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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 item is available for review/comment this month, having a deadline of 30 June 2007.

Ref.	Draft type	Description
IS2783	Interpretation statement	Deductibility of feasibility expenditure

The following draft item is available for review/comment this month, having a deadline of 2 July 2007.

Ref.	Draft type	Description
ED 0097	Standard practice statement	Transfer of depreciable property between associated persons – section EE 33 of the Income Tax Act 2004

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 07/01

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 the Bank of New Zealand.

Taxation Laws

This Ruling applies in respect of:

(a) sections BG 1, CC 7, EW 15, EW 31, GB 1, NF 1, NF 2, NG 1 and NG 8 of the Income Tax Act 2004; and

(b) sections 86F and 86I of the Stamp and Cheque Duties Act 1971; and

(c) the section 2 definition of "disposition of property" in the Estate and Gift Duty Act 1968.

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

The Arrangement to which this Ruling applies

The Arrangement is a new product ("TotalMoney") that Bank of New Zealand ("BNZ") will offer to customers. TotalMoney involves the creation of new types of accounts which must be in a group of accounts, and the facility to elect to group any number of these new types of accounts into one or more groups for the purpose of either "pooling" or "offsetting" the account balances. "Pooling" involves the aggregation of account credit balances for the purpose of determining the interest rate that will apply to the calculation and crediting of interest to each account balance. "Offsetting" involves the aggregation of account balances for the purpose of calculating the amount of interest debited to a lending facility account balance.

Further details of the Arrangement are set out below.

1. Customers in general have a range of accounts with BNZ, including current accounts, savings accounts, and various loans. TotalMoney offers new types of accounts, and the ability effectively to treat a group of these accounts in a collective or aggregated manner. TotalMoney is based around the concept of a group of new accounts, which will comprise new transaction accounts that can also be used for savings purposes ("transaction accounts") and which can include new lending facility account(s) ("loan accounts").

2. Transaction accounts will provide full deposit and withdrawal facilities through all existing channels providing ready access to funds including via EFTPOS, direct debits, automatic payments, internet and phone banking systems. An overdraft facility may be made available for a transaction account.

3. Loan accounts will be table and non-table home loans.

4. To participate in TotalMoney, these new transaction accounts and loan accounts must be opened by customers, or existing accounts must be converted into these accounts, and all the accounts must be in a group of accounts. The customer elects which accounts will be in which group, and for each group whether the accounts will be "pooled" or "offset".

5. Under the terms and conditions applicable to TotalMoney, TotalMoney is not available for business accounts.

Primary features of TotalMoney

6. The special features that TotalMoney offers in relation to the accounts within the group are "pooling" and "offsetting":

   (a) Pooling

   The pooling aspect of TotalMoney can operate in circumstances where there are several transaction accounts with credit balances. Interest on these credit balance

accounts would be calculated and paid having regard to the cumulative balance of all transaction accounts in the group that are nominated for the pooling feature. Normally interest-bearing accounts attract interest in accordance with interest rate brackets that apply to the balance of its own account. The cumulative balance is calculated purely for the purpose of ascertaining the relevant interest rate tier applicable to the accounts. There is no actual transfer of the separate funds to one account before the interest is calculated. Interest is calculated by reference to the applicable interest rate tier that applies to the accumulated balance.

(b) Offsetting

With the offset feature of TotalMoney, interest on a loan account within the group would be calculated and paid by the customer on the difference between the loan account balance and the credit balances of transaction accounts in the group that are nominated for the offset feature. Under the terms and conditions agreed between BNZ and its customers for TotalMoney, no interest is paid by BNZ on the credit balances that are "offset" against the loan account. The "offsetting" is purely for the purpose of calculating the balance of the loan account on which interest is payable, or, where the credit balances nominated for the "offset" feature exceed the balance of the loan account, the balance of the credit balances on which interest is receivable. There is no actual transfer of funds, or set-off or "netting" of funds together in an account, or transfer of any interest in or entitlement to funds.

7. Every transaction account in TotalMoney group must be selected to either "pool" or "offset". That is, customers can choose whether (some or all of) their transaction accounts with credit balances are "pooled" (in which case credit interest will be paid by BNZ to those accounts), or "offset" (against the loan account(s)). By default all accounts will be set to the "offset" feature unless changed to "pooled" (by the customer or BNZ on the customer's instructions). A customer can select and change between an account participating in either the "offset" or "pooling" features at any time for any period.

Pooling – further detail

8. BNZ will have a contractual obligation to pay interest to each transaction account with a credit balance participating in the pooling feature, based on the applicable interest rate tier that applies based on the total cumulative balance of all accounts being "pooled". BNZ will make a separate determination in relation to withholding tax on each interest payment made to each account, in accordance with its usual practice.

9. Account owners will have full deposit and withdrawal access to their transaction accounts. Overdraft facilities may be available in relation to these accounts. However, any overdraft balance is not taken into account for "pooling" purposes, in that debit interest is charged by BNZ in relation to the overdrawn balance of that account. The overdrawn balance does not reduce the "pooled" balance of the accounts with credit balances for the purposes of calculating interest in relation to those accounts.

Offsetting – further detail

10. Where one loan account is in the group, the interest payable on the loan account is calculated by reference to the balance of the loan account less the credit balances of accounts set to the "offset" feature. This will be the case as a matter of law (in terms of TotalMoney documentation) and as a matter of practice (in terms of BNZ's computer system). There is no actual set-off, netting or transfer of funds or transfer of any interest in or entitlement to funds. "Offsetting" occurs before debit or credit interest is calculated.

11. For example, in the case of a loan account which would otherwise be the same as a standard variable rate table home loan facility over 20 years with a "minimum payment", there will be no provision for the amount of interest saved under "offsetting" to reduce the "minimum payment". In other words, the effect of "offsetting" is the same as a decrease in the floating interest rate and a decision not to reduce the amount of the "minimum payment" – in either case, the term of the loan is reduced because the principal portion of the payment is effectively increased. (In the case of a non-table loan, interest payments will be reduced by "offsetting", principal repayments will not change and the loan term will not reduce).

12. Where there is more than one loan account in the group, the default position is that the loan accounts in the group are given a default priority, namely the oldest loan account in the group will receive a higher priority. However, the customer may elect that two or any number of those loan accounts can be prioritised into an order for "offsetting" purposes. The loan account with the highest priority will receive the benefit of "offsetting" first, and it is only where the credit balances of transaction accounts set to offset exceed the balance of that highest priority loan account that the next highest priority loan account balance is offset, and so on.

13. If the total credit balances of the transaction accounts set to "offset" are greater than the total debit balance of loan accounts, credit interest will

be applied to the difference and paid pro rata to the credit balance accounts in accordance with the balance of those accounts (essentially in line with the "pooling" feature of TotalMoney).

14. Interest is calculated by BNZ on a daily basis. If, during a month, there is both an entitlement of BNZ to receive interest (where the balance of participating loan accounts exceeds the balance of all transaction accounts set to the offset feature) and at another point in the month an obligation on BNZ to pay interest (if the balance of transaction accounts set to offset exceeds the balance of the relevant loan accounts), then the two interest payments (to and from BNZ) would actually be made, and would not be set-off.

Groups

15. TotalMoney is based on a group of participating accounts. A group of participating accounts can only be comprised of multiple accounts owned by customers in the following categories (or subset of these categories):

    (a) **Natural persons**

    An individual, or the individual and joint accounts of married, de facto and civil union couples, and any of their dependent and independent children (including natural children, adopted children, step-children and wards). The accounts of a sole trader used for their business can not be included in this group, however it is noted that the account of an individual (who may be a sole trader) may sometimes be used for business purposes.

    (b) **A company**

    Only the accounts owned by one company can be included in a group of accounts. For example, the accounts of a parent and a subsidiary company or of two associated companies can not be grouped. Any type of company can group their accounts.

    (c) **A trust**

    Only the accounts owned by one trust can be included in a group of accounts. Any type of trust can group their accounts.

16. There will be no grouping and pooling or offsetting of accounts in different categories.

Residency status

17. Customers may be either resident or non-resident in New Zealand for tax purposes. However, where a group of accounts consists of accounts owned by more than one legal person, either all of those persons must be residents of New Zealand for tax purposes or all of those persons must be non-residents of New Zealand for tax purposes.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

(a) The documentation of the transaction account terms and conditions (as comprised in the documents entitled "Terms and Conditions for your Bank of New Zealand TotalMoney Account" and "Terms and Conditions for your Bank of New Zealand TotalMoney Account for Companies & Trusts") and of the loan account terms and conditions (as comprised in the documents entitled "Facility Master Agreement" and the "Letter of Advice – TotalMoney Home Loan") will not be materially different to the draft documentation provided to the Commissioner on 23 February 2007 and 6 December 2006 respectively.

(b) There is no arrangement between the customers who have grouped their accounts which provides for the loan account owner(s) to make a payment(s) to the transaction account owner(s) in consideration for the transaction account owner(s) electing the "offset" feature of TotalMoney. For the avoidance of any doubt, a failure to satisfy this condition by the customers who enter into this arrangement means that this ruling does not apply only in relation to that arrangement.

How the Taxation Laws apply to the Arrangement

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

Gift duty

- In relation to a group where the participating accounts are owned by different legal persons, where a credit balance account owned by one person is offset against the loan account balance of another person, with the effect that the interest liability of that other person is less, there is no "disposition of property" for the purposes of section 2 of the Estate and Gift Duty Act 1968 and gift duty cannot apply.

Financial arrangements rules

- When a credit balance of a transaction account and a debit balance of a loan account are "offset", there is no amount of consideration paid or payable

by virtue of that "offset" for the purposes of the calculation of income and expenditure under sections EW 15 and EW 31 of the "financial arrangements rules" (as defined in section EW 1(2)).

Resident withholding tax ("RWT"), non-resident withholding tax ("NRWT") and approved issuer levy ("AIL")

- Under the "pooling" feature of TotalMoney:
  - "resident withholding tax" (as defined in section NF 2) and "non-resident withholding tax" (as defined in section NG 2) must be deducted by BNZ from the interest credited to the participating transaction accounts in a group, in accordance with the RWT rules (as defined in section OB 1) and the NRWT rules (as defined in section OB 1);
  - in relation to an account that is a "registered security" (as defined in section 86F of the Stamp and Cheque Duties Act 1971 "SCDA"), "approved issuer levy" (as defined in section 86F of the SCDA) may be paid by an "approved issuer" (as defined in section 86F of the SCDA) in relation to the interest credited to that account pursuant to section 86I of the SCDA.
- Under the "offsetting" feature of TotalMoney:
  - There is no payment of or entitlement to "interest" (as defined in section OB 1) in relation to the credit balances of participating transaction accounts in a group, and no obligation to deduct RWT or NRWT or pay AIL, except to the extent that the combined credit balance of those accounts exceeds the combined debit balance of the lending facility accounts.
  - To the extent that interest is credited to participating transaction accounts in a group:
    - "resident withholding tax" (as defined in section NF 2) and "non-resident withholding tax" (as defined in section NG 2) must be deducted by BNZ from the interest credited to the participating transaction accounts in a group, in accordance with the RWT rules (as defined in section OB 1) and the NRWT rules (as defined in section OB 1);
    - in relation to an account that is a "registered security" (as defined in section 86F of the Stamp and Cheque Duties Act 1971 "SCDA"), "approved issuer levy" (as defined in section 86F of the SCDA) may be paid by an "approved issuer" (as defined in section 86F of the SCDA) in relation to the interest credited to that account pursuant to sections 86F and 86I of the SCDA.

Section CC 7

- No income arises under section CC 7 for BNZ or its customers in relation to the Arrangement.

Tax avoidance

- Section BG 1 does not apply to vary or negate any of the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 12 March 2007 and ending on 31 March 2010.

This Ruling is signed by me on the 12th day of March 2007.

Martin Smith
Chief Tax Counsel

STANDARD PRACTICE STATEMENTS

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

SPS 07/03 REQUESTS TO AMEND ASSESSMENTS

Introduction

1. This Standard Practice Statement (SPS) sets out Inland Revenue's practice for exercising the Commissioner's discretion to amend assessments to ensure their correctness.

Application

2. This SPS applies from 17 May 2007.

3. This SPS applies to the exercise of the Commissioner's discretion under section 113 of the Tax Administration Act 1994 to amend assessments to ensure their correctness. It replaces all previous policies and standard practices regarding the exercise of the discretion under section 113, including SPS *INV-510 Requests to Amend Assessments* originally published in *Tax Information Bulletin* Vol 14, No 8 (August 2002).

4. Section 113 does not apply to the exercise of the Commissioner's discretion to amend assessments to ensure their correctness under section 82(3) of the Estate and Gift Duties Act 1968 and section 12G(2) of the Gaming Duties Act 1971. However, in exercising the discretion arising under either of those provisions, the Commissioner will, so far as permitted, apply similar principles to those set out in this SPS.

5. Please note that SPS *INV-510* included a discussion on the Commissioner's discretion in amending GST assessments under section 27(2) of the Goods and Services Tax Act 1985 ("the GST Act"). However, section 27(2) was repealed with application for GST return periods beginning on or after 1 April 2005, and the Commissioner's authority to amend GST assessments now arises pursuant to section 113.

6. This SPS should be read in conjunction with SPS *INV-490 GST returns – correcting minor errors (and clarification)*, SPS *INV-251 Voluntary Disclosures* and any SPSs subsequently issued in replacement.

7. Unless specified otherwise, all legislative references in this SPS refer to the Tax Administration Act 1994 ("the TAA").

Legislation

8. The relevant legislative provisions are:

   (a) sections 6, 6A, 14, 15B, 89C, 89N, 107A, 108, 108A, 113, 138E, 141FB, 141G and 141KB,

   (b) section MD 1(1) of the Income Tax Act 1994 ("ITA 1994"),

   (c) section MD1(1) of the Income Tax Act 2004 ("ITA 2004"), and

   (d) sections 19C(8), 20(5), 45(1) and (3) and 46 of the GST Act.

Summary

9. Section 113 gives the Commissioner the discretion to amend assessments to ensure their correctness when they contain genuine errors, or following the application of the disputes resolution process in Part IVA.

10. Section 113 is viewed in the context of taxpayers' obligations to make correct assessments, and the other duties arising under section 15B. The Commissioner has an obligation to protect the integrity of the tax system including applying the tax laws fairly, impartially and according to the law.

11. Section 113 operates alongside, but is not part of the disputes resolution process provisions that set out the procedures for resolving disputes between Inland Revenue and taxpayers. The Commissioner will not amend assessments while any item of those assessments remains the subject of current disputes under Part IVA. However, assessments can be amended consequentially following completion of the disputes resolution process or to reflect agreed adjustments.

12. When the Commissioner considers that assessments are incorrect (and there is no dispute), the Commissioner can exercise the discretion to amend assessments to correct the genuine errors.

13. This SPS is therefore generally directed at those instances where taxpayers request amendments to assessments (amendment requests), including by making voluntary disclosures, where genuine errors have been made. This SPS also considers the situation where genuine errors are discovered in the course of an investigation. The Commissioner will amend assessments, on a case-by-case basis, when satisfied that genuine errors were made and that none of the limitations set out in paragraphs 49 to 62 of this SPS apply.

Discussion

14. The Commissioner acknowledges that correcting tax errors is an integral part of tax administration. At times, the Commissioner will correct incorrect tax positions to give effect to amendment requests, voluntary disclosures or Inland Revenue investigations. The Commissioner will make any such amendments irrespective of whether they increase or reduce the initial assessments.

15. Pursuant to section 113, the Commissioner may amend assessments to ensure their correctness notwithstanding that taxpayers have not issued notices of proposed adjustment ("NOPAs") pursuant to section 89D in respect of the requested amendments. However, taxpayers seeking to amend incorrect tax positions that relate to:

    (a) non-genuine errors including matters of regretted choice, or

    (b) matters of disputed statutory interpretation,

    must issue NOPAs if within the applicable response period and may make voluntary disclosures when a tax shortfall results.

16. If the Commissioner has raised assessments pursuant to section 106(1) (commonly known as default assessments) and the taxpayers subsequently file tax returns in respect of those default assessments outside the relevant response periods, the Commissioner may treat the tax returns as amendment requests. The Commissioner will generally amend the assessments pursuant to section 113 after confirming that the tax returns contain correct tax positions. However, if taxpayers are within the relevant response periods they should consider issuing NOPAs with their tax returns pursuant to section 89D(1) in order to preserve their disputes rights against the possibility that the Commissioner declines the exercise of the section 113 discretion.

17. Section 113 contains a broad discretion allowing the Commissioner to amend assessments to ensure their correctness, but provides little guidance about how the Commissioner should exercise this discretion in practice. Accordingly, it is necessary to look at the legislative scheme, context and the relevant case law.

18. Section 113 reads:

    (1) Subject to section 89N, the Commissioner may from time to time, and at any time, amend an assessment as the Commissioner thinks necessary in order to ensure its correctness, notwithstanding that tax already assessed may have been paid.

    (2) If any such amendment has the effect of imposing any fresh liability or increasing any existing liability, notice of it shall be given by the Commissioner to the taxpayer affected.

Considering amendment requests

19. Taxpayers may make amendment requests pursuant to section 113 irrespective of whether disputes have been initiated in respect of other issues relating to the assessments.

20. A threshold issue is whether the Commissioner must consider amendment requests from taxpayers after they are identified. As a matter of law, the Commissioner cannot be compelled to either investigate claims that assessments are in error or subsequently to amend the assessments. Please see *Commonwealth Agricultural Services Engineers Ltd (In Liquidation) v CIR* [1926] 38 CLR 289, *CIR v Wilson* (1996) 17 NZTC 12,512 and *Lawton v CIR* (2003) 21 NZTC 18,042.

21. Where it is decided to devote resources to verify genuine errors and a view can reasonably be formed on the basis of the amendment request's merits, the Commissioner will make appropriate adjustments to assessments subject to the principles set out in this SPS, in the spirit of promoting voluntary compliance by taxpayers and to protect the "integrity of the tax system" under section 6(1).

22. When the Commissioner is not satisfied that assessments contain genuine errors, the Commissioner will not and cannot be compelled to amend the assessments. Please see *Wood v CIR* (1999) 19 NZTC 15,255.

"Care and management" considerations

23. The discretion to amend assessments under section 113 enables the Commissioner to act fairly towards all taxpayers including those who get their tax returns or assessments correct the first time and those who have made genuine errors. This also promotes integrity in the administration of the tax system.

24. It is important, however, to recognise that Inland Revenue does not have unlimited resources to undertake lengthy verification processes to determine whether assessments should be amended. When meeting the obligation to collect over time the highest net revenue that is practicable within the law under section 6A(3), the Commissioner must consider:

    (a) the resources available to the Commissioner,

    (b) promoting compliance, especially voluntary compliance, by all taxpayers, and

    (c) taxpayers' compliance costs.

25. Accordingly, it is consistent with the obligation under section 6A(3) for the Commissioner to limit the amount of time and other resources that will be spent investigating amendment requests. Therefore, at times not all requested amendments will necessarily be corrected. Ensuring a balance

between time spent considering amendment requests and other activities is also consistent with the obligation to protect the integrity of the tax system under section 6(1). The principles set out below reflect that balance.

26. The Commissioner will be reluctant to consider amendment requests that would require the application of disproportionate amounts of departmental resources (that is, excessive resources when compared to the amount of tax at stake). This is not to say that the Commissioner will only use minimal resources to determine amendment requests or never consider complex amendment requests. The extent and relevance of taxpayers' disclosures and the amount of tax at stake in respect of the amendment requests will indicate the amount of the Commissioner's resources needed to consider the requests. Ultimately, the allocation of resources will be determined on a case-by-case basis.

27. To assist in the consideration of any amendment requests, taxpayers should provide sufficient relevant information with their requests to ensure that the facts and tax laws relating to the errors are clear and unambiguous. Determining unresolved factual or legal issues may require disproportionate amounts of departmental resources. Therefore, the amendment request might not be considered, or later declined notwithstanding that high dollar amounts are involved.

Genuine errors

28. In this SPS, the term "genuine errors" is used to mean incorrect tax positions taken in assessments resulting in a tax liability being either overstated or understated. However, if taxpayers choose to take particular tax positions under tax laws where legitimate alternatives are available and later regret that choice, no error has occurred (please see paragraphs 37 and 38). This is because the Commissioner does not consider it appropriate to devote resources to correcting optional positions if the preferred positions could have been taken when the taxpayers made the original self-assessments by filing the tax returns. Arguably, to do so would not promote the integrity of the tax system pursuant to section 6(1).

29. The Commissioner accepts that where a taxpayer has taken an incorrect tax position and the Commissioner amends the taxpayer's assessment following an investigation, other taxpayers' tax positions may also be incorrect as a result of the first-mentioned taxpayer's incorrect tax position. These will also be regarded as genuine errors. The Commissioner will need to amend the other taxpayer's assessment under section 113 upon the consequential error being identified (subject to other statutory requirements). This is because section 89C(k) permits the Commissioner to amend assessments in such cases without first issuing notices of proposed adjustment.

Principles

30. In summary, the Commissioner will amend assessments to ensure their correctness, subject to resources being available and in accordance with the following principles:

    (a) The relevant case law indicates that the Commissioner is not required to, either consider whether genuine errors have occurred, or subsequently to amend the assessments. That is, the Commissioner may not consider all amendment requests once they are identified.

    (b) The Commissioner must take into account all relevant factors when considering amendment requests. (Please see paragraphs 23 to 27 of this SPS for a discussion of the care and management considerations). Once the amendment requests are identified, the Commissioner will initially examine them to ascertain all the relevant factors that may affect the decision to investigate claims that assessments are in error and to amend the assessments. For example, the length of time that has passed since the errors were made may be a relevant factor, as it may become more difficult to independently verify the matters included in the taxpayers' requests. However, this will not necessarily determine whether or not the Commissioner will amend the assessments.

    (c) The facts and tax laws relating to the genuine errors must be clear and unambiguous. The Commissioner will not contemplate the use of section 113 in respect of complex unresolved issues (for example, issues that are currently being heard by a hearing authority or covered only by proposed new legislation, which is yet to be passed by Parliament).

    (d) When statutory interpretation is at issue (that is, due to disagreement about the meaning of the law), the Commissioner does not consider it appropriate to amend assessments. Disputed statutory interpretation should properly be considered in the disputes resolution process.

    (e) When amending assessments under section 113, the Commissioner must be satisfied that the amendments will ensure the correctness of those assessments taking into account the relevant legislative scheme and case law.

    (f) The onus is on taxpayers to provide all relevant information with amendment requests. This will enable the Commissioner

to verify the genuine error by considering the merits of the amendment request.

(g) Amendment requests that would require disproportionate amounts of the Commissioner's resources to resolve will not generally be accepted. If the resources needed to amend assessments considerably exceed the monetary value of the requested amendments, the Commissioner will not usually amend the assessments. Similarly, amendment requests that relate to very small amounts of tax, or are vexatious or fraudulent in nature given the resources likely to be required, will not usually be considered.

(h) If the Commissioner is persuaded that the taxpayers made the genuine errors as a direct result of relying on advice given to them by Inland Revenue officers, favourable consideration will be given to the exercise of the discretion. Taxpayers should, however, note their obligation to take care in interpreting advice, especially in respect of statements not directed at them.

(i) Where taxpayers request the Commissioner to change assessments from one valid option to another, there is no genuine error to correct. This is a matter of regretted choice, such as where taxpayers choose one of several legitimate options for the calculation of a tax liability and later request that option be changed (please see paragraphs 37 and 38). If, however, the taxpayers can show that their tax returns simply erroneously recorded their original intended choice under tax laws, the Commissioner may further consider the amendment requests.

(j) The Commissioner will not amend assessments while any item of those assessments remains the subject of a current dispute under Part IVA.

(k) Generally, incorrect tax positions arising from arithmetical, transposition and other types of obvious errors that are clear and easily verified by Inland Revenue will be corrected subject to the limitations set out in this SPS.

(l) At times, an investigation commenced by Inland Revenue may indicate that following proposed or agreed adjustments there should be consequential changes made to the taxpayers' other tax periods (or to other taxpayers' tax periods as a result of the relevant transactions). In this circumstance, the Commissioner will also make consequential amendments pursuant to section 113 after the conclusion of the disputes resolution process and subject to taxpayers not commencing challenge proceedings in a hearing authority to:

(i) the taxpayers' other incorrect tax periods pursuant to section 89C(c), and

(ii) other taxpayers' incorrect tax positions that are taken as a result of the first-mentioned taxpayers' incorrect tax positions, in accordance with section 89C(k).

(m) Although the Commissioner does not have an absolute obligation to amend assessments that contain genuine errors, the Commissioner will do so after verifying the errors, unless overriding policy grounds exist that would lead to inconsistency with the Commissioner's obligations under sections 6 and 6A.

(n) Amendments will be made unless they are subject to any time limitations imposed pursuant to the Inland Revenue Acts referred to in this SPS.

Standard Practice

31. The following standard practice has been developed from the principles set out in paragraph 30.

Taxpayers' amendment requests

32. Taxpayers or their agents making amendment requests must supply the Commissioner with all relevant information to substantiate the claim. The amendment request and this information must be provided in writing and should include:

(a) the tax types and periods containing the errors,

(b) the amount of tax in error,

(c) a description of the errors including the background circumstances and the reasons for their occurrence,

(d) the nature of the errors, including any relevant tax laws,

(e) how and why the errors were identified,

(f) where relevant details of any incorrect advice given directly to the taxpayers by Inland Revenue and how the taxpayers relied on that advice,

(g) the action required to ensure correctness, and

(h) all other relevant documents and records supporting the amendment requests.

Amended tax returns

33. Taxpayers cannot, by law, correct errors in their self-assessments by simply filing "amended tax returns". However, amended tax calculations (for example, in a copy of an amended tax return) with

supporting information will be considered pursuant to section 113.

Considering amendment requests

34. The Commissioner must first determine the extent to which the amendment requests will be considered. Generally, the Commissioner will consider amendment requests if the information supplied is clear and the principles set out in paragraph 30 are satisfied.

35. When considering amendment requests, the Commissioner must take into account all relevant factors and merits on a case-by-case basis. These may include:

    (a) the reasons for the errors,

    (b) the amount of time which has passed since the errors were made,

    (c) the resources required or difficulty faced by the Commissioner in verifying the errors, and

    (d) the relative importance or amount of the amendments sought.

    If the amendment requests need further clarification, the Commissioner may either decline to consider them or ask for additional information from the taxpayers or their agents to verify the amendment requests.

36. In relation to arithmetical or transposition errors that are clear and result in incorrect tax positions, except for the application of the statutory time limitations, the length of time that has passed since the errors were made will not be a determining factor for exercising the discretion under section 113.

37. If the taxpayers show that their tax returns simply incorrectly recorded their decisions under tax laws, the Commissioner would generally amend the assessments. For example, the taxpayer makes a transposition error in their 2006 income tax return after documenting a decision to allocate 40% of research and development (R & D) expenditure to their 2006 income year pursuant to section EJ 21 of the ITA 2004. The final deduction claimed did not reflect the 40% intended to be claimed. Thus, the tax position taken was incorrect. The Commissioner would amend the assessment under section 113 to correct the transposition error if the taxpayer provides accounting or business records that substantiate the taxpayer's intention to allocate 40% of the deduction to the 2006 tax year.

38. However, the Commissioner cannot exercise the discretion under section 113 if the amendment requests involve matters of regretted choice. For example, as in paragraph 37, a taxpayer seeks to deduct R & D expenditure incurred in the 2006 tax year pursuant to section DB 26 of the ITA 2004. The taxpayer has elected to allocate 40% of the allowable deduction in their 2006 income tax return pursuant to section EJ 21 of the ITA 2004. They have documented their decision and a notice of assessment has been issued reflecting that decision. The taxpayer later decides that they would like to allocate 60% of the allowable deduction to the 2006 tax year and requests that the assessment be amended pursuant to section 113. In this circumstance, the Commissioner cannot amend the taxpayer's request because it involves a matter of regretted choice and is not a genuine error.

Amending assessments

39. After considering amendment requests, the Commissioner may amend assessments to ensure their correctness provided the following criteria are met:

    (a) the amendment requests are clear, that is, the errors are identified clearly, both factually and legally,

    (b) the taxpayers have provided all relevant information to ensure that the Commissioner can make correct assessments,

    (c) the Commissioner has verified the errors as genuine,

    (d) the amendments are to be made within the relevant time limits (please see paragraphs 55 to 62), and

    (e) none of the other limitations apply (please see paragraphs to 49 to 54).

40. If, after considering all the relevant information and submissions, the Commissioner is not satisfied that genuine errors were made, the Commissioner cannot amend the assessments. For instance, the facts may indicate that the taxpayers adopted particular legitimate options or are relying on legal interpretations with which the Commissioner may disagree.

41. Where such decisions are made, the Commissioner will advise the taxpayers or their agents of the decisions in writing and the reasons for the decisions.

42. When amending assessments the Commissioner will ensure that all consequential adjustments to other tax types and/or periods (and taxpayers' assessments) are included once they are confirmed by the affected taxpayers. However, in some cases the Commissioner may require further information from the taxpayers before making such consequential amendments.

43. Where the Commissioner is already investigating the tax type and period to which the amendment requests relate, the amendment requests will be considered as part of that investigation.

Investigations and consequential amendments

44. Inland Revenue undertakes various types of investigation activities. For the purpose of this SPS, an investigation means any examination of taxpayers' financial affairs to verify that they have paid the correct amount of tax and complied with their tax obligations as required by the law.

45. Irrespective of whether there is a current dispute, if the period and tax type relating to the amendment requests are already under investigation, the Commissioner will make any appropriate consequential amendments. That is, if the Commissioner is already devoting resources to verify the correctness of assessments, all reasonable consequential effects of the investigation will be considered (including the amendment requests) as part of that process.

46. The Commissioner may make any consequential adjustments (that is, not requested by the taxpayers under investigation) to the taxpayers' other assessments or to other taxpayers affected by adjustments resulting from the investigation. The consequential amendments could relate to the same or different tax types. For example, a taxpayer mistakenly claims incorrect GST input tax deductions for an exempt supply. This is discovered after a routine Inland Revenue investigation. The Commissioner amends the GST assessment following agreement by the taxpayer and also makes a consequential amendment to the taxpayer's corresponding income tax assessment to reflect the disallowed expenditure.

47. If, after following the standard practice set out in this SPS, the Commissioner agrees with the amendment requests, then subject to the limitations set out below, the amendments will be incorporated into the amended assessments arising from the investigation. The Commissioner cannot amend the assessments to reflect the amendment requests before finalising the position in relation to the other issues arising from the investigation. The amendments will be treated the same as any other agreed adjustments arising out of the investigation.

48. Finally, please see the comments in paragraph 52 in relation to the effect of a decision by Inland Revenue's Adjudications Unit (an adjudication decision) arising in the course of a dispute.

Limitations on the exercise of the discretion to amend assessments

49. In accordance with the obligations under sections 6 and 6A and the limitations set out in this SPS, the Commissioner will correct genuine errors once verified by Inland Revenue officers.

50. The following may act as general limitations on the exercise of the Commissioner's discretion to amend assessments.

Amendment requests following court and adjudication decisions

51. When taxpayers request assessment amendments to reflect court decisions affecting themselves or other taxpayers, the Commissioner will not necessarily amend the assessments. However, when exercising the discretion under section 113, the Commissioner will consider all relevant factors including whether:

    (a) the taxpayers have consistently asserted that they are entitled to take tax positions reflecting the court decisions,

    (b) the taxpayers have been associated with claims or actions against Inland Revenue on issues relevant to the requests,

    (c) Inland Revenue has advised the taxpayers that the outcome of a particular issue would apply to them, and

    (d) Inland Revenue has previously advised the taxpayers directly in relation to particular matters and the taxpayers have acted on that advice, which has later proved to be incorrect.

52. Where the Commissioner has issued assessments to taxpayers after commencing a dispute but prior to determination of the issue by adjudication, and the Adjudication Unit has subsequently reached conclusions on another period or periods, the Commissioner will apply those conclusions and amend any assessed periods where:

    (a) the dispute is in relation to the same issue, and/or

    (b) the Adjudication Unit has determined the issue in favour of the taxpayers.

    However, this approach is subject to no:

    (a) material factual differences existing between the periods in question, and

    (b) special circumstances existing such that an adjustment would be inconsistent with the Commissioner's obligations under sections 6 and 6A. For example, where the Adjudication Unit holds that the assessment should be increased but the Commissioner cannot refund the resulting overpaid income tax because of the time restriction arising from section MD 1(1) of the ITA 2004.

Amendment requests following a change in the Commissioner's practice

53. Generally, the Commissioner will not amend assessments where taxpayers have made amendment requests because of a change in the Commissioner's practice in administering the tax laws. This is because the Commissioner does not usually backdate the application of changes in

practice. However, where the Commissioner does backdate the change in practice in a concessionary way, the application of the new practice will be made clear to the taxpayers.

Current dispute

54. When the amendment requests are the subject of a current dispute under Part IVA, the Commissioner will not amend the assessments unless they are to reflect agreed adjustments and there are no other disputed issues in the period to which the agreed adjustments relate.

Time limits on increasing assessments

55. Further to the limitations set out above, the Commissioner cannot increase previously assessed amounts:

    (a) Pursuant to section 108, in respect of income tax if four years have elapsed from the end of the tax year when the income tax returns were provided unless the Commissioner considers those tax returns:

        (i) are fraudulent or misleading, or

        (ii) omit income for which tax returns must be provided:

            (A) that is of a particular nature, or

            (B) was derived from a particular source, and/or

    (b) Pursuant to section 108A, in respect of GST if four years have elapsed from the end of the GST return period in which the GST returns were provided, unless the Commissioner considers that the taxpayers have knowingly or fraudulently failed to disclose all of the material facts needed to determine the amount of GST payable for a GST return period.

Time limits on income tax refunds

56. Pursuant to section MD 1(1) of the ITA 1994 and the ITA 2004, the Commissioner cannot refund amounts of overpaid income tax including amounts arising from amendments made under section 113 in the following circumstances:

    (a) For assessments relating to the 2004-2005 and later tax years, Inland Revenue cannot refund amounts of overpaid tax if four years have elapsed from the end of the tax year in which the taxpayers provided the tax returns. However, this four-year refund limitation period may be extended to eight years if the refunds arise as a result of:

        (i) a "clear mistake or simple oversight" by the taxpayers, or

        (ii) the taxpayers' entitlement to a rebate of income tax under subpart KD of the ITA 2004,

        and Inland Revenue receives any refund request from or on behalf of the taxpayers before, or within four years following, the end of the initial four-year limitation period.

    (b) For assessments relating to tax returns before the 2004-2005 tax year, Inland Revenue cannot refund amounts of overpaid tax if eight years have elapsed from the end of the income year in which the original assessments were made.

Time limits on GST refunds

57. Pursuant to section 45(1) of the GST Act, the Commissioner cannot refund amounts of overpaid GST for taxable periods beginning on or after 1 April 2005 in the following circumstances:

    (a) if the Commissioner is satisfied that the amounts of tax paid exceed the amounts properly payable and four years have elapsed from the end of the taxable periods to which the assessments relate.

    (b) in respect of refunds pursuant to sections 19C(8), 20(5) or 46 of the GST Act, if the Commissioner is satisfied that the taxpayers did not receive refund amounts that they were clearly entitled to receive and four years have elapsed from the end of the year in which the refunds were made.

58. However, pursuant to section 45(4), the Commissioner may refund GST overpayments within four years of the end of the initial four-year limitation period if:

    (a) the GST overpayments arise from a "clear mistake or simple oversight" by the taxpayers, and

    (b) the Commissioner:

        (i) refunds the GST overpayment within four years of the end of the initial four-year limitation period, or

        (ii) receives refund requests from or on behalf of the taxpayers during the four-year limitation period referred to in paragraph 57(b) or within four years of the end of that period.

59. For taxable periods beginning before 1 April 2005, refunds for overpaid GST cannot be made if eight years have elapsed from the end of the taxable periods to which the assessments relate unless the taxpayers request the refunds in writing before the end of the eight-year period.

Amended assessments after expiry of the four-year time limit for increasing assessments

60. When taxpayers request assessment reductions ("credit adjustments") after the four-year limitation period for increasing assessments has elapsed, the Commissioner in considering the amendment requests will incorporate any adjustments that would have definitely been made to increase the assessments ("debit adjustments") but for the application of the four-year time limit. This will ensure the correctness of the assessments.

61. If the debit adjustments that the Commissioner would have made do not exceed the credit adjustments requested by the taxpayers, the Commissioner will reduce any credit adjustments by the amount of the debit adjustments.

62. The Commissioner cannot increase assessments outside the four-year time limit through offsetting the debit adjustments that would have definitely been made with the credit adjustments requested by the taxpayers. However, if the Commissioner is not satisfied that amending the assessments will ensure their correctness they will not be amended as requested.

General

Fresh or increased liability

63. Pursuant to section 113(2) if any assessment amendments impose fresh or increase existing liabilities the Commissioner will give written notice to the affected taxpayers.

Shortfall penalties

64. Where amendment requests (for example, by way of voluntary disclosures) impose fresh liabilities or increase existing liabilities, taxpayers may also be liable to shortfall penalties.

65. For further information about the assessment of shortfall penalties, please see the following current Interpretation Statements and any subsequently issued in replacement:

    (a) *Shortfall penalty for not taking reasonable care*, (in *Tax Information Bulletin* Vol 17, No 9 (November 2005)),

    (b) *Shortfall penalty - unacceptable interpretation and unacceptable tax position*, (in *Tax Information Bulletin* Vol l7, No 9 (November 2005)),

    (c) *Shortfall penalty for gross carelessness*, (in *Tax Information Bulletin* Vol 16, No 8 (September 2004)),

    (d) *Shortfall penalty for taking an abusive tax position*, (in *Tax Information Bulletin*n Vol 18, No 1 (February 2006)), and

    (e) *Shortfall penalty for evasion* (in *Tax Information Bulletin* Vol 18, No 11 (December 2006)).

66. Please also see *SPS 06/01 Discretion to cancel or not assess shortfall penalties for taking an unacceptable tax position* regarding the exercise of the Commissioner's discretion to not impose shortfall penalties for taking an unacceptable tax position and any SPS subsequently issued in replacement.

67. Taxpayers that make amendment requests resulting in debit adjustments will be eligible for voluntary disclosure reductions of any applicable shortfall penalties if the amendment requests meet the requirements under section 141G. Please see SPS *INV-251 Voluntary Disclosures* and any SPS subsequently issued in replacement for further details on the reduction of shortfall penalties for voluntary disclosures.

68. Furthermore, any applicable shortfall penalties will be further reduced by 50% for previous behaviour pursuant to section 141FB if the taxpayers are not:

    (a) convicted of a disqualifying offence (please see section 141FB(3)), and/or

    (b) liable for a disqualifying penalty (please see section 141FB(3)).

    Please see SPS 06/03 *Reduction of shortfall penalties for previous behaviour* and any SPS subsequently issued in replacement for further details.

No rights to challenge exercise of the discretion

69. Please note that pursuant to section 138E(1)(e)(iv) taxpayers cannot challenge the exercise of the Commissioner's discretion under section 113 by commencing proceedings in a hearing authority. However, the exercise of this discretion may be subject to judicial review.

This Standard Practice Statement is signed on 17 May 2007

Graham Tubb
Group Tax Counsel

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.

IS 07/01 GST TREATMENT OF SALE OF LONG-TERM RESIDENTIAL RENTAL PROPERTIES

This interpretation statement replaces public ruling BR Pub 97/12, which was published as "Sale of long-term residential properties—GST implications" *Tax Information Bulletin* Vol 9, No 13 (December 1997), and applied until 31 March 2001.

Summary

1. All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

2. Under section 14(1)(d) the following supplies are exempt from GST.

   - The sale, in the course or furtherance of a taxable activity, of a property used by the supplier for the purpose of providing residential accommodation by way of rental, service occupancy agreement or licence ("residential rental purposes"), if the property has been used by the supplier exclusively for that purpose for a period of not less than five years up to the date of sale.

   - The sale in the course or furtherance of a taxable activity of a reversionary interest in land that has been leased by the supplier for the principal purpose of residential accommodation by way of rental, service occupancy agreement or licence in a dwelling erected on that land, if the land has been used by the supplier exclusively for that purpose for a period of not less than five years up to the date of sale.

3. As section 14(1)(d) applies only to sales made in the course or furtherance of a taxable activity carried on by the vendor of the property, if the sale is not made in the course or furtherance of a taxable activity, it is not necessary to consider whether section 14(1)(d) could apply to exempt the sale from GST.

4. Section 14(1)(d) will not apply to the sale of a property acquired for the principal purpose of a taxable activity of property development where the principal purpose in respect of the property remains unchanged and the principal purpose continues to be the ultimate sale of the property. In such circumstances, the property would continue to be used for a property development activity, in the sense that the owner obtains an advantage from retaining the property for sale in carrying on that activity. That being the case, the property would not be used exclusively for residential rental purposes and section 14(1)(d) would not apply to exempt the sale of the property. This is so even though on a time and space basis 100 percent of the property has been used for residential rental purposes for a period of five years before the sale of the property.

5. For section 14(1)(d) to apply, the *vendor* must have used the property exclusively for residential rental purposes for not less than five years up to the date of sale. It would not be sufficient that the property had been rented out for that period by different owners. However, the property need not be occupied by the same tenant throughout the five-year period.

6. For the purpose of calculating the five-year period, a property will continue to be used for residential rental purposes even if it was vacant for periods during the five years while attempts were made to rent out the property as residential accommodation: *Schwerzerhof v Wilkins* [1898] 1 QB 640.

Background

7. Generally, the sale of a residential rental property (a property that has been used for residential rental purposes) is not subject to GST. This is because the provision of residential accommodation under any such arrangement is exempt from GST; therefore, the sale of a residential rental property is not in the course or furtherance of a taxable activity. However, in some circumstances a residential rental property may be sold by a registered person in the course or furtherance of a taxable activity. This will occur if the sales are on a sufficient scale as to be continuous and regular, and do not form part of the winding down or cessation of the exempt

activity. When a registered person ("the vendor") sells a residential rental property in the course or furtherance of a taxable activity, GST is chargeable on the sale of the property unless section 14(1)(d) applies to exempt the sale from GST.

8. Public ruling BR Pub 97/12 was published as "Sale of long-term residential properties—GST implications" *Tax Information Bulletin* Vol 9, No 13 (December 1997). That ruling applied up to 31 March 2001. It is not intended to reissue the ruling as it is considered that an interpretation statement setting out general principles relating to the interpretation of section 14(1)(d) is more useful.

9. This interpretation statement concerns the following aspects of the interpretation of section 14(1)(d).

- The requirement that the sale be made in the course or furtherance of a taxable activity.
- What constitutes exclusive use for residential rental purposes.

Legislation

10. Section 8(1) provides:

> Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 12.5 percent on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after the 1st day of October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

11. Sections 6(1), 6(2) and 6(3)(d) provide:

> (1) For the purposes of this Act, the term taxable activity means—
>
> (a) Any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:
>
> (b) Without limiting the generality of paragraph (a) of this subsection, the activities of any public authority or any local authority.
>
> (2) Anything done in connection with the beginning or ending, including a premature ending, of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity.
>
> (3) Notwithstanding anything in subsections (1) and (2) of this section, for the purposes of this Act the term "taxable activity" shall not include, in relation to any person,—
>
> ….
>
> (d) Any activity to the extent to which the activity involves the making of exempt supplies.

12. Sections 14(1)(c), (ca) and (d) provide:

> The following supplies of goods and services shall be exempt from tax:
>
> …
>
> (c) The supply of accommodation in any dwelling by way of—
>
> (i) Hire; or
> (ii) A service occupancy agreement; or
> (iii) A licence to occupy:
>
> (ca) The supply of leasehold land by way of rental (not being a grant or sale of the lease of that land) to the extent that that land is used for the principal purpose of accommodation in a dwelling erected on that land:
>
> …
>
> (d) The supply, being a sale, by any registered person in the course or furtherance of any taxable activity of—
>
> (i) Any dwelling; or
> (ii) The reversionary interest in the fee simple estate of any leasehold land,—
>
> that has been used by the registered person for a period of 5 years or more before the date of the supply exclusively for the making of any supply or supplies referred to in paragraph (c) or paragraph (ca) of this section:

Analysis

13. For section 14(1)(d) to apply the following criteria must be satisfied.

- The supply must be by way of sale.
- The supply must be by a registered person in the course or furtherance of any taxable activity.
- The property must have been used for the purpose of supplying residential accommodation by way of hire, service occupancy agreement or licence.
- The property must have been used exclusively for that purpose.
- The vendor must have used the property for that purpose for a period of not less than five years up to the date of sale.

"Supply in the course or furtherance of a taxable activity"

14. Section 14(1)(d) exempts from GST supplies that would otherwise be subject to GST. GST is chargeable on the supply of goods or services (other

than an exempt supply) by a registered person in the course or furtherance of a taxable activity carried on by that person: section 8(1). An "exempt supply" is a supply that is exempt from tax pursuant to section 14: section 2(1). A taxable activity is an activity that is "carried on continuously or regularly" and involves, or is intended to involve, the supply of goods or services for a consideration: section 6(1). However, "any activity to the extent to which it involves the making of exempt supplies" is not a taxable activity: section 6(3)(d).

15. In *CIR v Databank Systems Ltd* (1989) 11 NZTC 6,093 Richardson J suggested that one of the reasons for the express exclusion of exempt supplies in section 8(1) may have been to make it clear that a supply to which section 14 applied would not be subject to GST, even if it was made in the course or furtherance of a taxable activity.

16. To the extent that an activity involves the making of exempt supplies, it is not a taxable activity: *see Databank* p. 6,103). Therefore, if the sale of a property were made as part of an activity involving the making of exempt supplies, it would not be made in the course or furtherance of a taxable activity.

17. These principles are illustrated by *Case S36* (1995) 17 NZTC 7,237. The taxpayers in *Case S36* had purchased several residential properties for leasing as rental properties as part of their retirement plan, but were forced to sell the properties due to financial difficulties. The Taxation Review Authority ("TRA") found on the facts that the property sales were made in order to wind up an exempt activity and that, therefore, the sales were not made in the course or furtherance of a taxable activity. The TRA accepted that the sale of 20 properties over a two-and-a-half-year period was a continuous or regular activity, but considered the sales were excluded from the scope of the definition of "taxable activity" by section 6(3)(d). The sales were part of the exempt activity of the supply of residential rental accommodation being the winding down or cessation of that activity. The TRA did not accept that the sales constituted a separate activity of property development or dealing.

18. The assumption on which section 14(1)(d) is based is that the sale of rental properties by a residential landlord could constitute a taxable activity if the sales were on a sufficient scale. Section 14(1)(d) was enacted to make it clear that the sale of properties used for residential rental purposes by the Housing Corporation (now Housing New Zealand Ltd), which may regularly sell rental properties to its tenants (or otherwise), would be exempt from GST. This achieves symmetry of treatment, as input tax credits would not have been allowed in respect of the acquisition of such properties. There could also be other "large-scale" residential landlords to whom section 14(1)(d) potentially applies.

19. Therefore, a sale of a residential property is not chargeable with GST if either of the following circumstances applied:

- Although the sale is in the course or furtherance of a taxable activity, the sale is an exempt supply under section 14(1)(d) because the property has been used by the supplier exclusively for the purpose of residential rental for not less than five years.
- The sale is not made by a registered person in the course or furtherance of a taxable activity (for example, the sale is in the course or furtherance of an activity involving the making of exempt supplies). (In those circumstances, it is not necessary to consider whether section 14(1)(d) applies.)

20. Section 14(1)(d) refers to a supply by a registered person in the course or furtherance of a taxable activity, but goes on to provide for a situation where the supply will be treated as exempt (that is, the sale of a property that has been used exclusively for the supply of residential accommodation by way of hire for not less than five years before the date of the sale). Therefore, it is necessary to consider whether section 14(1)(d) applies only if the supplier is a registered person who carries on a taxable activity and the supply is made in the course or furtherance of that taxable activity.

21. Whether section 14(1)(d) applies to the sale of a property made by a registered person in the course or furtherance of a taxable activity, depends on whether the property is a dwelling that has been used exclusively for the purpose of the supply of residential accommodation by way of hire for the required five-year period.

Meaning of "used ... exclusively"

22. "Use" has a wide meaning. Its primary meanings are:

- To employ or make use of for a particular aim or purpose;
- To use up or consume.

See *Thornton Estates Ltd v CIR* (1998) 18 NZTC 13,577 (CA).

23. In *Thornton* the taxpayer argued that "used" in the context of section 104A meant "employed, applied, committed or dedicated"; therefore, land held by a property developer at balance date had been used in the production of assessable income as the land had been employed in, and dedicated to, a subdivision development during the income year in which the land was acquired. This argument was rejected. The Court of Appeal considered that in the context of section 104A "not used" meant "not used up". The court noted that the statutory definition of "unexpired portion" referred to that

which is left and considered that this interpretation was confirmed by the purpose of section 104A (to achieve a closer matching between the timing of deductions and the recognition of income for income tax purposes).

24. The Commissioner considers that in the context of section 14(1)(d) "used" means "employed for a particular purpose"—in this case, residential rental purposes. The issue in respect of section 14(1)(d) is how a property has been used during the period of five years up to the date of sale, rather than whether the property had been used at a particular point in time (as under section 104A).

25. A property may be used (employed) in a variety of ways. In *Sloss v Sloss* [1989] 3 NZLR 31, 36 Richardson J said:

> The physical occupation of property is clearly a use of that property. In its ordinary meaning, "uses" is not, however, confined in that way. In its natural meaning it is a word of wide import. The *Shorter Oxford English Dictionary* gives as the first meaning, "[the] act of using or fact of being used", and amongst the more detailed definitions is, "utilisation or employment for or with some aim or purpose". The owner of land may be said to use the land when, without doing anything on that land, he obtains advantages from the land (*Newcastle CC v Royal Newcastle Hospital* [1959] AC 248, 255), and in *R v Heyworth* (1866) 14 LT 600, 601, Lush J observed that: "The owner 'uses' the place [a slaughter house] by letting it out". Even the giving away of property may be a "use" of that property (*R v Wampole* (Henry K) & Co [1931] 3 DLR 754).

26. Therefore, the following is the case.

- A property may be said to be "used" by the owner when it is physically occupied by the owner.
- A property would also be used when it is rented out by the owner.
- A property could be said to be used by the owner when the owner obtains some advantage from the property without doing anything to it. In Sloss Casey J observed that:

> "Use" can attract many shades of meaning in the various contexts in which it appears, but one of its primary definitions in the Shorter Oxford English Dictionary relevant to the present inquiry is "employment for or with some aim or purpose". The degree of involvement by the user must vary according to the nature of the particular object. In an ordinary domestic situation, the ability of both spouses to exercise direct physical advantage or control will usually establish whether it is for their common use and benefit,—eg a holiday cottage or the family car. **But other assets may not be capable of such a physical relationship, and this is the case with the commercial property here. Its functions were to generate income and serve (hopefully) as an appreciating asset …. Those functions make up its "use" to its owner. (p. 44)**[Emphasis added]

In *Newcastle City Council v Royal Newcastle Hospital* [1959] 1 All ER 734 (PC) Lord Denning said:

> Counsel for the city council submitted that an owner of land could not be said to use the land by leaving it unused; and that was all that had been done here. Their Lordships cannot accept this view. An owner can use land by keeping it in its virgin state for his own special purposes. An owner of a powder magazine or a rifle range uses the land he has acquired nearby for the purpose of ensuring safety even though he never sets foot on it. The owner of an island uses it for the purposes of a bird sanctuary even though he does nothing on it, except prevent people building there or disturbing the birds. In the same way this hospital gets, and purposely gets, fresh air, peace and quiet, which are no mean advantages to it and its patients. (p. 735)

A property could be used simultaneously in more than one of the ways outlined above.

27. The definition of "exclusive" in the *Concise Oxford Dictionary* reads as follows.

> 1 excluding other things
> 2 … excluding all but what is specified

28. Therefore, for section 14(1)(d) to apply, the property must have been used for residential rental purposes and for no other purpose for the required period.

What constitutes exclusive use for residential rental purposes?

29. A property that has been rented out for residential rental purposes has clearly been used for that purpose. However, the property could at the same time be used for the purpose of property development (in the sense that an advantage is obtained for the purpose of the property development activity by having the property available for sale as part of the property development activity at that time or in the future). This view is supported by *CIR v Lundy* (2005) 22 NZTC 19,637 (HC); (2005) 22 NZTC 19,637 (CA), which concerned property developers who had acquired properties for sale and had rented out the properties for residential purposes pending sale. The High Court had held that the principal purpose did not change while the properties were rented. It was accepted that the properties had been applied for a non-taxable purpose, and that, therefore, an adjustment under section 21(1) was required. In discussing whether periodic or one-off adjustments were required, the Court of Appeal made the following comments:

> [41] Periodic adjustments, on the other hand, may be suitable where the use for non-taxable purposes is variable or where it is temporary and coincides with continued use in a taxable activity. In the latter case, one-off adjustments may be difficult to calculate and unfairly large where assets are of any size. **In this case, the taxpayers' principal purpose of the sale of the properties in the course of their taxable activities subsisted. The properties were therefore at all times being used for that taxable purpose. They were part of the taxpayers' trading stock and, indeed, remained on the market at all times. At the same time, they were let for residential purposes, but on a temporary basis.** Periodic adjustments were therefore appropriate. [Emphasis added]

30. In considering the amount of the adjustments required under section 21, the court said:

> [43] The above exercise spreads only the cost of the land and buildings between periods, however. **There still needs to be an apportionment between taxable and non-taxable uses in the particular period. This creates conceptual difficulties because it is not possible to separate out the use of the properties on any time or space basis. In terms of both time and space the properties in this case are 100% dedicated to use for both purposes—see the discussion at [41] above.** There must be an apportionment, however. Apportioning the depreciation on the buildings (but not the land) would be a possible (if somewhat rough and ready) means of recognising both uses. This is what the taxpayers did in this case. This was a reasonable allocation method and thus within the scope of the legislation. [Emphasis added]

31. Section 14(1)(d) contains the word "used", while section 21(1) refers to goods or services that a person applies for a purpose other than that of making taxable supplies. The "term "applied" has a wider meaning than "used": *Case N2* (1991) 13 NZTC 3,187. For a property to be "applied" for a particular purpose, it is not necessary that the property be "used" for that purpose, although some overt act on the part of the taxpayer would be required to demonstrate that the property had been so applied. "Applied" has the flavour of allocation for a particular use. The *Concise Oxford Dictionary* definition of "apply" includes "to devote". In this context it is not necessary to draw a distinction between "applied" in section 21(1) and "used" in section 14(1)(1)(d). The use of a property for a particular purpose would normally indicate that the property had been applied for that purpose. If a property has been applied for residential rental purposes, it is also used for residential rental purposes.

32. In *Lundy* the principal purpose in respect of the properties continued to be property development. The properties were part of the taxpayer's trading stock and were on the market at all times. The Court of Appeal considered that the properties were both used and applied for taxable and non-taxable purposes. Although the court in *Lundy* did not directly consider the meaning of "use", the discussion in *Lundy* makes it clear that the court considered the properties were used for taxable purposes as the principal purpose of sale in the course of the taxpayer's taxable activities subsisted (paragraph 41). At the same time the properties were used 100 percent on a time and space basis for residential rental purposes.

33. *Lundy* supports the view that when the principal purpose in respect of a property remains unchanged and the principal purpose in respect of the property continues to be the ultimate sale of the property, the property continues to be used for that activity. That being the case, the property would not be used exclusively for residential rental purposes. This would be so although the property was used 100 percent on a time and space basis for residential rental purposes. These uses are not incompatible. The Commissioner notes that rather than excluding the use of a property for a property development activity, the rental of the property pending sale could actually facilitate and promote the use of the property for the property development activity (by reducing holding costs or by enhancing sale prospects): *Case S81* (1996) 17 NZTC 7,505; *CIR v Lundy* (2004) 21 NZTC 18,595 (HC).

34. Therefore, section 14(1)(d) will not apply to the sale of a property acquired for the principal purpose of a taxable activity of property development, where the principal purpose in respect of the property remains unchanged and the principal purpose continues to be the ultimate sale of the property. In those circumstances, the property would be used for the property development activity, although on a time and space basis 100 percent of the property may also have been used for the purpose of rental for residential accommodation.

35. This interpretation is consistent with the policy objective underlying section 14(1)(d), which is to ensure symmetry of treatment of properties acquired for the principal purpose of providing residential rental accommodation. An input tax credit would not be available on the purchase of such properties. The effect of section 14(1)(d) is that the sale of the properties is not subject to GST in circumstances where the sale of the properties would otherwise be regarded as a taxable supply (being a supply made by a registered person in the course or furtherance of a taxable activity).

Section 14(1)(d) was not intended to exempt the sale of a property in respect of which the vendor had obtained an input tax credit.

36. The *vendor* must have used the property for residential rental purposes for not less than five years up to the date of the sale. It would not be sufficient that the property has been rented out for residential accommodation for a minimum of five years by different owners. However, section 14(1)(d) does not require that the property be occupied by the same tenant throughout the five-year period. Section 14(1)(d) refers to the use of the property by the person selling the property.

37. Section 14(1)(d)(i) could apply even if the property were vacant for periods during the five years while attempts are made to obtain a tenant for the property. In *Schwerzerhof v Wilkins* [1898] 1 QB 640 it was held that premises were used as a bakehouse, although actually vacant, during a period when the owner continued to make attempts to let out the property. That case concerned a provision that permitted an underground place to be used as a bakehouse if it was so used at the commencement of the relevant Act. The premises in question had long been used as a bakehouse, but were vacant at the commencement of the Act. The premises were vacant for a period of five months, during which time the premises were repaired. While the repair work was in progress the owner advertised the premises for lease. The new tenant began to use the premises as a bakehouse immediately and continued to do so. The court considered that the premises were used as a bakehouse at the commencement of the Act. Therefore, if the vendor has continued to be actively engaged in attempting to rent out a property for residential purposes, the property will continue to be used for residential rental purposes for the purposes of section 14(1)(d).

LEGISLATION AND DETERMINATIONS

This section of the TIB covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

CPI ADJUSTMENT 07/01 FOR DETERMINATION DET-001: *STANDARD-COST HOUSEHOLD SERVICE FOR CHILDCARE PROVIDERS*

In accordance with the provisions of Determination DET-001, as published in *Tax Information Bulletin* Vol 16, No 4 (May 2004), Inland Revenue advises that, for the 2007 income year:

(a) the *variable standard-cost* component has increased from $2.83 to $2.90 per hour per child; and

(b) the *administration and record keeping fixed standard-cost* component has increased from $276 to $283 per annum, for a full 52 weeks of childcare services provided.

The above amounts have been adjusted in accordance with the annual movement of the All Groups Consumers Price Index for the twelve months to March 2007, which showed an increase of 2.5%. For childcare providers who have a standard 31 March balance date, the new amounts apply for the period from 1 April 2006 to 31 March 2007.

CPI ADJUSTMENT – CPI 07/02 FOR DETERMINATION DET-05/03: *STANDARD-COST HOUSEHOLD SERVICE FOR BOARDING SERVICE PROVIDERS*

In accordance with the provisions of Determination DET-05/03, as published in *Tax Information Bulletin* Vol 17, No 10 (December 2005), Inland Revenue advises that the *weekly standard-cost* component for the 2007 income year, is retrospectively adjusted as follows:

(a) The *weekly standard-cost* for one to two boarders will increase from $207 each to $213 each.

(b) The *weekly standard-cost* for third and subsequent number of boarders will increase from $168 each to $173 each.

The above amounts have been adjusted in accordance with the annual movement of the All Groups Consumers Price Index for the twelve months to March 2007, which showed an increase of 2.5%. For boarding service providers who have a standard 31 March balance date, the new amounts apply for the period from 1 April 2006 to 31 March 2007.

NEW LEGISLATION

STUDENT LOAN SCHEME AMENDMENT ACT 2007

The Student Loan Scheme Amendment Bill (No 2) was introduced into Parliament on 13 November 2006. It received its first reading on 16 November 2006, its second reading on 20 March 2007 and the third reading on 22 March 2007. The resulting Act received Royal assent on 27 March 2007.

The Student Loan Scheme Amendment Act 2007 amends the Student Loan Scheme Act 1992, the Customs and Excise Act 1996, the Privacy Act 1993, the Tax Administration Act 1994, the Education Act 1989 and Regulations 5 and 6 of the Student Loan Scheme (Interest Rates Formulas) Regulations 2006.

The legislation aims to reduce barriers to student loan borrowers living overseas to return to New Zealand and to ensure that borrowers receive their correct entitlements under the Student Loan Scheme Act 1992.

INFORMATION MATCH BETWEEN CUSTOMS AND INLAND REVENUE

Section 62A of the Student Loan Scheme Act 1992, sections 280G and 280H of the Customs and Excise Act 1996, Schedule 3 of the Privacy Act 1993 and sections 81 and 87 of the Tax Administration Act 1994

Information-matching will be undertaken between Inland Revenue's student loan information and the border-crossing information held by the New Zealand Customs Service to establish borrowers' entitlement to interest-free student loans.

Background

The introduction of interest-free student loans has increased the financial incentive for borrowers not to advise Inland Revenue of their absence overseas. This is because borrowers who are overseas for 184 days or more are generally not eligible for interest-free student loans, while borrowers remaining in New Zealand are eligible. The government therefore agreed to introduce an information match to help Inland Revenue identify which borrowers are eligible for interest-free loans.

Key features

The Student Loan Scheme Act 1992 and the Customs and Excise Act 1996 have been amended to allow an information match of student loan borrower information. The Privacy Act has also being amended to make the information match subject to the rules in Part 10 of that Act.

Inland Revenue will provide Customs with the names, aliases, dates of birth and tax file numbers of student loan borrowers. An information match will occur by Customs comparing the name and date of birth information against any arrival and departure information it holds. If Customs has arrival or departure information relating to any borrower, Customs will supply Inland Revenue with the time and date of arrival or departure for that borrower.

Inland Revenue will use the border-crossing information obtained from Customs to determine whether borrowers are eligible for interest-free student loans.

Inland Revenue will also use border-crossing information to help ascertain whether borrowers are based in New Zealand or overseas and whether they are resident or non-resident.

The Commissioner and the Chief Executive of Customs may enter into an agreement to determine the frequency, form and method for the exchange of information.

Application date

The changes apply on or after 28 March 2007.

INLAND REVENUE'S ACCESS TO CUSTOMS' ARRIVAL AND DEPARTURE INFORMATION

Section 62B of the Student Loan Scheme Act 1992 and sections 280G and 280I of the Customs and Excise Act 1996

Inland Revenue will have ad hoc access to any recording system used by Customs to store arrival or departure information.

Background

Until this change was made, obtaining border-crossing movements of student loan borrowers on an ad hoc basis was a manual process.

Key features

The Chief Executive of Customs will allow authorised Inland Revenue employees to access information stored in any recording system used by Customs to store arrival or departure information.

Inland Revenue will be able to access the recording system only for the purposes of helping determine which borrowers are eligible for the interest write-off that gives effect to interest-free loans, whether borrowers are based in New Zealand or overseas, are resident or non-resident, and whether they are in New Zealand. Inland Revenue will be required to maintain a record of each time the database is accessed to allow appropriate use of the database to be monitored.

Access to Customs' database will allow Inland Revenue to confirm borrowers' arrival and departure dates on an ad hoc basis – for example, if a borrower challenges the date that the information match shows that he or she left New Zealand. This access will eliminate the current manual process.

Application date

The changes apply on or after 28 March 2007.

EXTENDING THE AMNESTY ON STUDENT LOAN PENALTIES

Sections 2 and 89 to 105 of the Student Loan Scheme Act 1992

The amnesty on student loan penalties has been extended until 31 March 2008.

Background

An amnesty on student loan penalties was introduced by the Student Loan Scheme Amendment Act 2005. The amnesty allowed non-resident borrowers in arrears the chance of a fresh start by having their penalties cancelled. The amnesty was introduced to remove barriers to borrowers returning to New Zealand.

Key features

The amnesty on student loan penalties has been extended by one year, until 31 March 2008. This will allow borrowers identified as non-resident as a result of the information match with Customs the chance of a fresh start. The old amnesty provisions (sections 45A to 45D and section 66A of the Act) have been repealed.

Fresh start for certain non-resident borrowers

Under section 90, the Commissioner is not obliged to issue a non-resident repayment obligation for any period before 1 April 2007 if it has not already been made.

Section 91 provides that any existing repayment obligations (whether resident, non-resident, assessed or not assessed) and penalties will be cancelled. The section applies to borrowers who were non-resident for tax purposes on 31 March 2006 and who were in arrears on all or part of a repayment obligation on 1April 2007. However, the amount cancelled is still subject to compounding interest at the applicable rate(s) from the date that the repayments were (or would have been) due, and remains part of the loan balance.

The effect of the amendments is to wipe the penalties slate clean for borrowers who were non-resident on 31 March 2006. For borrowers who were resident on 31 March 2006, but who were non-resident at any time before that date, Inland Revenue will not issue any non-resident assessment if not already made.

Example 1

Lenore has a loan balance on 1 April 2005 of $15,000. Lenore was issued with non-resident assessments of $1,997 for the 2005–06 tax year and $1,919 for the 2006–07 tax year, which she has failed to pay. The 2005–06 assessment ceased to be subject to standard interest (7% for the 2005–06 tax year) and instead became subject to compounding late payment penalties of 2% per month from 1 April 2006. The 2006–07 assessment ceased to become subject to standard interest (6.9% for the 2006–07 tax year) 1 year later on 1 April 2007. Her total late payment penalties on 31 March 2007 are $536 and her loan balance is $17,555. On 1 April 2007 her overdue debt is reduced to zero and her loan balance is reduced by $398 (penalties of $536 less interest of $138 charged in place of penalties) to $17,157.

Example 2

Keith left New Zealand on 31 March 2005 with a loan balance of $20,000. Inland Revenue was not aware that Keith was a non-resident and therefore did not issue non-resident assessments while Keith was overseas. After 1 April 2007, Inland Revenue becomes aware that Keith is non-resident and has been since 1 April 2005. Inland Revenue is not required to make non-resident repayment obligation assessments for tax years before 1 April 2007. Keith has not made any repayments while overseas and his loan balance is $22,877 on 1 April 2007, including compounding interest.

New amnesty

In exchange for not establishing or removing penalties under the "fresh start for certain non-resident borrowers" provisions, borrowers will have the chance to apply to Inland Revenue for the new amnesty and begin making regular payments. Borrowers will have from 1 April 2007 to 31 March 2008 to apply to come within the amnesty.

Who does it apply to?

Section 92 of the Act specifies that the new amnesty applies only to borrowers who were:

- non-resident for tax purposes on 31 March 2006; and
- in arrears on all or part of a repayment obligation on 1 April 2007.

Section 92 also specifies that the accounts of borrowers who had repaid their loans by 13 November 2006 will not be adjusted, although the borrowers concerned might technically have been in arrears.

Meeting repayment requirements

Sections 94 to 98 set out the repayment requirements for borrowers who come within the amnesty. Borrowers must give an undertaking to repay, and actually pay the following amount, to the Commissioner:

- $2,000, if the borrower's loan balance on the date they apply for the amnesty is $15,000 or less;
- $4,000, if the borrower's loan balance on the date they apply for the amnesty is $15,001 to $30,000; or
- $6,000, if the borrower's loan balance on the date they apply for the amnesty is more than $30,000.

Borrowers who apply for the amnesty between 1 April 2007 and 31 August 2007

For borrowers who apply for the amnesty between 1 April 2007 and 31 August 2007, the payments must be made in four equal instalments and will be due on 30 September 2007, 31 March 2008, 30 September 2008 and 31 March 2009.

The amount payable applies instead of:

- any overseas-based repayment obligation to which the borrower would otherwise be liable, if the amount is received by the Commissioner in the tax year ending 31 March 2008 or 31 March 2009; and
- any repayment holiday the borrower may have during the tax years ending 31 March 2008 or 31 March 2009.

Example

Kirsty applies for the amnesty on 6 April 2007. Her loan balance on that date is $25,000. To meet the amnesty conditions, Kirsty must make repayments as follows:

30 September 2007	$1,000
31 March 2008	$1,000
30 September 2008	$1,000
31 March 2009	$1,000

These repayment requirements apply instead of any overseas-based repayment obligation or repayment holiday Kirsty would have otherwise been entitled to.

Borrowers who apply for the amnesty between 1 September 2007 and 29 February 2008

For borrowers who apply for the amnesty between 1 September 2007 and 29 February 2008, the payments must be made in four equal instalments and are due on 31 March 2008, 30 September 2008, 31 March 2009 and 30 September 2009.

The amount payable applies instead of:

- any overseas-based repayment obligation the borrower may otherwise have for the tax years ending 31 March 2008 or 31 March 2009; and
- is offset against any overseas-based repayment obligation the borrower may have for the tax year ending 31 March 2010; and
- any repayment holiday the borrower may have during the tax years ending 31 March 2008 or 31 March 2009.

Example

Fran applies for the amnesty on 10 February 2008. Her loan balance on that date is $7,000. To meet the amnesty conditions Fran must make repayments as follows:

31 March 2008	$500
30 September 2008	$500
31 March 2009	$500
30 September 2009	$500

The payments due in 2008 and 2009 apply instead of any overseas-based repayment obligation or repayment holiday Fran would otherwise be entitled to.

Borrowers who apply for the amnesty in March 2008

For borrowers who apply for the amnesty in March 2008, the payments must be made in four equal instalments and are due on 30 September 2008, 31 March 2009, 30 September 2009 and 31 March 2010.

The amount payable applies instead of:

- any overseas-based repayment obligation the borrower may have for the tax years ending 31 March 2009 or 31 March 2010; and
- any repayment holiday the borrower may have during the tax year ending 31 March 2009.

For the tax year ending 31 March 2008, the borrower's repayment obligation is reduced to zero.

Example

Nicolas applies for the amnesty on 10 March 2008. His loan balance on that date is $48,000. To meet the amnesty conditions, Nicolas must make repayments as follows:

30 September 2008	$1,500
31 March 2009	$1,500
30 September 2009	$1,500
31 March 2010	$1,500

The payments due in 2008 and 2009 apply instead of any overseas-based repayment obligation or repayment holiday Nicolas would otherwise be entitled to. The payment in 2010 is offset against his repayment obligation (if any) for that year.

Hardship

Section 98 enables the Commissioner to reduce a payment instalment if the Commissioner is satisfied the reduction is necessary to alleviate significant financial hardship. Significant financial hardship includes difficulties that arise because of:

- the borrower's inability to meet minimum living expenses;
- their inability to carry out their usual occupation because of illness, injury or disability;
- their inability to meet mortgage repayments on their primary residence, resulting in the mortgagee seeking to enforce the mortgage on the residence;
- the cost of modifying a residence to meet special needs arising from a borrower's disability or a dependant's disability;
- the cost of medical treatment for a borrower's illness or injury or a dependant's illness or injury;
- the cost of palliative care for a borrower or their dependant; or
- the cost of a funeral for a borrower's deceased dependant.

Example

Nicolas (as outlined in the example above) could not afford to make the full $1,500 payment in 2008 because he had been in hospital for six weeks and was not earning any income during that period. The Commissioner reduces the instalment amount to $600, which Nicolas can afford to repay. Nicolas is still required to repay $1,500 for every other instalment, as the financial hardship was only temporary.

Relationship with New Zealand-based repayment obligations

Section 99 enables the amount a borrower pays to meet their amnesty repayment requirements to be offset against any New Zealand-based repayment obligations.

Example

Maria applied for the amnesty in June 2007 and was required to repay the following amounts:

30 September 2007	$500
31 March 2008	$500
30 September 2008	$500
31 March 2009	$500

Maria returns to New Zealand on 20 April 2008. Her New Zealand-based repayment obligation for the 2008–09 tax year is $2,050. All of her repayments while she is in New Zealand are made by deductions from her salary. The repayment deductions are more than enough to meet her amnesty repayment requirements.

People who applied for old amnesty

If a person applied for the old amnesty (before 1 April 2007) they must meet the repayment requirements outlined above. However, under section 100, the Commissioner can give credit for the extent to which the borrower complied with the conditions of the old amnesty.

Example

Bob applied for the old amnesty in April 2006 and met his repayment obligations for the 2006 tax year. Under the new amnesty, Bob is required to repay $4,000 in four six-monthly instalments. The Commissioner gives Bob credit for meeting the old amnesty conditions for a 12-month period, and Bob is required to meet the new amnesty conditions for a further 12-month period. Bob's new amnesty repayment requirement is $2,000, payable in two six-monthly instalments of $1,000 due on 30 September 2007 and 31 March 2008.

What happens if the amnesty condition is breached?

Under section 102, the first breach of the amnesty conditions, the Commissioner must give the borrower written notice of:

- the breach that has occurred;
- the action that must be taken by the borrower to remedy that breach;
- the date by which the breach must be remedied, which is 30 days after the date of the Commissioner's notice; and
- the fact that the Commissioner is exercising a discretion that can be used only once in relation to that borrower.

If the borrower remedies the breach according to the terms in the Commissioner's notice, the Commissioner must treat the borrower as having met the obligations outlined above.

A borrower may object under section 104 to a Commissioner's decision not to treat the borrower as having met their obligations on the ground that the decision is erroneous.

Increase to loan balance if borrower does not come under amnesty or amnesty condition breached

Under section 103, if a borrower does not apply for the amnesty before 1 April 2008, the borrower's loan balance will be increased by an amount equal to five percent of the borrower's loan balance on 31 March 2008, including any interest compounded by that date.

If the Commissioner considers, however, that the five percent penalty would be more than the late payment penalties that would have been charged if not for the "fresh start for certain non-resident borrowers" provisions, the Commissioner may reduce the amount added to the borrower's loan balance to an amount the Commissioner considers fair and reasonable. The intention is for the increase to the loan balance to be the lesser of five percent or the penalties that would have been charged if not for the "fresh start for certain borrowers" provisions.

If the borrower comes within the amnesty but fails to meet the repayment requirements, the borrower's loan balance will be increased on 31 March as outlined above, but the amount added to the loan balance will be reduced in proportion to the degree of the breach.

Under section 104, a borrower may object to the Commissioner's decision to increase the borrower's loan balance on the grounds that the decision is erroneous.

Example 1

Christian was a non-resident on 31 March 2006 and was in arrears. Christian does not apply for the old or the new amnesty, and on 31 March 2008 his loan balance is $41,000 (including interest compounded as at that date). On 1 April 2008 his loan balance will be increased by $2,050 (5%). His new loan balance is $43,050.

Example 2

Charlotte was a non-resident on 31 March 2006 and was in arrears. Charlotte does not apply for the old or the new amnesty and on 31 March 2008 her loan balance is $6,000 (including interest compounded as at that date). Because a 5% increase in Charlotte's loan balance is greater than the penalties that would have been charged if not for the "fresh start for certain non-resident borrowers" provisions, Charlotte's loan balance is increased by the amount of the penalties that would otherwise have been charged. As a result, on 1 April 2008 Charlotte's loan balance is increased by $260, to $6,260.

Example 3

Michael was a non-resident on 31 March 2006 and was in arrears. He applied for the new amnesty on 1 December 2007 and met the first three $1,000 repayments required but failed to meet the last one, even after notification by the Commissioner, and being given 30 days to remedy the breach. On 31 March 2008 his loan balance is $12,000 (including interest compounded as at that date). Because Michael met three-quarters of the instalments required, his loan balance is increased by (5% x ¾). As a result, on 1 April 2008 his loan balance is increased by $450, to $12,450.

Application date

The changes applied on or after 1 April 2007.

SIMPLIFYING THE LAW ON WHICH REPAYMENT RULES APPLY

Sections 2, 14, 14A, 44 and 57 of the Student Loan Scheme Act 1992

To simplify the law on which set of repayment rules apply – those for borrowers based in New Zealand or those for borrowers based overseas – annual repayment obligations will be based on whether the borrower is eligible for an interest-free loan, rather than on where they are tax-resident.

Background

Borrowers' residence for student loans purposes was previously based on where they were tax-resident. Tax residence can be difficult to determine because it depends on whether a person has a permanent place of abode in New Zealand, which is not always clear-cut (and Inland Revenue cannot always establish whether a permanent place of abode exists). It also makes administration of the student loan scheme difficult for borrowers to understand which repayment rules they are subject to.

Key features

Two new definitions have been inserted into section 2 of the Act. A borrower is "New Zealand-based" for each day on which they are entitled to the full interest write-off which gives effect to interest-free student loans. A borrower is "overseas-based" for each day on which they are not entitled to the full interest write-off which gives effect to interest-free loans.

The heading to Part 2 and sections 14, 44 and 57 of the Act have been amended to replace "resident" and "non-resident" with "New Zealand-based" and "overseas-based", respectively. The effect is that borrowers' repayment obligations will be based on whether they satisfy the eligibility criteria for an interest-free loan, rather than where they are tax-resident.

Aligning repayment obligations with when a borrower ceases to be entitled to an interest-free loan simplifies matters because there is just one, clear-cut rule for both: borrowers are either eligible for an interest-free loan, and therefore subject to the repayment rules for New Zealand-based borrowers, or they are not eligible for an interest-free loan, so are subject to the repayment rules for overseas-based borrowers. Borrowers are subject to the repayment rules for New Zealand-based borrowers from the effective date of entitlement to an interest-free loan.

Generally, borrowers who are overseas for more than six months are not eligible for an interest-free loan. However, the Commissioner can grant an exemption to these rules in certain circumstances. Borrowers who are granted an exemption will also be subject to the repayment rules for New Zealand-based borrowers.

In certain limited circumstances, a borrower may be non-resident for income tax purposes but be New Zealand-based for student loan purposes (meaning their repayment obligation will be based on their income). Sections 14A, 38AE, 38AEA and 38AJ require these borrowers to give details to the Commissioner of all amounts of their gross income that do not have a source in New Zealand. This will enable the Commissioner to have full details of their income so the correct repayment obligation can be established. The information must be provided to the Commissioner at the same time as the borrower would have provided a return of income for a tax year under the Tax Administration Act 1994 if he or she was a tax resident. The Commissioner may require the borrower to provide evidence of that income.

Application date

The changes applied from 1 April 2007.

NEW REPAYMENT RULES FOR OVERSEAS-BASED BORROWERS

Sections 31 to 36B and 106 to 111 of the Student Loan Scheme Act 1992

New repayment rules have been introduced for borrowers who are based overseas.

Background

Non-resident repayment obligations were initially designed so that loans would be repaid in a maximum of 15 years. This was achieved by requiring quarterly payments of a fixed amount of the principal (based on the loan balance at the beginning of the tax year following the year of departure), plus the estimated interest for the year. If the loan balance was less than $15,000, $1,000 of principal was required each year. For loans over $15,000, principal of one-fifteenth of the original loan balance was required. For many borrowers the amount that they were expected to pay was simply not achievable.

The repayment rules were inconsistent with the objective of encouraging borrowers to return to New Zealand and undermined the government's intent to ensure that debt levels are commensurate with the benefits borrowers receive from their tertiary study.

Key features

Part 3 of the Act has been repealed and replaced with a new Part 3 (sections 31 to 36B).

Three-year repayment holiday

Section 32 allows borrowers who become overseas-based after 1 April 2007 an automatic repayment holiday for a maximum period of three years, so their repayment obligation is nil during that period. The repayment holiday may be taken in more than one period, but entitlement remains only for periods during which the borrower is overseas-based.

Under section 33, a borrower may choose not to have a repayment holiday by giving notice to the Commissioner. An opt-out period can be taken more than once, and may be from an earlier date than when the borrower gives notice to the Commissioner. An opt-out period ends if

a borrower becomes New Zealand-based. Notice of an opt-out period may be given to the Commissioner by telephone, in writing, or in any other manner acceptable to the Commissioner. However, the Commissioner may still require the notice to be in writing.

Transitional rules for borrowers who are overseas-based on 1 April 2007

Sections 106 and 107 restrict entitlement to a repayment holiday for borrowers who were overseas-based on 1 April 2007:

- Borrowers who are not in arrears on a repayment obligation (whether established or not) are entitled to a three-year repayment holiday.
- Borrowers who are in arrears and have been non-resident for a continuous period of more than 364 days, but less than two years, are entitled to a two-year repayment holiday.
- Borrowers who are in arrears and have been non-resident for a continuous period of two years or more, but less than three years, are entitled to a one-year repayment holiday.
- Borrowers who are in arrears and have been non-resident for a continuous period of three years or more are not entitled to a repayment holiday.

Example 1

Katrina had lived in New Zealand all of her life. On 12 May 2008 she goes to the UK to do her OE. Katrina is entitled to a three-year repayment holiday from the day she becomes overseas-based. While she is on the repayment holiday her repayment obligation is nil, but she can make voluntary repayments if she wishes.

Example 2

Peter is overseas-based on 1 April 2007. He went overseas in 2002 and has always met his repayment obligations. Peter is entitled to a three-year repayment holiday from that date.

Example 3

Cath is overseas-based on 1 April 2007. She went overseas in September 2005 (and has been non-resident since leaving New Zealand). Cath has failed to meet her obligations since going overseas and is entitled to a repayment holiday of two years.

Example 4

Doug is overseas-based on 1 April 2007. He has been overseas for eight years (and has been non-resident since leaving New Zealand) and has failed to meet some of his repayment obligations. Doug is not entitled to a repayment holiday.

Repayment obligations of overseas-based borrowers not on a repayment holiday

Section 34 sets out the repayment obligations for overseas-based borrowers who are not on a repayment holiday. This includes the repayment obligations for borrowers who have chosen to have an opt-out period.

If the borrower's loan balance is less than $1,000, the borrower's repayment obligation for the first tax year that they are overseas-based and not on a repayment holiday is the amount of the borrower's loan balance.

Otherwise, repayment obligations are calculated as follows:

- $1,000 a year for loan balances of $15,000 or less;
- $2,000 a year for loan balances of $15,001 to $30,000; and
- $3,000 a year for loan balances over $30,000.

If the repayment obligation is for less than a full tax year, the obligation is multiplied by:

$$\frac{\text{the number of days in the tax year during which the borrower is overseas-based}}{365}$$

The amount of loan balance is the balance on the date the borrower took the repayment holiday and then at 31 March each year after that date (including interest compounded by that date).

Under section 35, for each tax year an overseas-based borrower is liable to pay a penalty on their entire loan balance, the borrower's repayment obligation is zero. In addition, if the repayment obligation calculated above is greater than the portion of the borrower's loan balance that is not subject to penalties, the repayment obligation is the amount of the loan balance not subject to penalties.

Section 36 specifies that repayments must be paid in two equal instalments that are due on 30 September and 31 March. If, however, a borrower is overseas-based for part of a tax year, under section 36A, the repayment obligation is payable in instalments determined by the Commissioner. For the part of the tax year that the borrower is New Zealand-based, the borrower's repayment obligation is determined in accordance with Part 2 of the Act, except that the amount of the repayment

threshold is decreased in proportion to the number of days the borrower is New Zealand-based.

As soon as practicable after being notified, or becoming aware that a borrower is or will be overseas-based, under section 36B the Commissioner must make an assessment of the borrower's overseas-based repayment obligation for that year. The Commissioner must also continue to make an assessment of the borrower's repayment obligation for each year the borrower remains overseas-based. As soon as practicable after making the assessment, the Commissioner must give notice to the borrower of the assessed amount, except if the amount assessed is zero.

Example 1

Olivia becomes overseas-based on 20 January 2009. On 5 May 2009, she opts-out of the repayment holiday, and the opt-out period applies from 1 April 2009. Because her loan balance is $31,500 on 31 March 2009, her repayment obligation for the tax year is $3,000. She is required to repay $1,500 on 30 September 2009 and a further $1,500 on 31 March 2010.

Example 2

Roberta becomes overseas-based on 1 February 2008. On 31 January 2011, her entitlement to a repayment holiday ceases. Roberta's loan balance on that date is $17,150. Roberta's repayment obligation for the remainder of the tax year is $2,000 x 59/365 = $323.29. She meets this repayment obligation and does not make any voluntary repayments. Her repayment obligation for the next tax year (1 April 2011 to 31 March 2012) is $2,000. $1,000 will be due on 30 September 2011 and a further $1,000 on 31 March 2012.

Interrelationship between amnesty on student loan penalties and new repayment obligations for overseas-based borrowers

The amnesty conditions override a borrower's entitlement to a repayment holiday or the repayment obligations of overseas-based borrowers not on a repayment holiday.

Under section 110, if a borrower was overseas-based on 1 April 2007, has come within the amnesty and met the repayment requirements, he or she is entitled to apply to the Commissioner for a three-year repayment holiday (once they have met the amnesty repayment requirements). An application may be made by telephone, in writing or in any other manner acceptable to the Commissioner. However, the Commissioner may require an application to be in writing. If a borrower does not make an application and subsequently becomes New Zealand-based, the borrower will be entitled to a repayment holiday of up to three years the next time they become overseas-based.

Under section 108, if a borrower comes within the amnesty but fails to comply with the amnesty conditions, he or she is entitled to a restricted repayment holiday as outlined under "Transitional rules for borrowers who are overseas-based on 1 April 2007". In addition, any amounts that the borrower has paid towards meeting the amnesty repayment requirements may be offset against any overseas-based repayment obligation which the borrower may otherwise have had after their restricted repayment holiday ends or while opting out of a repayment holiday.

Under section 109, if a borrower entitled to a restricted repayment holiday subsequently becomes New Zealand-based, they are entitled to a three-year repayment holiday when they next become overseas-based. However, any restricted repayment holiday they have had must count towards the borrower's total three-year repayment holiday.

Example 1

Jan comes within the amnesty and meets the repayment requirements, the last payment being made on 30 September 2009. Jan applies to the Commissioner for a repayment holiday. She is entitled to a three-year holiday from the date she became overseas-based.

Example 2

Tracey comes within the amnesty and meets the repayment requirements but does not make an application to the Commissioner for a repayment holiday. Her last repayment was made on 31 March 2010. Her loan balance on that date is $8,300. Tracey's repayment obligation for the following tax year is $1,000. Tracey subsequently returns to New Zealand and becomes a New Zealand-based borrower. Eighteen months after returning, Tracey goes overseas again and becomes an overseas-based borrower. Tracey is automatically entitled to a three-year repayment holiday from the date she becomes overseas-based.

Example 3

On 1 April 2007 Sarah had been non-resident for five years and was in arrears, so she was not entitled to a restricted repayment holiday. Her loan balance was $26,000 and therefore her repayment obligation for the year was $2,000. On 31 May 2007 Sarah applied for the amnesty. She met the first required repayment of $1,000 on 30 September 2007 but failed to meet the others. The $1,000 amnesty repayment is offset against her repayment obligation for the year of $2,000. The remaining $1,000 which she failed to pay is subject to penalties from 1 April 2008.

Example 4

On 1 April 2007 Richard had been non-resident for 13 months, meaning that he was entitled to a restricted repayment holiday of two years from that date. On 11 November 2007 Richard applied for the amnesty. He met the first two required repayments of $500 on 31 March 2008 and 30 September 2008 but failed to meet the payments due on 31 March 2009 and 30 September 2009. Richard's loan balance is increased by half of 5% on 1 April 2009 (because he met half of the amnesty's repayment requirements). The restricted repayment holiday of two years applies, so there is no repayment obligation for the 2008–09 tax year. Richard's repayment obligation for the year ending 31 March 2010 is $1,000. If Richard fails to meet this, penalties will apply from 1 April 2011.

Application date

The changes came into force on 1 April 2007.

INTEREST-FREE LOANS FOR BORROWERS STUDYING FULL-TIME OVERSEAS AT UNDERGRADUATE LEVEL

Section 38AJ of the Student Loan Scheme Act 1992

The Commissioner has been given the ability to grant borrowers studying full-time overseas at undergraduate level an interest-free loan.

Background

The Commissioner previously had the ability to grant borrowers studying full-time overseas at postgraduate level an interest-free loan, but not those studying at undergraduate level.

Key features

Section 38AJ gives the Commissioner the ability to grant borrowers studying full-time overseas at undergraduate level the full interest write-off which gives effect to interest-free student loans, if the Commissioner considers it fair and reasonable to do so.

For the exemption to apply, a borrower must provide the Commissioner with:

- a document from the New Zealand Qualifications Authority (NZQA) verifying that the borrower's course is at undergraduate level;
- evidence from the borrower's overseas education provider confirming that the applicant is enrolled full-time in the undergraduate course verified by the NZQA; and
- all other information, and in the manner that the Commissioner may reasonably require, to establish whether the grounds for the grant of an exemption apply.

Study at undergraduate level means study that is assessed by the NZQA as being equivalent to level 7 on the New Zealand Register of Quality Assured Qualifications.

Application date

The changes applied from 1 April 2007.

REMOVAL OF INTEREST WRITE-OFFS FOR BORROWERS INELIGIBLE FOR INTEREST-FREE LOANS

Sections 38A to 41 and section 55 of the Student Loan Scheme Act 1992

Interest write-offs for borrowers ineligible for interest-free loans have been abolished.

Background

Before the changes, borrowers who were overseas for more than six months and ineligible for interest-free loans may have been eligible for one of the following interest write-offs:

Full interest write-off for resident borrowers studying

Borrowers who were resident for tax purposes but who were not eligible for an interest-free loan for an entire tax year may have been eligible for a full interest write-off for the entire year if they had studied for part of that year. Eligible borrowers who completed their study part-way through the academic year were entitled to a full interest write-off to 31 March the following year. Borrowers received the write-off even if they had been overseas for most of the year.

Base interest write-off for resident borrowers

Borrowers who were not eligible for an interest-free loan, who retained their place of tax residence and who earned below the repayment threshold were eligible to have their base interest written off for up to two years.

Partial base interest write-off for resident borrowers

Borrowers who were not eligible for an interest-free loan, who retained their place of tax residence and whose base

interest charged was more than half of their repayment obligation were eligible to have the difference written off for up to two years.

Interest write-off for non-resident borrowers studying full-time overseas

Non-resident borrowers could qualify for a base interest write-off or base interest reduction in certain limited circumstances. Borrowers could qualify for either provision if they had:

- renegotiated all or part of their assessed repayment obligation for a year on financial hardship grounds; and
- satisfied Inland Revenue that they had been engaged in full-time study overseas and payment of base interest charged during the year in which they were in full-time study would cause serious hardship.

Key features

Sections 38A to 41 and section 55 have been repealed. The interest write-offs have been abolished because they are inconsistent with the policy intent of interest-free loans, which is to encourage borrowers to remain in, or return to, New Zealand.

Application date

The changes applied from 1 April 2007.

EXEMPTION FOR VOLUNTEERS

Section 38AEA of the Student Loan Scheme Act 1992

A new provision has been added to the Student Loan Scheme Act to specify the activities which may be engaged in by borrowers seeking an exemption from the requirement that they be New Zealand-based to qualify for an interest-free loan.

Background

Student loan borrowers working as volunteers or for token payment for a charitable organisation which has been "named" by regulations made under the Student Loan Scheme Act may be granted an exemption for up to two years from the requirement that they be in New Zealand for 183 or more continuous days to qualify for an interest-free loan.

Key features

Student loan borrowers will only qualify for the exemption available to volunteers if they are engaged in one or more of the following activities:

- work to relieve poverty, hunger, sickness or the ravages of war or natural disaster;
- work to improve the economy of a country that is recognised by the United Nations as a developing country;
- work to raise the educational standards of a developing country.

Application date

The amendment came into force on 1 April 2007.

LATE PAYMENT PENALTIES

Section 44 of the Student Loan Scheme Act 1992

The late payment penalty rate has been reduced to 1.5 percent.

Background

Previously, any amount not paid by the due date incurred a late payment charge of 2 percent. A further 2 percent compounding penalty was charged for each subsequent month of default. This was equal to an annual interest rate of 26.82 percent.

Key features

The late payment penalty rate has been reduced from 2 percent per month to 1.5 percent.

Application date

The changes came into force on 1 April 2007.

SMALL BALANCES

Sections 51, 51A and 60 of the Student Loan Scheme Act 1992

The small balance thresholds have been increased to $20 and a new provision has been introduced which allows Inland Revenue to refrain from collecting all or part of an overdue repayment obligation that is less than $333.

Background

The small balance thresholds allow the Commissioner to write-off amounts which it is uneconomical to pursue. They had not previously been increased since the student loan scheme was introduced.

Key features

The amount that may be written off for underpaid borrowers' end-of-year repayment obligations, employer

repayment deductions and final loan balances has been increased to $20.

A further change is a new provision which allows Inland Revenue to refrain from collecting all or part of an overdue repayment obligation that is less than $333. Any amount which is not collected will not be written off and remains subject to interest.

Application date

The increase in the amounts which may be written off will apply from 1 October 2007. The provision relating to amounts which Inland Revenue may refrain from collecting came into force on 28 March 2007.

APPLICATIONS IN WRITING

Sections 53 and 54 of the Student Loan Scheme Act 1992

The requirement that applications for relief from penalties or payment of a repayment obligation on hardship grounds could only be made in writing has been removed.

Background

Until now, borrowers were required to apply for relief from penalties or payment of their repayment obligation on hardship grounds in writing. In many cases Inland Revenue already holds the information necessary to verify a borrower's financial position. Requiring a written application can therefore create unnecessary work for both borrowers and Inland Revenue.

Key features

The changes remove the requirement that applications for relief from penalties or payment of a repayment obligation on hardship grounds must be made in writing. Inland Revenue will accept an application by telephone, in writing or by any other acceptable manner. However, the Commissioner may still require a written application.

Application date

The change applies to penalty applications made from 28 March 2007 and hardship applications made from 1 April 2007.

HARDSHIP RELIEF

Sections 54, 55, and 55A to 55D of the Student Loan Scheme Act 1992

The hardship provisions have been amended to allow hardship relief for any amount which has already been paid.

Background

Borrowers may be granted relief from payment of their annual repayment obligation in cases of serious hardship. (The payment is not written off, but is payable from future obligations.) However, under the old rules, the repayment obligation could not be reduced below any payments already made during the year, and the obligation to make payments due during the year could not be suspended.

Key features

The hardship provisions have been amended to ensure that payments of obligations that fall due during a tax year do not preclude a borrower from being granted relief from payment of an annual repayment obligation. Any amount which has already been paid that exceeds the amount of the repayment obligation determined at the end of the tax year may be refunded.

Hardship applications may be made for the current tax year and the preceding and following years.

Inland Revenue will be able to reduce any payments which fall due during the tax year, including to zero, if it is considered that the borrower is likely to qualify for hardship relief. The standard deduction rate for salary and wage earners of 10 cents in the dollar over the repayment threshold may be reduced by the issue of a special deduction rate which the borrower is required to give to his or her employer. The amount required during the tax year from borrowers required to make interim repayments or by overseas-based borrowers may also be reduced.

Borrowers must inform Inland Revenue of any changes in their circumstances which affect their application for hardship relief. Inland Revenue will be able to review any hardship relief given after the end of the tax year when all the facts for that year are established and may modify the relief previously granted if the circumstances on which the original decision to grant hardship relief have changed.

Application date

The changes apply to hardship applications made from 28 March 2007.

CARE AND MANAGEMENT

Section 3 of the Tax Administration Act 1994

The care and management provisions in the Tax Administration Act have been extended to include student loan interest.

Background

Section 6A of the Tax Administration Act 1994 requires the Commissioner to apply "care and management" in the

administration of the Revenue Act. This means that the Commissioner must collect the highest net revenue over time that is practicable, having regard to:

- the resources available to the Commissioner;
- the importance of promoting compliance with the Inland Revenue Acts; and
- taxpayers' compliance costs.

It was thought that these provisions applied to student loan interest but, in fact, they only applied to annual student loan repayment obligations.

Key features

The definition of "tax" in the Tax Administration Act has been extended to include student loan interest. This will allow, subject to the above conditions, for interest which has been under-charged because of administrative error to be written off.

Application date

The change came into force on 28 March 2007.

INTEREST WRITE-OFFS VALIDATED

Section 88 of the Student Loan Scheme Act 1992

Borrowers who had an interest write-off to which they were not entitled, but had repaid their loans by 13 November 2006, will not have the write-off reversed.

Background

A significant number of borrowers have received interest write-offs to which they were not entitled, and the write-offs would otherwise need to be reversed.

Key features

Section 88 ensures that borrowers whose loan balance was treated by the Commissioner as being zero on 13 November 2006 and who received one of the interest write-offs described under the background "Removal of interest write-offs for borrowers ineligible for interest-free loans" have had that interest write-off validated. This applies despite anything else in any other enactment or in a loan contract, but does not affect any loan obtained by the borrower under the student loan scheme after 13 November 2006.

Application date

The changes came into force on 28 March 2007.

INTEREST RATE FORMULA

Sections 2, 50 and 87 of the Student Loan Scheme Act 1992, Regulations 5 and 6 of the Student Loan Scheme (Interest Rates Formulas) Regulations 2006

From the 2008–09 tax year separate components of the student loan interest rate will no longer be set.

Background

The student loan interest rate is set by Regulations made under the Student Loan Scheme Act 1992. The Student Loan Scheme (Interest Rates Formulas) Regulations 2006 currently set: an interest adjustment rate, a base interest rate, and the total interest rate. The interest adjustment rate is based on the rate of inflation. Various base interest write-offs ensured that, once study was completed, New Zealand-based borrowers' loans never increased by more than the rate of inflation. The introduction of interest-free loans has removed the need for these interest write-offs, and thus the need to set the components of the total interest rate.

Key features

From the 2008–09 tax year only a total student loan interest rate will be set.

Application date

The changes come into force on 1 April 2008.

OTHER TECHNICAL AMENDMENTS

Refunds of over-payments when assessments are reopened

Section 58A of the Student Loan Scheme Act 1992

Section 58A(1) ensures that if a borrower's repayment obligation is reduced upon reassessment by the Commissioner, he or she can claim a refund of the difference in the assessed repayment obligations. The borrower has six months from being notified by the Commissioner of the difference in the assessed repayment obligations to claim a refund. The changes apply to any tax year.

Advising of absence from New Zealand

Section 37 of the Student Loan Scheme Act 1992

Section 37 specifies that a borrower must inform the Commissioner if he or she expects to be, or has been, overseas for more than six months (previously this was three months). The change applied from 1 April 2007.

Overseas employment exemption

Section 38AH of the Student Loan Scheme Act 1992

The words "derived from New Zealand" have been inserted into section 38AH(c)(i) to ensure that borrowers entitled to a full interest write-off on the basis that they are overseas for more than six months because of the nature of their employment must have salary or wages that are derived from New Zealand. The change applied from 28 March 2007, except for borrowers who applied to the Commissioner for a full interest write-off before the amendment came into effect. For these borrowers, the change comes into force on 1 April 2008.

Interest-free student loans for new borrowers

Section 38AL of the Student Loan Scheme Act 1992

Section 38AL gives the Commissioner the discretion to grant new borrowers a full interest write-off for up to 183 days from the date they first become a borrower. The changes make it possible for new borrowers who have gone overseas briefly during the first six months from when they initially drew down a loan to be entitled to an interest-free loan from the day the loan was drawn down. Section 65A allows borrowers to object to a decision made by the Commissioner not to grant an interest write-off or to object to the dates on which the interest write-off applies to. The amendments came into force on 1 April 2006.

Transitional provisions repealed

Sections 89 to 102 and section 112 of the Student Loan Scheme Act 1992

The heading to Part 7 and transitional provisions in sections 89 to 102 relating to assessments and repayments for tax years before 1 April 1994 have been repealed because they are redundant. The changes apply from 1 April 2007. Section 112 ensures that Tax Administration Act provisions continue to have effect. The changes applied from 28 March 2007.

Removal of information match between Inland Revenue and the Ministry of Education

Section 62 of the Student Loan Scheme Act 1992, section 307C of the Education Act 1989, section 85D of the Tax Administration Act 1994 and Schedule 3 of the Privacy Act 1993

Sections 62(2)(ab) and 62(2AA) of the Student Loan Scheme Act and section 85D of the Tax Administration Act have been repealed, and section 307C of the Education Act 1989 and Schedule 3 of the Privacy Act 1993 have been amended. The changes are necessary because the information match between Inland Revenue and the Ministry of Education to verify borrowers' study status has been abolished. This data match is now redundant, because the full interest write-off for borrowers who are studying has been abolished. The changes came into force on 1 April 2007.

Repayment deductions

Section 19 of the Student Loan Scheme Act 1992

Section 19(2) ensures that an employer is required to make a deduction from a borrower's salary or wages only if the employer is aware that a special deduction rate applies. The change came into force on 28 March 2007.

Commissioner to assess borrower's repayment obligation

Section 15 (1) of the Student Loan Scheme Act 1992

Section 15(1) has been repealed and replaced. The Commissioner must make an assessment of a borrower's repayment obligation for a tax year as soon as practicable after the borrower provides his or her return of income for that year under the Tax Administration Act, or details of his or her gross income in accordance with section 14A (described under "Simplifying the law on which repayment rules apply").

Interest statements

Section 43 of the Student Loan Scheme Act 1992

Section 43 has been amended to remove any doubt that Inland Revenue may issue an amended interest statement if the amount of interest previously charged is found to be incorrect. The change came into force on 28 March 2007.

Charging late payment penalties

Section 44B of the Student Loan Scheme Act 1992

The change, which came into force on 1 April 1992, being the date the student loan scheme was introduced, ensures that amounts which have become overdue, and thus subject to late payment penalties, are not also subject to interest.

The change was necessary because a change to the contract in 2005, under which interest is charged, failed to include the provision which ensured that interest ceases to be charged once a payment becomes overdue and thus subject to late payment penalties.

LEGAL DECISIONS – CASE NOTES

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

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

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

BILL OF RIGHTS

Case: Peter Lloyd Machirus v The Commissioner of Inland Revenue

Decision date: 3 April 2007

Act: New Zealand Bill of Rights Act 1990, Income Tax Act 1994, GST Act 1985

Keywords: Bill of Rights, Time Bar

Summary

The High Court dismissed the taxpayer's appeal and upheld the assessments and found there was no breach of the Bill of Rights Act. He further upheld the Commissioner's cross-appeal and held that the Taxation Review Authority erred in finding certain assessments statute-barred.

Facts

Appeal

The taxpayer derived income from legal and illegal means. His case, at least in part before the Taxation Review Authority (TRA), was that the proceeds of his criminal activities were not liable to either income tax or GST. The TRA confirmed the Commissioner's reassessments relating to the income tax liability and the November 1992 to May 1993 GST periods. However the TRA quashed the reassessments relating to the subsequent GST periods on the basis that they were time-barred.

The taxpayer appealed the TRA decision. The questions for determination in respect of his appeal for the High Court were stated by the TRA as being:

(i) Whether the TRA was wrong in holding that the income tax assessments for the 1991 to 1993 tax years were wrong;

(ii) Whether the TRA was wrong in finding that the taxpayer had not proven that the relevant income had been derived from criminal activities;

(iii) Whether the TRA was wrong in holding that the taxpayer had not proven that the GST outputs and inputs were monies derived from criminal activities;

(iv) Whether the TRA was wrong in holding that the taxpayer had not proven that the Commissioner had breached the New Zealand Bill of Rights Act 1990 ("NZBORA")

The taxpayer did not dispute those parts of the TRA decision in respect of questions (i), (ii) and (iii) but rather claimed his main appeal point was focused on sections 27 and 21 of NZBORA regarding unreasonable search and seizure and the right to natural justice. He also argued that specifically, a $50,000 gambling debt was deductible.

Cross-Appeal

The Commissioner cross-appealed the TRA decision on the basis that the Authority was in error to hold that an alleged failure to serve the GST reassessments of 30 November 1993, 31 May 1994, 30 November 1994 and 31 May 1995, on Mr Machirus until 2002 meant the reassessments were time-barred. The TRA was satisfied that the Commissioner had correctly calculated the GST owing by Mr Marchirus for each of the four periods however the Authority held that failure to give notice of the reassessments until 2002 invalidated the reassessments.

Decision

Taxpayer's Appeal

His Honour Justice Ronald Young noted at the outset that the taxpayer offered no evidence or arguments to challenge on appeal the correctness of the Income Tax and GST assessments. Accordingly he held that they were confirmed.

Regarding section 21 of the NZBORA His Honour held that the taxpayer's arguments had no basis. The taxpayer's argument was essentially based on the improper withholding of relevant information from him by the Commissioner until the TRA hearing and amounted to a miscarriage of justice such that justified a new trial.

His Honour found that on the evidence before him the taxpayer held sufficient business records and that the cheque butts in particular had little or no relevance to his case and in any event the information they contained could have been obtained through his bank statements. The taxpayer had a chance to produce these but did not, which illustrated that the taxpayer knew they had no relevance.

> I have approached this aspect of Mr Machirus' appeal as based on the claim that there was relevant evidence in existence which Mr Machirus would have wished to present to the Authority but which was not reasonably available to him before or at the Authority hearing. Essentially the new trial test of whether a miscarriage of justice has occurred. What is clear is that the cheque butts themselves have no real relevance to this case. It is also clear the information the cheque butts contained could have been obtained elsewhere either through his bank statements and cancelled cheques, or through the receipts, notebook and diary kept by him……..
>
> I am therefore satisfied that there is no ground of appeal based on s21 of the New Zealand Bill of Rights Acts regarding unreasonable search and seizure, nor is there any appeal ground based on a miscarriage of justice from relevant evidence coming to light after the Authority hearing.

Section 27 of the NZBORA was simply disposed of by the His Honour noting:

> Firstly, I doubt the application of section 27 to decisions by the Commissioner in this case. Section 27 is concerned with the adjudicative function. The Commissioner's function in this case is in collecting the tax due. Any determination of a dispute regarding whether tax is due and the amount due will be decided in the District Court or the Taxation Review Authority or the High Court.
>
> Secondly, without a timeline and an identification of reasons for delay it is not clear exactly what Mr Machirus complains about regarding delay. Since this case has been in the High Court much of the delay has arisen from either Mr Machirus' failure to comply with the Court timetable or his pursuit of unsuccessful pre-appeal applications.

Regarding the claimed $50,000 deduction, the High Court upheld the TRA finding that there was insufficient evidence to sustain such a claim and that the Commissioner's reassessment was correct.

Commissioner's Cross–Appeal

Due to the operation of section 27 of the GST Act 1985 the Commissioner's cross-appeal was allowed. The TRA had erred when it treated the failure to notify the GST reassessments as meaning that they were time-barred.

> It is clear, therefore, that even assuming that no notice of the reassessment was given to Mr Machirus after 2 October 1995 until 2002, the failure to do so does not invalidate the reassessment.

It was also noted by the Court that:

> Although not essential to my decision, there was in any event strong evidence that in fact Mr Machirus knew of the reassessments well before the expiry of the four-year period in 1999.

BREACH OF SOLICITOR'S UNDERTAKING TO THE COMMISSIONER

Case:	Manu Chhotubhai Bhanabhai & Ors v The Commissioner of Inland Revenue
Decision date:	26 April 2007
Act:	GST Act 1985, Supreme Court Act 2003
Keywords:	Solicitor's undertaking

Summary

The Supreme Court refused leave to appeal the Court of Appeal's Judgment holding that the solicitor had breached the undertaking given to the Commissioner. The Court of Appeal did not make an error in principle.

Facts

The taxpayers sought leave to appeal against a decision of the Court of Appeal, that they were liable to the Commissioner, on the settlement of units in a development undertaken by Golden Gate Holdings Limited. The taxpayers gave an undertaking that they would "forthwith" pay to the Commissioner the GST component of sale consideration".

The GST output tax on the settlement of the units subject to the solicitor's undertaking was payable on the settlement of the units. The Commissioner sought payment under the undertaking. The High Court and the Court of Appeal both held that the taxpayers were liable albeit for different reasons.

Decision

The Supreme Court dismissed the taxpayer's application. The decision dismissing the appeal stated that the undertaking was a "one-off" and therefore did not satisfy the criteria needed for 13(2)(a) or (c).

The Supreme Court agreed with the Commissioner in that the Court of Appeal did not make an error of principle of approach and the taxpayers were simply seeking a different conclusion based on the application of a correct approach to the interpretation of the undertaking.

The Supreme Court stated that there was no miscarriage of justice:

> The applicants seek also to invoke section 13(2)(b) of the Supreme Court Act 2003. They claim that a serious miscarriage of justice may have occurred. In order to come within the section 13(2)(b) ground for leave it is necessary to point to a sufficiently apparent error of such a substantial character that it would be repugnant to justice to allow it to go uncorrected. The circumstance that the Court of Appeal has reached its conclusion on a different basis than the High Court does not of itself suggest such error. No error of principle in approach appears from the Court of Appeal decision. There is no apparent error such as would give rise to a miscarriage of justice."

REGULAR FEATURES

DUE DATES REMINDER

June 2007

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

28 GST return and payment due

July 2007

9 Provisional tax installment due for people and organisations with a March balance date

20 Employer deductions

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

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

30 GST return and payment due

These dates are taken from Inland Revenue's *Smart business tax due date calendar 2007–2008*. 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**
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.

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***
☐ IS2783: Deductibility of feasibility expenditure	30 June 2007

Draft standard practice statement	***Comment deadline***
☐ ED 0097: Transfer of depreciable property between associated persons – section EE 33 of the Income Tax Act 2004	2 July 2007

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