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THIS MONTH'S OPPORTUNITY FOR YOU TO COMMENT

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

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

The following draft item is available for review/comment this month, having a deadline of 31 March 2008.

Ref.	**Draft type**	**Description**
DDP0010	General depreciation determination	Satellites

The following draft item is available for review/comment this month, having a deadline of 3 April 2008.

Ref.	**Draft type**	**Description**
ED00100	Standard practice statement	Disputes resolution process commenced by a taxpayer

Please see page 37 for details on how to obtain a copy.

NEW LEGISLATION

INCOME TAX ACT 2007

The Income Tax Act 2007, which received Royal assent on 1 November 2007, represents the fourth and final stage in the rewrite of income tax legislation using plain drafting techniques. The bill was introduced on 15 November 2006 and had its first reading on 23 November.

The Finance and Expenditure Committee reported the bill back to Parliament on 16 July 2007. The second reading and committee stages took place in August and the third reading on 25 October. It was the last bill referred to the Governor-General for signature by long-serving Clerk of the House, David McGee QC. It was also the largest bill to be passed by Parliament.

The Act rewrites Parts F to Y of the 2004 Act as well as the schedules to that Act. It also makes consequential amendments to Parts A to E to highlight the relationship between provisions in Parts F to Y with the core provisions, and to move income rules to Part C, deduction rules to Part D, and timing rules to Part E.

The rewriting of these provisions is not intended generally to change the effect of the law. However, there are a few exceptions to this general position, and these are listed as intended legislative changes in Schedule 51.

As the 2007 Act represents the final stage of the rewrite project, this *Tax Information Bulletin*:

- outlines the main aspects of the Act's scheme, purpose, and structure;
- explains the main consequential amendments to Parts A to E;
- outlines the main drafting improvements in Parts F to R and the schedules;
- outlines the intended legislative changes occurring in each Part;
- summarises the general approach to drafting in the 2007 Act; and
- outlines how the drafting style provides a consistent framework expected to be followed in the drafting of future legislation.

Summary of general structure of the Act

Parts	Contents
Parts A and B	A list of taxes and other obligations imposed on a person A general scheme and structure that enables people to determine and satisfy their income tax and other obligations Comprehensive linkages to other Parts that contain the detailed rules
Part C	An exhaustive list of provisions that state the circumstances in which a transaction or other event gives rise to income
Part D	An exhaustive list of general and specific provisions that state the circumstances in which a person has a deduction for an expenditure or loss, including a loss in value, arising from a transaction or event
Part E	A list of provisions that modify the general timing rules of derived (for income) and incurred (for expenditure or a loss) amounts and, in a number of cases, quantify that timed amount
Part F	A recharacterisation of the outcome of certain transactions for income tax purposes
Part G	Avoidance and valuation matters
Part H	How certain entities must determine and account for their tax obligations
Part I	How tax losses may be used The loss grouping rules for groups of companies
Part L	How a tax credit is used to satisfy a person's income tax liability

Part M	How tax credits are paid to persons entitled to particular tax credits
Part O	Rules for credit and debit accounts
Part R	Rules related to the payment, collection, and refunds of taxes and other payment obligations
Part Y	An index of defined terms, as well as the meaning of defined terms that apply across the Act
Part Z	Transitional provisions and some savings provisions
Schedules	Detailed lists of items relevant to determining a person's income tax liability

Application

The Income Tax Act 2007 applies from the first day of the 2008–09 tax year or the first day of the corresponding income year of a person who has a tax balance date other than 31 March.

History of the rewrite process

New Zealand's income tax legislation dates back to 1891. Since then, the legislation has significantly expanded the concept of "income tax" to keep pace with the changing nature of income-earning activities in New Zealand. Although income tax legislation was recast several times during the twentieth century, it was not until the 1990s that it was comprehensively reviewed from a structural and presentational perspective.

Various bodies and officials prepared reports and papers that discussed rewriting the income tax legislation, including:

- the Consultative Committee on the Taxation of Income from Capital (the "Valabh Committee");
- the Working Party on the Reorganisation of the Income Tax Act 1976; and
- the Organisational Review of the Inland Revenue Department.

These groups highlighted various weaknesses in the numbering, formatting and reorganisation of the legislation. Problems included:

- failure of the core provisions to integrate with each other and with the rest of the legislation;
- the difficulty of discerning the scheme and purpose of the legislation;
- a lack of logic in both the structure of the legislation and the ordering of some sections;
- the lack of organisation of the legislation and its failure to reflect adequately the legislation's role of quantifying taxable income, imposing a tax liability on that income, and setting out a process of assessment and collection; and
- the inconsistent drafting style and presence of redundant wording, cumbersome sections and repetitive provisions.

These reviews led to the establishment of the project to rewrite the Income Tax Act. The project's first stage was the re-ordering and renumbering of the Income Tax Act 1976, and the subsequent enactment of the 1994 Act and the Tax Administration Act 1994.

The 1994 Act organised the legislation into parts that were structured around a set of core provisions, using an alphanumeric system. There was some consolidation of material by topic, and the definitions were brought together in one section.

The next stage was the rewrite of the Core Provisions Act, which led to the enactment of the Taxation (Core Provisions) Act 1996. The rewritten core provisions contain a clear conceptual scheme for the Act, based on the transactional approach to taxation. This scheme is also integrated with the assessment rules in the Tax Administration Act 1994. This framework is not expected to be disturbed in the future unless structural changes arise out of a review of the entire scheme of the Act.

The 2004 Act contained the rewritten Parts C to E. The main objective was to integrate the income, deduction and timing rules with the framework set out in the core provisions.

Some minor adjustments were made to the core provisions to clarify some aspects of those rules – for example, the development of a structure for the concept of "assessable income". Another key adjustment was the identification of the relationship between each specific deduction rule and both the general permission and the general limitations rules.

Objective of the rewrite project

The rewrite project has consistently focused on the primary aim to produce legislation that clearly and unambiguously states the underlying policy. This objective is regarded as integral to reducing compliance and administrative costs and increasing voluntary compliance with the tax law.

Independent studies were commissioned to examine the readability of the 2004 Act by comparing provisions of the 2004 Act with their corresponding rule in the 1994 Act. The results of these studies generally concluded that provisions in the 2004 Act are easier to read and understand than their corresponding provisions in the 1994 Act.

Consultation

During the drafting, and in line with New Zealand's generic tax policy process, extensive consultation occurred with specialists within and outside Inland Revenue. The New Zealand Institute of Chartered Accountants and the New Zealand Law Society also made a significant contribution during the consultation and drafting process.

Consultation occurred at several points during the drafting of the Act:

- before and after the release of Inland Revenue's exposure drafts of legislation for Parts F to N of the 2004 Act;
- before the introduction of the Income Tax Bill 2006 in November 2006;
- during submissions and consideration of the bill by the Finance and Expenditure Committee; and
- after the select committee reported back the bill, but before its second reading.

This process was intended to provide assurance that the provisions in the 2007 Act have the same outcomes as those of the 2004 Act, unless a change in outcome is intended and listed in Schedule 51.

The government has indicated that it will promote a remedial amendment to correct any provision in the new Act which is found to produce a different result from the outcome under the corresponding provision in the 2004 Act. This process will not apply when an intended change in outcome is noted in Schedule 51.

Consultation was also undertaken on the manner of enacting the rewritten provisions. The options for the bill were to:

- amend the 2004 Act by replacing Parts F to the end of the Act with rewritten Parts; or
- produce a new Act containing rewritten Parts F to the end of the Act, including the schedules and consolidated parts A to E.

The second option was preferred in submissions and was supported by the Rewrite Advisory Panel mainly because it minimised confusion over the numbering of sections.

For example, the differences between the two options can be compared by reference to section FC 1 of the 2004 Act. This section is about the tax treatment of profit-related debentures. In the 2007 Act, the subject matter of section FC 1 is quite different from the content of section FC 1 of the 2004 Act. In the 2007 Act, section FC 1 describes the operation of subpart FC, which is about the income tax treatment of transfers of certain property on death. Therefore, if the option to amend the 2004 Act had been chosen, readers would have needed to distinguish between two provisions bearing the same reference in the 2004 Act. In referring to section FC 1, a reader would need to make it clear whether the reference was to section FC 1 of the Act before it was amended or section FC 1 of the Act as inserted by the amendment.

Taking the option of a new Income Tax Act meant that readers can identify the provision in this example as section FC 1 of the Income Tax Act 2004 or section FA 2 of the Income Tax Act 2007.

Erroneous interpretations of provisions in the Act

Taxpayers should continue to have regard to the comments of the select committee in its commentary in reporting back the Income Tax Bill 2002 (Income Tax Act 2004). These comments are likely to be equally relevant to the 2007 Act.

In particular, the committee noted at that time, that there was a:

> "... risk that some practitioners, having previously misinterpreted some provisions in the old Act, may fail to realise that the rewrite Act clarifies the correct interpretation that applies to those provisions, and continue to apply their erroneous interpretation to the new Act. Such a situation should be minimised as far as possible, and we therefore encourage the Inland Revenue Department to undertake an education programme to inform practitioners that they cannot necessarily rely on their current understanding of the law, and should actively check the provisions contained in the new Act."

This statement remains relevant, as it is clear from the commencement and transitional provisions that Parliament intends that readers discern the meaning of a provision using the normal rules of interpretation.

Transition from the 2004 Act to the 2007 Act

The transitional provisions provide that the 2004 Act may be used as an interpretive guide to the 2007 Act, but only in limited circumstances. The 2007 Act is not intended to contain any changes in policy unless such a change is signalled in Schedule 51.

Reference to the provisions of the 2004 Act will not be required unless either of the following situations arise:

- A provision in the 2007 Act is unclear or leads to an absurdity. In this situation, section ZA 1 ensures that the 2004 Act and associated case law are to be used as the key authoritative interpretive guide.
- A clearly stated provision in the 2007 Act is compared with the corresponding provision and the 2004 Act to determine if that provision contains an unintended policy change. In this situation, the non-legislative process established for the 2004 Act facilitates a review of the factual situation raised and, if necessary, provides for a recommendation to the government for a remedial retrospective

legislative change. This process is administered by the Rewrite Advisory Panel, headed by the Rt Hon Sir Ivor Richardson, former President of the Court of Appeal.

Impact on other legislation

The 2007 Act repeals the 2004 Act, but only in relation to tax on income derived in the 2008–09 and later tax years (sections A 2(2) and ZA 1(2)). The 2007 Act also makes consequential amendments to the Tax Administration Act 1994 (Schedule 50) and many other Acts of Parliament (Schedule 49).

Key features

The short title and commencement provisions located before Part A and the core provisions in Parts A and B have some consequential but minor changes. These provisions also draw the reader's attention to reliance on concepts contained in the Interpretation Act 1999.

The overall operation of the core provisions is not altered by the 2007 Act. However, a working knowledge of the core provisions and their relationships to the rewritten provisions is fundamental to understanding the scheme and purpose of the Act and the way in which Parts F to R support the operation of the core provisions.

In addition, a number of other improvements to the Act have been made, including:

- the signposting in Part I of all loss rules located in other Parts of the Act;
- the signposting in Part L of all tax credit rules relating to the satisfaction of a person's income tax liability that are located in other Parts of the Act;
- requiring tax withheld at source on prepaid income to be spread forward and matched with the timing of the income;
- the use of tables to provide quicker access to the memorandum account rules;
- the consolidation of the Income Tax (Withholding Payments) Regulations into the PAYE rules in Part R;
- providing for a consistent use of a balance date approach to business rules when transactions affect more than one income year;
- when appropriate, rules relating to particular types of entities or transactions are grouped together rather than being split between Parts F and H – for example, the collection of the consolidated company rules into subpart FM;
- the omission of redundant rules – for example, sections CY 1, DY 1 and DY 2 of the 2004 Act; and
- rationalising provisions that perform similar functions – for example, section OA 7, where a number of common rules deal with the treatment of opening and closing balances of memorandum accounts.

Policy changes and obsolete provisions

All intended changes giving a change in legislative outcome are listed in Schedule 51. These intended changes typically involve clarifications of existing policy where the rules contained an ambiguity that required resolution as part of the rewrite process.

Provisions in the 2004 Act that have also become unnecessary or obsolete have been omitted from the rewritten Act. Schedule 52 identifies these omissions, many of which were located in the "Z" subparts of Parts C, D and E of the 2004 Act.

General principles used in rewrite drafting

The principles used are:

- organising the material from the general to the specific, and using general rules to perform a pivotal role to provide links to the core provisions;
- starting Parts, subparts and sections with more widely used rules and concluding with less widely used rules;
- grouping provisions performing similar functions or having similar subject matter to provide the reader with the relevant context;
- reducing repetition by applying common sets of rules to minimise overlap;
- limiting the subject matter of each section to a single concept;
- adopting a plain language approach;
- using a consistent format to aid accessibility by improving the flow of text.

In general, the drafting approach has been to use subpart A in each Part to provide a link to the core provisions if the Part as a whole supports the operation of the core provisions. This is most evident in Parts I, L, M and R. Parts E to G do not lend themselves to this approach as they focus on a range of transactions or entities which have an effect on the operation of Parts C or D, and sometimes subpart BC in determining a person's schedular income tax liability.

Drafting changes

The main drafting changes made in rewriting Parts F to N of the 2004 Act relate mainly to structural relationships, are relatively minor, and are intended to improve the legislation. They fall into five main types:

- the modernisation of the style and language, including the use of tables – for example in Part O to improve access to the memorandum account rules;

- the use of defined terms that capture their subject matter more closely, which has led to changes to some recognised terms (see Table 1);
- the use of acronyms to shorten sentences by minimising long compound phrases as defined terms and to reflect common practice (see Table 2);
- the improvement in the clarity of the law; and
- the removal of redundant material moving some provisions to other Parts of the Act.

Table 1 – Some changes in terminology

Term	Formerly or now	Primary location
Additional income tax	now "imputation additional tax"	OB 71, OB 72
Ancillary tax, excluded ancillary tax	new terms	
Association rebate	use limited to mutual associations	subpart HE
Allowable rebate/rebate	now "tax credit"	Parts B and L
Basic tax deduction	now "amount of tax" (*deduction* is used only as a Part D concept)	
Basic rates	now "basic tax rate"	
Car	term incorporates old definition of "motorcar"	EZ 16 and FBT rules
Certificate of entitlement	now "notice of entitlement"	TAA mainly
Charitable or other public benefit gift	formerly "gift of money"	subpart LD
Complying trust	formerly "qualifying trust"	subpart HC
CTR	acronym – conduit tax relief (also used as a prefix for credit etc)	
Dividend withholding payment	now "FDP (foreign dividend payment)", prefix used for linked terms	
Dividend withholding payment deduction	now referred to as a "payment for a foreign dividend"	
Employer's superannuation contribution	formerly "specified superannuation contribution"	
Entitlement period	formerly "eligible period"	MC 11
ESCT	acronym – employer's superannuation contribution tax, previously SSCWT	
Family assistance credit	now "abating WFF tax credit (Working for Families tax credit)"	Part M
Family support	now "family tax credit"	Part M
Family support and family plus	now "WFF tax credit"	Part M
Family tax credit	now "minimum family tax credit"	Part M
FDP	acronym – foreign dividend payment (also used as a prefix for credit etc)	
First payment period, second payment period	formerly "first/second PAYE period" (the term "PAYE period" is retained in the TAA)	Part R, wider term required
Foreign dividend	formerly "foreign withholding payment dividend"	RG 2
Further FDP	formerly "further dividend withholding payment"	OC 30 to OC 34
ICA	acronym – imputation credit account (also used as a prefix for company)	

Term	Formerly or now	Primary location
Imputation year	now removed, same as *tax year*	
In-work tax payment	now "in-work tax credit"	Part M
Listed PAYE intermediary claim form	replaced by "subsidy claim form"	
Memorandum account	new general term for credit and debit accounts	Part O
Monthly remittance certificate	now "PAYE income payment form" (see "remittance certificate")	
New provisional taxpayer	replaced by "person with initial provisional tax liability"	subpart RC
Non-complying trust	formerly "non-qualifying trust"	subpart HC
Non-resident passive income	formerly "non-resident withholding income"	
NRWT	formerly "non-resident withholding tax"	
PAYE income payment	formerly "source deduction payment"	subpart RD
PAYE income payment form	formerly "remittance certificate"	
First/second PAYE period	now "first/second payment period" (the term "PAYE period" is retained in the TAA)	Part R, wider term required
PCA	acronym – policyholder credit account (also used as a prefix for credit etc)	
Prepaid expenditure	formerly "accrual expenditure"	EA 3
Public unit trust	formerly "qualifying unit trust"	
Qualifying amalgamation	now "resident's restricted amalgamation"	
Qualifying trust	now "complying trust"	subpart HC
Qualifying unit trust	now "public unit trust"	
Rebate	term removed (apart from use as *association rebate*) now "tax credit"	
Refundable tax credit	formerly "refundable rebate"	
Relationship period	formerly "specified period"	MC 11
Resident passive income	formerly "resident withholding income"	
Resident's restricted amalgamation	formerly "qualifying amalgamation"	
RWT	formerly "resident withholding tax"	
RWT withholding certificate	formerly "resident withholding tax deduction certificate"	TAA section 25
Schedular income subject to final withholding	term absorbed into definition of "schedular income"	
Schedular payment	formerly "withholding payment"	RD 8
Selected period	formerly "elected period"	MF 1
Small-business person	formerly "small-business taxpayer"	RC 40
Source deduction payment	now "PAYE income payment"	subpart RD
Specified superannuation contribution	now "employer's superannuation contribution"	
SSCWT	now ESCT	
Subsidy claim form	formerly listed PAYE intermediary claim form	
Supplementary dividend holding company	formerly " section LE 3 holding company"	
WFF tax credit	formerly "family support" and "family plus/family assistance credit"	Part M

All acronyms are listed as defined terms in section YA 1. Some acronyms are in common usage (for example, GST, PAYE and FBT). Others have a more specialist flavour (for example, NRWT, RWT, CFC, FIF, LAQC, UFTC, ASC and BETA).

The remaining acronyms mostly relate to the memorandum accounts (ASCA, CTRA, FDPA and MACA), where use of an acronym is logical and its use limited in practice. In the case of CTR, ESCT and FDP there is a new or changed acronym.

Table 2 – Acronyms and their meaning

ASC	available subscribed capital
ASCA	available subscribed capital account
BETA	branch equivalent tax account
CFC	controlled foreign company
CTR	conduit tax relief
CTRA	conduit tax relief account
ESCT	employer's superannuation contribution tax
FBT	fringe benefit tax
FDP	foreign dividend payment
FDPA	foreign dividend payment account
FIF	foreign investment fund
GST	goods and services tax
ICA	imputation credit account
LAQC	loss-attributing qualifying company
MACA	Māori authority credit account
NRWT	non-resident withholding tax
PAYE	pay-as-you-earn
PCA	policyholder credit account
RWT	resident withholding tax
UFTC	underlying foreign tax credit

Terminating provisions

Terminating provisions are placed in a separate "Z" subpart at the end of each Part. This continues the practice used in the 2004 Act, but the contents of each subpart have been reviewed and spent provisions or provisions having little future relevance have been omitted. The omission of any of these provisions does not remove their application to relevant past situations. Provisions in the 2004 Act that are omitted from the 2007 Act can be identified by referring to Schedule 52, part A.

COMMENTARY ON PARTS OF THE ACT

Part A

The broad purpose of the Income Tax Act 2007 is to define and impose tax on net income, to impose obligations concerning tax and to set out rules for the calculation and satisfaction of those obligations (section AA 1).

Section AA 2 reinforces the legislative principles of the Interpretation Act 1999 by highlighting how readers' aids to interpretation are to be used.

Section AA 3(1) has been omitted, as defining "this Act" to include the Tax Administration Act 1994 is no longer necessary. The drafting approach taken in the rewritten Act is to state clearly when the Tax Administration Act is being referred to.

Section AA 3(2) identifies the relationship of the Income Tax Act with the Interpretation Act, with particular reference to the defined term "person" in the Interpretation Act.

The Income Tax Act now provides that it applies to the Crown (section AA 4) to provide a better relationship with Part 4 of the Interpretation Act. Explicitly or not, the Income Tax Act has always applied to the Crown, as shown, for example, by the exemption given for government agencies in section CW 38 (Public authorities).

Part B

The scheme and purpose of Part B remains the same as in the 2004 Act – to impose income tax and other tax obligations and to set out how those obligations must be satisfied. As the core provisions are intended as an enduring framework, it is not expected that these rules will be altered in the future, unless fundamental changes are made to the policy underlying the scheme, its purpose and structure.

Overall, little substantive change has been made to the core provisions. However, some structural changes have been made to improve the relationship of the core provisions to Part I (Treatment of tax losses), Part L (Tax credits and other credits), and Part R (General collection rules).

Changes to the following core provisions have been made in rewriting Parts F to N of the 2004 Act:

- section BB 2(3) has been moved to section RA 4 (Provisional tax obligations);
- section BC 4(4) has been moved to subpart IA (sections IA 2 and IA 3);
- sections BC 8 and BC 10 have been moved to subpart LA (sections LA 4, LA 5 and LA 7);
- section BC 6(2) to (4) has been omitted as the restructuring of the tax credit rules means these particular rules are no longer necessary;

- a clear linkage has been made between section RB 3 and section BC 7 (relating to schedular income); and
- section BC 9 has been renumbered as section BC 8 in the 2007 Act, and explicit linkages developed between that provision in subpart LA (sections LA 2 to LA 5, LA 9, and LA 10).

While Part B was rewritten in the 2004 Act, it is useful to restate the scheme and purpose of Part B at this time. This enables readers to see the relationship of the various Parts of the Act to the core provisions and Part B in particular.

Subpart BA

The overall purpose of the core provisions is to establish:

- a statutory scheme for the calculation and satisfaction of taxation obligations; and
- the structural relationships of the core provisions.

Subpart BB

Subpart BB sets out the obligations that the 2007 Act requires a person to satisfy. Any of these obligations may be modified by the general anti-avoidance rule (section BG 1) and New Zealand's obligations under its double tax agreements (section BH 1).

The main obligations listed in section BB 2 are:

- the calculation and satisfaction of the income tax liability for each tax year (section BB 2(1) and subpart BC);
- the calculation and payment of provisional tax for a tax year (section BB 2(3) and the provisional tax rules);
- the calculation and satisfaction of withholding liabilities (section BB 2(4) and subpart BE); and
- the calculation and satisfaction of a variety of other taxes and payments (section BB 2(5) and subpart BF).

There is no intended change in outcome associated with the minor drafting improvements to sections BB 2(5) and BF 1. A new term "ancillary tax" has been introduced as a consequence of rewriting the definition of "income tax", to draw attention to the types of tax obligations imposed under the core provisions through the previous definition of "income tax".

Sections BB 3, BG 1 and BH 1 continue to provide an override for:

- the general anti-avoidance rule in sections BG 1 and GA 1; and
- bilateral relief under a double tax agreement entered into by New Zealand.

Subpart BC

Subpart BC is linked to sections BB 1 and BB 2 through its subject matter. Subpart BC sets out the detailed process that must be followed to meet the obligation to calculate and pay income tax for a tax year.

The concept of "schedular income" in section BC 7 takes on greater importance as some provisions in Part H (Taxation of certain entities) provide for a scheme-based approach to the calculation of an entity's income tax liability, rather than using the core provisions' global gross approach. An example is the rules relating to portfolio tax rate entities.

Unless a person is a non-filing taxpayer, this process contains a series of steps involving the calculation of net income, taxable income and the income tax liability for a tax year. A non-filing taxpayer's income tax liability for a tax year is, in general, determined by amounts of tax withheld at source.

To apply subpart BC (the calculation of the income tax liability for a tax year), a person must know the core concepts of **annual gross income** and **annual total deduction**.

These core concepts are defined in sections BC 2 and BC 3 respectively. The concept of "corresponding income year" ensures that the core provisions align the calculation of the income tax liability for a tax year to the tax balance date of the taxpayer. The tax balance date may be either the standard date (31 March) or an early or late balance date.

"Annual gross income for a tax year" is a global concept. Section BC 2 defines it as the "aggregate of all assessable income from all sources that is derived in or allocated to the corresponding income year". The concepts of "assessable income" and "allocation" are explained further in subpart BD.

"Annual total deduction for a tax year" is also a global concept, and section BC 3 defines it as the "aggregate of all deductions that are incurred in or allocated to the corresponding income year". The concepts of "deduction and allocation" are explained further in subpart BD.

Section BC 4 now reflects the wide range of uses to which a net loss may be put.

Sections BC 6 to BC 10 of the 2004 Act provide a framework for determining the income tax liability of a person and how the Act uses tax credits to satisfy this liability. As this framework has been more closely integrated with the detailed tax credit rules in Parts L and M, these core provisions have been simplified and harmonised with Part L. As a result, sections BC 6 to BC 8 and subpart LA now cover the same subject matter as sections BC 6 to BC 10 of the 2004 Act.

The rewrite of Parts F to N of the 2004 Act highlights the importance of the concepts of "schedular income" and "schedular income tax liability" in section BC 7 as part of the framework of the core provisions. These two terms provide a framework for:

- classes of income with unique tax rates or a final liability – for example, non-resident withholding income subject to final withholding; and
- an entity-based calculation of the entity's income tax liability for a tax year – for example, portfolio tax rate entities in subpart HL (Portfolio investment entities).

The intention is that the more specific rules will state how the schedular rule relates to section BC 7. For example, section RB 3 (Schedular income tax liability for filing taxpayers for non-resident passive income) states that, for the purpose of section BC 7, the schedular income tax liability for a person with schedular non-resident passive income subject to final withholding is determined under section RB 3 and not under the rules in sections BC 1 to BC 6.

The flowcharts in the core provisions have also been updated to highlight the interaction of Part L with the core provisions in section BC 8.

Subpart BD

Subpart BD has an important role to supplement the operation of subpart BC, as it explains the core concepts of **assessable income**, **deduction**, and **allocation**. It also defines the extent of New Zealand's income tax base.

Assessable income
The concept of "assessable income" is a calculated amount, and is defined in section BD 1. Assessable income is a person's income that remains after excluding any part of that income that comprises exempt income, excluded income or non-residents' foreign-sourced income. An amount of assessable income may be spread or allocated across more than one tax year.

To use this concept, the reader also needs to know the meaning of "income", "exempt income", "excluded income" and "non-residents' foreign-sourced" income.

Income
The concept of "income" is described in section BD 1. This definition is supported by all of the provisions in Part C through the explicit linkage in section BD 1(1). That section identifies that Part C is a code in relation to its role of determining whether an amount arising from a transaction or event is income.

Gains and profits that are not treated as income under Part C are not subject to income tax. Examples of this category are capital profits and windfall gains.

The only exclusions from income are found in subsections BD 1(2) (exempt income), (3) (excluded income) and (4) (non-residents' foreign-sourced income). These subsections represent a series of exclusions from what is income under section BD 1(1).

After applying these restrictions, the amount (or apportioned amount) that arises from a transaction is termed "assessable income". Assessable income under section BD 1(5) represents the amount of income that is included in the determination of a person's income tax liability for a tax year, subject to any allocation of that income between different tax years. This amount may be allocated across more than one tax year.

Exempt income
The category of exempt income (section BD 1(2)) is reserved for amounts of income that Parliament determines should not be subject to income tax. An example of exempt income is found in section CW 41 (Charities: non-business income).

Excluded income
Falling within the concept of "excluded income" (section BD 1(3)) are amounts of income that are not included in income because they are generally subject to tax in another way.

For example, life insurance premiums derived by a life insurer (and reinsurers) are treated as excluded income (section CX 39). The exclusion arises because the life insurance rules in subpart EY separate the income (underwriting) and savings elements of those premiums and include the underwriting elements in income.

Non-residents' foreign-sourced income
This category of income establishes the role that the source of income and a person's residence play in determining whether an amount of income is subject to taxation in New Zealand (section BD 1(4)). It also enables New Zealand to identify what deductions a non-resident may or may not be entitled to.

Source and residence
The concepts of "source and residence" are fundamental to determining the scope of New Zealand's income tax base. This is achieved through the operation of section BD 1.

Section BD 1(1) defines the subject matter by reference to the amounts listed as income in Part C. As explained later in this article, the concept of income under Part C does not depend on the concepts of time, residence or source.

Section BD 1(5) provides that the concept of "assessable income" does not include income derived by a non-resident that is not treated as being derived from New Zealand at the time that person is non-resident. The overall effect of section BD 1(1) gives the following outcomes:

- Income that a resident of New Zealand derives from anywhere in the world is treated as assessable income, provided that income is neither exempt nor excluded income (section BD 1(2) or (3)).
- Income that a non-resident derives from New Zealand is treated as assessable income, provided that income is neither exempt nor excluded income (section BD 1(2) or (3)).

- Income that a non-resident derives from sources outside New Zealand falls within non-residents' foreign-sourced income and is not assessable income (section BD 1(4)).

Allocation of income (timing)
Section BD 3 explains the basis on which the legislation allocates income to a particular income year. In this context, the term "income year" was chosen because allocation applies to both the standard (31 March) and non-standard tax balance dates.

The general rule is that the Act allocates income to an income year on the basis of when it was derived or credited in the account of a person, or dealt with in their interest or on their behalf. Common law principles are also to be taken into account when considering the sometimes divergent tax accounting results that arise between business and cash-basis taxpayers (section BD 3(3)).

It is important to note that the allocation made is of the income, not just the assessable income. Therefore, the method of allocating an amount of income applies also to any part of that income that is exempt income, excluded income, non-residents' foreign-sourced income and assessable income. Allocation of the income on a consistent basis for all categories of income is necessary because of the nexus tests under the general permission which link deductibility with assessable income (section DA 1).

For example, an amount of income derived by a non-resident may be apportioned between non-residents' foreign-sourced income and assessable income. The allocation of both the non-residents' foreign-sourced income and assessable income across income years will be proportionate to how the income is apportioned.

Assuming that deductions in deriving income are allowed under the general permission, this allocation of income can be expected to influence the amount of deduction allowed in each tax year.

The general rule may be overridden by any rule that allocates the income on another basis.

Deductions
Sections BD 2 and BD 4 explain the core concept of deduction and the timing of a deduction.

The concept of "deduction" in section BD 2 is a key link or signpost between the core provisions in subpart BC and the operative rules found in subpart DA (previously located in section BD 2 of the 2004 Act). This relocation reflects the intention that all deductions should be located in one Part.

Section BD 2 identifies that Part D is a code for determining whether an amount arising from a transaction or event is a deduction. This means that a person may not have a deduction unless it is listed in Part D – see, for example, section HF 1(2) (Profits of mutual associations in respect of transactions with members) of the 2004 Act.

Allocation of deduction (timing)
A deduction is always allocated to an income year (section BD 4). Again, the term "income year" is used to signal the application of the allocation provisions to persons with non-standard tax balance dates.

The general rule is that a deduction is allocated to an income year on the basis of when it was incurred. Again, common law principles must be taken into account when considering any possible divergent treatment that exists in tax accounting between business and cash-basis taxpayers.

This general rule of allocation may be overridden by any rule that allocates the deduction on another basis.

Other obligations

Provisional tax
Section BB 2(3) imposes the obligation to pay provisional tax. It also points to the details of the provisional tax rules in subpart RC which set out the process for calculating and paying provisional tax.

Withholding obligations
Sections BB 2(4) and BE 1 continue to provide the obligation to comply with various tax payment systems such as PAYE, RWT, NRWT, FBT, ESCT and FDP.

Section BE 1 also provides a link to the detailed provisions that a person needs to know in order to comply with these obligations.

Ancillary tax obligations
An ancillary tax is defined in section YA 1, as being any of ESCT, FBT, FDP, FDP penalty tax, further FDP, further income tax, imputation penalty tax, NRWT, PAYE, penalty tax for a Māori authority payable under section 140DB of the Tax Administration Act 1994, provisional tax, qualifying company election tax, RWT and withdrawal tax.

Parts C, D, and E (rewritten in the 2004 Act)

The importance of Parts C, D and E as a group is that together they provide the details that enable taxpayers to calculate their income tax liability for a tax year, as required by the core provisions. (For a full commentary on these Parts, see the commentary to the Income Tax Act 2004 in the June 2004 issue of the *Tax Information Bulletin*).

As a number of insertions have been made into Parts C, D and E since enactment of the 2004 Act, the new Act has required the renumbering of these three Parts.

Income and deduction provisions located in Parts F to N of the 2004 Act have been rewritten as new income provisions in Part C and deduction provisions in Part D. This drafting approach reflects the underlying policy that Part C is an exhaustive list of what is "income" and Part D is a complete list of what is "allowed as a deduction".

Examples include:

- the income and deduction rules for finance leases and consolidated groups of companies;
- section HF 1, which provides that all income derived by a mutual association is income of the association, overriding the principle of mutuality; section HF 1(1) in the 2004 Act has been rewritten as section CB 33, and this provision is signposted in section HE 1;
- sections CV 16, CV 17 and DW 3 in the 2007 Act (relating to non-resident shippers and film renters) are the new location for the operative aspects of sections FC 18 to FC 21 of the 2004 Act;
- section CB 2 (which relates to amounts received on disposal of business assets that include trading stock);
- sections CC 11 to CC 13 (which relate to finance leases and hire purchase agreements);
- section CD 11 (which relates to various avoidance arrangements);
- section DB 10 (which relates to profit-related or substituting debentures); and
- sections DB 57 to DB 59, and DC 5 (which relate to various avoidance arrangements).

The insertion has been made either in an existing rule or as a new section that has an overriding effect on the related rule. No change in outcome is intended.

This has meant that sections CW 44, CX 45, CY 1 and DY 1 of the 2004 Act have been omitted as no longer necessary.

Part C

The functions of Part C are:

- to provide an exhaustive list of what is income for income tax purposes;
- to identify the taxpayer to whom the income belongs;
- to provide a catchall provision in section CA 1(2) to pick up any amounts outside these other categories that would be income under ordinary concepts; and
- to define amounts that would be income but may, nevertheless, be exempted or excluded from being included in the calculation of the person's income tax liability.

If an amount arising from a transaction is not income under Part C, that amount does not fall within the scope. An example would be a capital gain arising from the sale of a private residence that does not fall within the land sales rules in subpart CB. This is illustrated in the diagram outlining the process of calculating and satisfying income tax liabilities set out in subpart BC.

A key principle is that, under Part C, income is a global or gross concept that does not depend on the concepts of time, source or residence. However, a specific provision in Part C may take into account the concepts of source or residence as a parameter in determining whether an amount is income. An example in the 2007 Act where residence is relevant to the determination of income is section CQ 2(1)(d) (Attributed CFC income).

An amount of exempt or excluded income may be subject to another form of tax obligation imposed under section BB 2. Generally, the provision signals the linkage to the obligation. For example, section CW 9(2) states that the FDP rules apply to this exempt dividend. This gives a clear signal that, despite the exempt nature of the dividend, a tax obligation remains in relation to the exempt dividend.

Part D

The purpose of Part D is to provide a legislative code of when an amount is a deduction. Subpart DA sets out some general rules for deductibility of expenditure or loss.

The legislation has a general deductibility rule, the general permission, which is set out in section DA 1. The rules in section DA 2 Act are general limitations to the general permission.

Section DA 3 sets out the legislative relationship between the specific rules and the general rules. Section DA 4 is a special provision that clarifies at an early stage the relationship between a deduction for an amount of depreciation loss and the capital limitation.

As a consequence of rewriting Parts F to N of the 2004 Act, a number of new deduction provisions provide for rules that were previously set out in a Part other than Part D. For example, in the 2004 Act, sections HF 1(3) and (4) provided a deduction for mutual association rebates. This provision has been rewritten as section DV 19 and signposted in section HE 1, both in the 2007 Act.

Part E

In the absence of specific timing rules, the core provisions timing rules (sections BD 3 and BD 4) provide for timing to be determined on the basis of when income is "derived" or expenditure is "incurred". Sections BD 3 and BD 4 state that the meaning of "derived" and "incurred" will continue to be determined by case law.

Part E is the location for sets of rules that have a predominant focus on matching or allocation. These rules apply where the policy is to provide a timing result that differs from the result arising from the time at which income is "derived" or expenditure or loss is "incurred".

The most significant specific timing rules are:

- revenue account property, section EA 2 (Other revenue account property);
- accrual expenditure, section EA 3 (Prepayments);
- depreciation (subpart EE);
- the financial arrangement rules (subpart EW) and the old financial arrangement rules in sections EZ 30 to EZ 49; and
- valuation of trading stock, livestock and bloodstock (section EA 1 and subparts EB, EC and ED).

Not every element of a specific provision that has a timing aspect been shifted to Part E. A simple ancillary rule that clarifies when an amount is derived or incurred remains with the substantive provision creating the income or deduction. From a reader's perspective, to shift an ancillary rule would provide little benefit.

In addition to the rules on depreciable assets, trading stock and revenue account property, Part E also covers areas within which the timing, income and deduction rules cannot easily be separated, such as the accrual rules, the international rules and many of the life insurance rules.

Part F – Recharacterisation of certain transactions

Part F in the 2007 Act contains a range of provisions related to:

- apportionment rules for cross-border transactions;
- modifications to the interest deductibility rules for certain types of debentures and, under thin capitalisation rules, some foreign-owned organisations and banks;
- rules for consolidated companies when calculating their income tax liability for a tax year;
- rules for determining how groups of companies use imputation credits; and
- modifications to the tax treatment of certain transfers of property and financial arrangements under a relationship agreement or upon death.

If a "modification" rule in Part F applies, a taxation effect that is different from one that would be produced under Parts C to E generally follows.

Apportionment was one of the functions ascribed to Part F in the 2004 Act. But as Part F does not generally perform this function in the 2007 Act, a number of apportionment rules have been moved closer to their related provisions in Parts C, D and E. Examples of apportionment rules moved to a different location in the 2007 Act are:

- section FB 2, which contains an apportionment rule for tax credits for foreign income tax and a source rule: the apportionment rule for tax credits has been moved to subpart YD (Residence and source in New Zealand); and
- section FB 7, which is an apportionment rule relating to depreciation, has been moved to subpart EE, making this rule easier to access.

Despite apportionment provisions being located close to their relevant rule, Part F retains the apportionment rules relating to interest deductibility on thin capitalisation. The complexity and detail of these rules has led to retaining them in Part F, rather than moving them to Parts C and D.

Subpart FA contains rules that alter the tax treatment of certain commercial arrangements by either:

- recharacterising the nature of, or amounts derived under, the arrangement (see for example, section FA 2 which recharacterises the nature of the arrangement by treating a debenture as shares for income tax purposes); or
- providing a different form of tax treatment for the parties to the arrangement (see for example, section FA 5 which alters the tax treatment of the party to the transaction).

Section FA 5 is intended to claw back deductions for lease payments that are effectively payments of the purchase price of the lease asset. This rule applies when an asset is leased under an operating lease, and the lessee acquires the asset at the end of the lease, and then sells the asset to a third party. As a result of this sale, the lessee has an amount of income equal to the amount of deductions allowed for the lease payments but only for any profit derived on that sale.

Subparts FB and FC contain the rules that provide for the income tax treatment on transfers of certain property – that is, transfers made under certain settlements of relationship property, and certain transfers of property after the death of the owner of the property.

The thin capitalisation rules that apportion certain interest expenditure between income derived from New Zealand and other income are contained in subpart FE and are directed at:

- a New Zealand taxpayer who is subject to a certain level or type of foreign control; or
- a foreign-owned bank that has a lower than prescribed level of equity.

A company's conduit tax relief may be restricted under subpart FF by an amount that correctly reflects the interest deductions of the company that relate to the assets that produce the conduit tax-relieved income.

Subpart FL deals with the income tax consequences when a New Zealand-resident company changes its residence to another country and loses its New Zealand residence.

Subpart FM draws together most of the rules for entry into a consolidated group and the tax treatment of certain transactions between member companies of a consolidated group. However, tax loss rules for consolidated groups are located in subpart ID because of their interrelationship to the more general loss rules in Part I.

Despite this general drafting approach, the application of some specific anti-avoidance rules to a consolidated group has been retained in subpart GB. The consolidated group rules relating to memorandum accounts have been retained in Part O (Memorandum accounts) as they are so closely related with the general rules in that Part.

Subpart FN applies when two or more companies that are part of a wholly owned group of companies form an imputation group to enable a company in the imputation group to pay an imputed dividend when another company in the imputation group has a credit for New Zealand tax paid. This subpart also includes the rules relating to trans-Tasman imputation groups.

Amalgamations involving only New Zealand-resident companies that are not dual resident and do not derive only exempt income are dealt with in subpart FO. These rules generally provide for no income tax consequences on the transfer of property and novation for liabilities that occur under the amalgamation.

Drafting improvements in Part F

A reference to debentures issued before 30 August 1940 contained in section FC 2 of the 2004 Act has been omitted from section FA 2 (Recharacterisation of certain debentures) as it is unlikely that debentures from this time would still exist.

Sections FA 6 and FA 12 (which relate to amounts derived under finance leases or hire purchase agreements) are clearly linked to the valuation provisions in the financial arrangement rules. This link makes explicit how a lessee determines their cost base for a lease asset for all purposes of the Act and simplifies the drafting of the lease and hire purchase rules.

An ambiguity in section FC 10(4) of the 2004 Act has been clarified in section FA 18(3) (Treatment of amounts paid in income years after agreement ends) by making it clear that the expenditure incurred by a lessee from hire purchase payments refers just to the interest component of those payments.

In section FB 13 (Trading stock), the period to which the provision relates has been changed from “tax year” (31 March) to “income year” (31 March or approved alternative balance date). This change was necessary to ensure that the provision aligns correctly with the trading stock provisions in Part E, which are based on the income year rather than the tax year.

Section FB 16, which rewrites section FF 10 of the 2004 Act, removes repetition of language contained in section EC 31 of the 2004 Act.

In sections FB 19, FB 20 and FB 21 (which relate to leased assets, mining assets and depreciable property), the transfer values have been rationalised with the depreciation provisions by using the defined terms “adjusted tax value” and “base value”.

In section FB 21(7), the relationship with the depreciation provisions has been clarified to show that subsection (7) applies only for the purpose of determining the correct depreciation rate.

Under the thin capitalisation or conduit rules, a person may have a reduction in the amount of interest that is taken into account in determining his or her net income for a tax year. This adjustment is structured as an amount of income in section CH 9, with the detailed calculation retained in section FE 6. No change in outcome is intended from the 2004 Act.

The consolidated company rules are set out in subpart FM and the amalgamation rules are located in subpart FO. Moving the rules together into one Part supports the overall objective of the Rewrite project of reducing compliance costs.

Intended changes in Part F

Section FA 3 – Share dealing

Section FA 3 rewrites section FC 3 of the 2004 Act. The section is an old provision, introduced in 1959 in response to sales of shares involving a dividend-stripping arrangement structured to create a loss on sale for tax purposes.

This rule deals with the situation where a person enters into an arrangement to buy shares on revenue account, strips out a dividend from those shares, and then sells them. In the absence of section FC 3, the person would be able to generate, for income tax purposes, a loss on the sale of those shares which would then be taken into account determining the person’s net income for the tax year. This outcome offsets the artificially created loss against assessable income.

This rule was originally enacted in 1959 (as section 136A of the Land and Income Tax Act 1954) to deny the loss for tax purposes. The rule was also drafted to ensure that the dividend continues to be treated as it normally would, for tax purposes, under the dividend rules.

An ambiguity in the proviso to the 2004 Act was identified in the rewrite of this provision. This ambiguity potentially allowed the “stripped-out” dividend to be counted twice in applying the proviso, and would have resulted in the rule being largely ineffective.

The intended change clarifies that the “stripped-out” dividend is counted only once in applying the rule. This is achieved in section FA 3 by creating an amount of income no less than the stripped dividend but no greater than the artificial loss arising because of the dividend stripping arrangement. The effect of this rule is that the income created effectively “offsets” the loss on sale created through the dividend-stripping arrangement.

Sections FA 5(6) and FA 9(3) – Finance leases and operating leases

The lease rules in sections FC 5 and FC 8E of the 2004 Act provide that when a leased asset is disposed of to a person who is associated with the lessee of that asset, and that associated person then disposes of the asset, the lessee is taxed on any profit on disposal. The policy intent of this rule is to ensure that the disposal rules applying to the lessee cannot be circumvented through transactions with associated persons. However, these rules are not clear about when the test of association applies.

Sections FA 5(6) and FA 9(3) place this test of association at the time the leased asset is disposed of to the associated person.

Transfers of property on death

Sections FC 2 to FC 6 have been drafted to make it clear that the transfer on death to the executor/administrator and the subsequent transfer from the executor/administrator to the estate are treated as one transfer.

Part G – Avoidance and non-market transactions

Part G contains two types of provisions – those dealing with avoidance, and those dealing with certain transactions treated as taking place at market value.

Two structural matters were identified in rewriting Part G:

- It was not entirely clear in what circumstances a provision's anti-avoidance nature merited locating it in Part G. In many cases, technical base-maintenance remedial provisions could be viewed as dealing with matters of avoidance.
- As other Parts of the Act also contain many provisions treating transactions as occurring at market value, the rationale for having valuation provisions in Part G was unclear. As a result, the provisions proposed to be retained in Part G are those that do not have a suitable alternative location or which have an anti-avoidance element.

The rewritten legislation locates in subparts GA and GB only those provisions that, in broad terms, apply to arrangements that are aimed at avoiding tax.

Subpart GC contains the rules that provide for the substitution of market value for the values adopted in a transaction where, in policy terms, the market value is regarded as being the more appropriate outcome.

Drafting improvements in Part G

Subpart GA contains the rules giving the Commissioner the general power to adjust a person's income tax liability when an arrangement is void under section BG 1.

Section GA 1 rewrites section GB 1(1) to (2C) of the 2004 Act. The drafting is simplified to refer to an adjustment in any way to taxable income. This approach is consistent with the law in section 99 of the 1976 Act and section BG 11 of the 1994 Act (before enactment of the Taxation (Core Provisions) Act 1996). The amendments to section BG 1 by the Taxation (Core Provisions) Act were intended to complement the global/gross approach adopted in the core provisions, rather than change the outcomes under the law.

While there have been some drafting changes to this provision, there is no intention to change the outcome. For example, the section no longer contains the words "without limiting the generality of the preceding subsections" as these words seemed to have no practical effect on the Commissioner's powers under the section.

Section GA 2 rewrites section GB 17B of the 2004 Act. This provision permits an adjustment to a person's excluded income, which is affected by an arrangement altering the incidence of FBT.

In a number of sections in subpart GB, objective tests replace a discretion to be exercised by the Commissioner. Having the application of these provisions rely on an objective test provides an improvement in the relationship and consistency with self-assessment. For example, section GB 4 (Arrangements for grouping tax losses: companies) no longer requires the Commissioner to form an opinion on whether the section applies but provides a list of objective tests for the application of the section. Other examples are sections GB 6, GB 33, GB 36(1) and GZ 1.

Section GB 26(3) (Arrangements involving repatriation of commercial bills) makes explicit the time of the "deemed" redemption as the time at which the actual redemption was originally provided for under the commercial bill facility. This timing was implied in the corresponding rule (section GC 14A(2) of the 2004 Act). By making this explicit, the relationship of this rule to the financial rules is clarified: this timing rule overrides the financial arrangement rules because of the reference to "necessary implication" in section EW 2(1).

Section GB 27(3) (Attribution rule for income from personal services) clarifies that the exclusion is not intended to apply to an individual who is a trustee acting as such. The rewritten provision relies on the definition of "trustee" in section YA 1 for this effect. Section GB 27 now refers to the income year of the associated entity to give consistency to the value of "substantial business assets" in section GC 14C(6) of the 2004 Act, which was measured at the end of that entity's accounting year.

An uncertainty existed under section GC 15 of the 2004 Act in relation to benefits provided to an employee's associate over whether an associated person or the actual employee was treated as receiving the benefit. It is clarified in the 2007 Act that the fringe benefit is treated as received by the actual employee under section GB 32.

Intended changes in Part G

Section GB 27(2)(c) – Attribution rule for personal services

The 2004 Act rule in section GB 14B(2)(c) is ambiguous on whether the threshold of $60,000 should include income that is available for attribution. The rewritten provision confirms the policy intention that the threshold amount of $60,000 net income includes amounts that would be attributed under the attribution rule.

Sections GB 35(2)(d) and GB 42(2)(d) – Multiple purposes in arrangements

Sections GC 22(1)(a)(iv) and GC 27A(1)(d) of the 2004 Act refer to an arrangement that has "the purpose" of obtaining a tax advantage. The context of these rules is that this purpose should not be an incidental purpose, indicating that the section actually contemplates there may be more than one purpose for the arrangement. The use of "the purpose" is thus inconsistent with the context and application of the drafting and is linguistically incorrect.

It is clear from the drafting of these two sections that they are intended to apply when one purpose of the arrangement is to obtain a tax advantage, irrespective of the number of purposes of the arrangement. As a result, in both rewritten provisions, the term "the purpose" has been clarified as "a purpose".

Part H – Taxation of certain entities

Part H of the Income Tax Act 2004 contains groups of rules that modify the calculation of taxable income for a tax year for certain persons and entities.

Qualifying companies and loss-attributing qualifying companies (LAQCs) are dealt with in subpart HA.

Most of the trust rules are set out in subpart HC. These rules describe the taxation of distributions from trusts and the taxation of undistributed income derived by trustees. Trusts are classified as complying trusts, foreign trusts, and non-complying trusts.

The agency rules are set out in subpart HD. They describe the circumstances in which a person is treated as an agent for another person in relation to the other person's tax obligations for income tax and tax administration purposes.

Subpart HE sets out the rules that apply to transactions between a mutual association and its members. These rules describe the income tax treatment of income derived by a mutual association and also of distributions to members.

The rules for Māori authorities are contained in subpart HF. These rules set out the taxation treatment for income derived by a Māori authority and distributions made from these authorities. The relationship with other Māori authority rules is also identified, for example, in relation to tax credits, memorandum accounts, refunds, tax rates and administrative rules.

Subpart HL sets out the rules applying to portfolio tax rate entities. Subpart HR contains rules for a variety of entities, such as partnerships, joint ventures, group investment funds, the Government Superannuation Fund and airport operators.

Drafting improvements in Part H

Qualifying companies

The requirements that a company must meet to become and to continue as a qualifying company have been moved to subpart HA, primarily to sections HA 5 and HA 6. Distributions from a qualifying company are treated either as fully imputed dividends or as exempt income. This effect is reflected in section CW 15.

The reference to "transitional capital amount" in section HG 13(1)(a)(i) of the 2004 Act has been removed. This reference is redundant as it related to unexpired 10-year bonus issues, which terminated in 1998.

Section HG 9(3) of the 2004 Act placed a restriction on the amount of deduction that a person is allowed for interest incurred. This restriction is now moved to section DB 9 as a limitation on the deduction.

Section HA 24(4), which rewrites sections HG 16(1) and HG 17(1)(a) of the 2004 Act, clarifies that the time at which the shareholder incurs an attributed loss from a loss-attributing qualifying company is subject to the balance date rule in section HA 26.

Trusts

The defined terms "qualifying trust" and "non-qualifying trust" have been replaced with the terms "complying trust" and "non-complying trust" to reflect the underlying policy. The word "qualifying" is not very meaningful and has been omitted.

Section HC 2 (Obligations of joint trustees for calculating income and providing returns) also draws into subpart HC the rule from section HD 1 of the 2004 Act relating to the taxation obligations of trustees. This rule also makes it clear that the core provisions are to be read as if co-trustees were a single person. Each of the trustees is jointly and severally liable to satisfy the obligations imposed under section BB 2.

The definition of "beneficiary income" in section HC 6 omits paragraphs (a)(iii) and (iv) of the definition in section OB 1 of the 2004 Act as they are no longer necessary.

The defined terms "distribution", "settlor" and "settlement" rely on the defined term "transfer of value". The drafting approach provides a general rule with specific exclusions, rather than producing a list of inclusions that extend a general term.

The 2004 Act definition of "distribution" is very extensive, with paragraph (a) applying to every vesting in interest in a beneficiary of property of a trust, any payment of property to a beneficiary of a trust, or the application for the benefit of a beneficiary of any property of a trust. In addition, this general concept is extended in paragraph (b) of the old definition to include transfers of property and service transactions between a trustee and beneficiary when the transfer value adopted benefits the beneficiary.

A number of provisions in the trust rules treat an amount derived as one of the categories of income of a person. A number of new provisions have been included in Part C, along with appropriate cross-referencing in subpart HC, to provide structural consistency with the core provisions. For example:

- Section HH 1(9) (which applies when a unit trust that is a superannuation scheme becomes a superannuation fund) is included in the dividend rules as section CD 12, with a cross-reference in section HC 1(5).
- The income aspects of sections HH 1(7), HH 3(1), HH 3(3), HH 3(5A) and HH 8 of the 2004 Act have been relocated to subpart CV (Income specific to certain entities).
- The "excluded income" provisions in sections HH 3(4), and HH 3A to HH 3F are now located in subpart CX (Excluded income). For example, a cross-reference from section HC 19 helps the reader identify its relationship with section CX 59 (Taxable distributions from non-complying trusts).
- Exempt income provisions in the 2004 Act have been moved to subpart CW (Exempt income).

  Section CW 53 (Distributions from complying trusts) rewrites the rule in section HH 3(5) of the 2004 Act as "exempt income". This provision is necessary because a distribution from a trust (not being beneficiary income) could otherwise be treated as income for tax purposes. An example of a distribution to which this rule would apply is the payment of a pension from a superannuation fund.

  Drafting this rule as an exempt income provision reveals the structural relationship of the rule to the deduction rules. By treating these distributions as exempt income, the beneficiary may not have a deduction for expenditure incurred in deriving a distribution from a superannuation fund. No change in outcome is intended.

Trustees and settlors are treated as tax agents for some purposes, and the obligations they are to comply with are more clearly signalled in the agency provisions in subpart HD.

Section HC 25 (Foreign-sourced amounts: non-resident trustees) is linked to section BD 1(4) and (5) in the core provisions, clarifying that section HC 25 overrides a core concept of the Act: taxation on the basis of both source and residence. This link is an illustration of the underlying theme of Part H, which is to modify the operation of Parts B to E in relation to a certain type of person or entity.

Tax agents
The main drafting improvement in subpart HD (Agents) is the signposting of general tax agency obligations that a person declared to be an agent must satisfy. This signposting occurs in sections HD 3, HD 8 and HD 18. The rewritten provisions also draw together other agency provisions that are located in other parts of the 2004 Act.

Mutual associations
Sections HF 1(1) and HF 1(5) of the 2004 Act relating to income derived by, respectively, a mutual association and a member of a mutual association, have been relocated to sections CB 33 and CB 34 respectively. This is signalled at the beginning of subpart HE.

Section HF 1(2) of the 2004 Act has been relocated to subpart DV (Expenditure specific to certain entities), again to provide structural consistency in the Act for the treatment of deductions.

Charitable trust
The concept of "charitable trust" is defined for the purposes of the trust rules in section HH 1 of the 2004 Act. As this definition is virtually the same as the concept of "charitable trust" used in subpart CW, the two terms have been rationalised. It is not necessary to retain a separate definition of "charitable trust" for the trust rules.

Intended change in Part H

Section HC 34(2) – Taxable distributions from non-complying trusts
Section HH 3(1) of the 2004 Act treats taxable distributions from a non-complying trust as a special class of income that is not included in the beneficiary's annual return of income. These distributions are derived from trust funds when the trustees have not complied with their New Zealand tax obligations.

A taxable distribution of this nature is subject to a special tax rate, but the rules do not expressly contain a due date for payment of that tax. The current practice is to require payment of this tax by the terminal tax date of the person liable for the tax on the distribution. Section HC 34(2) makes this clear.

Part I – Treatment of tax losses

Part I contains the loss rules. Since these rules were first introduced, many additions have been made to them, including ring-fenced losses for mining, and for CFC and FIF holdings. Over time, the Act has also extended the way in which a tax loss is used for purposes other than as an offset against the net income for a future tax year. The new subpart IA (General rules for tax losses) now provides clear links to the core provisions, as well as signposts to specific rules setting out the different ways in which a tax loss may be used.

The Part is structured to ensure that persons with tax losses carried forward must first use those losses by subtracting them from their net income for the tax year before they can make use of the variety of elective uses for tax losses. New terms central to these rules are "tax loss component", "tax loss", and "loss balance".

Subpart IA is a key part of the restructured Part I. This subpart also contains the general rules for carrying forward a tax loss, which are located in subparts IE and IF of the 2004 Act.

Subparts IC to IE deal with the main company-related loss rules. The loss grouping rules for companies are in subpart IC. Subpart ID sets out how the loss grouping rules are applied to a consolidated group of companies. The loss rules that apply to companies in certain amalgamations are set out in subpart IE.

The rules in subpart IP set out how losses may be used when the general loss rules and loss grouping rules are breached part-way through an income year. A breach of these rules occurs through a loss of continuity or commonality.

Subparts IQ to IT deal with how ring-fenced tax losses may be used. These losses include attributed CFC net losses, FIF net losses, mining and petroleum mining net losses, and life insurance policyholder net losses. Subpart IV contains the rules restricting the amount of a tax loss that a supplementary dividend holding company may use. Subpart IW sets out the circumstances in which a tax loss may be used to satisfy shortfall penalties.

Drafting improvements in Part I

Subpart IA now identifies those tax loss components that have specific restrictions on their use as "ring-fenced tax losses". The tax loss components treated as "ring-fenced tax losses" are as follows:

- a net loss for a tax year of an LAQC (use determined under sections HA 24 to HA 27);
- a life insurer's policyholder net loss under section EY 43(10) (use determined under section IT 1);
- excess expenditure of investment funds (use determined under sections DV 5(4) and DV 7(2));
- an attributed CFC net loss under section DN 4(3) (use determined under subpart IQ);
- a FIF net loss under sections DN 8(3) and DN 9(3) (use determined under subpart IQ);
- the net loss of a mining company, a resident mining operator and a non-resident mining operator when it relates to mining activities (use determined under subpart IS);
- a net loss of a petroleum mining company if it relates to mining activities before the 1990–91 tax year (use determined under sections IS 5, IZ 2 and IZ 3);
- an amount remitted as a condition of a new start grant under sections CX 48 or EW 46; and
- a net loss of a portfolio tax rate entity (use determined under section HL 23).

Section IA 10 (Amended assessments) clarifies the effect on a person's tax loss, loss balance and tax loss components when the Commissioner makes an adjustment to the amount of a tax loss component for a tax year under section 113 of the Tax Administration Act 1994.

Intended change in Part I

Section IA 4(1) – Tax losses
The relationship between the tax loss carry-forward and the grouping rules was previously unclear. Under the 2004 Act, a potential ambiguity existed about whether losses carried forward by a person should be applied to the person's own net income before the grouping rules could be applied.

The policy intention is that, when a person is allowed to carry forward a "loss balance", they must first use the "loss balance" to offset against their own net income (subject to the restrictions on "ring-fenced tax losses").

New section IA 4 (Using loss balances carried forward to tax year) clarifies that a person who carries forward tax losses from one tax year to the next tax year must first use the carried-forward loss balance to reduce net income for that next tax year. It also clarifies that a person can apply the elective loss rules only to losses carried forward from the previous tax year if the balance of carried-forward tax losses exceeds the net income of the current tax year.

Part L – Tax credits and other credits

The rewritten Part L contains the rules relating to tax credits that may be used to satisfy a person's income tax liability, and includes the core tax credit rules that were placed in sections BC 8, BC 9 and BC 10 of the 2004 Act. Part L also lists most of the rebates that were located in Part K of the 2004 Act, other than the family income assistance scheme (now the Working for Families or WFF tax credit) and the KiwiSaver tax credit.

Under the rewritten Part L, a person who has received a tax credit during a tax year includes the total amount of their credits in the assessment of their income tax liability and terminal tax for that year. However, the tax credits for housekeeping and for a payment of a charitable or public benefit gift may not be used to satisfy a person's income tax liability, as these continue to be paid separately under section 41A of the Tax Administration Act 1994.

Subpart LA contains the general rules relating to the use of tax credits and includes aspects of the rules contained in sections BC 8 to BC 10 of the 2004 Act. In particular, subpart LA identifies when a tax credit arises, and sets out how the Act applies a tax credit to satisfy a person's obligations under section BB 2. It also sets out how WFF tax credits are used.

The provisions describing the amount and time at which a person has a tax credit for PAYE, provisional tax, RWT, NRWT, for families, and for caregivers are listed in subpart LB.

The tax credit rules relating to amounts that were rebates in subpart KC of the 2004 Act are now in subpart LC (Tax credits for natural persons). This subpart describes the amount and when a person can use the tax credit, as well as the adjustment rules for part-year residency and change in balance date.

Tax credits for donations or "charitable or public benefit gifts" are dealt with in subpart LD. The use of imputation credits as a tax credit is dealt with in subpart LE, and the use of FDP credits for tax credit purposes is set out in subpart LF.

Subpart LJ contains the rules that determine the tax credit a New Zealand resident can use for foreign taxes paid on income sourced outside New Zealand. These rules more clearly identify the segmental approach to the calculation of the maximum tax credit for income from a particular source or of a particular nature.

Subpart LK contains rules covering a variety of tax credits, including tax credits relating to attributed CFC income, consolidated companies and companies that have amalgamated.

The underlying foreign tax credit rules are set out in subpart LL. Subpart LO sets out when Māori authority tax credits arise and when they can be used. Subparts LP and LQ contain the tax credit rules for supplementary dividends and conduit relief. Policyholder tax credits for life insurers are dealt with in subpart LR.

Subpart LS contains the rules for the tax credits relating to certain zero-rated or exiting investors for their investment through a portfolio tax rate entity. It also contains the rules for the tax credit payable to a portfolio investor tax rate entity for the entity's positive rate investors.

Intended changes in Part L

Sections LA 1 to LA 10 – Tax credits
The rewritten Parts K and L consolidate the concepts of "rebate" and "tax credit". The rationalisation of these terms and restructuring of these rules gives rise to a minor adjustment in the use of rebates and tax credits.

The 2004 Act takes an inconsistent approach to the time at which tax credits arise and the tax year in which those tax credits are used to satisfy an obligation under the Act, particularly in a business context. The restructuring of the tax credit rules achieves a matching of the income year in which the tax credits arise to the corresponding tax year. This change overcomes timing problems inherent in some of the tax credit rules and better reflects the policy intention behind the rules.

This change relates to the time at which a tax credit may be used to satisfy an income tax liability. The rule applies only if a person has a tax credit. It does not apply if a tax credit is anticipated but not received.

For example, section LB 3 (which rewrites section LD 3(2) of the 2004 Act) allows a person a tax credit "equal to the amount of tax withheld and paid in relation to the person's resident passive income for the tax year". Under section LD 3(2), the person was allowed a tax credit for all RWT paid in relation to the resident passive income derived during the tax year. This change ensures that only the part of the tax credit that relates to income included in the return of income for the tax year is included in a person's "total tax credit".

However, the clarification does not apply to tax credits that arise under subparts KC (Individual rebates) or KD (Tax credits for family support and family plus) of the 2004 Act, as these credits can only arise and be used in relation to a tax year.

Section LC 9(2) – Apportionment for housekeeper and low-income tax credits
An apportionment is necessary to determine the amount of entitlement to these credits when a person is absent from New Zealand during a tax year. The policy is to apportion the tax credit on the basis of absence or presence in New Zealand.

In the 2004 Act, two methods applied, with a weekly basis of apportionment applying to persons having regular pay periods and a daily basis to all other persons. The 2007 Act simplifies the apportionment calculation by providing one method – the daily basis – for all situations.

Part M – Tax credits paid in cash

Part M contains rules relating to tax credits that are paid rather than applied to satisfy a person's income tax liability. In particular, it includes the rules for the Working for Families tax credits, and the superannuation savings scheme (KiwiSaver and complying superannuation funds).

The Working for Families (WFF) tax credit rules are placed outside Part L because they mostly relate to the delivery of tax credits to eligible people on an interim basis during a tax year. This Part provides for the calculation of the various credits, which are then dealt with under Part L. Similarly, the placement of tax credits under the superannuation savings scheme in Part M ensures that it is not confused with tax credits that relate to satisfying a person's income tax liability.

Subparts MA to MC contain the general provisions for the WFF tax credit rules. Subpart MB contains the rules for calculating the amount of income on which the family tax credit is based. Subpart MC lists the rules under which a person may be entitled to a WFF tax credit.

Subparts MD to MF provide for the calculation and delivery of the various components of the WFF tax credits.

Subpart MK contains the rules providing the tax credit for the KiwiSaver scheme and complying superannuation funds.

Part O – Memorandum accounts

Part O contains the rules relating to memorandum accounts. The term "memorandum account" is a new, generic term covering imputation credit accounts, FDP accounts, CTR accounts, branch equivalent tax accounts, ASC accounts, Māori authority credit accounts and policyholder credit accounts.

The main purpose of Part O is to provide a way of tracking payments of tax, tax-relief amounts, and other types of payment made by or to certain entities in a way that enables the subsequent delivery of a tax credit under Part L or other tax benefits to people with interests in these entities. As a result, Part O indirectly relates to the core provisions via Part L and other provisions.

This Part draws common rules together and sets out separate tables for credits and debits that summarise the credit and debit rules for each type of memorandum account. These tables follow their related subpart. There are no intended changes in legislation listed in Schedule 51 for Part O.

Subpart OA contains the general rules that apply to all memorandum accounts. Examples of general rules include how to determine the balance of a memorandum account at any time, continuity rules that must be satisfied to preserve the carry-forward of credits in corporate entities from one tax year to the next, and how to calculate a maximum permitted ratio for attachment of certain credits to certain distributions.

Each subpart, from OB to OK, contains the specific rules for each type of memorandum account. These specific rules detail the credit or debit amount and the time at which they arise. Each subpart also quantifies the credit amount that may be attached to a distribution from the entity.

Each subpart also states the consequence of an account having a debit balance at 31 March and the additional amounts that may be payable as a result. Subpart OB deals with imputation credit accounts, subpart OC with FDP accounts, subpart OD with CTR accounts, subpart OE with BETA accounts, subpart OF with ASC accounts, subpart OJ with policyholder credit accounts, and subpart OK with Māori authority credit accounts.

Subpart OP contains the rules that set out how a consolidated group of companies applies the individual and general memorandum account rules. It also sets out specific memorandum account rules that apply only to a consolidated group of companies.

Drafting improvements in Part O

The main improvements in the clarity of the legislation are expected to arise from:

- restricting Part O to provisions relating to memorandum accounts, and as a result, moving tax payment and the tax refund rules to Part R;
- having separate tables for credits and debits that summarise the rules for credits and debits for each type of memorandum account;
- rationalising common rules into a new subpart OA; and
- drawing together common rules that apply to all or most memorandum accounts, such as consolidated group rules and the resident's restricted amalgamation rules.

Tables have been used at the end of each subpart to provide quick access to the credits and debits that arise within each type of memorandum account. A separate table has been set out for all credits and debits, with a brief description of their nature, the date of the credit or debit and a link to the provision that defines that particular credit or debit.

A number of repetitive rules have been rationalised and placed in a new subpart OA. For example, in the 2004 Act, a separate rule creates the opening balance for each type of memorandum account in each subpart. A similar situation arises for the rules relating to resident's restricted amalgamations, as these rules apply to most memorandum accounts.

Two minor consequential drafting changes have been added as a result of a newly defined term "memorandum account" to allow the drafting of some general rules in the rewritten subpart OA:

- In the definition of "tax position" in the Tax Administration Act 1994 (TAA), paragraph (j) includes the new term "memorandum account". Before this amendment, paragraph (j) of this definition referred to an undefined phrase "tax account". The phrase "tax account" does not appear elsewhere in the TAA and is used only once in the 2004 Act, in section MBB 2. It is clear from the language of the defined term "tax position" that the phrase "tax account" is intended to refer to the various memorandum accounts in Part M of the 2004 Act.
- In section 22(2) of the TAA, paragraphs (k) and (kb) have been combined and now refer only to memorandum accounts, other than a CTR account or an ASC account.

Part R – General collection rules

Part R consolidates the rules that set out how and when a person satisfies their obligations for amounts imposed under Part BB. The rules relating to tax payments and refunds from subparts MB to MD of the 2004 Act have been moved to Part R. Those rules related to terminal tax, provisional tax, PAYE intermediaries, tax pooling, early payment discounts and the use of tax refunds.

When a person satisfies an obligation under Part R, in most circumstances, a credit of tax will arise under Part L. When a company satisfies an income tax or FDP obligation, the company is generally required to account for those payments under the memorandum account rules in Part O.

Subpart RA draws together the general rules that relate to several different payment types. In particular, Part R provides a clear link from the obligations imposed under section BB 2 to the detailed rules for each payment type in the relevant subparts. Subpart RA also contains a set of common rules – for example, the date by which payment is required – and the treatment of amounts withheld by the payer as being received by the payee.

Subpart RB contains the rules that relate to the satisfaction of a person's terminal tax under section BC 8. This subpart also incorporates section NG 3 of the 2004 Act, which applies to a person with non-resident passive income when the NRWT withheld by the payer of the income is treated as the income tax liability in relation to that income.

The provisional tax rules are set out in subpart RC. These rules describe the circumstances in which a person has a provisional tax obligation, the methods for calculating the amount of provisional tax payable for a tax year, and the payment methods relating to a person's provisional tax liability for a tax year.

The PAYE and ESCT rules are now located in subpart RD because of the similarity in their operation. These rules define the PAYE rules and list the types of payments to which they apply. They also show how an employer calculates the amount of PAYE or ESCT to be withheld and when the amount withheld is to be paid to the Commissioner.

Subparts RE, RF and RG set out the rules describing when and how amounts are withheld from payments consisting of resident and non-resident passive income, as well as amounts in relation to foreign dividends received by a New Zealand company. These subparts also describe when and how these amounts are paid to the Commissioner or are treated as being paid.

Subpart RM consolidates the rules dealing with refunds of overpayments of taxes and other obligations under the Act. Subpart RP sets out the rules relating to PAYE intermediaries and tax pooling accounts.

The Income Tax (Withholding Payments) Regulations 1979 have been moved to and consolidated with associated provisions in subpart RD. Some administrative rules (which mainly relate to information and notification requirements) have been moved to the Tax Administration Act 1994.

Drafting improvements in Part R

A number of rules have been rationalised in subpart RA to avoid unnecessary duplication. Because of the intention to align payment dates, all payment dates are now located in subpart RA.

In the 2004 Act, payment and collection rules were spread through many of the subparts and related to:

- the treatment of an amount withheld from a payment of income for income tax and other purposes;
- the treatment of the various payment obligations as a debt due to the Commissioner; and
- who must satisfy the various payment obligations.

A minor clarification has been made in the provisional tax rules in relation to the attribution rule for services in section NC 37(5) of the 2004 Act. It is now clear that the period of time by which a return of income is filed includes an extension of time agreed to by the Commissioner. This minor clarification provides a consistent rule for those who have similar requirements for provisional tax purposes.

Part Y – Definitions and related matters

Definitions continue to be located at the end of the Act, just before the transitional provisions. Subpart YA lists the defined terms, whether the substance of a definition is set out in section YA 1 or is located close to its operating rules. An example of this latter approach is the definitions of the different types of trusts:

- "Complying trust" is defined in section HC 10.
- "Foreign trust" is defined in section HC 11.
- "Non-complying trust" is defined in section HC 12.

Subpart YB defines "associated person". This definition has been restructured to better communicate the concepts underlying the various codes which define "association".

The meaning of "control" is set out in subpart YC, and includes the voting interest and market value interest rules. Subpart YD sets out the rules relating to residence and source. Subpart YE contains the rules describing how references to balance dates and years are intended to be read throughout the Act. General rules for currency conversion appear in subpart YF.

Intended changes in Part Y

Section YA 1 – Definition of "land"
This definition has been rationalised. In particular, the first three paragraphs apply generally for the Act.

Section YA 1 – Definition of "mortgage"
This definition was introduced into the Income Tax Act at a time when mortgages were part of the system of land tax. The definition has been updated and simplified and now applies generally for the Act.

Section YA 1 – Definition of "natural resource"
The concept of "natural resource" is found in two definitions in the Act and is also a term used in many of New Zealand's double taxation agreements. The 2004 Act does not define this term, and as part of the rewrite objective is to provide clear legislation, it is desirable to define it.

The new definition of "natural resource" is derived from a review of all natural resource-related definitions within other New Zealand legislation. The definition in section YA 1 includes land, water, air, soil or subsoil, minerals, geographic or geologic features, electromagnetic spectrum, forms of energy, living organisms, ecosystems and any rights or interests in any of these things.

Section YA 1 – Definition of "pay"
The definition draws together a number of related terms and applies them generally for the Act. The Interpretation Act 1999 makes it clear that all parts of speech and grammatical forms of a word (for example, "pay, paid, and payment") are to have the same meaning throughout the Income Tax Act, unless the context dictates a different meaning.

Use of the defined term "tax year" in business-related rules
In the rewrite of Parts F to O of the 2004 Act, officials identified a number of provisions through the Act that refer to the defined term "tax year" (31 March year), when the context of these rules indicates that the reference should be to the defined term "income year" (balance date-related). This is particularly evident in rules relating to commercial activities.

The affected provisions are listed in the appendix to Schedule 51. The term "tax year" has either been omitted from the rule, as the term is unnecessary in the context of the rule, or has been rewritten to better reflect the income year context of the rule.

Part Z – Repeals, amendments and savings

Part Z contains the transitional rules, which have the same function as the equivalent rules set out in Part Y of the 2004 Act. The transitional rules apply from the beginning of the 2008–09 income year corresponding to the 2008–09 tax year.

Part Z also contains:

- repeals of enactments (section ZA 1 and Schedule 48);
- consequential changes required for other Acts of Parliament, including the Tax Administration Act 1994 (section ZA 2 and Schedules 49 and 50);
- transitional rules relating to the commencement (section ZA 3);
- savings of binding rulings (section ZA 4); and
- savings of accrual determinations (section ZA 5).

The transitional provisions provide that:

- the plain language legislation is to have full effect from the date the legislation comes into effect; and
- no change in the effect of the law from the 2004 Act is intended unless notified as a change in Schedule 51.

The 2004 Act can be used as an interpretive guide but only in cases when the meaning of a provision in the 2007 Act is unclear or gives rise to absurdity. This rule does not apply when changes in the law are intended and notified, or provisions in the Act are subsequently amended and introduce new policy. The provisions of the 2004 Act may also be used to identify that an unintended change in policy has occurred in the rewritten Act. The transitional provisions do not address this situation, however, so a non-legislative process is being developed for this purpose.

The most important transitional provisions are those in sections A 2(2), ZA 1(2) (When repeal effective), ZA 3(3), (4) and (5) (Intention of new law), and ZA 4 (Saving of binding rulings).

Subsections ZA 3(1) and (2) ensure that errors in other specific sources that reference corresponding provisions between the 2004 and 2007 Acts can be corrected, as contemplated by the Privy Council in the case of *Vela Fishing Ltd v CIR* (2003) 21 NZTC 18,123.

Section ZA 3 – Transitional provisions
The transitional provisions in section ZA 3 are intended to:

- provide a clear signal to users of the new law that no change from the 2004 Act is intended;
- preserve existing case law and Inland Revenue practice and policy statements as much as is reasonably possible;
- require the 2004 Act to be used as a guide to interpreting the meaning of the 2007 Act when the meaning of the new law is unclear or ambiguous;
- ensure that each of the provisions listed in Schedule 51 is not subject to the transitional provisions; and
- ensure that any provision that has been amended to introduce new policy after the new legislation comes into effect is not subject to the transitional provisions.

Testing for unintended changes in policy
It is reasonable to expect that the drafting of legislation in a comprehensive rewrite project will result in some inadvertent law changes. The courts may interpret new phrases and wording in a way that moves the interpretation of the rewritten Act away from the policy contained in the 2004 Act. For this reason, great care has been taken to ensure that the provisions in the 2007 Act are unambiguous and reflect the policy of the 2004 Act.

This has involved a process of testing and consultation on the drafting throughout the bill; from the development of the exposure draft, through to the introduction copy and reported-back versions of the bill.

Each of the drafts of legislation was reviewed on at least one occasion by a private-sector tax specialist. Significant levels of private-sector consultation also provide assurance that the rewritten legislation is intended to reflect accurately the current law unless notified.

Unintended changes in legislative outcome

It is still possible for a provision in the 2007 Act to contain an unintended change in legislative outcome. However, when the provision is clear and does not lead to an absurdity, the 2004 Act cannot be used as a guide to interpretation. In this situation, the 2004 Act can only be used to support a submission that there has been an unintended change in outcome.

The government has also given a commitment to promote retrospective amendments to the 2007 Act in circumstances when a provision in that Act contains an unintentional change in outcome of the law compared with the 2004 Act. This commitment is intended to avoid disadvantaging taxpayers who rely on the current law.

There will be occasions, however, when there will be differing views on whether a provision in the 2007 Act contains an unintended change in law. The Rewrite Advisory Panel has a role in this process. It consists of a representative from the New Zealand Law Society, the New Zealand Institute of Chartered Accountants, the Treasury, Inland Revenue and the independent chair. Its functions are to:

- consider any case brought to its attention on whether a provision in the 2007 Act has changed the effect of the law set out in the 2004 Act;
- advise the government of its conclusion on each case; and
- maintain a watching brief on the consistency of drafting of future income tax legislation.

This role of the Panel is intended to give taxpayers assurance that there will be a transparent process in place when the legislation comes into effect for determining whether it contains any changes in law, and to provide assurance that the drafting of income tax legislation will follow the styles and practices adopted in the 2007 Act.

Retrospective legislation

One concern that arises when considering enacting retrospective legislation is that any changes may have an adverse impact on a taxpayer's previously filed tax position. This impact will be considered when introducing the retrospective legislation. There remains the possibility that a future government will decide to retain the unintended change in policy. This arises because future governments and parliaments are not bound by an earlier government's policy or commitment to change the law.

Taxpayers who rely on the transitional provisions in coming to their tax position and who have been adversely affected by a government decision not to change the law are still required to meet their tax obligations.

They may be entitled to relief from penalties and use-of-money interest, however. The relief is to be available only if the person involved has taken reasonable care in taking an acceptable tax position, as provided for in section 141A of the Tax Administration Amendment Act 2004.

If, however, a person takes an unacceptable tax position resulting in a shortfall of tax in excess of the thresholds referred to in section 141B of the Tax Administration Act 1994, they may be liable for penalties and use-of-money interest.

Section ZA 4 – Binding rulings

Section 91G of the Tax Administration Amendment Act 2004 states that a binding ruling does not apply from the date a taxation law is repealed or amended if the repeal or amendment changes the way the taxation law referred to in the ruling applies.

A significant consideration is the potential cost to both taxpayers and Inland Revenue if new rulings become necessary because existing binding rulings applied for a period after the rewritten legislation comes into effect.

The same approach adopted for the 2004 Act has been adopted for the 2007 Act binding ruling section ZA 4. This section ensures that a binding ruling continues to apply to the provisions that correspond to provisions of the 2004 Act that were the subject of the ruling (if the ruling continues to exist). For example, a binding ruling issued for three years, on the basis of the equivalent former legislation, with effect from the 2007–08 to 2009–10 tax years will result in the binding ruling remaining effective until the end of the 2009–10 tax year.

Binding rulings are not intended, however, to apply to any provision that does not have a corresponding provision in the old law. The two typical cases when this occurs are provisions:

- listed in Schedule 51; and
- those amending the 2007 Act to enact new policy.

The reference to the new law as being the law which "corresponds to the old law" means it is Parliament's intention that taxpayers and Inland Revenue should not have to go to the time and effort of obtaining or issuing replacement binding rulings. To support this, section ZA 4 specifies that the Commissioner is prohibited from making a new binding ruling if the existing binding ruling is to continue to have effect. In other words, the intention is that the requirement that the new law "corresponds to the old law" is not intended to be given a narrow, obstructive interpretation that would prevent binding rulings being saved.

In the vast majority of cases, it is anticipated that there will be no doubt over the existence of the "corresponding" new law. It should be very clear that there is a new law which corresponds to and expresses the same ideas as the old law, even though it uses plainer language and is located under a different section number.

Section ZA 5 – Savings of accrual determinations
The "preservation" approach adopted to save binding rulings has been applied to continue accrual determinations in a similar fashion.

Schedules

The schedules have been renumbered and grouped by function. The appendix to Schedule 19 of the 2004 Act is of little practical use. Instead, it is now clear that the Commissioner's practice of issuing PAYE tables replaces this appendix, and is authorised under section RD 11(4). The comparative numbering for the schedules is set out in Table 3.

Table 3 – Comparative schedule numbering

2004 Act Schedule		2007 Act Schedule	
Schedule	1	Schedule	1
Schedule	2 part a	Schedule	5
Schedule	2 part b	Schedule	1
Schedule	3	Schedule	24
Schedule	4	Schedule	25
Schedule	5	Schedule	26
Schedule	6	Schedule	27
Schedule	6b	Schedule	19
Schedule	7	Schedule	20
Schedule	8	Schedule	17
Schedule	9	Schedule	18
Schedule	10	Schedule	10
Schedule	11	Schedule	12
Schedule	11b	Schedule	11
Schedule	12	Schedule	31
Schedule	13	Schedule	3
Schedule	14	Schedule	1
Schedule	15	Schedule	37
Schedule	16	Schedule	13
Schedule	17	Schedule	14
Schedule	18	Schedule	36
Schedule	19	Schedule	2
Schedule	19, appendix	omitted	
Schedule	20	Schedule	48
Schedule	21	Schedule	49
Schedule	22	Schedule	50
Schedule	22a	Schedule	51
Schedule	23	Schedule	52

Schedule 51

Schedule 51 contains the list of policy changes that have been approved by the government for inclusion in the 2007 Act. The policy changes are minor in nature. They were listed for consultation in exposure drafts of legislation and in submissions made to the Finance and Expenditure Committee. An explanation for each of the intended changes appears earlier in this article.

Importance of drafting approach for future legislation

The key aim of the rewrite has been to produce tax legislation that is clear, uses plain language and is structurally consistent. It is intended that this plain drafting approach be adopted for all future income tax legislation. It is therefore useful to review the key principles on which the 2007 Act is based.

Plain drafting has focused on refining structure, using plain language techniques, and clarifying the structural relationships between the core provisions and Parts of the Act.

Rewriting the income tax legislation has been integral to increasing voluntary compliance with the tax laws. The reason is that legislation that is clear, uses plain language and which is structurally consistent should make it easier for taxpayers to identify and comply with their income tax obligations.

The rewrite cannot, however, eliminate all the complexity and inconsistency of tax law because the subject matter is inherently complex. The challenge has been to ensure that the complexity results from the concepts rather than from the way the information is presented. The 2007 Act addresses this challenge through structure, drafting style and integrating the interpretive principles of the Interpretation Act 1999 with the drafting.

Structure

The overall scheme of the Act is determined by the structure and general application of the core provisions. This is complemented by links to the various parts which provide the detail for the workings of the core provisions.

The structure is based on the principle of working from the provisions that are the most generally applicable to those least generally applicable. This applies on an Act-wide basis as well as within each Part and subpart.

The subparts represent a grouping of provisions that address similar or related rules. For example, subpart CE addresses transactions relating to the income of employees and contractors. Each section in Parts C to E has been rewritten to address a single concept. In some cases this has led to sections in the 2004 Act being broken up into a number of parts.

In the 2007 Act, the main operative rule of a section is located at the start of the section. Other subsections within that section are then drafted to supplement the main operative rule. The 2007 Act also makes extensive use of signposts and cross-references to guide the reader to other relevant or related provisions. Each section is followed by cross-references to the corresponding provision in the 2004 Act and a list of the defined terms in the section.

Drafting style

The drafting approach used throughout the rewrite of the Income Tax Act is based on the style set out in the government discussion document, *Rewriting the Income Tax Act – objectives, process, guidelines* (December 2004) in conjunction with the Parliamentary Counsel Office Drafting Manual.

Examples of these guidelines include:

- replacing archaic expressions with more modern ones, while taking care not to change the law inadvertently, by rewriting words or expressions that have a well-understood meaning;
- using new defined terms when a term has a meaning that varies from its ordinary non-tax meaning, although some terms have been retained because there is a depth of case history behind them, and simpler words of equivalent meaning cannot be found;
- harmonising definitions when possible, making it easier to find defined terms;
- relocating the detail of definitions that are used for specific provisions from section OB 1 in the 2004 Act and placing them within the relevant provisions while retaining a reference to the definition has been retained in section YA 1; and
- placing reliance on aspects of the Interpretation Act 1999.

Rules of interpretation under the Interpretation Act 1999

The main rule for the interpretation of statutes in New Zealand is contained in section 5(1) of the Interpretation Act 1999 which states, *"The meaning of an enactment must be ascertained from its text and in the light of its purpose"*.

To reflect the purpose of the legislation, the drafting approach adopted in the rewritten Act:

- takes into account the scheme of the Act as a whole, that is to impose tax;
- takes into account the subject matter of the Part or subpart in which the section is situated;
- takes into account the context of the section itself as well as the words in the section;
- attempts to make the underlying policy more easily identifiable from the most natural reading of the provision; and
- relies more on the general rules of interpretation set out in the Act.

Readers' aids

Readers' aids are contemplated by subsections 5(2) and (3) of the Interpretation Act 1999, which state:

> *"(2) The matters that may be considered in ascertaining the meaning of an enactment include the indications provided in the enactment.*
>
> *"(3) Examples of those indications are preambles, the analysis, a table of contents, headings to Parts and sections, marginal notes, diagrams, graphics, examples and explanatory material, and the organisation and format of the enactment."*

In addition to diagrams, flowcharts, notes and lists of defined terms, the drafting of the Act uses Part, subpart, section headings and subsection headings. Tables are used extensively in Part O (Memorandum accounts) and also in Parts R and Y. Lists of defined terms follow each section.

Defined terms

All defined terms in the Act are listed in section YA 1. The drafting approach adopted for definitions that are not widely used through the Act locates those terms close to their relevant operative provisions if that is likely to assist readers. Section YA 1 then lists that definition by pointing to the substantive definition. This location may be either within the section or within the relevant subpart.

The drafting style adopted for definitions led to some defined terms being introduced by the word "means" and of others by "includes". In the 2007 Act, the term "means" is used to introduce an exhaustive definition. The use of "includes" with a definition generally introduces an incomplete definition.

Parts of speech and other grammatical forms of words

Section 32 of the Interpretation Act 1999 states *"Parts of speech and grammatical forms of a word that is defined in an enactment have corresponding meanings in the same enactment"*.

Definitions in the 2007 Act rely on section 32 of the Interpretation Act for different parts of speech or other grammatical forms of a word that have a corresponding meaning. For example, it is not necessary to add to a definition of "sell" a statement that "sale" has a corresponding meaning.

The defined term "pay" is an example of this drafting approach as the defined term "payment" in the 2004 Act is no longer necessary.

Parts of speech, number and gender

Sections 31, 33, 35 and 36 of the Interpretation Act 1999 establish rules in relation to parts of speech, number and gender. The effects of these rules are that:

- in all Acts of Parliament, the singular includes the plural, and vice versa; and
- unless an income tax provision adopts a unique approach to the determination of time and distance, any references to time and distance used in the rewritten Act are to use the rules set out in the Interpretation Act 1999.

Ambulatory nature of law

Section 6 of the Interpretation Act 1999 specifies that *"An enactment applies to circumstances as they arise"*.

The provision recognises the fact that an Act of Parliament may last for many years and operate within a changed society where the courts must consider circumstances that are often very different from those in which it was originally enacted.

For example, the purpose of the foreign investment fund rules is to make sure that New Zealand residents who have overseas investments are taxed on their share of the overseas entity's income on a current basis. As the nature of investments evolves, the courts will be called on to consider to what extent a new form of investment may fall within one of the classes of foreign investment fund referred to in section EX 29.

The drafters of the Income Tax Act 2007 have tried to achieve an enduring piece of legislation through the use of plain language and clear structure.

LEGISLATION AND DETERMINATIONS

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

LIVESTOCK VALUES – 2008 NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK

The Commissioner of Inland Revenue has released a determination, reproduced below, setting the national standard costs for specified livestock for the 2007-2008 income year.

These costs are used by livestock owners as part of the calculation of the value of livestock on hand at the end of the income year, where they have adopted the national standard costs ('NSC') scheme to value any class of specified livestock.

Farmers using the scheme apply the one-year NSC to stock bred on the farm each year, and add the rising two-year NSC to the value of the opening young stock available to come through into the mature inventory group at year-end. Livestock purchases are also factored into the valuation of the immature and mature groupings at year-end, so as to arrive at a valuation reflecting the enterprise's own balance of farm bred and externally purchased animals.

NSCs are developed from the national average costs of production for each type of livestock farming based on independent survey data. Only direct costs of breeding and rearing rising one-year and two-year livestock are taken into account. These exclude all costs of owning (leasing) and operating the farm business, overheads, costs of operating non-livestock enterprises (such as cropping) and costs associated with producing and harvesting dual products (wool, fibre, milk and velvet).

For bobby calves, information from spring 2007 is used while other dairy NSCs are based on survey data for the year ended 30 June 2007. For sheep, beef cattle, deer and goats, NSCs are based on survey data for the year ended 30 June 2006 which is the most recent available for those livestock types at the time the NSCs are calculated in December 2007.

For the 2007-2008 income year there has been a slight decrease (in dollar terms) in the NSC for sheep and beef cattle. The decreases reflect the lower incomes received by sheep and beef farmers which resulted in them having to cut expenditure significantly to generate a positive net profit.

The values for dairy cattle rising one-year calves have decreased as a result of farmers rearing more homebred calves (during the survey year). The number of calves homebred is the divisor for allocating costs to the rising one-year age group. The higher the number of homebred animals the lower the cost will be for each calf. It is understood that the reason for rearing more calves is due to the expected future demand for dairy heifers due to herd expansions and more dairy conversions.

The rising 2-year dairy cattle NSC at $104.80 increased 12.3% on the previous year. This increase reflected slightly higher overall costs per livestock unit (LSU) and a 9.0% increase in the dairy multiplier because of a higher proportion of immature cows relative to cows in milk. The dairy multiplier allocates costs between milk production and calve production.

The NSC for purchased bobby calves increased mainly because of large cost increases, especially for feed stuffs.

The NSC values for the other livestock types (deer, meat and fibre goats and pigs) are relatively static (in dollar terms). The increase in the NSC for dairy (milking) goats is mainly due to increases in meal used to feed the kidding does.

The NSCs calculated each year only apply to that year's immature and maturing livestock. Mature livestock valued under this scheme effectively retain their historic NSCs until they are sold or otherwise disposed of, albeit through a FIFO or inventory averaging system as opposed to individual livestock tracing. It should be noted that the NSCs reflect the average costs of breeding and raising immature livestock and will not necessarily bear any relationship to the market values (at balance date) of these livestock classes. In particular, some livestock types, such as dairy cattle, may not obtain a market value in excess of the NSC until they reach the mature age grouping.

One-off movements in expenditure items are effectively smoothed within the mature inventory grouping, by the averaging of that year's intake value with the carried forward values of the surviving livestock in that grouping. For the farm-bred component of the immature inventory group, the NSC values will appropriately reflect changes in the costs of those livestock in that particular year.

The NSC scheme is only one option under the current livestock valuation regime. The other options are market value, the herd scheme and the self assessed cost scheme ('SAC') option. SAC is calculated on the same basis as the NSC but uses a farmer's own costs rather than the national average costs. There are restrictions in changing from one scheme to another and before considering such a change livestock owners may wish to discuss the issue with their accountant or other adviser.

NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK DETERMINATION 2008

This determination may be cited as "The National Standard Costs for Specified Livestock Determination 2008".

This determination is made in terms of section EC 23 of the Income Tax Act 2004. It shall apply to any specified livestock on hand at the end of the 2007-2008 income year where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EC 23 of the Income Tax Act 2004 the national standard costs for specified livestock for the 2007-2008 income year are as set out in the following table.

Kind of livestock	Category of livestock	National standard cost
		$
Sheep	Rising 1 year	23.00
	Rising 2 year	15.70
Dairy Cattle	Purchased bobby calves	167.20
	Rising 1 year	608.60
	Rising 2 year	104.80
Beef Cattle	Rising 1 year	228.30
	Rising 2 year	132.30
	Rising 3 year male non-breeding cattle (all breeds)	132.30
Deer	Rising 1 year	76.90
	Rising 2 year	37.40
Goats (Meat and Fibre)	Rising 1 year	18.40
	Rising 2 year	12.60
Goats (Dairy)	Rising 1 year	134.50
	Rising 2 year	21.50
Pigs	Weaners to 10 weeks of age	85.50
	Growing pigs 10 to 17 weeks of age	67.40

This determination is signed by me on the 28th day of January 2008.

Susan Price
Senior Tax Counsel

FAIR DIVIDEND RATE METHOD DETERMINATIONS

The following determinations, concerning New Zealand resident investors' ability to use the fair dividend rate method to calculate foreign investment fund (FIF) income from a type of attributing interest in a FIF, have been made under section 91AAO of the Tax Administration Act 1994.

DETERMINATION FDR 2008/01 – USE OF FAIR DIVIDEND RATE METHOD FOR A TYPE OF ATTRIBUTING INTEREST IN A FOREIGN INVESTMENT FUND

Reference

This determination is made under section 91AAO(1)(a) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Policy Manager under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Units in a non-resident issuer to which this determination applies are an attributing interest in a foreign investment fund (FIF) for New Zealand resident investors. New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their units in the non-resident issuer each year.

As the non-resident issuer invests solely in financial arrangements denominated in New Zealand dollars, section EX 40(9)(d) of the Act applies and New Zealand resident investors are prevented from using the fair dividend rate method in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

Despite the non-resident issuer having assets which 80% or more by value consist of financial arrangements denominated in New Zealand dollars, I consider that it is appropriate for New Zealand resident investors in this arrangement to use the fair dividend rate method. The overall arrangement (as described to me by the applicant) contains sufficient risk so that it is not akin to a New Zealand dollar-denominated debt instrument.

Scope of determination

The investments to which this determination applies are units in a non-resident issuer which:

a. is a unit trust that is established and tax resident in Australia;

b. is managed by Liontamer Investment Management Pty Limited (Liontamer), a company incorporated and tax resident in Australia, or an entity which is associated with Liontamer;

c. issues New Zealand dollar denominated units (not being fixed rate shares or non-participating redeemable shares) to New Zealand resident investors;

d. invests proceeds from the issue of units in assets which are financial arrangements, in relation to which the return on maturity is calculated by reference to either:

   i. The movement in the value of an underlying basket of:
      - shares in companies listed on a recognised exchange,
      - commodities,
      - real property,
      - non-NZD denominated fixed interest securities traded on a recognised market.

   ii. The movement in an index or selected indices relating to the value of items listed in (i) above.

   iii. The movement in the value of an underlying actively managed fund or basket of funds investing in items listed in (i) above;

   iv. The movement in currencies traded in a recognised market;

   v. Any combination of (i) to (iv).

e. if it invests in financial arrangements in relation to which the return is determined by reference in any way to underlying non-New Zealand dollar denominated fixed interest securities, does not invest in any currency arrangements which provide an overall economic return as if the securities were denominated in New Zealand dollars;

f. does not derive a fixed return in excess of 1.00% per annum from its investment in financial arrangements;

g. may make distributions to the unit holders on a regular basis, but does not guarantee that any income will be derived or that a distribution will be made;

h. may pay to an investor an amount exceeding the issue price of the unit on redemption, but at the time the unit is first issued does not guarantee the redemption price of a unit will exceed its issue price.

Interpretation

In this determination, unless the context otherwise requires –

"Associated" means associated persons under sections OD 7 and OD 8 of the Act;

"Financial arrangement" means a financial arrangement under section EW 3 of the Act;

"Fixed rate share" means a fixed rate share under section LF 2(3) of the Act;

"Non-participating redeemable share" means a non-participating redeemable share under section CD 14(9) of the Act;

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Act;

"Recognised exchange" means a recognised exchange under section OB 1 of the Act;

"Recognised market" means recognised exchange under section OB 1 of the Act, reading paragraphs (c) and (d) of the definition of recognised exchange to include currencies or financial arrangements;

"Slice rule" means the slice rule under section CD 15(3) of the Act;

"The Act" means the Income Tax Act 2004.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may use the fair dividend rate method to calculate FIF income from the interest.

Application date

This determination applies for the 2007–08 and subsequent income years.

Dated at Wellington this 22nd day of January 2008

David Carrigan
Policy Manager
Inland Revenue

DETERMINATION FDR 2008/02 – FAIR DIVIDEND RATE METHOD NOT TO BE USED FOR A TYPE OF ATTRIBUTING INTEREST IN A FOREIGN INVESTMENT FUND

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Policy Manager under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Units in a non-resident issuer to which this determination applies are an attributing interest in a foreign investment fund (FIF) for New Zealand resident investors. New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their units in the non-resident issuer each year.

New Zealand resident investors who satisfy the requirements of section EX 40(7) of the Act will qualify to use the fair dividend rate (FDR) method to determine their tax liability in respect of their units in the non-resident issuer, and are not prevented from using the FDR method pursuant to section EX 40(8) and EX 40(9) of the Act in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

However, I consider that it is not appropriate for New Zealand resident investors in this arrangement to use the fair dividend rate method. Due to the nature of the overall arrangement (as described to me by the applicant), application of the FDR method would impose unnecessarily high compliance costs on New Zealand investors each of whom would be required to perform a substantial number of quick sale calculations and associated foreign exchange calculations every time they withdraw funds from the non-resident issuer during the year.

Scope of determination

The investments to which this determination applies are units in a non-resident issuer which:

a. is the Macquarie Cash Management Trust, a unit trust that is established and tax resident in Australia;

b. is managed by Macquarie Investment Management Limited (Macquarie), a company incorporated and tax resident in Australia, or an entity which is associated with Macquarie;

c. issues Australian dollar denominated units (not being fixed rate shares or non-participating redeemable shares) to New Zealand resident investors;

d. invests proceeds from the issue of units in assets which are Australian dollar denominated financial arrangements, currently short-term Australian dollar denominated debt securities;

e. does not invest in any currency arrangements which provide an overall economic return as if the securities were denominated in New Zealand dollars;

f. may make distributions of income (if any) to the unit holders in the form of cash or additional units but does not guarantee that any income will be derived or that a distribution will be made.

Interpretation

In this determination, unless the context otherwise requires –

"Associated" means associated persons under sections OD 7 and OD 8 of the Act;

"Financial arrangement" means a financial arrangement under section EW 3 of the Act;

"Fixed rate share" means a fixed rate share under section LF 2(3) of the Act;

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Act;

"Non-participating redeemable share" means a non-participating redeemable share under section CD 14(9) of the Act;

"The Act" means the Income Tax Act 2004.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the fair dividend rate method to calculate FIF income from the interest.

Application date

This determination applies for the 2007–08 and subsequent income years.

Dated at Wellington this 8th day of February 2008.

David Carrigan
Policy Manager
Inland Revenue

LEGAL DECISIONS – CASE NOTES

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

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

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

TRAINER'S PERCENTAGE IS EXEMPT INCOME

Case:	TRA Decision Number 2/08
Decision date:	11 January 2008
Act:	Income Tax Act 1994
Keywords:	exempt income, stake money, trainer's percentage

Summary

The trainer's percentage will be exempt income in the hands of an owner/trainer.

Facts

The disputant is a company which operates a racehorse-training stable. During the relevant period, its major shareholder ("M") owned or had an interest in a number of successful racehorses in his personal capacity. M and his son are employed by the disputant company as horse trainers and both hold training licences, as under the Rules of Racing a company is unable to hold a training licence.

Horses which were owned or partly owned by M lived in the disputant's stables and were trained by M and his son with horses owned by third parties.

Under the Rules of Racing, the trainer of a winning horse is entitled to 10% on the stake or prize money ("the trainer's percentage") and the owner receives the remaining 90%. The 10% trainer's percentage is paid directly to trainers with the 90% balance paid to the owners. Under section CB9(c) and (ca) of the Income Tax Act 1994, stake money is exempt income.

The disputant did not charge M any part of the standard daily charge for training horses which he owned or had a part ownership in. The trainer's percentage for all horses, including those that M only had a part ownership interest in, was paid into the disputant's bank account. At the end of the financial year, journal entries were made to reimburse the company for the expenses paid by the disputant for the maintenance of M's horses and to reconcile all of the trainer's percentage to M's personal account.

The Commissioner considered that the trainer's percentage was derived by the disputant and was accessible income to the disputant under section CD3 of the Income Tax Act 1994. The Commissioner's position was that the payment of the trainer's percentage is mandatory under the Rules of Racing and is not "stakes, being prize money". The Commissioner argued that the trainer's percentage has the hallmarks of income in the hands of trainers [Reid].

Decision

Judge Barber held that the trainer's percentage is exempt income under section CB9(c) and (ca) of the Income Tax Act 1994 where the trainer is also an owner.

Judge Barber made findings of fact that the employment terms between the disputant and M and the disputant and M's son enabled them to train M's horses on company time or on their own time without needing to pay the disputant for that service. The Judge said that it followed from that that M's horses were not being trained by the disputant but received the "necessary ancillary services" as horses in the stables at M's expense.

COMMISSIONER ENTITLED TO USE SECTION 19 DURING THE DISPUTE RESOLUTION PROCESS

Case:	Gerald Malcolm Foxley and Anor v The Commissioner of Inland Revenue
Decision date:	25 January 2008
Act:	Section 19 of the Tax Administration Act 1994
Keywords:	judicial review, improper purpose, dispute resolution process, substantive unfairness, procedural unfairness

Summary

The section 19 enquiry was convened for the proper purpose of assessing the taxpayers' tax liability. The Commissioner may use his section 19 power after the commencement of the dispute resolution process.

Facts

This case involved a judicial review of the exercise of the Commissioner's statutory power under section 19 of the Tax Administration Act 1994 ("TAA").

The taxpayers and the Commissioner are engaged in the dispute resolution process under Part IVA of the TAA 1994 concerning the taxpayers' liability for tax for the year ended 31 March 2002. Two sets of Notices of Proposed Adjustment ("NOPAs") and Notices of Response ("NORs") have been exchanged.

The Commissioner, at this stage, required the taxpayers to attend a section 19 interview. They alleged the Commissioner employed section 19 for the improper purpose of forcing them to settle. Further, they allege that section 19 is not available when the dispute resolution process is under way and that the Commissioner's use thereof was both procedurally and substantively unfair.

The Commissioner disagreed and alleged that section 19 was properly deployed to ascertain the taxpayer's correct tax liability.

On 25 May 2001, the taxpayers entered into a Deed of Transfer and Assignment of Interest of Forestry Rights with Fox and Fox Limited, a company of which they are the directors and shareholders. In terms of the deed the taxpayers assigned to Fox and Fox Limited, all rights and entitlements in and to the services and forestry rights in consideration for $488,000, of which $314,000 was to be paid for services and the balance for forestry rights.

Neither of the taxpayers returned any portion of the $488,000 in their returns for the period ending March 2002.

The Commissioner issued a NOPA on the basis that the payment was for forestry rights or services. The taxpayers' NOR denied the same but did not specify what was transferred.

The Commissioner issued a second NOPA alleging in the alternative that if forestry rights were not transferred and services not provided, the payment was a deemed dividend. The taxpayers' NOR alleged the payment was neither for cutting rights nor a dividend but was in fact for their interest in obtaining forestry rights that were under negotiation. They alleged that the cutting rights were obtained by Fox and Fox Ltd from the property owners concerned.

The Commissioner's solicitor decided that an inquiry based on section 19 should be made to fully understand the background facts to properly interpret the deed and issue a Statement of Position. The solicitor was also of the view that it might be possible to settle the dispute.

The taxpayers attacked the Commissioner's case alleging that the solicitors' memorandum and affidavits filed for the Commissioner reflected an improper purpose.

Decision

The Court found that the section 19 inquiry by the Commissioner was for the purpose of ascertaining the taxpayers' true tax position and not for the purpose of pressuring them to settle as alleged by the plaintiffs.

The Court held that there is nothing in section 19 itself or in Part IV that clearly precludes use of section 19 while a disputes process is under way. The availability of section 19 has not been the subject of any previous decision but it is well established that the Commissioner may use his powers under section 17 until the proceedings are on foot and potentially beyond, provided it is for the proper purpose. There is no reason why the section 19 power should be different.

The allegation of substantive unfairness on the part of the Commissioner failed as the Court found there was no abuse of power, as did the allegation of procedural unfairness based on the assertion that by its very nature the section 19 procedure will be unfair.

In the result, the judicial review was dismissed.

REGULAR FEATURES

DUE DATES REMINDER

March 2008

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

April 2008

7 End-of-year income tax

2007 end-of-year income tax due for clients of agents with a March balance date

21 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

These dates are taken from Inland Revenue's *Smart business tax due date calendar 2007–2008* and *Smart business tax due date calendar 2008–2009*. These calendars reflect 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.

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Draft depreciation determination	***Comment deadline***
☐ DDP0010: Satellites	31 March 2008

Draft standard practice statement	***Comment deadline***
☐ ED00100: Disputes resolution process commenced by a taxpayer	3 April 2008

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