

TAX INFORMATION

Bulletin



CORRECTION

In the Tax Information Bulletin **Volume 20 Issue 6** we published an incorrect figure in the National Average Market Values of Specified Livestock Determination, 2008

Under the heading *Jersey and other dairy cattle* the figure for *Mixed age cows* reads 079.00. It should read 2079.00.

We apologise for any inconvenience this may have caused.

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

The Office of the Chief Tax Counsel (OCTC) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The OCTC also contributes to the "Questions we've been asked" section and "This month's opportunity to comment" section where taxpayers and their agents can comment on proposed statements and rulings.

Legal and Technical Services

Legal and Technical Services contribute the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters.

Legal and Technical Services also contribute to "This month's opportunity to comment" section.

Policy Advice Division

The Policy Advice Division advises the government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as the Orders in Council.

Litigation Management

Litigation Management manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

GET YOUR TIB SOONER ON THE INTERNET

This *Tax Information Bulletin (TIB)* is also available in PDF at www.ird.govt.nz

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

If you would prefer to get the *TIB* from www.ird.govt.nz, please email us at tibdatabase@ird.govt.nz and we will take you off our mailing list.

You can also email us to advise a change of address or to request a paper copy of the *TIB*.

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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly 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 a user of that legislation, is highly valued.

A list of the items we are currently inviting submissions on can be found at www.ird.govt.nz. On the homepage, click on “Public consultation” in the right-hand navigation. Here you will find drafts we are currently consulting on as well as a list of expired items. You can email your submissions to us at public.consultation@ird.govt.nz or post them to:

Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington

You can also subscribe to receive regular email updates when we publish new draft items for comment.

Below is a selection of items we are working on as at the time of publication. If you would like a copy of an item please contact us as soon as possible to ensure your views are taken into account. You can get a copy of the draft from www.ird.govt.nz/public-consultation/ or call the Team Manager, Technical Services Unit on 04 890 6143.

Ref	Draft type	Description/background information
QB0033	Payments made in addition to financial redress under Treaty of Waitangi settlements – income tax treatment	This item addresses the income tax treatment of payments (based on interest for the period between settlement and payment) made to claimants under Treaty of Waitangi settlements and paid in addition to financial redress under the settlement. It is concluded that the payments are not interest within the statutory definition, not income under a financial arrangement and are not income under ordinary concepts. This item was previously released for consultation and is being re-released as a different view has been reached on the issue of whether the payments are income under ordinary concepts.
QB0066	Holiday houses – income tax treatment	This item addresses the circumstances where owners of holiday houses will be allowed a deduction for expenditure incurred in owning the holiday house. Whether a deduction will be allowed will depend on the connection with income earned. In particular, deductions will generally be allowed for the periods that a holiday house is rented out on an arm's length basis. Further, a deduction may be allowed for expenditure incurred while a holiday house is not rented out, if it is genuinely available for rent. Limited deductions may be allowed where a holiday house that is essentially available to only the owner and their family and friends is rented out for short periods. However, this will depend on the particular circumstances.

IN SUMMARY

New legislation

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Orders in Council

Minimum family tax credit amount increased

The Income Tax (Minimum Family Tax Credit) Order 2008, made on 6 October 2008, increases the net income level guaranteed by the minimum family tax credit. The net income level will rise from \$18,460 to \$20,540 a year from 1 April 2009.

Student loan scheme repayment threshold for the 2009–10 tax year

The income threshold at which New Zealand-based borrowers must begin repaying their student loans will rise from \$18,148 to \$19,084 from 1 April 2009.

Legal decisions – case notes

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Demand is not of substantial assistance in determining whether money is payable under the Unclaimed Money Act 1971

Westpac Banking Corporation, Bank of New Zealand and ANZ National Bank Limited v CIR

The taxpayers sought declarations that certain specified categories of money or obligations in relation to foreign drafts and New Zealand currency bank cheques are not “unclaimed money” in terms of the UMA. The Court upheld the Commissioner’s counterclaim and contended that the amounts payable by the banks pursuant to the unrepresented bank drafts and bank cheques are “unclaimed money” within the meaning of section 4(1)(e) of the UMA.

Procedural irregularities in tax assessments

JD & CE Henson Partnership & Ors v Commissioner of Inland Revenue

Taxpayers’ appeal against TRA decision which held that the income tax assessments were valid and correct. Taxpayers’ alleged that the assessments were invalid as they failed to quantify the amount of tax due and that the TRA lacked jurisdiction to hear a case where there were no valid assessments before it. Alternative argument on the correctness of the assessments. Appeal dismissed.

Standard practice statement

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SPS 08/04: Elections to change a balance date

Section 38 allows taxpayers, with the consent of the Commissioner, to elect to furnish a return of income for the year ending on the date corresponding with the balance date of their annual accounts, instead of using the standard 31 March otherwise required by the TAA.

Questions we’ve been asked

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Income Tax Act 2007: Research and development credits (subpart LH) – tax avoidance (section BG 1)

This QWBA considers the tax avoidance (section BG 1) implications of a particular form of restructuring undertaken by a group of companies in order to become eligible for research and development tax credits.

NEW LEGISLATION

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

ORDERS IN COUNCIL

MINIMUM FAMILY TAX CREDIT AMOUNT INCREASED

The Income Tax (Minimum Family Tax Credit) Order 2008, made on 6 October 2008, increases the net income level guaranteed by the minimum family tax credit. The net income level will rise from \$18,460 to \$20,540 a year from 1 April 2009.

The order increases to \$20,540 the **prescribed amount** in the definition in section ME 1(3)(a), Income Tax Act 2007, of the items in the formula for calculating the minimum family tax credit.

The increase applies for the 2009–10 and later tax years. The prescribed amount is used when calculating the amount that a person may be allowed as a credit of tax under section ME 1(2).

The order also amends the Income Tax (Family Tax Credit) Order 2007 to limit its application to the 2008–09 tax year.

Income Tax (Minimum Family Tax Credit) Order 2008
(SR 2008/384)

STUDENT LOAN SCHEME REPAYMENT THRESHOLD FOR THE 2009–10 TAX YEAR

The student loan scheme repayment threshold, which sets the income level at which compulsory repayments begin for New Zealand-based borrowers, will increase from its current level of \$18,148 to \$19,084 for the 2009–10 tax year.

The threshold is reviewed annually in December. It has been inflation-adjusted by the annual movement in the September 2008 CPI and rounded up so that it is divisible into whole dollars on a weekly basis.

Student Loan Scheme (Repayment Threshold) Regulations 2008 (SR 2008/450)

LEGAL DECISIONS – CASE NOTES

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

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.

DEMAND IS NOT OF SUBSTANTIAL ASSISTANCE IN DETERMINING WHETHER MONEY IS PAYABLE UNDER THE UNCLAIMED MONEY ACT 1971

Case	Westpac Banking Corporation, Bank of New Zealand and ANZ National Bank Limited v CIR
Decision date	3 November 2008
Act	Unclaimed Money Act 1971 ("UMA")
Keywords	Unclaimed money, foreign currency drafts

Summary

The taxpayers sought declarations that certain specified categories of money or obligations in relation to foreign drafts and New Zealand currency bank cheques are not "unclaimed money" in terms of the UMA. The Court upheld the Commissioner's counterclaim and contended that the amounts payable by the banks pursuant to the unrepresented bank drafts and bank cheques are "unclaimed money" within the meaning of section 4(1)(e) of the UMA.

Facts

This proceeding concerned the application of the Unclaimed Money Act 1971 ("UMA") to foreign currency drafts and New Zealand currency bank cheques, issued by the plaintiff banks in the course of their business, which are not subsequently presented for payment.

The plaintiff banks sought declarations that certain specified categories of money, or obligations in relation to foreign drafts and New Zealand currency bank cheques, are not "unclaimed money" in terms of the UMA. The Commissioner did not contest the declarations in that the various categories of money referred to are not unclaimed monies but did, by virtue of a counterclaim, contend that the amounts payable by the banks pursuant to the unrepresented bank drafts and bank cheques are "unclaimed money" within the meaning of section 4(1)(e) of the UMA.

Decision

MacKenzie J referred to the decision in Commissioner of Inland Revenue v Thomas Cook (New Zealand) Limited [2005] 2 NZLR 722 where the Privy Council held that the unclaimed monies (under similar instruments) were, for the purposes of the UMA, owing and payable at the date of issue, not from the time of any demand.

His Honour held there is no material difference on the facts between this case and the Thomas Cook case as the instruments are essentially identical. The fact that here, but not in Thomas Cook, the drawer is a bank is not a material distinction as in both cases the drawee was a bank. Accordingly, on the basis that Thomas Cook was binding, the Commissioner's counterclaim succeeded.

MacKenzie J did go further and consider the position if Thomas Cook did not apply (in the event, on appeal, it is considered not binding).

After concluding there is a liability owed under a bank draft when it is issued and under a bank cheque when it is delivered (as a complete promissory note), his Honour considered whether that liability would constitute "money payable" under the UMA. MacKenzie J stated that the essential question under the UMA is not whether the breach of the obligation arises (as in an action in contract) but when the obligation itself arises. His Honour concluded that a demand is not of substantial assistance in determining whether money is payable under the UMA and therefore, even if it were open to him to do so, his decision would not have differed from the Privy Council in that regard.

PROCEDURAL IRREGULARITIES IN TAX ASSESSMENTS

Case	JD & CE Henson Partnership & Ors v Commissioner of Inland Revenue
Decision date	24 September 2008
Act	Income Tax Act 1976, Tax Administration Act 1994, Taxation Review Authorities Act 1994
Keywords	Income tax assessment, assessment process, irregularities in assessment, jurisdiction of the TRA

Summary

Taxpayers' appeal against TRA decision which held that the income tax assessments were valid and correct. Taxpayers alleged that the assessments were invalid as they failed to quantify the amount of tax due and that the TRA lacked jurisdiction to hear a case where there were no valid assessments before it. Alternative argument on the correctness of the assessments. Appeal dismissed.

Facts

This was an appeal by the taxpayers against a decision of the Taxation Review Authority in which the Authority upheld the validity and correctness of the Commissioner's income tax assessments.

The High Court dismissed the taxpayers' appeal.

The taxpayers operated as a partnership. Following an investigation, the Commissioner issued manual notices of assessment for the 1992–1995 income tax years on 17 September 1996. The notices of assessment set out the adjustments to be made to the assessable income of the taxpayers but did not state the amount of tax to be paid. On 15 October 1996, the Commissioner issued statements of account setting out the amount of tax to pay.

Following discussions with the taxpayers, further notices of assessment were issued on 20 February 1997. These notices were manually prepared and specified the adjusted assessable income of the taxpayers without specifying the amount of tax to be paid. On 26 February 1997 statements of account were issued which set out the amount of tax to be paid as a result of the reassessments.

Following a disagreement over the validity of the Commissioner's assessments and the taxpayers' purported dispute of the assessments, the taxpayers commenced Judicial Review proceedings against the Commissioner. The Judicial Review proceedings were subsequently settled. The settlement deed stated that there were "exceptional circumstances" that permitted the Commissioner to invoke his power under section 89K of the Tax Administration Act 1994 to accept the taxpayers' late notices of proposed adjustment. The deed stated that the notices of assessment issued on 17 September 1996 were to be treated as if they had been issued after 1 October 1996, which enabled the dispute to be dealt with under the statutory disputes procedure. The taxpayers' challenge proceedings in the TRA were unsuccessful.

Decision

Appeal dismissed.

Jurisdiction issue

- Tax liability has to be quantified and recorded for there to be a completed assessment. At the time the notices of assessment dated September 1996 and February 1997 were issued the assessment process was not completed. However, there is specific statutory authority which provides that procedural irregularities will not invalidate an assessment. In this case, what occurred was that the Commissioner made assessments that were irregularly notified to the taxpayers.
- The settlement deed entered into between the Commissioner and the taxpayers cannot be read to confine the parties to only disputing the assessments dated September 1996 and February 1997. When the parties entered into the deed they were aware that it was the Commissioner's income tax assessments for the 1992–1995 tax years which were being disputed. The deed was executed against a statutory background in which Parliament made express provision that procedural irregularities could not invalidate an assessment. The judge reaffirmed the Court of Appeal in *Miller*, which referred to the need to avoid permitting "formalism run riot". Her Honour stated that to hold otherwise would be "overly formal, unrealistic and nonsensical".

Correctness issues

- The taxpayers had incorrectly included a \$6,400 capital payment as income in the 1992 year; the Commissioner's assessment in 1993 was to correct this error. There is nothing to suggest that the appellants were prejudiced by the adjustment not being made in the same tax year.
- The Commissioner had treated the overdrawn current account as a deemed dividend to Mr Henson and assessed it as income. The onus of proof was on Mr Henson to prove that he held half of his shares in the company on trust for his wife (and as such the deemed dividend was assessable income to the partnership). The evidence provided at the hearing as to whether the shares were held on trust was "at best, equivocal" and there was no contemporaneous material to support the contention. This appeal failed on the evidence.
- The Commissioner had disallowed the partnership's claim for a deduction for management consulting fees of \$27,000 and \$24,000 in respective tax years, for fees charged to the partnership by Standard 88 Limited. The burden of proof is on the taxpayers to prove that either the expenses had been incurred or that the alleged burglary resulting in loss of the documentation had occurred and her Honour noted that "more than self-serving oral evidence is required."

STANDARD PRACTICE STATEMENTS

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

SPS 08/04: ELECTIONS TO CHANGE A BALANCE DATE

Introduction

1. This Standard Practice Statement (“SPS”) sets out Inland Revenue’s practice for considering applications for the Commissioner’s consent to change a balance date for income tax purposes. This includes taxpayers who wish to change from a non-standard balance date to a 31 March balance date.

Application

2. This SPS applies from 1 January 2009.
3. This SPS applies to the exercise of the Commissioner’s discretion under section 38 of the Tax Administration Act 1994 (“the TAA”) when considering whether to give consent to taxpayers’ elections to change their balance dates. It replaces all previous Inland Revenue policy statements on changes of balance dates for income tax purposes, including those published in the Tax Information Bulletins, Vol 3, No 9 (June 1992) and Vol 5, No 11 (April 1994).
4. Due to the recent enactment of the portfolio investment entity rules, this SPS also updates the standard practice set out in SPS 05/06 Non-standard balance dates for managed funds and “as agent” returns, which was published in the Tax Information Bulletin, Vol 17, No 4 (May 2005). SPS 05/06 is therefore withdrawn from the application date of this SPS.
5. Unless specified otherwise, all legislative references in this SPS refer to the TAA.

Legislation

6. The relevant legislative provisions are:
 - (a) sections 6, 6A, 33, 37 and 38 of the TAA
 - (b) sections HD 16 and YA 1 of the Income Tax Act 2007 (“ITA 2007”).

Summary

7. Section 38 allows taxpayers, with the consent of the Commissioner, to elect to furnish a return of income for the year ending on the date corresponding with the balance date of their annual accounts, instead of using the standard 31 March otherwise required by the TAA.
8. Only taxpayers with an obligation to file returns under section 33 (generally being persons in business or those who receive income which is not taxed at source) may apply under section 38 to adopt a balance date other than 31 March. In addition, a portfolio tax rate entity that does not make payments of tax under section HL 23 of the ITA 2007 is not able to make an election under section 38.
9. The Commissioner has an obligation to protect the integrity of the tax system, including applying the tax laws fairly, impartially and according to the law. In doing this regard will be given to the general legislation intent that taxpayers are required to return income to 31 March. The Commissioner will also ensure that the timing of tax revenue to the Government is not seriously eroded. Every application will be considered on individual merit in accordance with this SPS.
10. The Commissioner will consent to a taxpayer’s election when the taxpayer is able to demonstrate that a 31 March balance date (or previously approved non-standard balance date) is impractical due to the nature of their business or their circumstances. Consent will not be given when elections are made for the purposes of smoothing administration/management workloads or deferring payments of tax liabilities.

Discussion

11. The Commissioner acknowledges there are situations where a balance date of 31 March may be impractical, and will provide consent to allow taxpayers to align their balance date to:
 - (a) adopt an alternative balance date when taxpayers can demonstrate that the nature of their business makes a 31 March balance date impractical, or

- (b) align with an agreed industry balance date, or
- (c) allow a shareholder-employee to use the same balance date as the relevant company, or
- (d) allow a subsidiary to use the same balance date as the parent company, or
- (e) align balance dates for business entities with a close working relationship, where they share a common business/management accounting system or central administration structure and already have an approved non-standard balance date, or
- (f) allow managed funds to adopt a balance date in common with a fund manager or trustee when it can be demonstrated that a parent-subsidiary like relationship exists between parties (excludes a portfolio tax rate entity that does not make payments of tax under section HL 23 of the ITA 2007), or
- (g) allow entities deemed to be agents of non-resident insurers to file “as agent” returns in terms of section HD 16 of the ITA 2007 (excludes a portfolio tax rate entity that does not make payments of tax under section HL 23 of the ITA 2007), or
- (h) adopt a balance date applicable to a non-resident taxpayer’s tax jurisdiction, when they perform business activities in New Zealand that have a centre of management outside New Zealand (does not apply to passive investment income), or
- (i) allow an estate to adopt the date that coincides with the date of death of the deceased taxpayer as the balance date for the continuing estate, or
- (j) allow a previously tax exempt entity to continue to use a balance date consistent with an existing date for financial reporting purposes. (For example, a charity that had only exempt income so was not previously required to file tax returns and is now required to file returns, may continue to use the non-standard balance date they had used prior to entering the tax base.)

Commissioner’s consent required

12. When a taxpayer wishes to adopt a non-standard balance date, or change from a non-standard balance date back to 31 March (or to change from one non-standard balance date to another), they are required to obtain the Commissioner’s consent under section 38 before they can file a return on the basis of that new balance date.
13. Section 38 reads:

38(1) [Returns to annual balance date] Instead of furnishing a tax year return under section 33 on the

basis of a corresponding income year that ends on 31 March, a taxpayer (other than a taxpayer to whom section 33A(1) or (5) applies) may, with the consent of the Commissioner, elect to furnish a return based on a corresponding income year that ends with the date of the annual balance of the taxpayer’s accounts.

38(1B) [When portfolio tax rate entity must not make election] A portfolio tax rate entity that does not make payments of tax under section HL 23 of the Income Tax Act 2007 must not make an election under subsection (1).

38(3) [Approval required for change of election] Any election made by a taxpayer for the purposes of this section shall continue in force unless and until it is altered by the taxpayer with the prior approval in writing of the Commissioner.

14. Section 38(1) provides that the Commissioner may consent to taxpayers furnishing their tax returns for a tax year that does not end on 31 March. However, the legislation provides no further guidance on how this discretion will be exercised. By implication, taxpayers will need to show that the use of a 31 March balance date would be impractical for their specific circumstances. (31 March is a default position by reference to the term “tax year” under section 33, and section YA 1 of the ITA 2007 defines “tax year” as a period starting 1 April and ending 31 March.)
15. In considering an election for a non-standard balance date, the Commissioner will form an independent view on matters, consistent with his statutory responsibilities under section 6 to maintain the integrity of the tax system. Consent will be provided where the Commissioner agrees that a taxpayer’s circumstances are such that requiring them to return income to 31 March would be impractical (meaning that taking into account their circumstances, including industry practice, a 31 March accounting for tax would place an unfair burden on them).
16. The Commissioner will not provide consent when a significant reason for the change is to defer the payment of tax, or to take earlier advantage of a tax incentive or concession than would otherwise have been the case had no change of balance date occurred. Nor would a wish to smooth out administrative or managerial workloads within the taxpayer’s business (setting aside matters relating to seasonal businesses) be sufficient reason on its own for the Commissioner to agree to a non-standard balance date.

Commissioner’s considerations

17. Careful consideration will be given to the reasons and information supplied in each application in support of a taxpayer’s election to change a balance date,

particularly business and commercial factors. The Commissioner's considerations may also extend to other relevant information held for a taxpayer and wider industry practice to establish an informed view whether the circumstances of a particular case provide sufficient cause for the taxpayer not to return income to 31 March or their current balance date. Paragraphs 19 to 33 of this SPS explain the relevant matters that will be considered by the Commissioner. Paragraphs 32 and 33 address the standard practice for election to change balance dates for managed funds and "as agent" returns. Paragraph 11 outlines the most common situations where the discretion has been exercised – some of these are the subject of further comment below.

18. When providing consent to a new balance date, the Commissioner will only agree to a balance date that is the last calendar day of a month, eg 30 November rather than 15 November – except for a continuing estate that elects to adopt a balance date that coincides with a deceased taxpayer's date of death.

Compliance costs

19. Business taxpayers will always incur administration costs in a number of ways, including general accounting, financial and reporting requirements. Compliance costs will be considered as a factor when a taxpayer is able to show that they will incur unreasonable or excessive such costs as a consequence of having to return income to 31 March. The Commissioner will have regard to normal compliance costs, excluding for instance those incurred by choice by taxpayers through self-imposed internal planning or reporting requirements.
20. The Commissioner will also have regard to the impact of other statutory reporting requirements on taxpayers' annual accounts and their tax obligation to return income.

Passive income

21. Passive income is generally income derived from investments or property without any direct physical exertion or application of specialist skill by a taxpayer (for example, income from interest or dividends). In contrast, a business activity includes a profession, trade, manufacture, or undertaking carried on for a pecuniary profit.
22. Taxpayers whose primary source of income is from passive investments will generally be required to return income to 31 March. Much of the information on earnings required to file a return is available from

financial institutions on a periodic basis.

23. An exception to taxpayers with passive income being required to return income to 31 March is when related entities are engaged in a common business activity that has a non-standard balance date. This concession is intended to avoid additional compliance costs and disruption with preparing annual accounts when a taxpayer derives passive income through the business activity of a related entity. For example, a family trust leases a factory to a family trading partnership. The family trust passively derives their primary source of income from the related family trading partnership, which has a non-standard balance date. In this case, the Commissioner will consent to the family trust adopting a common non-standard balance date. This will align the balance date with the partnership.
24. A further exception applies to taxpayers with an attributing interest in a Foreign Investment Fund ("FIF") when they calculate their FIF income using the accounting profits method or branch equivalent method. Section EX 69 of the ITA 2007 provides specific rules for change of FIF balance dates and also require the Commissioner's consent before a new accounting year can be used.

Taxpayers with wage/salary as well as business income

25. In situations where a taxpayer has income from salary or wages as well as business income the Commissioner may still agree to a non-standard balance date under the normal rules. For example, a taxpayer earns a salary as a teacher and also has a small orchard from which she derives business income. The taxpayer wishes to adopt a non-standard balance date of 30 June. The Commissioner would agree to the change of balance date as it is an industry approved balance date, despite the income from salary/wages. (In this situation the taxpayer will return their business income to 30 June, but will continue to return the income from her salary to 31 March.)

Annual business cycle

26. Some businesses have a "natural" end to their income year. For example, the end of a growing season, the end of a traditionally busy trading period, or the time in the annual business cycle in which the majority of income and relevant costs can be brought to account. Examples of businesses which have "natural" income years not ending on 31 March include farmers, or growers or harvesters of primary produce subject to seasonal climate conditions or natural cycles of stock

breeding. That may also extend to directly related service industries involved in say harvesting, processing, packaging and exporting of produce.

27. Market demands of manufactured goods and seasonal impacts on growing/harvesting of produce influence the trading patterns of many businesses. Taxpayers impacted by seasonal constraints or demands on their businesses may find a 31 March balance date impractical when their attention is on those seasonal activities and the majority of their income is yet to be derived.
28. The natural end to a season for growers or retail manufacturers can be identified with the end of their production cycle when the last, or majority, of their produce is delivered to a processor or retail outlet. Once the harvest or peak business period is completed, a grower or manufacturer then commences preparation for the next annual busy season.

Industry balance dates

29. The Commissioner recognises a number of industry specific non-standard balance dates (refer to Appendix A). These dates have been determined following representations to the Commissioner by the industries concerned. Taxpayers within these industries may apply for consent to adopt these approved industry balance dates. Refer to paragraphs 34 to 37 for the method of application.
30. Taxpayers aligned to an industry that has a recognised non-standard balance date still have the option to seek an alternative non-standard balance date (or remain with 31 March) if the industry balance date does not suit their circumstances.
31. Where taxpayers want to adopt an alternative non-standard balance date, they are required to make a full application that will be decided on the merit of each individual case as provided under paragraph 48(a).

Managed funds and “as agent” returns for non-resident insurers

32. Inland Revenue will consider elections for non-standard balance dates from the following entities (excludes portfolio tax rate entities that do not make payments of tax under section HL 23 of the ITA 2007):
 - (a) the trustee of a unit trust that wishes to align its balance date with that of its manager, or
 - (b) the trustee of a group investment fund that wishes to align its balance date with that of its manager, or
 - (c) the trustee of a superannuation fund that wishes to align its balance date with that of its trustee or,

where the fund is administered by an employer for the benefit of its employees, the balance date of the employer, or

- (d) a taxpayer (who is a resident for taxation purposes) required to file an “as agent” return that wishes to align the balance date of that return with the taxpayer’s own non-standard balance date.

Indicative examples of recognised relationships

33. A taxpayer may adopt a non-standard balance date if one of the following examples apply:

(a) **A unit trust wishes to align its balance date with that of its manager**

A unit trust may choose to align its balance date with that of its manager. The manager is the entity with responsibility for the management of the unit trust and is appointed under the trust deed. Adoption of the manager’s balance date is appropriate only if the manager has retained the responsibility for day-to-day administration of the unit trust.

(b) **A group investment fund wishes to align its balance date with that of its manager**

A group investment fund is administered and overseen by a manager. The fund may have a separate trustee, although there is no requirement that the trustee and manager be separate entities. Consent will only be granted to align the fund’s balance date with that of the manager. As with unit trusts, the concession applies when the manager has retained the responsibility for day-to-day administration of the trust and for preparing the trust’s accounts. When these functions have been contracted out to a third party, it is not appropriate to adopt the manager’s balance date.

(c) **A managed fund wishes to align its tax balance date for financial reporting purposes**

A managed fund (including unit trusts, group investment funds and superannuation funds) may choose to align its balance date with that for financial reporting purposes if it can be demonstrated that the alignment of balance dates helps reduce the managed fund’s tax risks. The purpose of this concession is to promote voluntary compliance and good tax practices. Inland Revenue expects the managed fund to set out the reasons for changing their balance dates. These reasons will be examined on a case-by-case basis.

However, this concession does not apply if:

- (i) the reason for changing the balance date is to

- improve the managed fund's administration of human resources (eg smoothing the workflows of their managers)
- (ii) the managed fund cannot provide evidence of what the tax risks are and how the change of balance date helps to mitigate these risks
- (iii) the managed fund can identify some of its tax risks but the change of balance date is irrelevant to the mitigation of these risks.
- (d) **Superannuation funds**
An employer superannuation fund wishes to align its balance date with that of the employer
 A scheme established for the benefit of employees of an employer may apply to adopt the balance date of that employer.
Any other superannuation fund (eg a wholesale or retail fund) wishes to align its balance date with that of its trustee
 The trust deed under which a superannuation fund is established will appoint a trustee to supervise the fund. Consent will be given for a fund to align its balance date with that of the trustee, provided that the trustee's role has not been contracted out to a third party.
- (e) **A taxpayer who is an agent of a non-resident insurer wishes to align the balance date of its "as agent" return to its own non-standard balance date**
 A taxpayer who insures with a non-resident insurer is required to return part of the premiums paid as income in a return known as an "as agent" return (section HD 16 of the ITA 2007). This income is returned by the taxpayer "as agent" for the non-resident insurer.
 Taxpayers with an approved non-standard balance date for their own returns will be granted consent to align the balance dates of their "as agent" returns to this date.
- (c) a continuing estate wants to adopt a balance date that coincides with a deceased taxpayer's date of death, or
- (d) a subsidiary company wants to align to the balance date used by a parent company, or
- (e) a non-resident taxpayer wants to adopt a balance date applicable in their country of residence, when they perform a business activity in New Zealand that has a centre of management outside New Zealand (does not apply to passive investment income).
35. These elections can be made by phone because the criteria for adopting a non-standard balance date can be easily verified at the time of contact. This is because the Commissioner will have this information in his records.
36. Other elections to adopt a non-standard balance date must be in writing where:
- (a) taxpayers adopt an alternative balance date when they consider 31 March is an inappropriate balance date, due to the circumstances of their business activity, or
- (b) taxpayers align balance dates for business entities with a close working relationship, where they share a common business/management accounting system or central administration structure with an approved non-standard balance date, or
- (c) managed funds want to adopt a balance date common with a fund manager or trustee when it can be demonstrated a parent-subsidiary like relationship exists between parties, or
- (d) entities deemed to be agents of non-resident insurers file "as agent" returns in terms of section HD 16 of the ITA 2007.
37. The above elections are required in writing as these are more complex situations that generally require careful consideration, research and confirmation of the relevant information.

Election methods

34. Some elections to adopt a non-standard balance date can be made by telephone (0800 377 774) or in writing. This applies to the following types of balance date changes where:
- (a) a taxpayer who operates a business wants to adopt a recognised industry balance date as listed in Appendix A, or
- (b) a shareholder-employee wants the same non-standard balance date as a company to which their shareholding relates, where earnings from the company is their primary source of income, or

Unacceptable reasons for a balance date change

38. The anniversary date of the commencement of a business is not a valid reason for a balance date other than 31 March.
39. Elections to change a balance date for reasons of tax deferral or tax avoidance, or to take advantage of any tax incentive or concession, will not be accepted.

Retrospective elections

40. Ideally, elections to change a balance date will be made and the Commissioner's consent received prior to the commencement of a new income year, so taxpayers can avoid additional compliance costs should consent be withheld.
41. Sometimes, the Commissioner's consent to a change in balance date will not have been received until after the start of an income year, or delays have been experienced with consent where the Commissioner has required further information. In situations where the timing of the application has been the only reason for withholding the Commissioner's consent past practice has been to defer the effective date for change of a balance date to the following income year.
42. The Commissioner's practice is modified to provide some flexibility, in limited circumstances, to provide consent to a retrospective application of a balance date change for current income year elections. Late applications for a change of balance date will be accepted if made before the earlier of the return filing date under section 37(1) for the current balance date and that for the proposed balance date but does not include extension of time arrangements for filing returns. Consent will be provided where taxpayers can show that:
 - (a) it is possible to file returns for all the income years, and
 - (b) the late election was not made for reasons of tax deferral or tax avoidance, or to take undue advantage of any tax incentive or concession, and
 - (c) any incidental tax deferral as a consequence of the proposed balance date is only insignificant when compared with their tax liability for the year under their current balance date.

New business taxpayers

43. The Commissioner will consider elections from new business taxpayers to adopt a balance date other than 31 March, with application to their first return/tax year.
44. In addition previously tax exempt activities that become new business taxpayers continuing the same activity may (with the Commissioner's consent) retain the use of a non-standard balance date already used for existing financial reporting purposes.

Misleading information

45. Once an election is received, the Commissioner will examine the reasons and information provided in support of the taxpayer's election to change their balance date. The onus is on taxpayers to make a full disclosure of the reasons for their election and to provide all relevant information to support their application. This will enable the Commissioner to adequately consider the taxpayer's election to change their balance date.
46. However, the Commissioner is not bound by any consent given based on misleading information.

Consequential changes

47. When the Commissioner agrees to a change of balance date, the taxpayer will be advised of the effective date of the change and the period for which they will be required to file a transitional return. Further information on transitional return periods is attached at Appendix B.

Standard practice

Commissioner's consent to a change in balance date

48. The Commissioner will agree to adopting a change in balance date in the following situations (excluding portfolio tax rate entities that do not make payments of tax under section HL 23 of the ITA 2007):
 - (a) A business taxpayer elects to change a balance date and can present good business reasons to persuade the Commissioner a 31 March balance date is impractical for returning income, or their circumstances have changed significantly and they should be permitted to further change a non-standard balance date previously consented to. This will include consideration by the Commissioner to elections by new business taxpayers to adopt a non-standard balance date, with application to their first return/tax year.
 - (b) A business taxpayer elects to adopt a recognised industry balance date.
 - (c) A franchise owner is required as a condition of a franchise agreement to use a non-standard balance date for financial reporting purposes and the applicable balance date has been recognised via agreement between the Commissioner and the master franchisor.

- (d) A shareholder-employee elects to adopt the same non-standard balance date as the company to which the shareholding relates and from which they derive their primary source of income.
 - (e) A continuing estate wants to adopt a balance date that coincides with a deceased taxpayer's date of death.
 - (f) A subsidiary company elects to adopt the same non-standard balance date as used by a parent company.
 - (g) A non-resident taxpayer, operating a business activity in New Zealand that has a centre of management outside New Zealand, elects to use a balance date for preparing annual accounts and returning income in their country of residence.
 - (h) A business entity with a close trading relationship with another business entity with a shared accounting system or central administration structure, elects to adopt a common non-standard balance date.
 - (i) A managed fund elects to adopt a balance date common in with a fund manager or trustee when it can be demonstrated a parent-subsidiary like relationship exists between parties.
 - (j) An entity deemed to be agent of a non-resident insurer is required to file "as agent" returns in terms of section HD 16 of the ITA 2007.
49. The Commissioner will confirm his agreement in writing as required under section 38(3), and also set out the transitional return period.

Elections to change a balance date

50. Elections to change a balance date for the situations listed under paragraph 48 (b) to (g) may be made by telephone 0800 377 774 or in writing, advising the following details (where relevant):
- (a) full name of the taxpayer seeking the non-standard balance date;
 - (b) Inland Revenue number if already registered;
 - (c) details of reasons for election to change the balance date;
 - (d) name of tax agent.
51. Since elections to change a balance date for the situations listed under paragraph 48 (a) and (h) to (j) are potentially more complex applications are required to be made in writing. For this group of applications, where relevant, the following information should be provided:
- (a) full name of the taxpayer seeking the balance date change;
 - (b) Inland Revenue number if already registered;
 - (c) details of reasons for election to change the balance date;
 - (d) name of tax agent;
 - (e) details of cash flows;
 - (f) details of stock patterns;
 - (g) details of any significant business transactions that will impact on their tax liability for the current financial year;
 - (h) other evidence to show that financial information prepared to the proposed balance date will be more appropriate to the entity;
 - (i) where a new business is seeking a non-standard balance date (other than a recognised industry balance date);
 - (j) where businesses claim they have a close trading relationship and share a common accounting system or central administration structure, evidence to show this.
52. The Commissioner will not agree to a change of balance date, where the basis of the application is one or more of the following:
- (a) The elected non-standard balance date is the anniversary date of the commencement of the business.
 - (b) A reason for changing the balance date is tax deferral or tax avoidance, or to take advantage of a tax incentive or concession.
 - (c) An election is made in order to smooth the workflow of a manager, or trustee, or tax agent.
 - (d) An election is made for reasons of administrative convenience.
 - (e) Functions have been contracted out to a third party (for example, a specialist administration manager) and the taxpayer elects to adopt the manager's balance date.

No right to challenge

53. Please note that section 138E(1)(e)(iv) does not confer a right of challenge to a decision by the Commissioner under section 38. However, if taxpayers consider that their election to change a balance date was not given proper and/or adequate consideration they are invited to discuss this with us or seek judicial review.

This Standard Practice Statement is signed on 22 December 2008.

Rob Wells

LTS Manager, Technical Standards

Appendix A: Industry specific non-standard balance dates

The Commissioner recognises a number of industry-specific balance dates. These dates have been determined following representations to the Commissioner by the industries concerned. Taxpayers within these industries, or closely aligned to them, may elect to adopt these approved industry balance dates, subject to the Commissioner's consent in writing under section 38(3).

Please refer to paragraphs 29 to 31 of the SPS.

Apriarists		30 November or 31 December
Education/childcare related services		31 December
Farmers,	cattle	31 May
	dairy	31 May, or 30 June, or 31 July*
	sheep	30 June
Fishing industries		30 September
Horse breeders		31 July
Meat processing and export		31 August or 30 September
Orchardists, pip fruit		31 March or 30 June or 31 December
Kiwifruit		31 March to 30 June
Seed dressers		30 November
Tobacco growers		31 July

* expanded to 30 June or 31 July to recognise regional variances within the dairy industry.

Note: When there is more than one recognised industry balance date for an activity, the Commissioner's consent will be required for any subsequent election to adopt an alternative industry balance date.

Appendix B: Transitional period returns

This explains how the Commissioner applies the legislation concerning the transitional income tax returns required following the Commissioner's approval of a change of balance date. It also states the Commissioner's policy on the application date for a change of balance date.

Section 39 set out the treatment for transitional returns.

When the new balance date is an early balance date (ie between 1 October and 31 March) the taxpayer's transitional year will run from the original balance date to the new balance date. (This will generally be a period of 6 months or more.)

When the new balance date is a late balance (ie between 1 April and 30 September) the taxpayer's transitional year will run from the original balance date to the new balance date in the succeeding year. (This will generally be a period of more than 12 months.)

Under section 39, when there is a change of balance date the taxpayer must file a transitional tax return.

This return is for the income derived during the transitional period which begins on the day after the original balance date and ends on the new balance date.

Section 39 reads:

39(1) If the Commissioner approves a change to a new balance date that is earlier in the year than the original balance date, the change is effected by the taxpayer having a transitional year of the period from the original balance date up to and including the new balance date in the next succeeding year.

39(2) If the Commissioner approves a change to a new balance date that is later in the year than the original balance date, the change is effected by the taxpayer having a transitional year of the period from the original balance date up to and including the new balance date in the same year.

39(3) If the change in balance date means that a taxpayer has 2 corresponding income years for the same tax year, the figures for both corresponding income years are aggregated when the taxpayer's net income or net loss is determined.

39(4) For the purpose of giving effect to this section and section 38, the Commissioner may, for any corresponding income year, make any assessment that the Commissioner considers necessary.

39(5) For the tax year corresponding to the income year or years in which the change of balance date occurs, the basic tax rate for the purposes of the Income Tax Act 2007 and this Act is the rate that would apply if the person's taxable income for the tax year were calculated using the formula—

$$\text{income year days} \times \frac{365}{\text{year}} \times \text{taxable income}$$

39(6) In the formula,—

- (a) **income year days** is the total days in the income year or years that correspond to the tax year:
- (b) **taxable income** is the person's taxable income for the tax year.

Note: Section 39 uses the terms “earlier” and “later”. These should not be confused with the terms “early balance date” and “late balance date”. Section 39 refers to a balance date that is “earlier in the year than the original balance date” and a new balance date that is “later in the year than the original balance date”. The “original balance date” may itself be a non-standard balance date.

Example 1

A 31 March balance date is to change to 31 January. The return for the 2007–08 income year will cover the period from 1 April 2007 to 31 January 2008 (a 10-month transitional year). The return for the 2008–09 income year will be from 1 February 2008 to 31 January 2009.

Example 2

A 31 March balance date is to change to 30 June. The return for the 2007–08 income year will cover the period 1 April 2007 to 30 June 2008 (a 15-month transitional year).

Returns for less than six months or more than 18 months

Changes to balance dates will generally result in a transitional period of more than 6 months, but no longer than 18 months. However, in some circumstances returns are required for a period of less than six months or more than 18 months. Returns for a period longer than 18 months only occur when there is a change from an early balance date to a late balance date. Returns for a period shorter than six months only occur when there is a change from a late balance date to an early balance date.

Example 3

In 2008 a taxpayer changes from a balance date of 30 September to 30 November for the 2008–09 income year:

1/10/07 – 30/9/08:	2007–08 income year
1/10/08 – 30/11/08:	Two-month period within the 2008–09 income year
1/12/08 – 30/11/09:	2009–10 income year.

In this case it is not possible to include the income derived during the two-month period in the 2008–09 income year with other income derived in the same income year, because there is no other income derived during the 2008–09 income year. The taxpayer must file a two-month return.

Example 4

In 2006 a taxpayer changes from a balance date of 30 November to 31 July for the 2007–08 income year:

1/12/05 – 30/11/06:	2006–07 income year
1/12/06 – 31/7/07:	Eight-month period within the 2006–07 income year
1/8/07 – 31/7/08:	2007–08 income year.

The legislation requires the taxpayer to add the income derived during the transitional period to other income derived in the same income year. Therefore, the taxpayer must add the income derived in the eight-month period from 1 December 2006 to 31 July 2007 to the income derived in the period from 1 December 2005 to 30 November 2006 giving a return for a 20-month period.

Adjustments when return is for a period of more or less than a year

Some adjustments may be necessary when the return is for other than a 12-month period. Under section LC 10 of the ITA 2007, when there is a change of balance date and the taxpayer is assessed for income tax for a period of less than a year, any tax credits (formerly rebates) allowable under sections LC 1 to LC 8 of the ITA 2007 are proportionately reduced. Similarly, when the taxpayer is assessed for a period of more than a year, the total of such tax credits is proportionately increased. Similar provisions relate to tax rates in section 39(5).

QUESTIONS WE'VE BEEN ASKED

QB 08/04: INCOME TAX ACT 2007: RESEARCH AND DEVELOPMENT CREDITS (SUBPART LH) – TAX AVOIDANCE (SECTION BG 1)

All legislative references are to the Income Tax Act 2007.

Question

We have been asked whether section BG 1 applies where:

- (1) a group of companies has a member company that performs research and development (“R & D”) activities;
- (2) that member company is not eligible for R & D tax credits because it does not fully satisfy the requirements in section LH 3(1), even though those requirements are fully satisfied by the group as a whole; and
- (3) the group of companies restructures in order to enable that member company to satisfy fully the requirements of section LH 3(1) and thereby claim R & D credits.

The following example illustrates this question: A, B, and C are a group of companies for tax purposes. Company C carries out R & D activities on its own behalf within the meaning of section LH 3(1)(a) but company B, which provides the finance for the R & D activities, bears the financial risk of the R & D activities within the meaning of section LH 3(1)(c). (It is assumed that company C satisfies all the other requirements in subpart LH.) As a result of not satisfying section LH 3(1)(c) company C is not eligible for tax credits for its R & D activities, because all the requirements in section LH 3 must be satisfied by the person claiming the R & D credit. In order to enable company C to claim R & D credits, the group agrees to restructure so that company C funds its R & D activities and bears the financial risk of its R & D activities within the meaning of section LH 3(1)(c). Company C has adequate staff capability and capital to manage the financial risk assumed, and has genuinely and appropriately incurred all relevant expenditure.

Answer

The following answer necessarily sets out general principles only. The facts of particular cases always need to be carefully considered and, if there are additional relevant facts or circumstances, the conclusion may be different. In some cases it may be necessary for taxpayers to obtain advice from a tax advisor.

Although it is clear that the ability to claim R & D credits is a purpose or effect of the restructuring, section BG 1 does not apply in the scenario outlined in the example because Parliament would not have intended eligibility for R & D credits to be denied in these circumstances.

Analysis

New Zealand businesses are eligible for tax credits for R & D activities that they perform, or which they commission others to perform for them, where the requirements contained in subpart LH are satisfied.

Relevant to the question is section LH 3(1), which provides:

LH 3(1) WHAT IS REQUIRED OF PERSON?

For the purposes of section LH 2, the person must, for the income year or period in the income year,—

- (a) perform on their own behalf, or have another person perform, research and development activities related to—
 - (i) the business referred to in section LH 1(1)(a), or an intended business of the person;
 - (ii) for an industry research co-operative, the business of a person who is an industry member under section LH 16; and
- (b) control the research and development activities; and
- (c) bear the financial risk of the research and development activities; and
- (d) effectively own the results of the research and development activities, if any; and
- (e) have—
 - (i) incurred expenditure described in schedule 21, part A (Expenditure and activities related to research and development) and not excluded under schedule 21, part B, for which they are allowed a deduction in the income year, or would be allowed a deduction if they derived income other than exempt income;
 - (ii) an amount of depreciation loss described in schedule 21, part A and not excluded under schedule 21, part B, for depreciable property used in the research and development activities, for which they are allowed a deduction in the income year, or would be allowed a deduction if they derived income other than exempt income.

The effect of section LH 3(1) is that, in order to be eligible for R & D credits, the company performing the R & D activities must **by itself** satisfy subparagraphs (a) to (e).

In terms of section BG 1, it is clear that the ability to claim R & D credits is a purpose or effect of the restructuring. Prior to the restructuring the company performing R & D activities was not eligible for R & D credits. The restructuring overtly enables the company to satisfy fully section LH 3(1) and thereby claim R & D credits.

It is considered however that section BG 1 would not apply. In enacting the R & D regime, Parliament sought to encourage investment in R & D activities and thereby improve the productivity and international competitiveness of New Zealand businesses: Taxation (Annual Rates, Business Taxation, KiwiSaver, and Remedial Matters) Bill 2007, Explanatory Note, at p3.

The restructuring ensures that eligibility for R & D credits is not lost in circumstances where the company performing R & D activities does not by itself fully satisfy section LH 3(1) but the group as a whole does. After the restructuring the company will incur the economic consequences (ie, the costs and financial risk of performing the R & D activities) Parliament intended to be incurred in order to qualify for R & D credits. Accordingly the company's receipt of R & D credits would be consistent with Parliament's aim of encouraging R & D activities in circumstances where the company satisfies the eligibility requirements in subpart LH. Moreover the restructuring does not itself involve any undue pretence or artificiality.

For these reasons the Commissioner considers that section BG 1 would not apply so to deny eligibility for R & D credits in the scenario outlined in the question.

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