction in salary agreed to by employees of Westpac, Newco and BT pursuant to the salary reduction agreement, the childcare services supplied by Westpac, and the payments by Westpac to ABC under the management agreement, are not income of those employees under sections BD 3, CA 1(2), CE 1 and CE 5 and are not "salary or wages", "extra pay" or a "withholding payment" (as defined in section OB 1) and are not "source deduction payments" (as defined in section OB 2)
- Section GC 17 does not apply to the Arrangement.
- Sections BG 1 and GB 1 do not apply to vary or negate the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 7 July 2006 and ending on 6 July 2009.

This Ruling is signed by me on the 7th day of July 2006.

Howard Davis
Senior Tax Counsel

LEGAL DECISIONS – CASE NOTES

This section of the *Tax Information Bulletin* 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.

SUPREME COURT DISMISSES APPLICATION FOR LEAVE TO APPEAL

Case: Jeffrey George Lopas and Lorraine Elizabeth McHerron v The Commissioner of Inland Revenue *SC 2/2006 [2006] NZSC 56*

Decision date: 2 August 2006

Act: Supreme Court Act 2003

Keywords: Leave to appeal

Summary

The applicants were unsuccessful in their appeal to the Court of Appeal, and sought leave to appeal to the Supreme Court. The first issue in dispute was whether the proviso to s. 51(1) of the GST Act 1986 is incorporated into s. 52(1). The Court examined all the submissions for the hearings below and concluded the applicant's argument on this ground was too weak to be the basis of a second appeal. The second issue was whether the Commissioner's second argument in the Court of Appeal that the applicants were not eligible for deregistration was recorded in the Statement of Position. The Court was satisfied that the argument was so recorded in general terms.

Facts

The applicants were the partners in the Jeffrey George Lopas and Lorraine Elizabeth McHerron Partnership, which was registered for GST from 1 October 1992 with a taxable activity of forestry. By subsequent deeds of trust dated 20 September 1999, a family trusts partnership was created, which was registered for GST from 1 October 1999.

On 4 October 1999, the applicants applied to cancel the original partnership's GST registration effective from 30 September 1999, on the basis that its taxable supplies for the 12 months following 30 September would be less than $30,000. The standard deregistration form was completed, stating that the applicants would be keeping business assets when registration ceased, including land with a cost price of $115,000. The Commissioner cancelled the registration with effect from 30 September 1999. The applicants took the view that s. 5(3) of the GST Act deemed the land to be an asset of the taxable activity supplied at a time immediately before deregistration, and paid GST on the cost price of the property, being the lesser of cost or open market value under s. 10(8).

On 8 October 1999, the applicants entered into an agreement for the sale and purchase of the land at a price of $375,000, inclusive of GST (if any) to the family trusts partnership. It was clear from the surrounding circumstances that the sale was contemplated before the GST deregistration of the applicants. The Commissioner subsequently amended the GST deregistration date from 30 September 1999 to 30 November 1999, resulting in output tax being payable on the sale price of $375,000, rather than the $115,000 previously envisaged. The applicants disputed the Commissioner's decision amending the effective date of deregistration from 30 September 1999 to 30 November 1999.

Decisions below

The Taxation Review Authority found in favour of the applicants, holding they were entitled to deregister for GST when they did.

The Commissioner appealed to the High Court. Panckhurst J held the sale of the property was not a cessation supply under s. 5(3) but a termination supply under s. 6(2), because there was an undoubted connection between the cessation of the taxable activity and the sale of the land. At the point of deregistration, beneficial ownership in the property had passed, and tax was payable under the general supply provisions rather than as a deemed deregistration supply.

The applicants appealed to the Court of Appeal on the basis that at the date of deregistration, beneficial ownership had not passed. They submitted that they had done what the legislation both expressed and

contemplated, and if the Commissioner had wanted to argue there was a transfer of beneficial ownership, the argument should have been put to the Authority, but it was not.

The Commissioner responded that the original decision was made on the basis of incomplete disclosure by the taxpayer, and if the Commissioner had been in possession of all the relevant facts at the outset, deregistration would always have taken effect from 30 November 1999. Further, a scheme to sell the land was already on foot to sell the land and cease all taxable activities within four days, so the application to deregister should have been made under s. 52(3), not s. 52(1).

The Commissioner also cross appealed on the correct interpretation of the statutory provisions in question, submitting that the "amount" referred to in s. 52(1) refers to the figure of $30,000 in s. 51(1), rather than the whole of that subsection, including the proviso. The applicants argued that the proviso was to be included as a matter of interpretation, and no inconsistency within the Act would be created by inclusion of the proviso in that way.

The Court of Appeal accepted the Commissioner's arguments on the cross appeal, finding the reference to "amount" included only the figure of $30,000, not any exclusions to be found within the provisos to s. 51(1). The court also found the applicants should have applied to be deregistered for GST under s. 52(3), not s. 52(1). The Commissioner was acting under a misapprehension when the applicants were deregistered the first time and was entitled under s. 13 of the Interpretation Act to re-exercise his discretion and to set a new GST deregistration date.

Decision of Supreme Court

The Supreme Court noted the dispute focused on two grounds. The first is whether the proviso to s. 51(1) is incorporated into s. 52(1). The applicants said the sale proceeds of the land were excluded from the calculation of the threshold for GST. The Commissioner said the proviso to s. 51(1) did not apply and the sale proceeds should be included. The other point was whether s. 52(1) or s. 52(3) applies to deregistration in this case. The applicants contended the Court of Appeal was wrong to accept the Commissioner's arguments on the second point, because they were raised for the first time in that Court, and were not contained in the Commissioner's Statement of Position.

The Supreme Court regarded the merit of the applicant's argument on the first ground as too weak to be the basis of a second appeal. In coming to this conclusion, it directed the parties to file all submissions that were before the Authority and the courts below. The Supreme Court was also satisfied that the Commissioner's argument in the Court of Appeal that the applicants were not eligible for deregistration was recorded in general terms in the Commissioner's Statement of Position, and in the circumstances there was no miscarriage of justice. The Court also noted the Commissioner had consistently maintained that the applicants should have disclosed their intention to on-sell the land in question and, if they had done so, they would not have been eligible to be deregistered on 30 September 1999. In the circumstances the court concluded a matter of general commercial significance did not arise, and the application was dismissed.

GST AVOIDANCE ARRANGEMENT UNSUCCESSFUL

Case: TRA04/2005 Decision Number 9/2006

Decision date: 8 August 2006

Act: Goods and Services Act 1985

Keywords: Tax avoidance, *Ch'elle Properties*, long settlement periods, shortfall penalty

Summary

A case similar to *Ch'elle Properties* where the taxpayer obtained GST refunds on the purchase of real estate on very long settlement terms. *Ch'elle Properties* was not directly applied to the arrangement but was influential and a Shortfall Penalty confirmed.

Facts

This case was about obtaining GST input tax refunds on real estate transactions with unusually long settlement periods (in this case over 35 years). It is broadly similar to *Ch'elle Properties* [2004] 3 NZLR 274.

The disputant was incorporated in 17 July 2001. The company was registered for GST in October 2001 on an invoice basis.

Mr C was a property developer and sole director of B Ltd. B Limited entered into agreements for sale and purchase of seven residential properties in Tokoroa, to two companies (collectively T Limited). The two companies were owned by another company which, in turn, was a 50% shareholder in B Limited.

The properties were purchased for $140,000 by T Ltd and each was on-sold to the disputant for $220,000 in October 2001 with deferred settlement until dates varying between June and October 2037.

A deposit of $10 was payable on execution of the agreements and the balance payable on 14 December 2001 "*or such later dates as may be agreed upon by the vendor*". It appears that the balances of the deposits payable for those agreements have not been paid.

T Limited was never able to give legal title to the disputant as the legal ownership remained with B Limited. T Limited issued seven tax invoices on 30 October 2001. The

disputant filed a GST return for the period ending 30 October 2001 which showed $1,540,000 of inputs and nil outputs. The Commissioner declined to pay a refund.

The true value of the properties was questionable due to the mortgagee sale in May 2003, where the properties were sold for $39,000 (equating to $5,571 each). An explanation of this huge discrepancy was that *"the properties were ransacked prior to the mortgagee sale"*. The unquestionable outcome of the sale is that it is highly unlikely that the properties would have been available for the deferred settlement 37 years hence.

Decision

Section 76 Tax Avoidance

The Judge declined to apply *Ch'elle Properties* to this case citing the amended statutory provisions.[par 22]

However, he said that he had no doubt that the arrangements in this case were designed and intended to exploit the anomaly which the Courts have decided (e.g *Nicholls v The Commissioner of Inland Revenue* (1999) 19 NZTC 15,233) results from a mismatch between registration on a payments basis vis a vis an invoice basis. [par 26]

The Judge referred to Section 19 of the Act (Accounting basis);

> *(1) Subject to sections 19A to 19D, every registered person must account for tax payable on an invoice basis for the purpose of section 20*

Prior to 10 October 2000, s. 19(1) was only subject to ss.19A-19C. Section 19D was enacted from 10 October 2000. At the relevant date it provided:

- The requirement by a person making a supply for consideration in excess of $225,000 to be registered on an invoice basis for that supply
- It only applies to agreements for sale and purchase which are not "short term" as defined in s.OB1 of the Income Tax Act 1994 (one Year and one day for the amended s. 19D);
- It catches taxpayers who make more than one relevant supply and the sum of the supplies is more that $225,00; if the Commissioner considers that the person ,making the supplies did so to avoid subs.(1).

The Judge held the opinion that T Limited was used as a vehicle to carry out the arrangements. [par 29]

The Judge after considering the criteria of s. 76 Tax Avoidance was of the view that there was clearly a series of contracts backed by a plan of understanding. His Honour cites *Challenge* to state:

> "*a scheme of arrangement which complies with the specific provisions of a taxing statute may nevertheless fall foul of the anti-avoidance provisions*" [par 41]

The fact that the series of transactions was carefully structured to meet the requirements of s. 19(D) does not affect any of the foregoing considerations. He used the words of Rodney Hansen J,

> "*The tension between the commercial and juristic character of the arrangement is stretched to breaking point. It conforms to the letter of the Act while departing from its fundamental objectives. It has therefore the purpose and effect of defeating the intent and application of the Act.*" (at p.285 of Ch'elle) [par 45 of TRA judgment]

He held that the scheme offended s. 76 and was void to the Commissioner. The Commissioner was correct in refusing to refund the input credit as filed. [par 46]

Penalties for taking an abusive tax position

The Judge referred to Mr C's related activities, in which he said that Mr C had been the guiding mind of three similar schemes. Each of the schemes are attempts to finance substantial purchases of real estate using the GST inputs and lengthy deferred settlements creating a mismatch between registration on an invoice basis and registration on a payments basis. Each scheme uses the device on long periods of deferred settlement and dubious price escalation mechanisms which inflate the value of the inputs claimed. [par 50]

His Honour focused on the knowledge of Mr C and his associated companies as relevant to the disputant's tax position. This was because His Honour concluded on the evidence that disputant was "closely aware of the detail of the *Ch'elle* scheme and its chilly reception by the Commissioner" [par 53]

His Honour had no difficulty accepting that the shortfall penalty was properly applied in this case. [par 63]

Mr C was perfectly aware at the time of these transactions that from December 1999, schemes of this nature were under a cloud. The Judge said,

> "*For somebody who represents himself to have (and has in these proceedings demonstrated) a sound grasp of the relevant law and practice it was highly imprudent of him to continue these schemes as has in this case. It was equally imprudent of the disputant in this case knowing what its principal did to associate itself with such schemes of arrangement.*" [par 64]

In the Judge's decision he expressed his opinion that the amount of shortfall penalty applied by the Commissioner was not excessive, and having regard to the circumstances, he was surprised that the Commissioner kept it at the 50% of the maximum permitted. [par 66]

NEW LEGISLATION

PARENTAL LEAVE AND EMPLOYMENT PROTECTION (PAID PARENTAL LEAVE FOR SELF-EMPLOYED PERSONS) AMENDMENT ACT 2006

Paid parental leave has been available to employees since 2002. It was extended to self-employed parents in legislation that came into force on 1 July 2006.

Self-employed mothers who have been working an average of 10 hours per week during either the previous 6 or 12 months before the expected date of delivery of a child will be entitled to 14 weeks' paid parental leave. Paid parental leave is also available to a self-employed person who assumes the care of a child with a view to adoption.

Key features

A self-employed person is required to take a break from work while receiving parental leave payments, but may maintain a level of oversight of the business during the parental leave period.

Parental leave payments may be transferred by a self-employed mother to an eligible partner who may be either an eligible employee or an eligible self-employed person. Eligible mothers who are employees may now transfer payments to eligible self-employed partners as well as employed partners.

Parental leave payments will be set at a rate equal to a self-employed person's average weekly earnings, up to a maximum consistent with that payable to an employee. The rate is set by Order in Council and is $372.12 per week for the year beginning 1 July 2006.

Self-employed persons who earn less than the minimum wage for a minimum of 10 hours per week will be entitled to parental leave payments at a flat rate equivalent to 10 hours per week at the rate of the minimum wage. That rate is $102.50 per week for the year beginning 1 July 2006.

The requirement for a further period of employment before a subsequent application for paid parental leave can be made has also been relaxed from 12 months to 6 months.

The Act provides for regulations prescribing application requirements.

The Parental Leave and Employment Protection Amendment Regulations 2006 were gazetted on 25 May 2006. An application must be accompanied by either:

(a) a statement and declaration by a chartered accountant, set out in the prescribed form; or
(b) a declaration made by the parent, in accordance with the Oaths and Declarations Act 1957, in the prescribed form.

Further information for self-employed persons, employers, chartered accountants and Justices of the Peace is available on the Department of Labour website at **www.ers.dol.govt.nz/parentalleave/** or by calling 0800 20 90 20 during business hours.

OTHER ITEMS OF INTEREST

REMOVAL OF 5 CENT COINS FROM CIRCULATION – EFFECT ON GST TAX INVOICES

From 31 July 2006 5 cent coins will be removed from circulation. This will mean that for cash transactions retailers will be rounding prices to the nearest 10 cents. An issue has been identified where a supplier issues an invoice and then the recipient pays in cash in respect of that invoice. In some circumstances this will mean, as a result of rounding, the amount of tax charged in a transaction may alter. If a tax invoice has previously been issued, section 25(3) of the Goods and Services Tax Act 1985 would require that a debit or credit note be issued in respect of this adjustment.

For example: A person receives a monthly statement/tax invoice from a retailer in respect of supplies for the amount of $25.85 (inclusive of GST). If they were to pay this account with cash the supplier will need to adjust the consideration up or down to either $25.80 or $25.90 (depending on their rounding policy.) The GST included in the transaction at $25.85 is $2.87. At $25.80 it is also $2.87. However at $25.90 the amount of GST increases to $2.88.

In the above example, because rounding up would mean the amount of GST changes section 25(3) would require the supplier to issue a debit note showing the change to the consideration. However, section 25(3B) provides the Commissioner with a discretion to not require a credit or debit note to be issued where the Commissioner is satisfied there are or will be sufficient other records available to establish the particulars of any supply (or class of supply) and that it would be impractical to require a credit or debit note to be issued.

It has been determined that, under the terms of section 25(3B), a debit or credit note need not be issued where the consideration for a transaction changes due to the effects of rounding necessitated by the withdrawal of 5 cent coins from circulation. This is because usual practice is to show the effects of rounding on the receipt issued by the supplier.

While a debit or credit note need not be issued as a result of rounding, the adjusted amount of tax is to be included in the appropriate GST return. In the example above, the supplier needs to include output tax of $2.88.

REGULAR FEATURES

DUE DATES REMINDER

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

November 2006

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

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

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

Name _____

Address _____

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Draft interpretation statement	***Comment deadline***
☐ IS0059: Sale of long-term residential rental properties—GST implications	24 November 2006

Draft questions we've been asked	***Comment deadline***
☐ ED0091: Meaning of "place of effective management"	3 November 2006
☐ QB0041: Ability to rule where an arranagement is being audited	30 November 2006

Draft public ruling	***Comment deadline***
☐ XPB00017: Federal Insurance Contributions Act (FICA)—fringe benefit tax liability	30 November 2006

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