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TAX INFORMATION Bulletin

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CORRECTIONS

INTERIM JUDGMENT PRINTED IN ERROR

Avowal Administrative Attorneys & Ors v the District Court at North Shore and the Commissioner of Inland Revenue

A summary of an interim judgment in this case was included in error in the June 2008 *Tax Information Bulletin*, Vol 20, No 5 at page 17. The High Court had made an order prohibiting publication of the judgment and any part of the proceedings (including the result) in news media or on internet or other publicly accessible database until the final disposition of the trial. You should not refer to or rely on the summary of the interim judgment, or disclose it further, pending further order of the Court.

NZIT INVESTMENTS NOT EXEMPT

In the *Tax Information Bulletins*, Vol 19, No 3 (April 2007) and Vol 20, No 4 (May 2008), we referred to investments in New Zealand Investment Trust plc (NZIT) that were exempt from being attributing interest under the new foreign investment fund (FIF) rules.

NZIT has advised that investments in the company do not meet the criteria for the exemption for the 2008 tax year. Investors in NZIT, therefore, need to take into account this investment when determining their tax obligations under the new FIF rules.

If a return of income has already been filed on the basis that the exemption applied, you should make a full voluntary disclosure of any tax shortfall due to the above change.

INCORRECT CURRENCY RATES

Due to a processing error, the October currency rates (Table A, pages 14–16) in the May 2008 issue of the *Tax Information Bulletin* are incorrect.

The correct rates can be found on our website at
www.ird.govt.nz/business-income-tax/overseas-currency-convert-nz.html

We apologise for any inconvenience the above may have caused.

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Product ruling BR PRD 08/01

Product ruling BR PRD 08/01 was applied for by Restaurant Brands Limited, and covers the engagement of delivery drivers with regard to section 91E(1) of the Tax Administration Act 1994. Subject to various conditions as stated in the ruling and for the purposes of certain stated sections of the Income Tax Acts 2004 and 2007, payments made to delivery drivers are not "income from employment", and will not be excluded from the definition of "taxable activity" in section 6 of the GST Act 1985.

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SPS 08/01: Disputes resolution process commenced by the Commissioner of Inland Revenue

SPS 08/01 sets out the Commissioner's rights and responsibilities with a taxpayer in respect of an adjustment to an assessment when the Commissioner commences the disputes resolution process.

SPS 08/02: Disputes resolution process commenced by a taxpayer

SPS 08/02 discusses a taxpayer's rights and responsibilities in respect of an assessment or other disputable decision when the taxpayer commences the disputes resolution process.

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KiwiSaver – creditable membership

Inland Revenue clarifies the meaning of the word "membership" as it appears in paragraph (a) of the definition of "creditable membership" in section YA 1 of the Income Tax Act 2007.

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Commissioner's output assessment successfully challenged

TRA 036/02 Decision 6/2008

The taxpayer had received an input tax credit through the Commissioner's default in filing a case stated but this did not lead to the conclusion the taxpayer had a taxable activity.

BINDING RULINGS

This section of the TIB contains binding rulings that the Commissioner of Inland Revenue has issued recently.

The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates tax liability based on it.

For full details of how binding rulings work, see our information booklet *Adjudication & rulings – a guide to binding rulings (IR 715)* or the article on page 1 of *Tax Information Bulletin* Vol 6, No 12 (May 1995) or Vol 7, No 2 (August 1995).

You can download these publications free from our website at **www.ird.govt.nz**

PRODUCT RULING – BR PRD 08/01

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by Restaurant Brands Limited.

Taxation Laws

This Ruling applies in respect of:

- Sections BD 2, DA 1 and DA 2(4) and the definition of "income from employment" in section OB 1 of the Income Tax Act 2004 for periods up to and including 31 March 2008.
- Sections BD 2, DA 1 and DA 2(4) and the definition of "income from employment" in section YA 1 of the Income Tax Act 2007 for the periods from 1 April 2008.
- The definition of "taxable activity" in section 6, and the definition of "employment under any contract of service" in section 6(3)(b) of the Goods and Services Tax Act 1985.

The Arrangement to which this Ruling applies

The Arrangement is a recurring arrangement in terms of section 91E(1) of the Tax Administration Act 1994 involving the engagement of delivery drivers by Restaurant Brands Limited ("RBL") pursuant to the Delivery Driver Contract (dated September 2006), and in accordance with information in the Delivery Driver Handbook (dated September 2006), and the Standard Practice Information provided to Inland Revenue in the ruling application (dated 10 October 2007) (collectively referred to as "the relevant documents"), to deliver RBL products to RBL customers. Further details of the Arrangement are set out in the paragraphs below.

Relationship between RBL and its delivery drivers

1. RBL prepares and sells a range of "fast food" products via its Pizza Hut business. RBL sells its products through a chain of restaurants and provides a delivery service to its customers at some of these restaurants. RBL engages the services of delivery drivers to deliver its products to its customers from its Pizza Hut stores.
2. The relationship between the delivery drivers (owner drivers) and Pizza Hut are governed by the following documents:
    - the "Delivery Driver Contract" dated September 2006 which includes the following:
        - An outline of "Delivery Driver Payments" (clause 7);
        - A form to compile the details of the driver, bank account, vehicle and motor insurance (schedule B); and
        - The driver uniform policy (schedule C);
    - the "Delivery Driver Handbook" dated September 2006 which incorporates the following:
        - The guideline on "Delivery Driver Payments";
        - A form to compile the details of the driver, bank account, vehicle and motor insurance (Schedule B); and
        - The "Contract Delivery Drivers Notice of Taxation Requirements";
        - The guideline on "Making a Delivery";
        - The "CHAMPS " guidelines on dealing with a customer; and
    - the Standard Practice Information provided to Inland Revenue in the rulings application.
3. In some cases, in-store employees make home deliveries for Pizza Hut stores from time to time, while also carrying out employment duties in-store. These employees are contracted with RBL under employment contracts and are not remunerated separately for the delivery services performed.

Terms of the Delivery Driver Contract

4. Under the terms of the Delivery Driver Contract the delivery driver agrees to:

(a) use only the motor vehicles detailed in the driver/vehicle details as provided in Schedule B to the contract in the performance of the contract (clause 3.1(d))

(b) ensure the performance of the delivery services in a safe, proper and courteous manner in accordance with the guidelines provided in the Delivery Driver Handbook as varied from time to time (clause 3.1) (attention is drawn to any delivery driver guidelines issued by RBL from time to time)

(c) be responsible for all costs and expenses of the driver's business including the costs and expenses of operating and maintaining all delivery vehicles (clause 4.1(b)

(d) immediately refer any discrepancies on delivery with regards to collection of monies and delivery records to RBL (clause 5.1(a))

(e) at the end of each delivery period provide to RBL's authorised representative:

- a complete account and record in the format specified by RBL (clause 5.1(b)(i)), and
- all monies collected by the delivery driver from customers of RBL during the course of that delivery period (clause 5.1(b)(ii))

(f) be responsible to account for any cheques, credit card slips or monies received on behalf of RBL as soon as possible and make good any shortfall (clause 5.1(c))

(g) be liable for, and indemnify RBL against, any liability, loss, claim or proceedings arising out of or relating to the use of the Contractor's vehicles in the provision of delivery services (clause 8.1)

(h) maintain throughout the continuance of the agreement, at their own expense:

- ACC contributions, where the delivery drivers engage employees to perform services under the contract, make the appropriate ACC employer contribution as required on behalf of those employees (if any) (clause 8.1(a))

(i) a minimum of Third Party Property Damage Liability Insurance in respect of the vehicle (clause 8.1(b))

(j) wear any uniforms provided by RBL and ensure their proper care and maintenance. A $30 deposit is retained out of the first payment, to be returned to the delivery driver on return of the uniform in good conditions (fair wear and tear excepted) (clause 9.1)

(k) provide and wear any additional uniform items as may be requested by RBL (eg, black trousers) (clause 9.1)

(l) provide a float of $20 for the purpose of making change during each delivery period (clause 9.2)

(m) return upon request, clean and in good condition uniforms and delivery pouches. Failure to do so will entitle RBL to deduct the replacement cost from any monies owing to the delivery driver (clause 9.3)

(n) produce to RBL's authorised representative documents that are necessary in the opinion of RBL to establish that the delivery driver has complied and continues to comply with their obligations under the contract (clause 10).

5. The delivery driver is not liable to take out any insurance or be responsible for loss or damage to the products delivered (as long as the loss or damage does not result from the delivery driver's wilful default, negligence or breach of the contract) (clause 8.3).

6. The delivery driver may not assign their rights under the contract without the prior written consent of RBL (clause 1.3).

7. In terms of RBL's obligations under the Delivery Driver Contract:

(a) the engagement of the delivery driver does not commit RBL to a guarantee of any minimum remuneration (clause 1.2)

(b) RBL also reserves the right to engage the services of other contractors (clause 1.4)

(c) RBL agrees to pay the delivery driver:

- for services on a per delivery basis (from 30 September 2006 an all inclusive payment of $5 per delivery including GST if any) (clause 7)
- within 14 days of submission of an invoice for services (clause 6.1)

(d) RBL is not responsible for any vehicle damage sustained as a result of the delivery driver's negligence or omission (clause 8)

(e) products carried by the delivery driver shall be at the risk of RBL (clause 8.3)

(f) the uniforms and delivery pouches remain the property of RBL (clause 9.3).

8. Under clause 1.2 either party may terminate the Delivery Driver Contract upon notice to the other party at the conclusion of any delivery.

9. The legal relationship between the delivery driver and RBL is described as that of "principal and independent contractor and not that of employer and employee" (clause 2.1).

Delivery Driver Payments

10. Clause 7 of the guideline on "Delivery Driver Payments" states that the delivery drivers will be reimbursed at the current delivery payment rate per delivery, at a maximum of two deliveries per round trip.
11. In the case of a mistake and redelivery is required, the delivery driver will receive another delivery payment if the mistake was through no fault of their own.
12. The following are examples of delivery driver payments/ reimbursements that are available.

    The delivery drivers receive payments/reimbursements for:

    - redeliveries that have resulted through overdue order complaints, only if the initial order was logged out from the restaurant (ie, order has left the restaurant) after 20-minute timeframe has lapsed
    - redelivery due to wrongly supplied delivery details (eg, wrong address/phone number supplied by RBL to the delivery driver)
    - delivery of hoax orders or orders cancelled after the product has left the restaurant (the product must be returned to the restaurant)
    - redelivery due to miscellaneous circumstances outside the delivery driver's control
    - cost of phone calls made to customers or back to the restaurant from a payphone.
13. The delivery drivers do not receive payments/ reimbursements for:
    - three or more home deliveries per delivery round, RBL policy is a maximum of two
    - complaints indicating driver's mishandling of the order (eg, pizza has been dropped by the delivery driver)
    - redelivery due to the delivery driver not finding the address where the original delivery details are correct (where possible delivery drivers are required to call from a pay phone to clarify the delivery details)
    - cost of cell phone calls to the customer or back to the restaurant
    - redelivery due to missing items off the order (eg, missing garlic bread). [It is the delivery driver's responsibility to check that they have the entire order before leaving the restaurant]
    - transporting stock between stores, stock transfers are the shift manager's responsibility and not the delivery driver's responsibility.
14. Delivery drivers are not guaranteed any minimum per hour delivery payment.

Uniform Requirements

15. Schedule C to the Delivery Driver Contract sets out the uniform requirements for delivery drivers to adhere to health regulations and Pizza Hut's professional standards. Key points of the requirements are listed below:
    - Pizza Hut hat – to be kept clean and worn with visor at front
    - Pizza Hut shirt – to be clean, free from wrinkles, tucked in and with a minimum of one button done up
    - name tag – to be visible to customers at all times;
    - Pizza Hut black trousers – to be clean and properly fitted;
    - a wedding band and a watch is the only allowable jewellery
    - a clean undershirt may be worn under the uniform. To be black or navy and contain no visible print.
16. Schedule C also states that drivers must practice good daily hygiene.
17. There is also a comment "REMEMBER TO DELIVERY CUSTOMERS YOU ARE PIZZA HUT!"

Notice of Taxation Requirements

18. The "Contract Delivery Drivers Notice of Taxation Requirements" is a guide contained in the Delivery Driver Handbook which states that:
    - the delivery driver is not an employee of RBL
    - the delivery driver should seek independent taxation advice to understand their rights and obligations
    - PAYE will not be deducted from payments for deliveries
    - the gross values of all payments received by the delivery driver for deliveries must be included in the delivery driver's annual income tax return
    - the delivery driver must calculate and pay their earner premium at the end of the year when they file their tax return
    - the delivery driver may be liable to pay provisional tax
    - the delivery driver must register for GST if the delivery driver has income of $40,000 or more.

Making a Delivery

19. The guidelines on "Making a Delivery" have suggestions for the manner in which deliveries are to be made, handling customer complaints, and what to do in the event of emergencies.

CHAMPS – guidelines on dealing with a customer

20. The CHAMPS guidelines on dealing with a customer include a problem-solving method and actions to take when certain scenarios arise (eg, if the order has missing items).

Standard Practice Information

21. The delivery drivers are not:
    - entitled to overtime or sick pay
    - required to belong to any union
    - able to supervise employees of RBL
    - able to access RBL's administration or support services, however, they do have access to staff toilets and product discounts
    - advertising for work nor do they have their own client base, however there is no restriction for them doing this.
22. Also, the delivery drivers:
    - are able to decide the hours they work (provided work is expected to be available). It is standard practice that the delivery drivers make themselves available for rostered hours
    - provide their own vehicles and associated equipment
    - are free to work for another principal
    - must hold an appropriate driver licence.
23. RBL trains the delivery drivers as to the manner in which deliveries are made. The delivery drivers are instructed as to what geographical area they will work in.
24. RBL employees take orders over the phone and decide the delivery sequence of the orders. A maximum of two orders can be delivered at any one time (to ensure quality control of the product).
25. From time to time RBL may pay at its discretion the delivery drivers a minimum of two deliveries per hour during certain hours, in order to ensure minimum coverage for RBL during quiet periods.
26. Although the delivery driver may find his or her own replacement driver, in practice this does not happen and generally another delivery driver is used by RBL.

RBL is currently reviewing the implementation of an incentive scheme, which will apply only to certain delivery drivers for maintaining delivery standards and will not be offered to in-store drivers or employees. The incentive payments are not contractually guaranteed and are not part of an ongoing arrangement.

Relationship between RBL's employees (employed under a different contract) and delivery drivers

27. In certain cases employees of RBL may, from time to time, be required to perform delivery services. Where this is the case, the employees also do other tasks (ie, making the pizzas, cleaning etc). In contrast, delivery drivers are contracted purely to deliver pizzas and are not asked to perform other tasks.
28. No other collateral contracts, agreements, terms or conditions, written or otherwise, have a bearing on the conclusions reached in this Ruling.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

(a) The terms of the relevant documents entered into by RBL and the delivery driver is exactly the same as those provided to the Inland Revenue in the Ruling application dated 10 October 2007, except in relation to the following clauses of the Delivery Driver Contract (dated September 2006) where the basic uniform and hygiene requirements, number of days or dollar amounts (as appropriate) may vary from time to time:
- Clause 6, which states that RBL agrees to pay the delivery drivers within 14 days of submission of an invoice
- Clause 7, which states the rate per delivery as a gross amount of $5
- Clause 9.1, which states that a $30 deposit will be retained out of the delivery driver's first payment, to be returned to the delivery driver on the return of the uniform in good condition
- Clause 9.2, which provides that a float of $20 be carried by the delivery driver
- Schedule C, which specifies the current uniform and hygiene requirements.

(b) RBL will provide the delivery drivers with the notice of taxation requirements at the commencement of the contract and advise the delivery drivers that as independent contractors they are required to comply with their own income tax, GST and ACC obligations.

(c) The actual relationship between RBL and the delivery driver is, and will continue to be during the period this Ruling applies, in accordance with the terms of the relevant documents in all material respects.

How the Taxation Laws apply to the Arrangement

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

- For the purposes of sections BD 2, DA 1 and DA 2(4) of the Income Tax Act 2004 and the Income Tax Act 2007, payments made by RBL to the delivery driver are not "income from employment" as defined in section OB 1 of the Income Tax Act 2004 and section YA 1 of the Income Tax Act 2007, so the driver is not prevented from claiming deductions under these sections by reason only that the driver earns "income from employment", and
- For the purposes of the GST Act, the provision of services by the driver to RBL will not be excluded from the definition of "taxable activity" in section 6 of the GST Act by section 6(3)(b) of that Act as they are not made under "contracts of service".

The period or income year for which this Ruling applies

This Ruling will apply for the period from 26 October 2006 until 26 October 2009.

This Ruling is signed by me on the 4th day of April 2008.

Paul Mason

Investigations Manager, Assurance

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.

DETERMINATION DEP 69: TAX DEPRECIATION RATES GENERAL DETERMINATION NUMBER 69

Note to Determination DEP 69

This determination applies both to the 2007/2008 income year, and the 2008/2009 and subsequent income years and is issued pursuant to section 91AAF of the Tax Administration Act 1994, having regard to the application of section ZA 2(2) of the Income Tax Act 2007.

Application

This determination applies to taxpayers who own items of depreciable property of the kinds listed in the table below.

This determination applies for the 2007/2008 and subsequent income years.

Determination

Pursuant to section 91AAF of the Tax Administration Act 1994 I set in this determination the economic rates to apply to the kinds of items of depreciable property listed in the table below by:

- adding into the "Transportation" asset category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed in the table below.

General asset class	Estimated useful life (years)	DV rate (acquired before 1/4/05) (%)	SL rate (acquired before 1/4/05) (%)	DV rate (acquired on or after 1/4/05) (%)	SL rate (acquired on or after 1/4/05) (%)
Flight Simulators (FTD and FNPT Certifiable) Aircraft Specific (full-motion)	15.5	12	8	13	8.5
Flight Simulators (FTD and FNPT Certifiable) Aircraft Specific (non-motion)	8	22	15.5	25	17.5
Flight Simulators (FTD and FNPT Certifiable) Upgradeable/ Multi Aircraft (non-motion)	15.5	12	8	13	8.5
Flight Simulators (Non-Certifiable) (non-motion)	4	40	30	50	40

- adding into the "Leisure" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed in the table below.

General asset class	Estimated useful life (years)	DV rate (acquired before 1/4/05) (%)	SL rate (acquired before 1/4/05) (%)	DV rate (acquired on or after 1/4/05) (%)	SL rate (acquired on or after 1/4/05) (%)
Flight Simulators (FTD and FNPT Certifiable) Aircraft Specific (non-motion)	8	22	15.5	25	17.5
Flight Simulators (FTD and FNPT Certifiable) Upgradeable/ Multi Aircraft (non-motion)	15.5	12	8	13	8.5
Flight Simulators (Non-Certifiable) (non-motion)	4	40	30	50	40

Interpretation

In this determination, unless the context otherwise requires, words and terms have the same meaning as in the Income Tax Act 2007 and the Tax Administration Act 1994.

This determination is signed by me on the 30th day of May 2008.

Susan Price

Senior Tax Counsel, Public Rulings

DETERMINATION DEP 70: TAX DEPRECIATION RATES GENERAL DETERMINATION NUMBER 70

Note to determination DEP 70

This determination applies both to the 2007/2008 income year, and the 2008/2009 and subsequent income years and is issued pursuant to section 91AAF of the Tax Administration Act 1994, having regard to the application of section ZA 2(2) of the Income Tax Act 2007.

Application

This determination applies to taxpayers who own items of depreciable property of the kind listed in the table below that have been acquired on or after 1 April 2005.

This determination applies for the 2007/2008 and subsequent income years.

Determination

Pursuant to section 91AAF of the Tax Administration Act 1994 I set in this determination the economic rates to apply to the kind of items of depreciable property listed in the table below by:

- adding into the "Agriculture, Horticulture and Aquaculture" industry category, the general asset class, estimated useful life, and diminishing value and straight-line depreciation rates listed in the table below.

General asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Plant supports (hanging retractable wire)	5	40	30

Interpretation

In this determination, unless the context otherwise requires, words and terms have the same meaning as in the Income Tax Act 2007 and the Tax Administration Act 1994.

This determination is signed by me on the 6th day of June 2008.

Susan Price
Director

NATIONAL AVERAGE MARKET VALUES OF SPECIFIED LIVESTOCK DETERMINATION 2008

This determination may be cited as "The National Average Market Values of Specified Livestock Determination, 2008".

This determination is made in terms of section EC 15 of the Income Tax Act 2004 and shall apply to specified livestock on hand at the end of the 2007-2008 income year.

For the purposes of section EC 15 of the Income Tax Act 2004 the national average market values of specified livestock, for the 2007-2008 income year, are as set out in the following table.

NATIONAL AVERAGE MARKET VALUES OF SPECIFIED LIVESTOCK

Type of livestock	Classes of livestock	Average market value per head $
Sheep	Ewe hoggets	52.00
	Ram and wether hoggets	49.00
	Two-tooth ewes	60.00
	Mixed-age ewes (rising three-year and four-year old ewes)	50.00
	Rising five-year and older ewes	41.00
	Mixed-age wethers	32.00
	Breeding rams	190.00
Beef cattle	*Beef breeds and beef crosses:*	
	Rising one-year heifers	333.00
	Rising two-year heifers	547.00
	Mixed-age cows	638.00
	Rising one-year steers and bulls	427.00
	Rising two-year steers and bulls	640.00
	Rising three-year and older steers and bulls	801.00
	Breeding bulls	1464.00
Dairy cattle	*Friesian and related breeds:*	
	Rising one-year heifers	1037.00
	Rising two-year heifers	1856.00
	Mixed-age cows	2150.00
	Rising one-year steers and bulls	292.00
	Rising two-year steers and bulls	480.00
	Rising three-year and older steers and bulls	664.00
	Breeding bulls	1062.00
	Jersey and other dairy cattle:	
	Rising one-year heifers	920.00
	Rising two-year heifers	1702.00
	Mixed-age cows	079.00
	Rising one-year steers and bulls	225.00
	Rising two-year and older steers and bulls	478.00
	Breeding bulls	884.00
Deer	*Red deer:*	
	Rising one-year hinds	152.00
	Rising two-year hinds	309.00
	Mixed-age hinds	363.00
	Rising one-year stags	198.00
	Rising two-year and older stags (non-breeding)	421.00
	Breeding stags	1064.00
	Wapiti, elk, and related crossbreeds:	
	Rising one-year hinds	186.00
	Rising two-year hinds	347.00
	Mixed-age hinds	399.00
	Rising one-year stags	229.00
	Rising two-year and older stags (non-breeding)	415.00
	Breeding stags	1146.00
	Other breeds:	
	Rising one-year hinds	100.00
	Rising two-year hinds	140.00
	Mixed-age hinds	176.00
	Rising one-year stags	109.00
	Rising two-year and older stags (non-breeding)	188.00
Goats	*Angora and angora crosses (mohair producing):*	
	Rising one-year does	26.00
	Mixed-age does	41.00
	Rising one-year bucks (non-breeding)/ wethers	23.00
	Bucks (non-breeding)/wethers over one year	26.00
	Breeding bucks	86.00
	Other fibre and meat producing goats (Cashmere or Cashgora producing):	
	Rising one-year does	41.00
	Mixed-age does	48.00
	Rising one-year bucks (non-breeding)/wethers	29.00
	Bucks (non-breeding)/wethers over one year	29.00
	Breeding bucks	240.00
	Milking (dairy) goats:	
	Rising one-year does	180.00
	Does over one year	260.00
	Breeding bucks	350.00
	Other dairy goats	50.00
Pigs	Breeding sows less than one year of age	195.00
	Breeding sows over one year of age	219.00
	Breeding boars	262.00
	Weaners less than 10 weeks of age (excluding sucklings)	56.00
	Growing pigs 10 to 17 weeks of age (porkers and baconers)	121.00
	Growing pigs over 17 weeks of age (baconers)	168.00

This determination is signed by me on the 23rd day of May 2008.

Susan Price

Director, Public Rulings

INTERPRETATION STATEMENTS

This section of the Tax Information Bulletin contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IS 08/02: DEDUCTIBILITY OF FEASIBILITY EXPENDITURE

Introduction

1. This interpretation statement contains guidelines that the Commissioner considers relevant in determining whether feasibility study expenditure is deductible under the general deductibility provisions in section DA 1 of the Income Tax Act 2007.
2. All legislative references are to the Income Tax Act 2007, unless otherwise stated.
3. This statement does not consider specific deductibility provisions that may be applicable to some types of feasibility expenditure; for example, provisions such as those found in Part D Subpart B, Part D Subpart T (petroleum mining), and Part D Subpart U (mineral mining).
4. This statement also does not consider the timing of any deduction to which a taxpayer might be entitled or Part E Subpart E (depreciation).
5. This statement is in two parts. The first part considers the application of section DA 1(1) (the general permission) to feasibility expenditure. The second part considers the application of section DA 2(1) (the capital limitation).

Summary

6. In many situations it is likely that feasibility expenditure will be non-deductible on the basis that it is either incurred preliminary to or preparatory to the commencement of a business or income-earning activity or it is capital in nature.

Deductibility: General principles

7. For a deduction to be claimed it will be necessary for the feasibility expenditure to be incurred by the taxpayer:
   - in the derivation of assessable income (either from the ultimate exploitation of the product of the expenditure in a business or income-earning activity, or by sale of the product of the expenditure), and
   - as an ordinary incident of a particular business or income-earning activity.
8. The deductibility of feasibility expenditure is subject to the application of the general principles under section DA 1(1), the general deductibility provision in the Act. Thus, for feasibility expenditure to be deductible under either paragraph of section DA 1(1) there must be a sufficient relationship or nexus between the expenditure and the taxpayer's business or income-earning activity. Any expenditure incurred before the establishment of a business or an income-earning process will not fulfil this statutory nexus because the expenditure will have been incurred too soon. Therefore, feasibility expenditure incurred preliminary to or preparatory to the establishment of a business or income-earning activity will not be deductible.
9. The decision whether a business or income-earning activity is being carried on is always one of fact and degree. Its resolution depends on a consideration of the nature of the activities carried on and the taxpayer's intention in engaging in those activities (as set down in *Grieve v CIR* (1984) 6 NZTC 61,682). A determination of the point at which a taxpayer makes a firm commitment to go into a business or income-earning activity is critical for establishing the earliest time at which that business or income-earning activity may have commenced. Commitment alone, however, is insufficient. The profit-making structure must also have been established and current operations must have begun in order to conclude that the business or income-earning process has commenced.
10. The correct characterisation of the nature of the relevant business is vital to resolving whether there is a sufficient nexus between the expenditure and a taxpayer's business. The activities must be characteristic of that kind of business and the expenditure must be incurred as part of the ordinary business operations.

11. The profit-making structure must also be in place for a business to have commenced. However, the extent of the profit-making structure required depends on the nature of the particular business.
12. The element of commitment is also critical. To conclude that a business or an income-earning activity has commenced, it must be shown that a decision has been made to enter into that business or activity. If expenditure relates to activities undertaken in order to decide whether to enter into a particular business or income-earning activity, that expenditure will lack the required nexus and will be non-deductible.
13. For feasibility expenditure incurred after a business or an income-earning activity has commenced to be deductible, it must be incurred as an ordinary incident of the business or income-earning process. This requires that the particular activities must be undertaken as part of the income-earning process (ie, the activities must be carried out with the intention of obtaining assessable income).

Capital limitation

14. When feasibility expenditure is deductible under section DA 1(1), it is still necessary to consider whether the expenditure is denied a deduction under section DA 2(1) as being expenditure of a capital nature.
15. Whether particular feasibility expenditure is capital or revenue in nature must be determined on the facts of any particular case. The most important factors to weigh in determining whether feasibility expenditure is capital or revenue in nature are whether the expenditure:
    - is recurrent or once and for all expenditure;
    - is on the profit-yielding structure or the income-earning process;
    - creates an identifiable asset; and
    - produces an enduring benefit.
16. In relation to the other three factors, it is necessary to identify the particular nature of the taxpayer's business. When incurring feasibility expenditure of the type in question forms part of the normal business operations (ie, part of the constant demands on the enterprise), case law indicates that the feasibility expenditure is more likely to be treated as being on revenue account and deductible.
17. In relation to the enduring asset and profit-making structure factors, it is necessary to consider how far along the process the expenditure was incurred and whether a particular asset has been identified. In these circumstances whether a decision has been made to commit to a particular proposal is likely to be important.
18. Feasibility expenditure incurred principally for the purpose of placing a taxpayer in a position to make an informed decision about the acquisition of an asset (or other enduring advantage) will not generally be expenditure incurred in relation to that particular asset or advantage. However, once the decision has been made to proceed with the acquisition or development of a particular capital asset, any expenditure incurred beyond that point will relate to the acquisition of that asset and will indicate that the expenditure is more likely to be of a capital nature.
19. The same principle applies in relation to determining whether the expenditure relates to the business or profit-making structure. If the feasibility expenditure is incurred principally for evaluating one or more proposals, it is unlikely the expenditure will relate to the business structure sufficiently to indicate the expenditure is capital in nature. However, when the feasibility expenditure goes beyond simply placing a taxpayer in a position to make an informed decision, it is necessary to consider whether the expenditure relates to the profit-making structure or profit-making process.
20. Once a decision has been made to proceed with the acquisition or development of an asset, any expenditure incurred after that time will more readily be treated as being related to the underlying capital project and thereby the profit-making structure of the business, so will not be deductible. For these purposes, it is irrelevant whether the expenditure is successful. In addition, commitment in this context does not necessarily mean a taxpayer will proceed with the acquisition or development regardless of future events (eg, the availability or otherwise of suitable planning consent), only that the taxpayer has made a firm decision to proceed. Similarly, it is considered that the fact the decision to proceed, or aspects of the process, may be contingent on factors beyond the taxpayer's control will not mean that a taxpayer is not committed to pursuing a certain course of action. Identifying when a decision to proceed has been reached in any particular situation will always be a question of fact and degree, and it is necessary to weigh all the relevant factors to determine whether a commitment has been made to a project.

Legislation

21. Whether feasibility expenditure is an allowable deduction is determined under sections DA 1 and DA 2(1), which provide as follows.

INTERPRETATION STATEMENTS

DA 1 General permission

Nexus with income

(1) A person is allowed a deduction for an amount of expenditure or loss (including an amount of depreciation loss) to the extent to which the expenditure or loss is—

(a) incurred by them in deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income; or

(b) incurred by them in the course of carrying on a business for the purpose of deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income.

General permission

(2) Subsection (1) is called the general permission.

DA 2 General limitations

Capital limitation

(1) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature. This rule is called the capital limitation.

22. It is the Commissioner's view that his conclusions in this statement as to the deductibility or non-deductibility of feasibility expenditure would not be altered if the same items were considered under the provisions of the 1994 Act or the 2004 Act.

What is feasibility expenditure?

23. Feasibility expenditure is neither a defined term for the purposes of the Act nor a term of art. However, it is generally used to describe expenditure incurred by a taxpayer for determining the practicability of a new proposal. A typical feasibility exercise would involve determining whether a particular course of action should be taken or certain capital assets acquired or developed. Depending on the circumstances, feasibility expenditure may include the cost of carrying out surveys or studies (eg, engineering surveys, environmental studies, and geological and geophysical studies), conducting comparative industry and market research, engaging professionals (eg, lawyers, consultants and financial analysts), producing samples or prototypes, and travel costs. These costs may be incurred "externally" if a third party is contracted to provide the services to the taxpayer, or "in-house" if the taxpayer's employees are paid to undertake the work. Feasibility expenses may arise at the outset of a new business venture or in the course of an existing business. In the latter case, they may be closely related to existing operations or may relate to proposals to expand the existing business or commence a new business.

24. Section DA 1(1) is the general deductibility provision in the Act, and relevantly provides that a deduction is allowed to the extent to which any expenditure or loss is incurred in deriving assessable income, or incurred in carrying on a business for the purpose of deriving assessable income. For feasibility expenditure to be deductible, therefore, it must first fall within one of these two bases of deductibility. In addition, simply satisfying section DA 1(1) may not be sufficient to ensure deductibility. A deduction may still be prohibited under a specific provision of the Act; for example, under section DA 2(1), which prohibits a deduction for expenditure of a capital nature.

25. Little New Zealand case law exists on the deductibility of feasibility expenditure. However, some overseas authorities, in particular, Australian and Canadian cases, are on point.

Deductibility under section DA 1(1)

General principles

26. The two leading New Zealand cases relevant to the interpretation of the general deductibility provision are the Court of Appeal decisions in *CIR v Banks* (1978) 3 NZTC 61,236 and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271. The following general principles can be taken from the cases:

- Expenditure will be deductible only when it has the necessary relationship both with the taxpayer concerned and with the gaining or producing of the taxpayer's assessable income or with the carrying on of a business for that purpose (*Banks* at page 61,240; *Buckley & Young* at page 61,274).
- A statutory nexus must exist between the particular expenditure and the assessable income of the taxpayer claiming the deduction (*Banks* at page 61,240).
- The heart of the inquiry is the identification of the relationship between the advantage gained or sought to be gained by the expenditure and the income-earning process. That in turn requires determining the payment's true character. It then becomes a matter of degree, and so a question of

fact, to determine whether a sufficient relationship exists between the expenditure and what it provided or sought to provide on the one hand, and the income-earning process on the other, for the expenditure to fall within the words of the section (*Banks* at page 61,242; *Buckley & Young* at page 61,274).

- Whether the expenditure is incurred in gaining or producing assessable income has to be judged as at the time the taxpayer became definitively committed to the expenditure for which the deduction is sought (*Banks* at page 61,241).
- The phrase "to the extent that" expressly contemplates apportionment (*Banks* at page 61,240; *Buckley & Young* at page 61,274).
- The amount of expenditure is not material. It is not a question of what a reasonable and prudent taxpayer would have expended. It is what the taxpayer has in fact paid (*Buckley & Young* at page 61,282).

Application to feasibility expenditure

27. The primary test for deductibility of expenditure under either paragraph of section DA 1(1) is that there must be a sufficient nexus between the expenditure and the taxpayer's business or income-earning activity. Feasibility expenditure is often incurred at the early stages of a new venture. This means the deductibility of such expenditure is often inextricably linked to the issue of whether and/or when a taxpayer has commenced business or commenced a new business or, in other than business cases, established an income-earning process.

28. Expenditure incurred before the establishment of a business or an income-earning process will not fulfil the statutory nexus required in terms of section DA 1(1) and will not be deductible. This is because the expenditure will have been incurred too soon. If a taxpayer has incurred feasibility expenditure *before* a business has commenced, or a new business to which the feasibility expenditure relates has commenced, or an income-earning process is established, as the case may be, a deduction will be denied.

"In business"

29. The leading New Zealand case on what constitutes being in business is *Grieve*. The Court of Appeal found that determining whether a taxpayer is in business involves a two-fold inquiry as to: (i) the nature of the activities carried on and (ii) the intention of the taxpayer in engaging in those activities. Richardson J (at page 61,691) identified several factors relevant to determining whether a taxpayer is carrying on a business, namely the:
    - nature of the activity;
    - period over which the taxpayer engages in that activity;
    - scale of operations and the volume of transactions;
    - commitment of time, money, and effort;
    - pattern of the activity; and
    - financial results.

30. Richardson J went on to note that it may also be helpful to consider whether the operations involved are of the same kind, and are carried on in the same way, as those that are characteristic of ordinary trade in the line of business in which the venture is conducted. However, in the end it is the *character* and *circumstances* of the *particular venture* that are crucial.

Commencement of business or income-earning activity

31. Although relevant to the issue of preliminary expenditure, the focus in Grieve was essentially on whether a business was being carried on, rather than on the issue of when it could be said that a business had commenced. The latter issue has been more specifically considered in other New Zealand and overseas cases, generally seen as commencing with the English case *Birmingham & District Cattle By-Products Co Ltd v IRC* (1919) 12 TC 92.

32. In *Birmingham*, Rowlatt J concluded that the taxpayer had not commenced business until the date it started to receive raw material and produce finished products. Until then all its actions were merely preparatory to the commencement of business; it was in the process of "getting ready".

33. *Birmingham* was cited by Barker J in the New Zealand Court of Appeal decision *Duff v CIR* (1982) 5 NZTC 61,131, 61,144, as being authority for the proposition that a business does not commence until the plant is ready and the owner is ready to commence dealings in the articles from which the owner is to derive profit; preparatory activities do not constitute the running of a business.

34. *Birmingham* was also confirmed by the Court of Appeal in *Calkin v CIR* (1984) 6 NZTC 61,781, where Richardson J noted the difficulty in distinguishing between transactions that are preparatory to the commencement of business and those that occur once the business has begun and concluded (at page 61,786):

    > Clearly it is not sufficient that the taxpayer has made a commitment to engage in business: he must first establish a profitmaking structure and begin ordinary current business operations.

35. *Calkin* was applied in the High Court decision *Stevens & Stevens v CIR* (1989) 11 NZTC 6,001. In *Stevens & Stevens*, Gallen J also noted that it is not always easy to establish when a business commences and stated (at page 6,006):

> Preliminary investigations will clearly not be enough, nor will the expenditure of capital requirements in order to enable the business to be carried on, see *Birmingham and District Cattle By-Products Company Limited v Commrs of IR*. The business must involve trading.

36. Gallen J considered the Canadian case *Minister of National Revenue v MP Drilling Ltd* [1976] CTC 58 (discussed in paragraphs 90–92) where it was held that a business had commenced when the permanent structure, the market and the products all existed, and the efforts of the respondent were directed to bringing them together with a resultant profit to it.

37. Thus, deciding when a taxpayer ceases incurring preliminary expenditure, preparatory to the commencement of a business or an income-earning activity, and commences incurring expenditure made during the course or conduct of a business or an income-earning activity is often difficult to determine. Preliminary investigations are not enough, and neither is expenditure on capital requirements to enable the business or activity to be carried on. The income-earning process must have begun and the expenditure must be incurred as part of that process (ie, as part of the ordinary business or income-earning activities).

Cases: New Zealand

38. Very little New Zealand case law considers whether a business has commenced in the context of a claim for the deduction of feasibility expenditure. However, a few decisions are relevant to some extent in this context. These cases consider the issue of the deductibility of pre-commencement expenditure. The general principles exhibited in these cases are equally applicable in the context of feasibility expenditure.

39. In *Case L74* (1989) 11 NZTC 1,431 the taxpayers were in partnership as property developers. They bought, renovated and sold properties. They decided to investigate buying land in the Cook Islands, building a motel and operating it. They travelled there and found that their proposed venture was not possible. When they sought to deduct the costs of travel, the Commissioner disallowed the claim on the basis that it was expenditure preparatory to the commencement of a new business.

40. Judge Barber agreed. The Taxation Review Authority (TRA) concluded the expenditure was both preparatory to the commencement of a new business as moteliers and related to the capital structure of such a new business.

41. The Canadian *MP Drilling* case (noted in *Stevens & Stevens* and discussed in paragraphs 90–92) was also briefly considered in New Zealand in *Case M68* (1990) 12 NZTC 2,384. That decision concerned a taxpayer incorporated in 1985 as an exporter, a marketing agent and an agricultural consultant. From 1985 to 1988, its managing director and principal shareholder was heavily involved in establishing a business for exporting certain agricultural products and services to developing countries. The taxpayer declared no income for the years ending 31 March 1986 to 31 March 1988 and sought deductions for expenditure incurred during that period. The largest components of the expenditure were travel costs and the manager's salary.

42. Bathgate DJ held that for the years ending 31 March 1986 and 31 March 1987 the taxpayer had not commenced business. In the TRA's opinion, the activities undertaken in that period were exploratory, preliminary to the undertaking of an income-earning process, and were to establish connections and build goodwill. This was the establishment of the company's business structure, before the commencement of business. The TRA stated (at page 2,391):

> Feasibility study, costs of inquiry, research and investigation, market testing and introduction expenses at the start, to build or establish a goodwill and until establishment and the undertaking of an income earning process, are generally in the nature of establishment expenses, designed to create and secure a lasting advantage, more remote from income earning, and are usually not deductible under either limb of s 104. They are capital in nature or character.

43. However, Bathgate DJ considered that the taxpayer's business had commenced in and from the 1988 income year. In that year, the taxpayer had established an overseas office and, notwithstanding that trading had not commenced and no profit had been generated, Bathgate DJ was satisfied that the income-earning process had commenced. He stated (at page 2,394):

> There was then in my opinion a close and discernible nexus between the expenditure and the income earning process, which by then had started, albeit only just started, so that the expenditure was then of revenue rather than of capital. The preliminary and preparatory work of the objector had largely ceased, an income earnings structure was then in existence, its goodwill was established and growing, and the business was carried on as had been initially intended, but had been delayed until the preliminaries had been completed and a decision made as to how and where the business would operate from. The advantages sought by the expenditure were those looked for in the nature of a trading operation, in the way of gaining or producing assessable income, rather than advantages of a preliminary and preparatory nature, of the once and for all type in establishing a structure, of the preceding years. Current business operations had begun.

44. Although this decision may at first glance seem inconsistent with cases such as *Stevens & Stevens* and *MP Drilling*, in reaching his decision Bathgate DJ noted (at page 2,395) that he had not overlooked the cases referred to by counsel for the taxpayer, including *MP Drilling*. In the TRA's opinion, the distinction between those cases and the taxpayer's case was one of fact and degree. The TRA also emphasised (at page 2,394) that a business may have commenced before a taxpayer was actually trading or earning assessable income.
45. In *Case S39* (1995) 17 NZTC 7,264 two friends incorporated the taxpayer company with the objective of developing a major media company. The majority shareholder was the company's managing director. He looked for media production opportunities for the company. Although he worked on many proposals with a view to making a profit, some of which were developed into projects, none had come to fruition during the period in question. The taxpayer company claimed various items of expenditure, the major item being management fees paid to the managing director's company for services provided by the managing director to the taxpayer. The Commissioner argued that the taxpayer's activities were preliminary and investigatory, so any expenditure was not deductible because business had not commenced and the expenditure was capital in nature.
46. Barber DJ found for the taxpayer and concluded that the type of work undertaken by the managing director for the taxpayer was not work that was preliminary to and investigatory of commencing business, but work that was preliminary to and investigatory of business projects. This was part of the business of media and entertainment production. Even though the work may have been entrepreneurial, speculative and prone not to result in completion or profit, it was work of the normal media and entertainment production type. The taxpayer was established to investigate and carry out or sell profitable production opportunities in the media area. The work was part of the taxpayer's business or income-earning process.
47. Counsel for the Commissioner argued that a project must get past development proposals and feasibility studies and achieve something. Barber DJ acknowledged that it is unusual for a business not to achieve income-earning transactions. However, Barber DJ stated (at page 7,272):

> It seems to me that development proposals and feasibility studies are very much part of a media production project and were part of the income earning process of the objector even though a project needs to progress much further for fees or profit to be obtained. I do not accept Mr Willox's submission that because there were no income earning transactions, a business had never been commenced by the objector.

48. Thus, *Case S39* supports the deductibility of feasibility expenditure in limited circumstances. In that case the TRA concluded that the investigatory work undertaken by the majority shareholder on behalf of the objector was part of the normal business operations of the objector as a media production company. The feasibility expenditure was held to relate to the business of the company (ie, the investigations were part of the company's income-earning process, not the profit-making structure) and were calculated to result in income to the taxpayer.
49. However, the important distinction between *Case S39* and the other cases discussed above is that in *Case S39* the feasibility studies and investigatory work were part of the company's ordinary business operations of the company. The business of a media production company required that the company investigate production opportunities. In other words, the feasibility expenditure incurred was incurred as part of the business activity of identifying profitable projects. This can be contrasted with feasibility expenditure incurred to determine whether to go into business, which is incurred before the commencement of business and lacks sufficient nexus to satisfy the deductibility provision. The situations where feasibility expenditure will constitute an ordinary incident of the business or income-earning process, such as was the case in Case S39, are limited. The deductibility or otherwise of any such expenditure must be determined on the application of the statutory language to the facts in any particular case.
50. Although there are few New Zealand cases in the area of pre-commencement expenditure, those that do exist illustrate the application of the general principles discussed earlier in this statement. No special rules apply to feasibility expenditure. Thus, the cases emphasise that the deductibility or otherwise of feasibility expenditure will depend on the particular facts of the case. A sufficient nexus must exist between the expenditure and the business or income-earning activity. When the expenditure is incurred before any decision is made to enter into the business or income-earning activity, the expenditure will have been incurred too soon and will be non-deductible (*Case M68*). When a business already exists, feasibility expenditure incurred in relation to a new business will still need to satisfy these tests *(Case L74)*. When feasibility expenditure is incurred as part of the ordinary income-earning process of a business, it may

satisfy the requirements of section DA 1(1)(b) for deductibility *(Case S39)*.

51. However, the few authorities that do exist concern relatively simple fact situations, primarily concerning pre-commencement expenditure, and do not exhibit any detailed legal analysis of applicable principles. In addition, the decisions are all TRA decisions, being the court of first instance in each case. In these circumstances, a consideration of relevant decisions from other jurisdictions is of benefit.

Cases: Australia

52. A leading Australian case in the context of feasibility expenditure is *Softwood Pulp and Paper Co Ltd v FCT* 76 ATC 4,438. In that case the taxpayer company was incorporated in 1961 to establish a new paper production industry in South Australia. This would involve building a new mill complex to process particular kinds of paper and other products. The company was owned by Australian promoters and a Canadian company that had experience in the same paper industry. The company incurred significant expenditure in relation to the proposed mill development. However, in February 1962, the Canadian company withdrew. No other promoter could be found, so the project was abandoned. The taxpayer sought a deduction for its expenditure. These expenses included overseas and local travel costs, legal and accounting expenses, the acquisition and testing of raw materials, and professional fees for the carrying out of feasibility studies by expert consultants.

53. The Supreme Court of Victoria rejected the taxpayer's claim. Menhennitt J considered the case, first, from the perspective of whether the taxpayer company was carrying on a business and, secondly, assuming it was carrying on a business, whether the expenditure was of a capital or revenue nature. On the first point, he concluded that everything the company had done was merely preparatory to the commencement of business. The key factor for the court was that at no stage had the company definitely decided to proceed with the mill. Menhennitt J, referring to *Birmingham* in support of his conclusion, stated (at page 4,451):

> The critical point is that the company had not reached a stage remotely near the carrying on of a business. Even assuming that at some stage prior to the mill turning, the company could be said to be carrying on a business, **in this case the company had not even approached the stage of making a decision about carrying on a business**. All that had happened had been that certain investigations had been made to decide whether or not the business was feasible, and whether or not it was economically viable on a competitive basis, but nothing had been done which could be said to be carrying on a business or anything associated with or incidental to the actual carrying on of a business. **Everything which was done was concerned with making a decision whether or not steps should be taken to set up a business, but no decision on even that matter had been reached.** [Emphasis added]

54. The Australian full Federal Court decision in *FCT v Ampol Exploration Ltd* 86 ATC 4,859 is usually cited in support of the deductibility of feasibility expenditure. In that case, the taxpayer carried on business as an oil exploration company, the "exploration arm" of the Ampol group of companies. In 1979, the taxpayer entered into several agreements with the Chinese Government to participate in geographical (seismic) surveys of offshore China to discover possible oil and gas fields. Participation involved no more than the possibility of the Chinese Government granting the right to bid to undertake further seismic and exploration work.

55. An existing company within the group was used as a joint venture vehicle by the taxpayer and another company in the group. The taxpayer assigned its interest under the agreements with the Chinese Government to the joint venture company. The consideration for the assignment was to be a sum agreed on or the taxpayer's costs in connection with the surveys plus a percentage. The taxpayer claimed a deduction for its survey expenditure and the costs of consultants who interpreted the data obtained. The Commissioner disallowed the claim and the taxpayer appealed. A majority (two to one) of the full Federal Court found for the taxpayer.

56. Lockhart J first considered whether the expenditure came within section 51 of the Income Tax Assessment Act 1936 (Cth), the equivalent of section DA 1(1). His Honour stated that for expenditure to fall within the first limb, the outgoings must be connected with the operations that gain or produce the assessable income. In relation to the second limb, a nexus must exist between the expenditure and the carrying on of the relevant business.

57. His Honour noted that despite the uniqueness of the situation, namely that the companies engaged in the activities had no interest from which an income-producing asset could arise, the taxpayer's role in the Chinese venture was perceived by those who controlled its affairs as a commercially sound method of carrying on its exploration business and as part of its ordinary business activities. They were seeking a profit opportunity. In addition, the circumstances that brought the deed of assignment into existence and the provisions of the deed were also held to be

relevant matters for the purpose of characterising the true nature of the expenditure for the purposes of the second limb.

58. Lockhart J found, on the basis of the facts in that case, that the expenditure was necessarily incurred in the carrying on of the taxpayer's business. He stated (at page 4,870):

> The characterisation of the expenditure, and therefore of the outgoing which it represents, is to be discerned from the business activities of the taxpayer generally and its role as the prospecting arm of the Ampol group in the Chinese project in particular. The understanding between the boards of Ampol and the taxpayer, … , that **a benefit, in the form at least of some payment to the taxpayer in the nature of reward or profit, would accrue to it**, requires that the question of deductibility should be approached in a practical fashion. The whole of the relevant expenditure was incurred in the course of carrying on of the taxpayer's business of petroleum exploration. [Emphasis added]

59. Lockhart J was also satisfied that the total expenditure was deductible under the first limb of section 51(1) of the Income Tax Assessment Act 1936 (Cth). The trial judge had drawn a distinction between outgoings incurred before the execution of the deed of assignment and those incurred after, on the basis that it was not until the deed was executed that the payment to be made to the taxpayer was determined. Lockhart J disagreed. His Honour stated (at page 4,870):

> In my opinion the expenditure incurred before the deed was both incidental and relevant to gaining or producing the taxpayer's assessable income in the form of a fee, using that word in the broad sense of a payment or remuneration for the taxpayer's role in the exploration enterprise off the Chinese coast. The deduction is not denied because the particular form of payment was not finally determined in a legally binding form until 3 April 1980. It was at all relevant times the intent of Ampol and the taxpayer that **a just reward of a business character would be paid to the taxpayer**. Only the particular method to be selected to achieve this objective remained to be determined.
>
> Viewed from a practical and business point of view the deed of assignment was the method finally selected to express the object of both Ampol and the taxpayer; first, to enable Ampol to derive a fair share of any benefits which might be produced in the future from the oil production enterprise, if one emerged at all, and, second, to ensure recoupment of the taxpayer's costs if the oil fields were found to be commercially feasible together with a payment geared to a percentage of those costs, and the major share in the benefits of any such enterprise. **The total expenditure was thus connected with the gaining of the payment** from Ampolex Queensland. [Emphasis added]

60. Lockhart J's decision emphasises that a sufficient nexus must exist between the feasibility expenditure and the relevant business or income-earning activity, and that this will be a question of fact in any particular case. In Ampol the activities were unique in that they provided only a right to bid for participation in the next stage of seismic surveys and exploration. There was no interest from which an income-producing asset could arise. The clear implication from the judgment is that the expenditure might well have been held to be non-deductible, except that in the particular facts of the case the activities were carried out by the taxpayer for the gaining of assessable income (in this case in the form of a fee to be paid to the taxpayer under the deed of assignment).

61. Although concluding that the expenditure was deductible in this particular case, Lockhart J did sound a cautionary note with regard to other fact situations. He stated (at page 4,870):

> It provides no warrant for a more general proposition that outgoings of companies engaged in petroleum exploration are necessarily deductible under the second limb of subsec. 51(1) if the expenditure is related to that activity. This is a question of fact in each case. Exploration or prospecting activities (e.g. geological, geophysical or geochemical surveys and appraisal digging) are the kind of activities in which a prospecting company engages if petroleum is to be found. It is, as the title of the activity suggests, of an exploratory nature. Petroleum may or may not be found; but unless expenses of this kind are incurred it will not be found. Once a proven field has been established other expenses, for example, development drilling or activities in the course of working or establishing a petroleum field will be incurred and they savour more of a capital nature since the work is done to bring into being a proven capital asset which will be the source of income-producing activity.

62. At first glance this statement seems somewhat contradictory, as one would expect that expenditure incurred in relation to petroleum exploration by a company engaged in that activity would be deductible. However, Lockhart J's caution is explicable on general principles.

63. It is considered that Lockhart J was merely emphasising that simply because expenses are incurred in relation to an activity does not mean those expenses are necessarily deductible. It is a question of fact in each case. In terms of general principles, it must still be established that a sufficient nexus exists between the expenditure and a business or income-earning activity. When a company is carrying on prospecting activities as a business, then exploration expenses will generally be deductible when they are necessarily incurred in the course of that business. However, it is equally possible that a company could be engaging

in prospecting activities that do not constitute an income-earning activity or a business, in which case there will be no relevant nexus and the expenditure will not be deductible. This was the case in *Esso Australia Resources Ltd v FCT* 98 ATC 4,768 (discussed in paragraphs 75–84).

64. Lockhart J went on to consider whether the expenditure was of a capital nature. That part of his judgment and the judgments of the other two members of the court are considered in paragraphs 144–147.

65. Another decision of the full Federal Court that emphasises the need for a sufficient nexus between the expenditure and the taxpayer's business or income-earning activity is *Griffin Coal Mining Co Ltd v FCT* 90 ATC 4,870. In that case, the majority of the court held that no nexus existed between smelter feasibility expenditure and the taxpayer's existing business of coal mining and sale.

66. The taxpayer carried on the business of coalmining and supplied coal to the State Energy Commission of Western Australia ("SECWA"). During 1981 to 1983 the taxpayer was involved in various disputes with SECWA and the taxpayer decided to diversify its mining activities to lessen its financial dependence on SECWA. The taxpayer expressed interest in becoming involved in the construction of an aluminium smelter to which it would be prepared to supply coal at little or no profit, or even at a loss, provided it was given an equity interest in the project. However, in May 1984 it was decided that SECWA would supply the smelter's electricity. As a consequence it was no longer clear that the taxpayer would necessarily supply coal to the new smelter. Nevertheless, the taxpayer continued its involvement in the smelter project.

67. In August 1984 the taxpayer and two other companies formed a consortium and conducted a feasibility study to determine the construction and operating costs, and to assess the environmental consequences, of building an aluminium smelter. The taxpayer also undertook its own feasibility study of the project. In addition, the taxpayer engaged various consultants to advise on matters such as industrial relations, finance, environmental issues and the negotiation of a joint venture agreement. Ultimately the development did not proceed, because the two other consortium participants withdrew in June 1985.

68. The Commissioner disallowed the taxpayer a deduction for the smelter feasibility study costs.

69. The majority of the full Federal Court held that the smelter feasibility costs were not deductible under section 51 of the Income Tax Assessment Act 1936 (Cth). They were incurred by the taxpayer as part of the cost of forming a new source of income. They were not merely of a preliminary nature made under the umbrella of the conduct of the existing business. At least from May 1984 there was no longer any link between the decision to be involved in the smelter venture and the supply of coal by the taxpayer. Participation in the project was seen as a worthwhile activity in its own right and a new separate activity of the company. The feasibility studies were not simply assessments of whether a project could be undertaken; they flowed into the selection of a site, settlement of environmental questions, and negotiation of contracts and firm commitments. The taxpayer had moved well beyond an incident occurring in the course of the business of coal extraction and sale.

70. Thus, the majority held that the smelter feasibility expenditure was not incurred as an ordinary incident of Griffin Coal's business. No nexus existed between Griffin Coal's existing business and the smelter feasibility expenditure. The latter was incurred in creating a new business structure, so was not deductible under either limb of section 51 of the Income Tax Assessment Act 1936 (Cth).

71. Other cases in this area highlight that identifying the nature or type of business or activity under consideration is fundamental to establishing when that business or activity commenced. In addition, they also confirm that a positive decision must be made to enter into that business, as was emphasised in Softwood (discussed in paragraphs 52 and 53).

72. In *Goodman Fielder Wattie Ltd v FCT* 91 ATC 4,438, a decision of the Australian Federal Court, the taxpayer was a company that carried on business in several divisions. In August 1981, the taxpayer contracted with the Queensland Institute of Technology ("QIT") to fund the establishment of a research and development centre for the production of monoclonal antibodies and related products suitable for commercial development. In return for funding the centre, QIT undertook to produce a range of highly specific monoclonal antibodies for commercial exploitation by the taxpayer. The centre was set up and research on a full-time basis commenced in early 1982. In November 1982 the taxpayer leased separate premises for its monoclonal antibodies division ("Mabco") to set up development and production facilities. Sales of the first monoclonal products took place in December 1982. The taxpayer claimed deductions for its contributions to the centre and expenditure incurred by Mabco on manufacturing, administration, and research and development for the 1981/82 to 1984/85 income years.

73. Hill J, applying *Softwood*, rejected the taxpayer's deductions for expenditure incurred up to November 1982. His Honour stated that critical to the resolution of the case was the characterisation of the business activity that was said to have commenced. The taxpayer claimed that the business carried on by it was to be characterised as one of researching and developing monoclonal antibody products for manufacture and sale. However, the taxpayer conceded that if the business was characterised as one of manufacturing and selling monoclonal antibody products, then that business did not commence until around November 1982. Referring to Softwood, Hill J noted that critical to that decision was the finding that the taxpayer had not yet committed itself to the project or made a final definitive decision to do so. In relation to the case before him his Honour concluded that the element of commitment was absent; the taxpayer was engaging in activities of a provisional kind only. The activity was that of funding a research project and could not be characterised as a business or even as an activity of gaining or producing assessable income.
74. With regard to the expenditure incurred after November 1982, the taxpayer claimed that its business included not only the manufacture and marketing of its heart worm product, but also research into, and the development of, other products. The Commissioner claimed that the expenditure was of a capital nature. This aspect of the decision is discussed in paragraphs 141–143.
75. *FCT v Brand* 95 ATC 4,633 concerned whether the voluntary prepayment of seven years' licence fees for a prawn farming project was an allowable deduction. The case turned on whether the prepayment was incurred in gaining or producing assessable income, or whether it was incurred "too soon". The Court concluded that the prepayment was an allowable deduction. Tamberlin J made several relevant comments in relation to the element of commitment to the income-producing or business activity.
76. His Honour referred to several decisions which placed an emphasis on the element of commitment, including *Goodman Fielder Wattie*. His Honour then stated (at page 4,649):

    > The purpose of research expenditure or payment for a feasibility study is firstly to investigate whether a proposed or possible line of business activity is viable and secondly to decide whether to make a commitment to the activity. The third stage is the entry into such a commitment. It does not follow from a favourable research or feasibility study, for example, that any commitment or outgoing will be made with a view to producing assessable income. In that sense such studies may be discrete from the relevant business activity and may be "too soon" before the business activity commences to justify classification as an activity expected to produce assessable income. This stands in marked contrast to the present case.

77. The full Federal Court also considered these issues in *Esso*. The taxpayer in that case carried on the business of exploring for, producing, and selling oil and gas. Since the 1960s, the taxpayer had explored for oil and gas offshore. From the early 1970s, the taxpayer, under the direction of its ultimate parent company, also explored for coal, synfuels (primarily oil shale) and certain other minerals. On occasion the taxpayer undertook exploration and production activities as a joint venturer.
78. From 1979 to 1984, the taxpayer claimed a deduction under section 51(1) of the Income Tax Assessment Act 1936 (Cth) for expenditure in investigating the acquisition of interests in potential joint ventures for exploration. The costs incurred were general costs that were preliminary to any decision to acquire a particular tenement, or interest therein, from which mining production could take place. The Commissioner denied the deductions and the taxpayer appealed to the Federal Court. Sundberg J held that the expenditure was not deductible. His Honour decided that the taxpayer, although it carried on exploration activities in the relevant years, was not in the business of exploring for coal and oil shale because it had not engaged in exploration for reward (not having conducted the exploration for the purpose of selling or earning fees from its exploration information) nor was it committed to commercial production.
79. It was central to the taxpayer's contentions, before the trial judge and on appeal, that its business included exploration for coal, synfuels and minerals. The taxpayer claimed that the nature, extent and scope of its activities and the quantum and recurrence of expenditure involved in them, including the acquisition of interests in potential mining prospects and ventures, were such that the taxpayer clearly satisfied the test of "carrying on a business". The taxpayer contended that the fact it had not at the relevant time earned assessable income from its new mining activities, commenced mining production in respect of any particular project, or committed itself to commence mining production in respect of any particular location did not mean it was not carrying on a mining business.
80. The Commissioner submitted that the evidence showed that the taxpayer had committed itself to no more than a strategy of assessing the feasibility of potential mining ventures as a possible source of

income from mining or production of those mineral resources. The taxpayer had not made the transition from merely considering whether to conduct a mining business to actually conducting such a business.

81. The full Federal Court stated that the primary question was whether the expenditure was necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. Only if this question were answered in the affirmative was it necessary to consider whether the expenditure was of a capital nature.

82. When considering whether expenditure was preparatory to an activity that might at some time in the future constitute the carrying on of a new or expanded business, the Court stated that "establishing the proper characterisation of the particular business said to have been carried on is critical to resolving whether there is a sufficient nexus between the expenditure and the taxpayer's business".

83. The court accepted that it was open to the trial judge to conclude that the taxpayer was not in the business of exploration, as it "did not engage in exploration for reward". Having accepted this, the court stated that the critical issue was then whether Sundberg J erred in his approach to the requirement of the element of commitment as a criterion for deductibility under the second limb of section 51(1) of the Income Tax Assessment Act 1936 (Cth). It was on the basis of that approach that Sundberg J concluded that the appellant had not made the transition from assessing and seeking opportunities to actually carrying on a mining business.

84. The court approved Sundberg J's approach and stated that the element of commitment was an important criterion for determining deductibility as it established the requisite nexus between expenditure claimed to be deductible and the business said to be carried on. In the court's opinion, the criterion affords a practical and principled basis for ascertaining whether the nexus between the expenditure and the derivation of assessable income is too remote or too tenuous.

85. The full Federal Court accepted that the trial judge had not erred in concluding that the taxpayer had not committed itself to commercial production, with the consequence that the element of commitment to the relevant income-producing activity in respect of which the expenditure was claimed to have been incurred was missing.

86. The taxpayer had relied on the decision in Ampol to support its claim for exploration expenditure. The court in Esso stated (at page 4,783):

> In our view the reliance placed on Ampol by the appellant is misconceived. It was critical to the majority's findings in favour of the taxpayer in Ampol that the taxpayer was engaged for reward in the exploration business. In other words, it was an exploration company which incurred the relevant expenditure with a view to turning to account for profit or reward the benefits it obtained from its exploration activities. That may be contrasted with the position in the present case. His Honour found that the appellant was not an exploration company and that it did not incur the relevant expenditure with a view to turning to account for profit or reward the benefits it obtained from its exploration activities. Rather, his Honour found … that the activities were:
>
> "… of a preliminary nature, aimed at ascertaining whether it was commercially worthwhile to enter into mining joint ventures."

Summary – Australian cases

87. The Australian cases in this area are consistent with the limited New Zealand cases discussed above. In this regard the Australian decisions deal with a wider range of factual situations and provide a more detailed analysis. The usefulness of examining Australian cases in relation to a claim for a deduction under section DA 1(1) has been established in this country for many years. See, for example, *Banks* and *Buckley & Young*. The Australian decisions are concerned with the interpretation of similar wording, and there is nothing in the New Zealand or Australian decisions to indicate that a different approach should be adopted in New Zealand.

88. In the area of feasibility expenditure, the Australian cases also indicate that the question of deductibility under the equivalent of section DA 1(1) depends on the facts of any particular case. There are no special rules in relation to feasibility expenditure and the principles applicable in relation to the general deductibility provision must be applied.

89. There must be a sufficient nexus between the expenditure and the business or income-earning activity for the expenditure to be deductible. Therefore, the business or income-earning activity must have commenced. When the expenditure relates to a new activity for an existing business, business operations must be found to have commenced in relation to that new activity *(Griffin)*. The cases emphasise that there must have been a commitment made to proceed with a particular activity in order for it to be said that the income-earning activity or business has commenced *(Softwood and Goodman Fielder Wattie)*. It is critical to establish the true character of the business or income-earning activity in order to determine whether that business or income-earning activity has commenced *(Ampol, Goodman Fielder Wattie* and *Esso)*.

90. When no commitment has been made to any business or income-earning activity, feasibility expenditure will not be deductible, because the business has not commenced, so there is an insufficient nexus between the expenditure and any relevant business or income-earning activity.

91. When the business or income-earning activity has commenced, there must still be a *sufficient nexus* between the expenditure and that business or income-earning activity in order for the expenditure to be deductible. Therefore, any feasibility expenditure must arise as an ordinary incident of the business or income-earning activity. In other words, the feasibility activities must be carried out as part of the ordinary current operations of the particular business or income-earning activity.

Cases: Canada

92. The Canadian case *Minister of National Revenue v MP Drilling Ltd*, referred to in *Stevens & Stevens* and *Case M68*, concerned a taxpayer company incorporated in September 1963 to carry on the business of marketing liquefied petroleum gases in the Pacific Rim. The facts showed that the successful marketing of these products involved arranging the supply with the producing oil companies, creating extraction plants, gathering gas and transporting it to seaboard by pipeline, obtaining permits for export, constructing storage facilities and negotiating firm contracts with overseas buyers. In 1966 it was decided that the plan to market gas was not feasible and the taxpayer company moved into operational drilling. The expenses incurred from 1963 to 1966 were largely for expert analysis and feasibility studies, plus travel costs in visiting potential overseas buyers. The Minister of National Revenue argued that these expenses were not deductible because they were payments on capital account, for the purpose of creating or acquiring a business structure and preparatory to a business.

93. The Federal Court of Appeal rejected the Minister of National Revenue's arguments. It considered that the business structure per se came into existence in late September 1963, when the company commenced its business operations by continuing the marketing negotiations, supply negotiations and technical studies through its consultants, until June 1964, when it opened its own office and employed its own staff, including a full-time general manager. The permanent structure, the market and the products all existed, and the efforts of the company were directed to bringing them together with a resultant profit to it.

94. However, it is important to note that in reaching this conclusion the court considered it "not without significance" that the Minister of National Revenue had not attempted to distinguish different types of expense. Although some of the expenditure was clearly incurred in the course of the income-earning process (eg, expenses incurred during the supply and sale contract negotiations), other expenses would not so readily fit within that category. As no particular expenses were drawn to the court's attention, however, the court concluded that all the expenditure was revenue in nature.

95. The Canadian approach to the question of when a business or an income-earning activity has commenced is similar to that taken in New Zealand and Australia. Indeed, *MP Drilling* has been cited in several New Zealand decisions.

Summary

96. For feasibility expenditure to be deductible under either paragraph of section DA 1(1) a sufficient relationship or nexus must exist between the expenditure and the taxpayer's business or income-earning activity. In relation to paragraph (a) this requires that the expenditure be incurred in deriving assessable income. In relation to paragraph (b), the expenditure must be incurred in the course of carrying on the particular business. The expenditure must be incurred as part of the ordinary business operations (*Banks* and *Buckley & Young*). Any expenditure incurred before the establishment of a business or an income-earning activity will not fulfil this statutory nexus, because the expenditure will have been incurred too soon (*Birmingham* and *Calkin*). Therefore, feasibility expenditure incurred preliminary to or preparatory to the establishment of a business or an income-earning activity will not be deductible.

97. The decision as to whether a business or an income-earning activity is being carried on is always one of fact and degree. Its resolution depends on a consideration of the nature of the activities carried on and the intention of the taxpayer in engaging in those activities. A determination of the point at which a taxpayer makes a firm commitment to go into a business or an income-earning activity is critical for establishing the earliest time at which a business may have commenced. Commitment alone, however, is not sufficient. Therefore, there are three elements to the determination that a business has commenced.

- A taxpayer's activities must be sufficiently intense to have the characteristics of the activities of that kind of business.
- The necessary profit-making structure must have been established.

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- The taxpayer must have passed the stage of merely "sounding out" whether to go into the business and have made a definite decision to do so.

98. The correct characterisation of the nature of the relevant business is, therefore, vital to resolving whether a sufficient nexus exists between the expenditure and a taxpayer's business. Without a determination of the true nature of a business, it is impossible to determine whether the activities are characteristic of that kind of business, and that, therefore, the expenditure was incurred as part of the ordinary business operations (*Goodman Fielder Wattie, Ampol, Esso* and *Case M68*).

99. The profit-making structure must also be in place for a business to have commenced. However, the extent of the profit-making structure required depends on the nature of the particular business. On the one hand, cases such as *Birmingham* and *Softwood* indicate that when the business involves manufacturing or production from a particular site, everything done before the establishment of the necessary plant is preparatory to business. On the other hand, cases such as *MP Drilling* and *Stevens & Stevens*, which dealt with the marketing of a product, indicate that when the business structure and the product exist it is enough to be negotiating supply contracts, arranging orders and so on. Dixon J in *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337 comments on this distinction (at page 359):

> The business structure or entity or organisation may assume any of an almost infinite variety of shapes and it may be difficult to comprehend under one description all the forms in which it may be manifested. In a trade or pursuit where little or no plant is required, it may be represented by no more than the intangible elements constituting what is commonly called goodwill, that is, widespread or general reputation, habitual patronage by clients or customers and an organised method of serving their needs. At the other extreme it may consist of a great aggregate of buildings, machinery and plant all assembled and systematised as the material means by which an organised body of men produce and distribute commodities or perform services.

100. Also critical is the element of commitment. The cases indicate that in determining whether an activity constitutes the carrying on of a business or an income-earning activity or whether it is preliminary to the carrying on or recommencement of a business or an income-earning activity, it is the element of commitment that establishes the requisite nexus between the expenditure claimed to be deductible and the business or income-earning activity said to be carried on for the purpose of gaining or producing income. If expenditure relates to activities undertaken to decide whether to enter into a particular business or income-earning activity, that expenditure will lack the required nexus, so will be non-deductible (*Softwood, Goodman Fielder Wattie, Brand* and *Esso*).

101. When feasibility expenditure is incurred after a business or an income-earning activity has commenced, for that expenditure to be deductible it must have the requisite nexus with the business or income-earning activity, that is, be incurred as an ordinary incident of the business or income-earning activity. This requires, therefore, that the particular activities must be undertaken as part of the income-earning process, that is, be carried out with the intention of obtaining some reward from sale or exploitation (*Ampol, Esso* and *Case S39*).

102. In summary, therefore, the following matters are relevant when determining whether feasibility expenditure is deductible under section DA 1(1).
    - There must be a sufficient nexus between the feasibility expenditure and the business or income-earning activity.
    - If the feasibility expenditure is incurred as preliminary or preparatory expenditure before the commencement of a business or an income-earning activity, there will not be a sufficient nexus and that expenditure will not be deductible.
    - The decision as to whether a business or an income-earning activity has commenced is one of fact and degree. Four factors are relevant.
        - It is critical to determine the true nature of the business.
        - A commitment must have been made to enter into that business.
        - The required profit-making structure for the particular business must be in place.
        - The ordinary current operations of the business must have begun.
    - If the business or income-earning activity has commenced then, in order to be deductible, the feasibility expenditure must have the requisite nexus with the business or income-earning activity. This means the feasibility expenditure must be incurred as part of the ordinary current operations of that business or income-earning activity (ie, the feasibility-related activities must be carried out with the intention of obtaining income from those activities).

Example 1

103. Several individuals, who are employed by the marketing division of a nation-wide retail company, are considering establishing their own retail marketing

consultancy business. To determine the feasibility of the business, they have purchased market industry information. They have also incurred travel and entertainment costs through travelling around the country and meeting with potential clients to ascertain the level of interest in the provision of consultancy advice. The individuals have also investigated the possibility of leasing office space and have incurred legal fees in that regard. Legal fees have also been incurred in seeking advice on the implications of the employees leaving their present employer.

104. The costs incurred to date are not deductible. The individuals have committed themselves to no more than a strategy of assessing the feasibility of a potential marketing consultancy business as a possible source of income. The individuals have not proceeded to commit themselves to any particular venture. The costs are preliminary and preparatory to the establishment of an income-producing structure. A decision to proceed with the business has not been made, the profit-making structure is not in place and normal business operations have not commenced.

Example 2

105. The directors of an established logging and saw-milling company are considering whether the company should start the production of gardening tools, which it could supply, initially to its existing clients, but in time to a wider group. The board is unsure about the financial viability of such a course, so engages consultants to provide financial projections and information about the likely demand for such products. Several of the directors also travel around the country meeting with clients to discuss the proposed venture.

106. The consultants' report indicates insufficient regular demand for the gardening tools to warrant the company providing such products in the short term. Given this, the board abandons the idea.

107. The consultants' fees and the directors' travel costs are not deductible. These costs are preliminary and preparatory to the establishment of a new income-earning activity. They do not relate to the existing logging and saw-milling business and are not part of the current operations of that business. The fact that the company resolved not to proceed with the production of the gardening tools does not affect the character of the expenditure.

Example 3

108. Two friends who are working for a large engineering company are considering setting up an engineering business of their own. They incur expenditure in the first six months of 2007 investigating possible ways to operate a business, including obtaining advice from an accountant and a solicitor and sounding out potential clients. In July 2007, they agree they will establish the business and, having secured several clients and set up an office, they resign from their current positions. They begin to actively work on establishing their processes and databases and in September 2007 they commence work for their first clients.

109. The expenditure incurred before July 2007 is not deductible. It was preliminary and preparatory to the establishment of an income-producing activity. A firm decision to proceed with the business had not been made, the profit-making structure was not in place and normal business operations had not commenced.

110. The expenditure incurred from July 2007 is deductible, subject to the capital limitation (which is discussed next). The decision to commit to the business has been made, the profit-making structure is in place and current operations have begun. Therefore, the business has commenced. This is the case regardless of the fact that work for a particular client does not commence until September 2007.

Prohibition of deduction under section DA 2(1)

111. If, on the facts and circumstances of any particular case, it is determined that feasibility expenditure is deductible under either section DA 1(1)(a) or section DA 1(1)(b), it is then necessary to determine whether the deduction is prohibited by section DA 2(1) as being expenditure of a capital nature.

General principles

112. The courts have formulated principles or "tests" for determining whether an expenditure or loss is of a capital nature. The leading statement of these tests is the case of *BP Australia Ltd v FCT* [1965] 3 All ER 209, which followed the earlier judgments of Dixon J in two Australian decisions: *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337 and *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634.

113. In *Sun Newspapers Ltd v FCT*, Dixon J described the distinction between expenditure on capital account and expenditure on revenue account as corresponding (at page 359):

> with the distinction between the business entity, structure, or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.

114. Dixon J identified three matters to be considered (at page 363):

(a) the character of the advantage sought, and in this its lasting qualities may play a part, (b) the manner in which the advantage is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure further use or enjoyment.

115. In *Hallstroms Pty Ltd v FCT*, Dixon J again summarised the distinction between expenditure on capital account and expenditure on revenue account (at page 647):

> The contrast between the two forms of expenditure corresponds to the distinction between the acquisition of the means of production and the use of them; between establishing or extending a business organisation and carrying on the business; between the implements employed in work and the regular performance of the work in which they are employed; between an enterprise itself and the sustained effort of those engaged in it.

116. His Honour indicated that determining whether expenditure was capital or revenue (at page 648):

> depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured employed or exhausted in the process.

117. The *BP Australia* formulation was adopted in New Zealand in cases such as *CIR v LD Nathan & Co Ltd* [1972] NZLR 209, *Buckley & Young, CIR v McKenzies New Zealand Ltd* (1988) 10 NZTC 5,233, *Christchurch Press Co Ltd v CIR* (1993) 15 NZTC 10,206, *CIR v Wattie* (1998) 18 NZTC 13,991, *Poverty Bay Electric Power Board v CIR* (1999) 19 NZTC 15,001, and *Birkdale Service Station Ltd v CIR* (2000) 19 NZTC 15,981. In *Wattie*, the Privy Council noted that the approach adopted in Hallstroms has been recognised as exemplifying the "governing approach" in New Zealand.

118. The courts have formulated various indicia for determining whether expenditure is capital or revenue. The following factors are relevant in this regard:

- the need or occasion which calls for the expenditure
- whether the expenditure is recurrent in nature
- whether the expenditure creates an identifiable asset
- whether the expenditure creates an advantage which is of enduring benefit to the business
- whether the expenditure is on the profit-making structure or on the profit-making process
- whether the source of the payment is from fixed or circulating capital
- the treatment of the expenditure according to the ordinary principles of commercial accounting.

119. Many of these factors overlap and some will carry more weight in given circumstances. Therefore, while they are helpful as a starting point, it is necessary to make a final judgement of whether the expenditure is of a capital or revenue nature by analysing the facts as a whole, weighing which factors carry the most weight in light of those facts.

120. It is also important to note that while the courts have formulated these factors to help in determining the capital versus revenue question, all the cases referred to above have recognised that, although past cases can be useful in assisting with the resolution of a new case, there are dangers involved in this approach. When the distinction between capital and revenue expenditure is not clear-cut, the factors should be weighed in the context of the whole set of circumstances in that particular case.

Application to feasibility expenditure

121. As noted previously, little New Zealand case law deals expressly with feasibility expenditure. However, a few decisions have touched on the issue.

Cases: New Zealand

122. The High Court decision in *Milburn NZ Ltd v CIR* (2001) 20 NZTC 17,017 is the most relevant in this context. The taxpayer company, Milburn NZ Ltd ("Milburn") made and sold cement, concrete and lime, and quarried aggregates for its concrete business. Fraser Shingle Ltd ("Fraser") was a wholly owned subsidiary of Milburn. Milburn implemented its business plan by investigating, acquiring and developing concrete businesses. Securing supplies of aggregate for its concrete plants was recognised as being important. During an expansion period, Milburn investigated 48 different sites for aggregate. The sites were generally existing quarries. At issue was Milburn's expenditure on sites in Bombay Hills and Alpha Creek near Westport, and Fraser's expenditure on an aggregate prospect on the Ngaruroro River in Hawke's Bay. All the expenditure on the three sites was for obtaining the consents or licences necessary to develop the three sites into quarries for aggregate and lime for the taxpayers' cement and concrete businesses. Milburn capitalised all expenses once the necessary consents were obtained.

123. The taxpayer companies claimed the expenditure was of a revenue nature or, alternatively, if it was capital it was part of the "cost of minerals" and deductible under section 74(2)(b) of the Income Tax Act 1976. The Commissioner considered that the expenditure by Milburn at Bombay Hills was capital in nature because it was substantial and was expenditure on establishing an asset that was a significant and important addition

to Milburn's operating structure. Alpha Creek involved the direct replacement of an existing strategic asset. Fraser's expenditure was similar in that it was incurred in investigating a resource alternative to an important existing one that was likely to be circumscribed in the future.

124. Wild J held that the expenditure was of a capital nature, regarding it as part of the cost of creating the permanent structure that produced the taxpayers' taxable income, rather than as part of the cost of earning that income. The expenditure to obtain the consents and licences was a necessary part of developing the three sites into quarries for the production of aggregate and lime for use in the taxpayers' cement and concrete businesses. His Honour concluded that the consents and licences were enduring rather than transient in nature and were not recurrent in nature.

125. Wild J based his view on the following factors (at page 17,023):

(a) The nature of the business of Milburn and Fraser.

(b) The importance of Bombay and Alpha Creek to Milburn's business, and the Ngaruroro gravels to Fraser's business.

(c) The amount of the expenditure.

(d) Its sustained nature i.e. the length of time over which the expenditure was incurred.

(e) The nature of the expenditure: all on obtaining of consent necessary before production could begin.

(f) (c)-(e) when contrasted with the amount, duration and nature of expenditure on Milburn's 48 other prospects.

126. He then reached the following conclusion:

> These six factors, certainly in combination, indicate to me that the taxpayers, **having investigated or evaluated the three sites, had made business decisions to expend money in developing the sites for commercial production**. The first step, or one of the first steps, to that end was to apply for the necessary consents. [Emphasis added]

127. The comparison drawn by the High Court provides support for the argument that in the capital versus revenue context in relation to an existing business a distinction may be drawn between amounts expended on initial investigations to determine possible prospects and amounts expended once a decision to proceed with any prospect in particular has been made. Once a decision has been made to proceed with the acquisition or development of a capital asset, it seems that expenditure is considered to be incurred on the business structure rather than the income-earning process. It is also noteworthy that Wild J compared the three sites in question with the other 48 prospects that were investigated. This suggests it is relevant to consider the frequency with which expenditure of the type under consideration is incurred in the ordinary course of the taxpayer's business. In *Milburn* it appears it was common to undertake investigatory work and to engage external consultants. However, town-planning work was carried out relatively infrequently (suggesting that recurrence of the specific type of expenditure is a factor to be considered in determining whether the expenditure is capital or revenue).

128. Wild J firmly rejected the taxpayers' argument that the classification of the expenditure depended on whether the various consents applied for were obtained or refused. Milburn's chief executive officer had earlier given evidence for the taxpayers detailing the need for an acceptable resource consent before the taxpayers would be confident of recovering an economic resource.

129. Wild J rejected the taxpayers' argument (at page 17,023):

> I am unable to accept the taxpayers' viewpoint, as advanced in evidence by Mr Williams, because it rather seeks to classify the expenditure dependant on the outcome of the various applications for consent. There is no logical nexus, and categorisation dependant upon outcome has been firmly rejected in New Zealand, Australia and England.

130. Since the outcome of the consent applications did not affect the categorisation of the expenditure, the obtaining of resource consents for only two of the three sites was not relevant. Wild J held that the expenditure on all three sites was capital in nature. The resource consent refusal for one site meant Fraser's project in that area did not continue. However, the abandonment of the project did not affect the capital nature of the expenditure incurred from the time the earlier business decision was made to proceed with the project.

131. Wild J also discussed the character of the advantage sought, in which lasting qualities, recurrence and the need or occasion that calls for the expenditure were also considered. His Honour held (at page 17,025) that "the expenditure was substantially to obtain the consents and licences necessary to develop the three sites into quarries for aggregate and lime for the taxpayers' cement and concrete businesses". Wild J rejected the taxpayers' argument (at page 17,025):

> The other perspective, which I do not think is the correct one, is that the expenditure was nevertheless of a revenue nature, in an effort to find out whether an economic resource existed.

132. In relation to whether the payments were once and for all and intended to create an enduring asset, Wild J again rejected the taxpayers' argument that expenditure on seeking consents and licences was incurred in an effort to find out whether an economic resource existed. Wild J stated (at page 17,026):

> The third test is whether the payments were once and for all and intended to create an enduring asset. From their perspective, the taxpayers argued that expenditure on seeking consents and licences needed to be incurred from time to time, and possibly more than once in relation to a particular site. For example, Alpha Creek was an instance where successive mining licence applications had been made. **They argued that the expenditure was all part of their trying to ascertain whether there was an economic resource capable of development. I hold firmly against that argument.** I consider the correct view is that the resource consent obtained for Bombay did not need to be reapplied for, the water rights obtained did not need to be reapplied for in the short to medium term, and nor did the mining licence for Alpha Creek. Whether viewed as an integral part of the quarries to which they related (the view I prefer), or as assets in their own right, the consents and licences were enduring rather than transient in nature. [Emphasis added]

133. In rejecting the taxpayers' argument, Wild J focused on the enduring nature of the consents and licences for which the taxpayers incurred expenditure. In contrast, the taxpayers' contention was more broadly focused on the expenditure enabling them to determine, through the granting of an appropriate or an inappropriate resource consent, whether an economic resource capable of development existed.

134. It would seem that Wild J's rejection of the taxpayers' argument, that the expenditure was incurred in order to ascertain the existence of an economic resource, was also based on his earlier findings. Wild J listed six factors (set out at paragraph 123) that indicated to him that the taxpayers "had made business decisions to expend money in developing the sites for commercial production. The first step, or one of the first steps, to that end was to apply for the necessary consents". Since the decision to proceed had been made before applying for the consents, expenditure incurred from that point was capital in nature, and it was irrelevant to that characterisation whether the consents were ultimately granted in a manner that enabled the resources to be developed economically.

135. In *Case N55* (1991) 13 NZTC 3,434 the taxpayer was the holding company of a group of manufacturing companies. The manufacturing activities were handled by the subsidiaries. The taxpayer supplied the subsidiaries with accounting, management and clerical services for which it charged management fees. During the relevant income years, the taxpayer undertook the development of a four-wheel drive vehicle on the basis that had the venture proceeded a subsidiary would manufacture the vehicle. The project was eventually abandoned. The taxpayer sought to deduct the development expenditure. It argued that the expenses were recurrent in nature and not once and for all and were part of its ongoing product development activities. No enduring benefit was brought into existence. The expenditure was not preliminary before commencement of a business because only product diversification was being sought, not a new business.

136. The Commissioner submitted that the expenditure was not consistent with the taxpayer's business, so was non-deductible under a previous equivalent of section DA 1(1). Barber DJ rejected the Commissioner's submission, finding that the expenditure was consistent and must be regarded as necessarily incurred in carrying on the taxpayer's business.

137. Barber DJ then went on to consider the capital–revenue distinction and concluded that the expenditure was capital. The TRA found that the expenditure was of a once and for all nature, incurred with a view to bringing into existence an asset or advantage for the enduring benefit of the business. The expenditure was not an ordinary expenditure in the regular conduct of the business and was related to the business structure, rather than the business process. Acknowledging that product development–type expenditure may be ongoing in some businesses, the TRA found that in this case it was related to the capital base for a new manufacturing process. In addition, Barber DJ stated that the expenditure could also be regarded as preparatory to the commencement of ordinary business operations in relation to a separate production line and system, so was capital on that basis.

138. Of note are Barber DJ's obiter comments in relation to product development expenditure (at page 3,440):

> In some situations there must be a fine line between deductible production or marketing expenditure and non-deductible capital product development expenditure. For instance, expenditure on altering or upgrading the packaging of an existing product would seem to be a fairly normal expense of manufacturing, distributing, and marketing the product rather than an outlay towards the capital structure for manufacturing, distributing, and marketing the product. I observe that labels such as "product development expenditure" may be misleading and the test is always the character of the particular expenditure.

139. The issue in *Case P3* (1992) 14 NZTC 4,017 was whether certain expenditure by a manufacturer of safety helmets qualified for an export market development

expenditure tax credit. This came down to whether the expenditure was capital or revenue in nature. The expenditure essentially comprised the salary cost of the taxpayer's design engineer who modified existing helmet designs and built samples in order to secure overseas orders. The Commissioner argued that the deduction available for export development expenditure did not extend to include research and sample raw material costs. In his view, the deduction did not extend to the cost of developing a product that may be of enduring benefit to the taxpayer.

140. Barber DJ referred to his earlier decision in *Case N55* and the passages from that decision indicating that in some situations product development expenditure could be revenue in nature. In *Case P3* Barber DJ concluded that the expenditure was a reasonable and normal trading or revenue expenditure. The TRA found that altering helmets was part of the ordinary incidents of the business. It was an ongoing, recurrent business activity for the taxpayer. This situation could be contrasted with the development of a one-off prototype undertaken by the taxpayer in *Case N55*.

141. The New Zealand authorities in this area, although limited, do indicate that to be expenditure of a revenue nature, the feasibility expenditure must be incurred as part of the ordinary current operations of the business. In much the same way as the enquiry under section DA 1(1), the expenditure must be incurred as an ordinary incident of the income-earning process in order to avoid the capital prohibition in section DA 2(1).

Cases: Australia

142. Several of the Australian authorities discussed above in relation to section DA 1(1) also consider whether the expenditure was capital in nature.

143. In *Softwood Pulp and Paper Co Ltd v FCT*, (refer to paragraphs 52and 53) Menhennitt J, having reached the view that the expenditure under consideration was preliminary to the commencement of business and therefore non-deductible on that basis, went on to conclude that even if he was wrong in that regard, the expenditure was of a capital nature. His Honour cited with approval the comments of Dixon J in *Sun Newspapers* (set out in paragraphs 111–112).

144. Menhennitt J then posed the question whether if any of the amounts fell within either of the first two limbs of section 51, they were nevertheless of a capital nature. His Honour concluded that the expenditure went beyond simply investigating the possibility of undertaking a new business activity and extended into the establishing of the profit-making structure, that is, options acquired over land, arrangements made for the supply of water, electricity, timber, etc. In these circumstances, even if the expenditure had satisfied either of the first two limbs of section 51, the expenditure would have been held to be capital.

145. The facts in *Softwood* can be contrasted with those in *FCT v Ampol Exploration Ltd* 86 ATC 4,859. In Ampol, the expenditure was held to relate to the company's ordinary business activities. The expenditure could not lead to the establishment of an asset and was not incurred for the purpose of creating or enlarging the business structure.

146. In *Ampol*, Lockhart J, in the majority, concluded that the expenditure was deductible under both limbs of the equivalent of section DA 1(1) (discussed in paragraphs 54–64). His Honour then went on to consider the "more difficult question" as to whether the expenditure was in fact of a capital nature. Lockhart J concluded that the payments in question were of a revenue nature, being part of the outgoings of the taxpayer in the course of carrying on its ordinary business activities. It was not expenditure incurred for the purpose of creating or enlarging a business structure or profit-yielding or income-producing asset.

147. In his Honour's opinion, an examination of the authorities established that there was no presumption that prospecting or exploration costs were prima facie of a capital nature. The authorities confirmed first, the danger of seeking to extract principles of general application in this branch of the law, and second, the correctness of the frequently repeated statement that whether expenditure is capital or not must be a question of fact in each case.

148. Burchett J agreed with Lockhart J that the expenditure was of a revenue nature. His Honour concluded that the relevant business of the taxpayer was the discovery and exploitation of oil, to which the seismic survey expenses were incidental. Their purpose was not to enlarge the framework within which that activity was carried on, rather they formed part of the activity.

149. The important factor in the majority's decision in Ampol is that the exploration activities, for which the expenditure was incurred, were part of the company's ordinary current operations. They were not adding to the business structure or undertaken with a view to obtaining an enduring asset. The activities were part of the company's income-earning process, that is, the process by which the company earned its rewards. On this basis, therefore, the expenditure was of a revenue nature.

150. The decision in *Goodman Fielder Wattie* highlights that determining the true nature of the relevant business, identified in the discussion on deductibility of expenditure under section DA 1(1), is also critical in the capital versus revenue context.

151. In *Goodman Fielder Wattie* Hill J had concluded that the expenditure incurred before November 1982 was incurred before the commencement of the business (discussed in paragraphs 72–74). With regard to the expenditure incurred after November 1982, the taxpayer claimed that it was carrying on a business that included not only the manufacture and marketing of its heartworm product, but also research into and the development of other products. The Commissioner claimed that the expenditure was of a capital nature.

152. Hill J considered the decisions in *Sun Newspapers*, *Ampol* and *Hallstroms*, and stated (at pages 4,449–4,450):

> The judgment in the *Sun Newspapers* case makes it clear that it is necessary to consider carefully the nature of the business which is carried on, so as to be able to distinguish between recurrent expenditure, that is to say "expenditure which is made to meet a continuous demand" (per Rowlatt J in *Ounsworth v Vickers Ltd* [1915] 3 KB 267 at 273) and that expenditure which is made once and for all. A pharmaceutical company, the business of which includes continuing research and development as part of the continuous or constant demand for expenditure in its business, does not each time that expenditure is incurred make an outlay of capital or of a capital nature. Its business, when properly analysed, includes its research and development, at least in the ordinary case. No doubt, there are matters of degree involved, and in a particular case the research and development may be concentrated on a product so far removed from the day to day products of the taxpayer, that the expenditure cannot be properly seen as part of its working expenditure.
>
> Counsel for the applicant relied heavily upon the decision of the Full Court of this court in *FC of T v Ampol Exploration Ltd* 86 ATC 4859; (1986) 13 FCR 545. In that case, it was held that the taxpayer, the exploration arm of the Ampol Group, was carrying on a business of exploring for petroleum and the expenditure it incurred in its China venture was held to have been necessarily incurred in the carrying on of that business and as not being of a capital nature. …
>
> By analogy it was said that where a company such as the applicant here is engaged in an activity where research and development forms part of its activity, part of the constant demand upon the enterprise, then expenditure on research and development is on revenue account.
>
> Research and development expenditure does differ somewhat from the exploration expenditure involved in the *Ampol* case. In general terms, one difference that is of significance is that the expenditure in *Ampol* was not expenditure directed towards the obtaining of rights of an enduring kind. On the peculiar facts of that case, the expenditure was directed merely at obtaining the right to negotiate, that not being a right of a proprietary kind. Research and development may, in a particular case, be directed towards obtaining patentable rights which can be seen as of an enduring kind and may, for that reason, be of a capital nature. It was not suggested here by counsel for the Commissioner that the applicant's expenditure was directed towards the obtaining of patent rights nor was this even put to any witness.

153. His Honour noted that the cases make it clear that whether property rights are ultimately obtained is not determinative. Acknowledging Dixon J's statements in *Hallstroms* as to what is required, his Honour concluded (at page 4,450):

> There is, in my opinion, much to be said for the view that the whole of the expenditure in issue in the present case, except perhaps so much of it as concerned the salary of Dr Watson, in the time he was involved in the patent dispute, was expenditure on revenue account rather than on capital account. A company engaged in an enterprise involving new technology such as the applicant, where the nature of its activity requires as part of its business ongoing research into product development incurs expenditure which is recurrent, expenditure which is part of the regular cost of its trading operations. That expenditure is, to adopt the words of Dixon J in *Sun Newspapers*, part of the process by which the organisation (being an organisation where research is part of its business activity) operates to obtain regular returns by means of regular outlays.

154. Thus, as in *Ampol*, in *Goodman Fielder Wattie* the expenditure was held to be recurrent expenditure that was incurred as part of the company's ordinary business activities of the company. The expenditure was not directed towards obtaining any rights of an enduring kind.

155. Thus the decisions in Australia in relation to the application of the equivalent to section DA 2(1) again emphasise the need to identify the nature of the particular business or income-earning activity and to identify whether the expenditure is incurred as part of the income-earning process of that business or activity or to create or expand the business structure. Similar considerations to those discussed in relation to deductibility under section DA 1(1) above, also apply to any denial of a deduction under section DA 2(1). The decisions in *Ampol* and *Goodman Fielder Wattie* highlight that when the expenditure relates to the income-earning process, that is, it is incurred as an ordinary incident of the business, the expenditure is more likely to be of a revenue nature. However, when the expenditure relates to the obtaining of an advantage of an enduring benefit, for example, a capital asset or another accretion to the business or profit-making structure, the expenditure will generally be of a capital nature.

Cases: Canada

156. *Bowater Power Co Ltd v Minister of National Revenue* [1971] CTC 818, a decision of the Canadian Federal Court (Trial Division), is also often cited as one of the leading cases supporting the deductibility of feasibility expenditure.

157. In *Bowater* the taxpayer company carried on the business of generating and selling electrical power and energy. During its 1959 and 1960 taxation years, the taxpayer claimed a deduction for expenditure for survey costs and engineering studies relating to developing additional power and the location of physical plant for its power station. It claimed the deduction on the basis that such expenditure was an ordinary operating expense incurred for the purpose of gaining or producing income from its business. The manager of the taxpayer gave evidence that the company was continually looking into the feasibility of installing thermal power. It was also continually looking at its existing facilities to see how to increase capacity and considering new sources of generation to meet increasing customer demand.

158. The costs claimed related to two specific feasibility studies undertaken for the taxpayer. The first involved a report on the feasibility of building a new power station on a lake adjacent to the company's existing supplies of water for its current hydro-power stations. The report covered the availability of construction materials at the site, the geography and geology of the area, the hydrology and water flows. The report concluded that it was not economically feasible to undertake the project because of the high cost per horsepower produced. The second report identified how the company could better utilise one of its existing watersheds, particularly as regards its hydro potential. The report concluded that it was economically feasible to proceed with the recommendations and the taxpayer went so far as to arrange finance. However, the project did not proceed. This was because a provincial government project to develop a hydro-power station in the area started and the government offered to sell power from that plant to the taxpayer at a cheaper rate than the rate at which the taxpayer could produce power if it improved its own site.

159. The Federal Court found for the taxpayer. Noel ACJ referred to *BP Australia* and *Hallstroms* and concluded that the matter must be viewed from a practical and business point of view. His Honour considered that having regard to the facts and the circumstances of the work conducted by the taxpayer the expenditures were part of the company's current operations. His Honour accepted evidence that the business of the taxpayer was developing and marketing electricity and that this required a continuous evaluation and appraisal of both its power resources and its method of operation. Noel ACJ concluded that the expenditures were made to effect an increase in the volume and efficiency of the taxpayer's business, so were for the purpose of gaining income.

160. Noel ACJ concluded that the costs of the feasibility studies were deductible as part of the current operations of the business. This finding is consistent with the New Zealand requirement of a nexus between the expenditure and the taxpayer's carrying on of a business. This finding is also consistent with the capital–revenue test from *BP Australia*, which considers whether payments are expended on a taxpayer's business structure or are part of the income-earning process.

161. Noel ACJ also recognised that a hydroelectric development is a capital asset once it becomes a business or commercial reality. If a taxpayer is merely considering whether or not to create a capital asset, the expenditure may be revenue in nature. However, once the development of the asset becomes a reality, the expenditure incurred is capital in nature. The stage at which a development becomes a business or commercial reality may be seen as equating to the stage at which a decision or commitment is made to create an asset. Noel ACJ stated (at paragraph 73):

> While the hydroelectric development, once it becomes a business or commercial realty [sic] is a capital asset of the business giving rise to it, whatever reasonable means were taken to find out whether it should be created or not may still result from the current operations of the business as part of the every day concern of its officers in conducting the operations of the company in a business-like way.

162. Although Noel ACJ acknowledged the capital nature of hydroelectric developments that have become a business or commercial reality, he concluded that the expenditure Bowater incurred on the two feasibility studies was deductible. This was based on a judgment as to whether the development had become a business or commercial reality. Consideration of this factor is consistent with the approach taken in New Zealand and Australia of determining whether a decision or commitment has been made to create an asset, and how far along a taxpayer is in the process of developing a capital asset.

163. However, the fact that ultimately the project did not go ahead also appears to have influenced Noel ACJ in his finding that the expenditure was deductible. The success or failure of a project is not a factor that is present in New Zealand or Australian law. Noel ACJ

recognised that a capital cost allowance (equivalent to New Zealand depreciation) is not permitted if the project fails or is aborted, and the expenditure is not deductible if it is not incurred in the ordinary course of a taxpayer's business. He referred to such expenditure as "nothings" (at paragraph 14), but considered that the expenditure incurred by *Bowater* was revenue in nature (at paragraph 71):

> The costs here of the engineering studies conducted to examine the potential of appellant's drainage area or to determine the feasibility of constructing power developments at certain sites in Newfoundland were also incurred in my view or laid out while the business of the appellant was operating and was part of the cost of this business. Had it lead to the building of plants, business profits would have resulted. Should these expenses be less current expenses because instead of being laid out in the process of inducing the buying public to buy the goods or with a view to introducing particular products to the market, they were laid out for the purpose of determining whether a depreciable asset should be constructed from which business gains could be collected and would then have been added to the value of this capital asset which would have been subject to capital cost allowances? I do not think so. The law with regard to the deduction of what might be called border-line expenses or "nothings" has moved considerably ahead in the last few years, as can be seen from the above decisions [see *Algoma Central Railway v MNR* [1967] CTC 130 , upheld on appeal [1968] CTC 161; and *Canada Starch Co Ltd v MNR* [1968] CTC 466].

164. Noel ACJ also noted that if the expenditure had led to the building of plants, business profits would have resulted, and it is considered that a capital cost allowance would have been permitted. By considering the effect of categorising the expenditure as capital in nature (for which no allowance would be permitted because the project failed) as well as the effect of *not* categorising the expenditure as revenue in nature, Noel ACJ appears to be considering the effect of "nothings" or "black hole" expenditure. He subsequently notes the law's progression with regard to the deduction of expenses that are ordinarily neither depreciable nor deductible.

165. A similar approach was taken in *Kruger Pulp & Paper Ltd v Minister of National Revenue* [1975] CTC 2,323.

166. A desire to prevent "black hole" non-deductible expenditure was more marked in the Canadian case *Gartry v R* 94 DTC 1947. In that case the taxpayer agreed to purchase a retired navy boat for use in his proposed fishing business. However, the boat sank before title formally passed to him. In determining whether the expenses were on revenue or capital account (and if they were on capital account, whether a deduction for a terminal loss was permitted), Bowman TCCJ stated:

> In analyzing this question one cannot ignore the anomalous result that a denial of deductibility on any basis would entail. Either the expenditures resulted in the appellant's obtaining an asset or they did not. If they did, and if the asset so acquired was depreciable property, it must follow that the provisions of subsection 20(16) were available to the appellant to permit the deduction of a terminal loss when the boat sank. If they did not result in the acquisition of an asset for the enduring benefit of the business they cannot, in light of the decisions in *Algoma Central Railway (supra)*, and in *Bowater Power Co. Ltd. v. M.N.R.*, 71 DTC 5469, be regarded as capital in nature. The Crown's position would relegate the appellant to the worst of both possible worlds. It says, in effect, to Mr. Gartry "You were spending money on a capital asset, a boat, and if those expenses had matured into full ownership before the boat sank you would have been able to claim a terminal loss. As it happens, the boat sank before title was transferred to you and you obtained nothing. **But they are still capital expenditures and so you can deduct nothing.**"
>
> This position is inconsistent with ordinary fairness, common sense and commercial reality. The disposition which in my view accords most closely to the facts and the authorities as I understand them is that the expenses should be treated as on revenue account or, to the extent that any are on capital account, as the cost of acquiring depreciable property which, when disposed of, are the subject of a claim for a terminal loss under subsection 20(16). Since either conclusion leads to deductibility it is not necessary that I determine specifically into which category they fall. [Emphasis added]

167. Therefore, *Gartry's* application of the principle that expenditure is revenue in nature if an asset is not obtained is consistent with *Bowater*.

168. *Wacky Wheatley's TV & Stereo Ltd v Minister of National Revenue* [1987] 2 CTC 2,311 involved three corporations in the business of retail marketing electronic equipment. They contemplated expansion into Australia, so several corporate representatives travelled to Australia to assess the market potential. They determined that expansion would not be profitable, but sought to claim the travel costs as deductible expenditure.

169. The Tax Court of Canada agreed with the taxpayer, concluding that the expenses were incurred for the purpose of producing income and they were not on account of capital. The court found that the business structure already existed and the costs were expended to ascertain the feasibility of extending those existing operations. The court stated (at page 2,315):

> If the Australian opportunity had proved viable and actual plans for entry into the Australian market had been made by the appellants, any expenditures incurred to facilitate the actual expansion would arguably be on capital account. The expenditures in question were not, however, of such a nature. These expenses were anterior

> to any business decision to enter the Australian market and it is my opinion that they were clearly incurred as part of the current expenses of the appellants' operations.
>
> Clear support for this conclusion is found in the case of *Bowater Power Co Ltd v MNR* …
>
> In the present case, the evidence shows that expansion into new markets was an on-going concern of the appellants. It is my opinion that the expenditures in question resulted from the current operations of each of the appellants "as part of the every day concern of its officers in conducting the operations of the company in a business-like way".

170. The principles applied in these cases are consistent with the New Zealand and Australian authorities discussed above. The courts considered whether the expenditure was incurred as part of the profit-making process or on the profit-making structure. It was also acknowledged that the evaluation by a business of a proposed course of action can be done as part of the income-earning process of that business, so expenditure incurred at the evaluation stage may be on revenue account notwithstanding that the proposal being evaluated, if implemented, would give rise to capital expenditure. On the particular facts of *Bowater* Noel ACJ was satisfied that the business of developing and marketing electricity required continuous evaluation and appraisal, so concluded that the expenditure was part of the current operation and deductible. A similar conclusion was reached in relation to the particular facts of *Wacky Wheatley's*. This is consistent with the decisions reached on the facts in *Ampol* and *Goodman Fielder Wattie*.

171. However, it is considered that a divergence in approach may be seen in the application of the principles to particular facts in the Canadian decisions. The Canadian courts appear more willing to conclude that if expenditure is *not* of a capital nature, for example if a commitment to any particular proposed course of action has not been made, then that expenditure *will be* part of the current operations of the business and thus satisfy the equivalent of the nexus test under the equivalent of section DA 1(1).

172. It is arguable that the approach of the Canadian courts in this regard is more liberal than that taken by the Australian and New Zealand courts. An approach that considers the success or failure of expenditure as relevant in determining the deductibility of the expenditure has consistently been rejected in New Zealand and Australia. A line of authority maintains that when determining whether expenditure is deductible it is irrelevant whether an outlay is successful (eg, *Lothian Chemical Co Ltd v Rogers* (1926) 11 TC 508 and *John Fairfax & Sons Ltd v FCT* (1959) 101 CLR 30). These cases establish that once a commitment has been made to purchase or develop a capital asset, subsequent expenditure incurred will be capital in nature irrespective of whether the asset is in fact acquired or developed. This follows from the deductibility or otherwise of a particular item of expenditure being determined when the expense is incurred (Banks at page 61,241), as opposed to at some other time (eg, the end of the income year in which it was incurred). In addition the enduring benefit test focuses on whether the expense was incurred *with a view to* (as opposed to definitively) bringing into existence an asset or advantage of enduring benefit. This line of authority has been approved and applied in New Zealand.

173. Thus, while the Canadian courts apply the same principles to the determination of the nature of particular expenditure, the fact the Canadian courts consider the success or failure of the expenditure as relevant means the conclusions reached by those courts on particular fact situations may differ from those that would be reached by a New Zealand court.

Summary

174. Whether particular feasibility expenditure is capital or revenue in nature must be determined on the facts of any particular case.

175. The cases indicate that four of the capital–revenue indicators are the most relevant to determining whether feasibility-type expenditure is capital or revenue in nature. These are whether the expenditure:
- is recurrent or once and for all expenditure
- is on the profit-yielding structure or the income-earning process
- creates an identifiable asset
- produces an enduring benefit.

176. In relation to whether the expenditure is recurrent or once and for all expenditure, it is critical to identify the particular nature of the taxpayer's business. When feasibility expenditure of the type in question forms part of the normal business operations (ie, part of the constant demands on the enterprise) the cases indicate that the feasibility expenditure will more likely be treated as being on revenue account and deductible (as in *Ampol* and *Goodman Fielder Wattie*). This can also be seen from *Milburn* where expenditure was regularly incurred on the preliminary stages of investigating potential new sources of aggregate (and was accepted to be revenue) but expenditure on obtaining resource consents occurred relatively infrequently (and was held to be capital).

177. The courts have taken into account how far along in the process the expenditure was incurred (to determine whether it is part of the proft-making structure) and whether a particular asset has been identified. If the expenditure is incurred principally for evaluating one or more proposals it is unlikely the expenditure will relate to the business structure sufficiently to indicate the expenditure is capital in nature. However, when the feasibility expenditure goes beyond simply placing a taxpayer in a position to make an informed decision, it will be necessary to consider whether the expenditure relates to the profit-making structure or profit-making process such as in *Softwood*. In that case, the expenditure went beyond simply investigating the possibility of undertaking a new business activity and extended into establishing the profit-making structure (eg, options acquired over land and arrangements made for the supply of water, electricity and timber). In these circumstances whether a decision has been made to commit to a particular proposal is likely to be important. Evidence of such a decision could include records such as board minutes, contracts with third parties and other documentation showing that a decision had been made.

178. The same principle applies in determining whether the expenditure produces an enduring benefit (the third *BP Australia* factor). The incurring of expenditure principally for placing a taxpayer in a position to make an informed decision about the acquisition of an asset (or other enduring advantage) will not generally be expenditure incurred in relation to that particular asset or advantage. However, once the decision has been made to proceed with the acquisition or development of a particular capital asset, any expenditure incurred beyond that point will relate to the acquisition of that asset and will indicate that the expenditure is more likely to be explicitly related to effecting an enduring advantage of a capital nature. In *Milburn* the taxpayers decided to proceed with the development of an asset in the case of the three sites under review, in contrast to the other 48 sites investigated by them. Expenditure incurred in relation to those three sites was held to be of a capital nature.

179. Once a decision has been made to proceed with the acquisition or development of a structural asset or an enduring advantage, any expenditure incurred after that time will more readily be treated as being related to the underlying capital project (and thereby the profit-making structure of the business), and will not be deductible. For these purposes, the position in New Zealand and Australia is that it is irrelevant whether the expenditure is successful. This position differs from that in Canada, where the outcome of the project is taken into account (see the earlier discussion of *Bowater*). However, the New Zealand courts do ask when a decision or commitment has been made to create an asset, which may be seen as a similar inquiry to the Canadian test of whether the development has become a business or commercial reality. In addition, commitment in this context does not necessarily mean that a taxpayer will proceed with the acquisition or development regardless of future events, (eg, the availability or otherwise of suitable planning consent), only that the taxpayer has made a firm decision to proceed. Similarly, it is considered that the fact the decision to proceed, or aspects of the process, may be explicitly contingent on any stated events, results or factors beyond the taxpayer's control will not mean a taxpayer has not made the relevant commitment (such as in *Milburn* where Fraser failed to obtain planning permission for its proposed aggregate extraction).

180. If a taxpayer chooses not to continue with the acquisition or development of an asset, despite having earlier made a firm decision to proceed, this does not affect any earlier finding that the expenditure incurred is capital in nature. When the creation of an asset fails to eventuate, the expenditure incurred cannot be re-characterised as revenue in nature. As stated by Wild J in *Milburn* (at page 17,025), "[t]he correct approach is to look at the expenditure at the time it was incurred". The failure to create a capital asset, despite the taxpayer's earlier commitment, would also mean no depreciation allowance could be deducted. Rather, the expenditure incurred from when the decision to proceed was made to when the course of action was abandoned would constitute "black hole" expenditure. This differs from the Canadian approach of generally treating expenditure as revenue in nature and deductible, if a capital asset fails to eventuate (see the earlier discussion of *Bowater*).

181. Identifying when a decision to proceed has been reached in any particular situation will always be a question of fact and degree and it is necessary to weigh all the relevant factors to determine whether a commitment has been made to a project.

182. Therefore, it is considered that the following matters will be relevant in determining whether feasibility expenditure will be denied a deduction under section DA 2(1).

- The incurring of feasibility expenditure of the type under consideration forms part of the normal business operations (ie, part of the constant demands on the enterprise). In this regard, it is

critical to identify the true nature of the business or income-earning process. Cases suggest that in the absence of this factor being satisfied, expenditure will generally not be deductible.

- A commitment or decision has been made to proceed with the acquisition or development of a capital asset. Any expenditure incurred from that time will generally no longer be feasibility expenditure. That expenditure will be considered to relate to that capital asset, enduring benefit or profit-making structure, so will be treated as capital in nature and a deduction will be prohibited.
- The categorisation of the expenditure is not affected by the ultimate success or failure in acquiring or developing a capital asset, or in obtaining an advantage of enduring benefit, or in establishing a profit-making structure. The existence or recognition of contingencies, which may affect the eventual outcome, does not alter the categorisation of expenditure once a commitment or decision has been made to proceed.
- The point at which a firm decision to proceed with the acquisition or development of an asset in any particular situation is a question of fact and degree.

183. It is useful to elaborate on the above bullet points. Genuine feasibility study expenditure is incurred when a taxpayer is exploring whether the acquisition or development of a capital asset is practical or possible. To obtain a deduction for such expenditure, the first requirement is that the expenditure must be incurred in the course of the taxpayer's normal business operations. *Milburn* and *Ampol* are examples where expenditure was incurred as part of each taxpayer's ordinary business operations. If this nexus requirement is not satisfied, the expenditure incurred is not deductible. For example, expenditure incurred in the course of operations that are outside a taxpayer's normal business operations cannot meet the nexus requirement.

184. Although a deduction is prima facie available when the nexus requirement is satisfied, expenditure of a capital nature is not deductible. This means consideration must be given to whether the expenditure incurred is capital or revenue in nature. As such, in the context of the type of expenditure incurred in this type of case, a timeline begins from when a taxpayer is exploring whether the development or acquisition of an asset is feasible (the expenditure on which is deductible if the nexus requirement is met) to when a taxpayer develops or acquires the asset. The capital asset that may ultimately be acquired or developed will be part of the taxpayer's profit-making structure and is not part of the income-earning process. Generally, expenditure on the development of such an asset is also capital in nature. It is a question of fact and degree as to when the expenditure incurred alters from relating to the exploration of whether the development or acquisition of an asset is practical or possible, and whether it should be developed or acquired, to when the expenditure relates to the development or acquisition of a sufficiently identified capital asset. At this latter stage, the capital nature of the expenditure means its deductibility is prohibited. *Milburn* provides an example of such a timeline, where expenditure incurred on the exploration of prospective quarry sites was deductible only up to a particular stage. Once the particular stage was passed, the expenditure incurred was capital in nature and non-deductible.

185. As stated in the second bullet point of paragraph 182, the point at which the expenditure alters from revenue to capital in nature is when a commitment, or decision, has been made to proceed with the acquisition or development of a capital asset. At one end of the spectrum, commitment can be viewed narrowly as a binding and almost irrevocable decision to acquire or develop an asset. This level of commitment may be satisfied by the approval given by a taxpayer's board to the acquisition or development of an asset. At the other end of the spectrum, commitment may be broadly viewed as a provisional and revocable decision that allows a taxpayer to continually reassess whether to continue with a project.

186. It is considered that in the current context, commitment does not require a legal or other form of binding decision that is final and irrevocable. In *Milburn*, the taxpayers made business decisions to develop the quarry sites and Wild J held that the disputed expenditure was capital in nature. Yet Fraser's commitment to developing its prospective quarry site could not have been binding, as it effectively revoked its commitment when it failed to obtain a resource consent.

187. Rather, commitment requires a decision *to proceed*, in contrast to a taxpayer continuing to weigh up whether *or not* to proceed. A commitment can still be made despite recognising that whether the development or acquisition ultimately goes ahead may be contingent on particular factors. For example, the taxpayers in *Milburn* had committed to developing the quarry sites, but the obtaining of appropriate resource consents was a known contingency. Other contingencies that may be recognised are the need for technical refinement to occur and the obtaining of the final

construction cost. Such matters would not necessarily mean a commitment or decision to proceed with the acquisition or development of a capital asset had not been made, if the facts and/or circumstances otherwise showed that the taxpayer was actively proceeding, rather than continuing to gather information on which to decide whether to proceed.

188. A commitment or decision to proceed can also be made despite the later development of a contingency (or deal breaker) that was not recognised at the time of commitment. For example, the legal requirements for building foundations may change after the commitment was made to construct a building. It is also noted that the point of commitment has been described in the Canadian case of *Bowater* as the point at which the project or development becomes "a business or commercial reality".

189. A taxpayer will have made a commitment or a decision to proceed with the acquisition or development of a capital asset, when preliminary work has been completed with indications that the development or acquisition of an asset is technically and financially viable, and the facts indicate that the development or acquisition is proceeding. This will be the case notwithstanding that there may be no explicit documentary evidence that a formal decision to proceed has been made.

190. The following points are also relevant in determining whether a taxpayer has made a commitment or a decision to acquire or develop a capital asset.

- Recognition that the project or development may ultimately fail, for example, if resource consent is not obtained, is not relevant in this context if the taxpayer is proceeding to develop the asset identified and is intending to seek such consent.
- The relevant asset needs only to be identified with sufficient particularity; the exact details do not need to be known. For example, if a taxpayer makes a commitment or decision to construct an office building, the later finalisation of whether to construct eight or nine storeys does not change the earlier commitment or decision.
- If a commitment or decision has been made, it will not matter if a taxpayer has not identified the development's exact cost or the net profit possible from the development. A commitment or a decision to build an asset is no less a decision to proceed merely because the exact costs cannot be accurately forecast at the time the commitment or decision is made.
- The project's or development's ultimate success or failure is not a relevant factor to consider in determining whether a taxpayer has made a commitment or a decision to proceed (based on New Zealand and Australian case law, in contrast to Canadian case law).
- Giving approval to a development or project in stages will not necessarily prevent there having been a commitment or a decision to proceed with a development that is capital in nature. A staged development may be used for various reasons, including accountability, reporting, or financial or budgetary capping. Once there is no longer a question of whether to proceed (ie, a commitment or a decision to proceed has been made), a taxpayer's use of a staged development does not alter the commitment or decision that has been made to proceed.

191. Where expenditure on capital account leads to the acquisition of more than one asset, the expenditure should be spread across the assets acquired. The apportionment of the expenditure should be made on a basis that is appropriate in the circumstances.

Example 4

192. A company owns and operates a specialised property business throughout New Zealand. The company investigates potential sites all over the country, identifies property developments considered to be economically feasible and sells this information to potential developers. The investigation of potential sites usually involves an employee visiting the area, requesting information from the local authority about the property, obtaining a valuation and, in some cases, instructing architects to provide preliminary drawings to show how the property might best be developed. When it is perceived that there may be difficulties in obtaining planning consent or meeting resource management requirements in relation to the particular type of development, the company often instructs specialist planning consultants to provide preliminary advice. Information obtained is compiled into a report on the potential site and this report is offered to interested parties for a fee.

193. The costs incurred to date are deductible. They are incurred as part of the company's normal and recurrent business operations. The costs incurred are an ordinary incident of carrying on the business of providing feasibility reports on potential property developments for reward. In addition, the expenditure is not directed to obtaining an enduring advantage.

Example 5

194. A company undertakes continual investigations into potential quarry sites as part of its normal business operations. When one or more sites are identified as feasible, the relevant information is provided to the company's board of directors. The board considers the information and determines which sites the company will proceed to develop.

195. The expenditure of the company in undertaking its investigations into potential quarry sites is deductible. The expenditure is an ordinary incident of the company's business and is for the purpose of gaining some reward from any site ultimately developed. The costs have been incurred in weighing up whether to proceed with a particular site and before any decision has been made to proceed with the acquisition or development of any particular site. The costs relate to providing the information the board needs to make an informed decision about whether to develop any particular site. However, once the board has decided to proceed with any particular site, any future costs incurred in relation to that particular site will be capitalised.

Example 6

196. A competitor company also regularly seeks out new quarry sites (including sites that it could develop itself and existing quarries that it could purchase). In the 2007 income year, it investigated 20 potential sites for development and undertook geological surveys to determine the best sites for development. Engineering reports were commissioned on the top five sites and the results were presented to the board of directors. The board gave approval to develop two of the sites.

197. Further tests were undertaken and reports were commissioned to determine the most appropriate extraction location and depth at each site. A large earthquake occurred at one of the sites and the company abandoned work on it as it was no longer suitable for extraction.

198. Work continued on the second site, although the company was aware the water table levels might affect the depth at which material could be extracted, including a remote possibility that the levels would be too high to make the site a viable commercial proposition.

199. The expenditure incurred on the 18 sites that were not selected for development is on revenue account. The expenditure is of a type incurred frequently by the company in the course of its business and the company was still weighing up whether to proceed with the development of the sites.

200. Expenditure incurred after the board gave approval to develop the two sites is on capital account. The company had decided to proceed with the development of capital assets. This is the case notwithstanding that one of the sites was never successfully completed (because of the earthquake damage) and notwithstanding that the development of the second site was contingent on water levels not being too high.

201. Also in the 2007 income year, the company wished to purchase two existing quarries. It considered 20 quarries from which it hoped to find two to purchase. Ten of the quarries were situated in New Zealand and the remaining 10 were in Australia. Fifteen of the quarry owners were selling the quarries as stand-alone assets, while the remaining five were offering 100% of the shares in a subsidiary company that owned the quarries as their sole asset.

202. The company procured engineering reports on each of the sites to determine which would be suitable for its purposes. On the basis of the engineering reports non-binding bids were placed on three sites and two quarries were ultimately purchased.

203. Expenditure on the engineering reports is deductible. This is the case regardless of whether the quarries were situated inside or outside of New Zealand and whether the quarries were purchased as a stand-alone asset or by way of shares in an asset-owning company.

STANDARD PRACTICE STATEMENTS

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

SPS 08/01: DISPUTES RESOLUTION PROCESS COMMENCED BY THE COMMISSIONER OF INLAND REVENUE

Introduction

1. This Standard Practice Statement ("SPS") sets out the Commissioner's rights and responsibilities with a taxpayer in respect of an adjustment to an assessment when the Commissioner commences the disputes resolution process.
2. Where a taxpayer commences the disputes resolution process, the Commissioner's practice is set out in *SPS 08/02: Disputes resolution process commenced by a taxpayer*.
3. This SPS has been updated due to changes made to the law under:
   (a) the Taxation (Savings Investment and Miscellaneous Provisions) Act 2006
   (b) the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006
   (c) the Taxation (Business Taxation and Remedial Matters) Act 2007
   (d) the Income Tax Act 2007
   (e) the relevant case law decided since *SPS 05/03: Disputes resolution process commenced by the Commissioner of Inland Revenue* was published.
4. The Commissioner regards this SPS as a reference guide for taxpayers and Inland Revenue officers. Where possible, Inland Revenue officers must follow the practices outlined in this SPS.

Application

5. This SPS applies from 13 June 2008. *SPS 05/03: Disputes resolution process commenced by the Commissioner of Inland Revenue* continues to apply from its commencement date up to 13 June 2008.
6. Unless specified otherwise, all legislative references in this SPS refer to the Tax Administration Act 1994 ("TAA").

Background

7. The tax disputes resolution procedures were introduced in accordance with the recommendations of the Richardson Committee in the *Report of the Organisational Review of the Inland Revenue Department* (April 1994) and were designed to reduce the number of disputes by:
   (a) promoting full disclosure
   (b) encouraging the prompt and efficient resolution of tax disputes
   (c) promoting the early identification of issues
   (d) improving the accuracy of decisions.
8. The disputes resolution process ensures that there is a full and frank communication between the parties in a structured way within strict time limits for the legislated phases of the process.
9. The disputes resolution process is designed to encourage an "all cards on the table" approach and the resolution of issues without the need for litigation. It aims to ensure that all the relevant evidence, facts and legal arguments are canvassed before a case proceeds to a court or hearing authority.
10. In accordance with the objectives of the disputes resolution process, the Commissioner (unless a statutory exception applies under section 89C or 89N(1)(c)) must go through the disputes resolution process before the Commissioner can issue an assessment.
11. The disputes resolution process was introduced in 1996 and reviewed in July 2003. There have been changes made to the disputes resolution process following recent legislative amendments and cases since 2005.
12. The early resolution of a dispute is intended to be achieved through a series of steps specified in the TAA. The main elements of those steps are:
    (a) a notice of proposed adjustment ("NOPA"): this is a notice that either the Commissioner or taxpayer issues to the other advising that an adjustment is sought in relation to the taxpayer's assessment, the

Commissioner's assessment or other disputable decision (the requisite form is the *IR 770 Notice of proposed adjustment*).

(b) a notice of response ("NOR"): this must be issued by the recipient of a NOPA if they disagree with it (the preferred form is the *IR 771 Notice of response*).

(c) a disclosure notice and statement of position ("SOP"): the issue of a disclosure notice by the Commissioner triggers the issue of a SOP. Each SOP must provide an outline of the facts, evidence, issues and propositions of law with sufficient details to support the position taken. Each party must issue a SOP (the requisite form is the *IR 773 Statement of position*). The SOP is an important document because it limits the facts, evidence, issues and propositions of law that either party can rely on if the case proceeds to court to what is included in the SOP (unless a hearing authority makes an order that allows a party to raise new facts or evidence under section 138G(2)).

13. There are also two administrative phases in the process – the conference and adjudication phases. If the dispute has not been already resolved after the NOR phase, the Commissioner's practice will be to hold a conference, unless the parties agree to abridge the conference phase (please see paragraphs 228 to 232 of the SPS). A conference can be a formal or informal discussion between the parties to clarify and, if possible, resolve the issues.

14. If the dispute remains unresolved after the SOP phase, the Commissioner will refer the dispute to adjudication, except in certain circumstances. Adjudication involves an independent review of the dispute by Inland Revenue's Adjudication Unit which was formed to provide an internal but impartial review of unresolved disputes. Adjudication is the final phase in the process before the taxpayer's assessment is amended (if it is to be amended) following the exchange of the SOPs.

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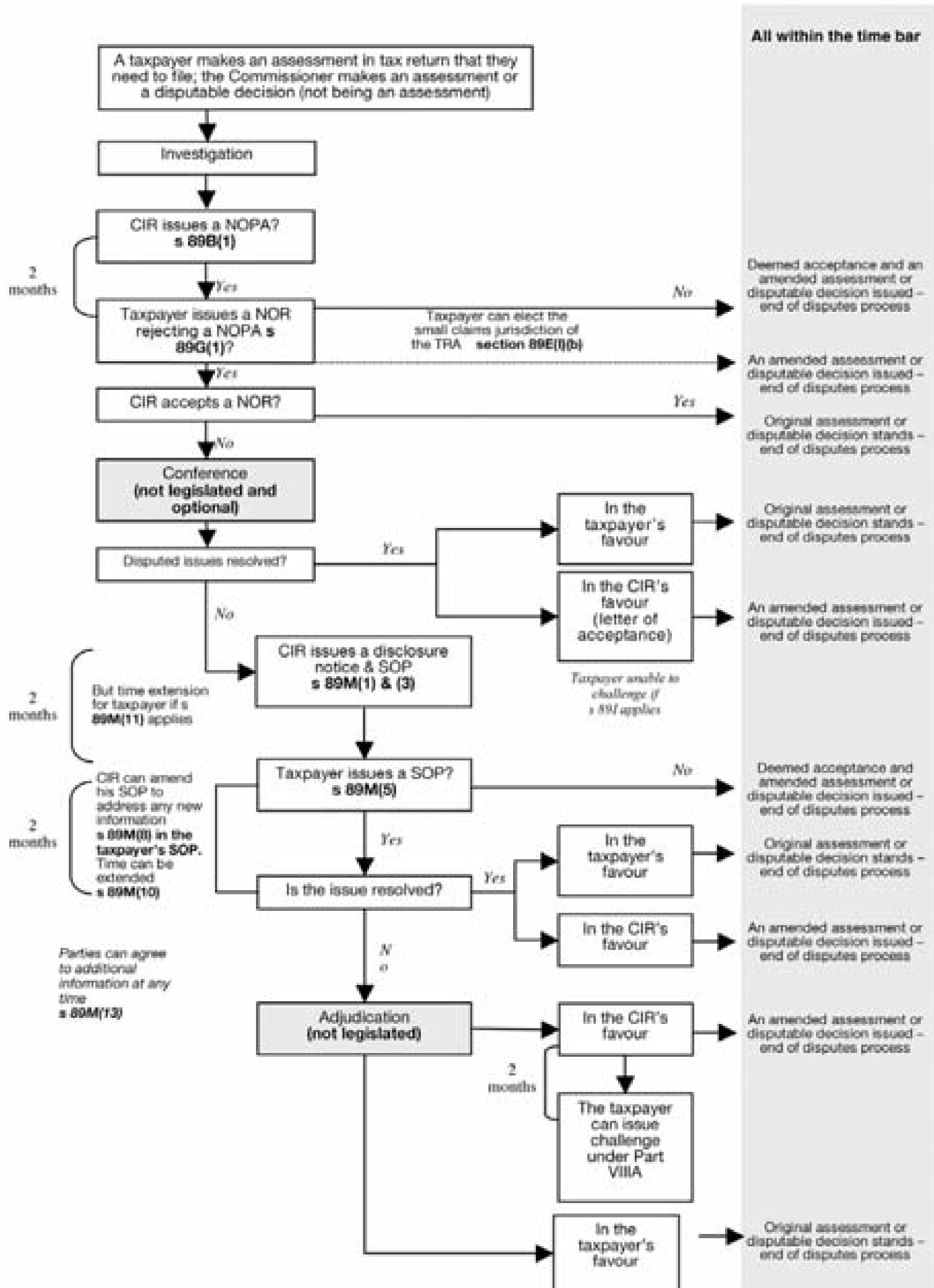
The disputes resolution process is set out in the following diagram.

Disputes resolution process commenced by the Commissioner of Inland Revenue



Summary of key actions and indicative administrative time frames

15. Set out below is a summary of the key actions and administrative time frames where a disputes resolution process is commenced by the Commissioner of Inland Revenue.

16. These actions and time frames are intended to be administrative guide lines for Inland Revenue officers. Any failure to meet these administrative time frames will not invalidate subsequent actions of the Commissioner, or prevent the case from going through the disputes resolution process.

Paragraph in the SPS	Key actions	Indicative time frames
	The Commissioner's NOPA	
91	The Commissioner will advise the taxpayer that a NOPA will be issued.	Usually within five working days before the date that the Commissioner issues a NOPA, but this may happen earlier.
96	The Commissioner will confirm whether the taxpayer has received the Commissioner's NOPA (either by telephone or in writing).	Within 10 working days from the date that the Commissioner's NOPA is issued, where practicable.
	Taxpayer's NOR	
188	The taxpayer issues a NOR in response to the Commissioner's NOPA within the applicable response period.	Within two months from the date that the Commissioner's NOPA is issued, unless any of the "exceptional circumstances" under section 89K applies.
189	The Commissioner will confirm whether the taxpayer will issue a NOR.	Usually two weeks before the response period for the Commissioner's NOPA expires.
209	The Commissioner will forward the taxpayer's NOR to the responsible officer.	Usually within one week after the taxpayer's NOR is received.
210	The Commissioner will acknowledge the receipt of the taxpayer's NOR.	Usually within two weeks after the taxpayer's NOR is received.
217	The Commissioner will advise that the taxpayer's NOR is invalid, but the two-month response period has not expired.	Inland Revenue officers will advise the taxpayer or their agent immediately after they become aware of the invalidity.
206	The Commissioner will consider the application of "exceptional circumstances" under section 89K, where a taxpayer's NOR has been issued outside the applicable response period.	Usually within three weeks after the taxpayer's application is received.
195	The taxpayer is deemed to accept the Commissioner's NOPA, because they failed to issue a NOR within the applicable response period and none of the "exceptional circumstances" apply in the case of a late NOR.	Usually two weeks after the response period to the Commissioner's NOPA has expired.
211	The Commissioner will advise the taxpayer whether their NOR is being considered, has been accepted or rejected in full or part.	Usually within one month after the taxpayer's NOR is received.
212	If the taxpayer's NOR has been accepted in full, the dispute finishes and Inland Revenue will take appropriate actions (for example, issue an amended assessment).	Usually within one month after the advice of acceptance of the NOR is issued.
	Conference phase (if applicable)	
219	The Commissioner will contact the taxpayer to initiate the conference phase.	A conference usually commences within one month after the Commissioner receives the taxpayer's NOR. The suggested average time frame of the conference phase is three months, subject to the facts and complexity of the dispute.
232	The decision not to hold, or abridge any conference must be documented in writing and conveyed by the Commissioner to the taxpayer or agent.	Usually within one week after the Commissioner's decision.
	Disclosure notice and the Commissioner's SOP	
236	The Commissioner will advise the taxpayer that a disclosure notice and the Commissioner's SOP will be issued.	Usually within two weeks before the date that the Commissioner's disclosure notice and SOP are issued.
	Taxpayer's SOP	
264	The taxpayer must issue a SOP within the response period for the disclosure notice.	Within two months after the date that the disclosure notice is issued, unless any of the "exceptional circumstances" under section 89K apply.
267	The Commissioner will confirm whether the taxpayer will issue a SOP.	Usually two weeks before the response period for the Commissioner's disclosure notice expires.
267	The taxpayer's SOP is forwarded to the responsible officer.	Usually within one week after the taxpayer's SOP is received.
269	The Commissioner will acknowledge the receipt of the taxpayer's SOP.	Usually within two weeks after the taxpayer's SOP is received.
269	The Commissioner will advise that the taxpayer's SOP is invalid, but the two-month response period has not expired.	Inland Revenue officers will advise the taxpayer or their agent as soon as they become aware of the invalidity.
270	The Commissioner will consider the application of "exceptional circumstances" under section 89K, where the taxpayer's SOP has been issued outside the applicable response period.	Usually within three weeks after the taxpayer's application is received.
271	The taxpayer is deemed to accept the Commissioner's SOP, because they failed to issue a SOP within the applicable response period and none of the "exceptional circumstances" apply.	Usually two weeks after the response period for the disclosure notice expires.
	Addendum to the Commissioner's SOP	
273	The Commissioner will advise the taxpayer whether the Commissioner will provide additional information via an addendum under section 89M(8) to the Commissioner's SOP.	Usually within two weeks after the taxpayer's SOP is received, subject to the facts and complexity of the dispute and the available response period.
272	The Commissioner can provide additional information via an addendum to the Commissioner's SOP under section 89M(8) within the response period for the taxpayer's SOP.	
	Within two months after the taxpayer's SOP is issued.	
277	The Commissioner will consider the taxpayer's request to include additional information in their SOP under section 89M(13).	Usually within one month after the date that the Commissioner's addendum is issued.
	Adjudication	
291	The Commissioner will prepare a cover sheet and issue a letter (including a copy of the cover sheet) to the taxpayer to seek their concurrence of the materials to be sent to the adjudicator.	
	Usually within one month after the date that the Commissioner's addendum (if any) is issued or within one month from the date that the response period for the taxpayer's SOP to expire.	
292	The taxpayer must respond to the Commissioner's letter.	Within two weeks after the date that the Commissioner's letter is issued.
293	The Commissioner will forward materials relevant to the dispute to the Adjudication Unit.	Usually after the taxpayer has concurred on the materials to be sent to the Adjudication Unit or within 10 working days after the date that the Commissioner's letter is issued if no response is received.
	Adjudication of the disputes case	Usually four months after the date that the Adjudication Unit receives the dispute files depending on the number of disputes that are before the Adjudication Unit, any allocation delays and the technical, legal and factual complexity of those disputes.

Standard practice and analysis

Notice of proposed adjustment

The Commissioner must issue a NOPA before making an assessment

17. The Commissioner must issue a NOPA before making an assessment (including an assessment of shortfall penalties but excluding other civil penalties and interest), unless an exception to the requirement that a NOPA be issued applies under section 89C.

18. Nevertheless, even if the Commissioner, in a very unlikely event, made an assessment in breach of section 89C, the assessment would be regarded as being valid under section 114(a).

19. Each exception under section 89C can apply independently or together depending on the circumstances. However, the Commissioner can also choose to issue a NOPA before making an assessment notwithstanding that an exception under section 89C applies.

A disputable decision

20. The Commissioner will generally issue a NOPA before issuing an assessment that takes into account a disputable decision.

21. For example, the Commissioner issues a notice of disputable decision to a taxpayer who is a director and shareholder of a company advising that the company's loss attributing qualifying company election for the 2007 tax year is invalid because it is received late. However, the company's loss calculation and assessment for the 2007 tax year are not affected. The Commissioner intends to issue an assessment to the taxpayer that takes into account the notice of disputable decision by disallowing the company's losses that the taxpayer has claimed. The Commissioner will issue a NOPA to the taxpayer before making the assessment.

Exceptions

Exception 1: The assessment corresponds with a tax return

22. Section 89C(a) reads:

> The assessment corresponds with a tax return that has been provided by the taxpayer.

23. The application of section 89C(a) is limited under the self-assessment rules. Generally, a taxpayer makes an assessment and files a tax return that includes that assessment. If the taxpayer's assessment is supported by the information in the tax return and any underlying source documents that the taxpayer has provided and the Commissioner agrees with the taxpayer's return and assessment there is no need for the Commissioner to invoke the disputes resolution process.

24. In these circumstances, instead of issuing a notice of assessment the Commissioner will issue a statement of account that confirms the taxpayer's assessment. The statutory response period for the purposes of the disputes resolution process will commence from the date that Inland Revenue receives the taxpayer's assessment.

25. Sometimes, if there is a deficiency in the taxpayer's tax return, the Commissioner will issue an assessment without first issuing a NOPA to the taxpayer because section 89C(a) applies. For example, the Commissioner can issue an assessment, where the taxpayer has provided all their income details but omitted to calculate their income tax liability in the tax return.

Exception 2: Simple or obvious mistake or oversight

26. Section 89C(b) reads:

> The taxpayer has provided a tax return which, in the Commissioner's opinion, appears to contain a simple or obvious mistake or oversight, and the assessment merely corrects the mistake or oversight.

27. This exception is intended to apply to a simple calculation error or oversight that Inland Revenue's Processing Centres generally discover with computer edits and simple return checks. This maintains the status quo for the many assessments arising in this situation.

28. The Commissioner will generally treat the following as a simple mistake or oversight:
    (a) an arithmetical error
    (b) an error in transposing numbers from one box to another in a tax return
    (c) double counting, such as inadvertently including in the taxpayer's income the same item twice
    (d) not claiming a rebate to which the taxpayer is entitled or that was incorrectly calculated, for example, the low income rebate for a taxpayer.

29. A "simple or obvious mistake or oversight" can be determined on a case-by-case basis with no dollar limit. The Commissioner may consider whether this exception applies irrespective of whether the taxpayer has requested that the Commissioner makes an amendment under section 113 or applies the exception under section 89C(b).

30. Where the Commissioner issues an assessment to correct a taxpayer's simple or obvious mistake or oversight, the Commissioner may consider imposing shortfall penalties on the taxpayer, if there is a tax shortfall and the taxpayer has committed one of the

culpable acts, for example, lack of reasonable care and not relied on the action or advice of their tax advisor for the purposes of section 141A(2B)).

Exception 3: Agreement to amend previous tax position

31. Section 89C(c) reads:

    The assessment corrects a tax position previously taken by the taxpayer in a way or manner agreed by the Commissioner and the taxpayer.

32. This situation can occur if the issue is raised by either the Commissioner or the taxpayer. There is no need to issue a NOPA because no dispute arises.
33. If the Commissioner proposes the adjustment, this exception cannot apply unless the taxpayer accepts the adjustment. For the purpose of section 89C(c), the agreement between the parties can be oral, although, generally, the Commissioner's practice will be to seek written agreement. Section 89C(c) applies if Inland Revenue officers can demonstrate that the Commissioner and taxpayer have agreed on the proposed adjustment.
34. However, if the parties agree on only one adjustment and dispute others in respect of the same assessment, the Commissioner cannot issue an assessment on the basis of the agreed adjustment because the tax position is not necessarily correct.
35. Where a taxpayer proposes an adjustment outside the disputes resolution process and the Commissioner agrees, for example a taxpayer makes a request to amend an assessment, the particulars must be recorded in writing and state that the assessment is made in accordance with the Commissioner's practice on exercising the discretion under section 113. (Please see *SPS 07/03: Requests to amend assessments*.) The Commissioner must also consider if shortfall penalties are applicable.

Exception 4: The assessment otherwise reflects an agreement

36. Section 89C(d) reads:

    The assessment reflects an agreement reached between the Commissioner and the taxpayer.

37. The same procedures apply for sections 89C(c) and (d). However, the agreement that the parties reach does not have to relate to a tax position that the taxpayer has previously taken.
38. For example, the taxpayer has disputed but now agrees that they are a "taxpayer" for the purpose of the definition in section YA 1 of the Income Tax Act 2007 ("ITA 2007") and has not provided a tax return. The Commissioner will issue an assessment to the taxpayer under section 89C(d) to reflect this agreement. The Commissioner must also consider whether shortfall penalties are applicable.
39. An example is where, pursuant to section 6A, the Commissioner settles a tax case and disputes resolution process. In such cases, the Commissioner will usually enter into an individual settlement deed and agreed adjustment in writing with the taxpayer to confirm the settlement.
40. The Commissioner will then give effect to that settlement deed and agreed adjustment by issuing an assessment to the taxpayer under section 89C(d) without first issuing a NOPA.
41. This is notwithstanding that the assessment does not necessarily reflect the Commissioner's own view of the correct tax position. (The Commissioner can also issue an assessment under section 89C(c).)

Exception 5: Material facts and law identical to court proceeding

42. Section 89C(db) reads:

    The assessment is made in relation to a matter for which the material facts and relevant law are identical to those for an assessment of the taxpayer for another period that is at the time the subject of court proceedings.

43. Pursuant to section 89C(db), the Commissioner can issue an assessment to the taxpayer in relation to the other period that is the subject of court proceedings, without first issuing a NOPA. The Commissioner does not have to follow the disputes resolution process for the same issue in the other period because the matter is before the court to resolve. A dual process towards resolution does not need to be adopted. The Commissioner will also consider whether shortfall penalties are applicable.
44. However, a taxpayer who has been issued with an assessment in relation to another period under section 89C(db), can dispute that assessment by issuing a NOPA to the Commissioner under section 89D within the applicable response period.
45. Section 89C(db) is intended to reduce compliance costs. Notwithstanding this provision, the Commissioner can elect to issue a NOPA in respect of the other period in order to resolve the dispute through the disputes resolution process.

Exception 6: Revenue protection

46. Section 89C(e) reads:

    The Commissioner has reasonable grounds to believe a notice may cause the taxpayer or an associated person –

    (i) To leave New Zealand; or

    (ii) To take steps, in relation to the existence or location of the taxpayer's assets, making it harder for the Commissioner to collect the tax from the taxpayer.

47. This exception is intended to ensure that the revenue is protected in the relevant circumstances. Section 89C(e) does not require that the taxpayer has physical possession of their assets.

48. If Inland Revenue officers apply the exception under section 89C(e), this should be supported by evidence of the "reasonable grounds" relied on (for example, the taxpayer's correspondence with third parties, application to emigrate overseas and any transcripts of interviews with the taxpayer, etc.)

Exception 7: Fraudulent activity

49. Section 89C(eb) reads:

> The Commissioner has reasonable grounds to believe that the taxpayer has been involved in fraudulent activity.

50. Pursuant to section 89C(eb), a taxpayer has been involved in a fraudulent activity if they have:
    (a) engaged or participated in, or has been connected with, any fraudulent activity that would have tax consequences for them, and
    (b) acted deliberately with the knowledge that they were acting in breach of their legal obligations and did so without an honest belief that they were so entitled to act.

51. If the taxpayer has not been convicted of an offence relating to a fraudulent activity section 89C(eb) can still apply provided that the Commissioner believes on reasonable grounds that the taxpayer has been involved in a fraudulent activity.

52. For example, the Commissioner intends to issue an assessment for the 2007 tax year to a taxpayer who carries on business as an advertising agent. The taxpayer arranges advertising for his clients for which he receives a commission payment from the advertising providers. The taxpayer requires an initial payment from his clients from which he subsequently deducts any advertising costs that are incurred. The taxpayer advises his clients that the only remuneration that he receives for his services is the commission paid to him by the advertising providers.

53. However, the Commissioner is aware that the taxpayer's practice has been to obtain a discount from the advertising provider but not disclose this discount to his clients or deduct the amount of the discount from the amount charged to the client for the advertising. The taxpayer would then retain the difference between the amount charged to the taxpayer and the actual cost of the advertising to supplement the commission actually received from the advertising provider. The Commissioner was advised by one of the taxpayer's clients that the taxpayer has not been passing onto them discounts obtained from an advertising service provider and the Commissioner has confirmed this after making further enquiries.

54. In this circumstance, the Commissioner considers that the taxpayer has been involved in fraudulent activity. The Commissioner can issue to the taxpayer an assessment of income tax for the 2007 year that includes all the taxpayer's assessable income without first issuing a NOPA pursuant to section 89C(eb).

55. This is because the Commissioner has reasonable grounds to believe that the taxpayer has been involved in fraudulent activity based on the information provided by the taxpayer's client and the Commissioner's own enquiries.

56. If Inland Revenue officers apply the exception under section 89C(eb), this should be supported by sufficient evidence of the "reasonable grounds" relied on. For example, evidence that verifies that the taxpayer may have or has committed an offence and, therefore, has been involved in fraudulent activity. The evidence does not have to be absolute proof but, merely sufficient to verify the "reasonable grounds".

Exception 8: Vexatious or frivolous

57. Section 89C(f) reads:

> The assessment corrects a tax position previously taken by a taxpayer that, in the opinion of the Commissioner is, or is the result of, a vexatious or frivolous act of, or vexatious or frivolous failure to act by, the taxpayer.

58. If Inland Revenue officers apply this exception, this should be supported by documentation that evidences:
    (a) the action or inaction giving rise to the tax positions previously taken, and
    (b) why that action is considered to be vexatious or frivolous and any shortfall penalties/prosecution consideration. Examples of a tax position taken as result of a vexatious or frivolous act are a tax position that is:
        (i) clearly lacking in substance, for example, where the taxpayer continues to take the same position that has previously been finalised, or
        (ii) motivated by the sole purpose of delay.

59. Where this exception applies, the Commissioner must also consider the imposition of shortfall penalties in respect of the taxpayer's tax position resulting from a vexatious or frivolous act.

Exception 9: Taxation Review Authority or court determination

60. Section 89C(g) reads:

> The assessment is made as a result of a direction or determination of a court or the Taxation Review Authority.

61. For the purpose of section 89C(g), a direction or determination includes any court or Taxation Review Authority ("TRA") decision that affects the particular taxpayer in relation to a specific tax period and a court decision on a "test case" that applies to the taxpayer irrespective of whether they were a party to the test case.

62. The Commissioner must retain a copy of the direction or determination to support the application of this exception. In these circumstances, the Commissioner will endeavour to make an assessment including imposing shortfall penalties, within two weeks after receiving the written direction or determination. However, if the direction or determination relates to a test case the Commissioner can issue an assessment within the period specified under section 89O(5).

Exception 10: "Default assessment"

63. Section 89C(h) reads:

> The taxpayer has not provided a tax return when and as required by a tax law.

64. If section 89C(h) applies because the taxpayer has failed to provide a tax return the Commissioner can make an assessment or amended assessment pursuant to section 106(1) (commonly known as a "default assessment").

65. Where a taxpayer seeks to dispute a default assessment through the disputes resolution process, the taxpayer must, within the applicable response period (that is, four months from the date that the default assessment is issued):

    (a) provide a tax return in the prescribed form for the period to which the default assessment relates (pursuant to section 89D(2C) for GST and section 89D(2) for all other tax types) notwithstanding that the tax return will not include the taxpayer's assessment, and

    (b) issue a NOPA to the Commissioner in respect of the default assessment.

66. The requirement to provide a tax return in respect of a default assessment made under section 106(1) before issuing a NOPA is an additional requirement of the disputes resolution process. This ensures that the taxpayer has provided the information that is required by the tax law before they are entitled to dispute the assessment.

67. If the Commissioner agrees with the taxpayer's NOPA and tax return, the Commissioner will generally amend the default assessment by exercising the discretion under section 113 subject to the statutory time bar in section 108 and any other relevant limitations. However, if the Commissioner does not agree with the taxpayer's tax return and NOPA the Commissioner can decide to not amend the default assessment and issue a NOR instead.

68. If a taxpayer cannot provide a NOPA because they are outside the applicable response period to dispute a default assessment or do not want to enter into the disputes resolution process they must still provide a tax return.

69. Although the Commissioner does not have to amend the initial assessment on receipt of the tax return from a defaulting taxpayer, the Commissioner can exercise the discretion to amend under section 113 subject to the time bar in section 108 or 108A and any other relevant limitations on the exercise of that discretion.

70. If the Commissioner decides not to exercise the discretion under section 113 to amend the default assessment on the basis of the tax return provided, the Commissioner can issue a NOPA in respect of the default assessment under section 89B(1) where, for example, new information received from the taxpayer suggests that the default assessment is incorrect. Any NOPA must be issued within two months after the date that the default assessment was issued.

71. The Commissioner is not precluded from further investigating an amended assessment issued on the basis of the taxpayer's tax return and, if necessary, issuing a NOPA to the taxpayer.

Exception 11: Failure to make or account for tax deductions

72. Section 89C(i) reads:

> The assessment is made following the failure by a taxpayer to withhold or deduct an amount required to be withheld or deducted by a tax law or to account for an amount withheld or deducted in the manner required by a tax law

73. This exception is intended to address a taxpayer's failure to withhold, deduct or account to the Commissioner for an amount of tax including PAYE, schedular payments to non-resident contractors (formerly withholding payments) and resident withholding tax ("RWT"). The Commissioner must also consider whether shortfall penalties are applicable.

74. The Commissioner may not apply this exception if there is a dispute that involves statutory interpretation (for example, whether a particular item attracts liability for RWT) and/or shortfall penalties.

Exception 12: Non-assessed tax return

75. Section 89C(j) reads:

> The taxpayer is entitled to issue a notice of proposed adjustment in respect of a tax return provided by the taxpayer, and has done so.

76. If a taxpayer proposes an adjustment in a NOPA with which the Commissioner agrees, the Commissioner can issue an assessment without first issuing a NOPA. This exception only applies to an adjustment that the taxpayer has proposed in their NOPA under section 89DA(1) within the applicable response period.

Exception 13: Consequential adjustment

77. Section 89C(k) reads:

> The assessment corrects a tax position taken by the taxpayer or an associated person as a consequence or result of an incorrect tax position taken by another taxpayer, and, at the time the Commissioner makes the assessment, the Commissioner has made, or is able to make, an assessment for that other taxpayer for the correct amount of tax payable by that other taxpayer

78. If transactions affect multiple taxpayers, whether in the same way or in related but opposite ways, the Commissioner can reassess any consequentially affected taxpayers under section 89C(k), if an assessment is, or could be issued to some of the taxpayers for the correct amount of tax payable. This is notwithstanding that the consequentially affected taxpayers have not agreed to the amended assessments.

79. However, those taxpayers subject to the amended assessments can still issue a NOPA to dispute the consequential adjustment if they are within the applicable response period. The Commissioner must also consider whether shortfall penalties are applicable.

80. Section 109(b) deems any assessment that the Commissioner makes to be correct and, therefore, the Commissioner can make any consequential amendment under section 89C(k) accordingly. However, the Commissioner must be satisfied that there is a direct consequential link between the taxpayers before making any consequential adjustment. For example:

    (a) Group loss offsets: if a loss company has claimed losses to which it is not entitled and the Commissioner has amended the loss company's loss assessment to disallow those losses, pursuant to section 89C(k), the Commissioner can also make a separate assessment for the profit company that has incorrectly offset the loss company's losses against its profits.

    (b) GST: the supplier and recipient of a supply have incorrectly assumed that a transaction was GST-exempt. The Commissioner later agrees that the recipient was entitled to a GST input tax credit and issues an assessment to them allowing the credit. The Commissioner can also issue an assessment to the supplier under section 89C(k) in respect of the output tax on the value of the supply.

81. However, in practice, the Commissioner can also issue a NOPA to all the taxpayers affected in such cases.

A taxpayer can dispute an assessment that is issued without a NOPA

82. The Commissioner can issue an assessment without first issuing a NOPA under section 89C in the circumstances outlined above. Although the Commissioner must always endeavour to apply the exceptions under section 89C correctly, any assessment made in breach of section 89C will still be treated as valid under section 114(a).

83. Where the Commissioner issues an assessment without first issuing a NOPA whether or not in breach of section 89C, the taxpayer can dispute the assessment through the disputes resolution process under section 89D(1). (Please see *SPS 08/02: Disputes resolution process commenced by a taxpayer*.)

84. However, where the Commissioner issues a NOPA to a taxpayer and they accept the proposed adjustment by written agreement or are deemed to accept the proposed adjustment, then section 89I(1) precludes the taxpayer from challenging the assessment.

85. However, section 89I cannot apply if the Commissioner and taxpayer have agreed on an adjustment before entering into the disputes resolution process. The parties can dispute the amended assessment, notwithstanding the previous agreement.

When the Commissioner can issue a NOPA

86. Section 89B specifies when the Commissioner can issue a NOPA.

87. Under section 89B(1) the Commissioner can issue one NOPA for multiple issues, tax types and periods. Alternatively, the Commissioner can issue multiple NOPAs for the same issue and period, consistent with the obligation to correctly make an assessment within the four-year statutory time period.

88. A NOPA is not an assessment. It is an initiating action that allows open and full communication between the parties. If possible, the taxpayer will be given the opportunity to settle a dispute by entering into an agreed adjustment with Inland Revenue before the Commissioner issues a NOPA.

89. However, the Commissioner or taxpayer is not precluded from issuing a NOPA in respect of any amended assessment that the Commissioner issues to reflect the agreed adjustment within the applicable response period.

90. A NOPA forms a basis for ensuring that the Commissioner does not issue an assessment without some formal and structured dialogue with the

taxpayer in respect of the grounds upon which the Commissioner will issue any assessment or amended assessment (*McIlraith v CIR* (2007) 23 NZTC 21,456).

91. Once an investigation has commenced, the intended approach must be discussed with the taxpayer. If the Commissioner decides to issue a NOPA to a taxpayer, the responsible officer must endeavour to advise the taxpayer of this proposed approach within five working days before the date that the NOPA is issued to allow the taxpayer time to consider their position and/or seek advice. However, the taxpayer can also be advised earlier.

92. The Commissioner should ensure that any issues relating to the same period and tax type are kept together in the dispute.

93. The Commissioner can also exercise certain statutory powers (for example, issuing a section 17 notice) after a dispute has commenced and will continue to investigate the facts that relate to the dispute.

94. If the parties agree upon some and dispute other proposed adjustments for the same tax period and type, the Commissioner cannot issue an assessment that reflects any agreed adjustment already accepted under section 89J(1) until all the remaining disputed issues are resolved (even if the Commissioner does not pursue the disputed issue further) or determined by the Adjudication Unit. That is, the Commissioner will not issue a "partial" or "interim" assessment under section 89J(1) if the Commissioner is not satisfied that the assessment is correct.

95. However, where the statutory time bar is about to fall due, the Commissioner can issue an assessment to reflect both the agreed and disputed adjustment, provided that the requirements in section 89N are met. (Please see paragraphs 146 to 188 for further discussion.)

96. Where it is practicable, Inland Revenue officers will contact the taxpayer or their tax agent within 10 working days after the NOPA is issued to ensure that it has been received. Inland Revenue officers making written contact should comply with section 14.

Exceptions to the statutory time bar

(a) *Time bar waivers*

97. If it is contemplated that the disputes resolution process cannot be completed before the statutory time bar period for amending an assessment commences, the parties can agree in writing pursuant to section 108B(1)(a) to waive the time bar by up to 12 months to enable the full disputes resolution process to be applied.

98. The taxpayer can also give written notice to the Commissioner and waive the time bar for a further six months after the end of the 12-month period under section 108B(1)(b) to allow sufficient time for the dispute to progress through the adjudication process. This notice must be given to the Commissioner within the initial 12-month period.

99. If the time bar is waived, the taxpayer must be advised in writing that:

    (a) a NOPA will be issued, and

    (b) the disputes resolution process will be followed.

100. To be effective, a statutory time bar waiver must be agreed in writing on the prescribed form (*IR775 Notice of waiver of time bar*) and delivered to the Commissioner before the relevant four-year period expires.

101. The statutory time bar waiver only applies to those issues that the parties have identified and understood before the initial statutory time bar. Other issues not so identified will still be subject to the original statutory time bar, unless section 108(2) or 108A(3) applies. (Please see paragraph 107 in this SPS.)

(b) *The Commissioner's application to the High Court under section 89N(3)*

102. If a NOPA has been issued and the disputes resolution process cannot be completed before the statutory time bar period expires, the Commissioner can apply to the High Court for more time to complete the process. (Please see the discussion regarding section 89N(3) in paragraphs 175 to 186 of this SPS.)

103. However, where the Adjudication Unit has insufficient time (that is, before the statutory time bar arises or further time allowed under section 108B(1) to fully consider a matter submitted to it expires) the Adjudication Unit will return the matter to the responsible officer to decide whether to issue an assessment or amended assessment or accept the taxpayer's position. Section 89N(2)(b) allows the Commissioner to amend an assessment at any time after the Commissioner has considered the taxpayer's SOP in relation to the particular period. (Please see paragraph 144 for further discussion.)

(c) *Exceptions under section 89N(1)*

104. When a NOPA has been issued, the Commissioner will follow the disputes resolution process unless an exception under section 89N applies. (The application of section 89N is discussed in detail later in paragraphs 141 to 185 of the SPS.) The Commissioner must obtain and document administrative approval for any departure from the full disputes resolution process.

Limitations on the Commissioner issuing a NOPA

105. Under section 89B(4), the Commissioner cannot issue a NOPA:
   (a) if the proposed adjustment is the subject of challenge proceedings, or
   (b) after the statutory time bar has expired.

106. The time bar that arises under sections 108 and 108A prevents the Commissioner from issuing an assessment that increases the amount assessed. The Commissioner can still issue an assessment that decreases the amount of the initial assessment subject to the limitation on refunding overpaid tax under sections RM 2(1) of the ITA 2007 and 45(1) of the Goods and Services Tax Act 1985.

107. However, the Commissioner is not subject to the statutory time bar that arises under sections 108 and 108A, if the Commissioner considers that the taxpayer has:
   (a) provided a fraudulent or wilfully misleading tax return (section 108(2)(a)), or
   (b) omitted income for which a tax return must be provided that is of a particular nature or source (section 108(2)(b)), or
   (c) knowingly or fraudulently failed to make a full and true disclosure of the material facts necessary to determine their GST payable (section 108A(3)).

108. Furthermore, the Commissioner is not subject to the statutory time bar that arises under section 108 if a taxpayer has a remaining tax credit to which section LA 6(1) of the ITA 2007 applies and the Commissioner seeks to amend an assessment or determination to give effect to section LA 6(3) of the ITA 2007 (section 108(3B)).

109. When considering whether the exception under section 108(2)(b) applies, the Commissioner will disregard omissions of relatively small amounts of income by applying the principle of *de minimis non curat lex* (*Babington v C of IR* (1957) NZLR 861).

110. The Commissioner accepts that the time bar ensures finality in relation to assessments, is a key protection for most taxpayers and the exclusions from its protection must be only invoked if there is an adequate basis in fact and law to support their operation. Section 89B(4)(b) requires that the Commissioner initially decides whether an exception to the time bar applies, for example, whether a tax return is fraudulent or wilfully misleading, before determining whether a NOPA can be issued under section 89B(1).

111. Any opinion that the Commissioner forms regarding the application of the exceptions to the time bar must be honestly held and reasonably justifiable on the basis of the evidence available and the relevant law. The decision must be clearly documented and include reference to the grounds and reasoning on which it is based. Any decision that is made under section 108A is not, in itself, a disputable decision.

112. The Commissioner is generally limited to a four-year period within which a taxpayer's assessment can be increased following an investigation or in certain other circumstances. In respect of a dispute, the assessment is amended (if necessary) after the disputes resolution process is completed. The Commissioner will endeavour to undertake the various steps involved in the process within the four-year period.

113. Section 89B(4)(a) applies to individual proposed adjustments. Where the proposed adjustment is the subject of court proceedings, the Commissioner cannot issue a NOPA in respect of those proposed adjustments. However, the Commissioner can issue a separate NOPA to the taxpayer in relation to the same tax period provided it relates to a different adjustment.

114. For example, a taxpayer challenges the deductibility of feasibility expenditure in the 2006 tax year pursuant to section 138B. The Commissioner can also issue a NOPA to the same taxpayer in relation to the tax treatment of a bad debt in the same tax year.

Contents of the Commissioner's NOPA

115. A NOPA is the document that commences the disputes resolution process. It is intended to identify the true points of contention and explain the legal or technical aspects of the issuer's position in relation to the proposed adjustment in a formal and understandable manner. This will ensure that information relevant to the dispute is quickly made available to the parties. Section 89F(1) and (2) specifies the content requirements for any NOPA that the Commissioner may issue.

116. Under section 89F(1)(b), the NOPA must be in the prescribed form (*IR 770 Notice of proposed adjustment*). Any NOPA that the Commissioner issues must identify, in sufficient detail the adjustment proposed and explain concisely the facts and law that relate to the adjustment and how the law applies to the facts. When preparing a NOPA, the Commissioner should avoid repeating facts, arguments or using unnecessary detail.

117. Section 89F(2)(b) requires that the NOPA states the key facts and law concisely and in sufficient detail. The Commissioner must ensure that the document is relatively brief and simple to enable the parties to quickly progress the dispute without incurring

substantial expenses or excessive preparation time but also detailed enough to explain all the issues relevant to the dispute.

118. The Commissioner should identify (but not reproduce in full) the relevant legislation and legal principles derived from leading cases. These references should be in sufficient detail to clarify the grounds for the proposed adjustment. However, lengthy quotations from cases should be avoided.

119. The Commissioner considers that Inland Revenue has a statutory obligation to inform a taxpayer adequately, but recognises that the matters relevant to the dispute will be set out in greater detail at the SOP phase if the dispute is not resolved.

120. Therefore, what is included in a NOPA or NOR is not conclusive as between the parties because they can introduce further grounds or information or adjust the quantum of the proposed adjustments later in the disputes resolution process (*CIR v Zentrum Holdings Limited* (2006) 22 NZTC 19,912). However, the parties cannot propose another adjustment involving new grounds and a fresh liability at the SOP phase.

121. The Commissioner must always endeavour to issue a NOPA that has sufficient details, is of a high standard and has been considered by a legal adviser. The Commissioner must endeavour to advise the taxpayer during the conference phase of any new grounds, information or reduction in quantum that will be introduced in the SOP.

122. If the Commissioner decides to increase the quantum of any proposed adjustment after the NOPA is issued the Commissioner must issue a new NOPA to the taxpayer.

123. Although candid and complete exchanges of information are implicit in the spirit and intent of the disputes resolution process, the Commissioner's practice will be to ensure that the NOPA is, within those limits, as brief as practicable.

124. The content of any NOPA that the Commissioner issues must satisfy all the requirements specified in section 89F(2)(a) to (c).

Identify adjustments or proposed adjustments – section 89F(2)(a)

125. The Commissioner must consider in respect of each proposed adjustment:

(a) the income amount or impact of the adjustment, and

(b) the tax year or period to which the proposed adjustment relates, and

(c) whether use-of-money interest will apply.

126. The Commissioner will also consider whether shortfall penalties and/or other appropriate penalties of lesser percentages apply. That is, where sufficient evidence is held to support the imposition of the penalties and this can be justified (by reference to any relevant guidelines.)

Shortfall penalties

127. Shortfall penalties are separate items of adjustment that must be explained and supported in the same manner as the underlying tax shortfall. Section 94A(2) also requires that shortfall penalties must be assessed the same way as the underlying tax. However, although assessments of shortfall penalties relate to the underlying tax they are not subject to the time bars that arise under section 108 or 108A.

128. Where there is sufficient evidence to suggest that shortfall penalties should be imposed, the relevant Inland Revenue officer must ensure that the shortfall penalties are proposed in the same NOPA as the substantive issues. However, the officer can dispense with this practice if any the following exceptions applies:

(a) the evidence supporting the imposition of shortfall penalties does not become available until after the Commissioner has issued the NOPA on the substantive issues. In such circumstances, a separate NOPA may be issued in respect of the shortfall penalties at a later stage.

(b) before entering into the disputes resolution process, a taxpayer has accepted the proposed adjustment in relation to the substantive issues, but not accepted the imposition of the shortfall penalties. In this circumstance, the Commissioner may still issue a NOPA to the taxpayer for the proposed penalties.

(c) the taxpayer makes a voluntary disclosure of the substantive issues to the Commissioner and the only disputed issue relates to the imposition of the shortfall penalties.

(d) prosecution action is being considered and shortfall penalties also apply because the taxpayer has committed one of the culpable acts (for example, evasion), in most instances the Commissioner must first complete any prosecution action against the taxpayer before the shortfall penalties can be imposed.

Pursuant to section 149(5), if shortfall penalties have been imposed the Commissioner cannot subsequently prosecute the taxpayer for taking the incorrect tax position unless the shortfall

penalties are imposed under section 141ED. Therefore, the Commissioner may omit proposing shortfall penalties in a NOPA if prosecution is being considered as an option. The Commissioner must issue a new NOPA in respect of any shortfall penalties that are to be imposed after the prosecution.

129. Furthermore, the Commissioner cannot propose shortfall penalties at the SOP phase if they were not previously proposed in the Commissioner's NOPA.

State the facts and law – section 89F(2)(b)

Facts

130. To provide a concise statement of facts, the Commissioner must focus on the material factual matters relevant to the legal issues. This includes, for each proposed adjustment, the facts relevant to proving all arguments made in support of the adjustment including any facts that are inconsistent with any arguments that the taxpayer has previously raised.

131. The Commissioner should endeavour to state all the material facts in brief, so as to avoid irrelevant detail or repetition. For example, where the parties both know the background to the disputed issues, a summary of the facts in the NOPA will suffice. Where possible, the Commissioner will refer to and/or append any documents that have previously set out the facts on which the Commissioner relies.

132. Although the Commissioner will make every attempt to be concise in the NOPA, the Commissioner considers that the explanation of the material facts should be relative to the complexity of the issues.

Law

133. Under section 89F(2)(b) the Commissioner must state the law concisely by including an outline of the relevant legislative provisions and principles derived from leading cases that affect the proposed adjustment.

134. It is sufficient that the Commissioner explains the nature of the legal arguments without providing lengthy quotations from the relevant case law.

How the law applies to the facts – section 89F(2)(c)

135. The Commissioner must apply the legal arguments to the facts to ensure that the proposed adjustment is not a statement that appears out of context. The application of the law to the facts must be stated concisely and logically support the proposed adjustment.

136. The Commissioner must outline all relevant materials and arguments (including alternative arguments) on which the Commissioner intends to rely. If more than one argument supports the same or a similar outcome, the NOPA must include all the arguments.

137. The evidence exclusion rule under section 138G(1) does not apply to the issues, facts, evidence and propositions of law that are raised in the Commissioner's NOPA. That is, the Commissioner is not restricted to raising the same issues, facts, evidence and propositions of law that are specified in the NOPA at the SOP phase or in challenge proceedings that the taxpayer has commenced where a disclosure notice has not been issued.

Time frames to complete the disputes resolution process

138. If the Commissioner has commenced the disputes resolution process by issuing a NOPA to a taxpayer and the dispute remains unresolved, where practicable, the Commissioner must negotiate a time line with the taxpayer to ensure that the dispute is progressed in a timely and efficient way.

139. Although not statutorily required, agreeing to a time line is a critical administrative requirement that requires both parties to be ready to progress the dispute in a timely manner. The parties should endeavour to meet the agreed time line. Where there are delays in the progress of the dispute the responsible officer will manage the delay including any relationship with internal advisers and liaise with the taxpayer.

140. If the negotiated time line cannot be achieved, the Commissioner must enter into a continuing discussion with the taxpayer to either arrange a new time line, or otherwise keep them advised of when the disclosure notice and SOP will be issued. This is consistent with the purpose of the disputes resolution process which is to promote the prompt and efficient resolution of disputes. Therefore, the failure to negotiate or adhere to an agreed time line will not prevent a case from progressing through the disputes resolution process in a timely manner.

141. In addition to the above administrative practice, the Commissioner is bound by section 89N(2). Under that provision, if a NOPA has been issued and the parties cannot agree on the proposed adjustment, the Commissioner cannot amend an assessment without completing the disputes resolution process unless any of the exceptions in section 89N(1)(c) apply. These exceptions are explained in paragraphs 146 to 186 of this SPS. If any of these exceptions apply the disputes resolution process will end and the dispute will not go through the adjudication phase.

142. Although not a statutory requirement, where practicable, it is the Commissioner's administrative practice to complete the adjudication phase for the purpose of resolving a dispute after the SOP phase.

143. However, if the adjudication phase cannot be completed (for example, because the statutory time bar is imminent), section 89N(2)(b) allows the Commissioner to amend an assessment after considering the taxpayer's SOP.

144. Inland Revenue officers must adequately consider the facts and legal arguments in the taxpayer's SOP before they decide whether to amend an assessment. Whether a SOP has been adequately considered will depend on what is a reasonable length of time and level of analysis for that SOP given the circumstances of the case (for example, the complexity of the issues).

145. Thus a simple dispute may only take a couple of days to consider adequately while a complex dispute could take a few weeks. If the statutory time bar is imminent the Inland Revenue officer will consider the taxpayer's SOP urgently.

Section 89N – exceptions – when an assessment can be issued without completing the disputes resolution process

146. If a NOPA has been issued and the dispute is unresolved, the Commissioner can issue an assessment without completing the disputes resolution process under the following circumstances:

Exception 1: In the course of the dispute, the Commissioner considers that the taxpayer has committed an offence under an Inland Revenue Act that has had the effect of delaying the completion of the disputes resolution process (section 89N(1)(c)(i)).

147. Section 89N(1)(c)(i) reads:

> (i) the Commissioner notifies the disputant that, in the Commissioner's opinion, the disputant in the course of the dispute has committed an offence under an Inland Revenue Act that has had an effect of delaying the completion of the disputes process:

148. The exception applies where the Commissioner may need to act quickly to issue an assessment because the Commissioner considers that the taxpayer has committed an offence under an Inland Revenue Act that has caused undue delay to the progress of the dispute.

149. For example, in the course of a dispute a taxpayer obstructed Inland Revenue officers in obtaining information from the taxpayer's business premise under section 16. The Commissioner will advise the taxpayer in writing that the Commissioner considers that they have committed an offence under section 143H. The offence has the effect of delaying the completion of the disputes resolution process meaning that the Commissioner does not have to complete that process and can amend the taxpayer's assessment under section 113.

150. Another example of when the exception may apply is where, in the course of a dispute, a taxpayer wilfully refuses to attend an enquiry made under section 19 on the date specified in the Commissioner's notice. In these circumstances, the Commissioner will advise the taxpayer in writing that the Commissioner considers that they have committed an offence under section 143F that has had the effect of delaying the completion of the disputes resolution process. The Commissioner can then exercise the discretion to amend the taxpayer's assessment under section 113 without completing the disputes resolution process.

151. In order to apply this exception, Inland Revenue officers must form an opinion that is honestly and reasonably justifiable on the basis of the evidence available. The Inland Revenue officer's decision must be clearly documented and stipulate the grounds and reasoning on which it is based.

Exception 2: A taxpayer involved in a dispute, or person associated to them, may take steps to shift, relocate or dispose of the taxpayer's assets to avoid or delay the collection of tax, making the issue of an assessment urgent (section 89N(1)(c)(ii) and (iii)).

152. If the Commissioner has reasonable grounds to believe that the taxpayer or a person associated with them ("associated person") intends to dispose of assets in order to avoid or defer the payment of an outstanding or pending tax liability, the Commissioner can urgently issue an assessment to the taxpayer. Sections 89N(1)(c)(ii) & (iii) read:

> (ii) the Commissioner has reasonable grounds to believe that the disputant may take steps in relation to the existence or location of the disputant's assets to avoid or delay the collection of tax from the disputant:
>
> (iii) the Commissioner has reasonable grounds to believe that a person who is, under the 1988 version provisions in subpart YB of the Income Tax Act 2007, an associated person of the disputant may take steps in relation to the existence or location of the disputant's assets to avoid or delay the collection of tax from the disputant:

153. In order to issue an assessment on the basis of either of the above exceptions, Inland Revenue officers must record any relevant correspondence and evidence (for example, the directors' written instructions to shift the company's assets overseas, evidence of electronic wiring of funds to overseas countries, transcripts of interviews with the taxpayer, etc) or other grounds for the reasonable belief.

Exception 3: The taxpayer involved in a dispute or a person associated with them involved in another dispute involving similar issues has begun judicial review proceedings in relation to the dispute (section 89N(1)(c)(iv) and (v)).

154. Section 89N(1)(c)(iv) and (v) reads:

> (iv) the disputant has begun judicial review proceedings in relation to the dispute:
>
> (v) a person who is, under the 1988 version provisions in subpart YB of the Income Tax Act 2007, an associated person of the disputant and is involved in another dispute with the Commissioner involving similar issues has begun judicial review proceedings in relation to the other dispute:

155. These exceptions apply to any judicial review proceedings that are brought against the Commissioner. In judicial review proceedings, the parties' resources are likely to be directed away from advancing the dispute through the disputes resolution process.

156. For the purpose of section 89N(1)(c)(v), a person associated with a taxpayer under the 1988 version provisions in subpart YB of the ITA 2007 may be involved in a similar issue to the taxpayer even if the issue relates to a different revenue type. In other circumstances, the revenue type may be the same. For example, if the dispute between the Commissioner and taxpayer relates to PAYE issues, but the dispute between the Commissioner and a person associated with the taxpayer relates to income tax the taxpayer may still be involved in similar issues to the person associated with them.

157. Even if the two disputes relate to the same revenue type, section 89N(1)(c)(v) will not apply in some circumstances. For example, the dispute with the taxpayer relates to the tax treatment of entertainment expenditure, whereas the dispute with the person associated with the taxpayer relates to the capital and revenue distinction of merger expenditure. The Commissioner would not regard these two disputes as involving similar issues.

Exception 4: The taxpayer fails to comply with a statutory requirement for information relating to the dispute (section 89N(1)(c)(vi)).

158. Section 89N(1)(c)(vi) reads:

> (vi) during the disputes process, the disputant receives from the Commissioner a requirement under a statute for information relating to the dispute and fails to comply with the requirement within a period that is specified in the requirement:

159. Generally, a taxpayer provides information to Inland Revenue voluntarily. However, when this does not occur the Commissioner can seek information from the taxpayer under a statutory provision, for example section 17 or 19. (The Commissioner's practice regarding section 17 is currently set out in *SPS 05/08: Section 17 notices*.) The requirement for statutory information will specify the period within which the information must be provided. This period will allow the taxpayer reasonable and sufficient time to comply.

160. Where the taxpayer does not comply with a formal requirement for information that relates to the dispute (for example, as a tactic to delay the progress of the disputes resolution process), the Commissioner can issue an assessment to the taxpayer without first completing the disputes resolution process.

Exception 5: The taxpayer elects to have the dispute heard by the TRA acting in its small claims jurisdiction (section 89N(1)(c)(vii)).

161. Section 89N(1)(c)(vii) reads:

> (vii) the disputant elects under section 89E to have the dispute heard by a Taxation Review Authority acting in its small claims jurisdiction:

162. A taxpayer can issue a NOPA to the Commissioner under section 89D or 89DA or a NOR rejecting the Commissioner's NOPA under section 89B (please see *SPS 08/02: Disputes resolution process commenced by a taxpayer*).

163. At the same time, under section 89E(1)(a) the taxpayer can elect in their NOPA or NOR that the TRA acting in its small claims jurisdiction should hear any unresolved dispute arising from the NOPA (whether issued by the Commissioner or taxpayer), if the amount in dispute is $30,000 or less. Any such election is irrevocable, final and binding on the taxpayer. In this case, the full disputes resolution process does not have to be followed.

Exception 6: The parties agree in writing that the dispute should be resolved by the court or TRA without completing the disputes resolution process (section 89N(1)(c)(viii)).

164. Section 89N(1)(c)(viii) reads:

> (viii) the disputant and the Commissioner agree in writing that they have reached a position in which the dispute would be resolved more efficiently by being submitted to the court or Taxation Review Authority without completion of the disputes process:

165. Under this exception, where the Commissioner or taxpayer commences the disputes resolution process, the parties can make such an agreement in writing before either party issues their SOP. This would occur, for example, if the parties could incur excessive compliance and administrative costs in completing the full disputes resolution process relative to the amount in dispute.

166. This exception allows the taxpayer to bring challenge proceedings against the Commissioner. Where this exception applies to disputes that the Commissioner or taxpayer has commenced (that is, after the parties have made the requisite agreement), the parties must have exchanged a NOPA and NOR before the taxpayer can bring challenge proceedings under section 138B(1) or (3).

Exception 7: The parties agree in writing to suspend the disputes process pending the outcome of a test case (section 89N(1)(c)(ix)).

167. Section 89N(1)(c)(ix) reads:

> (ix) the disputant and the Commissioner agree in writing to suspend proceedings in the dispute pending a decision in a test case referred to in section 89O.

168. Section 89O(2) allows a dispute to be suspended pending the result of a test case. Pursuant to section 89O(3), the parties can agree in writing to suspend the dispute from the date of the agreement until the earliest date that:

(a) the court's decision is made, or

(b) the test case is otherwise resolved, or

(c) the dispute is otherwise resolved.

169. If the parties agree to suspend the disputes resolution process, any statutory time bar affecting the dispute is stayed. The Commissioner can then make an assessment that is consistent with the test case decision. (However, the taxpayer is not precluded from challenging the Commissioner's assessment under section 89D(1), even if it is consistent with the test case decision.)

170. The Commissioner must issue an amended assessment or perform an action within the time limit specified in section 89O(5).

171. Section 89O(5) reads:

> The Commissioner must make an amended assessment, or perform an action, that is the subject of a suspended dispute by the later of the following:
>
> (a) the day that is 60 days after the last day of the suspension:
>
> (b) the last day of the period that –
>
> (i) begins on the day following the day by which the Commissioner, in the absence of the suspension, would be required under the Inland Revenue Acts to make the amended assessment, or perform the action; and
>
> (ii) contains the same number of days as does the period of the suspension.

172. If the statutory time bar arising under section 108 or 108A is imminent, section 89O(5) allows the Commissioner more time to complete the disputes resolution process.

173. For example, the Commissioner commences a dispute and on 1 March 2007 agrees with the taxpayer in writing to suspend the disputes proceedings pending the decision in a designated test case. The disputed issue is subject to a statutory time bar that commences after 31 March 2007 and the taxpayer does not agree to delay its application under section 108B(1)(a). A decision is reached in the test case on 31 July 2007.

174. The Commissioner must make an amended assessment or perform an action that is the subject of the suspended dispute by 29 September 2007. This date is calculated as follows:

(a) The suspension period commences on the date of the agreement (1 March 2007) and ends on the date of the court's decision in the test case (31 July 2007). This is a period of 153 days.

(b) The last date that the Commissioner can make an amended assessment falls on the later of the following two dates:

(i) 29 September 2007, that is 60 days after the date that the suspension period ends on 31 July 2007 pursuant to section 89O(5)(a), and

(ii) 31 August 2007, that is 153 days after the period commences on 1 April 2007 pursuant to section 89O(5)(b).

Exception 8: The Commissioner applies to the High Court for an order to allow more time to complete or dispense with the disputes process.

175. Section 89N(3) reads:

> … [T]he Commissioner may apply to the High Court for an order that allows more time for the completion of the disputes process, or for an order that completion of the disputes process is not required.

176. The Commissioner envisages that this exception will be used if section 89N(1)(c) does not apply and there are exceptional circumstances.

177. Any application made by the Commissioner under section 89N(3) must be based on reasonable grounds. Whether there are reasonable grounds will depend on considerations such as the complexity of the issues in the dispute, whether the taxpayer has caused delays, the dispute involves large amounts of revenue or there were significant matters in the dispute that were unforeseen by either party and provided a justification for the delay.

178. For example, due to unusual circumstances the Commissioner does not learn about a proposed adjustment until late. Further delays by the taxpayer and the need for the Commissioner to obtain significant legal advice means that the Adjudication Unit cannot consider the dispute before the time bar starts. In this circumstance, the Commissioner may apply to the High Court for an order that allows more time for the disputes process to be completed under section 89N(3). (Note: This is only an example of a possible unforeseen situation and it is anticipated that there will be a wide variety of circumstances under which an application under section 89N(3) will be appropriate.)

179. The Commissioner's application to the High Court under section 89N(3) is subject to statutory time limits. The Commissioner must apply before the four-year statutory time bar falls due.

180. The Commissioner must also issue an amended assessment within the time limit specified in section 89N(5). Section 89N(5) reads:

> If the Commissioner makes an application under subsection (3), the Commissioner must make an amended assessment by the last day of the period that
>
> (a) begins on the day following the day by which the Commissioner, in the absence of the suspension, would be required under the Inland Revenue Acts to make the amended assessment; and
>
> (b) contains the total of -
>
> (i) the number of days between the date on which the Commissioner files the application in the High Court and the earliest date on which the application is decided by the High Court or the application or dispute is resolved:
>
> (ii) the number of days allowed by an order of a court as a result of the application.

181. Section 89N(5) allows the Commissioner more time to complete the disputes resolution process where the statutory time bar under section 108 or 108A is imminent.

182. For example, the Commissioner commences the disputes resolution process. On 1 March 2007 the Commissioner applies to the High Court under section 89N(3) for an order allowing more time to complete the process. The disputed issue is subject to a statutory time bar that commences after 31 March 2007 and the taxpayer does not agree to delay its application under section 108B(1)(a). On 30 June 2007, the High Court makes an order that allows the Commissioner's application and gives the Commissioner 30 further days to complete the disputes resolution process.

183. Pursuant to section 89N(5), the Commissioner must make an amended assessment by 30 August 2007. This date is calculated as follows:

(a) The Commissioner would have one month to make the amended assessment before the statutory time bar commences. That is, 1 March 2007 to 31 March 2007. The period during which an amended assessment must be made under section 89N(5)(a) commences on 1 April 2007.

(b) The period during which the assessment must be made includes 122 days, that is the period between 1 March 2007 and 30 June 2007 (the date of the decision) under section 89N(5)(b)(i) and the 30-day period allowed by the High Court order under section 89N(5)(b)(ii). This is a total of 152 days.

(c) The Commissioner must issue an amended assessment to the taxpayer on the date that is 152 days from 1 April 2007. That is, by 30 August 2007.

184. During the period from 1 March to 30 August 2007, the parties may continue to attempt to resolve the dispute. This may include exchanging SOPs and going through the adjudication process.

185. The above example indicates that the Commissioner has more time to complete the disputes resolution process. The time bar will not commence until 30 August 2007.

186. Where the Commissioner applies to the High Court under section 89N(3) for an order to truncate the disputes resolution process, the Commissioner must issue an assessment within the period as calculated under section 89N(5). Applying the same facts as in the above example, the Commissioner must issue an assessment to the taxpayer by 30 August 2007.

Application of the exceptions in section 89N(1)(c)

187. The Commissioner's practice is that the parties must endeavour to resolve the dispute before or via the adjudication process. If this is not possible and any of the eight exceptions in section 89N(1)(c) apply the Commissioner can amend an assessment without completing the whole disputes resolution process, that is, before the parties accept a NOPA, NOR or SOP that the other has issued, or the Commissioner has considered the taxpayer's SOP. This will conclude the disputes resolution process and the dispute will not go through the Adjudication phase.

188. In this circumstance, the taxpayer can challenge the Commissioner's assessment by filing proceedings in the TRA (either acting in its general or small claims jurisdiction) or the High Court within the applicable response period, that is, within two months starting on the date that the notice of assessment is issued (please see paragraph 166 of this SPS).

Taxpayer's response to the Commissioner's NOPA: NOR

189. If a taxpayer disagrees with the Commissioner's proposed adjustment, then, under section 89G(1), they must advise the Commissioner that any or all of the proposed adjustments are rejected by issuing a NOR within the two-month response period. That is, within two months starting on the date that the Commissioner's NOPA is issued. The Commissioner interprets this as requiring Inland Revenue's receipt of the NOR within the response period.

190. For example, if a NOPA is issued on 8 April 2007, the taxpayer must advise the Commissioner that it is rejected by issuing a NOR to the Commissioner for receipt on or before 7 June 2007. However, taxpayers are encouraged to issue their NOR to the Commissioner once they have completed it.

191. The Commissioner will make reasonable efforts to contact the taxpayer or their tax agent two weeks before the response period expires to ascertain whether the taxpayer will issue a NOR in response to the Commissioner's NOPA. Such contact may be made by telephone or letter.

192. Section 89G(2) specifies the content requirements of a NOR. The taxpayer must state concisely in the NOR:

(a) the facts or legal arguments in the Commissioner's NOPA that they consider are wrong, and

(b) why they consider that those facts and arguments are wrong, and

(c) any facts and legal arguments that they rely upon, and

(d) how the legal arguments apply to the facts, and

(e) the quantitative adjustments to any figure proposed in the Commissioner's NOPA that results from the facts and legal arguments that the taxpayer relies upon.

193. In respect of the requirement under section 89G(2)(c) that the taxpayer specifies the facts and legal arguments upon which they are relying, the taxpayer can also refer to legislative provisions, case law and any legal arguments that are raised in the Commissioner's NOPA. The taxpayer does not have to refer to different legislative provisions, case law and legal arguments.

194. Pursuant to section 89G(2)(e), the requirement for a quantitative adjustment establishes to what extent the taxpayer considers that the Commissioner's adjustment in the NOPA is incorrect. This amount need not be exact, however, every attempt should be made to ensure that it is as accurate as possible. The amount in dispute can be altered, as the dispute progresses irrespective of whether the parties have agreed on the new figure.

Deemed acceptance

195. Under section 89H(1), if the taxpayer:

(a) has not issued a NOR within the two-month response period, and

(b) there are no exceptional circumstances as defined in section 89K(3),

the taxpayer is deemed to have accepted the adjustment that is proposed in the Commissioner's NOPA and section 89I applies. The Commissioner will usually advise the taxpayer that the deemed acceptance has occurred within two weeks after the two-month response period expires.

196. Pursuant to section 89I(2), the Commissioner must include or take into account each proposed adjustment that the taxpayer accepts or is deemed to accept in a notice of assessment issued to the taxpayer.

Exceptional circumstances under section 89K

197. Section 89K(3) reads:

(a) an exceptional circumstance arises if—

(i) an event or circumstance beyond the control of a disputant provides the disputant with a reasonable justification for not rejecting a proposed adjustment, or for not issuing a notice of proposed adjustment or statement of position, within the response period for the notice:

(ii) a disputant is late in issuing a notice of proposed adjustment, notice of response or statement of position but the Commissioner considers that the lateness is minimal, or results from 1 or more statutory holidays falling in the response period:

(b) an act or omission of an agent of a disputant is not an exceptional circumstance unless—

(i) it was caused by an event or circumstance beyond the control of the agent that could not have been anticipated, and its effect could not have been avoided by compliance with accepted standards of business organisation and professional conduct; or

(ii) the agent is late in issuing a notice of proposed adjustment, notice of response or statement of position but the Commissioner considers that the lateness is minimal, or results from 1 or more statutory holidays falling in the response period.

198. The legislation defines exceptional circumstances very narrowly. The cases regarding "exceptional circumstances," such as *Treasury Technology Holdings Ltd v CIR* (1998) 18 NZTC 13,752, *Milburn NZ Ltd v CIR* (1998) 18 NZTC 14,005, *Fuji Xerox NZ Ltd v CIR* (2001) 17,470 (CA), *Hollis v CIR* (2005) 22 NZTC 19,570 and *Balich v CIR*, unreported High Court, Auckland Registry, CIV 2006-404-4113, 21 February 2007 are also relevant.

199. The case law confirms that the definition of "exceptional circumstances" in sections 89K(3) and 138D should be applied consistently. The following guidelines have emerged from the case law:

(a) a taxpayer's misunderstanding or erroneous calculation of the applicable response period will usually not be regarded as an event or circumstance beyond the taxpayer's control under section 89K(3)(a)

(b) an agent's failure to advise their client that they have received a notice of assessment or other relevant document that causes the taxpayer to respond outside the applicable response period will not generally be considered to be an exceptional circumstance under section 89K(3)(b) (*Hollis v CIR*)

(c) an exceptional circumstance can arise if the taxpayer has relied on misleading information regarding the applicable response period given to them by the Commissioner that has caused them to respond outside that response period (*Hollis v CIR*).

200. The Commissioner will only accept a late NOR on rare occasions. Please see *Tax Information Bulletin* Vol 8, No 3 (August 1996) for some examples of situations that can be an "exceptional circumstance" beyond a taxpayer's control.

201. The exception for lateness as a result of statutory holidays is self explanatory. The Commissioner can also accept a late NOR if the Commissioner considers that the lateness is minimal, that is, the document was only one to two days late and the other factors relevant to the exercise of the discretion under section 89K(1) are satisfied. (Please see discussion in paragraph 203.)

202. For example, the response period ends on Saturday and the taxpayer provides a NOR on the following Tuesday. The Commissioner treats the response period as ending on Monday on the basis of section 35(6) of the Interpretation Act 1999 and accepts that the lateness of the NOR was minimal. That is, the Commissioner has received the NOR within one to two days of Monday, the last day of the response period. If the response period ended on Friday and the taxpayer provided the NOR on the following Monday, the Commissioner would also accept that the lateness is minimal.

203. Besides the degree of lateness, the Commissioner considers that the exercise of the discretion under section 89K(1) requires that the following factors are also taken into account:

(a) the date on which the NOR was issued, and

(b) the response period within which the NOR should be issued, and

(c) the real event, circumstance or reason why the taxpayer failed to issue the NOR within the response period, and

(d) the taxpayer's compliance history in relation to the tax types under consideration (for example, has the taxpayer paid tax or filed a tax return or NOR late in the past?)

204. For example, a taxpayer issues a NOR to the Commissioner two days after the applicable "response period" has expired. The taxpayer does not provide a legitimate reason for the lateness. The taxpayer also has a history of filing late NORs within the minimal allowable lateness period (that is, up to two days outside the applicable "response period") and has been

advised on the calculation of the "response period" on more than one occasion.

205. Although the degree of lateness was minimal on each occasion, the Commissioner would not accept the taxpayer's NOR in this circumstance. This ensures that the section 89K(3)(b)(ii) exception is not treated as an extension of the "response period" in all circumstances.

206. The Commissioner will consider a taxpayer's application made under section 89K(1)(b) after receiving the relevant NOR or SOP. The responsible officer will document the reasons for accepting or rejecting the taxpayer's application and advise the taxpayer of their decision in writing within 15 working days after Inland Revenue receives the application.

207. The taxpayer must provide reasons to support their claim that exceptional circumstances exist under section 89K(3). The taxpayer should address the factors referred to in paragraph 203. If the reasons provided are unclear, the Commissioner may require further information and give the taxpayer an opportunity to provide that information before determining whether section 89K applies.

208. If the Commissioner rejects a taxpayer's application made under section 89K to treat a NOR or SOP as made within the response period, the taxpayer will be deemed to have accepted the proposed adjustment made in the Commissioner's NOPA. (Any decision that the Commissioner makes under section 89K is not a "disputable decision".)

Receipt of a taxpayer's notice of response

209. When Inland Revenue receives a taxpayer's NOR, it will usually be forwarded to the responsible officer within five working days after its receipt. Upon receipt, the responsible officer will ascertain and record the following:

(a) the date on which the NOR was issued, and

(b) whether the NOR has been issued within two months starting on the date that the Commissioner's NOPA is issued, and

(c) the salient features of the NOR including any deficiencies in its content.

210. Where it is practicable, the Commissioner will advise the taxpayer or their tax agent by telephone or in writing within 10 working days that Inland Revenue has received the NOR.

211. The Commissioner will make reasonable efforts to advise the taxpayer or their tax agent within one month after receiving the NOR whether the NOR is being considered or has been accepted, rejected in full or in part.

212. Where the NOR is accepted in full, the Commissioner will usually issue to the taxpayer written confirmation that the NOR has been accepted in full and, if applicable, a notice of assessment within one month after advising that the NOR is accepted.

213. If the Commissioner must investigate further before deciding to accept or reject a NOR, the responsible officer will regularly update the taxpayer or their agent on the progress of the further analysis or enquiry work that is undertaken.

Deficiencies in the content of the notice of response

214. Where Inland Revenue has received a NOR that it considers has deficiencies (that is, the requirements under section 89G(2) are not met), the responsible officer will take reasonable steps to make the taxpayer correct the information in the NOR before the response period expires.

215. The taxpayer will be advised as soon as practicable that the NOR is invalid unless rectified and the additional or correct information must be provided within the response period.

216. The taxpayer will also be advised when the response period expires and that those deficiencies must be rectified to validate the NOR by then or within the minimal lateness period allowed pursuant to section 89K(3)(a)(ii) (please see paragraph **201**) and whether the Commissioner intends to provide any additional information to the taxpayer.

217. Taxpayers are encouraged to issue their NOR immediately after they have completed it because they could have insufficient time to rectify any invalidities or deficiencies if the response period is due to expire.

218. If a taxpayer does not provide the correct information in respect of a deficient NOR before the response period expires, they will be deemed to have accepted the proposed adjustment under section 89H(1), unless any of the exceptional circumstances under section 89K applies. This will conclude the dispute and preclude the taxpayer's right to challenge the adjustments before the High Court or TRA.

Conference

Conduct of a conference

219. Generally, if a dispute remains unresolved after the NOR phase, the conference phase will follow. The Commissioner will usually initiate the conference phase in a timely manner, that is within one month after the taxpayer's NOR is received. However, the Commissioner will not seek to advance the disputes resolution process by commencing the conference phase before the taxpayer's NOR has been fully considered.

220. If the start of the conference phase is delayed (for example, to allow legal advice to be obtained) the responsible officer will keep the taxpayer informed regarding the progress of the conference. The suggested average time frame for the conference phase is three months. However, this time will vary depending on the facts and complexities of the specific cases.

221. A conference is not statutorily required. Rather, the conference phase is an administrative process that aims to clarify and, if possible, resolve the disputed issues. However, the conference phase should not be used by either party to the dispute for the purpose of delaying the completion of the disputes resolution process.

222. The conference should be conducted in a way that is sufficiently flexible and consistent with the taxpayer's wishes and any other relevant factors such as the scope of the investigation. The Commissioner will establish a time frame to meet with the taxpayer and their advisors and, sometimes, if necessary, Inland Revenue officers will meet with the taxpayer immediately after considering further information. Where appropriate the conference can be adjourned to allow the parties to reconsider the positions that they have taken in the dispute.

223. A conference can range from a telephone call to several face-to-face meetings between the parties. If the parties are relying on expert evidence the experts may also attend the conference. All discussions in the conference must be recorded or otherwise documented (to provide the best record of such discussions and promote the free flow of conversation) and a consensus reached if possible.

224. Any discussions between the parties in the conference can include an agreement on facts, common grounds on which the dispute can proceed, a time frame for completing the disputes resolution process and an agreed adjustment. Recordings of discussions can be made on audio or video tape, MP3 and CD recorders, the FTR Gold system or by using any other suitable audio or visual technology. Any negotiations between the parties after the "on record" discussion of the disputed issues during the conference will be treated as being on a without prejudice basis if an agreement is not reached.

225. When a dispute remains unresolved after the conference phase has been completed, the Commissioner must issue a disclosure notice together with a SOP pursuant to section 89M(3) without any unnecessary delay.

226. The conference phase is not necessarily complete just because the parties have held the final meeting. For example, the parties may need further information or to consider further submissions made at the meetings. This will dictate when the Commissioner issues a disclosure notice. Also, the parties can engage in further discussions during or after the SOP phase to attempt to resolve some or all of the disputed issues.

Legal and other advisers attending a conference

227. If a dispute is not settled earlier, the parties can obtain expert legal or other tax advice during the conference phase in addition to any legal or other advice previously obtained. These advisers can attend any meetings in relation to the dispute. The advisers may also revisit some items that the parties have previously discussed (but not agreed to in writing or otherwise accepted).

Conference not held or abridged

228. The Commissioner considers that the conference phase is an important part of the disputes resolution process and will always attend a conference if requested by the taxpayer. If the parties are not in the same location the conference can be held at a place that is convenient for both parties.

229. In some circumstances, the Commissioner will not hold further discussions or a conference, notwithstanding that the Commissioner has not reached an agreement with the taxpayer.

230. However, the disputes resolution process will not be finished, because the disclosure notice and SOP phases will still be undertaken. A dispute that is not resolved in the SOP phase will generally be referred to adjudication for determination.

231. A conference can be dispensed with or abridged in one or more of the following situations, if:

    (a) there are revenue losses incurred as a result of delaying tactics that the taxpayer used to frustrate the collection of tax and the completion of the disputes resolution process, or

(b) the Commissioner is satisfied that the taxpayer or their agent is acting in a frivolous or vexatious manner. For example, where the taxpayer or their agent is setting unreasonable demands about the time, place, or terms of such meeting(s), or conducts themselves unreasonably at any meeting, or

(c) the taxpayer contests the Commissioner's policy and it is agreed to disagree or that a conference would not benefit the parties, or

(d) the taxpayer advises the Commissioner that they want to dispense with the conference.

232. Where it is practicable, the Commissioner will advise the taxpayer or their tax agent of the decision regarding whether or not the conference phase will be dispensed with or abridged in writing within seven days of that decision being made. The reasons for the final decision must be documented.

Disclosure notice

233. The Commissioner must issue a disclosure notice under section 89M(1), unless the Commissioner:

(a) does not have to complete the disputes resolution process because any of the exceptions under section 89N(1)(c) apply (please see earlier discussion), or

(b) does not have to complete the disputes resolution process because the High Court has made an order that the dispute resolution process can be truncated pursuant to an application made by the Commissioner under section 89N(3), or

(c) has already issued to the taxpayer a notice of disputable decision that includes or takes into account the adjustment proposed in the NOPA pursuant to section 89M(2).

234. Pursuant to the definition in section 3(1), a disputable decision is:

(a) an assessment, or

(b) a decision that the Commissioner makes under a tax law, except for a decision:

(i) to decline to issue a binding ruling, or

(ii) that cannot be the subject of an objection or challenge, or

(iii) that is left to the Commissioner's discretion under sections 89K, 89L, 89M(8), (10) and 89N(3).

235. When issuing a disclosure notice the Commissioner must also provide to the taxpayer the Commissioner's SOP (as discussed below) and include in the disclosure notice a reference to section 138G and a statement regarding the effect of the evidence exclusion rule pursuant to section 89M(3).

236. The Commissioner will usually advise the taxpayer two weeks before issuing the disclosure notice and SOP that these documents will be issued to them.

237. Where practicable, the Commissioner will contact the taxpayer shortly after the disclosure notice and SOP are issued to ascertain whether the taxpayer has received these documents.

238. If the taxpayer has not received the Commissioner's disclosure notice, for example, due to a postal error or an event or circumstance beyond the taxpayer's control, the Commissioner will issue another disclosure notice to the taxpayer. In this circumstance, the response period within which the taxpayer must respond with their SOP will commence from the date that the Commissioner issued the initial disclosure notice.

239. Where the taxpayer cannot issue a SOP within the applicable response period, they may issue a late SOP with an explanation of why it is late. The Commissioner will consider the late SOP in terms of the discretion under section 89K(1). (Please see paragraphs 197 to 199 for further discussion.)

Evidence exclusion rule

240. A disclosure notice is the document that triggers the application of the evidence exclusion rule. The Commissioner must explain the effect of the evidence exclusion rule and refer to section 138G in the disclosure notice, because this is one of the guiding principles of the disputes resolution process (please see paragraph 260 for further discussion).

Issue of a disclosure notice

241. The Commissioner can issue a disclosure notice at any time on or after the date that either party issues their NOPA.

242. Usually, the Commissioner will issue a disclosure notice after receiving a NOR, following the conference phase and in accordance with the time line agreed with the taxpayer.

243. The Commissioner's practice is to issue a disclosure notice within three months after all enquiries are concluded and the conference phase has been completed.

244. However, at times the Commissioner cannot issue a disclosure notice where, for example, the relevant Inland Revenue officer is still collecting additional information or further investigating the taxpayer. The responsible officer must ensure that any information

gathering and investigative activity is not excessive and the disclosure notice is issued promptly once the information gathering or investigation is complete. The responsible officer will advise the taxpayer two weeks before issuing a disclosure notice that it will be issued to them.

245. In these circumstances, the relevant officer should use one of the relevant statutory provisions to obtain any information needed to complete the conference or disclosure notice and SOP phases to ensure that the disputes resolution process is conducted in a timely and efficient manner.

246. Where a disclosure notice is issued earlier (for example, the facts are clear, the taxpayer has agreed on the disputed issues or a conference is not required) the reasons must be documented and explained to the taxpayer.

247. When deciding whether to issue a disclosure notice before the conference phase has been completed, Inland Revenue officers must be aware that, if the taxpayer discloses any new or novel matters in their SOP, they only have two months to reply under section 89M(8) barring a High Court application before the two-month period expires. (Please see section 89M(10).)

Statement of position

248. Pursuant to section 89M(3), when the Commissioner commences the disputes resolution process, the Commissioner must issue a SOP to the taxpayer together with the disclosure notice.

249. When the disputed issue relates to a tax type that is subject to the statutory time bar (for example, income tax, GST, etc) that falls within the current income year, the parties will endeavour to complete the disputes resolution process before the time bar starts. The parties can agree to a statutory time bar waiver if they have issued a SOP to each other and there is insufficient time to complete the adjudication process.

250. However, if no such agreement is reached, section 89N(2)(b) allows the Commissioner to advance to the next stage if the Commissioner has considered the taxpayer's SOP and completed the compulsory elements of the disputes process. The Commissioner can amend the assessment by exercising the discretion under section 113.

251. Whether the Commissioner has adequately considered a SOP will depend on what is a reasonable length of time and level of analysis for that SOP given the circumstances of the case (for example, the length of the SOP and the complexity of the legal issues).

252. Thus a simple dispute could only take a couple of days to consider adequately while a complex dispute could take a few weeks. If the statutory time bar is imminent the Inland Revenue officer will consider the taxpayer's SOP urgently.

Contents of a SOP

253. Generally, the contents of a SOP are binding. This is because matters that proceed to court are subject to the "evidence exclusion rule" which limits the parties to the facts, evidence (excluding oral evidence), issues and propositions of law that either party discloses in their SOP unless a court order is made under section 138G(2) allowing new facts and evidence to be raised.

254. However, a mistaken description of facts, evidence, issues or propositions of law and submissions made in the SOP can later be amended if the parties agree to include additional information in the SOPs under section 89M(13).

255. Under section 89M(4) the SOP must be in the prescribed form (*IR 773 Statement of position*). The SOP must contain sufficient detail to fairly inform the taxpayer of the facts, evidence, issues and propositions of law that the Commissioner wishes to rely on.

256. The minimum content requirements for a SOP under section 89M(4) are an outline of the relevant facts, evidence, issues and propositions of law. However, to allow the Adjudication Unit to successfully reach a decision, the SOP must also contain full, complete and detailed submissions.

257. An outline that consists of a frank and complete discussion of the issues, law, arguments and evidence supporting the argument is implicit in the spirit and intent of the disputes resolution process. (In very complex cases a full explanation of the relevant evidence and summary of less relevant evidence will be accepted.)

258. The disputes resolution process does not require that relevant documents are discovered or full briefs of evidence or exhaustive lists of documents exchanged. Rather, providing an outline of relevant evidence in the SOP will ensure that both parties appreciate the availability of evidence in respect of the factual issues in dispute. The Commissioner should ensure that an outline of any expert evidence on which they intend to rely is included in the SOP.

259. Submissions made in the NOPA phase must be sufficiently concise to enable the parties to progress the dispute without incurring substantial expense. However, at the SOP phase, if the issues are unresolved and likely to proceed to a court for resolution, then full, complete and detailed submissions should be made.

260. Subject to section 138G(2), the evidence exclusion rule prevents the court considering arguments and evidence that are not included in:

(a) the SOP, or

(b) any additional information that:

(i) the Commissioner provides under section 89M(8), that is deemed to be part of the Commissioner's SOP under subsection (9), and

(ii) the parties provide pursuant to an agreement under section 89M(13), that is deemed to be part of the provider's SOP under subsection (14).

261. Section 89M(6B) reads:

> In subsection 4(b) and 6(b), evidence refers to the available documentary evidence on which the person intends to rely, but does not include a list of potential witnesses, whether or not identified by name.

262. Pursuant to section 89M(6B), only documentary evidence and not potential witnesses must be listed in the SOP. Any witnesses' identities will continue to be protected without undermining the effect of the evidence exclusion rule.

263. If the SOP discusses shortfall penalties it must also state any other appropriate penalties of lesser percentages and shortfall penalty reductions (for example, voluntary disclosure or previous behaviour reductions) as alternative arguments. This ensures that the appropriate penalties are assessed in all cases. However, the Commissioner cannot propose shortfall penalties at the SOP phase that have not previously been proposed in the Commissioner's NOPA.

Receipt of a taxpayer's SOP in response

264. Where the Commissioner has issued a disclosure notice and SOP, the taxpayer must, subject to section 89M(11), issue a SOP within the two-month response period that starts on the date that the disclosure notice was issued.

265. Therefore, the Commissioner cannot consider a document that the taxpayer purports to issue as a SOP before the Commissioner has issued the disclosure notice because it will not have been issued within the response period. The taxpayer should resubmit this document after the disclosure notice is issued.

266. Pursuant to section 89M(11), the taxpayer can apply to the High Court within the response period for more time to reply to the Commissioner's SOP. The taxpayer must show that they had not previously discussed the disputed issue with the Commissioner and, thus, it is unreasonable to reply to the Commissioner's SOP within the response period.

267. The Commissioner will make a reasonable effort to contact the taxpayer or their tax agent two weeks before the response period expires to determine whether the taxpayer will issue a SOP in response to the disclosure notice. Such contact can be made by telephone or in writing.

268. The taxpayer's SOP will be referred to the responsible officer within five working days after Inland Revenue receives it. Upon receipt, the responsible officer will ascertain and record the following:

(a) the date on which the SOP was issued, and

(b) whether the SOP has been issued within the relevant response period, and

(c) the SOP's salient features including any deficiencies in its content.

269. Where it is practicable, Inland Revenue will acknowledge the taxpayer's SOP as received within 10 working days after receiving it. However, the Commissioner will advise the taxpayer or their agent of any deficiencies in the SOP's content as soon as practicable.

270. A taxpayer who has issued a SOP outside the applicable response period can apply for consideration of exceptional circumstances under section 89K. The reasons for accepting or rejecting the application must be documented and the responsible officer will make reasonable efforts to advise the taxpayer of the decision in writing within 15 working days after Inland Revenue receives the taxpayer's application.

271. A taxpayer is deemed to have accepted the Commissioner's SOP if they do not reply to it with their own SOP within two months after the date that the disclosure notice is issued and none of the exceptional circumstances under section 89K apply. Where practicable, the Commissioner will usually advise the taxpayer that deemed acceptance has occurred within two weeks after the date that the response period for the disclosure notice expires.

The Commissioner's response

272. Pursuant to section 89M(8), the Commissioner can, within two months after the taxpayer's SOP is issued, provide to the taxpayer additional information in response to matters that they have raised in their SOP.

273. The Commissioner can only provide additional information in response to new or novel information or arguments that the taxpayer has raised in their SOP or agreed to add to their SOP under section 89M(13). The Commissioner cannot add further information simply because it was omitted from the Commissioner's SOP (for example, information that was received under a section 17 notice after the SOP was issued).

274. The additional information must be provided as far as possible in the same format as the SOP to which it relates (that is, in accordance with section 89M(4)). As mentioned above, the additional information can include documentary evidence but not lists of potential witnesses.

275. If the Commissioner intends to provide additional information to the taxpayer under section 89M(8), the Commissioner will usually advise the taxpayer or their tax agent of this within two weeks after the taxpayer's SOP is received. However, the timing of this advice can vary depending on the facts and complexity of the dispute. The additional information provided under section 89M(8) is deemed to be part of the Commissioner's SOP. Thus, the evidence exclusion rule under section 138G applies to the additional information.

276. The taxpayer cannot reply to the additional information that the Commissioner provides, unless the parties agree that additional information will be accepted under section 89M(13).

Agreement to include additional information

277. Either party can agree to include additional information in their SOP under section 89M(13) at any time during the disputes resolution process including after the dispute has been referred to the Adjudication Unit. Although there is no statutory time limit, the Commissioner's practice is to allow one month (from the date that the Commissioner provides additional information under section 89M(8)) for such an agreement to be reached and information provided.

278. However, before agreeing to a request made by the taxpayer under section 89M(13) the Commissioner will consider the taxpayer's prior conduct and whether they could have provided the information earlier through the application of due diligence.

279. The Commissioner will usually also consider the materiality and relevance of the additional information and its capacity to help resolve the dispute and may decide to take it into account in coming to an assessment. In this circumstance, both parties will be expected to cooperate in resolving the relevance and accuracy of any such material. The Commissioner may wish to apply resources to verification and comment and this will be considered by the adjudicator.

280. If a taxpayer's request to include additional information in their SOP is declined, the reasons must be documented with detailed reference to the taxpayer's conduct, level of cooperation before the request was made and why the information was not provided earlier. The responsible officer will also advise the taxpayer or their tax agent of the reasons why their request was declined.

281. Any agreement to add further information to the SOP will be made subject to the taxpayer agreeing that the Commissioner can include a response to the additional information to the SOPs, if required, within an agreed time frame.

282. Any additional information that the parties provide under section 89M(13) will be deemed to form part of the provider's SOP under section 89M(14). Thus, the evidence exclusion rule under section 138G applies to the additional information.

Preparation for adjudication

283. The Adjudication Unit is part of Inland Revenue's Office of the Chief Tax Counsel and represents the final step of the disputes resolution process. The adjudicator's role is to review unresolved disputes by taking a fresh look at a tax dispute and the application of law to the facts in an impartial and independent manner and provide a comprehensive and technically accurate decision that will ensure the correctness of the assessment.

284. Generally, the adjudicator will make such a decision within four months after the case is referred to the Adjudication Unit. However, this will depend on the number of disputes that are before the Adjudication Unit, any allocation delays and the technical, legal and factual complexity of those disputes. (For further information on the time frame for adjudication of disputes please see the article titled "Adjudication Unit – its role in the dispute resolution process" that was published in the Tax Information Bulletin Vol. 19, No. 10 (November 2007).)

285. The adjudication process is an administrative (rather than a legislative) one. Recent judicial comments have been made in *C of IR v Zentrum Holdings Limited and Another, Ch'elle Properties (NZ) Limited v CIR* (2004) 21 NZTC 18,618 and *ANZ National Bank Ltd and others v C of IR (No. 2)* (2006) 22 NZTC 19,835 indicating that, as a matter of law, it is not strictly necessary for Inland Revenue officers to send all disputes to the Adjudication Unit for review and Inland Revenue officers are not necessarily bound by the Adjudication Unit's decisions.

286. Notwithstanding the above judicial comments, if the parties have not agreed on all the issues at the end of the conference and disclosure phases or to truncate the disputes resolution process under section 89N(1)(c)(viii), it is the Commissioner's policy and practice that all disputes are to be sent to the Adjudication Unit for

review, irrespective of the complexity or type of issues or amount of tax involved unless any of the following exceptions arise:

(a) the Commissioner has considered the taxpayer's SOP for the purposes of section 89N(2)(b) and referred the dispute to the Adjudication Unit for their preliminary consideration and the Adjudication Unit has determined that it has insufficient time to reach a decision in respect of the dispute before a statutory time bar would prevent an assessment from being increased (please see paragraph 250 to 252 for further discussion), or

(b) any of the legislative exceptions specified in section 89N(1)(c) apply (please see paragraphs 146 to 188 for further discussion) so that the Commissioner can amend an assessment without first completing the disputes resolution process, or

(c) the High Court has made an order that the disputes resolution process can be truncated pursuant to an application made by the Commissioner under section 89N(3) (please see paragraphs 175 to 186 for further discussion).

287. The decision not to refer the case to adjudication must be made by an Inland Revenue officer with a senior level of authority in Service Delivery (for example, at the time of writing this SPS the delegation was with Assurance Manager level or above). In respect of the first exception mentioned in paragraph 286(a) it is necessary that the parties have exchanged a SOP and it is a matter solely for the Adjudication Unit to determine whether it has insufficient time to fully consider the dispute.

288. Thus, during the course of a dispute, the Commissioner can issue an amended assessment to the taxpayer, for example, if the parties have agreed under section 89N(1)(c)(viii) to abridge the adjudication phase. Furthermore, before the dispute is referred to the Adjudication Unit, the taxpayer can request that the Commissioner issues an amended assessment and then challenge that assessment under section 138B(1).

289. If the dispute is to be referred to the Adjudication Unit, the Commissioner should not issue an assessment or amended assessment before the adjudication process is completed unless a time bar is imminent. In this circumstance, the responsible officer will prepare a cover sheet that will record all the documents that must be sent to the Adjudication Unit.

290. The cover sheet together with copies of the documents (NOPA, NOR, notice rejecting the NOR, conference notes, both parties' SOP, additional information, material evidence including expert opinions and a schedule of all evidence held) and any recordings of discussions held during the conference must be sent to the Adjudication Unit.

291. If the dispute is to be referred to adjudication, the responsible officer will issue a letter together with a copy of the cover sheet to the taxpayer before sending the submissions, notes and evidence to the Adjudication Unit. The cover sheet and letter are usually completed within one month after the date that the Commissioner's reply to the taxpayer's SOP (if any) is issued or the response period for the taxpayer's SOP expires.

292. The purpose of this letter is to seek concurrence on the materials to be sent to the adjudicator – primarily in regard to documentary evidence that has been disclosed at the SOP phase. This letter will allow no more than 10 working days for a response.

293. Once the taxpayer has concurred on the materials to be sent to the Adjudication Unit, those materials will be so forwarded. However, if no response is received from the taxpayer the materials will be forwarded after the 10 working days allowed for the taxpayer's response have elapsed. The adjudicator may also contact the parties after the initial materials have been received to obtain further information.

294. Where an investigation has covered a number of issues, the cover sheet will outline any issues that the parties have agreed upon and any issues that are still disputed. The adjudicator will only consider the disputed issues and not those issues that have been agreed upon.

295. Generally, the adjudicator only considers the materials that the parties have submitted. They do not usually seek out or consider further information, unless it is relevant. The adjudicator may consider such additional information notwithstanding that the parties have not agreed that the provider can include this information in their SOP under section 89M(13).

296. However, any additional material that the parties have not disclosed in their SOP (or agreed to include in their SOP under section 89M(13)) cannot later be raised as evidence in court because the evidence exclusion rule in section 138G(1) will apply (as discussed in paragraphs 260 to 262).

Adjudication decision

297. Once a conclusion is reached, the Adjudication Unit will advise the taxpayer and responsible officer of the decision. The responsible officer will implement any of the Adjudication Unit's decisions and follow up procedures where required including issuing a notice of assessment to the taxpayer where applicable.
298. Where the Adjudication Unit makes a decision against the Commissioner, the Commissioner is bound by and cannot challenge that decision. The dispute will come to an end.
299. Where the Adjudication Unit makes a decision against the taxpayer, they can challenge the assessment (whether made by the Commissioner or taxpayer) or disputable decision if they are within the applicable response period.
300. If the Commissioner has commenced the disputes resolution process, the taxpayer, if disagreeing with the adjudicator's decision and any later notice of assessment or amended assessment that is issued, can file proceedings in the general jurisdiction of the TRA or the High Court if any of the following conditions under section 138B(1) is met:
    (a) the assessment includes an adjustment that the Commissioner has proposed and the taxpayer has rejected within the response period, or
    (b) the assessment is an amended assessment that imposes a fresh or increases an existing liability.
301. A taxpayer can also challenge an assessment that the Commissioner issues before the dispute goes through the adjudication process (for example, when an exception under section 89N(1)(c) applies).
302. The taxpayer must file proceedings with the TRA or High Court within the two-month response period that starts on the date that the Commissioner issues the notice of assessment or amended assessment.
303. If applicable, the responsible officer will implement any decision made by the hearing authority and follow up procedures where required including issuing a notice of assessment or amended assessment to the taxpayer.

This Standard Practice Statement is signed on 13 June 2008.

Graham Tubb
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Legal and Technical Services

SPS 08/02: DISPUTES RESOLUTION PROCESS COMMENCED BY A TAXPAYER

Introduction

1. This Standard Practice Statement ("SPS") discusses a taxpayer's rights and responsibilities in respect of an assessment or other disputable decision when the taxpayer commences the disputes resolution process.
2. Where the Commissioner commences the disputes resolution process, the Commissioner's practice is stated in *SPS 08/01: Disputes resolution process commenced by the Commissioner of Inland Revenue*.
3. This SPS has been updated due to changes made to the law under:
   (a) the Taxation (Base Maintenance and Miscellaneous Provisions) Act 2005
   (b) the Taxation (Savings Investment and Miscellaneous Provisions) Act 2006
   (c) the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006
   (d) the Taxation (Business Taxation and Remedial Matters) Act 2007
   (e) the relevant case law decided since *SPS 05/04: Disputes resolution process commenced by a taxpayer* was published.
4. The Commissioner regards this SPS as a reference guide for taxpayers and Inland Revenue officers. Where possible, Inland Revenue officers must follow the practices outlined in this SPS.

Application

5. This SPS applies to a dispute commenced on or after 9 June 2008 or in the case of a dispute involving Goods and Services Tax ("GST") to a GST return period that ends on or after 31 March 2007. *SPS 05/04: Disputes resolution process commenced by a taxpayer* continues to apply from its commencement date up to 9 June 2008.
6. Unless specified otherwise, all legislative references in this SPS refer to the Tax Administration Act 1994 ("TAA").

Background

7. The tax dispute resolution procedures were introduced in accordance with the recommendations of the Richardson Committee in the *Report of the Organisational Review of the Inland Revenue Department* (April 1994) and were designed to reduce the number of disputes by:
   (a) promoting full disclosure
   (b) encouraging the prompt and efficient resolution of tax disputes
   (c) promoting the early identification of issues
   (d) improving the accuracy of decisions.
8. The disputes resolution process ensures that there is full and frank communication between the parties in a structured way within strict time limits for the legislated phases of the process.
9. The disputes resolution process is designed to encourage an "all cards on the table" approach and the resolution of issues without the need for litigation. It aims to ensure that all the relevant evidence, facts and legal arguments are canvassed before a case goes to court.
10. The disputes resolution process was introduced in 1996 and reviewed in July 2003. There have been changes made to the disputes resolution process following recent legislative amendments and case law since 2005.
11. The early resolution of a dispute is intended to be achieved through a series of steps specified in the TAA. The main elements of those steps are the issue of:
   (a) A notice of proposed adjustment ("NOPA"): this is a notice that either the Commissioner or taxpayer issues to the other advising that an adjustment is sought in relation to the taxpayer's assessment, the Commissioner's assessment or other disputable decision (the requisite form is the *IR 770 Notice of proposed adjustment*).
   (b) A notice of response ("NOR"): this must be issued by the recipient of a NOPA if they disagree with it (the preferred form is the *IR 771 Notice of response*).
   (c) A notice rejecting the Commissioner's NOR: this must be issued by the taxpayer if they disagree with the Commissioner's NOR (there is no prescribed form for a notice rejecting the Commissioner's NOR).
   (d) A disclosure notice and statement of position ("SOP"): the issue of a disclosure notice by the Commissioner triggers the issue of a SOP. Each SOP must provide an outline of the facts, evidence, issues and propositions of law with sufficient details to support the positions taken. Each party must issue a SOP (the requisite form is the *IR 773*

Statement of position). The SOPs are important documents because they limit the facts, evidence, issues and propositions of law that either party can rely on if the case proceeds to court to what is included in the SOPs (unless a hearing authority makes an order that allows a party to raise new facts or evidence under section 138G(2)).

12. There are also two administrative phases in the process – the conference and adjudication phases. If the dispute has not been already resolved after the NOR phase, the Commissioner's practice will be to hold a conference, unless the parties agree to abridge the conference phase (please see paragraphs 180 to 183 of this SPS). A conference can be a formal or informal discussion between the parties to clarify and, if possible, resolve the issues.

13. If the dispute remains unresolved after the SOP phase, the Commissioner will refer the dispute to adjudication, except in certain circumstances. Adjudication involves Inland Revenue independently considering a dispute and is the final phase in the process before the taxpayer's assessment is amended (if it is to be amended) following the exchange of the SOPs.

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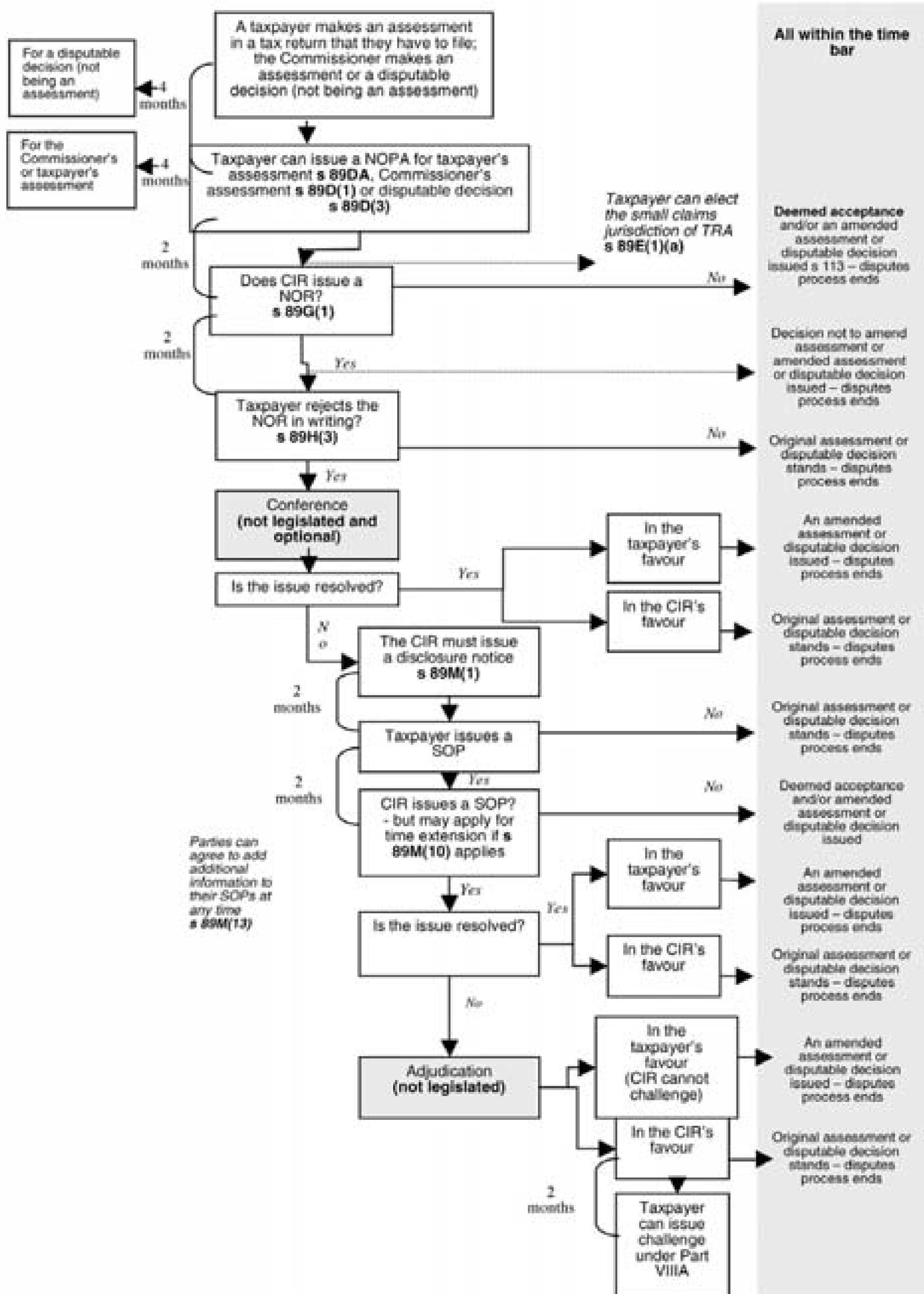
The disputes resolution process is set out in the following diagram.

Disputes resolution process commenced by a taxpayer



STANDARD PRACTICE STATEMENTS

Summary of key actions and indicative administrative time frames

14. Set out below is a summary of the key actions and administrative time frames where a disputes resolution process is commenced by a taxpayer.

15. These key actions and time frames are intended to be administrative guide lines for Inland Revenue officers. Any failure to meet these administrative time frames will not invalidate subsequent actions of the Commissioner or prevent the case from going through the disputes resolution process.

Paragraph in the SPS	Key actions	Indicative time frames
	The taxpayer's NOPA	
32, 37, 54, 65 and 70	A taxpayer's response period for issuing a NOPA in respect of an assessment or other disputable decision.	Within four months from the date that the assessment or other disputable decision is issued.
83	A taxpayer's response period for issuing a NOPA that relates solely to a research and development tax credit in respect of a notice of disputable decision or notice revoking or varying a disputable decision issued by the Commissioner.	Within one year that starts on the date that the Commissioner issues a notice of disputable decision or notice revoking or varying a disputable decision that is not an assessment.
86	A taxpayer's response period for issuing a NOPA that relates solely to a research and development tax credit in a notice of assessment that they have issued if they are a single person for the purpose of section 68D.	Within the period that ends two years (for an assessment that relates to the 2008–09 and 2009–10 income years) or one year (for an assessment that relates to the 2010–11 and later income years) after the date that the Commissioner receives the taxpayer's assessment.
86(b)	A taxpayer's response period for issuing a NOPA that relates solely to research and development tax credits in a notice of assessment that they have issued if they are a member of an ISDG or partner of a partnership that chooses to apply section 68E for the 2008–09 and later income years.	Within the period that starts on the date on which the Commissioner receives the taxpayers' assessment and ends two years (for an assessment that relates to the 2008–09 and 2009–10 income years) or one year (for an assessment relating to the 2010–11 and later income years) after the latest date that the taxpayer can provide an income tax or joint income tax return.
118	The Commissioner forwards and assigns the taxpayer's NOPA to the responsible officer.	Usually within five working days after the taxpayer's NOPA is received.
120	The Commissioner acknowledges the receipt of the taxpayer's NOPA (either by telephone or in writing).	Usually within 10 working days after the taxpayer's NOPA is received.
121	The Commissioner advises that the taxpayer's NOPA is invalid, but the applicable response period has not expired.	Immediately after the Inland Revenue officer becomes aware of the invalidity.
123	The Commissioner advises the taxpayer in writing that their NOPA is invalid and they have not rectified the invalidity within the applicable response period.	Usually within 15 working days after the date that the response period for issuing a taxpayer's NOPA expires.
134	The Commissioner considers the application of "exceptional circumstances" under section 89K, where a taxpayer's NOPA has been issued outside the applicable response period.	Usually within 15 working days after receiving the taxpayer's application.
	The Commissioner's NOR	
146	The Commissioner advises the taxpayer (either by telephone or in writing) whether the Commissioner intends to issue a NOR.	Usually within 10 working days before the response period for the taxpayer to issue a NOPA expires.
146	The Commissioner has issued and the taxpayer has received a NOR.	Within two months starting on the date that the taxpayer's NOPA is issued.
	The taxpayer's written rejection of the Commissioner's NOR	
165	The Commissioner confirms whether the taxpayer will reject the Commissioner's NOR.	Usually two weeks before the response period for the Commissioner's NOR expires.
162	The taxpayer rejects the Commissioner's NOR in writing.	Within two months after the date that the Commissioner's NOR is issued.
168	Inland Revenue forwards the taxpayer's rejection of the Commissioner's NOR to the responsible officer.	Usually within five working days after receiving the taxpayer's rejection.
168	The Commissioner acknowledges receipt of the taxpayer's rejection of the Commissioner's NOR.	Usually within 10 working days after receiving the taxpayer's rejection.
169	The taxpayer is deemed to accept the Commissioner's NOR, because they have failed to reject it within the applicable response period and none of the "exceptional circumstances" apply.	Two months after the response period for the Commissioner's NOR has expired.
	Conference phase	
171	The Commissioner contacts the taxpayer to initiate the conference phase.	Conferences usually commence within one month after the Commissioner receives the taxpayer's rejection of the Commissioner's NOR. The suggested average time frame of the conference phase is three months, subject to the facts and complexity of the dispute.
183	The Commissioner communicates the decision not to hold, or abridge any conference, which must be documented in writing and conveyed by the Commissioner or agent.	Usually within five working days after the date of the Commissioner's decision.
	Disclosure notice	
186	The Commissioner advises the taxpayer that a disclosure notice will be issued.	Usually within two weeks before the date that the disclosure notice is issued.
	Taxpayer's SOP	
199	The taxpayer must issue a SOP within the response period for the disclosure notice.	Within two months after the date that the disclosure notice is issued, unless any of the "exceptional circumstances" under section 89K apply.
213	The Commissioner confirms whether the taxpayer will issue a SOP.	Usually 10 working days before the response period for the disclosure notice expires.
213	The Commissioner forwards the taxpayer's SOP to the responsible officer.	Usually within five working days after the taxpayer's SOP is received
215	The Commissioner acknowledges the receipt of the taxpayer's SOP.	Usually within 10 working days after the taxpayer's SOP is received.
215	The Commissioner advises that the taxpayer's SOP is invalid, but the two-month response period has not expired.	Inland Revenue officers will advise the taxpayer or their agent as soon as they become aware of the invalidity.
215	The Commissioner considers whether "exceptional circumstances" under section 89K apply, where the taxpayer has issued a SOP outside the applicable response period.	Usually within 15 working days after the taxpayer's application is received.
216	The dispute is treated as if it was never commenced, if the taxpayer fails to issue a SOP within the applicable response period and none of the "exceptional circumstances" apply.	Usually 10 working days after the response period for the disclosure notice expires.
	The Commissioner's SOP	
218	The Commissioner issues a SOP in response to the taxpayer's SOP.	Within two months after the date that the taxpayer's SOP is issued, unless an application has been made to the High Court under section 89M(11).
	The Commissioner's addendum	
224	The Commissioner provides additional information via addendum to the Commissioner's SOP within the response period for the taxpayer's SOP.	Where applicable, within two months after the date that the taxpayer's SOP is issued.
228	The Commissioner considers a taxpayer's request to include additional information in the SOP	Usually within one month after the date that the Commissioner's SOP or addendum is issued.
	Adjudication	
241	The Commissioner prepares a cover sheet and issues a letter (with a copy of the cover sheet) to the taxpayer to seek concurrence on the materials to be sent to the adjudicator.	Usually within one month after the date that the Commissioner's addendum (if any) or the response period for the taxpayer's SOP expires.
242	The taxpayer responds to the Commissioner's letter.	Within 10 working days after the date that the letter is issued.
243	The Commissioner forwards materials relevant to the dispute to the Adjudication Unit.	Usually when the Commissioner receives the taxpayer's response or within 10 working days after the date that the Commissioner's letter is issued.
	Adjudication of the disputes case.	Usually four months after the date that the Adjudication Unit receives the disputes files, depending on the number of disputes that are before the Adjudication Unit, any allocation delays and the technical, legal and factual complexity of those disputes.
	The taxpayer can file challenge proceedings under section 138B in respect of an assessment or amended assessment.	Within two months after the assessment or amended assessment is issued.

Standard practice and analysis

Assessment

Taxpayer's assessment

16. Section 92(1) reads:

    A taxpayer who is required to furnish a return of income for a tax year must make an assessment of the taxpayer's taxable income and income tax liability and, if applicable for the tax year, the net loss, terminal tax or refund due.

17. Section 92(1) applies to tax on income derived in:
    (a) the 2005–06 and later tax years for a taxpayer whose income year matches the tax year, and
    (b) the corresponding income year for a taxpayer whose income year is different from the 2005–06 and later tax years.

18. If a taxpayer has to file an income tax return they must make an assessment of their taxable income and income tax liability and, if applicable, the net loss, terminal tax or refund due. The definition of disputable decision in section 3(1) includes an assessment made by a taxpayer.

19. Similar requirements apply to a taxpayer who must file a GST return under the Goods and Services Tax Act 1985 ("the GST Act"). For a GST return period that begins on or after 1 April 2005, the taxpayer must make an assessment of the amount of GST payable. Section 92B(1) reads:

    A taxpayer who is required under the Goods and Services Tax Act 1985 to provide a GST tax return for a GST return period must make an assessment of the amount of GST payable by the taxpayer for the return period.

20. Pursuant to sections 92(2) and 92B(2) the assessment date for an income tax or GST assessment made by a taxpayer is the date that Inland Revenue receives the taxpayer's tax return.

21. However, under section 92B(3) for a GST assessment and section 92(6) for an income tax assessment, a taxpayer cannot make an assessment of the amount of tax payable for a return period in their tax return if the Commissioner has previously made an assessment of the tax that is payable for that return period. This is commonly known as a "default assessment" and involves the Commissioner making a default determination that estimates the taxpayer's tax liability (for example, if they have missed a return filing deadline).

22. For further discussion regarding how a taxpayer can dispute a default assessment please see paragraphs 37 to 49. Any later amendment to a default assessment must be the Commissioner's assessment made under section 113. The Commissioner can make any such amendment on the basis of the information provided in the taxpayer's tax return and treat that return as a record of the taxpayer's assertion of their tax liability.

23. When the taxpayer's assessment is received, the Commissioner's practice is to stamp, either electronically or manually, the tax return with the date of receipt. This date is then entered into Inland Revenue's computerised database and a return acknowledgment form is sent to the taxpayer or agent. This practice ensures that the taxpayer will have a clear record of when their assessment was made.

The Commissioner's assessment

24. Notwithstanding section 92(1) and subject to the statutory time bar in sections 108 and 108A, the Commissioner can sometimes issue a notice of assessment to a taxpayer.

25. The Commissioner cannot make an assessment without first issuing a NOPA to a taxpayer, unless an exception under section 89C to the requirement for issuing a NOPA applies.

26. For example, under section 6A, the Commissioner settles challenge proceedings in the Taxation Review Authority ("TRA") and a disputes resolution process commenced by the taxpayer. The Commissioner enters into an individual settlement deed and agreed adjustment with the taxpayer to confirm the settlement. The Commissioner will apply section 89C(d) and give effect to the settlement deed and agreed adjustment by issuing an assessment to the taxpayer under section 89J(1) without first issuing a NOPA. In this circumstance section 89J(1) prevents the parties from further disputing the previously agreed adjustment.

27. The exceptions under section 89C are explained in the Commissioner's practice as stated in *SPS 08/01: Disputes resolution process commenced by the Commissioner of Inland Revenue*. (The Commissioner must ensure that any assessment is made in accordance with section 89C. However, if, on a rare occasion, an assessment was made in breach of section 89C, it will still be regarded as being valid under section 114(a)).

28. If the Commissioner issues an assessment without first issuing a NOPA, the taxpayer can issue a NOPA to the Commissioner under section 89D(1) or challenge proceedings under section 138B(3) in respect of that assessment.

Notice of proposed adjustment issued by the taxpayer

Six situations where a taxpayer can issue a NOPA

29. A taxpayer can issue a NOPA to the Commissioner in the following six situations:

Situation 1: NOPA in respect of the Commissioner's assessment

30. Section 89D(1) reads:

    If the Commissioner–

    (a) Issues a notice of assessment to a taxpayer; and

    (b) Has not previously issued a notice of proposed adjustment to the taxpayer in respect of the assessment, whether or not in breach of section 89C,–

    the taxpayer may, subject to subsection (2); issue a notice of proposed adjustment in respect of the assessment.

31. When the Commissioner issues to a taxpayer a notice of assessment that does not relate to a "default assessment" (as discussed in paragraph 21) without first issuing a NOPA, the taxpayer can issue to the Commissioner for receipt a NOPA in respect of the assessment. A taxpayer's response to a default assessment is discussed under the heading **Situation 2: NOPA in respect of the Commissioner's default assessment.**

32. A taxpayer's NOPA is not an assessment. It is an initiating action that allows open and full communication between the parties. A NOPA forms a basis for ensuring that the Commissioner does not issue an assessment without some formal and structured dialogue with the taxpayer in respect of the grounds upon which the Commissioner is issuing any assessment or amended assessment (*McIlraith v CIR* (2007) 23 NZTC 21,456).

33. If the Commissioner has issued an assessment the taxpayer can issue a NOPA under section 89D(1) in respect of any of the considerations that were relevant to making the assessment. This could include preliminary decisions which are necessary to make the assessment, for example, a decision made by the Commissioner under section 89C (*MR Forestry (No 1) Trust Ltd v CIR* (2006) 22 NZTC 19,954).

34. The taxpayer must issue the NOPA within the applicable "response period" as defined in section 3(1). Generally, this will be within the four-month period that starts on the date that the Commissioner issues the assessment unless the Commissioner accepts a late NOPA under section 89K(1). However, this response period is subject to the exception discussed in **Situation 6: NOPA that relates solely to a research and development tax credit.**

35. For example, if the Commissioner's notice of assessment is issued on 7 April 2008, under section 89D(1) the taxpayer must issue a NOPA in the prescribed form in respect of the assessment on or before 6 August 2008.

36. The taxpayer's right to issue a NOPA under section 89D(1) is unaffected, even if, in a very rare circumstance, the Commissioner made the assessment in breach of section 89C. The assessment will be deemed to be valid under section 114(a).

Situation 2: NOPA in respect of the Commissioner's default assessment

Default assessment that does not relate to GST

37. If a taxpayer has not filed a tax return, the Commissioner can make a default assessment under section 106(1) without first issuing a NOPA to the taxpayer.

38. Section 89D(2) reads:

    A taxpayer who has not furnished a return of income for an assessment period may dispute the assessment made by the Commissioner only by furnishing a return of income for the assessment period.

39. A taxpayer that intends to dispute a default assessment through the disputes resolution process must:

    (a) pursuant to section 89D(2) provide a tax return for the period to which the default assessment relates notwithstanding that the tax return cannot include the taxpayer's assessment (section 89D(2A)), and

    (b) issue a NOPA to the Commissioner in respect of the default assessment within the applicable response period. Generally, this will be within the four-month period that starts on the date that the Commissioner issues the default assessment.

GST default assessment

40. Similar rules apply to a NOPA that a taxpayer issues in respect of a GST default assessment.

41. Section 89D(2C) reads:

    A taxpayer who has not provided a GST tax return for a GST return period may not dispute the assessment made by the Commissioner other than by providing a GST return for the GST return period.

42. Where a taxpayer has not filed a GST return, the Commissioner can make a GST default assessment without first issuing a NOPA to the taxpayer.

43. If a taxpayer wants to dispute a GST default assessment through the disputes resolution process, they must:

(a) provide a GST return for the periods to which the GST default assessment relates pursuant to section 89D(2C) for return periods beginning on or after 1 April 2005, notwithstanding that the tax return cannot include the taxpayer's assessment (section 89D(2D)), and

(b) issue a NOPA to the Commissioner in respect of the GST default assessment,

within the applicable response period. That is, within four months from the date that the default assessment is issued.

44. The legislative requirement to provide a tax return in respect of a default assessment made by the Commissioner under section 106(1) when issuing a NOPA is an additional requirement of the disputes resolution process. This ensures that the taxpayer has provided the requisite statutory information before they dispute the assessment.

45. If the Commissioner agrees with the taxpayer's NOPA and tax return, the Commissioner will amend the default assessment by exercising the discretion under section 113 subject to the statutory time bar in section 108 and any other relevant limitations on the exercise of that discretion.

46. However, if the Commissioner disagrees with the taxpayer's tax return and NOPA the Commissioner cannot amend the default assessment. Instead, the Commissioner must issue a NOR to the taxpayer within the relevant response period to continue the disputes resolution process.

47. The taxpayer cannot commence a dispute or challenge proceedings in a hearing authority by simply filing the tax return to which the default assessment relates. If the taxpayer does not want to enter the disputes resolution process they should not issue a NOPA with their tax return.

48. If a NOPA is not issued, the Commissioner cannot be compelled to amend the default assessment on receipt of the taxpayer's tax return. However, the Commissioner will amend the assessment under section 113 on the basis of the information provided in the tax return subject to the statutory time bar in section 108 and any other relevant limitations on the exercise of that discretion if this would ensure that the assessment was correct. (Please see *SPS 07/03: Requests to amend assessments* for further details.) Any amended assessment must be treated as the Commissioner's assessment in this circumstance.

49. The Commissioner can decide not to amend the default assessment by exercising the discretion under section 113 on the basis of the tax return provided. For example, if the Commissioner considers that the taxpayer's tax position is incorrect. In this circumstance, the Commissioner can dispute the default assessment by issuing a NOPA in respect of the taxpayer's tax return under section 89B(1).

Situation 3: NOPA in respect of a deemed assessment made under section 80H

50. Section 89D(2B) reads:

> A taxpayer to whom section 80F applies who has not furnished an amended income statement for an assessment period may dispute a deemed assessment under section 80H only by furnishing an amended income statement for the assessment period.

51. Section 89D(2B) applies to a taxpayer who derives income solely from salary, wages, interest and dividends and who will receive an income statement from the Commissioner under section 80D(1).

52. Generally, where the taxpayer considers that the income statement is incorrect, they must advise the Commissioner of the reasons and provide the relevant information to correct the income statement under section 80F(1). This must be done within the statutory time limit. That is, the later of:

(a) the taxpayer's terminal tax date for the tax year to which the income statement relates, and

(b) two months after the date that the income statement is issued.

53. If the taxpayer does not provide the relevant information within the statutory time limit, they will be treated as having filed a tax return under section 80G(2) and made an assessment under section 80H in respect of that income statement. In this case, the date of the deemed assessment under section 80H will be the date that the statutory time limit under section 80F expires.

54. Pursuant to section 89D(2B), the taxpayer cannot issue to the Commissioner a NOPA in respect of the deemed assessment made under section 80H without first satisfying their statutory obligation to file an amended income statement for the assessment period.

55. If a taxpayer wants to dispute a deemed assessment under section 80H, they must:

(a) provide an amended income statement for the assessment period, and

(b) issue a NOPA to the Commissioner in respect of the assessment within the applicable response period (that is, four months after the date that the deemed assessment is issued.)

Situation 4: NOPA in respect of a disputable decision that is not an assessment

56. Under section 89D(3) a taxpayer can issue a NOPA in respect of a disputable decision that is not an assessment. Section 89D(3) reads:

    If the Commissioner–

    (a) Issues a notice of disputable decision that is not a notice of assessment; and

    (b) The notice of disputable decision affects the taxpayer, –

    the taxpayer, or any other person who has the standing under a tax law to do so on behalf of the taxpayer, may issue a notice of proposed adjustment in respect of the disputable decision.

57. For the purpose of section 89D(3) a person with standing under a tax law to issue a NOPA on behalf of the taxpayer includes a tax advisor and an approved advisor group. 8

58. Section 3(1) defines a "disputable decision" to include:

    (b) A decision of the Commissioner under a tax law, except for a decision –

    (i) To decline to issue a binding ruling under Part VA; or

    (ii) That cannot be the subject of an objection under Part VIII; or

    (iii) That cannot be challenged under Part VIIIA; or

    (iv) That is left to the Commissioner's discretion under sections 89K, 89L, 89M(8) and (10) and 89N(3).

59. A "decision of the Commissioner under a tax law" generally refers to a tax law that specifically confers a discretion or power on the Commissioner. Paragraph (b)(iii) excludes from the definition of "disputable decision" any decision that cannot be challenged under Part VIIIA.

60. For example, if the Commissioner:

    (a) does not exercise the discretion under section 113 to amend a taxpayer's income tax assessment, or

    (b) makes a decision under section 108A(3) regarding the application of the time bar, or

    (c) does not agree to a time bar waiver under section 108B,

    section 138E(1)(e)(iv) (within Part VIIIA) provides that this decision cannot be challenged and, therefore, is not a disputable decision for the purposes of section 89D(3). However, under section 89D(1), the taxpayer can issue a NOPA in respect of the initial assessment within the applicable response period if the Commissioner has not previously issued a NOPA in respect of that assessment.

61. A decision made by the Commissioner under section 108(2) (to increase an assessment) is not of itself, and in the absence of an assessment, a disputable decision. Any challenge to the correctness of the decision must be brought in the context of a challenge to the assessment itself (*Vinelight Nominees Ltd & Anor v Commissioner of Inland Revenue* (No 2) (2005) 22 NZTC 19,519).

62. Paragraph (b)(iv) of the definition of "disputable decision" in section 3(1) also excludes any decision that is left to the Commissioner's discretion arising under sections 89K, 89L, 89M(8), (10) and 89N(3). For example, the Commissioner:

    (a) does not exercise the discretion under section 89K(1) in respect of a NOPA that a taxpayer has issued outside the applicable response period. This decision to not exercise the discretion in the taxpayer's favour is not a disputable decision.

    (b) provides the taxpayer with additional information under section 89M(8) after receiving their SOP. The decision to provide this additional information is not a disputable decision.

63. The exceptions specified in paragraph (b) of the definition of "disputable decision" ensure that only substantive issues are disputed as disputable decisions and the procedural components of the disputes resolution process do not, in themselves, give rise to disputes although they may be amenable to judicial review.

64. The following examples illustrate what is a disputable decision:

    (a) a taxpayer who is a natural person can dispute the Commissioner's decision made under section YD 1 of the Income Tax Act 2007 ("ITA 2007") that they are a New Zealand resident for taxation purposes.

    (b) under section RD 3(5) of the ITA 2007, the Commissioner can determine whether, and to what extent, a payment is subject to PAYE. This determination cannot be challenged by the taxpayer and, therefore, is excluded from the definition of "disputable decision" under section 3(1)(b)(iii). However, an employer or employee can dispute an assessment of tax deductions on the basis that a section RD 3(5) determination on which it is founded is wrong in fact or law.

65. The taxpayer must issue the NOPA to the Commissioner within the applicable response period. Generally, this will be within the four-month period that starts on the date that the Commissioner issues

the notice of disputable decision or notice revoking or varying a disputable decision that is not an assessment unless the Commissioner allows a late NOPA under section 89K(1).

Situation 5: NOPA in respect of a taxpayer's assessment

66. Section 89DA(1) reads:

> A taxpayer may issue a notice of proposed adjustment in respect of an assessment made by the taxpayer for a tax year or a GST return period if the Commissioner has not previously issued a notice of proposed adjustment to the taxpayer in respect of the assessment.

67. Section 89DA(1) applies to tax on income derived in:
    (a) the 2005–06 and later income years for a taxpayer whose income year is the same as the tax year, and
    (b) the corresponding income year for a taxpayer whose income year is different from the 2005–06 and later tax years.

    For tax on income derived in the 2002–03 to 2005–06 income years please see the discussion in *SPS 05/04: Disputes resolution process commenced by a taxpayer*.

68. If a taxpayer needs to file an income tax return they must also make an assessment of their taxable income and income tax liability under section 92(1) unless the Commissioner has previously made an assessment for that tax year (section 92(6)).
69. Section 89DA(1) also applies to a taxpayer's GST assessment for a return period that begins on or after 1 April 2005. A taxpayer who has to file a GST return must also make an assessment of the amount of GST payable for the return period under section 92B(1).
70. Pursuant to section 89DA(1), a taxpayer can issue to the Commissioner a NOPA in respect of their own tax assessment.
71. The taxpayer's NOPA must be issued within the applicable response period as defined in section 3(1). Generally, this will be within the four-month period that starts on the date the Commissioner receives the taxpayer's assessment unless the Commissioner allows a late NOPA under section 89K(1).
72. The date that the Commissioner receives the taxpayer's assessment will be determined under section 14B. For example, under section 14B(8) the Commissioner will receive a NOPA that the taxpayer sends by post on the date it would have been delivered in the ordinary course of post.

Proposed adjustment – input tax credit

73. If a taxpayer receives a taxable supply and does not claim an input tax deduction under section 20(3) of the GST Act, they have several options.
74. Firstly, the taxpayer (registered person) can claim an input tax deduction in a later GST return period under section 20(3) of the GST Act within the applicable two-year period. Pursuant to paragraph (a) of the proviso to section 20(3) of the GST Act (appearing after paragraph (i) of the section), the two-year period is calculated from the earlier of the date that:
    (a) a payment is made for the taxable supply to which the input tax credit relates, and
    (b) a tax invoice in relation to that taxable supply is issued.
75. However, pursuant to the proviso to section 20(3) of the GST Act, the taxpayer can have unlimited time to claim the input tax credit if their failure to make the deduction under that section arises from one of the following reasons:
    (a) their inability to obtain a tax invoice, or
    (b) a dispute over the proper amount of payment for the taxable supply to which the deduction relates, or
    (c) their mistaken understanding that the supply to which the deduction relates was not a taxable supply, or
    (d) a clear mistake or simple oversight made by the taxpayer.
76. Alternatively, the taxpayer can propose an adjustment to the relevant assessment by issuing a NOPA to the Commissioner within the applicable response period.
77. If the taxpayer is outside the response period for issuing a NOPA and they have made a genuine error and otherwise satisfy the criteria set out in *SPS 07/03: Requests to amend assessments* they can request that the Commissioner amends the assessment by exercising the discretion under section 113.
78. For example, a taxpayer is registered for GST. They pay GST on an invoice basis and file monthly GST returns. In May 2005, they receive a tax invoice in respect of a taxable supply. However, the taxpayer omits to claim the input tax credit in respect of that taxable supply in the May 2005 GST return period. The omission occurs because the taxpayer has misplaced the tax invoice in one of their business files and only discovers it in December 2007.
79. The taxpayer has several options. They can claim an input tax deduction in the current GST return period under section 20(3) of the GST Act. The two-year restriction on claiming the deduction does not apply because the taxpayer's omission is due to their simple oversight.

80. Whether a "simple or obvious mistake or oversight" has occurred is determined on a case-by-case basis with no dollar limit. However, "a simple or obvious mistake or oversight" cannot include a taxpayer's GST position that they take as a result of:

    (a) a new, beneficial interpretation of, or favourable new case law, or

    (b) a regretted choice.

81. The taxpayer can also propose an adjustment to an input tax credit in the May 2005 GST period by issuing a NOPA to the Commissioner. However, the NOPA will be issued outside the four-month response period unless the Commissioner considers that one of the "exceptional circumstances" in section 89K applies and accepts the late NOPA.

82. Alternatively, the taxpayer can request that the Commissioner considers their case in terms of the discretion under section 113 if they have made a genuine error. (Please see *SPS 07/03: Requests to amend assessments* for details of this practice).

Situation 6: NOPA that relates solely to a research and development tax credit

83. Under section 89D, a taxpayer can issue a NOPA that relates solely to a research and development expenditure tax credit arising under section LH 2 of the ITA 2007 in respect of:

    (a) a notice of disputable decision (please see paragraphs 56 to 65), or

    (b) a notice revoking or varying a disputable decision that is not an assessment,

    that the Commissioner issues in the 2008–09 or later tax years. In this circumstance section 3(1) provides that the response period for a NOPA that relates solely to a research and development expenditure tax credit is within the one-year period that starts on the date the Commissioner issues such a notice.

84. For example, the Commissioner makes an assessment based on the taxpayer's tax return on 10 August 2009. The taxpayer later seeks to issue a NOPA in respect of the assessment under section 89D(1). The NOPA relates solely to a claim for a research and development expenditure tax credit arising under section LH 2 of the ITA 2007. The taxpayer must issue the NOPA within the one-year period that starts on 10 August 2009 and ends on 9 August 2010.

85. Under section 89DA, a taxpayer can also issue a NOPA that relates solely to a research and development expenditure tax credit arising from a notice of assessment that they have previously issued for the 2008–09 or later income years.

86. The NOPA must be issued within the period that pursuant to paragraph (e)(i) of the definition of "response period" in section 3(1):

    (a) ends:

        (i) two years (for an assessment that relates to the 2008–09 and 2009–10 income years), or

        (ii) one year (for an assessment that relates to the 2010–11 and later income years),

    after the date that the Commissioner receives the taxpayer's assessment if the taxpayer is a single person for the purpose of section 68D (that is, not a member of an internal software development group ("ISDG") or partner of a partnership to which section 68E applies), or

    (b) starts on the date on which the Commissioner receives the taxpayer's assessment and ends:

        (i) two years (for an assessment that relates to the 2008–09 and 2009–10 income years), or

        (ii) one year (for an assessment relating to the 2010–11 and later income years),

    after the latest date on which the taxpayer can provide an income tax or joint income tax return for the relevant tax year under section 37 if the taxpayer is a member of an ISDG or partner of a partnership that chooses to apply section 68E for the 2008–09 and later income years (paragraph (e)(ii) of the definition of "response period" in section 3(1)).

87. For the purpose of paragraphs (d) and (e) of the definition of "response period" in section 3(1) the date that the Commissioner receives the taxpayer's assessment must be determined under section 14B (as discussed in paragraph 72).

88. For example, a taxpayer that is a member of an ISDG provides their partnership's 2009 income tax return to the Commissioner on 1 July 2009 which is before the return filing due date of 7 July 2009 under section 37(1)(c). The taxpayer discovers that they have under claimed research and development expenditure tax credits in the assessment in their tax return.

89. Under section 89DA, the taxpayer can issue in respect of their assessment a NOPA that relates solely to the claim for a research and development expenditure tax credit. The taxpayer must issue the NOPA within the period that starts on 1 July 2009 (the date that the Commissioner received their assessment) and ends on 6 July 2011 (two years after 7 July 2009 which is the due date for filing the member's income tax return under section 37).

Contents of a taxpayer's NOPA

90. A NOPA is the document that commences the disputes resolution process. It is intended to identify the true points of contention and explain the legal or technical aspects of the issuer's position in relation to the proposed adjustment in a formal and understandable manner. This will ensure that information relevant to the dispute is quickly made available to the parties. Section 89F(1) and (3) specifies the content requirements for any NOPA that a taxpayer may issue.

91. Section 89F reads:

 (1) A notice of proposed adjustment must -

  (a) contain sufficient detail of the matters described in subsections (2) and (3) to identify the issues arising between the Commissioner and the disputant; and

  (b) be in the prescribed form.

 …

 (3) A notice of proposed adjustment issued by a disputant must –

  (a) identify the adjustment or adjustments proposed to be made to the assessment; and

  (b) provide a statement of the facts and the law in sufficient detail to inform the Commissioner of the grounds for the disputant's proposed adjustment or adjustments; and

  (c) state how the law applies to the facts; and

  (d) include copies of the documents of which the disputant is aware at the time that the notice is issued that are significantly relevant to the issues arising between the Commissioner and the disputant.

92. The prescribed form for a NOPA as required under section 89F(3)(b) is the *IR 770 Notice of proposed adjustment* form that can be found on Inland Revenue's website: www.ird.govt.nz. A handwritten NOPA in this form is acceptable. Additional information can also be attached to the prescribed form.

93. If the Commissioner receives a NOPA that is not in the prescribed form or has insufficient detail under section 89F(1)(a) the Commissioner's practice will be to advise the taxpayer that the NOPA must be in the prescribed form or include sufficient information. If this occurs on the last day of the response period the Commissioner will consider any resubmitted NOPA under section 89K(1)(a)(iii) provided that the lateness is minimal (please see paragraph 130).

94. If the taxpayer's NOPA does not satisfy the content requirements under sections 89F(1)(a) and 89F(3) the Commissioner can reject the NOPA on the basis of the invalidity and not issue a NOR.

95. When issuing a NOPA, the taxpayer must state the facts and law in sufficient detail, how the law applies to the facts and include copies of the documents that are significantly relevant to the dispute and known to the taxpayer when they issue the NOPA. However, the taxpayer must avoid repeating facts, arguments or using unnecessary detail. The Commissioner cannot treat a tax return provided by the taxpayer as a NOPA because it will not satisfy the requirements in section 89F(1) and (3).

96. Section 89F(3)(b) requires that the taxpayer's NOPA states the key facts and law concisely and in sufficient detail. The term "sufficient detail" means that the document must contain adequate analysis of the law and facts that are relevant to the dispute. This means sufficient discussion of the law to enable the Commissioner to clearly understand the proposed adjustment.

97. The Commissioner considers that it is necessary that the taxpayer provides "a statement of the facts and law in sufficient detail" to ensure that they have fully considered issues before they raise them in their NOPA.

98. Although not a requirement under section 89F(3) the taxpayer must ensure that a NOPA is relatively brief and simple to enable the parties to quickly progress the dispute without incurring substantial expenses or excessive preparation time. However, the taxpayer must also provide sufficient information to support the proposed adjustments in their NOPA and to reduce further administrative and compliance costs.

Identify the proposed adjustment – section 89F(3)(a)

99. The taxpayer must identify the proposed adjustment in their NOPA. This includes for each proposed adjustment:

 (a) the amount or impact of the adjustment, and

 (b) the tax year or period to which the proposed adjustment relates.

100. The proposed adjustment should be set out as specifically as possible. For example: "increase the 2007 repairs and maintenance expenditure by $3,000"; "increase the GST input tax deduction by $4,000 in the August 2007 return period", etc.

Provide a statement of the facts and law in sufficient detail – section 89F(3)(b)

Facts

101. To provide a brief and accurate statement of facts, the taxpayer must focus on the material factual matters relevant to the legal issues. The taxpayer must include the facts necessary for proving all the arguments raised in support of each adjustment, including any

facts that are inconsistent with any argument that the Commissioner has previously raised.

102. The taxpayer should endeavour to disclose all the relevant material facts clearly and with adequate amounts of detail relative to the complexity of the issues. The taxpayer is best suited to do this because they are usually very familiar with the background and facts that relate to the dispute. Disclosing the background and facts at the NOPA phase helps to resolve the dispute at an earlier stage. However, the taxpayer should not overstate the facts with irrelevant detail or repetition.

103. In complex cases, the Commissioner expects the taxpayer to explain the relevant facts clearly and methodically. The taxpayer should also assist the Commissioner to understand the background and facts of the dispute, so as to facilitate a speedy resolution of the case. The taxpayer should explain the facts and law in sufficient detail to inform the Commissioner of the grounds for the adjustment. It is unhelpful and can cause delays if the Commissioner has to second guess the factual bases of the taxpayer's case.

104. For example, in a dispute that involves a complex financial arrangement, the taxpayer should explain each element of it. This includes explaining the background to the financial arrangement, identifying the parties involved, highlighting the relevant clauses in an agreement, etc.

Law

105. Each proposed adjustment should stipulate the relevant section or sections that the taxpayer relies on including, if a section has multiple independent parts, the applicable subsection(s).

106. It is important that the taxpayer includes an adequate amount of analysis of the applicable legal principles or tests in their NOPA. If possible these should be supported by case authorities with full citations. For example, in a dispute that involves the tax treatment of a trade-tie payment, the taxpayer must apply the legal principles from a leading case such as *Birkdale Service Station v CIR* (2000) 19 NZTC 15,981. However, it is not necessary to laboriously describe large numbers of precedent cases on the same issue or include extracts from each.

How the law applies to the facts - section 89F(3)(c)

107. The taxpayer must apply the legal arguments to the facts. This ensures that the proposed adjustment is not a statement that appears out of context in relation to the rest of the document. The Commissioner considers that the application of the law to the facts must logically support the proposed adjustment and be stated clearly and in detail.

108. The taxpayer must present the materials and arguments on which they intend to rely or on which reliance will be placed. That is, if more than one argument supports the same or a similar outcome, all arguments must be made and supported by evidence. For each proposition of law, it is recommended that the NOPA makes a clear link to an outline of supporting facts.

Include copies of the relevant documents that support the adjustment – section 89F(3)(d)

109. The taxpayer must provide full copies of the documents that they know are significantly relevant to the dispute and in existence when they issue the NOPA. This ensures that the Commissioner has all the relevant information necessary to respond to the NOPA.

110. For example:

(a) a taxpayer proposes an adjustment to GST input tax credits in their NOPA. The taxpayer must provide copies of the relevant tax invoices as documentary evidence in their NOPA.

(b) a taxpayer's dispute involves a sale of land transaction. The taxpayer must provide a copy of the sale and purchase agreement and other relevant correspondence between the vendor and the purchaser as documentary evidence in their NOPA.

111. However, a NOPA will not necessarily be treated as invalid if the taxpayer has not provided all the documentary evidence with it. In some cases, new documentary evidence can emerge as the dispute progresses. For example:

(a) a dispute involves overseas parties who hold relevant documents outside of New Zealand.

(b) the documentation is quite old and may have been misplaced.

112. The taxpayer may be unaware of these documents when the NOPA was issued. The parties should then exchange this new evidence when it becomes known or available.

113. Where a taxpayer is aware of a particular document that is significantly relevant to their dispute, but cannot obtain a copy of it, the taxpayer should include the following matters in their NOPA:

(a) the nature of the document and its relevance to the dispute, and

(b) the reasonable steps that the taxpayer has taken to obtain a copy of the document, and

(c) the expected date that the document will be made available to the Commissioner.

114. However, the practice allowed in the immediately preceding paragraph should not be treated as dispensing with the requirements under section 89F(3)(d). The Commissioner expects the taxpayer to send copies of the relevant documents mentioned in their NOPA as soon as they become available and can reject the proposed adjustment if they fail to do so.

Election of the small claims jurisdiction of the Taxation Review Authority

115. Pursuant to section 89E(1), if a taxpayer issues a NOPA they can elect in that NOPA that the TRA acting in its small claims jurisdiction hears any unresolved dispute that arises from the NOPA, if the following requirements are met:

    (a) the taxpayer's NOPA is issued under section 89D or 89DA (please see earlier discussion), and

    (b) the amount in dispute is $30,000 or less.

116. The Commissioner's practice is not to oppose any election made by the taxpayer under section 89E(1), for example where the dispute involves complicated legal issues, because the taxpayer's election is irrevocable and is binding on them. In this circumstance, the full disputes resolution process does not have to be followed.

117. Section 89E(1) applies in respect of a disputes resolution process that is commenced under Part IVA on or after 1 April 2005.

Receipt of a taxpayer's NOPA

118. Inland Revenue will usually assign a taxpayer's NOPA to the responsible officer within five working days after it is received.

119. After receiving the NOPA, the responsible officer will determine and record the following:

    (a) the date on which the NOPA was issued, whether the NOPA has been issued within the applicable response period and the date by which the Commissioner's response must be issued, and

    (b) the NOPA's salient features including any deficiencies in its content.

120. Where this is practicable, Inland Revenue will advise the taxpayer or their tax agent that it has received the NOPA by telephone or in writing within 10 working days.

Deficiencies in the contents of a NOPA

121. If Inland Revenue has received a NOPA that it considers has deficiencies (that is, it has not satisfied the requirements under section 89F(1)(a) and (3)), the responsible officer must take reasonable steps to ensure that the taxpayer can correct the information in the NOPA before the response period expires.

122. Any decision regarding the NOPA's validity made by the Commissioner must be based on reasonable grounds. For example, where the Commissioner treats the NOPA as invalid because there is insufficient information to allow the Commissioner to make an informed decision regarding the assessment. The taxpayer must be advised as soon as practicable that the NOPA is invalid unless rectified and the additional or correct information must be provided within the remainder of the response period.

123. Taxpayers are encouraged to issue their NOPA immediately after they have completed it because they could have insufficient time to rectify any deficiency or invalidity if the response period is about to expire.

124. If the Commissioner does not accept that a NOPA is valid because it has deficiencies and the information is not corrected before the response period expires, the dispute will be treated as if it has never been commenced (unless the taxpayer resubmits a late NOPA and the Commissioner accepts it under one of the exceptional circumstances under section 89K).

125. The responsible officer will document the reasons for not accepting a NOPA and advise the taxpayer of these reasons in writing immediately if the taxpayer is still within the response period or 15 working days after the response period for issuing the taxpayer's NOPA expires if there is insufficient time for the taxpayer to resubmit the NOPA.

NOPA that a taxpayer has issued outside the applicable response period

126. Unless an "exceptional circumstance" arises under any of the circumstances specified in section 89K(1) in respect of a dispute that was commenced on or after 1 April 2005, the Commissioner cannot accept a NOPA that a taxpayer issues under section 89D or 89DA outside the applicable response period.

Exceptional circumstances under section 89K

127. The legislation defines exceptional circumstances very narrowly. The cases on "exceptional circumstances," such as *Treasury Technology Holdings Ltd v CIR* (1998) 18 NZTC 13,752, *Milburn NZ Ltd v CIR* (1998) 18 NZTC 14,005, *Fuji Xerox NZ Ltd v CIR* (2001) 17,470 (CA), *Hollis v CIR* (2005) 22 NZTC 19,570, and *Balich v CIR* (2007) 23 NZTC 21,230 are also relevant. The case law confirms that the Commissioner should apply the definition of "exceptional circumstances" in sections 89K(3) and 138D consistently.

    The following guidelines have emerged from the case law:

(a) a taxpayer's misunderstanding or erroneous calculation of the applicable response period will usually not be regarded as an event or circumstance beyond the taxpayer's control under section 89K(3)(a)

(b) an agent's failure to advise their client that they have received a notice of assessment or other relevant documents that causes the taxpayer to respond outside the applicable response period will not generally be considered to be an exceptional circumstance under section 89K(3)(b) (*Hollis v CIR*)

(c) an exceptional circumstance can arise if the taxpayer has relied on misleading information that the Commissioner has given them that causes them to respond outside the applicable response period (*Hollis v CIR*).

128. The Commissioner will only accept a late NOPA on rare occasions. Please see *Tax Information Bulletin* Vol 8, No 3 (August 1996) for some examples of situations that can be considered "exceptional circumstances" beyond a taxpayer's control.

129. Section 89K(3) reads:

> (a) an exceptional circumstance arises if—
>
> (i) an event or circumstance beyond the control of a disputant provides the disputant with a reasonable justification for not rejecting a proposed adjustment, or for not issuing a notice of proposed adjustment or statement of position, within the response period for the notice:
>
> (ii) a disputant is late in issuing a notice of proposed adjustment, notice of response or statement of position but the Commissioner considers that the lateness is minimal, or results from 1 or more statutory holidays falling in the response period:
>
> (b) an act or omission of an agent of a disputant is not an exceptional circumstance unless—
>
> (i) it was caused by an event or circumstance beyond the control of the agent that could not have been anticipated, and its effect could not have been avoided by compliance with accepted standards of business organisation and professional conduct; or
>
> (ii) the agent is late in issuing a notice of proposed adjustment, notice of response or statement of position but the Commissioner considers that the lateness is minimal, or results from 1 or more statutory holidays falling in the response period.

130. The statutory holiday exception is self-explanatory. The Commissioner can also accept a late NOPA if the Commissioner considers that the lateness is minimal, that is, the document was only one to two days late.

131. For example, the response period ends on a Saturday and the taxpayer provides a NOPA on the following Tuesday. The Commissioner treats the response period as ending on Monday on the basis of section 35(6) of the Interpretation Act 1999 and accepts that the lateness of the NOPA was minimal. That is, the Commissioner received the NOPA within one to two days of Monday, the last day of the response period. If the response period ended on Friday and the taxpayer provided the NOR on the following Monday, the Commissioner would also accept that the lateness is minimal.

132. Besides the degree of lateness, the Commissioner will consider the following factors when exercising the discretion under section 89K(1):

(a) the date on which the NOPA was issued, and

(b) the response period within which the NOPA should be issued, and

(c) the real event, circumstance or reason why the taxpayer did not issue the NOPA within the applicable response period, and

(d) the taxpayer's compliance history in relation to the tax types under consideration (for example, whether the taxpayer has a history of paying tax late or filing late tax returns or NOPAs in the past?)

133. For example, a taxpayer issues a NOPA to the Commissioner two days after the applicable "response period" has expired. The taxpayer does not provide a legitimate reason for the lateness. The taxpayer also has a history of filing late NOPAs within the minimal allowable lateness period (that is, up to two days outside the applicable "response period") and has been advised on the calculation of the "response period" each time.

134. Although the degree of lateness was minimal each time, the Commissioner would not accept the taxpayer's NOPA in this circumstance. This ensures that the section 89K(3)(b)(ii) exception is not treated as an extension of the "response period" in all circumstances.

135. The Commissioner will consider a taxpayer's application made under section 89K(1) after receiving the relevant NOPA. The responsible officer will document the reasons for accepting or rejecting the taxpayer's application and advise them of their decision in writing within 15 working days after Inland Revenue receives their application.

136. If the Commissioner rejects a taxpayer's application made under section 89K(1), the Commissioner can still consider the validity of the taxpayer's tax position in terms of the practice for applying the discretion under section 113. Please see *SPS 07/03 Requests to amend assessments* for details of this practice. However, the Commissioner's decision to reject an application made under section 89K(1) is not a "disputable decision" for the purposes of section 89D(3).

Time frames to complete the disputes resolution process

137. If a taxpayer has issued a NOPA to the Commissioner and the dispute remains unresolved, when practicable, the parties should negotiate a time line to ensure that the dispute is progressed in a timely and efficient way.

138. Agreeing to a time line is not statutorily required but, rather, is a critical administrative requirement that requires both parties to be ready to progress matters. The parties should endeavour to meet the agreed time line. If there are delays in the progress of the dispute the responsible officer must manage the delay including any relationship with internal advisers and liaise with the taxpayer.

139. If the negotiated time line cannot be achieved, the Commissioner must enter into continuing discussions with the taxpayer to, either arrange a new time line, or otherwise keep them advised of when the disclosure notice will be issued. Therefore, the failure to negotiate or adhere to an agreed time line will not prevent the case from progressing through the disputes resolution process in a timely manner.

140. In addition to the above administrative practice, the Commissioner is bound by section 89N. Under section 89N(2), if the parties cannot agree on the proposed adjustment, the Commissioner cannot amend the assessment without completing the disputes resolution process (that is, consider the taxpayer's SOP), unless any of the exceptions in section 89N(1)(c) apply. These exceptions are explained in *SPS 08/01: Disputes resolution process commenced by the Commissioner of Inland Revenue*.

141. Although not a statutory requirement of the disputes resolution process, when practicable, it is the Commissioner's administrative practice to go through the adjudication phase for the purpose of resolving the dispute after the SOP phase.

142. However, if the adjudication phase cannot be completed (for example, because the statutory time bar is imminent), the Commissioner can amend the assessment under section 113 after considering the taxpayer's SOP. Inland Revenue officers will adequately consider the facts and legal arguments in the taxpayer's SOP before deciding whether to amend the assessment. It is expected that this will occur only in very rare circumstances.

143. Whether the Commissioner has adequately considered a SOP will depend on what is a reasonable length of time and level of analysis for that SOP given the circumstances of the case (for example, the length of the SOP and the complexity of the legal issues).

144. Thus a simple dispute could take only a couple of days to consider adequately while a complex dispute could take a few weeks. If the statutory time bar is imminent the Inland Revenue officer will consider the taxpayer's SOP urgently.

145. If the Commissioner issues an amended assessment because section 89N(1)(c) or 89N(2)(b) applies (please see the discussion in *SPS 08/01: Disputes resolution process commenced by the Commissioner of Inland Revenue*) the disputes resolution process will end and the dispute will not go through the adjudication phase. Any decision that the Commissioner makes under section 89N(1)(c) is a disputable decision for the purpose of section 89D(3).

Notice of response

The Commissioner's response to a taxpayer's NOPA: Notice of response

146. If the Commissioner disagrees with the taxpayer's proposed adjustment, then, under section 89G(1) the Commissioner must advise the taxpayer that any or all of their proposed adjustments are rejected by issuing a NOR within the applicable response period. That is, within two months starting on the date that the taxpayer's NOPA is issued. The Commissioner interprets this to mean that the taxpayer must receive the NOR within this period. For example, if a taxpayer issues a NOPA on 8 April 2007, the Commissioner must advise the taxpayer of its rejection by issuing to them a NOR and they must receive that NOR on or before 7 June 2007.

147. Where it is practicable, the Commissioner will make reasonable efforts to contact the taxpayer or their tax agent within 10 working days before the response period expires to advise whether the Commissioner intends to issue a NOR to them in response to their NOPA. Such contact may be made by telephone or letter.

148. The Commissioner must issue the NOR to the taxpayer (section 14(3)(a)) or a representative authorised to act on their behalf (section 14(3)(b)). In respect of the latter, it is a question of fact whether the recipient is authorised to receive the NOR on the taxpayer's behalf. The taxpayer must ensure that their NOPA stipulates the name of the person or agent that they have nominated to receive any NOR issued by the Commissioner (*CIR v Thompson* (2007) 23 NZTC 21,375).

149. For example, a tax agent sends a NOPA to the Commissioner. Although the tax agent would appear to have ostensible authority to receive the Commissioner's NOR, the Commissioner's practice will be to contact the tax agent to confirm whether the agent can accept service of the NOR. Therefore, the Commissioner must ensure that a NOR issued in accordance with section 14(3)(b) complies with any relevant instructions given by the taxpayer or the recipient's authority to receive can otherwise be verified.

150. Section 89G(2) specifies the content requirements for a NOR. The Commissioner must state concisely in the NOR:

(a) the facts or legal arguments in the taxpayer's NOPA that the Commissioner considers are wrong, and

(b) why the Commissioner considers that those facts and arguments are wrong, and

(c) any facts and legal arguments that the Commissioner relies upon, and

(d) how the legal arguments apply to the facts, and

(e) the quantitative adjustment to any figures proposed in the taxpayer's NOPA that results from the facts and legal arguments that the Commissioner relies upon.

151. Under section 89G(2)(e), the requirement for a quantitative adjustment establishes the extent to which the Commissioner considers that the adjustment in the taxpayer's NOPA is incorrect. This amount need not be exact, although, every attempt should be made to ensure that it is as accurate as possible. The amount in dispute can be varied, as the dispute progresses. For example, if the parties agree on new figures at the conference phase.

152. The Commissioner considers that Inland Revenue has a statutory obligation to inform the taxpayer adequately. Therefore, any NOR that the Commissioner issues to reject the adjustment proposed in the taxpayer's NOPA must be relatively brief but sufficiently detailed to explain all the relevant facts, quantitative adjustments, issues and law.

Deemed acceptance

153. Section 89H(2) reads:

> If the Commissioner does not, within the response period for a notice of proposed adjustment issued by a disputant, reject an adjustment contained in the notice, the Commissioner is deemed to accept the proposed adjustment and section 89J applies.

154. If the Commissioner issues a NOR outside the two-month response period, the Commissioner is deemed to have accepted the adjustment proposed in the taxpayer's NOPA under section 89H(2). This will finish the dispute and the Commissioner must issue an assessment or amended assessment to the taxpayer pursuant to section 89J(1) (please see the discussion in paragraphs 159 to 162).

155. However, the Commissioner is not precluded from later exercising the discretion under section 113 and issuing to the taxpayer an amended assessment that reflects another adjustment for a different issue to that previously accepted under section 89H(2) for the same tax period.

Exception to deemed acceptance

156. Notwithstanding section 89H(2), the Commissioner can apply to the High Court for an order that a NOR can be issued outside the two-month response period under section 89L(1). Section 89L only applies if an exceptional circumstance has occurred or prevented the Commissioner from issuing a NOR to the taxpayer within the response period. The Commissioner will endeavour to apply the requirement for exceptional circumstances in section 89L(1)(a) consistently with the similar requirement in section 89K(1)(a) (please see discussion in paragraphs 127 to 136).

157. Under section 89L(3), an "exceptional circumstance":

> a) is an event or circumstance beyond the control of the Commissioner or an officer of the Department that provides the Commissioner with a reasonable justification for not rejecting an adjustment proposed by a disputant within the response period; and
>
> b) Without limiting paragraph (a), includes a change to a tax law, or a new tax law, or a decision of a court in respect of a tax law, that is enacted or made within the response period.

158. For example:

(a) A flood damaged an Inland Revenue office during the applicable response period for a taxpayer's NOPA. The taxpayer's NOPA was lost in the flood. The Inland Revenue officer could not obtain another copy of the NOPA within the applicable response period. The absence of information has prevented the Commissioner from forming

a view on the subject matter in dispute. The Commissioner can apply for a High Court order under section 89L for further time to issue a NOR.

(b) A taxpayer issues to the Commissioner a NOPA that claims additional tax depreciation on computer software. During the two-month response period, a High Court decision was made in respect of another taxpayer. The High Court held that a depreciation claim amounted to tax avoidance and should be disallowed. The Commissioner can apply to the High Court for further time to issue a NOR to the taxpayer, so as to consider the full effect of the High Court decision.

(c) The Inland Revenue officer to whom a taxpayer's NOPA was assigned is absent on annual leave for the remainder of the response period. The Inland Revenue officer does not arrange for another officer to prepare and issue a NOR to the taxpayer within the response period. The Commissioner is deemed to accept the NOPA under section 89H(2). In this circumstance, the Commissioner does not consider that an exceptional circumstance prevented the Inland Revenue officer from rejecting the adjustment within the response period for the purpose of section 89L(1)(a).

Implication of section 89J

159. Pursuant to section 89J(1), if the Commissioner accepts or is deemed to accept any adjustment that is proposed in a taxpayer's NOPA, the Commissioner must include or take account of the adjustment in:

(a) a notice of assessment, and

(b) any further notice of assessment or amended assessment,

that is issued to the taxpayer unless the Commissioner has applied to the High Court for an order that a notice can be issued rejecting the proposed adjustment under section 89L(1).

160. In this circumstance, the Commissioner's practice will be to not later issue a NOPA that purports to reverse any proposed adjustment previously accepted under section 89H(2) because section 89J(1) prevents the Commissioner from issuing to the taxpayer a further amended assessment that does not include or take into account the previously accepted adjustment.

161. However, pursuant to section 89J(2) the Commissioner can issue a notice of assessment or amended assessment that does not include or take into account an adjustment that the Commissioner has, or is deemed to have accepted, if the Commissioner considers that, in relation to the adjustment, the taxpayer:

(a) was fraudulent, or

(b) wilfully misled the Commissioner.

162. If the Commissioner considers that section 89J(2) applies following a deemed acceptance under section 89H(2) the Commissioner cannot resume the earlier disputes resolution process but can later issue a NOPA in respect of any of the adjustments proposed in the earlier disputes resolution process.

163. Pursuant to section 89J(2), the Commissioner must decide whether any of the exceptions to section 89J(1) apply before an assessment or amended assessment that does not include an adjustment that the Commissioner has, or is deemed to have accepted can be issued.

164. Any opinion that the Commissioner forms under section 89J(2) must be honestly held, based on a correct understanding of the relevant grounds and reasonably justifiable on the basis of the facts and law available. An opinion formed by the Commissioner under section 89J(2) is a disputable decision for the purposes of section 89D(3).

Rejection of the Commissioner's notice of response

165. If the Commissioner has issued a NOR under section 89G(1) that rejects the adjustment proposed in the taxpayer's NOPA, the taxpayer must reject the Commissioner's NOR within the applicable response period. That is, within two months starting on the date that the Commissioner issues the NOR. Otherwise, the taxpayer is deemed to have accepted the Commissioner's NOR under section 89H(3) and the dispute will finish.

166. The Commissioner will make reasonable efforts to contact the taxpayer or their tax agent two weeks before the response period for the Commissioner's NOR expires to determine whether the taxpayer will reject the Commissioner's NOR in writing. Such contact can be made by telephone or in writing.

167. The taxpayer must reject the Commissioner's NOR in writing. The written rejection must be issued within the response period and can be in any form. The taxpayer does not have to expressly reject each of the rejections of proposed adjustments that are included in the Commissioner's NOR. The taxpayer's written rejection must simply make it clear that the taxpayer rejects the Commissioner's NOR.

168. For example, in certain circumstances, the Commissioner can treat a notice of proceedings and statement of claim that the taxpayer serves on the Commissioner within the response period to commence challenge proceedings as a valid rejection in writing of the Commissioner's NOR under section 89H(3)(a). However, if parties do not agree to suspend the dispute under section 89N(1)(c)(viii) the Commissioner must issue a disclosure notice and the taxpayer must issue a SOP in response within the applicable response period to continue the disputes resolution process.

169. Where it is practicable, the taxpayer's written rejection will be referred to the responsible officer within five working days after Inland Revenue has received it and acknowledged as received within 10 working days.

170. If deemed acceptance occurs (that is, the taxpayer has not rejected the Commissioner's NOR in writing), the Commissioner will make reasonable efforts to advise the taxpayer of this within two weeks after the response period to the Commissioner's NOR has expired.

Conference

Conduct of a conference

171. Generally, if a dispute remains unresolved after the Commissioner's NOR has been rejected, the conference phase will follow. The Commissioner will usually commence the conference phase in a timely manner, that is, within one month after receiving the taxpayer's notice rejecting the Commissioner's NOR. However, the Commissioner must not endeavour to advance the disputes resolution process by initiating the conference phase before the taxpayer's rejection of the NOR has been fully considered.

172. If the start of the conference phase is delayed (for example to obtain legal advice) the responsible officer will keep the taxpayer informed regarding the progress of the conference. The suggested average time frame for the conference phase is three months. However, this time frame will vary depending on the facts and complexity of the specific case.

173. A conference is not statutorily required. Rather, the conference phase is an administrative process that aims to clarify and, if possible, resolve the disputed issue by conducting an open discussion. However, the conference phase should not be used by either party to the dispute for the purpose of delaying the completion of the disputes resolution process.

174. The conference should be conducted in a way that is sufficiently flexible and consistent with the taxpayer's wishes and any other relevant factors such as the scope of the investigation. The Commissioner will establish a time frame to meet with the taxpayer and any advisors and, sometimes, if necessary, Inland Revenue officers will meet with the taxpayer immediately after considering further information. Where appropriate, a conference can be adjourned to allow the parties to reconsider the position that they have taken in the dispute.

175. A conference can range from telephone calls to several face-to-face meetings between the parties. If the parties are relying on expert evidence the expert may also attend the conference. All discussions in the conference must be recorded or otherwise documented (to provide the best record of such discussions and promote the free flow of conversation) and a consensus reached if possible.

176. Recordings can be made on audio or video tape, MP3 and CD recorders, the FTR Gold system or by using any other suitable audio or visual technology. This can include any agreement on facts, common grounds on which the dispute can proceed, a time frame for completing the disputes resolution process and an agreed adjustment. Any negotiations between the parties after the "on record" discussion of the disputed issues during the conference will be treated as being on a without prejudice basis if an agreement is not reached.

177. When a dispute remains unresolved after the conference phase has been completed, the Commissioner must issue a disclosure notice under section 89M(1) without delay.

178. The conference phase is not necessarily complete just because the parties have held the final meeting. For example, the parties may need further information or to consider further submissions made at the conference. This will dictate when the Commissioner issues the disclosure notice. Also, the parties can engage in further discussions during or after the SOP phase to attempt to resolve some or all of the disputed issues.

Legal and other advisers attending a conference

179. If a dispute is not settled earlier, the parties may want to obtain expert legal or other tax advice at the conference phase in addition to any legal or other advice previously obtained. These advisers can attend any meetings in relation to the dispute. The advisers can revisit some items that the parties have already discussed (but not agreed to in writing or otherwise accepted).

Conference not held or abridged

180. The Commissioner considers that the conference phase is an important part of the disputes resolution process and will always attend a conference if requested by the taxpayer. If the parties are not in the same location the conference can be held at a place that is convenient for both parties or by telephone or videoconference.

181. In some circumstances, the Commissioner will not hold further discussions or a conference, notwithstanding that the parties have not reached an agreement. However, the disputes resolution process will not end, because the disclosure notice and SOP phases will still be undertaken. Where the dispute is not resolved in the SOP phase, the parties will endeavour to resolve the dispute via the adjudication process.

182. Conferences can be dispensed with or abridged in one or more of the following situations. If:

    (a) there are revenue losses incurred as a result of delaying tactics that the taxpayer has used to frustrate the collection of tax, or

    (b) the Commissioner is satisfied that the taxpayer or their agent is acting in a frivolous or vexatious manner. For example, where the taxpayer is setting unreasonable demands about the time, place, or terms of such meetings, or conduct themselves unreasonably at any meeting, or

    (c) the taxpayer contests the Commissioner's policy and it is agreed to disagree or that a conference would not benefit the parties, or

    (d) the taxpayer advises the Commissioner that they want to dispense with the conference phase.

183. Where it is practicable, the Commissioner will advise the taxpayer or their tax agent of the decision regarding whether or not the conference phase will be dispensed with or abridged in writing within five working days after that decision is made. The reasons for the final decision must be documented.

Disclosure notice

184. The Commissioner must issue a disclosure notice under section 89M(1), unless the Commissioner:

    (a) does not have to complete the disputes resolution process because any of the exceptions under section 89N(1)(c) apply (please see the discussion in *SPS 08/01: Disputes resolution process commenced by the Commissioner of Inland Revenue*), or

    (b) does not have to complete the disputes resolution process because the High Court has made an order that the dispute resolution process can be truncated pursuant to an application made by the Commissioner under section 89N(3), or

    (c) has already issued to the taxpayer a notice of disputable decision that includes or takes into account the adjustment proposed in the NOPA pursuant to section 89M(2). Section 89M(1) and (2) reads:

        (1) Unless subsection (2) applies, and subject to section 89N, the Commissioner must issue a disclosure notice in respect of a notice of proposed adjustment to a disputant at the time or after the Commissioner or the taxpayer, as the case may be, issues the notice of proposed adjustment.

        (2) The Commissioner may not issue a disclosure notice in respect of a notice of proposed adjustment if the Commissioner has already issued a notice of disputable decision that includes, or takes account of, the adjustment proposed in the notice of proposed adjustment.

185. The meaning of disputable decision is discussed earlier in paragraphs 57 to 63.

186. The Commissioner will usually advise the taxpayer two weeks before a disclosure notice is issued that it will be issued to them.

187. Where practicable, the Commissioner will contact the taxpayer shortly after the disclosure notice and SOP are issued to ascertain whether they have received these documents.

188. If the taxpayer has not received the Commissioner's disclosure notice, for example, due to a postal error or an event or circumstance beyond the taxpayer's control, the Commissioner will issue another disclosure notice to the taxpayer. In this circumstance, the response period within which the taxpayer must respond with their SOP will commence from the date that the Commissioner issued the initial disclosure notice.

189. Where the taxpayer cannot issue a SOP within the applicable response period, they should issue a late SOP with an explanation of why it is late. The Commissioner will consider the late SOP in terms of the discretion under section 89K(1) (please see paragraphs 127 to 136 for details).

Evidence exclusion rule

190. A disclosure notice is the document that can trigger the application of the evidence exclusion rule under section 138G(1). This rule restricts the evidence that the parties can raise in court challenges to matters disclosed in their SOP. (Both parties can refer to evidence raised by either party.)

191. Any disclosure notice that the Commissioner issues will explain the effect of the evidence exclusion rule and refer to section 138G because this is one of the guiding principles of the disputes resolution process.

192. Section 89M(6B) defines "evidence" for the purposes of the evidence exclusion rule to mean the available documentary evidence and not lists of potential witnesses. Therefore, the identities of both parties' witnesses in sensitive cases will continue to be protected, without undermining the effect of the evidence exclusion rule.

Issue of a disclosure notice

193. The Commissioner can issue a disclosure notice at any time on or after the date that the taxpayer issues a NOPA because there is no statutory time frame specifying when the notice must be issued.

194. The Commissioner does not have to issue a disclosure notice to a taxpayer when they ask for one to be issued. However, the Commissioner will usually discuss such a request with the taxpayer and advise whether a disclosure notice will be issued and, if not, the reasons why and the implications for the dispute.

195. Generally, the Commissioner's practice is to issue a disclosure notice after the exchange of a NOPA, NOR, notice rejecting the NOR, the conclusion of the conference phase and any other enquiries and in accordance with any time line agreed with the taxpayer. The Commissioner will usually issue a disclosure notice within three months after all enquiries are concluded and the conference phase has been completed.

196. However, sometimes the Commissioner cannot issue a disclosure notice within the three months mentioned in paragraph 195 if, for example, the relevant Inland Revenue officers are still further investigating the taxpayer. In this case the responsible officer must ensure that any information gathering and investigative activity is reasonable and not excessive. The responsible officer must endeavour to issue the disclosure notice immediately after any further information gathering or investigation is complete. The responsible officer will advise the taxpayer two weeks before issuing a disclosure notice that it will be issued to them.

197. When possible, the responsible officer should use the relevant statutory power under the TAA to obtain any information needed to complete the conference or disclosure phases. This will ensure that the disputes resolution process is conducted in a timely and efficient manner. If the Commissioner is waiting for information to be provided pursuant to a statutory power Commissioner will defer issuing a disclosure notice to ensure that any information provided by the taxpayer can be included in the Commissioner's SOP.

198. If a disclosure notice is issued earlier (for example, the facts are clear, the taxpayer agrees, or a conference is not required) the reasons must be documented and explained to the taxpayer.

Taxpayer's statement of position

199. Pursuant to section 89M(5), once the Commissioner has issued a disclosure notice, the taxpayer must issue to the Commissioner a SOP in the prescribed form (the *IR 773 Statement of Position* found on Inland Revenue's website) within the two-month response period that starts on the date that the disclosure notice is issued.

200. The Commissioner cannot consider a document that the taxpayer purports to issue as a SOP before the Commissioner has issued the disclosure notice because it would have been issued outside the applicable response period. The taxpayer must submit another SOP after the disclosure notice is issued to satisfy their obligation under section 89M(5).

201. Unless an "exceptional circumstance" in section 89K applies, if the taxpayer issues a SOP to the Commissioner outside the response period, the Commissioner will treat the dispute as if it was never commenced. The Commissioner does not have to issue an assessment to include or take account of the taxpayer's proposed adjustment. Section 89M(7)(b) reads:

> (7) A disputant who does not issue a statement of position in the prescribed form within the response period for the statement of position, is treated as follows:
>
> ...
>
> (b) if the disputant has proposed the adjustment to the assessment, the disputant is treated as not having issued a notice of proposed adjustment.

Contents of a taxpayer's statement of position

202. The content of a SOP is binding. If the matter proceeds to court, then pursuant to section 138G(1) the parties can only rely on the facts, evidence (excluding oral evidence), issues and propositions of law that either party discloses in their SOP barring an application by the parties to the court to include new information under section 138G(2).

203. The taxpayer's SOP must be in the prescribed form (the *IR 773 Statement of position* form that can be found on Inland Revenue's website: www.ird.govt.nz) and include sufficient detail to fairly inform the Commissioner of

the facts, evidence, issues and propositions of law on which the taxpayer wishes to rely. In particular, the taxpayer must clarify what tax laws are being relied on and advise if any of these are different to those relied on in the taxpayer's NOPA.

204. However, if the Commissioner receives a SOP that is not in the prescribed form (as described in paragraph 203) the Commissioner's practice will be to advise the taxpayer that the SOP must be in the prescribed form. If this occurs on the last day of the response period the Commissioner will consider the resubmitted SOP under section 89K(1)(a)(iii) provided that the lateness is minimal.

205. Section 89M(6) reads:

> A disputant's statement of position in the prescribed form must, with sufficient detail to fairly inform the Commissioner,–
>
> (a) Give an outline of the facts on which the disputant intends to rely; and
>
> (b) Give an outline of the evidence on which the disputant intends to rely; and
>
> (c) Give an outline of the issues that the disputant considers will arise; and
>
> (d) Specify the propositions of law on which the disputant intends to rely.

206. The minimum content requirement for a SOP is an outline of the relevant facts, evidence, issues and propositions of law. To allow the Adjudication Unit to successfully reach a decision, the outline in the SOP must contain full, complete and detailed submissions.

207. An outline that consists of a frank and complete discussion of the issues, law, arguments and evidence supporting the arguments is implicit in the spirit and intent of the disputes resolution process. (In very complex cases the taxpayer should provide a full explanation of the relevant evidence).

208. The disputes resolution process does not require that relevant documents are discovered or full briefs of evidence or exhaustive lists of documents exchanged. Rather, providing an outline of relevant evidence in the SOP will ensure that both parties appreciate the availability of evidence in respect of the factual issues in dispute. The taxpayer should include an outline of any expert evidence on which they intend to rely in the SOP.

209. If the Commissioner considers that the SOP has insufficient detail to allow a correct assessment to be made the SOP can be treated as invalid under section 89M(4).

210. Subject to any order made by the court under section 138G(2), the evidence exclusion rule found in section 138G(1) prevents a hearing authority from considering arguments and evidence that are not included in:

(a) the SOP, or

(b) any additional information that:

(i) the Commissioner provides under section 89M(8), that is deemed to be part of the Commissioner's SOP under subsection (9), or

(ii) the parties provide pursuant to an agreement under section 89M(13), that is deemed to be part of the provider's SOP under subsection (14).

211. Section 89M(6B) reads:

> In subsection 4(b) and 6(b), evidence refers to the available documentary evidence on which the person intends to rely, but does not include a list of potential witnesses, whether or not identified by name.

212. Pursuant to section 89M(6B), the SOP must list any documentary evidence but cannot list potential witnesses. Any witnesses' identities will continue to be protected without undermining the effect of the evidence exclusion rule.

Receipt of a taxpayer's statement of position

213. If a taxpayer has issued a SOP the Commissioner can accept the SOP or issue a SOP in response to the taxpayer's SOP. Furthermore, section 89N(2) allows the Commissioner to amend an assessment under section 113 after the Commissioner has considered the SOP. (However, the Commissioner's practice is to send the dispute through the adjudication process. Please see paragraphs 234 to 245 for details.)

214. The Commissioner will make reasonable efforts to contact the taxpayer or their tax agent 10 working days before the response period expires to determine whether the taxpayer will issue a SOP in response to the disclosure notice. Such contact will be made by telephone or in writing. The taxpayer's SOP will be referred to the responsible officer within five working days after Inland Revenue receives it. Upon receipt of the SOP, the responsible officer will ascertain and record the following:

(a) the date on which the SOP was issued, and

(b) whether the SOP has been issued within the relevant response period, and

(c) the salient features of the SOP including any deficiencies in its content.

215. Where it is practicable, the Commissioner will acknowledge that the taxpayer's SOP is received

within 10 working days after it is received. However, the Commissioner will advise the taxpayer or their agent of any deficiencies in the SOP's content as soon as practicable. They will be further advised when the response period expires that those deficiencies must be rectified to validate the SOP and whether the Commissioner intends to provide any additional information to the taxpayer.

216. Where a SOP is issued outside the applicable response period, the taxpayer can apply for consideration of exceptional circumstances under section 89K. The reasons for accepting or rejecting the application must be documented and the responsible officer will make a reasonable effort to advise the taxpayer of the decision in writing within 15 working days after Inland Revenue has received the taxpayer's application.

217. As mentioned above, the dispute will be treated as if it was never commenced, if the taxpayer issues a SOP outside the applicable response period and none of the exceptional circumstances under section 89K apply. Where practicable, the Commissioner must advise the taxpayer of this within 10 working days after the response period for the disclosure notice has expired.

Commissioner's statement of position in response

218. When the taxpayer has issued a NOPA, section 89M(3) allows the Commissioner to issue a disclosure notice without a SOP. If the dispute remains unresolved the Commissioner's practice is to issue a SOP that addresses and responds to the substantive items in the taxpayer's SOP within the applicable response period (that is, within two months starting on the date that the taxpayer issued their SOP).

219. However, in very rare circumstances the Commissioner may not issue a SOP in response to the taxpayer's SOP. For example, where an assessment must be issued because a statutory time bar is imminent, an exception arises under section 89N(1)(c) or the High Court has made an order that the disputes resolution process can be truncated pursuant to an application made under section 89N(3).

220. If there is insufficient time to provide a SOP in response the Commissioner can apply to the High Court for further time to reply to the taxpayer's SOP under section 89M(10) if the application is made before the response period expires and the Commissioner considers that it is unreasonable to reply within the response period because of the number, complexity or novelty of matters raised in the taxpayer's SOP.

221. Such applications are expected to be rare but can arise if the taxpayer is less than co-operative with supplying information and/or has failed to maintain proper and adequate records.

222. The Commissioner's SOP must be in the form that the Commissioner has prescribed under section 35(1) and include sufficient details to fairly inform the taxpayer of the facts, evidence, issues and propositions of law on which the Commissioner wishes to rely.

223. Section 89M(4) reads:

> The Commissioner's statement of position in the prescribed form must, with sufficient detail to fairly inform the disputant,–
>
> (a) Give an outline of the facts on which the Commissioner intends to rely; and
>
> (b) Give an outline of the evidence on which the Commissioner intends to rely; and
>
> (c) Give an outline of the issues that the Commissioner considers will arise; and
>
> (d) Specify the propositions of law on which the Commissioner intends to rely.

224. If the Commissioner has issued a SOP, the Commissioner can also provide to a taxpayer additional information in response to matters raised in their SOP under section 89M(8) within two months starting on the date that the taxpayer's SOP is issued. This is intended to cover situations where new evidence becomes available after the Commissioner has issued a SOP and before the response period expires. For example, where the Commissioner learns that certain information has been omitted from the Commissioner's SOP and this information can be added to the SOP within the applicable response period. The additional information can include documentary evidence but not lists of potential witnesses.

225. Any additional information must be provided as far as possible in the same format as the SOP in which it is included. The additional information provided under section 89M(8) is deemed to form part of the Commissioner's SOP and, thus, subject to the evidence exclusion rule under section 138G(1).

226. However, when the taxpayer has commenced the dispute, the Commissioner must endeavour to include all the relevant details in the Commissioner's SOP. The Commissioner's practice is to issue a SOP to the taxpayer towards the end of the response period to allow sufficient time for gathering any further information in response and considering the SOP's content. This will minimise the occasions when additional information must be provided under section 89M(8).

227. The taxpayer cannot reply to the Commissioner's SOP or any additional information provided, unless the Commissioner agrees to accept additional information under section 89M(13). (Please see the discussion under "Agreement to include additional information" below.)

Agreement to include additional information

228. The parties can agree to include additional information in their SOP under section 89M(13) at any time during the disputes resolution process including after the dispute has been referred to the Adjudication Unit. Although there is no statutory time limit, the Commissioner's practice is to allow one month (from the later of the date that the Commissioner issues a SOP or provides any additional information under section 89M(8)) for such an agreement to be reached and information provided.

229. However, before agreeing to a request made by the taxpayer under section 89M(13) the Commissioner will consider the taxpayer's prior conduct and whether they could have provided the information earlier through the application of due diligence.

230. The Commissioner will usually also consider the materiality and relevance of the additional information and its capacity to help resolve the dispute and may decide to take it into account in coming to an assessment. In this circumstance, both parties will be expected to cooperate in resolving the relevance and accuracy of any such material. The Commissioner may wish to apply resources to verification and comment and this will be considered by the adjudicator.

231. If a taxpayer's request to add additional information to their SOP is declined, the reasons must be documented with detailed reference to the taxpayer's conduct, level of cooperation before the request was made and why the information was not provided earlier. The responsible officer will also advise the taxpayer or their tax agent of the reasons why their request was declined.

232. Any agreements to add further information to the SOP will be made subject to the taxpayer agreeing that the Commissioner can also include responses to the additional information to the SOP under section 89M(13), if required.

233. Any additional information that the parties provide under section 89M(13) will be deemed to form part of the provider's SOP under section 89M(14). Thus, the evidence exclusion rule under section 138G(1) applies to the additional information.

Preparation for adjudication

234. The Adjudication Unit is part of the Office of the Chief Tax Counsel and represents the final step in the disputes resolution process. The Adjudicator's role is to review unresolved disputes by taking a fresh look at the tax dispute and the application of law to the facts in an impartial and independent manner and provide a comprehensive and technically accurate decision that will ensure the correctness of the assessment.

235. Generally, the adjudicator will make such a decision within four months after the case is referred to the Adjudication Unit. However, this will depend on the number of disputes that are before the Adjudication Unit, any allocation delays and the technical, legal and factual complexity of those disputes. (For further information on the time frame for adjudication of disputes please see the article titled "Adjudication Unit – Its role in the dispute resolution process" that was published in the Tax Information Bulletin Vol. 19, No. 10 (November 2007)).

236. The adjudication process is an administrative (rather than a legislative one). Recent judicial comments have been made in *C of IR v Zentrum Holdings Limited and Another, Ch'elle Properties (NZ) Limited v CIR* (2004) 21 NZTC 18,618 and *ANZ National Bank Ltd and others v C of IR (No. 2)* (2006) 22 NZTC 19,835 indicating that, as a matter of law, it is not strictly necessary for Inland Revenue officers to send all disputes to the Adjudication Unit for review, and Inland Revenue officers are not necessarily bound by the Adjudication Unit's decisions.

237. Notwithstanding the above judicial comments, if the parties have not agreed on all the issues at the end of the conference and disclosure phases or to truncate the disputes resolution process under section 89N(1)(c)(viii), it is the Commissioner's policy and practice that all disputes are to be sent to the Adjudication Unit for review, irrespective of the complexity or type of issues or amount of tax involved unless any of the following exceptions arise:

    (a) the Commissioner has considered the taxpayer's SOP for the purposes of section 89N(2)(b) and referred the dispute to the Adjudication Unit for their preliminary consideration and the Adjudication Unit has determined that it has insufficient time to reach a decision in respect of the dispute before a statutory time bar would prevent the Commissioner from subsequently increasing the assessment (please see paragraph 142 for further discussion), or

(b) any of the legislative exceptions specified in section 89N(1)(c) apply (please see *SPS 08/01: Disputes resolution process commenced by the Commissioner of Inland Revenue* for further discussion) so that the Commissioner can amend an assessment without first completing the disputes resolution process, or

(c) the High Court has made an order that the disputes resolution process can be truncated pursuant to an application made by the Commissioner under section 89N(3).

238. The decision not to refer the case to adjudication must be made by an Inland Revenue officer with a senior level of authority in Service Delivery (for example, at the time of writing this SPS the delegation was with Assurance Manager level or above). In respect of the first exception mentioned in paragraph 237(a) it is necessary that the parties have exchanged a SOP and it is a matter solely for the Adjudication Unit to determine whether it has insufficient time to fully consider the dispute.

239. Thus, during a disputes resolution process, the Commissioner can issue an amended assessment to the taxpayer, for example, if the taxpayer has reached an agreement with the Commissioner under section 89N(1)(c)(viii) to abridge the adjudication phase. Furthermore, before the dispute is referred to the Adjudication Unit, the taxpayer can request that the Commissioner issues an amended assessment and then challenge that assessment under section 138B(1).

240. If the dispute is to be referred to the Adjudication Unit, the Commissioner should not issue an assessment or amended assessment before the adjudication process is completed unless a time bar is imminent. The responsible officer will prepare a cover sheet that records all the documents that must be sent to the Adjudication Unit.

241. The cover sheet together with copies of the documents (NOPA, NOR, notice rejecting the NOR, conference notes, both parties' SOP, additional information, material evidence including expert opinions and a schedule of all evidence held) and any recordings of discussions held during the conference must be sent to the Adjudication Unit.

242. When the dispute is to be referred to adjudication, the responsible officer will issue a letter and copy of the cover sheet to the taxpayer before sending the submissions, notes and evidence to the Adjudication Unit. The cover sheet and letter is usually completed within one month after the date that the Commissioner issues the SOP or provides additional information under section 89M(8).

243. The purpose of this letter is to seek the taxpayer's concurrence on the materials to be sent to the adjudicator - primarily in regard to the documentary evidence that has been disclosed at the SOP phase. This letter will allow the taxpayer no more than 10 working days from when it is received to provide a response.

244. Once the taxpayer has concurred on the materials to be sent to the Adjudication Unit, those materials will usually be so forwarded. However, if the taxpayer does not provide a response the materials will be forwarded within 10 working days after the date that the letter is issued to the taxpayer advising that the materials will be sent to the Adjudication Unit. The adjudicator can also contact the parties after the initial materials have been received to obtain further information.

245. Where an investigation has covered multiple issues, the cover sheet will outline any issues that the parties have agreed upon and any issues that are still disputed. The adjudicator can then consider the disputed issues and not reconsider those issues that have been agreed upon.

246. Generally, the adjudicator only considers the materials that the parties have submitted. They do not usually seek out or consider further information, unless it is relevant. The adjudicator may consider such additional information notwithstanding that the parties have not agreed that the provider can include this information in their SOP under section 89M(13).

247. However, any additional material that the parties have not included in their SOP (or is not deemed to be included in their SOP under section 89M(14)) cannot later be raised by the parties as evidence in the TRA or a hearing authority because of the evidence exclusion rule in section 138G(1) (please see the discussion above).

Adjudication decision

248. Once a conclusion is reached, the Adjudication Unit will advise the taxpayer and responsible officer of the decision. The responsible officer will implement the Adjudication Unit's recommendations and follow up procedures where required, including issuing a notice of assessment to the taxpayer where applicable.

249. If the Adjudication Unit makes a decision that is not in the Commissioner's favour, the Commissioner is bound by and cannot challenge that decision. The dispute will come to end. The Commissioner will issue an assessment or amended assessment to the taxpayer to reflect the decision.

250. If a taxpayer commences the disputes resolution process, they can file challenge proceedings in the general jurisdiction of the TRA, its small claims jurisdiction (if the taxpayer so elects in their NOPA under section 89E(1)) or the High Court within the applicable response period if any of the following conditions is met:

    (a) the Commissioner or taxpayer has issued an assessment that was the subject of an adjustment that the taxpayer proposed and Commissioner rejected within the applicable response period and the Commissioner has later issued an amended assessment to the taxpayer (section 138B(2)), or

    (b) the Commissioner or taxpayer has issued an assessment that was the subject of an adjustment that the taxpayer proposed and the Commissioner rejected within the applicable response period by a NOR or other written disputable decision and the Commissioner has not issued an amended assessment (section 138B(3)), or

    (c) the Commissioner or taxpayer has issued a disputable decision that is not an assessment that was the subject of an adjustment that the taxpayer proposed and the Commissioner rejected within the applicable response period (section 138C).

251. A taxpayer must file proceedings with the TRA or High Court within the two-month response period that starts on the date that the Commissioner issues:

    (a) the amended assessment if the challenge proceedings are filed under section 138B(2), or

    (b) the written disputable decision rejecting the taxpayer's proposed adjustment if the challenge proceedings are filed under section 138B(3), or

    (c) the written disputable decision rejecting the taxpayer's proposed adjustment if the challenge proceedings are filed under section 138C.

252. If applicable, the responsible officer will implement any decision made by the hearing authority and follow up procedures where required including issuing a notice of assessment or amended assessment to the taxpayer.

This Standard Practice Statement is signed on 9 June 2008.

Graham Tubb
Group Tax Counsel
Legal and Technical Services

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out answers to some enquiries we've received. We publish these as they may be of general interest to readers. A general similarity to items published here will not necessarily lead to the same tax result. Each case should be considered on its own facts.

KIWISAVER – CREDITABLE MEMBERSHIP

This section of the *TIB* sets out answers to some questions we've received on "creditable membership" and eligibility for the member tax credit.

Question

What does the word "membership" in paragraph (a) of the definition of "creditable membership" in section YA 1 of the Income Tax Act 2007 mean?

Answer

As this has caused confusion, Inland Revenue has recently clarified its view that "membership" in paragraph (a) of the definition of "creditable membership" commences from the earlier of an account being opened by a provider for a member (in anticipation of securities being allotted) or securities allotting.

This interpretation will not change the position for members who are automatically enrolled into KiwiSaver – their creditable membership will commence in accordance with paragraph (b)(i) of the definition (as deductions will usually commence prior to their account being opened). This will mean however that for members who contract directly via a provider, their MTC eligibility will generally commence from when their provider opens up an account for them as opposed to when funds are first transferred to the provider.

Consider the following example:

- Joe opts to join KiwiSaver via a provider on 5 January 2008 who opens an account for him. Joe makes no contributions at this time.
- On 5 April 2008 Joe's $1,000 kick-start contribution is paid to his provider.
- On 15 June 2008 Joe makes his first contribution of $3,000 to his provider.

Given Inland Revenue's interpretation of "membership" commencing from the date on which an account is opened for a member, Joe's eligibility for the member tax credit will commence from 5 January 2008. However, if Joe's provider had not opened an account for him in January, his eligibility for the member tax credit would have occurred (under paragraph (b)(ii) of the definition of "creditable membership") from 1 April (the first of the month in which his $1,000 kick-start contribution was paid to his provider and thus an account opened).

Question

What does Inland Revenue's clarification of the word "membership" mean for members who joined KiwiSaver via a provider during the transitional period (1 July 2007 to 30 September 2007) and made a contribution prior to 31 October 2007?

Answer

This interpretation has no impact on members who joined KiwiSaver during the transitional period and made a contribution prior to 31 October 2007. These members fall within the paragraph (b)(iii) of the definition of "creditable membership". Accordingly, their eligibility for the member tax credit will commence from the earlier of:

- the first of the month in which their KiwiSaver provider received a valid application for KiwiSaver membership from them, or
- the first of the month in which their first contribution to KiwiSaver was received by their scheme provider or Inland Revenue.

Question

What does Inland Revenue's clarification of the word "membership" mean for members who joined KiwiSaver via a provider during the transitional period (1 July 2007 to 30 September 2007) but did not make their first contribution until after 31 October 2007?

Answer

The eligibility for the member tax credit for these members will commence from the earlier of:

- the actual day that their KiwiSaver provider opened up an account for them, or
- the first of the month in which their first contribution to KiwiSaver was received by their scheme provider or 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 and the Supreme Court.

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

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

COMMISSIONER'S OUTPUT ASSESSMENT SUCCESSFULLY CHALLENGED

Case	TRA 036/02 Decision 6/2008
Decision date	9 May 2008
Act	Goods and Services Act 1985, Taxation Review Authority Regulations 1994
Keywords	GST, TRA regulations, input tax, output tax

Summary

The taxpayer had received an input tax credit through the Commissioner's default in filing a case stated but this did not lead to the conclusion the taxpayer had a taxable activity.

Facts

The taxpayer company had claimed a GST input on the purchase of residential property arguing the residential property was acquired for property development (a taxable activity) and was only rented (an exempt activity) to defray costs. The Commissioner took the view that the input claim was not available as there was an exempt activity being conducted. The taxpayer requested the case to be taken to the Taxation Review Authority (TRA); however, the Commissioner failed to file that case in time and the taxpayer's objection was allowed by the TRA (see *Case S49* (1996) 17 NZTC 7,331).

Subsequently the Commissioner formed the view that Case S49 meant the Commissioner had to accept (notwithstanding his own views to the contrary) that there was a taxable activity conducted by the taxpayer and the Commissioner assessed output tax on the disposal of the property accordingly. This had the effect of offsetting the input tax credit created by *Case S49*.

The taxpayer objected to this on the basis that there was no taxable activity and the decision in *Case S49* was a penalty upon the Commissioner. The taxpayer also challenged the transfer done to offset the output and input, and attempted to claim the input tax credit again, relying on the argument that the effect of *Case S49* was to penalise the Commissioner and not to allow its objection.

Decision

The TRA found:

- the result of *Case S49* was not a penalty to the Commissioner as the TRA had no jurisdiction to penalise any litigant before it: para [46]
- therefore, it was not open to the taxpayer to claim the input tax a second time: para [47]
- the offset was not amenable to the TRA's jurisdiction sec 129 TAA 1994: para [48].

The decision in *Case S49*, however, did not compel the Commissioner to accept that the taxpayer had a taxable activity. That issue was not considered or determined in *Case S49* (para [51]) which turned solely upon whether the Commissioner had filed in a timely manner at the TRA (paras [61], [63]). Nothing further could be read into that decision and it represented a windfall to the taxpayer.

The TRA recited relevant authority addressing the use of residential property in GST (*Carswell, Morris*) to conclude it could not come to any conclusion regarding the presence or absence of a taxable activity by the taxpayer. It invited the parties to return to the TRA to address this issue (paras [72–79], [84]). It also invited the Commissioner to consider whether he wished to pursue this point given the Commissioner's apparent belief there was no taxable activity.