

# TAX INFORMATION BULLETIN

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## GET YOUR TIB SOONER ON THE INTERNET

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

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

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

## **THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT**

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

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

The following draft item is available for review/comment this month, having a deadline of 31 October 2007:

<b>Ref.</b>	<b>Draft type</b>	<b>Description</b>
PU0151	Public ruling	GST – Lottery operators and promoters

Please see page 33 for details on how to obtain a copy.

## BINDING RULINGS

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

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### PRODUCT RULING – BR PRD 07/02

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 ASB NZ Shares Trust.

#### Taxation Laws

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

This Ruling applies in respect of sections CD 3, CD 14 and GB 1(3).

#### The Arrangement to which this Ruling applies

The Arrangement is the establishment and continued operation of the ASB NZ Shares Trust (the “ASB NZ Trust” or the “Trust” or the “Fund”) pursuant to the Master Deed (which is dated 17 October 1997) (the “Master Deed”), the Establishment Deed (which is also dated 17 October 1997) (the “Establishment Deed”), a “Variation of Master Unit Trust Deed Dated 17 October 1997” (dated 27 April 1999), a Deed of Amendment to ASB NZ Shares Trust Establishment Deed (dated 18 June 2001) and the ASB Unit Trusts Prospectus (dated 6 September 2006).

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

1. The ASB NZ Trust is a unit trust pursuant to the Unit Trusts Act 1960 and is a “unit trust” for the purposes of the definition of that term in section OB 1.
2. The trustee of the ASB NZ Trust is Trustees Executors Limited (the “Trustee”). It is registered as a trustee company under the Trustee Companies Act 1967. The manager of the Trust is ASB Group Investments Limited (formerly ASB Investment

Services Limited) (the “Manager”), part of the ASB Group of Companies. The beneficial interests in the Trust are divided into units. Each unit confers an equal interest in the Trust, but units do not confer any interest in any particular investment of the Trust

3. The Applicant has confirmed that the Fund has complied with the previous ruling (BR Prd 04/09). There has been no material change to the management or operation of the Fund.

#### Investment

4. The ASB NZ Trust acts as a special purpose vehicle, which holds units in the AMP Investments’ Tracker Fund (the “AMP Tracker Fund”). Ownership of units in the AMP Tracker Fund enable the ASB NZ Trust to obtain the same financial results through one investment as would be achieved by direct investment in the securities which make up the NZX50 Index (“the Index”) tracked by the Tracker Fund.
5. ASB selected the AMP Tracker Fund as its underlying investment for the following reasons:
  - The corporate strength and stability of AMP Limited (“AMP”), and the strong likelihood that AMP would be able to support an index-tracking fund well into the foreseeable future;
  - AMP’s technical expertise, particularly the investment management skill and capability of AMP Capital Investors (New Zealand) Limited in being able to construct and efficiently manage an index-tracking fund;
  - The high standard of service provided by AMP eg, regular statements and reporting on the AMP Tracker Fund; good working relationship; and
  - AMP’s competitive investment management fees resulting in a lower cost to ASB NZ Trust Fund investors in having their funds invested in the AMP Tracker Fund through the ASB NZ Trust.

6. Clauses 3.1 and 3.2 of the ASB NZ Trust's Establishment Deed state the "investment objectives" of the ASB NZ Trust and identify the "authorised investments" as follows:
- 3 Investment Policy
- 3.1 Objectives: The objective of the Trust is to invest in the AMP Investments Tracker Fund, subject to the need for the Trust to hold some cash for liquidity and administrative purposes. The funds of the Trust that are available for investment shall be invested in the AMP Investment Tracker Fund as soon as practicable after receipt by the Trustee. The Trust and the Trustee do not have an intention to profit from holding, acquiring or selling AMP Investments' Tracker Fund units. The Trust and the Trustee do not have an intention to profit from holding, acquiring or selling AMP Investments' Tracker Fund units.
- 3.2 Authorised Investments: For the purposes of this Trust "Authorised Investments" means:
- the AMP Investments' Tracker Fund;
  - cash balances with banks, brokers, agents, funds, including, without limitation, the ASB Money Market Trust, or custodians held for the liquidity and administrative purposes of the Trust referred to at Clause 3.1;
7. Pursuant to the Establishment Deed, the ASB NZ Trust is only authorised to invest contributions from members in: (a) the AMP Tracker Fund and (b) cash investments. The Fund may hold cash investments to facilitate the easier administration of the Fund. The cash investments are held as cash by the Fund in bank deposits. The Fund will hold cash in the following instances:
- Following a contribution to the Fund, pending the investment of that contribution;
  - Following the sale of AMP Tracker Fund units to meet a request to redeem Trust units in cash;
  - To make income distributions to unitholders; and
  - To meet administration expenses of the Fund.
8. It is the intention of the ASB NZ Trust that investment in AMP Tracker Fund units, taking into account the appropriate distribution of excess cash, will be completed on a weekly basis. The level of funds is monitored on a weekly basis and invested if in excess of the cash pool. Funds passed to the Manager are invested in the underlying pool within 24 hours.
9. Under clause 11.3(h) of schedule 1 to the Master Deed the unitholders can sanction any variation of the "authorised investments" of the Trust by extraordinary resolution. However, the Fund intends to maintain its current investment strategy.

#### *AMP Tracker Fund*

10. The AMP Tracker Fund is a "group investment fund" within the meaning of section OB 1. The AMP Tracker Fund is required to buy and sell shares as required to ensure that it continues to track the Index. The AMP Tracker Fund has a current binding ruling (BR Prv 05/01) which states that such buying and selling is not motivated by any intention to derive a profit or gain from such sales.
11. The ASB NZ Trust will generally distribute to its unitholders part of the distributions it receives from the AMP Tracker Fund six-monthly. To determine the amount of the distribution, the Manager of the ASB NZ Trust will determine the Trust's "net income" by taking into account, not only the distributions received by the AMP Tracker Fund, but also all costs, charges and expenses due by or to the ASB NZ Trust.
12. The Establishment Deed also provides for special distributions to occur at other times determined by the Manager. However, in the period between receipt of income from the AMP Tracker Fund and any distribution the ASB NZ Trust is required to invest amounts not held for administrative or liquidity purposes in units in the AMP Tracker Fund.
13. The AMP Tracker Fund units will be issued subject to the ordering rule (section CD 14(2)) and may only be redeemed in whole, and not in part. Units in the AMP Tracker Fund are not quoted on any exchange.

#### *Suspensions*

14. The Fund has not previously suspended redemptions. A suspension from issuing or redeeming units will only occur in exceptional circumstances, being:
- If a material adverse change in the financial markets occurs, namely, a breakdown in liquidity caused by an act of God or a system failure or a terrorist attack; or
  - If there is a fundamental breakdown in the functioning of financial markets, namely, the failure of pricemaking software; or
  - If it is required so as to avoid a breach of any applicable law.

Any such suspension will be for a maximum period of 3 business days, unless the exceptional circumstance giving rise to the need to suspend is beyond the control of the Trustee and Manager of the Fund, in which case the suspension shall be only for such period as is strictly necessary for the Fund and/or the Manager to recover from that event.

*Redemption of ASB NZ Trust Units*

15. The Manager has the power to purchase units from unitholders, when unitholders wish to redeem or sell their units. The Manager may use this power only when the Fund does not have enough funds in the cash pool to redeem the units requested and the Fund is unable to borrow to meet the unitholders' requests. To date, the Manager has not utilised this power.

*Redemption of AMP Tracker Fund Units*

16. When the ASB NZ Trust is required to redeem units in the AMP Tracker Fund, the parcel of securities held by the AMP Tracker Fund attributable to the ASB NZ Trust's investment can be returned to the ASB NZ Trust. Alternatively, the redemption parcel of securities can be delivered to the AMP Tracker Fund manager as agent for the unitholder (ie, the ASB NZ Trust). In this alternative situation, the AMP Tracker Fund manager will sell the basket of securities comprising the redemption parcel as agent for the ASB NZ Trust, and the AMP Tracker Fund manager will pay the proceeds to the ASB NZ Trust (or in certain circumstances, the AMP Tracker Fund manager will hold the securities and transfer to the ASB NZ Trust the equivalent dollar value of the redeemed securities).
17. The ASB NZ Trust always requests the AMP Tracker Fund manager to redeem the basket of securities for cash, instead of receiving the basket of securities. Therefore, the ASB NZ Trust, upon redemption of units in the AMP Tracker Fund, will receive a transfer of securities followed by an immediate sale of those securities by the AMP Tracker Fund manager as agent for the ASB NZ Trust.
18. Although the AMP Tracker Fund's prospectus refers to a threshold of 100,000 units being the minimum redemption amount (in order to redeem the units in the AMP Tracker Fund), ASB Bank have agreed with the AMP Tracker Fund manager that the treatment of redemptions for parcels of 100,000 units or greater will also apply to parcels of 50,000 or greater in respect of redemptions for the ASB NZ Trust.

## Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

- a) There is no agreement, arrangement or understanding between the Fund or the Trustee or the Manager and any unitholder (or any person associated with any unitholder) which directly or indirectly has a purpose or effect of the redemption or disposition of any of a unitholder's units occurring in substitution for, or instead of, one or more distributions from the Fund.

- b) The Trust will be a widely-held trust, as that term is defined in section OB 1.
- c) Any cancellation of ASB NZ Trust units will not be part of a pro rata cancellation as that term is defined in section OB 1.
- d) The ASB NZ Trust units will not be quoted on the official list of any recognised exchange as that term is defined in section OB 1.
- e) The ASB NZ Trust units are issued on such terms that their redemption is subject to the ordering rule as stated in section CD 14(2).
- f) The income of the Fund, net of any expenses incurred by the Fund, will be paid out to unitholders either as cash or additional units in the Fund. However, the Manager may use its discretion, and decide not to make such a payment if the amount to be paid is so minimal that the administrative costs of making the payment would exceed the amount to be distributed. The payment of income to unitholders on this basis is consistent with the Fund's normal dividend policy and Trust Deed. Not necessarily paying out the full value of the Tracker Fund units received as income reflects the Trustee's normal prudence in only distributing the "profits" of the Fund and does not occur for tax purposes;
- g) The Manager has the power to purchase units from unitholders, when unitholders wish to redeem or sell their units. The Manager may use this power only when the Fund does not have enough funds in the cash pool to redeem the units requested and the Fund is unable to borrow to meet the unitholders' requests.
- h) Where unitholders elect to receive distributions as additional Fund units instead of cash, these constitute a "taxable bonus issue" as that term is defined in section OB 1.
- i) The AMP Tracker Fund was chosen to provide a cost effective means for simulating an investment that matches the composition and weighting of the Index. The AMP Tracker Fund was not selected in order to maximise returns.
- j) The Fund has not taken into account historical returns in deciding to maintain its current investment strategy.
- k) The investment objectives and authorised investments of the Trust will not be amended.
- l) The cash pool is held in cash deposits which are held on call in bank deposits. The holding of such cash will arise only from the following circumstances:
- To meet the administration expenses of the Fund;
  - Pending investment in AMP Tracker Fund units;

- To meet a withdrawal from the Trust; or
- To make income distributions to unitholders.

The proportion of the Fund's assets to be held as cash will not be greater than what strictly arises out of the above described circumstances, and in any event will not exceed the greater of \$200,000 or 4% of the total assets of the Fund.

- m) Condition (l) shall not be breached if the limit referred to in condition (l) is exceeded when this occurs due to the following reasons:
- Where a large cash subscription has been paid into the cash pool; or
  - Receipt of dividends from the AMP Tracker Fund, and

the Fund takes immediate action to remedy this within the shortest practicable time, and in any event, no longer than five business days.

- n) In the event that the Fund has insufficient cash available to meet redemptions, the Fund may temporarily borrow in order to redeem units. Any borrowing that occurs will be: (i) only to the extent that is strictly necessary and will not in any event exceed 2% of the value of the Fund; and (ii) repaid as soon as possible and in any event within five business days.
- o) The Fund will only sell or otherwise dispose of AMP Tracker Fund units in the following circumstances:
- To meet the administration expenses of the Fund;
  - The Manager must purchase or redeem AMP Tracker Fund units in order to meet the needs of the Fund's unitholders; or
  - In order to wind up the Trust.
- p) When the Fund is given the option of re-investing its dividends for additional units in the AMP Tracker Fund, the Fund will always accept the reinvestment option. In any such case, the value of the units received is equivalent to the value of the cash dividend (net of tax, fees and expenses) and the distribution of cash or units constitutes a "dividend" as that term is defined in section CF 2.
- q) This ruling shall cease to apply if at any time:
- (i) there is a unitholder, or two or more unitholders that are associated with each other, or are acting in concert in relation to their investments in the Fund, who hold/s more than 75% of the issued units of the Fund; and
  - (ii) if that unitholder, or one or more of such unitholders, ordinarily hold securities on revenue account or the disposal of securities by that unitholder, or one or more of such unitholders, would ordinarily give rise to gross income for income tax purposes.

For the purposes of this condition unitholders are associated with each other if they are "associated persons" within the meaning of section OD 7 or OD 8(3).

- r) This Ruling only applies while this Fund remains a widely-held trust (as that term is defined in section OB 1), and the Fund units are offered to the public.
- s) Apart from the Trust Deed and/or Prospectus and/or any Rules of the Fund that have been supplied to Inland Revenue as part of the application for this ruling, there is no agreement, arrangement or understanding between the Fund or the Trustee or the Manager (or any party acting on behalf of the Fund) and any unitholder (or any person associated with or acting on behalf of any unitholder) regarding the control of the Fund, the nature and timing of its investments, or the timing of the investing or withdrawal of funds.

For the avoidance of doubt, (i) the fact that a unitholder has the ability to invest, or withdraw at any time and/or (ii) the entry into of agreements, arrangements or understandings contemplated by the Trust Deed for the purpose of enabling investment or withdrawal, will not alone constitute an agreement, arrangement or understanding to which the preceding sentence applies.

- t) The Fund will not exercise any voting rights associated with the holding of AMP Tracker Fund units.
- u) If the Fund is resettled this Ruling shall not apply from the date of resettlement. The Fund will not be resettled in order to enhance the performance of the Fund or to minimise the losses of the Fund in any way.
- v) A suspension from issuing or redeeming units will only occur in exceptional circumstances, being:
- (1) If a material adverse change in the financial markets occurs, namely, a breakdown in liquidity caused by an act of God, or a system failure or a terrorist attack;
  - (2) If there is a fundamental breakdown in the functioning of financial markets, namely, the failure of pricemaking software; or
  - (3) If it is required so as to avoid a breach of any applicable law.

Any such suspension will be for a maximum period of 3 business days, unless the exceptional circumstance giving rise to the need to suspend is beyond the control of the Trustee and Manager of the Fund, in which case the suspension shall be only for such period as is strictly necessary for the Fund and/or the Manager to recover from that event.



- w) The distribution period of the Fund will only be altered for administrative reasons and shall not be altered to enhance the performance of the Fund in any way.
- x) The Manager has the power to purchase units from unitholders, when unitholders wish to redeem or sell their units. The Manager may use this power only when the Fund does not have enough funds in the cash pool to redeem the units requested and the Fund is unable to borrow to meet the unitholders' requests.
- y) The AMP Tracker Fund is an "unlisted trust" in terms of the definition of that term in section CD 14(9).
- z) Cancellation of AMP Tracker Fund units will not be made as part of a pro rata cancellation of units.
- aa) AMP Tracker Fund units will not be quoted on the official list of a recognised exchange.
- bb) The AMP Tracker Fund units are issued on such terms that their redemption is subject to the ordering rule as stated in section CD 14(2).
- cc) There is no agreement, arrangement or understanding between the AMP Tracker Fund or its trustee or its manager and the ASB NZ Trust (or any person associated with the ASB NZ Trust) which directly or indirectly has a purpose or effect of the redemption or disposition of any of the ASB NZ Trust's units occurring in substitution for, or instead of, one or more distributions from the AMP Tracker Fund.
- dd) The Trust will either: (1) redeem its AMP Tracker Fund units to the AMP Tracker Fund or (2) sell its units to the AMP Tracker Fund manager. The Trust will not dispose of its units in any other manner.
- ee) All distributions received by the AMP Tracker Fund will be paid out (either as cash or AMP Tracker Fund units) to investors in the AMP Tracker Fund net of any expenses incurred by the AMP Tracker Fund.
- ff) Any powers exercised by the Trustee under the Master Deed and Establishment Deed are for the purposes of either buying units in the AMP Tracker Fund to reflect the level of funds invested in the Trust, or selling or redeeming units in the AMP Tracker Fund to fund redemptions of units in the Trust.
- gg) The existing binding ruling for the AMP Tracker Fund (BR Prv 05/01) or any such replacement ruling or rulings in respect of the same taxation laws remain current and in force.
- hh) The Fund will not be wound up with a view to enhancing the performance of the Fund or to minimise losses of the Fund in any way. This condition will not be breached if:
- (i) the Manager decides to wind up the Fund for reasons unrelated to the performance of the investments of the Fund; or
- (ii) if the unitholders independently resolve to wind up the Fund.

## How the Taxation Laws apply to the Arrangement

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

- Income distributed by the Trustee will be treated as a dividend pursuant to section CD 3.
- Any amount received by unitholders on redemption of units in the Fund will be excluded from the definition of dividend in section CD 3 by section CD 14(2) to the extent that that amount does not exceed the available subscribed capital per share cancelled.
- Section GB 1(3) does not apply to the arrangement.

## The period or income year for which this Ruling applies

This Ruling will apply for the period from 30 June 2007 to the earlier of:

- The date upon which Portfolio Investment Entity ("PIE") status applies to the Fund in terms of section HL 11; or
- 31 December 2007.

This Ruling is signed by me on the 29<sup>th</sup> day of June 2007.

**John Trezise**  
Sector Manager

## PRODUCT RULING – BR PRD 07/03

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

### Name of the Person who applied for the Ruling

This Ruling has been applied for by ASB World Shares Trust.

### Taxation Laws

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

This Ruling applies in respect of sections CD 3, CD 14 and GB 1(3).

### The Arrangement to which this Ruling applies

The Arrangement is the establishment and continued operation of the ASB World Shares Trust (the “ASB World Trust” or the “Trust” or the “Fund”) pursuant to a master deed dated 17 October 1997 (the “Master Deed”), an establishment deed also dated 17 October 1997 (the “Establishment Deed”), a “Variation of Master Deed Dated 17 October 1997” (executed on 27 April 1999), a Deed of Amendment to ASB World Shares Trust Establishment Deed (dated 18 June 2001) and the ASB Unit Trusts Prospectus (dated 6 September 2006).

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

1. The ASB World Trust is a unit trust pursuant to the Unit Trusts Act 1960 and is a “unit trust” for the purposes of the definition of that term in section OB 1.
2. The trustee of the ASB World Trust is Trustees Executors Limited (the “Trustee”). It is registered as a trustee company under the Trustee Companies Act 1967. The manager of the Trust is ASB Group Investments Limited (formerly ASB Investment Services Limited) (the “Manager”), part of the ASB group of Companies. The beneficial interests in the Trust are divided into units. Each unit confers an equal interest in the Trust, but units do not confer any interest in any particular investment of the Trust.
3. The Applicant has confirmed that the Fund has complied with the previous ruling (BR Prd 04/08). There has been no material change to the management or operation of the Fund.

#### *Investment*

4. The ASB World Trust acts as a special purpose vehicle, which holds units in the AMP Investments’ World Index Fund (the “AMP WiNZ Fund”).

Ownership of units in the AMP WiNZ Fund enable the ASB World Trust to obtain the same financial results through one investment as would be achieved by direct investment in the securities which make up the AMP World Index (the “Index”) tracked by the AMP WiNZ Fund.

5. ASB selected the AMP WiNZ Fund for its underlying investment for the following reasons:
  - The corporate strength and stability of AMP Limited (“AMP”), and the strong likelihood that AMP would be able to support an index-tracking fund well into the foreseeable future;
  - AMP’s technical expertise, particularly the investment management skill and capability of AMP Capital Investors (New Zealand) Limited in being able to construct and efficiently manage an index-tracking fund;
  - The high standard of service provided by AMP eg, regular statements and reporting on the AMP WiNZ Fund; good working relationship; and
  - AMP’s competitive investment management fees resulting in a lower cost to ASB World Trust Fund investors in having their funds invested in the AMP WiNZ Fund through the ASB World Trust.
6. Clauses 3.1 and 3.2 of the ASB World Trust’s Establishment Deed state the “investment objectives” of the ASB World Trust and identify the “authorised investments” as follows:
  - 3 Investment Policy
    - 3.1 Objectives: The objectives of the Trust are to:
      - (a) invest in the AMP Investments’ World Index Fund subject to the need for the Trust to hold some cash for liquidity and administrative purposes; and
      - (b) provide after tax foreign currency hedges in respect of 50% of the foreign currency securities indirectly invested in through the Trust’s investment in the AMP Investment’s World Index Fund.
  - 3.2 Authorised Investments: For the purposes of this Trust “Authorised Investments” means:
    - (a) the AMP Investments’ World Index Fund;

The funds of the Trust that are available for investment shall be invested in the AMP Investments’ World Index Fund or in foreign currency contracts as soon as practicable after receipt by the Trustee. The Trust and the Trustee do not have an intention to profit from holding, acquiring or selling AMP Investments’ World Fund units.

- (b) cash balances with banks, brokers, agents, funds, including, without limitation, the ASB Money Market Trust, or custodians held for the liquidity and administrative purposes of the Trust referred to at Clause 3.1; and
- (c) foreign exchange contracts for the foreign currencies of the securities making up the AMP World Index entered into to provide the hedges referred to in clause 3.1
7. Pursuant to the Establishment Deed, the ASB World Trust is only authorised to invest contributions from Members in: (a) the AMP WiNZ Fund, (b) a fixed 50% after tax foreign currency hedge and (c) cash investments. The Fund may hold cash investments to facilitate the easier administration of the Fund. The cash investments are held by the Fund in bank deposits. The Fund will hold cash in the following instances:
- Following a contribution to the Fund, pending the investment of that contribution;
  - Following the sale of AMP WiNZ Fund units to meet a request to redeem units in cash;
  - To make income distributions to unitholders;
  - To meet obligations under the fixed 50% after tax foreign currency hedge; and
  - To met administration expenses of the Fund.
8. It is the intention of the ASB World Trust that investment in AMP WiNZ Fund units (taking into account the appropriate level of hedge, or distribution of excess cash, whichever is relevant) will be completed on a weekly basis. The level of funds is monitored on a weekly basis and invested if in excess of the cash pool. Funds passed to the Manager are invested in the underlying pool within 24 hours.
9. The currencies to be hedged are the US dollar, Japanese yen, Euro, British pound, Australian dollar and Canadian dollar. The weighting of these currencies in the hedge will be determined exactly, based on the Trust's underlying exposure, on each rollover date, based on the latest country weightings (included in the Index) which are made available by AMP Capital Investors (New Zealand) Limited.
10. The ASB World Trust is required to place an order for a 74.6% hedge (or an equivalent residual figure should the applicable income tax rate change from 33%) and accept the closest to this figure that is obtainable within the set limits. Further, realignment of the hedge level will occur monthly at the rollover of forward contracts to a new forward date. All hedge contracts will mature on or about the fifteenth business day of the month following entry. The level of the hedge is to be maintained at between 71.6% and 77.6% of the non-New Zealand dollar amount invested offshore. This variance is required to take account of redemptions and subscriptions arising during a month. It is also required to take account of the fact that foreign currency hedges can generally only be obtained in round amounts. Where the hedge moves outside the plus or minus 3% (pre-tax) band the hedge will be adjusted back to 74.6%, on the day that this occurs, based on the country weightings made available by AMP Capital Investors (New Zealand) Limited on the last roll-over date.
11. Under clause 11.3(h) of schedule 1 to the Master Deed the unitholders can sanction any variation of the "authorised investments" of the Trust by extraordinary resolution. However, the Fund intends to maintain its current investment strategy.
- AMP WiNZ Fund*
12. The AMP WiNZ Fund is a "group investment fund" within the meaning of section OB 1. The AMP WiNZ Fund is required to buy and sell shares as required to ensure that it continues to track the Index. The AMP WiNZ Fund has two current binding rulings (BR Prv 04/26, regarding sections BD 1(1), CD 3, CD 4, and CD 5 of the Income Tax Act 1994 and BR Prv 04/27, regarding sections OZ1 and CG 1 of the Income Tax Act 1994) which state that such buying and selling is not motivated by any intention to derive a profit or gain from such sales. The AMP WiNZ Fund is listed on the New Zealand Stock Market ("NZSX").
13. The AMP WiNZ Fund will make taxable distributions to the Trust from any income received by the AMP WiNZ Fund semi-annually within 20 days from the end of June and December.
14. The Trust will generally distribute such part, as is determined by the Manager, of its net income 6-monthly to unitholders and that net income will be calculated taking into account all costs, charges and expenses due.
15. The Establishment Deed also provides for special distributions to occur at other times determined by the Manager. However, in the period between receipt of income from the AMP WiNZ Fund and any distribution, the ASB World Trust is required to invest amounts not held for administrative or liquidity purposes in units in the AMP WiNZ Fund and maintain the fixed 50% after tax foreign currency hedge.
- Suspensions*
16. A suspension from issuing or redeeming units will only occur in exceptional circumstances, being the following situations:
- (1) If a material adverse change in the financial markets occurs, namely, a breakdown in liquidity caused by an act of God or a system failure or a terrorist attack;

- (2) If there is a fundamental breakdown in the functioning of financial markets, namely, the failure of pricemaking software; or
- (3) If it is required so as to avoid a breach of any applicable law.

Any such suspension will be for a maximum period of 3 business days, unless the exceptional circumstance giving rise to the need to suspend is beyond the control of the Trustee and Manager of the Fund, in which case the suspension shall be only for such period as is strictly necessary for the Fund and/or the Manager to recover from that event.

The issuing and redeeming of units was suspended for 5 days as a result of the September 11 terrorist attack.

#### *Redemption of ASB World Fund units*

17. The Manager has the power to purchase units from unitholders, when unitholders wish to redeem or sell their units. The Manager may use this power only when the Fund does not have enough funds in the cash pool to redeem the units requested and the Fund is unable to borrow to meet the unitholders' requests. To date, the Manager has not utilised this power.

#### *Redemption of AMP WiNZ Fund units*

18. When the ASB World Trust is required to redeem units in the AMP WiNZ Fund, the ASB World Trust can sell its units to a third party, or it can redeem its units to the AMP WiNZ Fund. Upon redemption, the ASB World Trust will receive a parcel of securities equal to the value of the units at that time. The AMP WiNZ Fund manager may sell those securities on behalf of (as agent for) the ASB World Trust, and then give the ASB World Trust cash for those units. The ASB World Trust also has the option (as opposed to redeeming its units to the AMP WiNZ Fund) to sell its units through the AMP WiNZ Fund manager.
19. Redemption requests for AMP WiNZ Fund units must be for a minimum of 1,000,000 WiNZ units. When the ASB World Trust makes a redemption request to the AMP WiNZ Fund, the AMP WiNZ Fund manager makes a choice as to how to effect that redemption request. The AMP WiNZ Fund manager may effect redemption by either: (1) cancellation of the units or (2) purchasing those units on its own behalf. In either situation, when the AMP WiNZ Fund manager effects a redemption request, the unitholder (ie, the ASB World Trust) will receive the same redemption amount for its AMP WiNZ Fund units.
20. Requests to dispose of parcels of less than 1,000,000 AMP WiNZ Fund units will be facilitated by the AMP WiNZ Fund manager in parcels of 100,000 AMP WiNZ Fund units. The ASB World

Trust will only dispose of its AMP WiNZ Fund units by making a redemption request to the AMP WiNZ Fund manager. The ASB World Trust will not dispose of AMP WiNZ Fund units in any other manner.

## Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

- a) There is no agreement, arrangement or understanding between the Fund or the Trustee or the Manager and any unitholder (or any person associated with any unitholder) which directly or indirectly has a purpose or effect of the redemption or disposition of any of a unitholder's units occurring in substitution for or instead of one or more distributions from the Fund.
- b) The Trust will be a widely-held trust, as that term is defined in section OB 1.
- c) Any cancellation of ASB World Trust units will not be part of a pro rata cancellation as that term is defined in section OB 1.
- d) The ASB World Trust units will not be quoted on the official list of any recognised exchange as that term is defined in section OB 1.
- e) The ASB World Trust units are issued on such terms that their redemption is subject to the ordering rule as stated in section CD 14(2).
- f) The income of the Fund, net of any expenses incurred by the Fund, will be paid out to unitholders either as cash or additional units in the Fund. However, the Manager may use its discretion, and decide not to make such a payment if the amount to be paid is so minimal that the administrative costs of making the payment would exceed the amount to be distributed. The payment of income to unitholders on this basis is consistent with the Fund's normal dividend policy and Trust Deed. Not necessarily paying out the full value of the WiNZ Fund units received as income reflects the Trustee's normal prudence in only distributing the "profits" of the Fund and does not occur for tax purposes.
- g) The Manager has the power to purchase units from unitholders, when unitholders wish to redeem or sell their units. The Manager may use this power only when the Fund does not have enough funds in the cash pool to redeem the units requested and the Fund is unable to borrow to meet the unitholders' requests.
- h) Where unitholders elect to receive distributions as additional Fund units instead of cash, these constitute a "taxable bonus issue" as that term is defined in section OB 1.

- i) The AMP WiNZ Fund was chosen to provide a cost effective means for simulating an investment that matches the composition and weighting of the Index. The AMP WiNZ Fund was not selected in order to maximise returns.
- j) The Fund has not taken into account historical returns in deciding to maintain its current investment strategy.
- k) The investment objectives and authorised investments of the Trust will not be amended.
- l) The cash pool is held in cash deposits which are held on call in bank deposits.. The holding of such cash will arise only from the following circumstances:
  - Pending investment in AMP WiNZ Fund units;
  - To meet a withdrawal from the Trust;
  - To make income distributions to unitholders;
  - Pursuant to the fixed 50% after tax foreign currency hedge; and
  - To meet administration expenses of the Fund.

The proportion of the Fund’s assets to be held as cash will not be greater than what strictly arises out of the above described circumstances, and in any event will not exceed the greater of \$200,000 or 4% of the total assets of the Fund.

- m) Condition (l) shall not be breached if the limit referred to in condition (l) is exceeded when this occurs due to the following reasons:
  - Where a large cash subscription has been paid into the cash pool; or
  - Receipt of dividends from the AMP WiNZ Fund; or
  - From proceeds or settlement of maturing currency hedge contracts; and

the Fund takes immediate action to remedy this within the shortest practicable time, and in any event, no longer than 5 business days.

- n) The Fund may borrow temporarily in order to meet the following obligations where it is unable to meet such demands out of its current cash reserves:
  - (1) to redeem units;
  - (2) to meet hedging contract obligations.

Any such borrowing will only be to the extent that is strictly necessary and in the case of borrowing to redeem units will not exceed 2% of the value of the Fund and in the case of borrowing to meet hedging obligations will not exceed 10% of the value of the Fund. All such borrowing will be repaid within five business days.

- o) The Fund will only sell or otherwise dispose of AMP WiNZ Fund units in the following circumstances:

- To meet administration expenses of the Fund that cannot be met out of the cash pool; or
- Where the Manager must purchase or redeem AMP WiNZ Fund units in order to meet the needs of the Fund’s unitholders; or
- In order to wind up the Trust; or
- To meet hedging contract obligations that cannot be met out of the cash pool.

- p) When the Fund is given the option of re-investing its dividends for additional units in the AMP WiNZ Fund, the Fund will always accept the reinvestment option. In any such case, the value of the units received is equivalent to the value of the cash dividend, (net of tax, fees and expenses).
- q) This ruling shall cease to apply if at any time:
  - (i) there is a unitholder, or two or more unitholders that are associated with each other, or are acting in concert in relation to their investments in the Fund, who hold/s more than 75% of the issued units of the Fund; and
  - (ii) if that unitholder, or one or more of such unitholders, ordinarily hold securities on revenue account or the disposal of securities by that unitholder, or one or more of such unitholders, would ordinarily give rise to gross income for income tax purposes.

For the purposes of this condition unitholders are associated with each other if they are “associated persons” within the meaning of section OD 7 or OD 8(3).

- r) This Ruling only applies while this Fund remains a widely-held trust (as that term is defined in section OB 1), and the Fund units are offered to the public.
- s) Apart from the Trust Deed and/or Prospectus and/or any Rules of the Fund that have been supplied to Inland Revenue as part of the application for this ruling, there is no agreement, arrangement or understanding between the Fund or the Trustee or the Manager (or any party acting on behalf of the Fund) and any unitholder (or any person associated with or acting on behalf of any unitholder) regarding the control of the Fund, the nature and timing of its investments, or the timing of the investing or withdrawal of funds.

For the avoidance of doubt, (i) the fact that a unitholder has the ability to invest, or withdraw at any time and/or (ii) the entry into of agreements, arrangements or understandings contemplated by the Trust Deed for the purpose of enabling investment or withdrawal, will not alone constitute an agreement, arrangement or understanding to which the preceding sentence applies.

- t) The Fund will not exercise any voting rights associated with the holding of AMP WiNZ Fund units.



- u) If the Fund is resettled this Ruling shall not apply from the date of resettlement. The Fund will not be resettled in order to enhance the performance of the Fund or to minimize the losses of the Fund in any way.
- v) A suspension from issuing or redeeming units will only occur in exceptional circumstances, being:
- (1) If a material adverse change in the financial markets occurs, namely, a breakdown in liquidity caused by an act of God, or a system failure or a terrorist attack; or
  - (2) If there is a fundamental breakdown in the functioning of financial markets, namely, the failure of pricemaking software; or
  - (3) If it is required so as to avoid a breach of any applicable law.

Any such suspension will be for a maximum period of 3 business days, unless the exceptional circumstance giving rise to the need to suspend is beyond the control of the Trustee and Manager of the Fund, in which case the suspension shall be only for such period as is strictly necessary for the Fund and/or the Manager to recover from that event.

- w) The distribution period of the Fund will only be altered for administrative reasons and shall not be altered to enhance the performance of the Fund in any way.
- x) The Manager has the power to purchase units from unitholders, when unitholders wish to redeem or sell their units. The Manager may use this power only when the Fund does not have enough funds in the cash pool to redeem the units requested and the Fund is unable to borrow to meet the unitholders' requests.
- y) There is no agreement, arrangement or understanding between the AMP WiNZ Fund or its trustee or its manager and the ASB World Trust (or any person associated with the ASB World Trust) which directly or indirectly has a purpose or effect of the redemption or disposition of any of the ASB World Trust's units occurring in substitution for or instead of one or more distributions from the AMP WiNZ Fund.
- z) The Trust will only dispose of its AMP WiNZ Fund units by making a redemption request to the AMP WiNZ Fund manager or by selling to a third party. The Fund will only sell to a third party in the exceptional circumstance where the request to the AMP WiNZ Fund Manager cannot be actioned within 7 business days.
- aa) Any powers exercised by the Trustee under the Master Deed and Establishment Deed are for the purposes of either buying units in the AMP WiNZ Fund, matched by a 50% after tax hedge, to reflect the level of funds invested in the Trust, or selling

units in the AMP WINZ Fund to fund redemption of units in the Trust, or in order to meet its payment obligations under the hedging arrangement or to meet administration expenses of the Fund.

- bb) The existing binding rulings for the AMP WiNZ Fund (BR Prv 04/26 and BR Prv 04/27) or any such replacement ruling or rulings in respect of the same taxation laws remain current and in force.
- cc) The Fund will not be wound up with a view to enhancing the performance of the Fund or to minimise losses of the Fund in any way. This condition will not be breached if:
- (i) the Manager decides to wind up the Fund for reasons unrelated to the performance of the investments of the Fund; or
  - (ii) if the unitholders independently resolve to wind up the Fund.
- dd) The AMP WiNZ Fund has deferred the application of the Foreign Investment Fund legislation until 1 October 2007 by giving the required notice to the Commissioner of Inland Revenue before 1 April 2007.

## How the Taxation Laws apply to the Arrangement

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

- Income distributed by the Trustee will be treated as a dividend pursuant to section CD 3.
- Any amount received by unitholders on redemption of units in the Fund will be excluded from the definition of dividend in section CD 3 by section CD 14(2) to the extent that that amount does not exceed the available subscribed capital per share cancelled.
- Section GB 1(3) does not apply to the arrangement.

## The period or income year for which this Ruling applies

This Ruling will apply for the period from 30 June 2007 to 30 September 2007.

This Ruling is signed by me on the 29<sup>th</sup> day of June 2007.

**John Trezise**  
Sector Manager

## NEW LEGISLATION

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### ORDER IN COUNCIL

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#### Further rise in FBT rate for low-interest loans

The prescribed rate used to calculate fringe benefit tax on low-interest, employment-related loans has risen to 10.37%, up from the 9.79% rate announced for the preceding quarter.

The revised rate applies from 1 October 2007.

The rate is reviewed regularly to align it with the results of the Reserve Bank's survey of first mortgage interest rates and was last adjusted with effect from 1 July 2007.

The new rate was set by Order in Council on 27 August 2007.

*Income Tax (Fringe Benefit Tax, Interest on Loans)  
Amendment Regulations No (2) 2007 (2007/262).*

## STANDARD PRACTICE STATEMENTS

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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.

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### SPS 07/05 TRANSFER OF DEPRECIABLE PROPERTY BETWEEN ASSOCIATED PERSONS – SECTION EE 33 OF THE INCOME TAX ACT 2004

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#### Introduction

1. When a taxpayer acquires depreciable property from an associated vendor the taxpayer's depreciation base is generally limited to the original cost of the property incurred by the associated vendor. The Commissioner of Inland Revenue ("the Commissioner") can however exercise a statutory discretion to allow depreciation based on the cost to the taxpayer if the Commissioner considers that such treatment is "appropriate".
2. This Standard Practice Statement ("SPS") sets out various factors that the Commissioner will consider in deciding whether the taxpayer should be permitted depreciation based on the taxpayer's cost when acquiring depreciable property from an associated person.

#### Application

3. This SPS applies to decisions made by the Commissioner from 14 September 2007. It replaces the item "Depreciation on secondhand assets" published in *Tax Information Bulletin*, Vol. 4, No. 5 (December 1992) and other past Inland Revenue practices regarding section EE 34 of the Income Tax Act 2004 (Please note: the order of former sections EE 33 and EE 34 was reversed as a result of section 40 of the Taxation (Savings Investment and Miscellaneous Provisions) Act 2006. The amendment was made to better reflect the generally applicable rule first. It also provides that in a non-qualifying amalgamation, the rule in the current section EE 34 will override the general rule in the current section EE 33.)
4. Unless specified otherwise, all legislative references in this SPS refer to the Income Tax Act 2004 ("ITA 04").

#### Standard Practice

5. Section EE 33(3) limits the basis on which a taxpayer can calculate depreciation on depreciable property that has been transferred from an associated person. However, the Commissioner has the discretion to permit depreciation to be based on the actual cost price of the depreciable property to the taxpayer when the Commissioner considers that such treatment is appropriate in the circumstances.

6. The Commissioner may exercise the discretion under section EE 33(4)(a)(ii) in the taxpayer's favour in accordance with the criteria explained below. Primarily, these are based on matters considered in New Zealand and Australian cases on equivalent legislation, but also include other criteria that the Commissioner considers relevant, including the overall commercial context in which the transfer takes place and the obligation to protect the integrity of the tax system under section 6 of the Tax Administration Act 1994 ("the TAA").
7. The discretion cannot be exercised as of right. In deciding whether or not to exercise the discretion under section EE 33(4)(a)(ii), the Commissioner will consider all relevant factors in the context in which the transfer has taken place, including a full analysis of the following factors:
  - (a) Whether the transfer is genuine,
  - (b) Whether the transfer is made at no more than the fair market value,
  - (c) Whether there is a permanent transfer of legal ownership of the property,
  - (d) Whether the associated vendor (or its controllers) continues to retain virtual ownership of, or beneficial interest in, the transferred property:
    - (i) Through power over or control of the associated purchaser, or
    - (ii) Through a leaseback or similar agreement, or
    - (iii) Through continued actual use of the transferred property for income-producing purposes, and
  - (e) The commercial or non tax-related reasons for the transfer of the property.
8. It is important to note that none of the above factors are decisive on their own. The Commissioner will give appropriate weight to each factor on a case-by-case basis before deciding whether or not to exercise the discretion.

#### Background

9. Inland Revenue's practice on the transfer of depreciable property between associated persons



was published in *Tax Information Bulletin*, Vol. 4, No. 5 (December 1992). The practice referred to section 111(2) of the Income Tax Act 1976, which was the predecessor to the repealed section EG 17(2) of the Income Tax Act 1994 and the current section EE 33(4)(a)(ii). The practice reflects the High Court decision in *CIR v Lys & Others* (1988) 10 NZTC 5,107.

10. It is recognised that the past practice did not fully reflect the law that developed from the case law in New Zealand and Australia, and did not address every factor that might be relevant. The Commissioner has now taken the opportunity after the rewrite of the Income Tax Act 2004 to fully review the criteria that are relevant to the exercise of the discretion. The updated guidelines produced in this SPS will ensure that consistent decisions are made in relation to the exercise of the discretion.

## Legislation

11. Sections EE 33 is relevant to this SPS. Section EE 33 applies for the 2005–06 and later income years, except for subsection (3)(a)(ii). The subsection applies for the 2006–07 and later income years. Section EE 33 reads:

**EE 33      Transfer of depreciable property on or after 24 September 1997**

**EE 33(1)      WHEN THIS SECTION APPLIES**

This section applies when, on or after 24 September 1997, a person (**person A**) acquires, directly or indirectly, an item of property from an associated person to whom 1 of the paragraphs in subsection (2) applies. The income year referred to in the paragraphs is the income year of the associated person.

**EE 33(2)      ASSOCIATED PERSON**      The associated person must be a person to whom 1 of the following paragraphs applies:

- (a) the associated person is allowed a deduction for an amount of depreciation loss for the item for the income year in which person A acquires it:
- (b) the associated person would have been allowed a deduction for an amount of depreciation loss for the item for the income year in which person A acquired it, if section EE 11(1) had not applied:
- (c) the associated person was allowed a deduction for an amount of depreciation loss for the item for the income year before the income year in which person A acquired it:
- (d) the associated person has been allowed a deduction for the item under section DZ 9 (Premium paid on land leased before 1 April 1993) for the income year in which person A acquired it:
- (e) the associated person has been allowed a deduction for the item under section DZ 9 for the income year before the income year in which person A acquired it:
- (f) the associated person would have been allowed a deduction for an amount of depreciation loss for the item for the income year in which person A acquired it, if the associated person had incurred a cost for the item for which the person was denied any other deduction and if section EE 11(1) had not applied:
- (g) the associated person would have been allowed a deduction for an amount of depreciation loss for the item for the income year before the income year in which person A acquired it, if the associated person had incurred a cost for the item for which the person was denied any other deduction:
- (h) the associated person would have been allowed a deduction for the item under section DZ 9 for the income year in which person A acquired it, if the associated person had incurred a cost for the item for which the person was denied any other deduction:
- (i) the associated person would have been allowed a deduction for the item under section DZ 9 for the income year before the income year in which person A acquired it, if the associated person had incurred a cost for the item for which the person was denied any other deduction:
- (j) the associated person would have been a person to whom any of paragraphs (a) to (i) applied, if the associated person had not made an election under section EE 8.

**EE 33(3)      COST OF ITEM TO PERSON A**

For the purpose of determining the amount of depreciation loss that person A has, the cost of the item to person A is treated as 1 of the following:

- (a) if section EE 49 applies for the associated person and the item, the lesser of–
  - (i) the cost of the item to person A;
  - (ii) the item’s market value when the associated person starts to use it, or to have it available for use, for the purpose of deriving assessable income or carrying on a business for the purpose of deriving assessable income; or
- (b) if section EE 49 does not apply for the associated person and the item, the lesser of–
  - (i) the cost of the item to person A;
  - (ii) the cost of the item to the associated person.

**EE 33(4)      EXCLUSIONS**      Subsection (3) does not apply–

- (a) if–
  - (i) the item is not depreciable intangible property; and
  - (ii) the Commissioner decides that it is appropriate to use the cost of the item to person A for the purposes of determining the amount of depreciation loss that person A has for the item:
- (b) if the cost to person A is income of the associated person, other than under section EE 41(1):

- (c) if person A acquires the item under a relationship agreement or a matrimonial agreement to which section FF 16 (Depreciable property) applies.

**EE 33(5) RATE** The annual rate that person A applies to the item must be 1 of the following (not including an item of fixed life intangible property, for which the rate is set in section EE 27):

- (a) if person A uses the same depreciation method for the item as that used by the associated person for it, the annual rate that person A applies to it must not be more than the annual rate that the associated person applied to it:
- (b) if person A uses a depreciation method for the item different from the method that the associated person used for it, the annual rate that person A applies to it must not be more than a rate equivalent to the rate that the associated person applied to it, as determined by schedule 10 (Straight-line equivalents of diminishing value rates of depreciation).

**EE 33(6) RELATIONSHIP WITH SECTION EE 34 AND SUBPART FI** This section—

- (a) is overridden by section EE 34:
- (b) does not apply to a bequest of property, if it is property to which subpart FI (Effect of certain disposals and resulting acquisitions) applies and the property is disposed of at market value.

- 12. Sections EE 6, EE 7, EE 34, FF 16, OB 1 and subpart FI are also mentioned in this SPS. These legislative provisions are not cited here, as the primary focus of the SPS is on section EE 33(4)(a)(ii).

## Discussion

- 13. Section EE 33 is concerned with the depreciation base that applies when depreciable property is transferred between associated persons on or after 24 September 1997 in circumstances to which subsection (2) applies. For the purposes of section EE 33, the term “associated persons” is defined in section OB 1.
- 14. Taxpayers should not take a tax position by claiming tax depreciation on the basis of the transfer price of the depreciable property until the Commissioner confirms that the discretion will be exercised.

## General

- 15. The Commissioner may exercise the discretion under section EE 33(4)(a)(ii) at any time. However, taxpayers seeking the exercise of the Commissioner’s discretion should make requests in writing with supporting documentation to the appropriate Inland Revenue offices. Alternatively, taxpayers may apply to the Office of Chief Tax

Counsel for a private binding ruling. Requests can be made either when taxpayers are committed to the completion of the transfer of depreciable property between associated persons or when the transfer has been completed and before a tax position is taken in respect of the matter.

- 16. The supporting documentation should include all relevant transaction documents, correspondence and a summary of any unwritten terms of understandings between the parties. These may include:
  - (a) certificates of title,
  - (b) sale and purchase agreements,
  - (c) financial, gifting and legal documents relating to the transaction,
  - (d) independent valuation reports,
  - (e) acknowledgements of debt,
  - (f) loan agreements,
  - (g) constitutional documents such as trust deeds, and
  - (h) any other relevant information.

Taxpayers should also address the factors as set out in paragraphs 20 to 71 below when requesting that the Commissioner exercise the discretion.

- 17. In deciding whether to exercise the discretion, the Commissioner will look objectively at the substance of the transaction in the commercial or business context in which it takes place. That is, the Commissioner will need to be satisfied that the transaction is undertaken for business or commercial reasons and not just to achieve a tax advantage.
- 18. Particular focus will be given to whether in substance the transferred property continues to fall under the control of, form part of the assets of, or be used by the vendor or by an entity or a group of entities over which the associated vendor (or its controllers) has control or power. The presence of “virtual ownership” or a “beneficial interest” will be weighed against other factors such as any legitimate non tax-related reasons for the transfer in accordance with normal commercial and conveyancing practices, the obligation to protect the integrity of the tax system under section 6 and the Commissioner’s responsibilities under the care and management provisions under section 6A of the Tax Administration Act 1994. For example, when a taxpayer’s request is incomplete or ambiguous, the Commissioner will not apply a large amount of resources to elicit the information from the taxpayer for the purpose of deciding whether or not to exercise the discretion under section EE 33(4)(a)(ii).

19. The expression “associated vendor” when used in this SPS includes persons who are associated with, or who have control over the associated vendor.

### Factors to be applied in deciding whether the discretion should be exercised

20. In determining whether there are appropriate circumstances for the Commissioner to exercise the discretion in favour of a taxpayer, the following factors will be considered along with any other relevant factors (see paragraphs 23 to 71 of this SPS):
- (a) Whether the transfer is genuine,
  - (b) Whether the transfer price is at no more than the fair market value,
  - (c) Whether there is a permanent transfer of legal ownership of the property,
  - (d) Whether the associated vendor (or its controllers) continues to retain virtual ownership of, or beneficial interest in, the transferred property:
    - (i) Through power over, or control of the associated purchaser, or
    - (ii) Through a leaseback or similar agreement, or
    - (iii) Through continued actual use of the transferred property for income-producing purposes, and
  - (e) The commercial or non tax-related reasons for the transfer of the property.
21. The Commissioner has reviewed the relevant case law, including *CIR v Lys & Others*, relevant Australian cases, and the policy basis for the general discretion in section EE 33(4)(a)(ii).
22. Further discussion of the relevant criteria taking into account the findings in the case law is set out below.

#### Factor One: whether the transfer is genuine

23. The property must be acquired as though it were an arm’s length transaction and in accordance with normal commercial and conveyancing practices. The transfer of property must not be a contrivance or artifice that involves the insertion of artificial persons for the purpose of obtaining depreciation uplift.
24. The price (also see paragraphs 30 to 35 of this SPS) and other terms relating to the transfer should be consistent with an arm’s length transaction. That is, they should reflect genuine bargaining between the associated parties. The separate minds and the will of the parties should

have been applied to the bargaining process and be reflected in the documentation. Generally, there should be a willing seller and a willing purchaser. The associated parties should be able to demonstrate that the contract under which the transfer takes place has been negotiated in a manner that takes into account their own interests. (See *Granby Pty Ltd v FC of T* 95 ATC 4,240 and *Mansworth (HMIT) v Jelly* [2002] BTC 270.)

25. However, it is appropriate to consider the general context of the transaction. In particular, the Commissioner accepts that family dealings may be conducted in a less formal way. For example, there may not be appropriately executed documentation in family dealings. The Commissioner will then consider the totality of the circumstances in which the property is transferred in family dealings, including the evidence of the associated vendor and purchaser.
26. In *Lys*, the sale and purchase of a farm property from Mr Lys to his family trust involved a “Marshall” clause. The clause related to a loan between the parties that was subject to interest but only if it was demanded. The right to demand the interest avoids a gift arising even if the interest is never demanded (*Re Marshall (dec’d); C of IR v Public Trustee* [1965] NZLR 851). The High Court held that the transaction from Mr Lys to the family trust was nevertheless made in an arm’s length manner given that the trust was properly settled and also operated at arm’s length from Mr Lys, on the facts of the case. The use of the “Marshall” clause and the debt forgiveness did not mean that the transaction was inconsistent with normal commercial and conveyancing practices in that context.
27. However, if the transaction in *Lys* were a commercial or industrial transaction instead of a family transaction, the presence of the “Marshall” clause and debt forgiveness might be inconsistent with normal commercial and conveyancing practices. Therefore, the context of the transaction is important.
28. The Commissioner accepts that common terms of transfers within family groups will be regarded as genuine, even if financed with interest-free loans and fairly informal documentation, provided appropriately executed documentation is available that indicates a genuine intention to permanently transfer title to the property.
29. However, if a “Marshall” clause is used, it is expected that the interest rate which may be applied is set at a market rate, and not at a rate or formula allowing excess profits derived from the asset to be transferred to the vendor in the form of interest.

**Factor Two: whether the transfer price exceeds fair market value**

30. The Commissioner will not exercise the discretion if the transfer price exceeds fair market value. The term “fair market value” means that the assets are valued at a price that an arm’s length third party would pay and that the association of the parties to the transfer do not influence the price. In order to show that the transfer price is at fair market value, an independent and current valuation of the assets transferred should be undertaken at the time of transfer by a professionally qualified valuer and provided to the Commissioner. The valuation result should represent a sufficiently objective approximation of the consideration in money that could be obtained for the type of depreciable property concerned.
31. The Commissioner will not accept rating or insurance valuations if they do not represent the fair market value of the depreciable property. The Commissioner is also unlikely to accept a valuation that exceeds the replacement cost of the depreciable property transferred. The Commissioner may require that a separate valuation from an independent valuer be provided in cases when there is doubt regarding the transfer price.
32. The Commissioner expects the taxpayer to use recognised and acceptable commercial asset valuation methodologies for the type of property concerned. Where applicable, the valuation methodologies should not conflict with generally accepted accounting principles and New Zealand Equivalents to International Accounting Standards (“NZ IAS”).
33. Please note that the definition of “depreciable property” in sections EE 6, EE 7 and OB 1 excludes intangible property except for depreciable intangible property. On this basis, the value of the asset should not usually reflect intangible factors such as dominant market positions, brand values or be based on assumed future cash flows attributable to the use of the property.
34. The Commissioner may choose to disregard a valuation if that valuation method is not appropriate for the depreciable property transferred. (See *Erris Promotions Ltd v CIR* [2004] 1 NZLR 811; (2003) 21 NZTC 18,330.) The Commissioner may not accept valuations under the “discounted cash flow” or the “net present value” methods if intangibles such as the associated vendor’s dominant market position and business goodwill have been included in the value of the depreciable property. It is observed that in some cases, the net present value methodology has limitations, such as not providing an appropriate basis for measuring fair wear and tear or obsolescence and the calculation of depreciation.

*Partial transfers*

35. In the situation when the associated vendor transfers only part of the depreciable property, issues surrounding the apportionment of the cost of the transferred part of the property may arise. In cases of partial transfers, the taxpayer must provide arm’s length valuation advice in respect of that apportionment to the Commissioner to support the request for the exercise of the discretion.

**Factor Three: whether there is permanent transfer of legal ownership in the property**

36. Legal ownership of the property must be permanently transferred to the associated purchaser. The requirements for transfer of legal ownership differ, depending on the type of property in question. For example, in respect of land that comes under the Land Transfer Act 1952, a memorandum of transfer must be registered before transferring legal ownership. Other legal documents such as the sale and purchase agreement or title to the property may also be required to evidence a transfer of legal ownership in the property. In some cases involving chattels, possession may be sufficient evidence of a transfer of legal ownership.
37. Legal formality is only one factor. If the facts suggest that the transfer may be intended to be temporary, this test may not be met. The Commissioner may consider the transfer to be temporary if, for example, the sale agreement contains a provision that allows the associated vendor to repurchase the property at any time or if the associated vendor has expressed a clear intention that they will repurchase the property.
38. When the associated parties have negotiated for the transfer to include an option (whether formal or informal) for the associated vendor to repurchase the transferred property at a future date, these circumstances must be drawn to the attention of the Commissioner, and the Commissioner will consider the terms of the option, and the likelihood of its exercise, in determining whether the factor of permanent transfer of legal ownership is satisfied.

**Factor Four: whether the associated vendor continues to benefit directly or indirectly from the transferred property**

39. *Lys* and some Australian cases that were decided on the counterpart of section EE 33(4)(a)(ii) found that retention of virtual ownership or beneficial interest in the transferred property by the associated vendor is a factor that should be given considerable weight when deciding whether the discretion should be exercised.
40. The Commissioner considers that in the absence of evidence that would otherwise constitute strong commercial (or non tax-related) justifications for

the transaction or normal business practice, the retention of virtual ownership may indicate that exercising the Commissioner's discretion under section EE 33(4)(a)(ii) would be inappropriate.

41. This is, however, not to say that retention of some degree of ownership interest by the associated vendor will always be fatal to the exercise of the discretion. Firstly, retention of a minority beneficial interest is insufficient to outweigh other factors that are in favour of exercising the discretion. (See *Case X8 90 ATC 132.*)
42. The findings in *Case X8* are consistent with those in *Case 107* (1964) 11 CTBR (NS) 640, in which the Commonwealth Taxation Board of Review in Australia held that the discretion should not be exercised because the associated vendor retained "the larger proportion of the ownership of the assets after the formation of the partnership." The decision in *Case 107* implies that retention of a minority beneficial interest by the associated vendor will not be a sufficient reason in itself for the Commissioner to refuse to exercise the discretion.
43. Secondly, the Commissioner considers that in rare circumstances, the discretion may still be exercised even though there is retention of the majority ownership or beneficial interest in the transferred property. However, the taxpayer has the onus to prove that the transaction can be justified in accordance with normal commercial and conveyancing practices. (Also please see paragraphs 62 to 71 of the SPS.)
44. For example, in *Case 21* (1956) 7 CTBR 106, the Commonwealth Taxation Board of Review considered that the commercial justifications for the transfer of the building, namely for the purpose of expanding its own manufacturing processes, were sufficient to outweigh the factor that the purchaser owned 98% of the associated vendor.
45. Thirdly, as shown in *Case 107*, the Commissioner will ascertain the potential tax advantages that would flow to the associated vendor as a result of retaining some interest in the transferred property and if the discretion was exercised. The Commissioner will then compare these potential advantages with the disadvantages borne by the purchaser of the transferred property (for example, in *Case 107*, the disadvantages were measured by the difference between the transfer price paid by the purchaser and the share of tax depreciation claimable on the original historical cost). If the above potential advantages far outweighed the disadvantages, this is an indicator that the discretion should not be exercised.

#### **What is "virtual ownership"?**

46. The concept of "virtual ownership" is referred to in the cases but not fully explained. The

Commissioner considers that the following circumstances are indicative of the existence of this factor:

- (a) If the vendor (or its controllers) holds power over or control of the associated purchaser,
  - (b) If the vendor benefits through a leaseback or similar arrangement, and/or
  - (c) If the vendor benefits through continued actual use of the transferred property for income-producing activity.
47. Any reference to the vendor in the following discussion is intended to also refer, where appropriate, to any persons who control the vendor. This recognises that where material economic interests in the property are retained and none of the exceptions in paragraphs 43 to 45 apply, the discretion should not be exercised.
    - (i) ***Whether the vendor (or its controllers) holds power over or control of the associated purchaser***
  48. When the associated vendor (or its controllers) has control of the purchaser (either directly or indirectly), it is considered that the associated vendor has a material degree of virtual ownership of the transferred property.
  49. The general control tests in the ITA 04 may be applied but, because they usually only apply to companies, the Commissioner will, for the purpose of section EE 33(4)(a)(ii), apply a modified set of rules based on accounting principles by reference to NZ IAS and New Zealand Financial Reporting Standards, the latter of which may continue to apply to some public benefit entities after 31 March 2007.
  50. In *Related Party Disclosures* (NZ IAS 24) and *Consolidated and Separate Financial Statements* (NZ IAS 27), "control" is defined as "the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities." The Commissioner considers that both the "power" and the "benefit" elements are relevant when determining whether there is a continued economic interest in the transferred property.
  51. In essence, if the vendor (or its controllers) holds power over or control the associated purchaser, it is assumed that there is potential capacity to benefit and that the benefits will extend to any increased economic advantages flowing from the exercise of the section EE 33(4)(a)(ii) discretion.
  52. Having the potential capacity to benefit from the property means the associated vendor is entitled to a significant level of current or future benefits arising from the activities of the associated purchaser. The "benefit" element can exist independently of a power to influence, for example, as a beneficiary under a trust or as a non-controlling shareholder.

However, the critical factor is that the vendor must ultimately have the potential to receive those benefits, for example, as a shareholder or a beneficiary. It is irrelevant whether the vendor actually receives the benefits (for example, a beneficiary in a discretionary trust.)

53. These circumstances will give rise to a presumption of control or power over the associated purchaser by the associated vendor:

- (a) A direct or indirect majority voting interest in the associated purchaser,
- (b) A power to obtain a majority voting interest through the ownership of options or convertible rights,
- (c) A power to appoint or remove a majority of the members of the governing body of the associated purchaser,
- (d) A power to set or modify the financing and operating policies that guide the activities of the associated purchaser,
- (e) A power to extract distributions of economic benefits from the associated purchaser,
- (f) A right that is directly attributable to the ownership interest in the associated purchaser, to a majority of the economic benefits arising from the associated purchaser, irrespective of the timing or the mode of distributions of the benefits, or
- (g) A unilateral power to dissolve the associated purchaser and obtain a significant level of the residual economic benefits.

54. When the transfer is made to a party in which non-associated persons have a material beneficial interest or virtual ownership of the transferred property (for example, by shareholding or otherwise), the Commissioner will take that circumstance into account when deciding whether or not to exercise the discretion. (Please see paragraphs 39 to 45 of this SPS for details.)

**(ii) Benefiting through a sale and leaseback arrangement**

55. Another issue to be considered in exercising the discretion under section EE 33(4)(a)(ii) (even when the purchaser is not controlled by the associated vendor through the tests discussed above and in the examples of this SPS) is whether the property is still used by the associated vendor.

56. A sale and leaseback arrangement involves the sale of a property by a vendor and the leasing of the same property back to the vendor (or an associate controlled by the vendor or its controllers) for use. Some arrangements can be much more complex. In deciding whether to exercise the discretion in a situation when there is a leaseback arrangement,

the Commissioner will consider whether the arrangement is on arm's length market terms and properly documented, and also whether, in substance, the property has returned to the effective ownership of the vendor. The Commissioner may also consider whether the effective risk and rewards associated with ownership of the transferred property are passed back to the associated vendor (or an associate) through the leaseback arrangement.

57. Under generally accepted accounting principles (including those stated in *Leases* (NZ IAS 17)), leases are classified according to the extent to which the risks and rewards incidental to ownership of a leased property lie with the lessor or the lessee. A lease that transfers substantially all the risks and rewards incidental to ownership of a property to the lessee is described as a finance lease (see paragraph 4 of NZ IAS 17). Title to the property may or may not eventually be transferred to the lessee. A lease that is not a finance lease is called an operating lease.

58. When the leaseback is a finance lease, most of the risks and rewards incidental to ownership are transferred back to the associated vendor who is considered to continue to benefit from the transferred property.

59. If the leaseback is an operating lease, the accounting treatment is that in effect a normal sale transaction has occurred and it is considered that the associated vendor does not continue to benefit from the transferred asset/property, assuming that the operating lease payments have been struck at market value.

60. The fact that property is returned to the possession of the associated vendor through leasebacks or similar arrangements is therefore not in itself normally decisive in terms of exercise of the discretion if the arrangements are at arm's length and all the rewards and risks incidental to the ownership of properties are not transferred back to the associated vendor. However, other factors mentioned in this SPS may remain relevant.

**(iii) Benefiting through continued use of the transferred property for income-producing purposes**

61. Consideration has been given to the test set out in the withdrawn statement in *Tax Information Bulletin*, Vol. 4, No. 5 (December 1992) – where the purchaser buys the property for use in income-producing activities and the vendor no longer uses it for income-producing activities. While it is considered that the other factors set out above should normally be adequate to guide decision-making, consideration of this factor is potentially useful in some circumstances, such as sale and leaseback arrangements, described above,

and as indication of the commercial reality of the transfer. The Commissioner will consider any continued actual use (for income production or otherwise) by the vendor to be a relevant factor.

**Factor Five: the commercial or non tax-related reasons for undertaking the transfer of the property between parties**

62. Taxpayers should demonstrate that the transfer of property between associated persons is driven by material commercial or non tax-related reasons. Examples of such non tax-related reasons could be business restructuring (such as consolidations, mergers and takeovers), asset protection and estate planning. (Please note: the treatment of transfers of property in a non-qualifying amalgamation is discussed in paragraphs 67 to 71 of the SPS.) The Commissioner will take these reasons into account when deciding whether to exercise the discretion under section EE 33(4)(a)(ii). In appropriate cases, it may be necessary to consider any wider arrangement relating to the transfer and compare the non tax-related or commercial reasons given with those for the purpose of obtaining depreciation uplift under section EE 33(4)(a)(ii).
63. Some factors may indicate that exercising the Commissioner's discretion will be inappropriate. Clearly, if:
  - (a) no commercial reasons at all can be put forward for the transaction, or
  - (b) an artificial structure is used without commercial justification, or
  - (c) the transfer of property is part of a wider tax avoidance arrangement,

the Commissioner's discretion will not be exercised in the taxpayer's favour.
64. Furthermore, the Commissioner will not exercise the discretion to assist the taxpayers in their tax planning, such as "refreshing" of tax losses to reflect movements in market value.
65. For example, the associated vendor is a company that carries forward large amounts of tax losses from previous tax years. The company expects a breach of shareholding continuity in 2007 due to shareholder changes. Immediately before the breach, the associated vendor transfers the whole business operation to an associated company at market value. The result is that some of the existing losses can be utilised and offset against the depreciation claw back. The Commissioner will not exercise the discretion, as a principal purpose of the transfer of property is to avoid forfeiture of tax losses in the associated vendor.
66. In some instances, the taxpayer may have had no choice but to undertake a transfer, through circumstances beyond its control, such as a law

change, or pursuant to the terms of a binding arrangement enforced by a non-associated third party. In such cases, and provided that the first four criteria above are met, the Commissioner will usually exercise the discretion in favour of the transferee.

*Transfer of depreciable property in non-qualifying amalgamation on or after 14 May 2002*

67. Section EE 34 sets out the tax treatment of depreciable property transferred in a non-qualifying amalgamation on or after 14 May 2002. The provision overrides section EE 33.
68. Section EE 34(3)(a)(ii) confers a discretion on the Commissioner. The exercise of the discretion means that the amalgamated company can depreciate the property at the transfer value, rather than at the original cost of the property to the amalgamating company.
69. Given the similarity to the discretion under section EE 33(4)(a)(ii), the Commissioner will apply similar principles as set out in this SPS when exercising the discretion under section EE 34(3)(a)(ii). Examples of factors that may be considered are:
  - (a) The degree of shareholding commonality between the amalgamating companies and the amalgamated company,
  - (b) Whether the amalgamation exhibits an attempt to manipulate the depreciation provisions in the ITA 04,
  - (c) Whether the amalgamation process involves the introduction of an "artificial person" as a contrivance,
  - (d) Whether the beneficial interests of the amalgamated company materially differ from the beneficial interests in the amalgamating companies, and
  - (e) Whether the amalgamation arrangement was entered into for commercial purposes or for the purpose of obtaining a tax advantage.
70. The Commissioner notes that amalgamations for the purposes of operational and financial efficiencies are consistent with normal commercial practices. It is also observed that some degree of shareholding commonality between amalgamating and amalgamated companies may represent a normal commercial situation. This, by itself, will not negate the exercise of the Commissioner's discretion under section EE 34(3)(a)(ii).
71. Even if the shareholding commonality between amalgamating and amalgamated companies exceeds 50%, the Commissioner may still exercise the discretion under section EE 34(3)(a)(ii) provided that other legitimate non tax-related reasons exist and outweigh this factor.

## Miscellaneous matters

### *Relationship property*

72. When depreciable property is transferred pursuant to a relationship agreement or matrimonial agreement, section EE 33(4)(c) sets out the situations in which section EE 33 does not apply. Instead, section FF 16(7) provides for the associated purchaser to be allowed a depreciation deduction that is not more than the amount that would have been allowed to the associated vendor, had the associated vendor retained the asset.

### *Disposal of depreciable property on the death of a taxpayer*

73. Section EE 33(6)(b) states that the section does not apply to the disposal and resulting acquisitions of depreciable property on the death of a taxpayer under subpart FI, notwithstanding that the transfer of property is deemed to be at market value.

## Examples

74. These examples help to clarify the application of the standard practice in this SPS:

### **Example 1: transfer from individual taxpayers to a loss-attributing qualifying company (“LAQC”)**

Mr and Mrs H bought a house in Wellington ten years ago for \$260,000 and have been living there ever since. Mr H has recently been promoted in his employment and Mr and Mrs H have relocated to Auckland.

Mr and Mrs H have decided to commence a rental activity. The house in Wellington is rented out to an unrelated third party.

Mr and Mrs H have obtained an independent valuation from a registered valuer, who advises that the property has a market value of \$650,000. Instead of carrying on the rental activity themselves, they set up a LAQC and sell the house to the LAQC. Mr, Mrs H and the H Family Trust are equal shareholders of the LAQC. H Family trust has been settled with Mr H as one of the trustees and the beneficiaries are Mr and Mrs H's children.

The legal title of the property in Wellington is transferred to the LAQC. The LAQC is responsible for paying the interest on the mortgage, rates, insurance and any repairs. The unrelated tenant pays their weekly rents by direct credit to the LAQC's bank account.

The LAQC seeks to depreciate the property based on its acquisition cost for \$650,000, which is also the market value of the house. A request has been made under section EE 33(4)(a)(ii).

The Commissioner will not exercise the discretion under section EE 33(4)(a)(ii) in this example, although the transfer of the depreciable property is genuine and permanent and the transfer price does not exceed the fair market value. The reasons are as follows:

- (a) Mr and Mrs H continue to benefit indirectly from the transferred property: Mr and Mrs H have a legal and equitable interest in the LAQC. If the LAQC makes a profit or a loss from the rental activity, Mr and Mrs H, in their capacity as shareholders of the LAQC, will receive a distribution of the profit or an allocation of the loss.
- (b) The non tax-related reasons for the transfer of the real property do not outweigh the factor that the transferors retain significant beneficial interests in the transferred property: Mr H's promotion in his employment and family relocation seem to be the only non tax-related reasons for the transfer in this example. The Commissioner considers that these reasons are not sufficient to displace the transferors' significant beneficial interest in the transferred property.

### **Example 2: transfer between individual taxpayers**

Jack, a 70-year-old sole trader operating a dairy decides to sell the business assets to his nephew, Johnny. Johnny will take over Jack's dairy business. Jack and Johnny enter into a sale and purchase agreement, whereby all the business assets in the dairy will be sold to Johnny at a price based on an independent valuation. The payment consists of an Acknowledgment of Debt for 75% of the transferred price and cash for the remaining 25%.

Jack retires after the transfer. Johnny carries on the dairy business. Jack helps out in the dairy occasionally but is not otherwise involved in the business. Jack forgives some of the debt annually. Johnny requests that the Commissioner exercises the discretion under section EE 33(4)(a)(ii).

Jack and Johnny are associated persons in accordance with the definition of “relative” in section OB 1.

The Commissioner will exercise the discretion under section EE 33(4)(a)(ii) to allow Johnny to claim tax depreciation on the basis of the assets' transferred price. This is because:

- (a) The transaction is genuine: the transfer of the assets is the result of genuine negotiation between Jack and Johnny. Consideration has passed by Johnny to Jack for the transfer of business assets.



- (b) The transferred price is at a fair market value: the transferred price does not exceed the fair market value of the business assets.
- (c) The transfer of business assets is permanent: the parties to the transaction do not intend to lease or transfer the business assets of the dairy back to Jack.
- (d) The transferor does not continue to benefit from the transferred property: Jack does not have any control over the transferred assets in the dairy. Johnny runs the dairy business by himself. Jack only helps out occasionally.
- (e) The transfer is not tax driven: the main reasons for the transaction are to enable Jack to retire due to his old age and for succession planning.

However, Jack is required to calculate depreciation claw back or gain on disposal at the time of the transfer.

**Example 3: transfer from a partnership to a trust**

Jack and Jill (husband and wife) have a partnership which owns ten rental properties (which originally cost \$3 million), all of which are currently leased. They decide to sell the properties to a family trust – JJ Family Trust, for \$3.8 million. The transfer price is based on independent valuations. The sale and purchase agreement contains a loan with a Marshall clause allowing interest to be charged at current bank lending rates, if demanded.

Jack, Jill and Mr Y (an independent solicitor) are the trustees of JJ Family Trust. Only Jack and Jill have the power to appoint and remove trustees. Jack and Jill are also the beneficiaries of the trust along with their two children and their parents. A request has been made by the trustees of JJ Family Trust under section EE 33(4)(a)(ii) to depreciate the properties based on the cost of the properties to the trust.

The Commissioner will not exercise the discretion under section EE 33(4)(a)(ii) in this example although the transfer of the depreciable property is genuine and permanent and the transfer price does not exceed the fair market value. The reasons are as follows:

- (a) Jack and Jill continue to benefit indirectly from the transferred properties: this example can be distinguished from the *Lys* case. In that case, the vendor in the transfer of depreciable property to the family trust was not a beneficiary of the trust. Thus, the vendor did not retain any virtual ownership of or beneficial interest in the transferred property.

In the current example, Jack and Jill are the beneficiaries of the JJ Family Trust. Furthermore, they have control over the family trust by being the trustees and having the sole power to appoint and remove trustees. Thus, Jack and Jill can potentially remove Mr Y as the trustee, cast majority votes in trustees' meetings and make decisions to distribute a large proportion of economic benefits to them in their capacity as beneficiaries.

- (b) The taxpayers have not provided any non tax-related reasons for transferring the real properties from the partnership to JJ Family Trust: the Commissioner accepts that a sale by a partnership to a family trust does not necessarily mean that the transaction is something less than an ordinary commercial transaction. However, in this example, Jack and Jill did not explain the reasons for the transfer.

The Commissioner acknowledges that if Jack and Jill provided details on non tax-related reasons for the transaction, the Commissioner would need to consider them and weigh these reasons against the factor that the indirect benefits derived by Jack and Jill from JJ Family Trust. For example, both Jack and Jill are barristers sole. They decide to use a family trust to protect the real properties against possible claims by their clients in their legal practice.

However, the Commissioner may still refuse to exercise the discretion because their non tax-related reasons for the transaction cannot outweigh their significant beneficial interest in JJ Family Trust.

This Standard Practice Statement is signed on 14 September 2007.

**Graham Tubb**  
Group Tax Counsel  
Legal and Technical Services

## LEGAL DECISIONS – CASE NOTES

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

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

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

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### TAXPAYER FAILS IN ABUSE OF PROCESS CLAIM

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<b>Case:</b>	Sandra Hineato Anderson v The Commissioner of Inland Revenue
<b>Decision date:</b>	4 July 2007
<b>Act:</b>	Judicature Amendment Act 1972 and Tax Administration Act 1994
<b>Keywords:</b>	judicial review, abuse of process, due process

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#### Summary

The taxpayer claimed that the Commissioner has assessed her as being liable for shortfall penalties for tax evasion due to the fact that an Inland Revenue officer had given her incorrect advice as to how to complete ten GST returns and a business cessation form. The Court found that no such advice was given and the claim of abuse of process had not been made out. Furthermore, the allegation that the Commissioner failed to follow due process in investigating his own role in relation to the completion of the GST forms and business cessation form had not been proved.

#### Facts

The plaintiff taxpayer was the sole director and shareholder of a company that was registered for GST purposes. The company owned two residential properties. Following communications between an Inland Revenue Department (“IRD”) employee, the taxpayer and the taxpayer’s tax agent regarding outstanding GST returns for the company, the taxpayer met with an IRD employee.

At that meeting the ten outstanding GST returns were completed as “nil” returns and a *Business cessation (IR 315)* form were completed and handed to the IRD employee. The date for cessation of the business entered onto the IR 315 was some eighteen months prior to the meeting and the two properties owned by the business were not listed as assets. The Company subsequently sold both properties and did not return the GST on the sales.

The Company was audited and the taxpayer was asked why the properties had not been included on the IR 315 and why GST from the sale of the properties had not been included in the GST returns. The taxpayer said she had been told to backdate the company’s trading cessation date by the IRD employee and could only “plead ignorance”.

The Commissioner issued a Notice of Proposed Adjustment (“NOPA”) to the taxpayer, including a shortfall penalty for tax evasion in respect of incorrectly completing the GST returns as nil returns and for incorrect completion of the business cessation form. The NOPA was sent to both the taxpayer and her tax agent. A Notice of Response (“NOR”) was received out of the statutory response period.

#### Decision

The Court dismissed the application for Judicial Review.

The Court made findings of fact in favour of the Commissioner to the effect that the IRD employee had not told the taxpayer how to complete the IR 315 and that the taxpayer was the only person who had knowledge of the status of the (sale of) the properties. He also noted other evidence to the effect that the taxpayer had been aware of the obligation to return the GST from the sales of the properties.

The Court held that there was nothing said or done by the IRD employee that could be characterised as an abuse of process or unfairness.

The Court held further that the NOPA detailed the investigation undertaken by the Commissioner and noted that the allegation that the Commissioner had failed to follow due process in investigating his own role in relation to the completion of the GST form and the IR 315 was not made out on the facts.

The Court held in the alternative, if it was incorrect in its conclusions and there was some apparent basis for intervention, that the circumstances of the case did not involve “exceptional circumstances” as required for judicial review in tax cases.

## APPEALING STRIKE OUT OF JUDICIAL REVIEW APPLICATION

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<b>Case:</b>	Ch'elle Properties (NZ) Limited v The Commissioner of Inland Revenue
<b>Decision date:</b>	18 July 2007
<b>Act:</b>	Judicature Amendment Act 1972
<b>Keywords</b>	judicial review, strike out, GST transactions, illegality, negligence, statutory duty, Bill of Rights

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### Summary

The taxpayer appealed the High Court decision to strike out its application for judicial review of the Commissioner's actions. The allegations against the Commissioner included illegality in withholding refunds; retrieving refunds accidentally paid; negligence; breach of statutory duty and not complying with the Bill of Rights Act.

### Background

This was an appeal from the decision of the High Court allowing the Commissioner's application to strike out Ch'elle Properties Ltd ("Ch'elle") Judicial Review proceedings.

### Facts

Ch'elle filed GST returns for the taxable periods ending 31 May 1999 and 31 July 1999 claiming input tax credits totalling approximately \$9 million. This was based on the purported purchase of 117 properties. The properties were sold by vendors set up and controlled by Nigel Ashby ("Mr Ashby"). Minimal deposits were paid and settlement was deferred for 20 years.

As Ch'elle was registered for GST on an invoice basis it claimed the GST on the purchases at the time an invoice was issued. The vendor companies were registered for GST on a payment basis, allowing it to defer accounting for output tax until settlement.

The Taxation Review Authority ("TRA"), High Court ("HC") and most recently, the Court of Appeal ("CA") found Ch'elle was not entitled to input credits in relation to 114 of the property transactions on the basis the scheme was one of tax avoidance.

In June 2004 Ch'elle also sought declaratory relief by way of judicial review and damages under the six causes of action set out below:

- The Commissioner acted illegally when he recouped money paid accidentally to Ch'elle pursuant to section 43 of the GST Act;
- The Commissioner was illegally withholding \$9 million of input tax credits as he had not invoked section 46 of the GST Act;

- The Commissioner acted illegally in making his assessment and during the disputes process and adjudication. Therefore the decisions of the TRA and High Court were invalid;
- The Commissioner was negligent in that he breached a statutory duty of care and caused foreseeable loss;
- The Commissioner breached a statutory duty;
- The Commissioner had not complied with the New Zealand Bill of Rights Act ("NZBORA") in that he breached Ch'elle's right to natural justice.

The Commissioner sought to have the action struck out on the basis the claim amounted to an abuse of process, was untenable and/or futile.

Justice Keane in the HC struck the judicial review application out on the basis the causes of action on which Ch'elle relied were either untenable, an abuse of process or futile. There was no basis on which the taxpayer could resurrect its claim by amending its pleading. [see *Ch'elle Properties (NZ) Limited v CIR (2005) 22 NZTC 19,622*]

### Decision

#### 1<sup>st</sup> cause of action

In view of the TRA and HC decisions in the Challenge proceeding, the declaration that the Commissioner was unlawfully in possession of the refund was unavailable to Ch'elle. The refund was not and never should have been the property of Ch'elle. In addition, a declaration that the Commissioner acted illegally in removing the refund would be misleading since it had been established that Ch'elle was not entitled to the refund.

#### 2<sup>nd</sup> cause of action

The CA agreed that while the Commissioner failed to follow the section 46 procedure (which the Commissioner accepted), the fact the scheme was found to be tax avoidance meant the declarations sought would be futile.

#### 3<sup>rd</sup> cause of action

The CA agreed with the HC that no declaration of invalidity was available as the TRA hearing cured any procedural problems with the previous assessment. In addition, despite Ch'elle arguing otherwise, the Commissioner's SOP addendum was issued within the response period. Finally, in relation to the argument that the Commissioner could not advance arguments which differed from Adjudication, the issue was estopped from being argued as the HC had found in the Commissioner's favour and Ch'elle had not appealed this point.

#### 4<sup>th</sup> cause of action

The CA found the negligence claim deficient as no particulars of the purported breach were provided. The CA agreed with the HC finding that it was undesirable

to impose a duty of care on the Commissioner given the elaborate statutory construct within which the Commissioner and taxpayers relate.

### 5<sup>th</sup> cause of action

The CA found the allegation of breach of statutory duty to be totally misconceived in that if the refunds were properly payable Ch'elle would not need to rely on this tort for payment.

### 6<sup>th</sup> cause of action

The CA agreed with the HC that the final cause of action relying on section 27 New Zealand Bill of Rights Act could not succeed as the authority did not extend beyond procedural fairness. In addition, any possible breach on the part of the Commissioner before the assessments were issued was cured by the objection process. For this reason they preferred not to express an opinion as to the ambit of section 27(1) or circumstances in which compensation could be awarded.

## TRA'S ALTERNATIVE ASSESSMENT UPHELD

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<b>Case:</b>	Max Beckham v The Commissioner of Inland Revenue
<b>Decision date:</b>	30 July 2007
<b>Act:</b>	Income Tax Act 1994
<b>Keywords:</b>	assessment under alternative ground, assessment by TRA

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### Summary

The TRA upheld the taxpayer's challenge to the Commissioner's assessment but then assessed an alternative ground. The High Court dismissed the taxpayer's appeal against the TRA's decision.

### Fact

This is a consolidated appeal from two decisions of the Taxation Review Authority ("TRA") concerning the taxpayer's liability to pay income tax on the proceeds of sale of farmland. The decision was deferred pending the final outcome of *Zentrum Holdings Ltd v The Commissioner of Inland Revenue* as it was relied on by the taxpayer. (On 23 May 2006 the Court of Appeal released its judgment in *Zentrum Holdings Ltd* allowing the Commissioner's appeal. In September 2006 the Supreme Court granted the taxpayer leave to appeal, but in the event that appeal was abandoned and the parties accepted that the High Court was bound by the Court of Appeal's judgment.)

The taxpayer was a farmer who sold farmland to a company of which he was the sole shareholder and

director for the purpose of subdivision. He did not declare the sale receipt for income tax purposes.

The Commissioner assessed the taxpayer's liability to pay tax under section CD1(2)(f) of the Income Tax Act 1994. He contended that the taxpayer was party to an undertaking or scheme for the sale and subdivision of the land and that the work done on the land was of more than a minor nature and was carried out within ten years of the date of acquisition of the property: section CD1(2)(f), and, in the alternative, that the taxpayer was assessable on the profit on the sale, as at least 20% of the profit was due to resource consent being granted: section CD1(2)(e).

The taxpayer challenged the assessment to the TRA. In a decision dated 19 July 2005 the TRA upheld the challenge, concluding that the taxpayer was not the developer of the subdivision. However the TRA decided that the evidence established that the granting of resource consent resulted in an increase in value of the property by at least 20%, which meant the Commissioner could assess the taxpayer under the alternative ground of section CD1(2)(e). The TRA reasoned that as the Commissioner had the power to do so, so did he, and it was not necessary to refer the matter back for reassessment under the alternative provision. The TRA gave the taxpayer leave to call further evidence or make further submissions.

The taxpayer appealed and the Commissioner cross-appealed. The TRA then issued a "final decision" endorsing the earlier decision and assessing the taxpayer's tax liability.

### Decision

In relation to the first issue the taxpayer argued that the challenge considered by the TRA related only to the validity of the assessment under section CD 1(2)(f), and that once that challenge was determined the TRA's role and jurisdiction came to an end. There was no basis to reassess under a different section. He relied on the High Court decision in *Zentrum Holdings Ltd v Commissioner of Inland Revenue* in which the Commissioner was prohibited from arguing on appeal a ground that was not the ground of assessment. That decision was overturned by the Court of Appeal.

The Commissioner argued that the TRA was correct in holding that section CD 1(2)(e) had been raised in the challenge and that the Commissioner was not precluded from relying on it. That provision was raised in both the Commissioner's and the taxpayer's statements of position, as well as in the taxpayer's notice of claim to the TRA and the Commissioner's notice of defence. The taxpayer contended that these references merely provided background material. The assessment was made under section CD1(2)(f), but the Adjudication Unit's Notice of Final Determination stated that "had section CD1(2)(f) not applied, the amount Mr Beckham derived from the sale of the land would have been gross income under section CD 1(2)(e) ...."

The High Court rejected the taxpayer's arguments. Frater J held that where a disclosure notice is issued and the taxpayer subsequently challenges the assessment, the matters in issue are limited to the legal and factual issues identified in the statements of position, but all of those issues are legitimate matters of dispute in the challenge proceedings. The alternative ground of assessment was clearly foreshadowed in the communications between the parties and there was no procedural impropriety or unfairness involved in applying it.

Given the decision that the TRA had jurisdiction to consider the alternative ground, it followed that it also had the power, like the Commissioner, to reassess the quantum of tax payable under that ground. The Court rejected the taxpayer's argument that the issues were fully determined at the point where the challenge to the first assessment was upheld. It followed that the September decision constitutes the final determination of issues by the TRA and any right of appeal must be from that decision.

In relation to the merits of the substantive assessment, the High Court held that, on the evidence, it was open to the TRA to hold that at least 20% of the difference between the value of the land as a farm and the sale price was attributable to the resource consent.

## TAXPAYER LOSES PROCEDURAL POINT

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<b>Case:</b>	Decision 11/2007
<b>Decision date:</b>	31 July 2007
<b>Act:</b>	Tax Administration Act 1994, Taxation Review Authorities Regulations 1998
<b>Keywords:</b>	points of objection notice, calculation of statutory time frames, address for service

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### Summary

The calculation of the time frame for filing a case stated with the TRA commences when a points of objection notice is received by the Director Litigation Management Unit and not by its receipt by the wider Inland Revenue Department.

### Facts

These proceedings were instituted by the Case Stated procedure on 20 May 2002.

In these proceedings the objector has claimed that the Commissioner failed to file a Case Stated within the statutory time period.

A points of notice ("PON") was posted by the Objector on 15 February 2002, addressed to "Senior Appeals Officer" Inland Revenue Dept, P O Box 2198, Wellington. The objector took it that items posted in the normal course of

business deemed to have been delivered the day following posting. The Objector therefore took it that it would have been received on Monday 18 February 2002.

The Objector claimed that 63 days had elapsed between the date of receipt by the Inland Revenue Department ("IRD") on 18 February and the filing date on 21 May 2002 therefore, according to the objector the Case Stated was filed three days late. The Commissioner filed an application for an extension of time (to protect its position) for a further working day. The Objector opposed this application, on the grounds that the letter and PON were addressed in the manner required and therefore deemed to have been received by the Respondent on 18 February 2002. The Objector also made reference to the Tax Administration Act ("TAA") and the need to treat an Objector fairly and impartially and to take account ss. 4, 5 and 6 of the New Zealand Bill of Rights Act 1990.

The PON which was posted by the Objector on 15 February 2002 was not received by the Litigation Management Unit until 1 March 2002. It appeared to have been received by another part of IRD (Processing Centre in Upper Hutt) on 20 February 2002. The Commissioner filed the Case Stated on 21 May 2002 which was well within the 60 day time frame. Counsel for the Commissioner argued that service of the PON must be on the Commissioner by personally delivering the document to the Director, Litigation Management, Freyberg Building, Aitken Street, Wellington.

### Decision

Regulation 23(a) of the Taxation Review Authorities Regulations 1998 requires an objector to serve the Commissioner with the PON, by personally delivering the document to the *Director, Litigation Management, P O Box 2198, Wellington*. The Objector chose not to personally deliver or courier the PON but instead chose to post it. It did not reach Litigation Management until 1 March 2002 and at law, service of the PON was not achieved by the Objector until 1 March 2002 and therefore the 60-day period for the respondent to file a case stated commenced from that date and expired on 29 May 2002. The Case Stated was filed on 21 May 2002 and so was well within the time.

Judge Barber relied on Regulation 23 in this ruling. He noted that s 6 of the Tax Administration Act 1994 and s 27 of the Bill of Rights Act 1990 could not help the Objector in any substantive way. Section 6 of the TAA requires the IRD to protect the integrity of the tax system, including, *inter alia*, to be fair, impartial and administer according to law.

The application for an order to allow the objection was refused on the above grounds.

The Judge stated that if receipt by the Processing Centre at Upper Hutt was determinative (in this case it's not), so that the Commissioner would have filed the case stated one day or so late, the application for an extension of time pursuant to reg.25 (2) of the Taxation Review Authorities



Regulations 1998 on the basis that he was satisfied there were exceptional circumstances for the Commissioner's failure to file the case in time would have been granted.

## TAXPAYERS LOSES COSTS APPLICATION

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<b>Case:</b>	K & W Wynyard & Fox Trust v The Commissioner of Inland Revenue
<b>Decision date:</b>	30 August 2007
<b>Act:</b>	Judicature Amendment Act 1972; High Court Rules
<b>Keywords:</b>	indemnity costs

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### Summary

The taxpayer was unsuccessful in seeking indemnity or increased costs from the Commissioner.

### Facts

The taxpayers had commenced judicial review proceedings against the Commissioner of Inland Revenue in respect of the application of the disputes process at Part IVA TAA 1994.

Upon receiving the proceedings the Commissioner conceded the case and agreed to pay the taxpayer's costs of the proceedings. The taxpayers sought to recover a large sum of costs purportedly incurred in the course of the litigation. The Commissioner refused to pay the large sum and offer instead to pay \$5,200 based upon the High Court Rules schedule of costs for a moderately difficult case (scale 2B).

The taxpayers filed an interlocutory application seeking indemnity costs (full repayment of all costs associated with the matter) or increased costs for a more difficult case (scale 3C in the schedule to the HCR).

### Decision

MacKenzie J concluded that there were no grounds for indemnity or increased costs.

His Honour said:

“Category 3 applies to proceedings that because of their complexity or significance require counsel to have special skill and experience ... These proceedings were quite straightforward.... As to banding, because of the Commissioner's prompt acknowledgement of the position, and admission of the claim, the only substantive step undertaken was... [the] commencement of proceedings” (par [5]-[6])

The Commissioner's reliance on category 2B was appropriate. No award of increased costs was made.

As to indemnity costs (under r 48C(4) HCR) His Honour concluded:

In claiming indemnity costs, counsel for the [taxpayers] refers to the extensive interaction with the Commissioner over the tax affairs of the applicants and associated entities, prior to the proceedings being issued. Those matters are not properly taken into account in determining whether indemnity costs should be awarded. Costs are awarded for steps taken in the proceedings, not for the interactions of the parties which have preceded the issue of proceedings. Tax proceedings are no different from any other proceedings in that respect.” (at par [7]).

His Honour also dismissed as irrelevant reference to a “without prejudice” offer to resolve the taxpayer's tax position as it pre-dated the proceedings (par [8]).

The taxpayers received costs of \$5,200 less the Commissioner's costs due to his success opposing the taxpayer's application (\$480)

## SPECIAL LEAVE TO APPEAL

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<b>Case:</b>	Peter Lloyd Machirus v The Commissioner of Inland Revenue
<b>Decision date:</b>	30 August 2007
<b>Act:</b>	Court of Appeal (Civil) Rules
<b>Keywords:</b>	special leave to appeal

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### Summary

The taxpayer was denied special leave to appeal out of time as the Court considered there was no merit in the appeal itself.

### Facts

The taxpayer sought special leave to appeal out of time a decision of Ronald Young J delivered on 3 April 2007. Special leave was required as the taxpayer was five weeks' late in filing his appeal.

The taxpayer was late to file the appeal due to the fact that he initially did not pay the filing fee and later the appeal was not in the prescribed form. The Commissioner opposed the special leave application to file out of time.

### Decision

The Court of Appeal declined to grant leave based on the fact that in their view the appeal had no merit. There was no error in the approach taken by the High Court Judge on the Bill of Rights issues. All of the relevant information necessary for the taxpayer to plead his case had been provided to the taxpayer by the Commissioner and at the High Court the taxpayer did not avail himself of the opportunity to show that he was at a disadvantage.

## REGULAR FEATURES

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### DUE DATES REMINDER

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#### October 2007

**23 Employer deductions**

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

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

**29 GST return and payment due**

#### November 2007

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

**20 Employer deductions**

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

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

**28 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](http://www.ird.govt.nz)

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

PU0151: GST – Lottery operators and promoters

***Comment deadline***

31 October 2007

*No envelope needed—simply fold, tape shut, stamp and post.*

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